

**Testimony of
Dean Foods Company by Evan Kinser
Milk Marketing Order Hearing
Docket No. AO-313-A48; DA-04-06
Kansas City, Missouri
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Introduction

Hello, my name is Evan Kinser. I am employed by Dean Foods Company as Manager of Dairy Risk Management and Commodity Procurement. My business address is 2515 McKinney Avenue, Suite 1200, Dallas, TX 75201.

Dean Foods owns and operates 9 distributing plants regulated by Central Milk Marketing Federal Order. I am appearing today to support and explain the philosophy of Dean Foods in arriving at proposals #4, #5, #6, #7, #8, #9, #10, #11, #12, and #13. I will further explain our position on the remaining proposals. Mr. Paul Christ will explain the detailed mechanics of the proposals.

Definition of the Problem

There are two problems: 1) The provisions of adequate incentives to attract an adequate and reliable supply of milk to the pool, and 2) the provisions of adequate incentives to attract pooled milk to pool distributing plants. The current order provisions fall short in solving either of these problems. The current provisions of the Central Order promote inequity among handlers and dairy farmers. These inequities arise from depooling and do not allow for equal treatment of all milk with respects to the distribution of the pool value. The ability to depool and repool at will amplifies the challenge of getting milk to the market. As testified to yesterday there are great

challenges to getting milk to St. Louis, Missouri the largest metropolitan area in the marketing area.

Purpose of the Federal Order System

Understanding the correct purpose of the Federal order system is key to this hearing being successful. Distractions from the intent in the past have led to tweaks or small patches, when more concise and meaningful action was needed. The focus always needs to be on the original intent, and what changes should be made today to ensure the original intent is carried out. Today, we can and should take different actions than in the past. These actions must address a now greater array of market conditions and resulting opportunistic behaviors.

The Agricultural Marketing Agreement Act (AMAA) of 1937 states as a declaration of policy the following:

“(4) Through the exercise of the powers conferred upon the Secretary of Agriculture under this title, to establish and maintain such orderly marketing conditions for any agricultural commodity enumerated in section 8c(2) [which includes milk] of this title as will provide, in the interest of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing seasons to avoid unreasonable fluctuations in supplies and prices.”

The Federal order system strives to provide a stable supply of milk, which has routinely been construed to mean packaged fluid milk only, with minimal fluctuation recognizing there is some degree of seasonality that is unavoidable.

The current provisions are miserably failing to accomplish the purpose of supply stability. There are multiple examples in the exhibits that have been presented at this hearing that illustrate volatile swings in milk pounds pooled on the order. The best exhibit to illustrate the swing in

pounds in the order is seen in Exhibit 9. On several pages (14, 17, 19, and 21) there is a graph titled "Utilization of Producer Milk by Class." This graph clearly illustrates there is a problem. It shows radical swings in the percent of the producer milk that is utilized by each class of milk. To understand this more clearly, page 22 (Table #12) shows the Producer Milk Utilization by class. Connected to this are the actual pounds contained in Table #13 (page 23). In looking first at Table 13, studying the right most column, Total Producer Receipts, it becomes clear that something is going on. Notice the significant decrease of pounds in the pool in July 2003 – October 2003 and then again in March 2004 through May 2004. Closer inspection will show this significant drop in producer milk is almost entirely associated with Class III pounds, seen two columns to the left. Table 12 shows how this affects the make up of the pool, when the Class III pounds leave the pool; the other Class pounds remain the same, and the utilizations swing dramatically.

Central Order Provisions

The purpose of the Federal order has been confused and misapplied in developing regulations that govern the Federal orders. Some would lead the Secretary to believe the Federal order's purpose is to ensure all plants have a sufficient supply of milk. The AMAA and action by the secretary simply does not support this; it is clear that the concern of an adequate and stable milk supply applies to distributing plants. The track record and structure of this order makes this clear. There are many key sections from the order language to substantiate the only milk supply of concern to the order is that available to distributing plants. By absence and extension, the milk supply of other plants is a residual concern of the order, and only to the extent it is

necessary to ensure that reserve producers – those standing ready to serve the fluid market – have outlets for their milk.

The importance of distributing plants' milk supply is clearly illustrated in Section 1032.7 (g). This provision gives the market administrator the authority to change shipping percentages of pool plants to distributing plants. There is no statement about the need for milk in a supply plant, or a supply plant system. The purpose of these plants being part of the order is to meet the needs of the distributing plants. In the event current requirements are ineffective, the market administrator can make a change.

A dissection of Section 1032.7, the definition of a Pool Plant, clearly illustrates the only plants mandated to be regulated by the order are distributing plants. All other plants are allowed to participate based on defined service to a distributing plant. Rather than spend the time to explain each subsection, I would offer the following as a quick summary of Section 1032.7.

<u>Paragraph</u>	<u>Plant</u>	<u>Regulation</u>
A	Distributing	Mandated
B	UHT - Distributing	Mandated
C	Supply	Voluntary
E	Distributing System	Voluntary/Mandatory
F	Supply System	Voluntary
G	Call provision	Voluntary
H	Plant Exemptions	Special Circumstances

These key sections of the order language demonstrate the order's main concern must be with distributing plants' milk supply. However, the order also provides a pricing mechanism for all the order's milk. The pricing system is built around price discrimination based on the milk's use. This serves as an attraction for milk to be in the pool. The largest contributor to the pool is the

Class I price. This is clear from studying the pricing formulas found in Sec. 1000.50 that Class I is structured to be the highest price in the pool.

Summary of Federal Order Logic

The system is designed for classified pricing while maintaining certain relationships between the prices. It was thought the supply plants and producers shipping to them would want access to the dollars generated by the distributing plants. Therefore this system regulates those plants (distributing plants), requiring them to contribute to the pool, and relies on economic incentives to drive regulation for the balance (supply plants). This is based on the assumption that the revenues generated by distributing plants would always provide sufficient incentives to attract a milk supply to the pool. In the absence of forced regulation, the contributing plants would have left the order rather than contribute. Without their contribution to the pool, the incentive would be lost to draw other milk to the pool. Having locked in the contributing plants to regulation, it was thought would-be unregulated handlers (supply plants) would voluntarily submit to regulation in order to capture the benefits of the higher Class I price.

Change in Grade A Volume

However, it hasn't quite worked out that way. One possible cause for these glaring shortcomings could be the result of not adjusting to changes in the underlying structure of the dairy industry.

There are several significant changes that have occurred in the dairy industry since the implementation of the AMAA in 1937. I could spend hours discussing such changes as cow genetics, production methods, cooling and processing technology, transportation systems, etc.

One dynamic that seems to have been overlooked, and a key principle in operation of the Federal

Order, is the issue of availability of Grade A milk. The industry has changed from having significant manufacturing grade supplies to all but exclusively Grade A milk production (See EXHIBIT _____ A & B). One could get the impression from how the orders currently are written and behave, that there continues to be a need for more Grade A milk. If these exhibits were the only facts, likely the reverse conclusion would be drawn. There is more than ample supply of milk available to the Grade A market. The regulations have not recognized that the incentives, once needed to switch from manufacturing to Grade A, are no longer necessary.

Inequity

The fact remains this system requires proper economic incentive and properly defined regulation. Missing these two key ingredients allows handlers to associate milk with the order and draw money out of the order, while not providing any service to distributing plants. However, the problem is not limited to these handlers merely being free riders, drawing from the pool for no service. It extends beyond that, when there are costs incurred by those servicing the market these cost are not shared, instead they are left with the handlers who have continued to do the right thing and serve the market. When the free riders leave, the costs do not go away, these costs are forced upon a smaller pool of handlers. More correctly said, they are forced upon a smaller contingent of dairy farmers. It is like going out with a group of friends and sharing a great meal, eating as much as you can, but when the server comes with the check you simply get up from the table and leave the bill to be divided among those who didn't do the same.

Among Handlers

Current regulations allow handlers who may or may not choose to be pooled to enjoy the benefits of the pool, so long as they meet the requirements of the order for that month. Furthermore,

when there is a cost to serve the market, they are allowed to excuse themselves from the table, until the next meal is being served. This idea of excusing themselves has been termed depooling. A more technical definition of depooling was provided in prior testimony. The result of this structure is, when there is no economic incentive (reward) to stay pooled, and no economic disincentive (cost) for leaving the pool, this milk withdraws from the pool. Handlers operating non-pool Class III, hard cheese, operations are in prime position for exercising this option.

Nothing demonstrates this exact situation any more clearly than recent history. A quick glance back, a little over a year, clearly demonstrates that in today's marketplace this system is broken. Undeniably, there is insufficient economic incentive and poorly defined regulation, resulting in failure of the order to achieve its intent. Furthermore it is producing disorderly marketing, a result it was intended to prevent.

Producer Prices

Like my illustration of leaving before the bill is covered at dinner; there are costs currently not equitably shared among producers. Let's look at an example of two different dairy cooperatives. We will compare to similar cooperatives with the only exception being the percentage of their milk that they sell to a distributing plant. Distributing plants are the only plants that are forced into regulation under the Federal order. All other plants can choose to be pooled or not to be pooled. The degree you service a disturbing plant, by definition, lessens your ability to depool milk. The inability to depool milk lessens your competitiveness in the marketplace when others can. Let's suppose there is a cooperative shipping 50% its milk to a distributing plant, we'll call this Coop A. 50% of Coop A's milk supply must be pooled by definition; there is no choice. The balance of the milk could be depooled. Now, let's contrast that with Coop B, which is

shipping 20%. That is enough milk so that if they wanted to fully pool, they could pool all their milk receipts regardless of the month (this could drop to 15% for the months of March through July), but it does not force them to pool any more than the 20%. Now, focusing on the worst-case scenario we will look at April 2004. Here Coop A had to pool 50% of their milk with a negative \$4.02 PPD (Table #5 Exhibit 9). This means that Coop A's blended PPD is negative \$2.01 ($\$4.02 * 50\%$). Suppose Coop B pooled 20% at the same PPD and has a blended PPD of a negative \$0.804 ($\$4.02 * 20\%$). The Class III price was announced at \$19.66/cwt; with the negative \$4.02 PPD resulting in a blend of \$15.64. If we assume that the remaining milk of each went to cheese production, both co-ops are able to overpay the blend, because neither had the negative PPD on all their milk. But they are not both able to pay the same price. Coop A would be able to pay \$17.65 ($\$19.66 - \2.01). Coop B would be able to pay \$18.856 ($\$19.66 - \0.804). Let's say that Coop B wants to be profit maximizing, yet competitive. They would pay at Coop A's price level allowing them to make \$1.206/cwt ($\$18.856 - \17.65) in profit. In reality, Coop B might see a chance to expand their procurement, so they decide to pay \$18.00. If Coop A believes that Coop B is going to overpay the blend and pay more than Coop A, Coop A will have to lose money to match Coop B. If Coop A guessed that they needed to pay \$17.95 to be competitive, it would mean that Coop A paid \$0.30 more than their ability to pay. In this example, I make no provisions for the operational efficiencies or inefficiencies of Coop A verses Coop B, they are assumed to have the same cost structure. This is merely an illustration of how different shipping percentages to a distributing plant affects a handler's ability to pay for milk.

Hidden Costs

A cost that often gets overlooked by the marketplace, but is not overlooked by the market administrator is the cost of operating the Order. In the current system, which allows for

depooling, the administrative assessment is imposed only on those pooling. It is a tax on those who remain in the pool, even though everybody, including those who depooled, obtains the benefits of having announced minimum prices.

Summary of Inequities

I hope at this point it is clear to the Secretary that there are three fatal flaws in the system. First, it forces regulation on distributing plants, but allows all others voluntary participation. Secondly, these plants choose to participate when they can siphon funds out of the system for their betterment, but when the reverse is true, they bail with no cost to them. Third, the reality is that when milk leaves the pool the costs of administration must be born by a smaller few. This creates a heavier burden for those remaining in the pool that is not rewarded when the market improves, because the free riders will return.

Exposure to Order Failure – Call Provision

I would like to point out that beyond economic effects of the flawed system, such provisions position the order to completely fail its purpose. I earlier referenced 1032.7 (g) to illustrate that the purpose of the Federal order was to ensure a supply to distributing plants. This provision provides for the market administrator to increase or decrease for all or part of the marketing area the shipping percentage to encourage needed shipments or to prevent uneconomic shipment to distributing plants. The current provisions only require 20 percent of pooled milk to be shipped to a distributing plant during August through February and 15 percent in all other months. No more than the reciprocal percent can be diverted to a nonpool plant. With the current provisions relying on economic incentives to keep milk in the pool and subject to the call provision, the change in shipping percentage would need to be significant.

I turn to April 2004 to illustrate how significant the call percentage needed to be. I'll begin with the assumption that all the distributing plants pooled in the Central Marketing Order were 100% Class I, which we know to be an overstatement based on Exhibit 14 page 7 of 53 Pool Distributing Plant Utilization. Exhibit 9 Page 22 shows us the Class I percentage of producer milk. For example, in April 2004 the Class I percentage was 60.62 percent. This would say that 39.38% of the milk was used in other classes. If conditions had warranted for the market administrator to adjust the shipping percentages the shipping percentages would have needed to be in excess of 60.62 percent. If more milk was needed than the approximately 371 million pounds of milk utilized in Class I and there was only about 612 million pounds of milk in the pool (Exhibit 9, Table #12 and #13), it would have required something greater than the 60.62 percent. The milk that is pooled is all the market administrator can call on. So, to force milk to move from Class II, III or IV into Class I, or face being depooled, the shipping percentage would needed to be higher than 60.62 percent. However if a call had been issued, it is possible that some of the Class III milk would not have met the requirement. Many handlers could benefit from being disqualified and forced out of the pool. This would have forced the shipping requirement even higher on handlers with Class II and IV uses, since those handlers were the only ones who would have wanted to be in the pool. If these handlers wanted to be in the pool they would likely have done whatever was necessary to remain pooled. The shipping percentage would only be even higher if you used the real Class I utilization of the distributing plants. Such a scenario would have required the shipping requirement be set higher than 80 percent (recognizing the average Class I utilization in Pool Distributing Plants is 80 percent as opposed to 100%).

The response to this line of thinking could be that milk will be readily available when the shipping percentage is increased and can be easily purchased. Actually, the opposite is the case, especially as it relates to the most recent examples for milk supply in the North. Cheese plants are most interested in keeping all their milk when the price is high, so they can make cheese and not short any customers. Now, put yourself in the place of a Class III handler, like Coop B. During recent examples of negative PPD's, Coop B was looking at above average, and in the case of 2004, record high, cheese prices. If Coop B wanted to pool milk they would have to give up at least 15% or 20% of its milk, depending on the month of what they wanted to pool [defined by Sec 1032.7 (c)]. This would mean less milk to the vat and they would receive the negative PPD on that milk, and any additional milk they pooled. I've already explained the implications of pooling on their ability to pay for milk. Given that information and my testimony about voluntary participation, the other alternative provided Coop B by the current order regulation is to keep all their milk, make cheese, and pool nothing. This would be a win-win situation for Coop B. They are able to make as much cheese as possible for customers, and they don't have a negative PPD. Thus, the market administrator has no authority to call on Coop B to ship additional milk when and if he is decided there are insufficient supplies available for the distributing plants. The handlers shipping milk to the distributing plants will have a negative PPD, but will have to compete with Coop B when they go to pay for the milk.

The point to this illustration is that current provisions allow milk to leave the pool. This renders the order virtually useless in ensuring an adequate and reliable milk supply to distributing plants and maintaining uniform prices paid by handlers to producers. Just the opposite occurs. The

power of the market administrator to make milk available to the distributing plants is severely hampered by the opportunity to depool. To the degree that shipping percentages would have been increased, what milk remained in the pool could have opted out of the pool (depool). Those handlers would not respond to the increased shipping percentages.

Philosophy of our Proposed Solutions

Something must be done to change the order to rectify the shortcomings I discussed above. We appreciate the Secretary's recognition of the need to change in requesting proposals and subsequently having this hearing. We further appreciate that the Secretary recognized ten proposals submitted by Dean Foods. Our proposals are aimed at current pooling abuses. The first most glaring and important pooling abuse is depooling. To the degree the Secretary does not solve this obvious error, the balance of our proposals are hardly band-aids. If the Secretary does correct the problem of depooling, these other proposals offer various levels of correction to achieve a pool as was designed to exist with order reform.

In an ideal world, from Dean Foods' perspective, the Federal Order would operate in such a way to allow a distributing plant or a distributing plant unit to have an individual handler pool. This system would put the pressure on the distributing plant to manage the pool in such a way as to resolve the purposes of the Federal Order. If this would be allowed, it would force distributing plant handlers to think about how to insure their future supply of milk. They would need to keep economic incentives in place that would insure that even when it is temporarily undesirable to ship milk (as has been the case), the long run loss for opting out of the pool would be too great to forgo the long-term reward. However, the Secretary has rejected individual handler pools.

Thus, I will introduce the proposals with modifications. Our proposals can be divided into two major categories. First, depooling, which is the most important concern and serves to amplify our second concern, pooling abuses. We have proposed multiple solutions for pooling abuses, each having a different degree of efficacy. We understand that many of our proposals are at odds with others. We did not mean for all proposals to be adopted, but to provide the industry and the Secretary options to correct the shortcomings of the current order provisions. I will not comment much on their mechanics or function, Mr. Paul Christ will be providing this information and detail in his testimony. I am going to introduce these proposals in order of preference.

Proposal #6

In proposal number six we propose establishing a *dairy farmer for other markets* provision, much like the same titled provision included in Northeast Milk Marketing Order, Sec 1001.12 (b)(5) & (6). We would like to modify the language that was submitted for the hearing and published in the official hearing notice to ensure that it reflects our intent. Our proposal would read as follows:

Amend § 1032.12 by adding a new paragraph (b)(5) to read as follows:

§ 1032.12 Producer.

(b) * * *

(5) For any month, any dairy farmer whose milk is received at a pool plant or by a cooperative association handler described in § 1000.9(c) if ~~the~~ any pool plant operator or ~~the~~ any cooperative association caused milk from the same farm to be delivered to any plant as other than producer milk, as defined under the order in this part or any other Federal milk order, during the same month or any of the preceding 11 months, unless the equivalent of at least ten days' milk production has been physically received otherwise as producer milk at a pool distributing plant during the month.

A conforming change needs to be made by the Secretary under proposal 15 to clarify potential implications created by proposal six. This change would occur in Sec. 1032.13 (d)(1), which contains the following:

...If a dairy farmer loses producer status under the order in this part (except as a result of a temporary loss of Grade A approval), the dairy farmer's milk shall not be eligible for diversion until milk of the dairy farmer has been physically receive as producer milk at a pool plant;

To make our proposal highly effective and consistent it should be changed to read as follows:

...If a dairy farmer loses producer status under the order in this part (except as a result of a loss of Grade A approval not to exceed 21 days in a calendar year, unless it is determined by the market administrator to be unavoidable circumstances beyond the control of the dairy farmer such as a natural disaster (ice storm, wind storm, flood) or fire in which case the market administrator may determine the time of extension grated to the effect farm(s)) the dairy farmer's milk shall not be eligible for diversion until milk of the dairy farmer has been physically receive as producer milk at a pool plant;

This change is not meant to harm dairy farmers who have had a disaster occur. This is meant to close a loophole that might otherwise allow for depooling, while avoiding the ramifications intended in this (and other) proposals. It is focused to give the market administrator clear definition, as well as the latitude to intervene when there is reason.

Effect of Northeast Order

Similar language exists in the Northeast Order. A major difference is milk can get into the pool "free" in July. If milk leaves in the spring, it is out until July. This year, this provision played well into the hands of several handlers in the Northeast. To illustrate this I have Exhibit C 1
- C 6. This is the Pool Price Announcements for the Northeast Order for February through July.

Notice that the Class III pounds dropped by 223 million pounds from March into April (the PPD also went from \$1.07 to a negative \$2.38 at the same time). The pool lost another 37 million pounds of Class III milk in May, likely because of negative PPD. Then the provision worked. The milk could not “repool” on the Northeast Order in June. The system shortcoming was that the Mideast Milk Marketing Order does not contain the same or any similar language. Some savvy handlers moved milk to qualify for pooling on the Mideast Order for June. These handlers repooled their milk back on the Northeast Order in July, as is allowed. Exhibit C 1 – C 6 illustrates this point. Notice that in from June to July the Class III pounds increase 176 million pounds, close to the level in March.

To illustrate this point I will turn to Exhibit 17, submitted by Paul Huber with the Mideast Order. I would also like to remind the Secretary of Mr. Huber’s testimony with regard to how one might interpret the numbers, more importantly where this additional milk came from and where it returned. It would seem almost obvious that this isn’t milk that suddenly appeared. It is milk that was most likely left homeless because of an earlier month’s pooling decision. I requested Exhibit 17 - Pounds of Milk by State, February 2003 and 2004, Pounds of Milk by State, June 2003 and 2004, Pounds of Milk by State, July 2003 and 2004 and Pounds of Milk by State, August 2003 and 2004, to help illustrate how Northeast handlers took advantage of the pooling provisions of the Mideast Order in June. I included February, because all milk would have desired to be in the pool that month. This helps to single out other things that changed in the Mideast Order from 2003 to 2004. I will not bore the Secretary, nor the hearing attendees, with every line of the three tables, instead I would like to focus the attention to two states, New York and Vermont and the footnote includes New Jersey. Why would milk in New York, Vermont

and New Jersey suddenly become pooled on the Mideast order for a single month and then disappear? The answer is the product of this proposal at work in the Northeast Order. The New York, Vermont and New Jersey milk could not pool in its “home” order. Having lost its home it needed another market, and the next best option was the Mideast order. Here we find what appears to be, in simple terms, an additional 67.422 plus million pounds of milk on the Mideast Order because it was unable to pool on Northeast order, because of pooling decisions made in the two prior months.

Think ahead for a moment and consider if a correction were implemented in all orders. Milk would either stay pooled, or ship to a distributing plant to return to the pool. In practice, this can't happen overnight. Such a change would require additional hearings. So, if this were to begin which Order would be the right place to start? It should be the order with the most generous pooling provisions, the Upper Midwest Order. A hearing has been held in that order in which we asked for this same provision. We believe that is the right order for the Secretary to initiate a new policy and begin righting the existing wrongs. Then the Central Order becomes the next vulnerable point, so we are here today asking the Secretary take immediate action to fix this glaring error in the order. The Mideast order, the next most critical order, has a request for proposals out, and we will submit this same language and urge the Secretary to have a hearing in that order. This would complete the core part of the order system that desperately needs this language change.

Proposal #7

Amend § 1032.12 by adding a new paragraph (b)(5) and (6) as follows:

§ 1032.12 **Producer.**

(b) * * *

(5) For any month of February through June, any dairy farmer whose milk is received at a pool plant or by a cooperative association handler described in § 1000.9(c) if ~~the any~~ pool plant operator or ~~the any~~ cooperative association caused milk from the same farm to be delivered to any plant as other than producer milk, as defined under the order in this part or any other Federal milk order, during the same month, any of the 3 preceding months, or during any of the preceding months of July through January, unless the equivalent of least ten days' milk production has been physically received otherwise as producer milk at a pool distributing plant during the month; and

(6) For any month of July through January, any dairy farmer whose milk is received at ~~the any~~ pool plant or by ~~the any~~ cooperative association handler described in § 1000.9(c) if any pool plant operator or any cooperative association caused milk from the same farm to be delivered to any plant as other than producer milk, as defined under the order in this part or any other Federal milk order, during the month or the preceding month, unless the equivalent of least ten days' milk production has been physically received otherwise as producer milk at a pool distributing plant during the month.

Like in proposal number six we would look for the same changes in Sec. 1032.13 (d)(1).

Illustration of Dairy Farmer for Other Markets Effectiveness

As pointed out earlier in my testimony this type of provision exists in the Northeast Order. In fact it is just like Proposal #7 with different months. Earlier I illustrated how the absence of this provision had a negative effect on the Mideast Order. Before offering another depooling solution, which is much less effective, thus less desirable, I would like to contrast the pool consistency of the Northeast with other markets with significant cheese manufacturing (i.e. Upper Midwest, Central, Pacific Northwest, Western (when it existed) and Mideast). I believe from this illustration it will be clear that the provision is effective and accomplishes the intent – pool stability.

I summarized Exhibit 13, Federal Order Statistical Overview (All orders) Jan 2000 – current, in creating in Exhibit ____D. Page 1 of Exhibit ____D is a summary of the following 4 pages. This exhibit illustrates the volatility of the Class III percentage of the Northwest, Upper Midwest, Central, Mideast and Pacific Northwest. For example, examine August 2003 each market has a negative PPD at the base zone (meaning it would be a larger negative any place there is a negative location adjustment) of the order. Notice that in all orders but the Northeast, the percent Class III utilization is noticeably less than what would be deemed “normal.” If you only saw the Class III utilization for the Northeast Order in 2003, you would be hard-pressed to pick which months handlers would have desired to depool, given the different rules. To examine the situation on a more macro level, look at the first page of Exhibit ____E. This just looks at the variance in Class III utilization by month and annually. Notice the variance on the Northeast order is less than one-quarter of one percent. The variance in each of the other orders is greater than one percent, with the Upper Midwest topping five percent. The Central order is close to three percent. What is it that makes the Northeast unique? It is the “dairy farmer for other markets” provision. When this provision exists handlers have to evaluate more than the current month’s economic impact. This requirement causes them to behave differently than handlers pooling milk on this order, who only have to consider the immediate implications. They do not have to consider any possible future missed opportunities. Such consideration is currently required by the Northeast Order’s “dairy farmer for other markets” provision.

Dean Foods prefers Proposal #6 to Proposal #7 because the ramifications are longer and thus more significant. As I illustrated earlier, the Northeast order is not perfect. If it and the Mideast

order were worded like Proposal # 6, it would not have caused the implications on the Mideast order this year that occurred. However, when you create a limitation on handler reentry due to voluntary depooling, a re-entry point must be provided. The Northeast allows that point to be July. Instead of a set month, both of our proposals allow handlers to serve the fluid market to return to the pool. This provides the handlers greater flexibility than in the Northeast order, but also helps to reinforce the purpose of the Federal Order system. In Proposal #7 the standards are more lenient and they can return via the calendar, like the Northeast order. But handlers still have the option of serving the market to return earlier.

We believe the Exhibit 13 Federal Order Statistical Overview (All orders) Jan 2000 – current provided by the market administrator and the summary of it in Exhibit E. Page 1 – 5 clearly illustrated the effectiveness of the dairy farmers for other markets provisions. We urge the secretary to adopt this provision, with the most effective version provided in Proposal #6. However if the Secretary feels handlers still need a greater degree of latitude to play games in the marketplace we feel the weaker standards offered in Proposal #7 represents a significant improvement over the current standards and any other proposals offered at this hearing.

Proposal #8

Amend Section 1032.13 by adding a new paragraph (f) to read as follows:

§ 1032.13. Producer Milk

* * *

(f) The quantity of milk reported by a handler pursuant to § 1032.30(a)(1) and/or § 1032.30(c)(1) may not exceed 115 percent of the producer milk receipts pooled by the handler during the prior month. Milk diverted to nonpool plants reported in excess of this limit shall be removed from the pool by the marker administrator. Milk received at pool plants, other than pool distributing plants, shall be classified

pursuant to § 1000.44(a)(3)(v) and § 1000.44(b). The handler must designate, by producer pick-up, which milk is to be removed from the pool. If the handler fails to provide this information, the market administrator will make the determination. The following provisions apply:

(1) Milk shipped to and physically received at pool distributing plants shall not be subject to the 115 percent limitation;

(2) Producer milk qualified pursuant to § _____ 13 of any other Federal order and continuously pooled in any Federal order for the previous six months shall not be included in the computation of the 115 percent limitation;

(3) The market administrator may waive the 115 percent limitation utilizing;

(i) For a new handler on the order, ~~subject to the provisions of § 1032.13(f)(3), or~~

(ii) For an existing handler with significantly changed milk supply conditions due to unusual circumstances;

(4) The market administrator may increase or decrease the applicable limitation for a month consistent with the procedures in § 1032.7(g); and

(5) A bloc of milk may be considered ineligible for pooling if the market administrator determines that handlers altered the reporting of such milk for the purpose of evading the provisions of this paragraph.

Before turning to the remaining proposals offered by Dean Foods, I want to make it clear that the most important action that could be taken by the secretary at this hearing is implementing a solution for depooling. Any of the other proposals that Dean Foods or any other participant in this hearing could present pales in importance for the health and viability of the order system than to eliminating depooling from our federal order vocabulary. This was made clear in testimony by Mr. Hollon and his Exhibit 18 Table 8 A through I and Table 9 I. This exhibit is shows how allowing depooling and making changes to the pooling provisions will be of minimal impact to the problems plaguing this order by illustrating a farm in Idaho. This also applies to

other milk supplies. To change this the secretary would need to implement something more drastic than has been proposed at this hearing thus far.

With it clearly understood that depooling must be addressed by the Secretary we offer a few other things for her consideration. These proposals when added to the pooling change, can go a long way toward moving the Central order to a level of Class I utilization that was expected as a result of the order Reform process. Exhibit _____E contains a copy of Table 1 from the Final Decision released March 1999. This table shows the Class I utilization of each of the 11 Marketing areas. In examining this table you will see that the Central order was expected to have a Class I utilization of 50.1%. If you look at the numbers provided from Exhibit 9, Table 12, it is clear that is not the case. The only time it is the case is when the Class III milk depools. Based on this low Class I utilization and the challenges that discourage the movement of milk to certain areas of the marketplace, Dean Foods has proposed the following changes to the pooling provisions to be considered along with, but secondary to correction of depooling.

Proposal #4

Amend Sec. 1032.7 by removing paragraphs (c), (d), (f) and (g) and revise Sec. 1032.9 to read as follows:

§ 1032.9 Handler.

Handler means:

- (a) Any person who operates a pool plant or a nonpool plant.
- (b) Any person who receives packaged fluid milk products from a plant for resale and distribution to retail or wholesale outlets, any person who as a broker negotiates a purchase or sale of fluid milk products or fluid cream products from or to any pool or nonpool plant, and any person who by purchase or direction causes milk of producers to be picked up at the farm and/or moved to a plant. Persons who qualify as handlers only under this paragraph under any Federal milk order are not subject to the payment provisions of Sec. Sec. ----.70, ----.71, ----.72, ----.73, ----.76, and ----.85 of that order.

(c) Any organization with respect to milk that it receives for its account from the farm of a producer and delivers to pool plants or diverts to nonpool plants pursuant to Sec. ----.13 of the order. The operator of a pool plant receiving milk from such organization may be the handler for such milk if both parties notify the market administrator of this agreement prior to the time that the milk is delivered to the pool plant and the plant operator purchases the milk on the basis of farm bulk tank weights and samples.

Proposal #5

1. Amend Sec. 1032.7 by revising paragraph (c) introductory text to read as follows:

Sec. 1032.7 Pool plant.

* * * * *

(c) A supply plant from which the quantity of bulk fluid milk products shipped to (and physically unloaded into) plants described in paragraph (c)(1) of this section is not less than 35 percent during the months of July through January and 25percent in all other months of the Grade A milk received from dairy farmers (except dairy farmers described in § 1032.12(b)) and from handlers described in § 1000.9(c), including milk diverted by pursuant to § 1032.13, subject to the following conditions:

2. Amend Sec. 1032.13 by redesignating paragraphs (d)(3) through (6) as paragraphs (d)(5) through (8), revising paragraphs (d)(1) and (2), and adding paragraphs (d)(3) and (4) to read as follows:

Sec. 1032.13 Producer milk.

* * * * *

(d) * * *

- (1) Milk of a dairy farmer shall not be eligible for diversion until ~~unless~~ milk of such dairy farmer has been physically received as producer milk at a pool plant and the dairy farmer has continuously retained producer status since that time. If a dairy farmer loses producer status under the order in this part (except as a result of a loss of Grade A approval not to exceed 10 days), the dairy farmer's milk shall not be eligible for diversion until ~~unless~~ milk of the dairy farmer has been physically received as producer milk at a pool plant;
- (2) The equivalent of at least four days' milk production is caused by the handler to be physically received at a pool plant in each of the months of July through November and January;
- (3) The equivalent of at least four days' milk production is caused by the handler to be physically received at a pool plant in each of the months of ~~December~~ February through June if the requirement of paragraph (d)(2) of this section (Sec. 1032.13) in each of the prior months of July through November and January are

not met, except in the case of a dairy farmer who did not market any Grade A milk during each of the prior months of July through November and January.

- (4) Of the quantity of producer milk received during the month (including diversions, but excluding the quantity of producer milk received from a handler described in Sec. 1000.9(c)) the handler diverts to nonpool plants not more than 65 percent during the months of July through January, and not more than 75 percent during the months of February through June, provided that not less than 35 percent of such receipts in the months of July through January and 25 percent of the remaining months' receipts are delivered to plants described in Sec. 1032.7(a) and (b);

We offer proposal #4 and #5 as alternatives. We believe there are many pooling abuses that allow significant amounts of milk to ride the pool and not serve the market. The exhibits prepared by the market administrators contain numerous illustrations. Clear examples can be found by looking at Exhibit #9 Table 30, Exhibit #12 Page 3 of 53, contrasted against the total producer milk found in Exhibit #9 Table 13 and Exhibit #12, pages 14 – 53 of 53.

We would prefer Proposal #4, which would eliminate supply plants. Mr. Hollon in his testimony stated that they are an inefficient way to serve the market. Exhibit 10, Page 17 of 42 illustrates that supply plants are not doing their job of serving the Class I market.

In Proposal #5 we offer an alternative to eliminating supply plants. Here we propose some change to the supply plant definition that will help make milk available to the Class I market. Offering this as an alternative is a way of acknowledging that the industry may not be ready to eliminate the supply plants, but to not take action to correct their failure would be irresponsible.

Beyond just increasing the shipping percentages we believe other actions should be taken by the secretary, to increase the effectiveness of supply plants. We believe the provisions allowing

split-plants are abused. In proposal #9 we offer eliminating split plants all together. Proposal #10 would require a 12-month decision if a handler opted to create a nonpool plant.

Proposal #9

Amend Sec. 1032.7 by removing paragraph (h)(7).

Proposal #10

Amend Sec. 1032.7 by revising paragraph (h)(7) to read as follows:

Sec. 1032.7 Pool plant.

* * * * *

(h) * * *

- (7) That portion of a regulated plant designated as a nonpool plant that is physically separate and operated separately from the pool portion of such plant. The designation of a portion of a plant must be requested in advance and in writing by the handler and must be received by the market administrator. Such nonpool status shall be effective on the first day of the month following receipt of the request by the market administrator and thereafter for the longer of twelve (12) consecutive months or until notification of the desire to requalify as a pool plant, in writing, is received by the market administrator. Requalification will require deliveries to a pool distributing plant(s) as provided for in Sec. 1032.7(c). For requalification, handlers may not use milk delivered directly from producer's farms pursuant to Sec. 1000.9(c) or Sec. 1032.13(c) for the first month.

The final area that we believe needs action as it relates to pool supply plants is the use of systems. This is typically a convenience to handlers to pool additional milk on orders without making shipments to the market. We offer in Proposal #11, 12, and 13 potential changes to lessen this abuse of the pool supply plants. In Proposal #11 we propose completely eliminating the supply plant system. Proposal #12 would only allow a single handler to have a system. Proposal #13 would require that every plant in a system participate with some of the shipment, but only at 40% of what they would be required to ship if they were a stand-alone and not allow

plants to qualify with direct ship milk. We are modifying proposal #11 to remove the requirement for shipments to qualify a supply plant.

Proposal #11

Amend Sec. 1032.7 by removing paragraph (f), redesignating paragraphs (g) and (h) as paragraphs (f) and (g), and revising paragraph (c)(2) to read as follows:

~~Sec. 1032.7 Pool plant.~~

~~*****~~

~~(c) ***~~

- ~~(2) The operator of a pool plant under paragraph (c) located in the marketing area may not include as qualifying shipments milk delivered directly from producer's farms pursuant to § 1000.9(c) or § 1032.13(c). Handlers may not use shipments pursuant to § 1000.9(c) or § 1032.13(c) to qualify plants located outside the marketing area;~~

~~*****~~

Proposal #12

Amend Sec. 1032.7 by revising the introductory text of paragraph (f) to read as follows:

Sec. 1032.7 Pool plant.

- (f) A system of supply plants may qualify for pooling if 2 or more plants operated by one handler meet the applicable percentage requirements of paragraph (c) of this section in the same manner as a single plant, subject to the following additional requirements:

Proposal #13

Amend Sec. 1032.7 by revising paragraph (c)(2) and adding a new paragraph (f)(5) and to read as follows:

Sec. 1032.7 Pool plant.

(c) ***

- (2) The operator of a pool plant located in the marketing area may not include as qualifying shipments milk delivered directly from producer's farms pursuant to §

1000.9(c) or § 1032.13(c). Handlers may not use shipments pursuant to §
1000.9(c) or § 1032.13(c) to qualify plants located outside the marketing area;

* * * * *

(f) * * *

(5) Provided no single plant ships less than 40 percent of the applicable percentage requirement of paragraph (c) of this section.

Proposal #2

We have concerns about certain aspects of this proposal. First we feel that 125% is too loose. It allows guessing to be less of a factor making the cost of making an error less. Handlers are allowed a greater degree of slop for miscalculations in their estimates. I hate to continue to say the same thing in a different way, but the facts are what they are. The pool should be about ongoing equity, not about being in when it is good and leaving when it costs. We urge the Secretary to adopt proposal number six over this proposal, or if she agrees with the philosophy to adopt proposal eight. If the Secretary cannot find her way to do that, we would propose a compromise halfway between 125 and 115.