

**BEFORE THE UNITED STATES DEPARTMENT
OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE**

In the Matter of :
Milk In The Mideast : **Docket Nos.:**
Marketing Area : **AO-166-A72;**
: **DA-05-01**
:

**Comments Upon and Exceptions to the Recommended Decision
on behalf of
Dairy Farmers of America, Inc. (DFA), Michigan Milk Producers
Association, Inc. (MMPA), National Farmers Organization, Inc.
(NFO), Dairylea Cooperative Inc. (Dairylea), and Land O' Lakes,
Inc. (LOL)**

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I. INTRODUCTION

These comments and exceptions are submitted on behalf of Dairy Farmers of America, Inc. (“DFA”); Michigan Milk Producers Association, Inc. (“MMPA”); National Farmers’ Organization Inc. (“NFO”); DairyLea Cooperative Inc. (“DairyLea”); and Land O’Lakes Inc. (“LOL”). They are submitted in response to the Recommended Decision published February 22, 2006 at 71 Fed. Reg. 9033.

The hearing proposals concerned (1) appropriate pooling standards for Order 33, including the potential dual pooling of milk; (2) depooling and repooling of milk; and (3) transportation credits for movement of milk to Class I plants. The previous interim final decision addressed the issues of pooling standards for Order 33. This Recommended Decision concerns the remaining issues of depooling and transportation credits.

II. SUPPORT FOR THE ADOPTION OF PROPOSAL 7

These cooperatives recommended adoption of Proposal 7 at the Hearing to address the important matter of depooling. These cooperatives support the Recommended Decision on this issue and wish to comment on several points: (1) the findings of marketing disorder caused by depooling; (2) the Secretary’s determination to treat the depooling issue as part of the pooling provisions of each Order so that remedies for depooling are addressed on an order by order basis; and (3) the Department’s choice of Proposal 7 as the superior option for the depooling remedy.

These cooperatives wish to commend the Secretary for the findings made concerning the basis of, and nature of, the disorderly marketing conditions created by open depooling of milk in Order 33. We believe these findings reflect important insights into the functioning of the Order

program and at the same time reject the contentions of those who suggest that the Order program is nothing more than a mechanism for transfer payments from Class I handlers and their suppliers to all producers. The Recommended Decision made the following findings and analysis:

The record reveals that when manufacturing handlers and cooperatives opt to not pool milk, unequal pay prices may result to similarly located dairy farmers. . . . The record of this proceeding reveals that the ability of manufacturing handlers and cooperatives to not pool all of their eligible milk receipts gives rise to disorderly marketing conditions and warrants the establishment of additional pooling standards to safeguard marketwide pooling. Current pooling provisions do not require or prohibit handlers and cooperatives from pooling all eligible milk receipts. However, the record reveals that when handlers and cooperatives opt to not pool milk inequities arise among producers and handlers that are contrary to the intent of the Federal milk marketing order program— maintaining orderly marketing conditions.

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This decision does find that disorderly marketing conditions are present when producers do not receive uniform prices. Handlers and cooperatives opting to not pool milk do not account to the pool at the classified use-value of those milk receipts. They do not share the higher classified use value of their milk receipts with all other producers who are pooled on the order, primarily the producers who are pooled on the order and are incurring the additional costs of servicing the Class I needs of the market. This is not a desired or reasonable outcome especially when the same handlers and cooperatives will again pool all of their eligible receipts when class-price relationships change in a subsequent month. These inequities borne by the market's producers are contrary to the intent of the Federal order program's reliance on marketwide pooling— ensuring that all producers supplying the market are paid uniform prices for their milk regardless of how the milk of any single producer is used.

71 Fed. Reg. at 9040.

It is a fundamental purpose of milk marketing orders to provide a mechanism for establishing minimum uniform prices among all producers in a common milkshed and supplying

a common marketplace. The recognition that order provisions which generate non-uniformity of prices among farmers need to be reviewed, revised and reformed to eliminate the disorder reflected in such nonuniform prices is an extremely important decision for the order program. Many have commented in many different contexts – both in this record and elsewhere – that free and open depooling of milk (which has been such a prominent aspect of the federal order landscape since January 1, 2000) in many ways makes a mockery of the system. This Recommended Decision, along with those for Order 32 and Order 30 which have been contemporaneously announced, shows that the Department will move forward with tailored amendments to the orders to remedy this disorderly market condition. We commend and support the Department’s efforts in this respect.

Secondly, we support the Department’s determination that depooling and repooling should be addressed on an order by order basis, in terms of fashioning the appropriate remedy since this is essentially a pooling provisions issue.

A major issue was made at the hearing by those who sought to frustrate revisions to Order 33 that depooling was a national issue which could only be addressed, or should only be addressed, by changes to national pricing formulae or other order revisions made on a national basis. These cooperatives strongly support the conclusion of the Secretary and the Recommended Decision that depooling and repooling provisions are a part of the Order’s pooling provisions and therefore need to be addressed on an order by order basis because they are a function of marketing conditions unique in each area. We urge the Secretary to hold fast to this finding and adopt the proposed revisions to Order 33 as suggested in these comments.

The proposed amendments to Order 33 which provide for the ability to repool 115% (or 120% in the month of March) of the prior month’s milk volume appropriately fit this market.

These allowances are reasonable to the extent that they will accommodate substantial depooling and repooling over a period of several months. Nevertheless, the amended pooling provisions will materially change the status quo by requiring all handlers to factor into their depooling decisions the economic consequences of the required staged repooling. The provisions in Order 33 are appropriately different from those proposed for adoption in Orders 32 and 30 because the marketing conditions and the demands of the marketplace in these areas are different.

We must note, and the Secretary will note, that dairy commodity prices are currently at the support price level.¹ The cycles of dairy markets being what they are, at some point in the future these prices will increase from the support level and this will create the possibility (perhaps the likelihood) of price inversions and negative PPDs, which are the triggers for depooling. We trust that the Secretary will expeditiously move forward on these Recommended Decisions so that final decisions are published, the necessary referenda held, and final orders issued so as to become effective prior to the next depooling cycle.

Finally, we commend and support the Secretary's choice of remedy for depooling. We recognize that there are a number of options including Proposals 4, 5, 6, and 8 which were presented at the Hearing as alternative means for addressing the depooling issue in Order 33. These cooperative proponents which collectively represent a substantial proportion of the milk pooled (and depooled for that matter) on the Order considered the various options available, the pros and cons, and reached a conclusion that a repooling limitation at the 115% level would be the most appropriate mechanism for addressing this problem in Order 33. This repooling maximum constitutes a substantial limitation upon, but not an absolute lockout of, depooled

¹ If necessary, official notice is requested of the Dairy Market News weekly publications during this comment period.

milk. We endorse the Secretary's finding that this is the appropriate mechanism for this Order.

III. COMMENTS UPON THE DESIRED AND INTENDED OPERATION OF THE REPOOLING LANGUAGE AND THE 115% LIMITATION.

We would like to reiterate our interpretation and intention as proponents with respect to certain of the language proposed for adoption through Proposal 7; and make one request for modification of the proposed language.

Our overriding intent was and is that the unbridled depooling and repooling of milk promotes disorderly marketing conditions and should be constrained. Indeed, the proponents of the various competing solutions at the hearing agreed that there should be limitations – the views only differed on the best constraints. We commend and support the selection of our proposal – Proposal 7 – as the most appropriate solution. We chose the limit parameters of 115% and 120% because our study indicated that they were appropriate for the market's demand and supply pattern. While no limit can anticipate every occurrence, these ranges seemed to provide a reasonable level of deterrent without causing normal milk supplies associated with the Order to be denied pool privileges.

At the same time, we sought to make certain that milk shipments to pool distributing plants would be encouraged and pooled, and not inadvertently deterred. We did not want to set up a situation where a supplier would not want to deliver to fulfill a Class I order. If in a month following depooling, a supplier is near its maximum limit and has a Class I order, it may not want to ship if it would cause the handler to be over its pooling limit. For this reason, we proposed the language included in the Recommended Decision in subpart (e)(2) which limits pooling to 115% (or 120% in March) of the prior month's volume "*plus* (2) Milk shipped to and physically received at pool distributing plants and allocated to Class I use in excess of the volume

allocated to Class I in the prior month;” (emphasis added).

It was, and is, our intention that for purposes of the 115% calculation, the incremental amounts over the prior month’s shipments to pool distributing plants be exempt from the 115/120% limitation in the language of proposed (e)(1). The volume of deliveries equal to the prior month’s total shipments to distributing plant(s) should remain in the base amount to which the 115% or 120% is measured against. So as not to discourage shipments to distributing plants, however, any incremental volumes delivered should be “free” from any constraints of the 115% or 120 % repooling limitations.

Upon reflection, in order to most practicably and efficiently carry out the intention of the proposal, we are now requesting that the language concerning additional, incremental deliveries to distributing plants apply to all delivery volumes, and not just volumes classified as Class I. We request this for marketing predictability reasons: the marketer cannot know for certain what volumes of milk are classified as Class I until after the end of the month; and these determinations may be subject to the plant operator’s directions to which the marketer may not be privy. If the milk is needed at the distributing plant, it should not count “against” the 115%/120% repooling limitation. Therefore, we request that the language of (e)1 and (2) provide: “*plus* (2) Milk shipped to and physically received at pool distributing plants in excess of the volumes shipped to and physically received at pool distributing plants in the prior month;”

We recognize that this amended language could potentially create the ability for distributing plants to traffic in (sell) repooling qualification, whereas Class I classification is limited by Class I use volume. However, we believe this possibility is materially limited by the net shipment provisions for pool qualification generally, which are part of Order 33; and the language, discussed below, which gives the Market Administrator the authority to identify

inappropriate schemes for repooling and treat such schemes accordingly. Thus, upon full reflection, we believe that incremental, additional shipments to distributing plants, irrespective of how such shipments are classified, should not be included in the numerator of the repooling fraction.

Similarly in terms of our intention, in section (3) of section 1033.13 (e) we wanted to allow for milk to move between orders because of a demand for milk, but not to abet depooling. Thus, this allowance accommodates continual pooling of milk that moves between orders as it will not be included in the depooling equation on an equal volume basis. This should allow milk to move between pools but not allow a handler to move milk to take advantage of depooling situations.

Finally, we recognize that there will likely be situations that will call for interpretation but do not occur often enough, or are not sufficiently predictable to be anticipated with specific language. Thus, we want the Market Administrator to have some discretion in interpreting and applying the regulations. The proposed language does not give the Market Administrator discretion in setting the re-pooling percentages from month to month, since we believe that that would likely result in a never-ending request to do so and render the provisions nugatory. However, we do want the Market Administrator to be able to look into specific situations such as a new handler (a merger of cooperatives or two handlers with independent milk supplies becoming a single entity) or a supplier acquiring a large volume of new supplies. We understand that the nuances of each situation will be different and the Market Administrator, on the basis of the facts at hand, should investigate each occurrence. The burden of proof will rest on the entity requesting a relaxation of the rules to accommodate additional pooling. Finally, if there is a situation where the Market Administrator feels a bloc of milk has been reported in such a way as

to evade the rules on depooling and re-pooling, the language is intended to enable the Market Administrator to investigate the circumstances and deny the privileges of pooling to the bloc of milk, if appropriate.

IV. EXCEPTIONS TO THE RECOMMENDED DENIAL OF PROPOSAL 9 FOR TRANSPORTATION CREDITS

These cooperatives take exception to the Recommended Decision's failure to recommend adoption of Proposal 9 for marketwide service payments in the form of transportation credits.

We would first note that there was very limited opposition to the proposals for these marketwide service payments. The only outright opposition came from Continental, on brief, and from limited testimony of several favorably-situated independent producers. The balance of participants, including Dean Foods, supported the concept of transportation credits as worthy in assisting the supply for the Class I market, although there was some difference in view point among various parties with respect to the specifics of the credits. Dean Foods, for instance, in its brief objected to the 75 mile no-credit zone. Similarly, Foremost and Alto supported supply plant shipments; while MMPA has explicitly opposed credits for supply plant shipments. In our view, some weight should be given to the substantial consensus of view that orderly marketing would be assisted by adoption of marketwide service payments in the form of transportation credit for deliveries of milk for Class I use.

We are quite puzzled, and concerned, with the Recommended Decision's conclusion that the record is insufficient because certain information was only compiled for the month of October 2004. There are several troublesome aspects to this reasoning. First, the record clearly establishes that within Order 33 there is a major structurally deficit milk supply/demand situation. This is clearly depicted in the Market Administrator's compiled information in Exhibit

7, Requests 8(a) through 8(e). While this supply/demand data is for October 2004, there is producer supply information for other months in the record and to the expert eye of the Department, it can only be perfectly clear that the Southern Ohio/West Virginia/Northern Kentucky portion of the marketing area (Exhibit 7, request 8(e)) is severely deficit of a local supply on a year round basis. Although the full array of data is for October, the record plainly depicts a year round need for imported milk supplies.² The production-to-demand balance in the entire state of Indiana and in Western Pennsylvania is only somewhat better than that in Southern Ohio. (Exhibit 7, requests 8(b) and 8(e)). As proponents' testimony indicated, the transportation credits were intended to address both the long distance in-area movements of milk, as well as importation of milk from out of the area. There is clear, undisputed evidence that the necessary movements for Class I needs in-area across the large flat price zones are not compensated by the order's prices. Any milk from out of the area, whether imported in October or other months, has an even greater deficit of transportation cost to location allowance. There cannot be any real dispute that these location pricing shortfalls for movements of Class I milk are year-round phenomena; and the fact that proponents used a full array of data for one month only does not alter or depreciate that fact.

The Recommended Decision with respect to depooling found "disorderly marketing conditions are present when producers do not receive uniform prices," an extremely important

² We must comment that while these cooperatives as proponents requested substantial data assembly of the Market Administrator's staff, we have never viewed, and do not understand our ability to request work by that staff to be limitless. The data for October 2004, as an exemplary month, was almost all "new" data, not routinely compiled and which the Market Administrator had to compile solely at our request for the hearing. As Ms. Uther of the Market Administrator's staff testified, there were unable to fulfill the request for May data also, which was requested. (Tr. 91) Making that project 12 times as voluminous, to have a full year of data, would have been a very substantial request which we did not consider necessary, and, it obviously would not have been physically possible.

finding for the Order program. However, the same result – non-uniform prices among producers – is structurally built into the order when transportation differentials (location prices) are insufficient to support the cost of moving milk for Class I purposes from the point of supply to the point of demand. One group of suppliers in the market, who are able to deliver to the low-cost Class I options will receive one minimum blend price under the order; another group of suppliers who must transport their production to more distant Class I locations for qualification without compensation for the additional cost under the order will receive another, non-uniform lower return.³ This is a disorderly marketing condition created by the order’s location prices, just as with the non-uniformity of prices created by free and open depooling/repooling provisions. The transportation differentials proposed are a limited, targeted remedy for the problem: They are targeted since the credits only apply to Class I deliveries. Unlike location prices, which levy a cost of moving milk from one point to another irrespective of classification, the Proposal 9 transportation credits only apply to movement for Class I. Furthermore, they are limited in that they are less than the marginal cost of transporting milk and offset by any allowance already established in the order for moving milk from the same location to the point of delivery.

The Recommended Decision’s discussion of over-order charges is also troubling and we take exception to it. The Recommended Decision suggests that supplying cooperatives can recover via over-order charges the additional transportation costs which they incur and which are not provided for under the Order. We respectfully disagree that the information in the record can

³ It is not an answer to this problem to say that orders do not set farm point prices, or to say that both producers are receiving a uniform price under the order, adjusted for location. The bottom line facts, which are what were recognized in the depooling debate, are that as a practical matter, uniformity is measured at the farm gate by producers and suppliers, and that fixed, substantial Class I transportation cost deficits yielded by the Order’s price grid create an order price uniformity problem of the same nature as that caused by depooling and repooling.

lead to that conclusion. Mr. Gallagher for Dairylea and DFA provided information on the year round yield to sellers of Class I premiums in Order 33. The bottom line of that testimony showed that on a year round basis, **before accounting for any costs of operating the cooperatives**, Class I over order premiums generated 71 cents to be available to pay producers. In October, the figure was 45 cents per hundredweight. The record further shows that these returns are substantially less than what is paid (on all classes of milk) to independent producers who are not responsible for any of the market servicing costs, and have no cooperative dues.⁴ Consequently, we are perplexed and take exception to the finding that proponent cooperatives are somehow able to recover their transportation expenses and still be competitive in the market place. The record data establishes that this is just not possible and providing limited reimbursement for transportation costs for Class I milk only, which costs are not otherwise reflected in the order values, as requested in Proposal 9 is only a small step in partially eliminating this degree of disorder in non-uniform returns to producers.

We furthermore take exception to the Recommended Decision's suggestion that providing limited transportation credits on bulk milk movements to handlers in deficit locations would somehow skew competition between handlers. This argument completely begs the question of what objective order prices have in getting Class I milk to processing plants. In the

⁴ To acquire milk from producers for marketing over the short or long term, cooperatives must pay a competitive price at the farm gate. The cost of acquisition is set by their competition, such as the independent producers like Mr. Bear who testified. These producers receive, as the record establishes, in excess of \$1.00 over the order minimum, and pay no marketing costs to support the full needs of the receiving plant. (Tr. 1054–57 (Bear); Tr. 1097–99 (Soehnlén); Tr. 894–896 (Steiner)) The plant(s) do not choose to incur these costs, but look to the cooperatives to tailor their supply. To say that the cooperatives' Class I transportation costs not covered by the order's price grid, should just be taken out of the premiums received from handlers, and therefore out of the cooperative producers' bottom lines, is in essence to say that the cooperative producers should not receive uniform, or even reasonably competitive, prices under the order.

current order configuration, the order prices simply do not attract milk to Southern Ohio plants for the same return as do the order prices at Northern Ohio plants. Therefore, producers supplying those diverse locations are rewarded with non-uniform returns. We do not believe that is what the Order system intends.

As proponents of Proposal 9, we are left with the uneasy feeling that the proposal was rejected for lack of data (i.e. all year round data) which was not raised as an issue at the hearing itself and may not have been available, or for other reasons which were also not raised at the hearing (such as the impact of credits on handlers' packaged milk distribution).⁵ We respectfully contend as we did at the hearing that the record fully establishes that non-uniformity of return to producers is a disorderly marketing condition which is endemic in the marketplace because of the Order's current inadequate and inequitable failure to reasonably compensate for transportation for Class I use.

We take exception to the Recommended Decision's denial of Proposal 9.

⁵ We are concerned that there may be a structural defect in the hearing process when a Proposal is rejected by the Secretary on the basis of detailed objections, the substance of which were not raised, at least not in detail if at all, in the hearing process (which would allow the proponents to address the concerns where possible). For instance, the necessity of year-round data, if that is in fact a necessity, was not demanded and by all indications it would not have been feasible. (Tr. 91) Also, the issue of the impact of transportation credits on competition in packaged product among distributing plants is an issue which, to our knowledge, has not been raised, and certainly has not been determinative, in any previous hearing concerning transportation credits.

V. CONCLUSION

These cooperatives again commend the Department for recommending what we believe to be the most appropriate solution for the disorderly marketing which currently results from the open depooling and repooling of milk on Order 33. At the same time we take exception to the denial of Proposal 9 for marketwide service payments in the form of transportation credits. We urge the Department to take the most expeditious action possible to make final the recommended decision on Proposal 7; and to reverse the denial of Proposal 9.

RESPECTFULLY SUBMITTED,

Date: April 24, 2006

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