

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

In the Matter of : **Docket Nos.:**
:
Milk In The Central Marketing Area : **AO- 313-A48**
:
: **and DA-04-06**

**BRIEF FOR DAIRY FARMERS OF AMERICA, INC. (“DFA”)
and
PRAIRIE FARMS DAIRY, INC. (“PRAIRIE FARMS”)**

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I. INTRODUCTION

This brief is submitted on behalf of Dairy Farmers of America, Inc. (“DFA”) and Prairie Farms Dairy, Inc. (“Prairie Farms”). It addresses all proposals at the hearing, those advanced by these proponents and those proposals advanced by other parties. The hearing proposals concern pooling and market servicing issues and revolve around one central theme: How can the terms of Order 32 be updated to provide more stable, orderly marketing in this vast area covering the Central portion of the country?

The dysfunction of Order 32 at present was described by a number of witnesses, including in particular the individual dairy farmers who took time to come to the hearing to express their concerns with the disorderly conditions of the past 12 to 24 months. Open depooling has become so notorious among producers and the industry that it is imperative that the Secretary address this disorderly condition on an emergency basis. In addition, the proposals for other amendments to the pooling provisions and transportation credits are well supported in the hearing record and will add to the functionality and orderliness of marketing in the area.

II. FACTUAL BACKGROUND

Proponents

1. Dairy Farmers of America, Inc., (DFA) is a Capper-Volstead cooperative association of 13,500 dairy farms producing milk in forty-nine (49) states. DFA regularly markets milk on 10 of the 11 federal milk orders, including Order 32. DFA’s Central area Council consists of some 5,500 member farms primarily in the marketing area for Order 32. (TR. 223)

2. Prairie Farms Dairy, Inc., is a Capper-Volstead cooperative owned by more than 800 dairy farmer members. (TR. 223) Prairie Farms owns and operates 7 milk processing plants located in Order 32 and pooled under the Order. In addition, Prairie Farms is the operating partner for 7 other Order 32 distributing plants. (TR. 518–519; Exh. 27) Prairie Farms owns or operates in joint ventures 14 pool plants in Order 32 and 6 unregulated plants in the marketing area. (Exh. 27)

The Market

3. Federal Order 32, the Order regulating handling of milk in the Central marketing area, effective January 1, 2000, is a product of the consolidation of the following former orders: Iowa, Order 79; Southern Illinois-Eastern Missouri, Order 32; Central Illinois Order 50; Nebraska Western Iowa, Order 65; Eastern South Dakota, Order 76; Kansas City, Order 64; Southwest Plains, Order 106; Eastern Colorado, Order 1137; and Western Colorado, Order 1134.

4. The Order stretches more than 600 miles from North to South and more than 1,200 miles from East to West. Most of the area of the Order south and west of Iowa consists of a number of large metropolitan areas, including St. Louis, Kansas City, Denver, Wichita, and Oklahoma City, with only modest concentrations of milk production nearby. Milk production in the area is most concentrated in northern portions of the marketing area and contiguous production areas. However, the areas of greatest population, including the four metropolitan areas of 1 million or more, are to the south and west.

5. “Open” pooling was specifically rejected as a basis for associating milk with federal order pools in the order reform process.

6. In the Order reform decision, the combined Class I utilization of the Central Order was estimated to be about 50%. That utilization level has not been achieved. (TR. 656-657; Exh. 35E)

7. The actual Class I utilization on Order 32 was 26% in 2002 and 32.8% for 2003. (Exh. 9, Table 8) The 2003 figure was significantly enhanced by massive depooling of Class III and IV milk during the year.

8. The reduced Class I utilization has resulted from the pooling of large numbers of producers and milk volumes from sources outside the marketing area, without substantial service of the Class I market. (Exh. 9)

9. The pooling of milk from areas not closely associated with the marketing area has resulted in a reduction in the blend price. The reduced blend price materially impairs the ability of Order 32 plants to attract milk supplies for the fluid market, as the experience of Prairie Farms and Dean Foods has demonstrated.

10. The pooling of milk without substantial performance has been facilitated by pooling provisions which allow milk to be pooled on the Order with the requirement of few if any deliveries to distributing plants serving the marketing area.

11. In spite of the low utilization on the Order, distributing plant operators in the largest metropolitan area of the market, St. Louis, have had difficulty attracting milk supplies from Order 32 sources, even with substantial premium prices prevailing. Furthermore, in several parts of the marketing area, including southern Illinois, eastern Missouri, and western Colorado, production has declined or migrated to supply other markets. At the same time, the Order 32 blend price and performance requirements are insufficient to attract additional supplies from

Order 30 or to get milk pooled on Order 32 to actually service Order 32 distributing plants. (Lee, Kiser)

12. In addition to the lack of sufficient order incentives to supply Class I markets, milk which is dedicated to manufacturing uses has freely moved on and off the Order to take advantage of price fluctuations and class price inversions. This “open depooling” is a major source of marketing disorder in Order 32.

13. The testimony of dairy producers strongly attested to the disorder from current Order 32 provisions:

a. Jim Huffman of southwestern Nebraska described the havoc which reduced (and even negative) PPDs have generated for his operation and those of neighbors in his region. (TR. 354–374)

b. James Reed, a DFA member and President of the Kansas Dairy Association testified to the losses he has suffered on his farm in central Kansas from the reduced returns caused by depooling. Last Spring alone, he lost \$3,000 to \$4,000 from depooling. His position, and that of the Kansas Dairy Association is that producers should share in the Order’s returns day in and day out, not just when it is to that producer’s individual advantage. (TR. 379)

c. Bob Seiler, a dairy farmer from Valley Center, Kansas, estimates the losses on his farm from depooling at \$11,600 during March to October 2004. Amendment of the Order is necessary to stabilize prices and returns. (TR. 393–402)

d. Richard Groves, a third generation dairy farmer from Skidmore, Missouri, testified to the market disruption and adverse effects to his small business caused by depooling.

Farmers in southern Missouri who depooled had a higher pay price than he did as a pooled Class I supplier in several months. (TR. 403–410)

e. Doug Nuttleman, a DFA Board member from Stromburg, Nebraska, milks 150 cows and farms 2,000 acres. He testified that the Class I demand in the market is relatively steady and that producers should not be able to share in its returns only when it is to their advantage. When there are massive depoolings in the market, his price, as a Class I supplier, is on the low end. (TR. 412–424)

f. Bill Siebenborn, a DFA Board member, milks cows in north central Missouri and has a small business. The DFA proposals in the hearing (Proposals 1–3) were the result of producer participation in the cooperative decision making process. The depooling issue is the largest single issue in Order 32 among producers. Depooling creates differences in pay prices among similarly situated producers. The differences are substantial. This is a disorderly marketing condition. (TR. 425–430)

g. Barbara Rhinehart has been a dairy producer in Linn County Missouri for 42 years. Her farm, which supplies the Class I market to Anderson-Erickson in Des Moines, IA, has suffered substantial losses from depooling in Order 32. It is her view that producers supplying manufacturing markets should not be “in and out” leaving the Class I suppliers at a disadvantage. (TR. 602–617)

14. The Order 32 blend price at key areas of the Order in Illinois and Missouri is insufficient to attract milk from Order 30 and to keep milk from moving to Orders 5 and 7 to the south and east. Proposals 1 and 2 will provide some help for this problem. (Lee, TR. 518–28)

15. Allowing producers to jump in and out of the pool freely is unfair to the dedicated suppliers of the Order 32 Class I market, such as the members of Prairie Farms. (Lee, TR. 528-30)

16. Depooling has led to substantial differences in pay prices among similarly situated producers in Prairie Farms procurement area. These differences have sometimes been \$2 to \$4 per hundredweight in northwest Illinois and Eastern Iowa. (Lee, TR. 530–531)

17. Order 32 does not presently provide a sufficient incentive for milk to move from western areas of surplus and new production to eastern areas of demand, such as St. Louis. The transportation credits in Proposal 3 could address this to some degree. (Lee, TR. 532–34)

The Proposals advanced by DFA and Prairie Farms

18. Proposals 1, 2, and 3 can be summarized as follows: (1) Proposal 1 deals with performance standards for both local and distant milk. Its goal is to more fairly define the milk that should share in the pool's Class I returns. (2) Proposal 2 deals with the issue of depooling. Its goal is to minimize the practice of depooling by requiring milk that chooses to “opt out” of the pool to face greater economic consequences for that behavior. Both DFA and Prairie Farms depool milk when advantageous and feasible. However, they think this practice is detrimental to the order system and to dairy farmers and wish it stopped or curbed. (3) The modification to proposal 3 would establish a “transportation pool” funded by blend price revenues to offset a portion of the cost to transport milk to the market for Class I. (Hollon, TR. 225)

19. Depooling is a marketing problem because it results in different returns from the Order for milk sales; and different pay prices among producers. Milk is only depooled when the result means more money for the handler who depools. Since by definition Class I milk cannot

depool, the Class I sale is always disadvantaged when milk is depooled. In depooling, Class I suppliers are **always** disadvantaged; it is a practice which is beneficial solely to suppliers for Class II, III, and IV. This is the ultimate in irony – that the source of additional value to the pool, Class I milk, is unable to be competitive with other class sales due to depooling. (Hollon, TR. 235-36)

20. The magnitude of the difference in returns from depooling is large. Exhibit 18 Table 2-E shows that in April 2004 a handler which was unable to depool was \$4.02 per hundredweight behind in ability to pay versus a handler which was able to depool. For the supplier who delivered a tanker load of milk per day to a fluid bottler, that difference amounted to \$62,310 for the month; for 10 loads per day \$623,100 per month. Differences of this magnitude would be insurmountable for nearly any milk procurer. (Hollon, TR. 236)

21. While underwriting risk management tools is not a purpose of federal orders, depooling makes risk management tools normally available to dairy farmers virtually useless since the magnitude of risk they must now account for, because of swings in PPDs, is far too wide for any speculator to be willing to take on and the price for such activity so great as to render the hedge useless. (Hollon, TR. 238) This experience was confirmed by the testimony of dairy farmers.

22. Depooling in 2004 caused reductions in the Order 32 PPD of from \$.95 to \$2.15 per hundredweight. (Hollon, TR. 239)

23. Proposal 2 would not eliminate the ability to depool. It would however place a price on a handler's depooling decision. (Hollon, TR. 240-42) By exacting a price for the depooling decision, the 125% repooling limit would curb the practice to a meaningful degree.

24. Proposal 1 is addresses to the need to modify existing pooling standards in Order 32. When the current performance standards are reviewed, it becomes clear that they allow and perhaps encourage business decisions to be made that would never take place in the real world. This leads to and supports the conclusion that the performance standard is faulty and needs correction. (Hollon, TR. 267; Exh. 9I)

25. Without adoption of Proposal 1, it is possible and indeed likely that large volumes of milk from outside the Order 32 area could become attached to the pool without meaningful performance for the market. (Hollon, TR. 250-52)

26. Under Proposal 1, milk outside the marketing area and the adjoining defined area needs to perform in order to derive the benefits of the marketwide pool. Under Proposal 1 diversions to plants located outside the prescribed geographic area would not be allowed to pool. The proposal requires that to be eligible for pooling, all deliveries must be to either an Order 32 pool plant or a plant located within the prescribed area of states which have counties in the marketing area. Also this delivery standard, in order to achieve the goal of a more reasonable performance standard must be coupled with a minimal increase in touch base standards and the limitation on depooling. (Hollon, TR. 268)

27. Proposal 1 is needed because the current performance standards will allow and even encourage milk from areas too distant to ever serve the market on a regular basis to become attached to the Order pool. The “once and done” standard combined with the ability to easily depool any volume can be very detrimental to the Order 32 blend price. (Hollon, TR. 264-65)

28. Proposal 3 is a proposal for marketwide services. DFA and Prairie Farms support Proposal 3 with respect to the supply plant transportation credit. Only a small percent of the Class I market is served via milk from supply plants, however. The remainder comes directly off the farm (or through a reload) – and in a more efficient manner. The credit should not apply to only one portion of the supply and ignore the balance, especially when the balance is delivered in a more efficient mode of transportation. The proposed modification would add a payment for direct-shipped milk that delivers to a pool distributing for Class I use. It would allow the payment for milk that is reloaded also, but at the same rate as for milk that is not reloaded. (Hollon, TR. 280-81)

29. Proposal 3 as modified would provide credits using the rate of payment \$0.003 per hundredweight per mile on allocated Class I volumes. This is a rate which is both responsible and reasonable and pushes the market towards efficiency. The proposal would be limited to payment for deliveries of 500 miles; and it would net the pounds paid to any distributing plant against any diversion or transfers made on the same day as a protection from abuse of the credit. Additionally the proposal directs the Market Administrator to make the measure of miles be the shortest distance possible by comparing the shortest road miles from the distributing plant to the nearest farm on the route. The handler requesting the credit must provide data to the Market Administrator justifying all calculations. Our proposal would exempt the first 25 miles from payment, a distance which reasonably represents the distance that producers serving the market through supply plants pay for hauling. (Hollon, TR. 288)

30. The proposed mileage limits on the transportation credit are based upon empirical studies of the actual costs and distances for hauling in Order 32 and its milkshed. They are calculated to compensate for the Class I supplies while avoiding the potential for abuse.

31. There is a need for this hearing to proceed on an emergency basis. The issues with depooling have already been a problem in the market since the hearing. Opponents who have argued that there is no need for emergency treatment because the concerns are past are wrong already. Amendments are needed as soon as possible. The concerns with performance standards also have a very short-term horizon for need. California milk moved very easily through the Order system shifting from one market to the next as regulation changed. The producers in Order 32 have no desire to experience the blend damage that producers in Order 30 have from distant western milk and emergency action will help alleviate that concern.

Other proposals

32. Dean Foods identifies two problems in Order 32: (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. It offered an array of proposals to address these issues. (Kinser, TR. 622)

33. Dean Foods' Proposals 6, 7, 8 are addressed to the depooling problem. Proposals 4, 5 and 9–13 are aimed at other pooling abuses.

34. Proposals 6 and 7 are “dairy farmer for other market” provisions which would exclude from pooling under Order 32 milk from a farm which had been delivered “as other than producer milk” during the month or a fixed number of prior months, 11 months in Proposal 6 or

3 months in Proposal 7. The effect would be to prohibit the re-pooling of depooled milk for the established number of months.

35. Dean Foods' Proposal 8 would limit repooling of depooled milk to 115% of the handler's prior month's poolings, a stricter limitation than proposed in DFA and Prairie Farms Proposal 2.

36. Dean Foods' Proposals 4, 5, and 9–13 would tighten up pooling provisions relating to supply plants on Order 32 dramatically by eliminating such plants (Proposal 4); eliminating systems of supply plants (Proposal 11); eliminating split plants (Proposal 9); or increasing substantially the shipping or performance requirements for supply plants (Proposal 5); split plants (Proposal 10); and supply plant systems (Proposals 12 and 13).

37. Proposal 14 offered by the Order 32 Market Administrator would amend the payment provisions of the Order to assure a one (1) business day difference between the date for payments into the pool by handlers and the date of payment out by the Market Administrator.

III. THE POOLING PROVISIONS OF ORDER 32 SHOULD BE ADJUSTED AS PROVIDED IN PROPOSAL 1.

A. The need for enhanced performance requirements in Order 32.

The evidence is abundant in this record that the performance requirements in Order 32 require further, additional adjustments. The evidence is in the form of: (1) continued low blend prices in relation to competing federal orders both to the south and the north; (2) performance standards which do not meet the most fundamental tests of economic reality; and (3) continued difficulties in attracting milk to distributing plants in the market.

The hearing record clearly shows (DFA Exhibit 18, Chart 2) that poolings on the Order continue to be well in excess of any reasonable, necessary reserve. These supplies readily flee the market when price relationships make that more economical, and when on the Order they depress the Order's blend price.

One of the measures of orderly marketing is some reasonable economic relationship between blend prices from Order to Order. The comparison of relative returns between markets shown on Exhibit 18 tables 5A-E through 7A-E and on Prairie Farms Exhibit 28 and 29, illustrates the continued disadvantage to Order 32 relative to competing orders both to the north (Order 30) and to the south and east (Orders 5 and 7). This is a situation which creates chronically difficult supply circumstances for Order 32 handlers and their producer suppliers. The adverse blend price relationship is a product of the utilization on the market which reflects permissive pooling of distant reserves.

The Order provisions allow the free pooling of milk supplies which cannot possibly supply the market on an economical basis. This is demonstrated in great detail and with great specificity in Exhibit 18 tables 8A-I and 9I. For instance, with current performance requirements and the lack of depooling controls, it is possible to pool milk in Southern Idaho at a profit even though these milk supplies will not economically serve the Order. The exhibits show the same comparison for possible poolings from Southern Idaho whether the milk is Class III or Class IV. Elvin Hollon's detailed analysis of all these scenarios for these milk movements and poolings shows beyond any peradventure that the current pooling provisions allow, and will inevitably facilitate, the pooling of milk supplies which have no economic basis to supply the market.

The recent history of federal order pooling – with California milk dual-pooling on federal orders and with the current pooling of large volumes of Idaho milk in Order 30 – demonstrates that if pooling provisions allow uneconomic attachment of milk supplies, the milk will find its way into the pool. Order 32 must be amended to preclude these possibilities and to enhance the competitiveness of producers regularly pooled and supplying the Class I market.

B. Explanation of Proposal 1.

There are four enhancements to Order 32 performance requirements in Proposal 1: (1) an increase in the supply plant shipping percentages; (2) language limiting the diversions to nonpool plants outside of the marketing area; (3) an increase in the touch base requirements for pool producers; and (4) an adjustment in the diversion percentage for 9 (c) milk. We will review these proposed changes to Order language in turn:

1. Increase in supply plant shipping requirements. Proposal 1 will amend § 1032.7(c) as follows:

(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 ~~20~~ 25 % during the months of August through February and ~~15~~ 20 % 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.

The result of this language change is to increase the delivery standard for supply plants by 5% to 25% during the months of August through February and by 5% to 20% for all remaining months. In light of the data showing that market reserves are still excessive, and blend prices too low to attract a reserve supply or retain a supply from other markets, this modest change in

shipping requirements is warranted. Higher levels than were granted were requested in the last performance hearing. These proposed changes will allow the Secretary to increase order requirements at a measured pace. Now is the time for this change. Other proposals such as 4, 5, and 9-13 have been made to enhance the performance standards of the Order. No proposals have been offered to reduce performance requirements. Proposal 1 is a small change in the right direction.

2. Limits on diversions to out of area plants. Proposal 1 would amend § 1032.13 (d) to provide: “ (d) Diverted by the operator of a pool plant or a cooperative association described in § 1000.9(c) to a nonpool plant located in the States of Colorado, Illinois, Iowa, Kansas, Minnesota, Missouri, Nebraska, New Mexico, Oklahoma, South Dakota and Wisconsin subject to the following conditions.”

This language noted in Mr. Hollon’s testimony differs slightly from that of the notice. There was an error in the sentence structure of the initial request to the Secretary. The phrase “to a nonpool plant” should be in the position it is here rather than following the words “Wisconsin” and before the word “subject”. This clarifies the intent of the amendment.

The intent is to allow any plant or cooperative handler to divert milk only to non pool plants in the prescribed area. As always, any delivery may be made to an Order 32 pool plant. A plant outside the prescribed area can become a supply plant by meeting the supply plant requirements. The states listed in our prescribed area all have either a county or counties located in the marketing area or have been a regular portion of the market’s supply (as noted in the Market Administrator statistics) since 2000.

3. Revised touch base requirements. The “touch base” eligibility for pooling should be modified as follows:

(1) Milk of a dairy farmer shall not be eligible for diversion until at least one day’s production 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 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 received as producer milk at a pool plant;

(2) The equivalent of at least one day’s milk production is caused by the handler to be physically received at a pool plant in each of the months of August through November and January through February.

(3) The equivalent of at least one days' milk production is caused by the handler to be physically received at a pool plant in each of the months of March through July and December if the requirement of paragraph (d)(2) of this section (§1032.13) in each of the prior months of August through November and January through February are not met, except in the case of a dairy farmer who marketed no Grade A milk during each of the prior months of August through November or January through February.

The “once and done” touch base provision has been eliminated. However the “until” language has been retained which will continue the practice that milk that has lost its association with the market must first re-associate with the market before obtaining diversion privileges. We view this as an additional safeguard for the blend price pool and do not wish to change it.

The “once and done” standard has been replaced with a single day’s touch base in each of the months of August through November and January and February. These months correspond to the times when Class I demand is the highest and hardest to fill. Having a requirement for a

touch base delivery should help make milk available for Class I use. The month of December was excluded because of the Christmas / New Year holiday period which while it has a high demand for part of the month is nonetheless difficult to comply with any touch base standard because demand changes radically at the end of the month.

Section (3) describes the necessary touch base requirements for the “non shipping” months if the requirements are not met in the shipping months.

4. Diversion limitations. Proposal 1 limits 9(c) diversions as follows:

(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 § 1000.9(c)) the handler diverts to nonpool plants not more than 75% during the months of August through February, and not more than 80% during the months of March through July, provided that not less than 25% of such receipts in the months of August through February and 20% of the remaining months' receipts are delivered to plants described in § 1032.7(a) and (b);

This language provides the shipping and diversion requirements for a 9(c) handler. These requirements are the same as those for a supply plant in both percentage requirements and months of application.

IV. OPEN DEPOOLING IN ORDER 32 SHOULD BE LIMITED THROUGH THE ADOPTION OF PROPOSAL 2.

A. Proposal 2's limitations on repooling of depooled milk should be adopted.

1. The depooling/repooling problem. Depooling has become a problem of orderly marketing in federal orders which goes to the heart of the order system. The huge swings in volumes of milk pooled, up to half of the total volume of milk on Order 32 being pooled or

depooled from month to month, is such that it almost makes a mockery of the system. Because depooling has economic results which are profitable to the depooler, all entities, including DFA and Prairie Farms when possible, have depooled supplies of milk from time to time. Both of these organizations recognize, however, that the permissibility of open and free depooling must come to an end in the interest of orderly marketing for the system as a whole.

We want to briefly discuss several of the orderly marketing issues which depooling creates. The record documenting these problems is virtually uncontroverted and is a clear mandate for the requested adoption of Proposal 2. There are three marketing problems relating to depooling which we would like to highlight: first, depooling creates a lack of uniform returns among dairy farmers. There is a wide array of testimony in this record with respect to the disorderliness resulting from the lack of uniformity of producer returns created by depooling. The uniformity issues were described both by the cooperative witnesses, Elvin Hollon and Gary Lee, and by the individual dairy producers. The differences in pay prices among producers because of depooling can be of the order of several dollars per hundredweight. These are substantial, meaningful and quite disorderly marketing conditions which must be remedied.

Secondly, the free and open depooling of milk exacerbates the problem of availability of milk for Class I uses in Order 32. It almost goes without saying that milk which moves on and off of the pool in relationship to changes in the configuration of Class prices is unavailable for the fluid market. Being part of the federal order pool should require a commitment to availability for Class I beyond that which free depooling involves. Particularly in Order 32, where there is a documented problem with the availability of supplies to the distributing plants in the Order, depooling-at-will should not be part of the terms of participation in the pool.

Finally, as several witnesses testified, depooling's contribution to huge swings in the PPD creates marketing problems for producers who are dedicated to supplying the Order and wish to avail themselves of risk management strategies. It is important to understand the dynamics here: hedging milk prices with dairy futures or options contract is not a strategy which can avoid or ameliorate the impact of depooling. To the contrary, the impact of depooling on the PPD interferes with the ability of dairy farmers to hedge the inherent price fluctuations in the dairy product markets. In other words, depooling exacerbates – to a degree that is beyond any risk management strategy's control – the variations in milk prices.

In summary, to further price uniformity among producers, to make milk supplies that are pooled in the Order more regularly available for Class I utilization, and to allow producers the ability to manage the inherent risk in dairy product markets more readily, there must be amendments to Order 32 to limit depooling of milk.

2. The Proposal 2 Solution. The Proposal 2 limitation on depooling represents a substantial change in order regulations which has been criticized by other participants as being insufficient change, on the one hand, or providing for too much change, on the other. We believe that the degree of limitation of repooling which Proposal 2 provides is appropriate for this market at this time.

Proposal 2 does not eliminate depooling. It simply limits the ability of a handler to immediately repool the depooled milk by placing a 125% limitation on increases in pooling from month to month. A handler can, when depooling is lucrative, eliminate whatever portion of his milk he chooses from the pool and pocket the short term revenue enhancement. However, the handler will need to be aware that he will need to phase his dedicated manufacturing milk back

into the pool over a period of time after it has been depooled. Page 16 of Exhibit 10 shows that the handler could depool up to 49% of his manufacturing milk and have 100% re-pooled within three months after the initial depooling. However, to the extent that more than 49% was depooled, the handler would need more than three months to get all milk back on the pool (unless, of course, it is delivered to Class I distributing plants where it would automatically be pooled).

DFA and Prairie Farms evaluated all of the potential options that were in the hearing notice (and others that were not) for addressing the disorder of open depooling. They considered proposals for other market provisions similar to Dean Foods' Proposals 6 and 7. They considered lesser percentages for the repooling limitation such as 115% in Dean Foods' Proposal No. 8. After analyzing these options and taking into account the operations of servicing the Order 32 market regularly, it is submitted that Proposal 2 fits the market. The proposed language on depooling is:

Amend § 1032.13 by adding new paragraphs (f)(1) through (f)(4) 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) for the current month may not exceed 125 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. Milk received at pool plants in excess of the 125 percent limit, other than pool distributing plants, shall be classified pursuant to § 1000.44(a)(3)(v). 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 provisions of 1032.13(d)(5) shall apply. The following provisions apply:

- (1) Milk shipped to and physically received at pool distributing plants shall not be subject to the 125 percent limitation;
- (2) Producer milk qualified pursuant to § ____ .13 of any other Federal Order in the previous month shall not be included in the computation of the 125 percent limitation; provided that the producers comprising the milk supply have been continuously pooled on any Federal Order for the entirety of the most recent three consecutive months.
- (3) The market administrator may waive the 125 percent limitation:
 - (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) 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.

Proposal 2 represents an effective, but moderate, current solution for the depooling problem. It has important safeguards to allow milk to be delivered to distributing plants and to allow new handlers to come into the Order. It avoids the potential pitfall of Proposal 8 which could well limit appropriate and non-abusive pooling of milk in situations where, because of seasonal production fluctuations and for other valid reasons, month to month increases in production could exceed 15 percent. Proposal 2 is a step forward for orderly marketing which the Department should take.

B. Objections and Objectors to Proposal 2.

The AMPI et al. objections. AMPI et al. object to any limitation on depooling on the grounds that pooling means a one-way flow of revenue from Class I handlers to other users. We

do not believe that this is a principle of federal orders, or that it should be. If the only purpose of federal order marketwide pools was to blend Class I revenues, one would assume that there would be no pricing or pooling of any other uses; but that is not the case. All use values are blended to derive a uniform minimum producer price, blend price or PPD. The AMAA does not authorize only classifying, pricing and pooling Class I uses; it authorizes pooling of *all* uses of milk. 7 U.S.C. § 608c(5)(B)(ii), the statutory authority for marketwide pools, directs “the payment to all producers and associations of producers delivering milk to all handlers of uniform prices for all milk so delivered, irrespective of the uses made of such milk by the individual handler to whom it is delivered” There is simply no basis in AMPI’s argument.

The further argument made by AMPI that open depooling and repooling has always been the practice in federal orders, is not correct and, in any event, should not impede the correction of an order malfunction. In fact, the inequity of depooling and repooling has been addressed in other orders (e.g. Order 1's post-reform dairy farmer for other markets provision) and in the federal order reform decision (price announcements were advanced to limit price inversions which contribute to depooling). The fact that the problem has not been cured should certainly not prevent its being addressed here.

National All Jersey and Central Equity Cooperative. These organizations apparently have the same or similar motivations as AMPI. To the extent that they actually market milk, they do so primarily for manufacturing uses, Class III or IV, but want to take advantage of the Class I market when it is lucrative, while having nothing to do with it when it is not to their economic advantage. In our view, there is neither “equity” in this position nor statutory authority for it.

The contentions of some that depooling and negative PPDs are national issues which should not be addressed in Order 32 or any one order are incorrect. First of all, the Secretary has made it abundantly clear that pooling provisions of each order are the products of marketing conditions in those orders. Each order has different marketing conditions and therefore require different pooling provisions. Even though certain pricing policies in the federal order, such as advanced pricing of Class I milk, contribute to price inversions and these pricing programs are national, nevertheless, the pooling and depooling provisions in each order need to accommodate market conditions in that order in their own unique way. There is no reason, in fact it would be wholly unjustified, to await an as yet unrequested and likely never-to-be-conducted national hearing to synchronize pricing of all classes before addressing the present extremely disorderly conditions in Order 32 created by open depooling provisions in the Order.¹

The disorderliness of open depooling needs to be fixed and needs to be fixed now before the next price inversion occurs² and its accompanying disorder discredits the Order program further.

¹ The Secretary should not give any credence to the arguments of AMPI or any other parties who request the indefinite preservation of inequitable pooling rules because there is a theoretical fix which they did not request for this hearing.

² The next massive depooling has already occurred in December when approximately 550,000,000 pounds of Class III milk was depooled. The historical pool volumes on Order 32 can be compared with the current pool volumes, published by the Market Administrator at <http://www.fmmacentral.com> official notice of which is requested.

V. THE DEAN FOODS PROPOSALS

DFA and Prairie Farms acknowledge the urgency for making Order 32 more Class I friendly which is represented in the Dean Foods' (DFC) smorgasbord of proposals, numbered 4 through 13. However, DFA and Prairie Farms are representatives of a broader perspective and constituency in the marketplace, which includes not only major commitments to the Class I market, but also maintenance of reserve manufacturing facilities and specialty products operations. From this broader perspective, in our view, the DFC proposals go too far, too fast for Order 32 in 2004–05 in addressing the dual problems of depooling and pooling standards. We would offer just a few comments on specific proposals.

Depooling is an industry practice which has evolved over a number of years. It has transformed from a practice limited in geographic scope to the outlying areas of upper midwestern orders in the 1970s to its current must-do competitive status, a near-national feeding frenzy in times of price inversions. In this context, Proposal 2 has been crafted as a very substantial change in permissible practices; but not a night-to-day change of the magnitude which would be represented by adoption of Proposal 6 in Order 32. DFC's Proposals 6, 7 and 8 may work fine for DFC; but for the market as a whole, the still-stiff medicine of Proposal 2 is the right stuff for the problem at this time.

With respect to pooling standards, we cannot support the abolition of supply plants (DFC Proposal 4) at this time. While supply plants represent a relatively small portion of the total Class I supply in the Order, they may be the only access to the market for some producers,

especially smaller producers; and the existing supply plants do provide some much-needed Class I supplies. Consequently, provision for supply plants should be retained in the Order, with performance requirements adjusted in accordance with Proposal 1.

VI. PROPOSAL 3 FOR MARKETWIDE SERVICE PAYMENTS, AS MODIFIED TO INCLUDE TRANSPORTATION CREDITS ON DIRECT-SHIPPED MILK, SHOULD BE ADOPTED.

A. The problem of servicing Class I in Order 32.

The data indicates that the Order 32 blend is insufficient to hold its milk supply away from Order 5 (Southern Illinois farm to Madisonville, KY bottler) by \$0.61 per cwt through 10 months of 2004; from Order 5 (Southern Missouri farm to Madisonville, KY bottler) by \$0.92 per cwt; and from Order 7 (Southern Oklahoma to a Fort Smith, AR bottler) by \$0.62 per cwt. Moreover, a St. Louis bottler is \$1.22 per cwt short of being able to attract a reserve supply from Order 30 / Southwest Wisconsin; and a Des Moines, IA area bottler is \$1.41 short of being able to attract a reserve milk supply from a Central Minnesota milk supply. These costs far exceed the requested 10 cents assembly credit requested in Proposal 3. Certainly having a Class I milk supply to sell is of marketwide benefit. The cost of such a credit is approximately 3 cents on the entire pool volume. (Exhibit 10 at DFA Request 11 – 12) We support the proponents of Proposal 3 in their efforts to secure an assembly credit.

A transportation credit on tanker shipments for Class I should also be adopted. This marketwide service payment will also assist in providing milk to the Class I market. We concur with the proposal and language. The proposed rate under Proposal 3 is reasonable. In the recent

hearing held to provide for cost recovery associated with hurricanes in the southeast the cost recovery was limited to actual costs or \$2.25 per mile – that rate being considered a high end rate. Dividing \$2.25 by 500 hundredweights (50,000 pound over the road tanker volume) yields \$0.0045 per mile so the \$0.003 requested (2/3 of the cost), is both reasonable and is in line with the concept of Order minimums. The same calculation at \$2.00 per mile yields a \$0.004 / 75% recovery ratio; and at \$2.10 - \$0.0042 / 71%. (If one holds the rate per loaded mile constant and drops the tank size smaller – as might better reflect a farm pickup tank size – an even more conservative reimbursement ratio results.)

We also support Proposal 3 for a supply plant transportation credit. The cost to the blend pool ranges from \$0.006 - \$0.01 per cwt. (Exhibit 10 at DFA Request 11 – 12) a very minimal cost for the market efficiency which would be promoted.

However, Proposal 3 is incomplete. Only a small percent of the Order 32 Class I market is served by milk from supply plants. Exhibit 10, DFA #7 (Pounds of Milk Transported from Supply Plants into Pool Distributing Plants in Increments of 100 Miles in 2003) indicates that in 2003 213.7 million pounds were delivered from supply plants. In 2003 there was 4.7 billion pounds of Class I milk so only 4.5% of the Class I supply reached the market in this manner. The remainder came directly off the farm (or through a reload) and in a more efficient manner. It makes no sense to provide a credit for one portion of the supply and ignore the balance which is delivered more efficiently.

The marketwide service payments should reflect incentives to move milk as needed within the current marketing conditions of the Order. It has been abundantly demonstrated that the Central Order blend price is not able to attract either a supplemental milk supply from other

Orders or keep its milk supply from seeking a home in other markets to the South and East.

Within the market area, production is flat or declining in the east. The states that show increases are on the western side of the Order and they to some extent serve as a reserve supply within the Order. That role may increase in the future and should be recognized in the configuration of marketwide service payments which require recognition of direct ship milk movements.

We propose to modify Proposal 3 to add a payment for direct-shipped milk delivered to a pool distributing plant for Class I use. This will allow payment for milk that is reloaded also. Payment should be at the same rate as for milk that is not reloaded. This will recognize the reloading (and supply plant) service but provide the market with a “carrot” to move to the most efficient manner of delivery – farm direct.

The same rate of payment, \$0.003 per cwt per mile, should be used as proposed for supply plant movements. This is both responsible and reasonable and pushes the market towards efficiency. The proposed payment should be limited to deliveries of up to 500 miles. The entitlement to credits at the plant should be netted against any diversion or transfers made on the same day as a protection from abuse of the credit. Additionally, we propose that the Market Administrator determine the measure of miles as the shortest distance possible by consulting the shortest road miles from the distributing plant to the “origination point” of the nearest farm on the pick up route. The handler requesting the credit must provide data to the Market Administrator justifying all calculations. This proposal should exempt the first 25 miles from payment. That distance represents the distance that producers serving the market through supply plants pay for in hauling charges. It seems reasonable to treat all producers in the same manner in this regard.

The record fully supports all of the elements of the modified proposal with respect to direct shipped milk. The hauling costs and distances used are based upon detailed data beginning with that in Exhibit 10 at DFA Request #9 which is a summation of producer haul charges by county, summed up to the state level for the Central Order. This data is taken from actual payroll tapes and was collected by the Market Administrator. Data collection and publication of this information is a routine practice in most Market Administrator offices. There is a single recap of “every county” data for January 2004 and a monthly average for each state for all months from January 2002 to August 2004. A review of the data shows that from month to month the change in rate is small. December 2003 rates are used to build upon December 2003 pounds in the record since both are needed for the calculation. For example, the December 2003 average haul rate for Iowa was 18.4 cents.

The credit, in keeping with principles applied in other marketwide service payments, should not pay for 100% of the hauling cost, nor reimburse for 100% of the miles. It is equitable and reasonable to exempt from the credit the mileage that a producer pays for delivery to a supply plant in the northern sector of the market. In this way all producers will have the same responsibility for the farm to market haul for Class I. This is consistent with the design of the supply plant credit which is to offset the cost from the plant to the bottler. Its proponents envisioned the producer paying the haul to the plant. Page 91 of Exhibit 9 (Central Federal Milk Order No. 32 Pool Supply Plants) is a map showing the location of supply plants in the market. The majority³ remainder of the Order 32 supply plants do assemble and ship milk to the market.

³ The DFA plant in Fort Morgan does not function as a reload and transship point; nor does the Prairie Farms plant in Carbondale, IL.

For this reason, the states in which those supply plants are located were used to attempt to measure the miles that local producers are responsible for paying for hauling. Those states are Iowa, Minnesota, North and South Dakota⁴ and Wisconsin.

DFA Exhibit 18, Table 10 (Analysis of Local Haul Mileages) makes the computations for mileages.⁵ DFA regularly negotiates for haul rates, buys haul routes, sells haul routes and maintains extensive costs for doing so. Its analysis of a farm haul yields a rate per loaded mile cost of \$3.03. This figure covers mileage costs (both stop and go, pickup and transport), labor and time on the route, maintaining the equipment and a facility which sometimes functions as a pump over, the equipment itself and a fuel adjustor. As expected these costs are not static. They reflect a large number of truck – tank combinations. The range is 20,000 pounds on the low end to 53,000 on the upper end. In some cases the route goes directly from the haulers location to all farms and then to a customer. In other cases routes are picked up and pumped over. Higher volume tanks lower the rate while lower volume tanks increase it. On the basis of this DFA database, \$3.03 is a typical rate and 45,000 pounds is a typical tank size. The calculation using these constants and the weighted average hauling paid in the Central Order region where there are supply plants yields a 23 mile distance that the producer rate pays for. This supports the 25 miles for the proposal. Thus, any rate calculation for credit should not pay for the first 25 miles of haul.

⁴ South Dakota data is combined with the North Dakota information; but is overwhelmingly influenced by the South Dakota volumes.

⁵ The methodology was explained by Mr. Hollon at TR. 212-221.

We have attempted to determine an estimated impact on the Order blend from adoption of Proposal 3 as modified. Exhibit 10, DFA 13 (Producer Milk Received at Central Order Distributing Plants) was designed to show the milk received in 4 quadrants of the market in order to preserve confidentiality. The accompanying tables show the pounds by county that made up that supply. DFA Exhibit 18, Table 10-B (Recap of Transportation Proposal) details by example what was done with the data. Pounds were assigned to each bottling plant in each quadrant. In the case where the bottler was a DFA or Prairie Farms customer proprietary information was used. Where that was not the case, an estimate based on market intelligence sources was made. In each case the total was balanced to the Market Administrator data. When deliveries were compared to Class I use for January, 83% of all deliveries on average were used in Class I. This percentage was confirmed with reference to DFA sales and found to be reasonable.

Using pounds by bottler and supply by county, the pounds were assigned to each plant from the closest source. In some cases large counties were split between plants as those counties were the reserve supply for the milkshed. We assigned all milk to the county seat and computed mileages from an internet calculator. We inserted all the appropriate county location differentials for each bottler location and each county supply source. We then computed the credit amount using the language in our proposal. The mechanics of the computation were as follows:

- (1) Determine the miles between supply and demand less 25; (2) cap the miles at 500;
- (3) if more than 0 miles multiply by \$0.003; (4) reduce this product by any positive difference in Federal Order location adjustment; (5) if positive multiply by the pounds; (6) multiply this product by 83% to arrive at a credit payment for Class I; and (7) sum the pounds, miles and dollars for each quadrant.

DFA Exhibit 18, Table 10 C (Recap of Transportation Proposal) sums for the market all of the data from each Quadrant for January 2004. For the deliveries made, \$573,414 dollars would be spent in a farm direct transportation credit as we have proposed. The effect on the entire pool for January 2004 would be an estimated \$0.045 per hundredweight.

Exhibit 10 at DFA requests #11, 12, 14 and 15 each explain some portion of the Marketwide service payments credit calculations and resulting cost estimates. It appears that the two proposals made by Foremost Farms and the modification as proposed by DFA and Prairie Farms would cost the pool (reduce the blend by) approximately 8.1 cents per hundredweight on all milk. This would in turn provide a payment to the Class I shipper of approximately 25 cents per hundredweight.

B. The proposed marketwide service payments/transportation credits language.

The Order language for a Direct Ship Transportation Credit we propose is as follows:

Insert as appropriate in the newly formed Section 1032.55 proposed by Foremost Farms, et al:

(1) Transportation credits paid pursuant to paragraph (a)(1) and (2) of this section shall be subject to final verification by the market administrator pursuant to § 1000.77. and

(2) In the event that a qualified cooperative association is the responsible party for whose account such milk is received and written documentation of this fact is provided to the market administrator pursuant to § 1032.30(c)(3) prior to the date payment is due, the transportation credits for such milk computed pursuant to this section shall be made to such cooperative association rather than to the operator of the pool plant at which the milk was received.

It is intended that each handler would compute and apply for credit as appropriate at pool time. Each handler would have to maintain a file of locations and distances and

perform the various computations. While cumbersome to establish the task can easily be accomplished with computer aid. The Market Administrator would accept and make payments and then audit as necessary.

Transportation credits shall apply to the following milk:

(1) Bulk milk received directly from the farms of dairy farmers at pool distributing plants subject to the following conditions:

(i) The quantity of such milk that shall be eligible for the transportation credit shall be determined by multiplying the total pounds of milk physically received from producers meeting the conditions of this paragraph by the Class I utilization of all producer milk of the pool plant operator receiving the milk after the computations described in § 1000.44;

(ii) The transportation credit shall be limited to the first 500 miles of delivery.

Transportation credits shall be computed as follows:

(1) The market administrator shall subtract from the pounds of milk described in paragraphs (a)(1) of this section the pounds of bulk milk transferred or diverted from the pool plant receiving the milk if milk was transferred or diverted to a nonpool plant on the same calendar day that the milk was received. For this purpose, the transferred or diverted milk shall be subtracted from the most distant load of milk received, and then in sequence with the next most distant load until all of the transfers have been offset;

This Section defines that the credit will apply to milk shipped directly from farms, limited to Class I use only and for no more than 500 miles. Additionally any transfers or diversions away from the distributing plant on the same day as the credit is applied for will be netted against the computation.

(2) With respect to the pounds of milk described in paragraph (a)(1) of this section that remain after the computations described in paragraph (b)(1) of this section, the market administrator shall:

(i) Determine an origination point for each load of milk by locating the nearest city to the closest producer's farm from which milk was picked up for delivery to the receiving pool plant;

(ii) Determine the shortest hard-surface⁶ highway distance between the receiving pool plant and the origination point;

(iii) Subtract 25 miles from the mileage so determined;

(iv) Multiply the remaining miles so computed by 0.3 cents (\$0.003);

(v) Subtract the Class I differential specified in § 1000.52 applicable for the county in which the origination point is located from the Class I differential applicable at the receiving pool plant's location;

(vi) Subtract any positive difference computed in paragraph (d)(3)(v) of this section from the amount computed in paragraph (d)(3)(iv) of this section; and

(vii) Multiply the remainder computed in paragraph (d)(3)(vi), if positive, by the hundredweight of milk described in paragraph (b)(2) of this section. If the remainder computed in paragraph (d)(3)(vi) is negative no transportation credit shall be computed.

⁶ Hard surface highway distances are the historical mileage measures used in federal order mileage calculations which typically have been from city locations to plant points. In the event that in some rural areas of the milkshed, the roadways from the designated "origination point" to the pool plant involve any gravel public roadways, the shortest distance should be used, gravel or hard surface.

VII. THE MARKET ADMINISTRATOR'S PROPOSAL 14 SHOULD BE ADOPTED.

The Market Administrator requests a modest change in Order language to correct a potential cash flow problem in the producer settlement fund. The problem arises when the calendar configuration requires payment from the producer-settlement fund on the same business day as payments are required to come in from handlers. In the event that cash has not been received at the time when payments out must be initiated, there is the potential for the need to pro-rate payments to handlers, which could lead to handlers being short of funds to pay producers. The request that the Order language maintain a single business day between date for receipt to come into the pool and date of required payment out is reasonable and should be adopted.

VIII. THE PROPOSALS SHOULD BE ADOPTED ON AN EMERGENCY BASIS.

While no one can predict with certainty the future direction and rate of movement of milk prices, there is nothing in the hearing record to suggest that volatility is going to decline and events since the hearing have already confirmed this fact. Consequently, the circumstances which lead to depooling will remain, and all of the disorder which depooling has meant will continue until amendments have been adopted. At the same time, the potential double whammy of distant milk depressing the Order's blend will remain a present danger. Furthermore, the lack of sufficient incentives in the Order to attract milk to Class I and compensate suppliers for those deliveries will continue to

