UNITED STATES DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE
(DAIRY PROGRAMS)

Milk in the Mideast	: Docket Nos.:
	: AO-361-A35
Marketing Area	: DA-01-04

COMMENTS ON BEHALF OF
LAND O'LAKES, INC.

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Introduction and Background

These comments will address the Proposed Rule amending pooling standards of the Mideast Milk Order. The second hearing in the post federal order reform era related to pooling performances and distant milk supplies. Federal order reform was instituted in January, 2000 following a Congressional mandate in the 1996 Fair Act. Regional conflicts have divided the dairy industry since Class I differentials were enhanced in the 1985 Farm Bill.

The Class I price surface instituted by USDA in January 2000 was the result of a great deal of discontent over an extended period of time. It should come as no surprise the transition to the new surface, coupled with a consolidation of the number of federal orders, a product-driven four class system, and uniform provisions would create new equilibrium points. It has taken the better part of two years for dairy farmers and the industry as a whole to recognize incentives/disincentives and react to them. The shift toward equilibrium has for the most part been accomplished. USDA has always recognized the utility of blend price differences and the effect on producers to change markets.

The Secretary explained after the previous national hearing review and reform process in 1990:

Producers make their production and marketing adjustments on the basis of changes in blend prices and differences in blend prices among orders. It is not uncommon for supply areas of individual orders to expand or contract in response to the blend price changes over time. Also, because milk is free to move to handlers regulated under different orders, it is not uncommon for milk to shift from one order to another in response to blend price differences that result from changes in supply and demand conditions under different orders.

59 Fed. Reg. 424722, 42426 (August 17, 1994).

The Second Amplified Decision stated:

Blend price changes (and differences in blend prices among orders) provide the economic signal for producers to make production decisions and for making marketing decisions.

61 Fed. Reg. 49081, 49086 (September 18, 1996)

The Proposed Rule issued January 1998 stated overlapping route disposition and milk procurement are the most important criteria to consider in the consolidation process. The criterion of overlapping route disposition was given greater weight than overlapping areas of milk supply. The Secretary also recognized that differences in Class I utilization rates, to the extent they result in differences in blend prices paid to producers, provide an incentive for milk to move from markets with lower Class I utilization percentages to markets with higher Class I use.

In addressing pooling issues, the Secretary stated that "the pooling of producer milk should be performance oriented in meeting the needs of the fluid market. Proposed provisions provide a balance between reasonable and needed performance criteria and a liberal pooling policy. Pooling provisions for the consolidated orders are overall less restrictive in the movement of milk between orders and make it easier for producers to become associated with and pooled on a market. Additionally, the provisions are more market oriented because they allow milk to become pooled and price where the greatest needs are exhibited for satisfying fluid demands. Additionally, there is enhanced flexibility in how plants can be pooled without diminishing the ability of the regulatory plan to satisfy the fluid demands of a market."

Based on the criteria by the Secretary and the limited amount of time, which has transpired since implementation of order reform, the regulatory system is working quite well and as anticipated. There are two issues arising from this hearing which need to be addressed.

Distant Versus Local Milk Supplies

The concept of "distant" versus "local" supplies of milk is no longer a relevant or meaningful distinction. With the implementation of consolidated orders, what is referred to as local milk, that produced within the market order boundaries, may be more than 1000 miles from end to end in the case of the Central Order which stretches from Indiana to Utah. Similarly, the Mideast Order stretches 450 miles from east to west and 800 miles from north to south. To apply performance provisions to "local" milk, i.e., that which is produced within the order boundaries, on a different basis than for "distant" milk, which historically has meant milk produced outside the order boundaries defies logic. This is especially true given that USDA has indicated overlapping route sales was given the most weight of the seven consolidation criteria. To carry this to an extreme, milk could be diverted from a supply plant to a pool distributing plant several hundred miles away with the producers being located at any number of varying points in between, while a supply plant located just outside the marketing area would be restricted to qualifying only by transfer even though the distributing plant was in the vicinity of both the supply plant and the producer supply of milk. Proponents would have you believe there is a difference in performance standards predicated by a marketing order boundary. Having said that, the DFA witness testified "performance standards are universal in their intention – to require a level association to a market marked by the ability and willingness to supply that market." For this reason, pooling provisions need to be "performance oriented" rather than "location oriented." The Secretary has acknowledged that federal order boundaries do not preclude route sales or producer milk from crossing from one marketing area to another.

Land O'Lakes (LOL) strongly reaffirms the concept of performance oriented pooling provisions as a basis for regulation as opposed to location based provisions.

Paper Pooling vs. Performance

A number of references by witnesses referred to "paper pooling." The inference was that milk was being associated with the market without serving the fluid needs of the market. The inference was also made that milk produced outside the order boundaries was being pooled by a variety of methods referred to as "paper pooling." These methods included diversion by distributing plants, associating large volumes of milk during periods of "free ride" when no qualifying shipments need to be made, and back-hauling milk after it was delivered to a distributing plant to be used for manufacturing. Some witnesses did acknowledge that milk which served the market based on performance criteria on a year round basis is deserving of sharing in the producer value and does not fall within the scope of "paper pooling." The fact is that LOL is performing on a regular basis with a pool supply plant located at Kiel, Wisconsin with a procurement area largely outside the boundaries of the Mideast marketing area.

Land O'Lakes, Inc. agrees that serving the Class I needs of the market is the parameter which determines performance requirements and pooling provisions.

In addition to that concept, LOL recognizes the historical philosophy of USDA that all Grade A milk will have the opportunity to be pooled. Order provisions have consistently recognized this fact. Given that parameter, restrictive pooling provisions merely provide that milk will be associated as reserve supplies on a different federal order, which is probably already carrying an excess of reserve supply. So the question ultimately becomes, which order(s) are going to carry the reserve supply?

LOL believes the pooling requirements should require that Class I needs are met at a minimum and beyond that, let economics and the theory of location dictate equilibrium points between orders.

Land O'Lakes offers the following comments to the tentative decision:

LOL supports the adoption of year-round performance standards. Eliminating the automatic pool plant status for March through August will preclude additional volumes of milk from becoming associated with the Mideast Order only during free ride months and provide for a more uniform level of producer receipts throughout the year. The market administrator has the ability through current order provisions to adjust supply plant performance standards on a monthly basis. LOL supports adoption of monthly diversion limitations for the same reason.

LOL supports the adoption of two days touch base for each producer August through November. This provision provides additional assurance that those producers who demonstrate the ability to service the market on a consistent basis will share in the distribution of pooling proceeds.

Land O'Lakes is generally disappointed in the tentative decision for the following reasons:

This decision discriminates between producers based on location in an attempt to restrict pooling access. Justification is that the milk produced outside the order boundaries should not be associated with the Mideast order. This is clearly contrary to positions communicated by the Department in earlier (although recent) decisions.

[59 Fed. Reg. 424 722, 42426 August 17, 1994]

[61 Fed. Reg. 49081, 49086 September 18, 1996]

This decision will at the least result in more expense for those producers who are pooled in supply plants located outside the Mideast Order boundaries by not allowing for the most efficient and cost-effective milk to move directly off the farm by diversion to serve the needs of the fluid market. The needs are met in either case whether the milk is diverted or transferred. The same volume of milk is delivered and used for fluid needs. This is not about the fluid needs of the market being met. If that were the case, shipping percentages should be increased uniformly to all supply plants serving the market. This has not been done nor has a request for increased shipping percentages been instituted. Clearly the Department is attempting to build a fence around the Mideast Order "so as to not cause a significant change, and indeed to provide for the continued pooling of milk that has been pooled by those market participants." P. 11 Docket No. AO-361-A35; DA-01-04

This decision seems to imply the Department will determine which milk should be or should not be pooled on the order basically by erecting a fence along the order boundaries. In so doing, producers are left with the inability to make "marketing adjustments on the basis of changes in blend prices and differences in blend prices among orders."

According to the Secretary, "it is not uncommon for supply areas of individual orders to expand or contract in response to the blend price changes over time. Also, because milk is free to move to handlers regulated under different orders, it is not uncommon for milk to shift from one order to another in response to blend price differences that result from changes in supply and demand conditions under different orders.5"

59 Fed. Reg. 424722, 42426 (August 17, 1994)

Producers located outside the marketing area will be forced to either incur additional expenses of delivering milk to a supply plant, reloading and transferring milk to the fluid market or resign themselves to the fact that their milk "should not be pooled on the order." P. 10 Docket No. AO-361-A35, DA-01-04

Additional pumping and handling of milk increase DMC and decreases quality, which is a consideration for fluid handlers in determining suppliers. Pooling decisions should be determined by economics rather than by location. Producers located outside the marketing area should not be held to a different (higher) standard of performance than those who live inside order boundaries. The Proposed Rule issued January 1998 stated overlapping route disposition and milk procurement are the most important criteria to consider in the consolidation process. The criteria of overlapping route disposition was given greater weight than overlapping areas of milk supply. The Secretary also recognized that differences in Class I utilization rates, to the extent they result in differences in blend prices paid to producers, provide an incentive for milk to move from markets with lower Class I utilization percentages to markets with higher Class I use.

In addressing pooling issues, the Secretary stated (Proposed Rule, January 1998) "the pooling of producer milk should be performance oriented in meeting the needs of the fluid market. Proposed provisions provide a balance between reasonable and needed performance criteria and a liberal pooling policy. Pooling provisions for the consolidated orders are overall less restrictive in the movement of milk between orders and make it easier for producers to become associated with and pooled on a market. Additionally, the provisions are more market oriented because they allow milk to become pooled and priced when the greatest needs are exhibited for satisfying fluid demands. Additionally, there is enhanced flexibility in how plants can be pooled without diminishing the ability of the regulatory plan to satisfy the fluid demands of a market."

Clearly this decision, as stated, is slanted toward more restrictive pooling and is contrary to the goals stated by the Secretary during the course of Federal Order Reform. This decision would reverse the stated intent of the Department during the reform process. Producers should make marketing decisions based on economics and not location. Additionally the performance criteria should not be biased toward those producers who happen to be located inside the Mideast Order boundaries.

Land O'Lakes takes exception to the elimination of milk shipments to a distributing plant regulated by another Federal Milk Order as pool-qualifying shipments under the Mideast Order. Distributing plants located in the vicinity of order boundaries typically have sales in more than one marketing area. The plant is regulated based on the plurality of its sales in a market. The provision which allows qualifying shipments to other order plants makes additional Class I volume available to the Federal Order pool (Mideast) which regulates the supply plant. The additional Class I value is shared by all producers in the Mideast pool. Furthermore, the Class I utilization is protected for those producers whose milk is pooled on the other Federal Order. Consequently, those producers are not adversely impacted.

It has been clearly demonstrated that fluid sales cross order boundaries. Land O'Lakes favors the continuation of qualifying shipments to other Federal Orders to recognize the Class I value of sales outside the marketing area to those producers whose milk is pooled on that market.

Respectfully submitted,

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Land O'Lakes, Inc.