

Exhibit 8

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

In the Matter of :
Milk In The Pacific Northwest : **Docket Nos.:**
Marketing Area : **AO-368-A29 et al;**
 : **DA-01-06**
 :

|Statement Regarding Proposals 1 – 2|

Elvin Hollon
| Dairy Farmers of America, Inc. |

December 4, 2001

Seattle, Washington

Statement of Dairy Farmers of America

Dairy Farmers of America (DFA) is a member owned Capper Volstead cooperative of 16,905 farms that produce milk in 46 states. DFA pools milk on 10 of the 11 Federal Milk Marketing Orders including the Pacific Northwest Federal Order.

We support the proposals being made at this hearing by the Northwest Milk Marketing Federation.

DFA is an ardent supporter of Federal Milk Marketing Orders and we believe that without them dairy farmers economic livelihood would be much worse. Federal Orders are economically proven marketing tools for dairy farmers. The central issue of this hearing - providing for orderly marketing and economically justifying the appropriate performance qualifications for sharing in the market wide pool proceeds of an Order is the heart of the Federal Order system. If these issues are not addressed properly system wide, Orders will be jeopardized. That would be detrimental to all the members of our group both in their day-to-day dairy farm enterprises and the milk processing investments that they have made.

Summary of Proposals for This Hearing

We have an interest in the proposals being heard at this hearing as the amendments are being requested by producers due to the present day dynamics surrounding the pooling of milk in Federal Milk Marketing Orders.

Proposals 1 and 2 deal with the "open pooling" of large volumes of milk from locations distant to the market. Milk distant to the market needs to have additional performance requirements that are workable and consistent system wide with Federal Order policy.

Not Just a Federal Order 124 Issue

With regard to Proposals 1 and 2 we note that the underlying issue is not just a local Order 124 issue. We have concerns identical to those expressed by the other proponents here and in the Central, Mideast and Upper Midwest Federal Orders - that milk from distant areas is pooling on the Order and drawing down the blend price but not serving the market in any regular form. We have concerns similar to these in Order 135. There large volumes of milk are finding their way onto the pool but not performing for the market in a reasonable manner. We find this practice detrimental to our members, our customers and the entire Federal Order system. We have presented proposals and testimony supporting them in hearings held in the Upper Midwest, Mideast and plan to

express that concern in other Federal Order hearings and seek solutions that are consistent and in line with Federal Order principles system wide.

The central issue in each case is the interface between the pricing surface, altered by Federal Order Reform (Reform) and the pooling provisions found in each Order. Those relationships were changed by Reform. The link between performance and pooling was altered and needs review. Organizations, including DFA, have moved quickly to take advantage of these changes in Order rules. Indeed, in the competitive dairy economy if a competitor makes a pooling decision that results in increased funds you must attempt to do the same or face a more difficult competitive position. Individual organizations cannot unilaterally disarm! We think this process of extensive distant market open pooling is inconsistent with Federal Order policy and clearly disparaged in the Reform record.

The end result of this action is that milk that rarely if ever performs for the market pools and reduces blend returns to producers that regularly perform for the market.

Federal Order Reform

The Final Rule published on September 1, 1999 in the Federal Register culminated the Federal Order Reform process. It was a lengthy process but produced needed beneficial results for the industry - which could not have been accomplished without the informal rule making process. Through it the number of Federal Orders were reduced from 31 Orders / marketing areas down to 11. It provided clear rules for what constitutes a market. The pricing provisions were improved, modernized and made more uniform and transparent across the Federal Order system. A more common classification system and standardization of the provisions common to all Orders was instituted. The Option 1 - A differential surface that was the result of extensive computer modeling and was extensively evaluated by university, government and industry persons, a superior Class I advance price mechanism, the "higher of" pricing mechanism for Class I and common multiple component pricing provisions across all Orders using component pricing were all valuable improvements to the Federal Order program.

Even though the process was lengthy and thorough, the dairy industry is dynamic and changing and we currently find that provisions of the Order system need review and alteration. Areas that need review include the pricing provisions that were addressed in the Class III and IV hearing held last spring. (AO-14-A69, etc) The combination of an absolute versus a relative price surface that we now have and its interface with the prevailing pooling provisions is an issue that is now plaguing the industry and is being addressed at this and other hearings.

Federal Order Benefits and Principles

Federal Orders offer benefits to both producers and handlers and have always operated in a deliberate and organized manner guided by basic economic principles. Two primary benefits of Orders are to allow producers to gain from the orderly marketing of milk and to share the proceeds through market wide pooling. Orderly marketing embodies principles of common terms and pricing that attracts milk to move to the highest valued market when needed and clears the market when not needed. Market wide pooling allows **qualified** producers to share in the returns from the market equitably and in a manner that provides incentives to supply the market in the most efficient manner. Becoming "qualified to share in the blend price" is directly related to the level of performance described in each specific Order provisions.

The Concept of a "Market"

Fundamental to Federal Order principles are the concepts of a marketing area (market) and the concept of "performance to the market" in order to be qualified to share in the returns from that market. The Federal Milk Order Market Statistics Annual Summary defines a marketing area as, "*...a designated trading area within which the handling of milk is regulated by the Federal Order.*" It is clearly an identified geographic area and defined deliberately by a set of rules and for a specific purpose. In every set of Federal Order Regulations, Section 2 defines the geographic area of the marketing order.

Federal Order Reform sought out industry comment on marketing areas, established seven criteria for their establishment and then used those criteria to divide much of the lower 48 states into 11 Federal Order markets. The criteria and the Department's explanation of them, taken directly from the Final Rule are as follows:

"The same seven primary criteria as were used in the two preliminary reports and the proposed rule were used to determine which markets exhibit a sufficient degree of association in terms of sales, procurement, and structural relationships to warrant consolidation. The Final Rule explained the criteria are as follows:

- 1. Overlapping route disposition.** The movement of packaged milk between Federal Orders indicates that plants from more than one Federal Order are in competition with

each other for Class I sales. In addition, a degree of overlap that results in the regulatory status of plants shifting between orders creates disorderly conditions in changing price relationships between competing handlers and neighboring producers. This criterion is considered to be the most important.

2. Overlapping areas of milk supply. This criterion applies principally to areas in which major proportions of the milk supply are shared between more than one Order. The competitive factors affecting the cost of a handler's milk supply are influenced by the location of the supply. **The pooling of milk produced within the same procurement area under the same order facilitates the uniform pricing of producer milk. Consideration of the criterion of overlapping procurement areas does not mean that all areas having overlapping areas of milk procurement should be consolidated. An area that supplies a minor proportion of an adjoining area's milk supply with a minor proportion of its own total milk production while handlers located in the area are engaged in minimal competition with handlers located in the adjoining area likely does not have a strong enough association with the adjoining area to require consolidation. For a number of the consolidated areas it would be very difficult, if not impossible, to find a boundary across which significant quantities of milk are not procured for other marketing areas. In such cases, analysis was done to determine where the minimal amount of route disposition overlap between areas occurred, and the criterion of overlapping route disposition generally was given greater weight than overlapping areas of milk supply.**¹ (emphasis added)

Some analysis also was done to determine whether milk pooled on adjacent markets reflects actual movements of milk between markets, or whether the variations in amounts pooled under a given order may indicate that some milk is pooled to take advantage of price differences rather than because it

¹ Milk Procurement areas were considered as a criteria for Order 124 boundaries and the distant areas in question here were not found to be a part of the Order 's Marketing area.

**is needed for Class I use in the other market.²
(emphasis added)**

3. Number of handlers within a market. Formation of larger-size markets is a stabilizing factor. Shifts of milk and/or plants between markets become less of a disruptive factor in larger markets. Also, the existence of Federal order markets with handlers too few in number to allow meaningful statistics to be published without disclosing proprietary information should be avoided.

4. Natural boundaries. Natural boundaries and barriers such as mountains and deserts often inhibit the movement of milk between areas, and generally reflect a lack of population (limiting the range of the consumption area) and lack of milk production. Therefore, they have an effect on the placement of marketing area boundaries. In addition, for the purposes of market consolidation, large unregulated areas and political boundaries also are considered a type of natural barrier.

5. Cooperative association service areas. While not one of the first criteria used to determine marketing areas, cooperative membership often may be an indication of market association. Therefore, data concerning cooperative membership can provide additional support for combining certain marketing areas.

6. Features or regulatory provisions common to existing orders. Markets that already have similar regulatory provisions that recognize similar marketing conditions may have a head start on the consolidation process. With calculation of the basic formula price replacement on the basis of components, however, this criterion becomes less important. The consolidation of markets having different payment plans will be more dependent on whether the basic formula component pricing

² "Open pooling" was reviewed and was not considered to be criteria for deciding marketing area and certain areas were not put together as markets if their basis of commonality was for "economic paper pooling" versus meeting the criteria established. Additional analysis was done to make sure whether or not milk supplies that were associated with an Order (including those that were "paper-pooled") really should be a factor in determining the Marketing Area. In the case of Order 124 the distant milk in question here was not included in the marketing Area.

plan is appropriate for a given consolidated market, or whether it would be more appropriate to adopt a pricing plan using hundredweight pricing derived from component prices.

7. Milk utilization in common dairy products.

Utilization of milk in similar manufactured products (cheese v. butter-powder) was also considered to be an important criterion in determining how to consolidate the existing orders."

64 Fed. Reg. 16045 (April 2, 1999).

The Concept of Pooling Market Proceeds

All Federal milk orders today, save one, provide for the marketwide pooling of milk proceeds among all producers supplying the market. The one exception to this form of pooling is found in the Michigan Upper Peninsula market, where individual handler pooling has been used.

Marketwide sharing of the classified use value of milk among all producers in a market is one of the most important features of a Federal milk marketing order. It ensures that all producers supplying handlers in a marketing area receive the same uniform price for their milk, regardless of how their milk is used. This method of pooling is widely supported by the dairy industry and has been universally adopted for the 11 consolidated orders."

64 Fed. Reg. 16130 (April 2, 1999).

Additionally, each Order has precise terms that a supplier must follow in order to share in the blend proceeds. These provisions are known by the industry as "**performance standards**". This concept is explained, defended and endorsed in the Final Rule as follows:

"There were a number of proposals and public comments considered in determining how Federal milk orders should pool milk and which producers should be eligible to have their milk pooled in the consolidated orders. Many of these comments advocated a policy of liberal pooling, thereby allowing the greatest number of dairy farmers to share in

the economic benefits that arise from the classified pricing of milk.

A number of comments supported identical pooling provisions in all orders, but others stated that pooling provisions should reflect the unique and prevailing supply and demand conditions in each marketing area. **Fundamental to most pooling proposals and comments was the notion that the pooling of producer milk should be performance oriented in meeting the needs of the fluid market. This, of course, is logical since a purpose of the Federal milk order program is to ensure an adequate supply of milk for fluid use.³ (emphasis added)**

A suggestion for "open pooling," where milk can be pooled anywhere, has not been adopted, principally because open pooling provides no reasonable assurance that milk will be made available in satisfying the fluid needs of a market.⁴ (emphasis added) Proposals to create and fund "stand-by" pools are similarly rejected for the same reason.

The pooling provisions for the consolidated orders provide a reasonable balance between encouraging handlers to supply milk for fluid use and ensuring orderly marketing by providing a reasonable means for producers within a common marketing area to establish an association with the fluid market. Obviously, matching these goals to the very disparate marketing conditions found in different parts of the country requires customized provisions to meet the needs of each market.

For example, in the Florida marketing area, where close to 90 percent of the milk in the pool will be used for fluid use, pooling standards will require a high degree of association with the fluid market and will permit a relatively small amount of milk to be sent to manufacturing plants for use in lower-valued products.

³ The concept of a performance standard is fundamental to the Federal Order System and was endorsed by both the industry and the Secretary.

⁴ "Open pooling" was totally rejected in the Reform deliberations by the Secretary.

In the Upper Midwest market, on the other hand, a relatively small percentage of milk will be needed for fluid use. Accordingly, under the pooling standards for that order smaller amounts of milk will be required to be delivered to fluid milk plants and larger amounts of milk will be permitted to be sent to manufacturing plants for use in storable products such as butter, nonfat dry milk, and hard cheese. The specific pooling provisions adopted for each order are discussed in detail in the sections of this document pertaining to each of the consolidated orders."

64 Fed. Reg. 16130 (April 2, 1999).

We find no compelling reason to change this guideline. Open pooling is a cause for concern from our members in Federal Order 124. They are concerned when milk from distant areas shares in the blend price pool but does not perform – that is does not deliver regularly nor balance the market. The cost of providing those services to the market always falls back on the local milk supply. And if current practice is not amended it will guarantee a continuing lower return for the local dairy farmers who supply the local Class I market! The resulting draw of blend price funds to distant producers who do not perform is not reasonable. It was analyzed and excluded by Order Reform and thus is an "end run" that should not be allowed now.

Additionally, "open pooling" has an inherent conflict with the principles underlying the models that formulated the price surfaces derived in Reform. The differential models assumed that supplies of milk associated with a demand point and aggregated into a market, actually shipped from the counties they were located in to the population centers where the demand points were fixed. To the best of our knowledge there were no provisions in the mathematical equations for those models allowing for milk to be associated with a market if it did not actually ship to or supply the market. The current practices clearly exploit that price surface and if we are to retain it, which we support doing, we must structure the regulations to parallel the model!

This means that using direct deliveries from inside the marketing area to qualify supply plants and milk supplies from outside the marketing area should be greatly limited if allowed at all.

The principle of allowing direct ship milk to qualify a supply plant was instituted to allow achievement of the economies of direct shipped milk - saving the cost of reload and pump over. It is now being used for another purpose – to substitute milk produced in the market for supplies located far out of market in the

qualification equation. This runs counter to the initial intent of the provision and to the principles that formed the pricing grid.

Performance standards are universal in their intention – to require a level of association to a market that marked by the ability and willingness to supply that market. However, they are individualized in their application. Each market requires standards that work for the conditions that apply in that market. The Reform record develops and defends this concept.

A review of the various Federal Order performance standards shows the diversity of standards, but the common requirement of performance to the market in order to share in the blend price pool. During the Reform process as individual Order performance standards were being evaluated many times a particular standard was chosen from one of the predecessor Orders. Frequently the most lenient standard was selected from among a group of available choices. This attempt, however good in its intent, has not always proven to be workable and is one of the reasons for this proceeding.

Exhibit 9, Table 1 titled **Summary of Producer Milk Provisions Under Federal Milk Marketing Orders** is a comparison of Federal Order producer milk standards. Note that while the intentions of the various standards are the same – to establish the requirements necessary to share in the Orders proceeds, the specifics vary from Order to Order.

Exhibit 9, Table 2 titled **Summary of Minimum Pooling Standards for Supply Plants Under Federal Milk Orders** is a comparison of Federal Order pooling standards. Again, note that while the intentions of the various standards are the same – to establish the requirements necessary to share in the Order proceeds, the specifics vary from Order to Order.