

Supplemental Prepared Testimony of

**William C Van Dam
On behalf of
Northwest Dairy Association**

**Federal Milk Market Order Hearing
Docket Nos. AO 368 A32 and AO 271 A37
September 23-25, 2003, Phoenix, AZ
November 17-21, 2003, Seattle, WA
Continued on Jan 20, 2004, Alexandria, VA**

My name is William C. Van Dam. I have previously been sworn in and testified on November 18, 2003 in Seattle. Again, I am testifying on behalf of Northwest Dairy Association.

Correction of previous testimony In my testimony of Nov 18th we presented on pages 2 through 6 the proposed language for order 124. However, in Section 1124.10(a)(6) on the second line we referenced the incorrect pooling plan. It should be corrected as follows:

Reference to Section **1131.7(a),(b),or (e)** should be replaced with **1124.7(a), or (b)**

Changes to "similar package" proposal. NDA supports the same language for Order 124 that Mr. Hollon entered into the record on the last day of the Seattle phase of this hearing.

Producer Handler exemption history: The present exemption of the Producer Handler traces its beginnings to Kansas City in the early 1930's. USDA Marketing Research Report No. 14, dated May 1952, titled Early Development of Milk Marketing Plans in Kansas City, Missouri, Area gives a detailed history of the events of that time and is the source of the information included in this section. We ask that official notice be taken of this publication.

In July 1935 after several years of efforts to compromise with producer-distributors, the Department gave up all efforts to regulate the operations of producer-distributors. Essentially that same exemption exists to this day. However, none of the conditions that existed at that time remain the same today, except perhaps the understandable desire of producer-distributors to "not be regulated".

A brief review of the critical factors of that time (and how they have changed) is in order.

1. There were in the Kansas City area 335 producer-distributors and they distributed about half of all the milk in the area. At that time there was the clear distinction that producer-distributors sold raw milk and the other handlers sold pasteurized milk. In fact the regular handlers were at that time known as pasteurized handlers. This was a period in our country's history when the consumers were gradually understanding the merits of pasteurized milk. The importance of this change should not be underestimated in this context. Pasteurization was what we now would label a "value added" process. The pasteurized handler had the new superior technology and therefore the producer-handler was not viewed as a direct competitor. The combined benefits of Federal Order audits and uniform pricing were judged to outweigh the need to include producer-distributors in the Federal Order.

The raw milk distinction no longer applies and obviously is not relevant to the issues before this hearing.

2. There was no history of regulation at that time. It was a new concept and there was a great deal of resistance to regulation, which grew as time went on. In April 1934, 298 producer distributors filed reports with the Kansas City Market Administrator. By December of that year the number of reporting producer-distributors had dropped to 154. During this time span the raw milk producers (producer-distributors) became better organized for the sole purpose of getting the government out of their business.

By today, of course, regulation has been with us for nearly 70 years. Every contentious issue has been well tested in court. Compliance will not be a problem.

3. All of the producer-distributors of 1935 were small operations and none of them sold milk across state lines. There was a strong belief - supported by a narrow interpretation of 'interstate commerce' by the US Supreme Court - which made it unlikely the administration could enforce Federal Order regulations upon a producer-distributor whose operations were not in 'interstate commerce'. This was an issue that had a legitimate bearing on the Secretary's decisions being made in 1935. However, that changed just a year later, in 1936, when the Supreme Court reversed its position and decided that 'interstate commerce' included anyone who may affect interstate commerce whether an actual participant or not. By that time, however, the preferential exemption for Producer Handlers had been put into place.

Today there is no question about the ability to regulate a handler who is not a producer, even if that handler is very small and does not ship milk across state lines. There are a number of such regulated handlers in the Pacific Northwest market. Several Oregon bottlers, for example, don't want to worry about standardizing to California standards, and are too far from Washington or Idaho to distribute anywhere but in Oregon. Examples would include Umpqua, Valley of the Rogue, and Eberhart Dairy.

None of the key issues that influenced the exemption of producer-distributors in 1935 exist today. The current Producer Handler exemption is an artifact from another time and does not fit today's realities and circumstances.

Small Business Definition: My testimony presented on Nov 18^h in Seattle contained on page 7 the following paragraph;

Small Business. With the above background, then, I would like to point out that the public policy consideration to support small business overwhelmingly argue for ensuring that the Producer Handler exemption does not injure the 933 pooled producers who are, as far as we know, mostly with the definition of "small business".

Given the frequent, and largely misapplied, reference to "small business" by Dr. Ron Knutson in his Seattle testimony, the record needs a clearer statement on this issue. While our statement is correct, it requires a more detailed discussion.

Upon our request the Market Administrator's office prepared and entered into the record Exhibit Number 51 (first table) which is titled Total Number, Number of Small and Small as a Percent of Total: Producers, Fully Regulated Pool Plants, Partially Regulated Plants, Producer Handler Plants, Exempt Plants and Nonpool Plants, June 2003.

Dr. Knutson in his prepared testimony on page 4 gives an accurate one sentence summary of the intent of the Regulatory Flexibility Act.

"In 1980, Congress enacted the Regulatory Flexibility Act to require Federal agencies to analyze the impact of federal laws on small business and consider meaningful alternatives that would achieve the agency's goals without unduly harming small business."

I question whether the intent of the RFA reaches to a "special obligation to foster and protect" small business as suggested by Dr. Knutson, but clearly regulators are required to analyze the impact on small business and they must consider alternatives consistent with regulatory goals, but the RFA does not require the Secretary to take "special" steps to protect small business at the expense of regulatory goals.

The RFA contains a precise definition of who is and who is not a "small business" and Exhibit 51 applies these definitions to the PNW Order 124 and the Arizona-Las Vegas Order 131. This table identifies two key groups of small businesses that require analysis and consideration. The largest, by far, is the group of pool producers in the PNW order who produce less than 500,000 pounds of milk per month. In June 2003 there were 574 producers who were small businesses. In that month these producers represented 64% of all producers pooled. It needs to be stressed that the smallest Producer Handler that would be regulated under the proposals under consideration at this hearing is 6 times larger than the largest dairy farm that could meet the "small business" definition for a dairy producer.

The second group that meets the definition of “small business” is the 11 fully regulated plants in the PNW. In June 2003 these plants represented 46% of all fully regulated plants in the PNW. These 11 plants are, of course, the smaller plants located in the PNW and are those most directly negatively impacted by the exemption allowed the Producer Handlers because they must compete for available sales. If the provisions of the RFA require the regulators to (again quoting Dr. Knutsen) “consider meaningful alternatives that would achieve the agency’s goal’s without unduly harming small business”, then the best way to achieve the uniform pricing mandate from Congress would be to adopt our proposals, as an alternative to today’s exemption which places these 11 small business regulated handlers at a competitive disadvantage.

The term “small business” cannot, as defined by RFA, be applied to any of the Producer Handlers that would be impacted by the proposed rules, because their farms exceed the small business threshold. Therefore the provisions of RFA do not apply to the Producer Handlers who will be impacted by the proposals being considered at this hearing. The provisions of RFA apply only to the extent the federal regulations impact the defined small businesses. In this hearing those who are due consideration are the 574 “small business” dairy farmers in the PNW and the 11 “small business” fully regulated handlers. Both of these groups will benefit from the proposed limits on Producer Handlers

The paragraph following the one quoted above from my Nov 18th testimony reads as follows:

“It may be that the potentially regulated Producer Handlers also are within the definition of “small business”. However, we point out that many of the smaller regulated plants fit this definition also.”

Since then, we have learned that this paragraph is wrong. It should read:

None of the potentially regulated Producer Handlers meet the definition of “small business”. However, we point out that 11 of their fully regulated handler competitors do.

Women and minority interests: The issue of women’s and other minority group ownership has been raised by the opponent Producer Handlers. I have reviewed the membership list of NDA. This list cannot be electronically separated into sex or ethnic groups since it contains no field referencing such criteria. However, all of our members are adversely affected by the current Producer Handler regulations both directly through reduced Class I premium dollars in the FO pool and indirectly by the unfair milk price advantage allowed NDA’s direct competitors in the bottled milk business. Therefore to illustrate a point I have conducted the following count on our membership list:

1. First I crossed off all corporations because their names do not give any clue as to gender of the member. But since Washington is a community property state, I

would note that many of these corporations have significant ownership by women.

2. Second I crossed off all "generic names" for the same reason, but subject to the same qualification.
4. This left a list of 445 membership names that could show that ownership included a female. Of the 445 names left 130 or 29% contained a female name. Included in this list were 9 dairies that contained **only** the name of a female.

Even with the conservative approach just outlined, there are far more women-owned businesses who would benefit from our proposals, than that are objecting to them.

In spite of the growing size of the modern dairy farm, the production side of this business remains a family business. The women and men are all deeply involved in the business and work and own the business as a family.

There can absolutely be no doubt that the numbers will correctly show overwhelmingly that if the interests of women and minorities are to be specifically considered then the consideration must be concentrated on the interests of the owners of the pooled producers and their families.

The inference that the Producer Handler exemption should continue because these businesses provide jobs for Hispanic workers is a misleading comment on several counts.

1. Nearly all pooled dairy farms and dairy processing plants in the Pacific Northwest hire Hispanic workers. Producer Handlers are not doing anything unique (or innovative) in this respect.
2. The Producer part of the Producer Handler operations who would be subject to regulation are in every case among the largest and most efficient of dairy farms in the FO 124 area. While it may be, as the opponents suggest, that their bottling plants may have a difficult time competing if they had to pay the same price for milk as their competitors, there is no reason to believe that the Producer portion is at any risk whatsoever. The Hispanics working at the dairy farms would continue to have their jobs.
3. Producers and handlers do regularly go out of business. It is a fact of economic life and although we all feel badly about the loss of jobs, it is not the function of the FO system to keep some dairies in business, at the expense of others. The simple graph below (the last item in the risk section) shows that all sectors of this business regularly go out of business.

Risk. At the Seattle phase of this hearing and again here yesterday witnesses for the Producer Handler opponents attempted to argue that the Secretary should recognize that by being vertically integrated they somehow have more at risk than other producers and other handlers. Exactly how they think the Secretary should evaluate that was not clear.

The greatest difficulty of the "risk" argument advanced by the Producer Handler witnesses is that there is no framework for that consideration in traditional Federal Order theory. Risk of losing an investment is simply not considered in Federal Order thinking. Producers regularly go out of business, because it is not the purpose of Federal Orders to protect them from low prices or lack of a market. Handlers regularly go out of business because it is not the purpose of Federal Orders to protect them from low margins or the loss of a customer. Different producers and different handlers all have different amounts at risk, even on a per hundredweight basis. No consideration is given in any Federal Order context to the additional risk that comes from investments in expansion. It makes no sense for Producer Handlers to argue that their investments should be protected, while the investments of other producers and handlers are not.

The record is disturbingly clear that neither producers nor handlers are guaranteed success with Federal Order regulation. I have taken the following information from

Count of Dairy Producers, Producer Handlers and Regulated Handlers
In the Pacific Northwest Order, 1998 and 2003

| | 1998 | 2003 | change | percent |
|--------------------|-------|------|--------|---------|
| Dairy Producers | 1,188 | 943 | - 245 | 20.6% |
| Regulated Handlers | 20 | 16 | - 4 | 20.0% |

Producer Handlers are also not exempt as is shown below. At our request the Market Administrators office prepared a new Exhibit 51 (second table) titled Pacific Northwest Order – Federal Order No. 124, Class I Route Dispositions by Producer-Handler and 7(a) Pool Plants, Number of Plants and Average Pounds by Size-Range, December of Selected Years. There is a very important and relevant point that needs to be made from this data. For illustration I have reproduced part of the material (from the left side top set of data) from that Exhibit which shows in regular print. I have then added just a few calculations which appear in **bold print**.

Excerpt from Exhibit 51
Pacific Northwest Order Producer Handlers

Number of Plants by Size-Range

| Year | >1,000,000 | <1,000,000 | Total |
|--------------------------|------------|------------|------------|
| 1990 | 5 | 15 | 20 |
| 1995 | 5 | 12 | 17 |
| 2000 | 5 | 6 | 11 |
| 2002 | <u>4</u> | <u>5</u> | <u>9</u> |
| 1990 to 2002 Loss | 1 | 10 | 11 |
| Percent | 20% | 67% | 55% |

The overall loss of Producer Handlers between 1990 and 2002 was 11 or 55%. But the breakdown between smaller Producer Handlers and larger ones goes to the heart of matter under consideration at this hearing. The table shows a loss of only 1 plant with monthly Class I sales of greater than 1 million lbs per month. Even the loss of that one plant is a bit suspect and may be a technicality related to school sales or some other marketing anomaly; but the point is well made without adjusting the data. And that point is that of the 11 Producer Handlers that went out of business during this 13 year period a full 10 of them had sales of less than 1,000,000 pounds per month. This is real life data that supports our contention that smaller Producer Handlers because of their cost structure do not have, in the final analysis, any advantage over the regulated handler. It is not the larger Producer Handlers who are leaving the business

Service fees: Several opponent Producer Handler witnesses have stated that they face balancing costs that are not faced by their regulated competitors. We do not accept that argument as being true for us, in our bottling operations, nor for our bulk milk customers. In Washington (where NDA markets to bottlers directly) and in the Greater Portland market (where NDA markets through a multi-cooperative organization known as Oregon Milk Marketing Federation) the typical base service charge levels to bottlers range from the mid \$.30's to the mid \$.40s. However, the exact number depends on how milk is purchased, and how a bottler cooperates in helping us minimize the cost of balancing his milk.

One key factor is the cost of balancing "weekend milk". It helps us not to have surges on weekends, which can challenge our manufacturing plants (especially during the spring and summer when milk production peaks, and at times like the holidays when some plants shut down). So we give a credit of up to 10 cents, for evening out purchases throughout each week.

In addition, as a supplier to bottling plants we have to bear (or pass on) the costs of balancing the seasonal fluctuations in consumer demand, which typically causes bottling plant demand to peak during the September to December time frame, when production is approaching its lowest levels in our climate. This counter-cyclical pattern presents a huge balancing problem. As an example of how that works, we have an agreement with DFA to supply milk to the Wilcox Dairy plant at Roy, Washington. They have committed to a constant level amount of purchases, from season to season. DFA balances the plant's needs. If they call on us for balancing, that "over contract" milk costs \$1.45/cwt.

A drying plant is capital intensive, and its operating costs are mostly fixed. One can see that in the data used by USDA in establishing the current make allowances. Running a few more loads through that plant costs very little, because the equipment is already there, and the labor is already scheduled, and at best the only cost increase from processing an additional load of raw milk is a bit of energy and the cost of the powder bag. But at the same time, conversely, it is also true that taking a few loads out of the plant to supply a bottler saves the plant very little money, and at the

margin we forego most of the make allowance that would be available if we could run those additional truckloads of milk. The problem for manufacturing plant operators is that they can't make money under the current make allowance structure unless (or maybe even if) the plant is full, so balancing the bottlers in the market is very costly when it requires taking milk out of a manufacturing plant.

NDA did a lot of work in developing our service cost structure, and I can assure you that it is cost-based and easily explained to those who use us to balance their needs. That is why the customers accept it.

Thank you for this opportunity to add this testimony. I shall be glad to take any questions.