Cedar Grove Cheese Inc. Comments
in re: Docket No. AO-361-A39;DA-04-03B

Our discussion focuses on proposed amendments to Section 1030.13(f).

We will address the following six points:

1. The proposed amendments to the market order address an alleged problem identified at a hearing held prior to changes in the market order. Even if conditions at the time of the hearing justified the amendments, subsequent changes may have made the amendments unnecessary. Rational consideration of the proposal would balance the costs and benefits of the proposed amendment. Such calculation will be impossible until we have had experience operating within the market order as amended. In the mean time, the market order should reject or delay the amendment.

2. The proposed amendments will not necessarily achieve the objective of increasing the amount or share of milk in the market area that participates in the pool and is available for Class I use. The proposal excludes, for an extended period of time, milk that is depooled in one month regardless of the reason for depooling. No evidence has been presented that the amount of milk that will be pooled when farmers and handlers would otherwise benefit from depooling will be greater than the amount of milk that will be subsequently excluded under the proposed rule.

3. By excluding milk from the market order, the amendment will fail in its objective to make sure that producers receive equal value for their milk regardless of the use of the milk. Excluded handlers will be put at a price disadvantage when competing for producer milk.

4. Because the proposed amendment does not and can not contain a mechanism for determining the reason why milk is depooled in any given month, it provides inordinate, unguided and unprecedented discretion to the market administrator. The administrator is given power to determine what milk can be pooled and denied access to the pool. Without knowing how or on what basis the market administrator will exercise this discretion, no one can predict, evaluate or comment on the effect of the discretion or of the amendment as a whole. The unguided discretion is an invitation to abuse and litigation.

5. The amendments should be rejected because of their contribution to market power and economic benefits to a few firms within the market order at the expense of the majority of participating companies. A few firms control access to the Class I market. Their control is facilitated by the market order recognition of “systems” for purposes of meeting pooling requirements. Bottled milk distributors can count on an adequate supply from a few firms supported by the “system” This has led to a variety of contractual, ownership and full supply arrangements that exclude non-participating handlers. As a result, excluded handlers may be unable to

independently meet the ten percent shipping requirement, especially in milk surplus months. Under the proposed amendment, the excluded handler will then be excluded in large part during subsequent months and the dominant handlers will capture the bulk of pool distributions. Alternatively, the dominant handlers will be able to charge more to other handlers for access to the “system” or to satellite. This violates the market order rule prohibiting discrimination against small businesses. This problem is particularly unjust because the controlling handlers proposed and will likely block vote their farmers members to approve this amendment.

6. An alternative mechanism exists that could eliminate the “problem” of depooling without the problems identified here. Specifically the market order could reduce or eliminate the time lag between price setting for Class I and other classes of milk. Advanced pricing of milk would be desirable for all market participants. If prices for all classes were announced at the same time, there would be no negative PPDs and no market order generated reasons to depool. All participating milk would be available to meet the needs of the order and the higher value of Class I and II milk would be shared equally among market participants.

Consideration Should be Delayed to see the Impact of Recent Changes

The hearings that form the basis for the proposed amendments were held prior to approval of the current market order. Subsequent to the hearings, changes were approved that exclude distant milk from the order. That milk was not used to fulfill the Class I needs of the market and reduced the percentage of Class I milk in the market. It is likely that the distant milk was among the milk depooled when the producer price differentials were negative. Without the distant milk, the proportion of milk that will depool probably will be smaller than it was in the past. Higher Class I shares during months prior to rapid increases in cheese and butter prices will also result in smaller swings in blend prices.

The recent changes in the order will not necessarily prevent price inversions in volatile market situations. However, the size and impact of inversions will be smaller. That will change the calculations when the benefits of the proposed amendments are weighed against the costs to the market of those amendments (discussed further below). Possibly, the amendments would not have been proposed at hearings concerning the new market order. Moreover, the desirability of the amendments cannot be evaluated until there has been some experience under the order as revised. Therefore, the proposed amendments were not properly derived from the previous hearings. And the time is not ripe for considering the amendments given the lack of information about their desirability under the current order.

At this time the amendments should be delayed or rejected.

No Evidence Indicates that the Amendments will Increase Pooled Milk

The proposed amendments to the milk market order are intended to increase participation in the market order . The assumption is that this will be accomplished by discouraging depooling of milk during periods when the class prices result in negative producer price differentials. During these “non-normal times, cheese and/or butter manufacturing subsidizes bottled milk suppliers. The proposed mechanism to discourage handlers from depooling milk is to exclude a large portion of that milk from the market order for subsequent months. To the extent that milk would be voluntarily removed from the order to avoid paying in to the pool, the cost of being denied pool payments may discourage handlers from depooling. The decision would be based on the size of the negative PPD, the portion of milk that could be depooled and the predicted value of future pool draws that would be foregone.

One cannot conclude that this calculation will always result in a handler deciding to pool all milk in every month.

Nor can one assume that the decision to depool will correspond in every case to negative PPDs. First the PPD is not known at the time the pooling decision is made. And, second, a handler may choose to depool even though the PPD is positive if the handler wishs to pay at least some producers a lower price than the minimum required by the market order.

In addition, depooling and increases in milk of more than 25 percent can occur for reasons unrelated to either the PPD or the desire to underpay the market order minimums. Thus, rapid growth in producer milk can occur from adding producers, growth of producers, or producers who have seasonal milking. Milk also can be depooled as a result of clerical errors, low Class I demand or lack of access to a bottling plant. In any of these cases, the milk may be excluded from the market order in subsequent months. The amendments will do little to discourage this depooling since it is for the most part not voluntary, but they will prevent the milk from reentering the order in subsequent months. Producers associated with handlers whose milk is excluded by the proposed market order rule will not share the full benefits of the order or contribute to Class I availability.

In other words there is no simple rule. The net effect of the amendments on the amount of milk available to the pool cannot be predicted given the current information. More milk may be excluded from the pool than will be kept in the pool as a result of the proposed rule. When the added milk from handlers who were discouraged from depooling is balanced against the lost milk from handlers whose milk is excluded, it may well be that the total milk available to the pool is decreased by the amendment. No evidence has been presented indicating that the amendment will advance the market order objective of making milk available for the fluid market. Lacking such evidence, the proposed amendment should be rejected.

Producers Associated with Some Handlers will Benefit While Others Will Be Harmed

The proposed rule will have different impacts on some handlers and their associated producers. The form of this discrimination is fairly predictable.

The proponents of the rule change suggest that it advamces the objective that all producers serving the order should benefit equally. However, milk from some handlers will be excluded by the proposed rule. The exclusion will not always be the result of a calculated unwillingness of a handler to make milk available to the pool. But, regardless of reason for exclusion, the excluded handler will be at a price disadvantage relative to competitors who are able to participate in the market order. Consequently, their patron producers are likely to receive less money for their milk. Companies that control access to the fluid milk market will be able to extract rents to provide access. This too will put companies who have to pay for access to the fluid market at a competitive disadvantage and leave less money for their producers. One result may be a continuation of the concentration of the market.

Contrary to the official explanation the proposal will not enable producers to share equally in the benefits of the market order. Rather, the proposal will simply redistribute those benefits to producers affiliated with companies that have the greatest market power and access to bottling facilities. Since this is not a legitimate objective for the market order to pursue, the proposal should be rejected.

The Proposal Gives the Market Administrator Unprecedented and Unguided Discretion

As discussed earlier, handlers may not fully pool their milk during any given month for a variety of reasons. The assumption of the proposed amendment that milk is voluntarily taken out of the market during a month only because the handler chooses to avoid paying a negative producer price differential on diverted milk is not justified. Neither is it necessarily the case that producers serving handlers who depool will receive lower prices than other producers. In fact, no simple rule exists to determine why milk is depooled. Clerical errors, lack of access to buyers, or rapid changes in milk supply due to seasonal production, growth of producers or addition of new suppliers can all result in milk being excluded under the rule.

Because automatic application of the rule could result in milk being excluded that “should “ be included and, likewise, milk being included that “should” be excluded, the proposal gives the market administrator discretion. However, the language does not make it clear how that discretion would be administered. Nor is it obvious that the market administrator could exercise discretion in a consistent and impartial manner.

What type of evidence, for example, would a handler have to produce to prove that depooling was not done to avoid payment into the pool? Would the producer have to document calls to all distributing plants indicating they were unwilling to purchase milk? Would the producer be required to satellite with a member of a system if that would enable the handler to pool? Is there any limit to the fee that could be charged for market access or to the price below which a handler would not have to sell milk? How would a plant that depools milk because of an administrative or clerical error prove that no intent was involved? Would an assumption of intent exist whenever the ppd was negative or the handler paid some (one?) of its producers a price that was below the market order minimums? Would the same assumptions apply to proprietary and cooperative handlers? Would shifting producers between Grade A and Grade B change the market administrator's application of the 125 percent limitation? Could such shifting be done repeatedly?

The proposal does not begin to address these questions. It would be unfair to the market administrator to provide such unguided discretion. While it is not even clear that the proposed changes will have their intended effects, it would be even harder to determine what decisions by the administrator would be desirable or fair to market order participants. Any decision will hurt some producers and help others. Therefore, the administrator should not be saddled with this unguided task.

Without discretion, however, the proposal will have unintended and contradictory consequences. The likely impact of the proposed amendment on market participation and distribution of benefits becomes even harder to predict. Therefore, the entire proposal should be rejected.

The Proposal Contributes to Market Power and Control of Class I Premiums

In most months, especially during periods when the producer price differential is negative, the market has more than enough fluid milk. Recently, grade a milk has been selling at as much as a dollar below class. Handlers who have tied up access to the bottlers through supply contracts are able to participate in the pool. Independent handlers may have little or no way to sell milk to Class I in order to meet the required 10 percent shipping requirement. Under the previous rules of order 30, handlers were only required to ship between 3 and 5 percent of milk during high demand months. Following the order merger, this requirement was raised to ten percent during all months of the year. These are onerous requirements for many small handlers because there is no demand for their milk for fluid use at that level most of the time. Increasing concentration of both suppliers and bottlers has made this problem worse. Guaranteed shipping and full supply agreements have made the market for spot loads extremely thin.

The task of balancing the milk supply through seasonal or market variations in supply and demand has fallen to the small independent handlers. The market order has empowered handlers to set up systems to meet shipping requirements. This task, formerly accomplished by the market order administration, has been essentially privatized. Companies that have access to large bottling operations administer these systems. The market order allows those companies to include other handlers in their system and treats them as a single entity for meeting shipping requirements. During months when the companies with supply arrangements have sufficient shipments to bottlers to meet the requirements of the entire system, smaller handlers in the system may not be asked for any shipments in order to qualify for the order. During months when more milk is needed or when it is less desirable to ship milk for fluid use, the smaller handlers are called on to make shipments. The variability and unpredictability of this system is onerous for the small handlers. The “system” charges the small handlers either by giving them a lower price for the milk they have to ship, or by charging them a fee to not have to ship. Thus, the system enables the larger operators to charge others for access to the market and enables the principal operators to place the burden of a variable milk supply on the smaller handlers.

This extension of market power is a direct result of the decision of the market order to require high shipping percentages from each handler regardless of the market demand. The additional decision to recognize systems enables the large companies to extend their control over a larger milk supply than comes from their own producers. And it enables them to collect rents and shift the burden of balancing to other plants. Not surprisingly, the cooperatives that block vote for their members to approve the market order are among the chief beneficiaries of this system.

If the decision is made to exclude milk that has been depooled, the system should be treated as the base for determining the 125 percent permissible in following months. That method would be consistent with the rest of the order language that treats shipments of the system as the basis for eligibility. That would also recognize that the system controls access to bottling plants and could prevent individual plants from being eligible for inclusion. On the other hand, treating the system as the basis for the 125% would give even greater power to the system.

The depooling “problem” is cause by inversion of class prices. These inversions occur because of volatility in the cheese markets. The very same companies that complain about the impacts of depooling are among those that brag that they are able to manipulate the price of cheese on the Chicago Merchantile Exchange and thus the price of milk. Therefore, and because it contributes to the power of the systems and the problems of market access, the proposal to exclude milk from the market should be rejected.

If the market order approves this change, the government is increasing its already substantial complicity in the creation and maintenance of market power in the buying and selling of milk and other dairy products. This functions to the detriment of small, independent handlers, their producers and consumers at large. This proposed amendment, along with the other noted aspects of the market order as it currently exists, are contrary to the legitimate purposes of the market order. Using a government agency to exclude competitors, capture more of the benefits of the market order and extend their monopolistic control will potentially violate the provisions of the Capper-Volstead exemption.

An Alternative Mechanism Could Eliminate the Depooling "Problem"

The discussion provided with proposed amendment to the market order recognizes that the problem of depooling results from differences in the timing of the mechanisms for setting milk class prices. Depooling would not be desirable if the market order set the prices of all classes of milk at the same time. Only because the order provides advance pricing for fluid milk and retroactive pricing for Class III and IV does the ppd become negative. In theory, the fluid milk price should be set higher at all times because it is a product with less elastic demand. This higher price should subsidize all other classes of milk use. If that were the case, no handler would benefit from depooling.

The proposal justifies the advanced pricing of some classes of milk by stating that the milk used in fluid does not have the option of depooling. Then, the proposal attempts to make depooling uneconomical for all uses of milk. To the extent that it is successful, one could imply that the other classes should then also be given advanced pricing.

All classes of milk could be advance priced (a result that would be nice for farmers), or all classes of milk could be priced retroactively. Either way, the problem of depooling would be eliminated and all the problems with the proposal that we have addressed here would be avoided.

Depooling is a symptom of instability in the markets for the underlying commodities. Some have suggested that the numerous opportunities to take advantage of price inversions and inventory valuation contribute to incentives for companies to manipulate the spot and futures markets for dairy commodities. A unified market order pricing system could help eliminate some of the incentives for market instability. The proposed amendment on the other hand may make price manipulation and instability more beneficial for the large companies.

Summary

Because the proposal is an inferior solution, increases market power, cannot be administered fairly, and has not been demonstrated to advance any of the objectives for which it was put forth, Cedar Grove Cheese believes that the amendment should be rejected.

The market order has become a mechanism for supporting market oligarchy rather than encouraging innovation and efficiency. The region's profitability and share of the national dairy industry has steadily declined. The proposed amendment amounts to fighting over the scraps. Instead, we should be working together to advance the dairy industry by improving what and how we serve consumers and by eliminating unnecessary bureaucratic inefficiency.