

Statement in Support of

Proposal 2

By Dennis Tonak

On behalf of the Proponents

Cass Clay Creamery, Inc.

Dairy Farmers of America, Inc.

Land O Lakes, Inc.

Manitowoc Milk Producers Cooperative

Mid-West Dairymen's Co.

Milwaukee Cooperative Milk Producers

Swiss Valley Farms Company

Woodstock Progressive Milk Producers Association

Upper Midwest Marketing Area

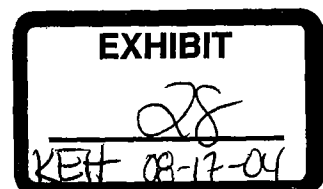
Federal Milk Order No. 30

Public Hearing

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My name is Dennis Tonak. I am the manager of Mid-West Dairymen's Company located at 4313 West State Street, Rockford, Illinois. Mid-West is a relatively small cooperative with 137 dairy farm members in southern Wisconsin and northern Illinois. Mid-West is responsible for supplying the raw milk needs of an Order 30 distributing plant. Mid-West has a joint venture ownership interest in that plant. Mid-West also operates an Order 30 supply plant in Rockford. The majority of the Mid-West members' milk delivers to the fluid plant. Mid-West also sells milk to nonpool plants in the region.

This statement is on behalf of the proponents of Proposal 2. The original proponents are Cass Clay Creamery, Inc., Dairy Farmers of America, Inc., Foremost Farms USA Cooperative, Land O' Lakes, Inc., Manitowoc Milk Producers Cooperative, Mid-West Dairymen's Company, Milwaukee Cooperative Milk Producers, Swiss Valley Farms Company, and Woodstock Progressive Milk Producers Association. Though Foremost Farms was an original proponent this statement is not given on their behalf. Additionally this statement is supported by and given on behalf of Plainview Milk Products Cooperative and Westby Cooperative Creamery. All are qualified cooperatives representing producers in the Federal Order 30 market.

Introduction of Issues

Federal Orders are economically proven marketing tools for dairy farmers. Without them dairy farmer's livelihood would be much worse. The central issue of this hearing is to determine who may share in the marketwide pool proceeds. Among the basic purposes of the Federal Order structure are to assure an adequate supply of milk for the fluid market, equitably share the pool proceeds in an economically justifiable manner, and promote orderly marketing.

Orderly marketing would encompass principles that attract milk to the highest value use when needed and clear the market when not needed. Marketwide pooling allows qualified producers to

share in the market returns on a fair and equitable basis and establish requirements that provide the necessary incentives to efficiently supply the market. Working in conjunction with classified pricing, these principles and requirements assure an adequate supply for the fluid market.

The supporters of Proposal 2 recognize the disorderly market conditions that now exist due in large part to what we see as loopholes in the Federal Order regulations. Milk can exit the pool at any time there are negative consequences to pooling and immediately return to the pool when it is extremely advantageous to do so. Milk that is so distant from the Order 30 Class I market that it virtually never ships to fluid use, after meeting the initial one day touch base requirement, shares in the fluid earnings of the pool in an opportunistic manner.

The agricultural press in the region has widely reported on the December 2003 milk pooled by state and county information released by the Market Administrator's office. Jerome County, Idaho had more milk pooled on Order 30 than any county in Minnesota or Wisconsin. While the milk pooled from the other counties in the top 5 was relatively stable, when compared to December 2002, the milk from Jerome County has doubled. (Exh. 5, Tables 17 & 19) This leads producers to ask questions such as "How can this be?" "How much money is this taking from me?" "Does any of this milk come to the Upper Midwest on a regular basis?"

Questions were also raised about the negative PPD's in April and May and the pooled milk volumes in February through June. Exh. 5, Tables 3 & 9 shows that in February 2004 there was 1,944,216,880 pounds pooled with a PPD of \$.47; in March 2004 there was 675,051,623 pounds pooled with a PPD of \$.21; in April there was even less milk pooled – 608,028,839 pounds – with a PPD of -\$4.11; in May 2004 662,635,115 pounds pooled with a PPD of -\$1.97, and in June 2004 the pool more than tripled with 2,113,701,569 pounds pooled and a PPD of \$.30. The discussions when

the negative PPD's hit producers mailboxes were about milk jumping out of the pool and leaving others "holding the bag," about equity and fairness, about a level playing field, and about government regulations that allow this to happen.

Producers who supply milk to meet the fluid needs of the marketplace have been penalized by the very regulations that they have supported in the past. Proposal 2 is a modest step in restoring a level of equity among those who supply the fluid market and those who function primarily as a reserve supply for the market's needs. It would also mandate that milk from far outside the market area must be able to physically supply the Class I market on a continuing basis.

The adoption of Proposal 2 does not stop milk from Idaho or other distant locations from pooling on Order 30. It merely requires that this "distant milk" proves that it can and will supply the fluid market needs – not just for one day to "touch base" – but day after day, week after week.

Our proposal does not stop depooling. It does, however, limit the ability of handlers to immediately repool and grab a share of "the good times."

Proposal 2 consists of three interconnected and interwoven parts.

1. Limit the transportation credit;
2. Establish definitive performance requirements for distant milk;
3. Limit repooling after depooling.

The adoption of only one part of the proposal will not achieve fairness and equity for those producers who regularly supply the market.

Limit Transportation Credit

This may be the least controversial part of Proposal 2. The transportation credit helps offset the hauling cost on the Class I portion when milk is transported from a supply plant to a distributing plant

in Order 30. The transportation credit results in a decreased PPD since the transportation credit value is subtracted from the Producer Settlement Fund. Our proposal would limit the payment of the transportation credit to a maximum of 400 miles. It would not affect the calculation of the transportation credit in any other way.

Exh. 7, Table S-2 shows that in 2003 the maximum distance for milk that received the transportation credit to move was less than 400 miles. Conversations with the Market Administrator's staff indicated that the mileage in prior years was not significantly different. Exh. 9, Table 1B shows mileages between supply plants in the larger milk producing counties within the marketing area and selected distributing plants: AMPI - Jim Falls is located in Chippewa County, Wisconsin, the seventh largest county in terms of milk pooled; Grassland is in Clark County, Wisconsin, the third largest; Kraft-Beaver Dam, Wisconsin, is in the eighth largest county, Dodge; Melrose is in Stearns County, Minnesota, the largest county after Jerome County, Idaho; Mullins Cheese – Mosinee, Wisconsin, is in Marathon County, the fourth largest; Fond Du Lac is ranked fifth and the location of an NFO supply plant; Little Chute, Wisconsin is in the tenth largest county, Outagamie. The greatest mileage shown is from Stearns County, Minnesota (Melrose Dairy Proteins) to the now closed Swiss Valley plant in Chicago at 502 miles and to Dean Foods at Huntley, Illinois, at 477 miles. It is highly unlikely that it will be necessary to move milk from Stearns County, Minnesota to northern Illinois on an ongoing basis to meet Class I needs. It is more likely that the Stearns County milk would move to the Minneapolis area – a distance of 93 miles from Melrose to Marigold Foods. Even if milk moved from the Stearns County area to northern Illinois distributing plants on a regular basis, it would not be appropriate for the Order transportation credit to cover the full mileage when closer alternatives are available.

Exh. _____, is a modification of Exh. 9, Table 1B showing averages of the mileage from various plants to a selected plant. This illustrates that milk is available from various heavy production areas with less than 400 miles of transportation.

Milk located in the Marketing Area and associated with supply plants in those states that contain a portion of the Marketing Area is more than adequate to meet the fluid needs of the market. This is easily seen by reviewing Exh. 9, Table 3 K which shows that except during the times of massive depooling the market's Class I utilization would have averaged less than 20% annually. With a 20% Class I utilization there is no need to encourage the movement of supply plant milk when the distance between supply plant and distributing plant is greater than 400 miles.

In the 38 months from April 2001 through May 2004 3,186,515 pounds of Idaho milk delivered to Order 30 distributing plants. (Exh. 9, Table 2) This milk would not receive a transportation credit since it was not shipped from a supply plant. At least in 2003 it did not originate from a supply plant in Idaho and we do not see anything to suggest that the balance of that milk was shipped from an Idaho supply plant.

I should add that the 3.2 million pounds of Idaho milk delivered to the Order 30 distributing plants over 2.8 million pounds was delivered to the distributing plant in Rockford. Mid-West paid the going market price for this milk. Neither Mid-West nor the receiving plant paid the transportation cost to move the milk from Idaho to Rockford. Additionally it was very rare for a producer to ship more than the equivalent of one day's production to Rockford.

Since there has not been any milk that shipped over 400 miles from a supply plant to a distributing plant, our suggested change to the transportation credit would not impact any current pool participants.

A mileage limit on the transportation credit would prevent the draining of the producer settlement fund dollars if new supply plants were located great distances from the distributing plants at some time in the future. This also would help assure that those producers located in and around the Marketing Area who traditionally supplied the market would receive the maximum returns for their efforts.

Distant Milk and Market Performance

Jerome County Idaho had more milk pooled on Federal Order 30 in December 2003 than any other county. Since Jerome is between 1,200 and 1,600 miles from many of the Order 30 pool plants (Exh. 9, Table 1a) the obvious question becomes does the Jerome milk actually perform or does it just "paper pool"? And further should that milk really share in the market wide pool? We must review what is meant by "performance" to answer those questions.

The decision from the 2001 Order 32 (Central Order) hearing directly addresses the performance question. We want to highlight a few selected paragraphs from that decision:

"The pooling standards of all milk marketing orders, including the Central order, are intended to ensure that an adequate supply of milk is supplied to meet the Class I needs of the market and to provide the criteria for identifying those who are reasonably associated with the market as a condition for receiving the order's blend price. The pooling standards of the Central order are represented in the *Pool Plant, Producer, and the Producer milk* provisions of the order. Taken as a whole, these provisions are intended to ensure that an adequate supply of milk is supplied to meet the Class I needs of the market. In addition, it provides the criteria for identifying those whose milk is reasonably associated with the market by meeting the Class I needs and thereby sharing in the marketwide distribution of proceeds arising primarily from Class I sales.

...

Pooling standards are needed to identify the milk of those producers who are providing service in meeting the Class I needs of the market. If a pooling provision does not reasonably accomplish this end, the proceeds that accrue

to the marketwide pool from fluid milk sales are not properly shared with the appropriate producers. The result is the unwarranted lowering of returns of those producers who actually incur the costs of servicing and supplying the fluid needs of the market.

...

This decision finds that the milk of some producers is benefiting from the blend price of the Central order while not demonstrating actual and consistent service in satisfying the Class I needs of the Central milk marketing area.

...

The reform Final Decision, as it related to the Central marketing area, did not intend or envision that the pooling standards and pooling features adopted would result in the sharing of Class I revenues with those persons, or the milk of those persons, who would not be demonstrating a measure of service in providing the Class I needs of the Central marketing area.

...

As previously indicated, pooling milk on the Central order without demonstrating actual performance in servicing the Class I needs of the market area is neither appropriate nor intended."

The only logical way for distant milk to be part of the marketing area supply on an ongoing basis is for that distant milk to perform by delivery to meet the market's fluid needs. This would establish without a doubt that the distant milk is part of the marketwide supply and is entitled to a share of the pool.

Johann Von Thunen, who is considered to be the father of modern location economics, advanced his theories in *The Isolated State*. His theories have been refined and are applied today to such wide and diverse areas as rental values, land use and city planning, and agricultural pricing. His major hypothesis in its simplest form was the further the production area is from the consumption area the lower the value of that production, in direct relationship to transportation cost. Additionally products

with high value and high transportation costs would be produced closest to the consumption areas. When the transportation cost became so great that the production value was substantially reduced an alternative use with better returns would be found for the land, if such use were available.

Von Thunen's theory is validated with the Idaho milk. The Idaho milk cannot economically move to serve the fluid needs of the Upper Midwest market when an alternative use such as cheese is available locally in Idaho. (Exh. _____)

The Federal Order Reform decision created a new Upper Midwest marketing area through the consolidation of the old Order 68 and old Order 30 with some modifications. The major criteria used as outlined in the decision were overlapping procurement and sales areas, the production of similar manufactured products, related geography, and natural boundaries. According to the Reform Decision overlapping route disposition was generally the most important criteria for establishing the boundaries of marketing areas. The overlap of disposition would indicate competition for Class I milk sales.

Overlapping milk supplies were also used as criteria. Quoting from the Decision **"The pooling of milk produced within the same procurement area under the same order facilitates the uniform pricing of producer milk."** The Reform Decision also states that natural boundaries often inhibit the movement of milk. It is our view that these natural boundaries may also define changes in geography, topography, and land types. Such geographical changes may also be reflected in changes in dairy and other agricultural production characteristics.

Defining the marketing area so that there were as many common characteristics as possible is obviously important. From the Reform Decision:

"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" and I want to emphasize the following
" 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 various parts of the country requires customized provisions to meet the needs of each market. ...In the Upper Midwest market ... 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."

There is a thorough discussion in the Reform Decision that marketing areas should encompass areas with similar characteristics - from geography to competition for both producer milk and Class I sales to the manufacture of similar products. The Decision goes on to discuss that the pooling and performance requirements should be specific to these common areas and provide for the sharing of the marketwide pool with that milk which is consistently available to serve the fluid needs of the market. Additionally the milk within that common market area should be allowed to serve the fluid needs as efficiently as possible.

To that end, plants and more specifically supply plants, within the marketing area can form units for the purpose of meeting the minimum pooling and performance requirements. This allows for all milk within or at the margins of the marketing area to be pooled if it has demonstrated - with a one day touch base shipment - that it is available to meet the fluid needs.

This approach to pooling and performance is reasonable since any milk within the marketing area is relatively close to a fluid plant. (Exh. 5, Figure 1) Milk in the largest producing counties, with the exception of Jerome County, Idaho, is within a few hours of the major population centers. (Exh.

9, Table 1B.) Within the context of the marketing area and the immediately surrounding procurement area, it is logical and makes economic sense for a portion of the producer milk to make deliveries to distributing plants and allow the remaining milk to have the benefit of pooling. The alternative would require every producer to deliver some prescribed amount of his milk to fluid plants in order to fully participate in the marketwide pool.

Idaho Milk and Market Performance

Twelve percent of the milk pooled on the Upper Midwest order in December 2003 originated in Idaho, and, as previously mentioned, more milk was pooled on the Order from Jerome County, Idaho than from any other county. This has made Idaho a flashpoint in the discussion of pooling and performance of distant milk. The milk in Idaho cannot reasonably serve the fluid needs of the Order 30 marketplace. The distances from Idaho to the Upper Midwest fluid plants are in the 1100-1600 mile range. The Class I returns do not justify the freight cost. (Exh. _____,) The touch base delivery cost only realizes a positive return in most cases if there is ongoing pooling without further deliveries.

Idaho is geographically isolated from the Order 30 Marketing Area. There is a mountain range and the Great Plains to cross when milk leaves Idaho for the Upper Midwest. We do not know of any overlapping fluid milk sales. There is no direct milk procurement overlap, though DFA, Manitowoc, and others have members in Idaho. Mid-West and others assist in the pooling of the Idaho milk, although Mid-West has no membership in Idaho.

During the time period of 2000 through 2002 the Upper Midwest market had a range in Class III utilization from 71.1% to 81.1% and the Class IV utilization ranged from 0.4% to 2.8%. The negative PPD and subsequent depooling in some months in 2003 and 2004 make comparisons more difficult but in relatively normal months the Class III utilization ranged from 68.5% to 77.9% and the

Class IV utilization ranged from 1.7% to 8.2%. (Exh. 9, Table 3k) It appears that the Class IV utilization increase had some relation with the Idaho pooling. The Upper Midwest market has a high usage of milk in Class III products.

Milk pooled on Order 30 and diverted to nonpool plants in Idaho is 26.2% Class IV and 73.8% Class III or a ratio of 1 pound of Class IV to 3 pounds of Class III. (Exh. 9, Table 4) The ratio for milk allocated to Class III and IV in the Order 30 pool ranges from 1 pound of Class IV to between 10 and 25 pounds Class III depending on the month. Based on these relationships the milk in Idaho is not used in manufactured products in a similar ratio to the Upper Midwest milk. The Order Reform criteria for inclusion in the marketing area of the production of similar manufactured products are not met.

In December 2003 there were 33 producers from Jerome County, Idaho with milk - 102,087,118 pounds - pooled on Order 30. (Exh. 5, Table 19) This is an average production of 3,093,549 pounds per producer. Stearns County, Minnesota had 768 producers with 88,817,055 pounds pooled for an average production of 115,647 pounds per producer. In December, Idaho had a total of 263,365,666 pounds pooled from 182 producers - an average production of 1,447,064 pounds per producer. Minnesota had 548,429,503 pounds pooled from 4,569 producers for an average of 120,032 pounds. The Idaho producers average over ten times larger than the Minnesota dairy farmer.

We can find no evidence that there is a common marketing area encompassing the current Upper Midwest marketing area and the distant Idaho area. Due to the distances involved, the Idaho milk cannot function as a reliable reserve supply for the Upper Midwest market. In fact it is our recent experience that often when the Idaho milk makes a "touch base" delivery, local milk must be moved

out of the fluid plant to make room. This results in the local milk balancing shipments from Idaho and not what one would expect from a reserve supply – that is the reserve supply, or in this case Idaho milk, balancing the local milk supply.

Order 30 requires that 10% of the pooled milk deliver to a pool distributing plant. There are no pool plants in Idaho. In fact only .2% of the Idaho milk has ever delivered to a pool plant, and of that less than one third touched a fluid plant directly. The Idaho milk, plain and simple, is pooled based on the pool plant deliveries of milk that is either inside or close to the marketing area. . Some would call this “paper pooling”. It may be more appropriate to call it “fee for services.”

Mid-West is familiar with the pooling of Idaho milk and has pooled some Idaho milk for approximately three years. In a typical arrangement, the milk in Idaho pays a fee for pooling. This fee may range from a certain portion of the pool draw to a percentage of the Class III such as one or two percent or it may be a set per hundredweight fee such as ten or fifteen cents. Pooling fees have become a significant revenue stream for some Order 30 handlers.

The Upper Midwest handler then includes the Idaho milk on the Report of Receipts and Utilization sent to the Market Administrator after the close of the month. The Upper Midwest handler’s actual “handling” of the milk generally involves only making data entries on a piece of paper. Thus the term “paper pooling.” Upper Midwest located milk is used to meet the “10% shipping” requirement and the Idaho milk receives the benefits of the Upper Midwest PPD. This would generally be done by a transfer of money from the Upper Midwest handler to an Idaho plant or producer group with the Upper Midwest handler retaining the pooling fee.

The pooling fees are not shared uniformly across the market. They are not part of a marketwide pool but are retained by the individual handler. The effect of the Idaho pooling is shared uniformly

across the marketwide pool. The bottom line is that the pooling of Idaho milk decreases the PPD for all, but some receive a pooling fee that may more than offset the decrease. But the Idaho pooling very definitely has a cost to all market participants.

In Mid-West's case – and we expect with others – the benefit gained from pooling the Idaho milk is used in three interrelated ways – it helps offset the cost of supplying the fluid market, it helps make up the negative PPD's, and it helps the financial returns to our producer-members either directly on pay price or as a source of earnings. Mid-West does not particularly like the pooling of Idaho milk but if we didn't do it, someone else would. We also see it as a method of business survival in a very competitive marketplace.

PPD Impact

The Idaho milk has generally had a negative impact on the PPD. (Exh. 9, Table 5A) Initially the impact of the Idaho pooling was a modest few pennies-but still a lot of money for Midwestern dairy farmers struggling with low prices. By mid 2003 the PPD impacts were becoming much larger. As an example the Idaho milk is estimated to have reduced the PPD by \$0.73 in September 2003. Not only was the volume pooled growing, thus increasing the pool dilution effect, but also there was an increasing spread between Class III and Class IV prices. Class IV milk jumped both in total pounds and in utilization percentage. (Exh. 5, Table 9 and Exh. 9, Table 3k) While these pooling gains may have been a windfall for some of the large Idaho producers, it pulled money from the pockets of family farmers in the Midwest.

There are wide swings in the volumes of Idaho milk pooled that are directly related to price relationships and that have no bearing on market performance. In other words if the return is positive - pool, if it is not- don't pool. There is no thought given to remaining in the pool – to

maintaining pool integrity or association – but only to sharing the returns of the marketwide pool if those returns are positive.

The termination of the Western Order will only magnify the pooling of distant milk, the Reform decision stated, **“Class I utilization rates are a function of how much milk is pooled on an order with a given amount of Class I use. Differences in 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.”**

Since the termination of the Western Order there is no marketwide Class I utilization available to milk in Idaho and Utah. This milk will be driven to find a new pooling home and will only add to the PPD burdens in the Upper Midwest.

While the Reform decision anticipated some changes in milk pooling it did not – and in all likelihood could not – envision the magnitude of the changes. The Reform decision anticipated that milk primarily at the borders of marketing areas would shift until equilibrium would be reached. This has not happened. Opportunistic pooling has dramatically affected the relationships that existed before Order Reform. The industry continues to search for ways to assure that milk that pools and derives benefit from the marketwide pool is actually entitled to those benefits. This hearing is part of that process and is in keeping with principles outlined in the Reform decision.

From the Reform Decision:

“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.

...

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 the market."

The lenient Order 30 pooling requirements have worked to the advantage of those who wish to share in the marketwide pool but who do not wish to bear the burden of continually serving the needs of the market.

Distant Milk Solution

The proponents and supporters of Proposal 2 concluded that milk outside the marketing area and the adjoining defined area needed to perform, i.e. ship 10% to a fluid plant, in order to derive the benefits of the marketwide pool. If 10% of the pooled Idaho milk were actually delivering to fluid plants in the Order, then it truly would be part of the market and would be entitled to a share of the pool. The question we wrestled with was how to best accomplish this objective. There may be a better alternative to Proposal 2 but we have not found it. Under proposal 2 diversions to plants located outside the prescribed geographic area would not be allowed to pool. In order to gain pool status our proposal requires a producer to continue to touch base only once, but all other deliveries must be to either an Order 30 pool plant or a plant located within the prescribed area.

We should note a change to our proposed language is necessary to avoid conflicting interpretations. The corrected language in section 1030.7(c) (2) last sentence should read

“Cooperative associations may not use shipments pursuant to section 1000.9(c) to qualify plants located outside the **area described above.**”

The approach that Proposal 2 takes is mirrored on the Order 33 decision. That decision basically said that in area milk could not be used to qualify out of area milk. The out of area milk needs to perform on its own merit.

The predecessor orders to the current Order 30 have had a long tradition of differentiating between in area and out of area milk. Since 1976, Order 68 had a provision for reserve supply plants. Initially these plants had no regular shipping requirement except for the initial load of milk which established association with the market. There was however, one major criteria these reserve supply plants had to meet – they had to be located in the marketing area. The same criteria applied for supply plant systems in old Order 30. A supply plant had to be located in the marketing area to be part of a supply plant system. Supply plants outside the marketing area were obligated to perform on their own behalf.

Further support for the approach that out of area milk should perform on its own is found in the requirements for the formation of pool plant systems in current Order 30. A supply plant must be located in the marketing area or be a grandfathered plant. Supply plants outside the marketing area, except for the grandfathered exception, cannot be part of a supply plant system. This method for supply plants to meet the Order’s performance requirements was developed to allow milk to move to fluid use in the most economical fashion. By excluding plants from outside the marketing area there was assurance that the included supply plants had ties to the market – even if an individual plant did not ship for fluid use. From the Reform Decision:

“The only requirement affecting an individual plant within the unit is that the plant must be physically located within the marketing area. This

restriction is necessary to prevent distant plants from receiving the benefits of participating in the marketwide pool without actually having an association with the market."

The Idaho issue was raised in the Order 30 hearing held in 2001. At that time there was very little Idaho milk pooled on Order 30. The focus of many of the Hearing participants was the double dipping of the milk pooled from California.

One of the proposed distant pooling solutions at the 2001 hearing was based on performance by State units. The proposal would have required each "State unit" outside the marketing area to ship 10% of the pooled milk to a distributing plant. While this approach required the distant milk to perform, in the words of the decision it established a different standard since:

"For example, of the milk received from Idaho, the DFA proposal would establish a standard for at least 10 percent of such milk to be shipped to a distributing plant in order for this milk to be producer milk pooled on the order. However, the same would not be required, for example, that 10 percent of all Wisconsin milk be shipped to distributing plants regulated under the order."

We view the plant-based approach in Proposal 2 appropriate since supply plants or supply plant systems inside the Order area are treated no differently than supply plants located far from the Order's core. Both are responsible to ship 10% to distributing plants.

Additionally, there may have been difficulties in determining if a State unit met the shipping requirement at the time of pooling (though this would have been easily determined at audit). It is much easier to determine if an individual supply plant meets the minimum performance requirement at pool time.

Since the time of the 2001 Hearing, the market situation has changed dramatically. The Western Order, which encompassed much of Idaho, has been terminated. The formation of the CMPC supply

plant system has facilitated the availability of milk for fluid use, at least in the old Order 30 area. Class IV prices have swung from much higher than Class III to being significantly lower.

This changed relationship is primarily due to a change in purchase price of nonfat dry milk powder by the CCC under the milk support price program. This action was far outside the Federal Order realm though it has a major effect on Federal Order Class prices and pools.

The adoption of Proposal 2 will ensure that any milk, no matter how near or far from the marketing area, can and will serve the needs of the fluid market if it is going to enjoy the rewards of the marketwide pool.

Depooling and Repooling

The purpose of pooling is to share revenue. The generally accepted thinking is that through classified pricing the Class I milk will generate added revenue for the pool. Exh. 9, Table 11b shows this to be true. In each and every month since January 2000 the Class I milk added more revenue to the pool than the producers delivering to Class I received on component value, somatic cell adjustment, and PPD. During the same time period the Class I value exceeded the Class III value in all but three months. Those were three of the seven months of negative PPD's occurring since July of 2003. (Exh. 9, Table 11a) It is fair to say that the Class I milk adds significant value to the pool.

This Class I revenue is shared with everyone who meets the current order performance requirements. It does not make any difference if it is Class III milk in Minnesota or paper pooled Class IV milk in Idaho. There is a uniform return of the order value to all pooled milk – be it Class I, Class II, Class III or Class IV – when adjusted for component levels and delivery location. Participation in the marketwide pool equalizes value among all producers serving different segments

of the market. The Federal Order system, with the exception of the individual handler pools, has had marketwide pooling and revenue sharing for many years.

Over the past 20 plus years the individual handler pool structure in Federal Orders has been eliminated and replaced with marketwide pooling. With an individual handler pool the revenue from the classified prices is not shared with all market participants but it is only shared with the milk that delivered to an individual plant. There could be wide variations in the minimum prices paid to neighboring producers shipping to different plants if those plants had different milk utilizations and therefore different prices. This approach helped to assure adequate milk for the Class I needs since the Class I value was only shared with the milk that actually delivered for fluid use. It also could lead to disorderly market conditions as producers with milk delivery to lower valued uses tried to gain some of the Class I dollars.

One way to conceptualize an individual handler pool in today's markets would be to take a look at June 2004. There was a total of 2,113,701,569 pounds pooled. Of that 335,824,408 pounds were allocated to Class I with 1,475,199,200 pounds allocated to Class III. The balance was in Class II and Class IV. The PPD at Chicago on the total pooled volume was \$.30. Exh. 5, Tables 3 and 9. The net Class I contribution to that \$.30 PPD was \$15,861,902. Exh. 9, Table 11a. Under an individual handler pool the milk that delivered to Class III cheese plants would have a \$.00 PPD instead of \$.30 while the milk delivering to Class I would have a \$4.72 PPD instead of \$.30. I realize this is an over simplification, but it does point out the value of a marketwide pool to Class III milk.

Milk delivering to Class II, III and IV plants can and will depool when there is no financial gain from pooling. In May 2004, the Class I milk which always has to pool received a negative \$1.97 PPD at Chicago. At the same time a cheese plant did not have to pool and in effect created an individual

handler pool. The imputed PPD was zero. Exh. ___ . Incidentally, if the Class I milk could have created an individual handler pool in April, the PPD would have been a positive \$.68.

In 2000 and 2001, there were many months that milk delivering to Class II and Class IV plants did not pool. The reasoning was the same – sharing in the marketwide pool did not add value. This milk was quickly pooled, however, whenever there was a gain.

The ability to depool at will and then quickly repool creates large differences in pricing at Federal Order values. This is especially noticeable when comparing the Class II price and the Statistical Uniform Price in 2000 and the Class III Price and the Statistical Uniform Price since July 2003 – the last 12 months. See Exh. 5, Tables 3, 5, and 6.

These price differences create inequity among producers. We have already heard from producers who are impacted by the decisions to pool or not pool. The producer doesn't make these pooling decisions. Handlers make the decision when they fill out the Report of Receipts and Utilization. If milk is reported, it is pooled provided, of course, that it met the "once and done" touch base. If it isn't reported, it isn't pooled. This sounds a lot like paper pooling.

It also creates inequity among handlers. When there are negative PPDs, and the associated Class III depooling, it is very difficult for those supplying Class I in Order 30 to compete with cheese plants.

In April 2004 Mid-West "made up" the \$4.11 negative PPD and paid a \$00.00 PPD. We did it with the pooling fees we received from pooling Idaho milk. Not everyone has that income stream. One cooperative that supplies fluid plants and Class II and Class III markets did not pay a negative PPD, but reduced component prices below Federal Order values. At the same time there were individual cheese plants that apparently depooled since they paid positive PPD's in the 40 to 60 cent range.

There is not any way to recover the negative PPDs from the Federal Order. A handler that must pool is always at a disadvantage when there is a negative PPD. And when there is a positive PPD, the handler who depooled during the negative PPD immediately returns to share in the pool.

There has been a recent effort to recover the negative PPD's through increased fluid market service charges. While admirable and welcomed by those who supply the fluid market, this effort is not sustainable over the long term. The increased price may have contributed to the larger than normal decline in fluid milk sales this summer. The fluid plants in Order 30 where the added price has been implemented have been placed at a competitive disadvantage with fluid plants in the Central and Mideast Orders and other areas where there has not been an increase.

The fluid plant cannot always recover this increased cost from the marketplace. Many of the longer term packaged milk supply arrangements with national and regional accounts have a price adjuster for changes in the Federal Order cost of milk. There may not be any provision, however, for changes in over order prices. The fluid plant ends up "eating" this increase and the books show red ink.

Central Milk Producers Cooperative and Upper Midwest Milk Marketing Agency (CMPC and UMMA) are pricing agencies composed of some of the cooperatives who supply milk for Class I use in the Upper Midwest. CMPC and UMMA put the increased service charge (negative PPD surcharge) in place for those plants that obtain milk from the CMPC and/or UMMA membership. Mid-West is not a member of CMPC or UMMA. Woodstock is not a member of CMPC or UMMA. There are other fluid plant suppliers who are not members. This adds to the difficulty of maintaining a negative PPD surcharge premium.

On April 16, 2004 I received a call from a cheese plant inquiring if Mid-West would need additional milk at the Muller-Pinehurst fluid plant the following week. We did. During the course of our discussion I mentioned that the projections were for a fairly large negative PPD in April. They immediately concluded the phone call by telling me they would find somewhere else to sell the milk, that they had to cancel an offer made to deliver milk to another fluid plant, and they would just depool and not worry about the negative PPD. I am sure that this milk is part of the one billion, 475 million pounds that returned to the pool in June.

If the current depooling/repooling scenario is allowed to continue, everyone will become like this cheese plant and make a decision to not serve the fluid market. Carried to the extreme, no one would serve the fluid market, except perhaps when there was a positive PPD. This would be disorderly marketing raised to a new level.

The Order 30 regulations determine which milk may share in the pool. The relatively loose pooling requirements contribute to the depooling/repooling problem. We are requesting a modest change to the regulations that would improve the equity among producers and among handlers.

Depooling Solution

In the development of Proposal 2, the proponents reviewed the Order's pooling requirements. Among possible changes reviewed and discarded were changing the touch base to an every month requirement; eliminating split plants so that a plant was either a pool plant or a nonpool plant at any given location; mandate a touch base prior to pooling after milk had been depooled; institute a producer for other markets provision; and develop a type of committed supply program. All of these would have meant some change, and in some cases great change, at great cost for Order 30 handlers. Generally, the touch-base-and-done, the ability to have split plants, and the 10%

aggregate shipping requirement have worked well for producers and handlers in the marketing area. Our desire was to not change historical physical operations if possible. Under Proposal 2 not a single hauler, plant, or producer in the marketing area has to make a change in how milk is picked up, delivered or shipped.

Proposal 2 would limit how much milk a handler could add to the pool or repool each month. Milk pooled would be limited to 125% of the previous month's pooled volume with a few exceptions. It will not eliminate depooling. It does mean there are potential consequences to massive depooling. If you depool under the current regulations there are no long-term consequences. In fact there are virtually no negative impacts for those who depool.

If 100% of the eligible Class III milk had pooled in July 2003 through May 2004 the estimated PPD would have averaged \$-.098, while the actual PPD averaged \$-.773. If only 50% of the eligible Class III milk had pooled the average PPD would have been \$.289 for the eleven months. Exh. 9, Table 5d. If there had not been any Idaho milk pooled, and 100% of the eligible Class III had pooled, the average PPD would have been \$.022 and with 50% of the eligible Class III pooled, the PPD would average \$.0855. Exh. 9, Table 5e.

Under Proposal 2 someone who wants to share in the marketwide pool would need to continuously pool milk. If a very low level of milk was pooled in a current month there would be less milk eligible to share in the pool in the future months. We believe this is in keeping with the basic philosophy of Federal Orders – those who participate share in the pool benefits.

Proposal 2 limits the pooling of milk in the current month to 125% of the handler's volume pooled in the previous month. The level of this limitation was chosen after receiving information similar to that found in Exh. 9, Tables 9 and 10. The largest percentage change in Table 10 is the 111% from

February to March. The 125% limitation in our proposal should accommodate this 111% increase and allows for additional added volume. As an additional safeguard though, March has a 135% limit. We felt it was important to allow room for a handler to grow their business volume, but felt it unlikely that the business volume would grow by more than 20% in a given month. Allowances are also built in for the Market Administrator to waive the percentage limitation for new handlers or for an existing handler with a changed situation – such as a merger, acquisition, or simply a distributing plant that changes regulation.

Under our proposal there is no limitation on pooling in August. In the Upper Midwest Order, August is often seen as the start of a new marketing year. The supply plant systems are formed to start operation in August. There is an extra “draw” on fluid milk in late August to fill the school pipelines.

Restricting the pooling of milk based on prior performance is not new to Federal Orders. The Northeast Order has had a “producer for other markets” provision for many years. Under this provision, milk of a producer cannot be immediately repooled if it has been depooled and is, in fact, excluded from the pool for an extended period of time. Proposal 2 would not impose such a burden on an individual producer but limits pooling based on an aggregate total of the handler’s previous month’s pooled pounds.

Years ago, other Orders primarily in the South and/or Southeast either had a producer for other markets provision or a base plan. In these markets, the intent of such provisions was to limit the sharing of the marketwide pool during the spring months to those who pooled during the fall.

The pooling of distant milk has previously been discussed. We are concerned that if a safeguard for ongoing performance – the 125% limitation – is not in place, there would be individual months

that distant milk would meet the 10% shipment requirement in an effort to gain access to the marketwide pool. Exh. ___, Table 4, discussed by Elvin Hollon, shows there are individual months when this would be advantageous. The competition for access to the Class I market in a single month and the impact on the pool due to large volume swings would create instability. This instability could be prevented through our proposed limitation on repooling.

An additional benefit to our proposed limitation on pooling is that it would mitigate the need for an increase in the administrative assessment fee. The pool volumes would be more stable. It is our view that there would be more milk pooled and less need for a fee increase. At the very least, with stability in the pool volumes, it would be easier for the Market Administrator to make staffing and other operational decisions.

Conclusion

Milk from distant areas is being pooled on Order 30 in increasing volumes. This milk reduces the price paid to local producers who regularly supply the market. Due to distance and economic returns the distant milk does not supply the market to any appreciable amount on a regular basis.

This distant milk was not envisioned as part of the Federal Order 30 market under Federal Order Reform. It has not been part of the market from a geographical basis and has not met the performance requirements of the market on its own. The fact that this milk shares in the marketwide pool should be corrected.

Additionally, the record shows that there is local milk that shares in the marketwide pool on an opportunistic basis. This milk detracts from the prices received by those who regularly and continually serve the needs of the Order 30 market – both when it pools and when it doesn't pool. Inequity among producers and handlers is apparent due to the changes in pooling of this local milk. There

also has been chaos in the marketplace. This milk should only share in the marketwide pool if and when it demonstrates that it is regularly and continually part of the Order 30 market.

The Order 32 decision says it very well. I just want to condense and paraphrase:

1. Producers who consistently bear the costs of supplying the fluid market should share the pool.
2. Pooling standards are used to identify the producers who serve the Class I market.
3. Some producers benefit while not actually and consistently serving the market.
4. Pooling without performance is neither appropriate nor intended.

The solutions we propose are based on the rationale in prior Federal Order decisions and are sound and logical.

Emergency Request

The proponents and supporters of Proposal 2 submit that emergency marketing conditions exist that warrants the omission of a recommended decision. The volume of distant milk pooling on this market without providing any appreciable level of service to fluid plants has been growing. The termination of the Western Order will only facilitate further volume increases. Since our request for a hearing, there have been two large negative PPDs. The continuing volatility of market prices almost guarantees further negative PPDs and the associated depooling. These create destructive and disorderly conditions and make it difficult to serve the fluid marketplace.

EXH_____.

**Comparison of Actual PPD with
Imputed PPD when Class III depools**

Month	Actual PPD	Imputed Class III PPD	
Jul-03	-0.41	0.00	depool
Aug-03	-1.58	0.00	depool
Sep-03	-1.07	0.00	depool
Oct-03	-0.88	0.00	depool
Nov-03	-0.07	0.00	depool
Dec-03	0.54	0.54	
Jan-04	0.37	0.37	
Feb-04	0.47	0.47	
Mar-04	0.21	0.21	
Apr-04	-4.11	0.00	depool
May-04	-1.97	0.00	depool
Jun-04	0.30	0.30	
Average	-0.6833	0.1575	