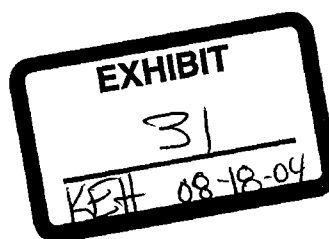


**Testimony of
Dean Foods Company by Evan Kinser
Milk Marketing Order Hearing
Docket No. AO-361-A39; DA-04-01
Bloomington, Minnesota
August 18, 2004**

Introduction.....	2
Purpose of the Federal Order System	3
Upper Midwest Order Provisions	4
Summary of Federal Order Logic.....	6
Change in Grade A Volume.....	6
Inequity	8
Among Handlers	9
Producer Prices	10
Hidden Costs.....	12
Summary of Inequities	13
Exposure to Order Failure – Call Provision.....	13
System Failure	16
Philosophy of our Solutions.....	16
Proposal #3.....	18
Example from Northeast Order.....	19
Proposal #4.....	20
Proposal #5.....	21
Proposal #6.....	22
Proposal #1.....	23
Proposal #2.....	24
Proposal #7.....	24



**Testimony of
Dean Foods Company
Milk Marketing Order Hearing
Docket No. AO-361-A39; DA-04-01
Bloomington, Minnesota
August 18, 2004**

Introduction

Hello, my name is Evan Kinser. I am employed by Dean Foods Company as Manager of Dairy Risk Management and Commodity Procurement. My business address is 2515 McKinney Avenue, Suite 1200, Dallas, TX 75206.

Dean Foods owns and operates distributing plants regulated by Federal Milk Marketing Order #30, as well as other milk plants located in the marketing area defined by Federal Milk Marketing Order #30.

In spite of Mr. English's comment about this being and I quote "a very, very lengthy testimony," I hope you find only one of those "very's" would have sufficed. However in his defense it has been shortened based on the evidence that has been submitted. Many of the comments that I was prepared to make are now redundant and no longer necessary for forming a complete record. Still there are some points that either need introduction or clarification. For that purpose, I am appearing today to support and explain the philosophy of Dean Foods in arriving at proposals #3, #4, #5, and #6. I will further explain our concerns about Proposal #1 and #2.

Experts will supplement my testimony with additional testimony. Mr. Paul Christ will explain the mechanics of the proposals. Ms. Mary Ledman will cover the adverse economic effects of depooling if the order is allowed to remain, as it currently exists.

Purpose of the Federal Order System

Understanding the correct purpose of the Federal order system is key to this hearing being successful. Distractions from the intent in the past have led to tweaks or small patches, when more concise and meaningful action was needed. The focus always needs to be on the original intent and what changes should be made today to ensure the original intent is carried out. Today, we can and should take different actions than the past. This action must address a now greater array of market conditions and resulting opportunistic behaviors.

The Agricultural Marketing Agreement Act (AMAA) of 1937 provides for a system that would “insure a sufficient quantity of pure and wholesome milk,” which has routinely been construed to mean packaged fluid milk only, through ensuring that “for the payment to all producers and associations of producers delivering milk to the same handler of uniform prices for all milk delivered by them” and “for the payment to all producers and associations of producers delivering milk to all handlers of uniform prices for all milk so delivered, irrespective of the uses made of such milk by the individual handler to whom it is delivered.” With this reminder of the regulation that is to guide us, I would submit the intent is as follows: The Federal order system is to compensate dairy producers serving, and standing ready to serve, distributing plants in order to insure a sufficient supply of quality milk is available to produce packaged milk. This should

be accomplished with uniform payments for milk, regardless of their milk's use and equal prices charged to handlers using milk for the same purpose.

Upper Midwest Order Provisions

The purpose of the Federal order has been confused and misapplied in developing regulation that governs the Federal orders. Some would lead the Secretary to believe the Federal order's purpose is to ensure all plants have a sufficient supply of milk. The AMAA simply does not support this; it is clear the concern of milk supply applies to distributing plants. The track record and structure of this order makes this clear. There are many key sections from the order language to substantiate the only milk supply of concern to the order is distributing plants. By absence and extension, the milk supply of other plants is a residual concern of the order only to the extent it is necessary to ensure that reserve producers – those standing ready to serve the fluid market – have outlets for their milk.

The first section highlighting the importance of distributing plants milk supply is Section 1030.7 (g). This provision gives the market administrator the authority to change shipping percentages of pool plants to distributing plants. There is no statement about the need for milk in a supply plant, or a supply plant system. The purpose of these plants being part of the order is to meet the needs of the distributing plants. In the event current requirements are ineffective, the market administrator can make a change.

The next section highlighting the importance of distributing plants milk supply is Section 1030.55 – Transportation credits and assembly credits. This also illustrates that the purpose of

the Order is to ensure distributing plants have a sufficient supply of milk. This particular section is meant to provide economic incentive for handlers to move milk to distributing plants. There is no provision to ensure that all pool plants have ample supply of milk. The transportation credit is only provided to pool supply plants for milk that ships to pool distributing plants. The assembly credit is given to any handler that delivers producer milk to a pool distributing plant. Both provide handlers economic incentives to “give up” milk by helping to offset the cost of assembling and transporting milk for shipments to distributing plants. No credit is provided for a nonpool plant shipping to a pool supply plant and no credit is provided for a pool supply plant shipping to a pool supply plant.

A dissection of Section 1030.7, the definition of a Pool Plant, clearly illustrates the only plants mandated to be regulated by the order are distributing plants. All other plants are allowed to participate based on defined service to a distributing plant. Rather than spend the time explain each subsection I would offer the following as a quick summary of Section 1030.7.

<u>Paragraph</u>	<u>Plant</u>	<u>Regulation</u>
A	Distributing	Mandated
B	UHT - Distributing	Mandated
C	Supply	Voluntary
E	Distributing System	Voluntary/Mandatory
F	Supply System	Voluntary
G	Call provision	Voluntary
H	Plant Exemptions	Special Circumstances
I	MA Exemption	Voluntary

These key sections of the order language clearly demonstrate the order’s main concern must be with distributing plants’ milk supply. However, the order also provides a pricing mechanism for all the order’s milk. The pricing system is built around pricing discrimination based on the milk’s use. This serves as an attraction for milk to be in the pool. One of the largest contributors

to the pool is the Class I price. This is clear from studying the pricing formulas found in Sec. 1000.50 that Class I is structured to be the highest price in the pool.

Summary of Federal Order Logic

The system is designed for classified pricing to maintain certain relationships between the prices. It was thought the supply plants and producers shipping to them would want access to the dollars generated by the distributing plants. Therefore this system regulates those plants (distributing plants) that are structured to contribute to the pool and relies on economic incentives to drive regulation for the balance (supply plants). This is based on the assumption that the revenues generated by distributing plants would always provide sufficient incentives to attract a milk supply. In the absence of forced regulation, the contributing plants would have left the order rather than contribute. Without their contribution to the pool the incentive would be lost to draw other milk. Having locked in the contributing plants to regulation, it was thought would-be unregulated handlers (supply plants) would voluntarily submit to regulation for the benefits.

Change in Grade A Volume

One possible cause for these glaring shortcomings could be the result of not adjusting to change in the underlying structure of the dairy industry. There are several significant changes that have occurred in the dairy industry since the implementation of the AMAA in 1937. I could spend hours discussing such changes as cow genetics, production methods, cooling and processing technology, transportation systems etc. One dynamic that seems to have been overlooked, which is a key principle in operation of the Federal Order, is the issue of availability of Grade A milk. The industry has changed from a manufacturing grade to all but exclusively Grade A milk

production. The regulations have not recognized that the incentives, needed to switch from manufacturing to Grade A, are no longer necessary.

I would like to submit some exhibits into the record to illustrate this change. EXHIBIT _____H, Measure of Growth in Federal Milk Order Market – Selected Years, 1947-2002, published in *Upper Midwest Dairy News*, May 2003. EXHIBIT _____I, Grade A Milk Production as a Percentage of Total Milk Production, published in *Upper Midwest Dairy News*, May 2003.

One could get the impression for how the orders currently behave that there continues to be a need for Grade A milk. If these exhibits were the only facts, likely the reverse conclusion would be drawn; there is more than ample supply of milk available to the Grade A market. There is an upward trend in the percentage of milk that is Grade A, nearing 100% and a declining percent of milk utilized in Class I.

According to EXHIBIT _____I, nationally only two percent of the milk produced is not Grade A. Of the states in the same exhibit, the lowest percentage is North Dakota with 74 percent Grade A. However, when one considers the population of North Dakota and the fact that it borders Minnesota, the 6th largest milk producing state where all but four percent of the milk is Grade A, there is little concern about North Dakota having access to a sufficient supply of Grade A milk.

EXHIBIT _____H shows the percentage of milk utilized in Class I. Again, the concern of the order is to assure a milk supply to distributing plants, which require Grade A. The percentage of milk utilized in Class I has declined fairly steadily. This exhibit only accounts for milk pooled within a Federal milk order. It does not account for milk outside of the Federal Order pool, regardless of the reason. There is a declining percent of milk utilized in Class I. The exception to the decline is 1998, when there was a financial incentive to depool. Again, Class I milk, produced at a distributing plant, does not have a choice about its participation in the pool; it must participate in the pool by regulation. Other classes of milk have the option of participating or not. For part of 1998, there was not economic incentive to be in the pool, in fact there was economic incentive to be out. Therefore, the producer pounds reported in this exhibit, relative to the amount of milk required by Class I, resulted in a year over year increased percentage of the milk pooled used in Class I. If this same analysis had been done comparing against total milk production, it is unlikely the same increase would have been seen.

Inequity

The fact remains this system requires proper economic incentive and properly defined regulation. Missing these two key ingredients allows handlers to associate milk with the order and draw money out of the order, while not providing any service to distributing plants. However, the problem is not limited to these handlers merely being free riders, drawing from the pool for no service. It extends beyond that, when there are costs incurred by those servicing the market these cost are not shared, instead they are left with the handlers who have continued to do the right thing and serve the market. When the free riders leave, the costs do not go away, these costs are forced upon a smaller pool of handlers. More correctly said, they are forced upon a smaller

contingent of dairy farmers. It is like going out with a group of friends and sharing a great meal, eating as much as you can, but when the server comes with the check you simply get up from the table and leave the bill to be divided among those who didn't do the same.

Among Handlers

Current regulations allow handlers who may or may not choose to be pooled to enjoy the benefits of the pool, so long as they meet the requirements of the order for that month. Furthermore, when there is a cost to serve the market, they are allowed to excuse themselves from the table, until the next meal is being served. This idea of excusing themselves has been termed depooling. A more technical definition of depooling would be when handlers do not report milk that would normally pool on their pool report; typically this is done for financial reasons.

The only milk that can depool is the milk that is voluntarily pooled by pool supply plants and 9(c) handlers, as opposed to milk that is mandatorily pooled by regulated distributing plants. I discussed this earlier in my testimony when I reviewed section 1030.7. The result of this structure is, when there is no economic incentive (reward) to stay pooled, and no economic disincentive (cost) for leaving the pool, this milk withdraws from the pool. Handlers operating Class III, hard cheese, operations are in prime position for exercising this option.

Nothing demonstrates this exact situation any more clearly than recent history. A quick glance back, a little over a year, clearly demonstrates that in today's marketplace this system is broken. Undeniably, there is insufficient economic incentive and poorly defined regulation resulting in failure of the order to achieve its intent. Furthermore it is producing a result it was intended to prevent, disorderly marketing. Ms Ledman will talk about this topic more extensively.

Who are the handlers that depooled milk? Looking at the request for proposals noticed for this hearing, specifically proposal number two, you will find a lengthy list of cooperatives who would seem to oppose depooling. Is this to say they do not depool, I would think not. However, it would indicate they have more to gain by discontinuing depooling than allowing the system to stay as it is. Admittedly, there are some cooperatives that did not sign onto that proposal, they likely oppose it, but what about the proprietary plants normally pooled on the order. The majority of the proprietary plants pooled on the Order are Class III operations and they likely depooled and would like to continue to have that option. Which operations return all the money to producer? Cooperatives do, either in the form of payment for milk, earnings, or some combination. This being the case, it would seem that the depooled proprietary plants have little incentive to overpay for milk relative to their pooled cooperative competition. If this assumption is correct they desire to return as little as possible to the dairy farmers.

Producer Prices

Beyond the effects handlers' payment decisions, there are other very painful effects of depooling. Like my illustration of leaving before the bill is covered at dinner; there are costs currently not equitably shared among producers. Let's focus again on the cooperatives that are proponents of proposal number two noticed for this hearing. The proponents are as follows: Cass-Clay Creamery Inc., Dairy Farmers of America, Foremost Farms USA, Land O'Lakes, Mid-West Dairymen's Company, Milwaukee Cooperative Milk Producers, Manitowoc Milk Producers Cooperative, Swiss Valley Farms, and Woodstock Progressive Milk Producers. Each of them is a dairy cooperative. The only other proposal that would work to accomplish anything similar would be the proposals that Dean Foods has made. Why would these cooperatives have

cared, any more than other cooperatives? What about other proprietary plants? Is there a reason for a select group to ask for a change and others to accept status quo? Yes, it continues to be the same issue I've reiterated in this testimony. Distributing plants are the only plants that are forced into regulation under the Federal order, all other plants choose. To the degree you service a disturbing plant, by definition, lessens your ability to depool milk. The inability to depool milk lessens your competitiveness in the marketplace when others can. One might think that this statement runs counter to my earlier argument that proprietary plants represent the majority of the milk that depools and they would not pay more than they have to for milk. I stand by that statement. Suppose they pay five cents per hundredweight more for milk, which simply lowers their profit margin. I will illustrate for those forced to be in the pool paying that five cents additional per hundredweight could be moving them to deeper negative margin. Let's suppose there is a cooperative shipping 25% its milk to a distributing plant, we'll call this Coop A. 25% of Coop A's milk supply must be pooled by definition; there is no choice. The balance of the milk could be depooled. Now, let's contrast that with Cheese Factory C, a handler that is shipping the bare minimum, 10%. That is enough milk that if they wanted to fully pool they could pool all their milk receipts, but it does not force them to pool any more than the 10%. Now, focusing the worst-case scenarios we will look at April 2004. Here Coop A had to pool 25% of their milk with a negative \$4.11 PPD. This means that Coop A's blended PPD is negative \$1.0275 ($\$4.11 * 25\%$). Suppose Cheese Factory C pooled 10% at the same PPD and has a blended PPD of a negative \$0.411 ($\$4.11 * 10\%$). The Class III was announced at \$19.66/cwt; with the negative \$4.11 PPD would result in a blend of \$16.18. If we assume that the remaining milk of each went to cheese production, each handler can easily pay the blend, but they are not both able to pay the same price. Coop A would be able to pay \$18.6325 ($\$19.66 -$

\$1.0275). Cheese Factory C would be able to pay \$19.25 (\$19.66 - \$0.41). Let's say that Cheese Factory C wants to be profit maximizing, yet competitive; they would pay at Coop A's price level allowing them to make \$0.6175/cwt. In reality Cheese Factory C might see a chance to expand their procurement, so they decide to pay \$18.90. If Coop A believes that Cheese Factory C is going to overpay the blend and pay more than Coop A, Coop A will have to lose money to match Cheese Factory C. If Coop A guessed that they needed to pay \$18.85 to be competitive, it would mean that Coop A paid \$0.2175 more than they had to pay. In this example, I make no provisions for the operational efficiencies or inefficiencies of Coop A verse Cheese Factory C, they are assumed to have the same cost structure. This is merely an illustration of how based on different shipping percentages to a distribution affect a handler's ability to pay for milk.

Hidden Costs

A cost that often gets overlooked by the marketplace, but is not overlooked by the market administrator is the cost of operating the Order. Proposal seven is a request from the market administrator to increase the maximum administrative assessment rate for the Upper Midwest Order from five cents to eight cents per hundredweight. This request is a direct byproduct of the current system of allowing milk to come and go from the order. Mr. Kyburz must be staffed to handle a pool in excess of two billion pounds, however in the past 18 months, seven months he has had to attempt to cover that overhead with the income on only a fraction of the milk. I will not take the time to illustrate the detailed implications on Mr. Kyburz and his staff, as I'm sure he will do so in direct testimony. Yet, I feel it important to show that proposal number seven is a direct cost of this lax system and it is forcing the cost to be raised. To the degree the department fails to recognize the flaw in the current system, which allows for depooling and increase the

administrative assessment, it will only be a tax increase on those who are already picking up the tab.

Summary of Inequities

I hope at this point it is clear to the Secretary that there are three fatal flaws in the system. First, it forces regulation on distributing plants, but allows all others voluntary participation. Secondly, these plants choose to participate when they can siphon funds out of the system for their betterment, but when the reverse is true, they bail with no implications to them. Third, the reality is there are implications when milk leaves the pool; the costs that exist must be born by a smaller few. This creates a heavier burden for those remaining in the pool that is not rewarded when the market improves, because the free riders will return.

Exposure to Order Failure – Call Provision

I would like to point that beyond economic effects of the flawed system, such provisions position the order to completely fail its purpose. Earlier referenced 1030.7 (g) for the purpose of illustrating that the Federal Order was to ensure a supply to distributing plants. This provision provides for the market administrator to increase or decrease for all or part of the marketing areas the shipping percentage to encourage needed shipments or to prevent uneconomic shipment to distributing plants. The current provisions only require ten percent of pooled milk to be shipped to a distributing plant; no more than 90 percent can be diverted to a nonpool plant. With the current provisions relying on economic incentive to keep milk in the pool and available for such provision, the change in shipping percentage would need to be significant.

I turn to July 2003 to illustrate how significant. If we would make an assumption that all the distributing plants pooled in the Upper Midwest Marketing Order were 100% Class I that would say that 50.3% of the milk was diverted. If conditions had warranted for the market administrator to adjust the shipping percentages the shipping percentages would have needed to be in excess of 49.7 percent. To explain how I arrived at this result look at Exhibit 10, Table 2f. Notice that the Class I percent was 49.7 percent. If more milk was needed than the approximately 328 million pounds of milk utilized in Class I and there was only about 660 million pounds of milk in the pool (Exhibit 10, Table 2e), it would have required something greater than the 49.7 percent. The milk that is pooled is all the market administrator can call on. So, to force milk to move from Class II, III or IV into Class I, or face being depooled the shipping percentage would needed to be higher than 49.7 percent. However if a call had been issued, it is possible that some of the Class III milk would not have met the requirement. This would have been to the handler's betterment to be disqualified and be forced out of the pool. This would have forced the requirement even higher on Class II and IV, since those handlers were the only ones who would have wanted to be in the pool. By these handlers wanting to be in the pool they would likely do whatever is necessary to remain pooled. The percentage would only be worsened if you assumed there are no stand-alone Class II facilities. Such a scenario would have required the shipping requirement be set greater than 65.6 percent (the sum of the Class I and II percentage). The reality of the marketplace needs was likely something between these the 49.7 percentage in the prior example and this 65.6 percent.

The response to this line of thinking could be milk will be readily available when this happens and can be easily purchased, but actually the opposite is the case, especially as it relates to the

most recent examples in the Upper Midwest. Cheese plants are most interested in keeping all their milk when the price is high, so they can make cheese and not short any customers. Now, put yourself in the place of a Class III handler, back to Cheese Factory C. During recent examples of negative PPD's, Cheese Factory C was looking at above average, and in the case of 2004 record high, cheese prices. If Cheese Factory C wanted to pool milk they would have to give up at least 10% of what they wanted to pool [defined by Sec 1030.7 (c)]. This would mean less milk to the vat and they would receive the negative PPD on that milk and any milk they pooled in addition to shipments. I've already explained the implications of that on their ability to pay for milk. Given that information and my testimony about voluntary participation, the other alternative provided by the current order regulation to Cheese Factory C, is to keep all their milk, make cheese, and pool nothing. This would be a win-win for Cheese Factory C. They are able to make as much cheese as possible for customers; they don't have a negative PPD. Thus, the market administrator has no authority to call on Cheese Factory C to ship additional milk if it is decided there are insufficient supplies available for the distributing plants. The handlers shipping milk to the distributing plants will have a negative PPD, but will have to compete with Cheese Factory C when they go to pay for the milk.

The point to this illustration is that current provisions allow milk to leave the pool. This renders the order virtually useless to its purpose of ensuring a milk supply to distributing plants. The power of the market administrator to make milk available to the distributing plants is severely hampered. To the degree these percentages would have been increased what milk remained in the pool could have opted to not pool (depool) and those handlers would not had to respond to the increased shipping percentages.

System Failure

Smooth function of this system requires two keys 1) proper economic incentive and 2) properly defined regulation. We believe that both are missing within the current regulation.

Philosophy of our Solutions

Something must be done to change the order to rectify the shortcomings. We appreciate the Secretary's recognition of this in requesting proposals and subsequently having this hearing. We further appreciate that the Secretary recognized four proposals submitted by Dean Foods. Our proposals were aimed at restoring the missing keys 1) proper economic incentive and 2) properly defined regulation.

To accomplish these two objectives there are several different approaches that could be used. In the end it is a matter of execution and preference, as opposed to objective. Being candid, Dean Foods has two objectives and we aren't too picky about the execution so long as the objective is achieved. I hope from the testimony that it will be clear these objectives are consistent with the intent of the order and correct shortfalls we have illustrated. First, there needs to be smaller orders and likely more of them. The objective of the order doesn't provide that every pound of milk have guaranteed access to the order draw, rather that the distributing plants have sufficient supplies of milk. Accordingly, this will help to create economic incentive. Second, regulation requiring that once milk attaches the milk stays. This regulation would create equity for all involved in the Order.

Dean Foods understands and accepts that the majority of the plants that we own and operate are in the group of plants that are regulated by requirement, as opposed to option/economic incentive regulation. We further understand that it is believed that the products that these plants produce are highly perishable and face a less elastic demand curve. These beliefs have led to the conclusions that those products and others similar to them should be the highest priced. Regardless of our belief and comfort level with this, we are not going to protest or express opinions about these conditions at this particular hearing. However, we do have and would like to express our concerns about how the dollars generated by these circumstances are handled, what economic incentives they are used to create, and most importantly how these dollars are uniformly distributed to producers.

In an ideal world, from Dean Foods' perspective the Federal Order would operate in such a way to allow a distributing plant or a distributing plant unit to have an individual handler pool. This system would put the pressure on the distributing plant to manage the pool in such a way as to resolve the purpose of the Federal Order. If this would be allowed it would force distributing plant handlers to think about how to insure their future supply of milk and keep economic incentives in place that would insure that even when it is temporarily undesirable to ship milk (as has been the case) the long run loss for not continuing to ensure a sufficient supply of quality milk would be too great to forgo the long-term reward, in order to gain a short-term pricing advantage.

I will introduce the proposals with modifications. I will not comment on their mechanics or function, Mr. Paul Christ will be providing this information and detail in his testimony.

Proposal #3

In proposal number 3 we propose establishing a *dairy farmer for other market* provision, much like the same titled provision included in Northeast Milk Marketing Order, Sec 1001.12 (b)(5) & (6). We would like to modify the language that was submitted for the hearing and published in the official hearing notice to ensure that it reflects our intent. Our proposal would read as follows:

Amend § 1030.12 by adding a new paragraph (b)(5) to read as follows:

§ 1030.12 **Producer.**

(b) * * *

(5) For any month, any dairy farmer whose milk is received at a pool plant or by a cooperative association handler described in § 1000.9(c) if ~~the~~any pool plant operator or ~~the~~any cooperative association caused milk from the same farm to be delivered to any plant as other than producer milk, as defined under the order in this part or any other Federal milk order, during the same month or any of the preceding 11 months, unless the equivalent of at least ten days' milk production has been physically received otherwise as producer milk at a pool distributing plant during the month.

A conforming change needs to be made by the Secretary under proposal eight to clarify potential implications created by proposal three. This change would occur in Sec. 1030.13 (d)(1), which contains the following:

...If a dairy farmer loses producer status under the order in this part (except as a result of a temporary loss of Grade A approval or as a result of the handler of the dairy farmer's milk failing to pool the milk under any order), the dairy farmer's milk shall not be eligible for diversion unless at least on day's production...

To make our proposal highly effective and consistent it should be changed to read as follows:

...If a dairy farmer loses producer status under the order in this part (except as a result of a loss of Grade A approval not to exceed 21 days in a calendar

year), the dairy farmer's milk shall not be eligible for diversion unless at least on day's production...

Example from Northeast Order

Similar language exists in the Northeast Order. A major difference is milk can get into the pool "free" in July. If milk leaves in the spring, it is out until July. This year, this provision played well into the hands of several handlers in the Northeast. They left the pool in April and May because of negative PPD. Then the provision worked. They could not "repool" on the Northeast Order in June. The system shortcoming was that the Mideast Milk Marketing Order does not contain the same or any similar language. Some savvy handlers moved milk to qualify for pooling on the Mideast Order for June. These handlers likely pooled their milk back on the Northeast Order in July. These numbers are not yet available.

To illustrate this point I will turn to Exhibits 13, submitted by Sharon Uther with the Mideast Order. I would also like to remind the Secretary of Ms. Uther's testimony with regard to how one might interpret the numbers, more importantly where this additional milk came from. It would seem almost obvious this isn't milk that suddenly appeared. It is milk that was most likely left homeless because of earlier month's pooling decision. I requested Exhibit 13 - Pounds of Milk by State, February 2003 and 2004, and Exhibit 13 Pounds of Milk by State, June 2003 and 2004 to help illustrate how Northeast handlers took advantage of the pooling provisions of the Mideast Order in June. I included February, because all milk would have desired to be in the pool that month. This helps to single out other things that changed in the Mideast Order from 2003 to 2004. I will not bore the Secretary, nor the hearing attendees, with every line of the two tables, instead I would like to focus the attention to two states, New York and Vermont. Why would milk in New York and Vermont pounds pooled on Mideast suddenly increase? The answer is the

product of this proposal at work in the Northeast Order. It could not. Having lost its home it needed another market and the next best option was the Mideast. Here we find what appears to be, in simple terms, an additional 67.422 million pounds of milk on the Mideast Order because it was unable to pool on Northeast order, because of pooling decisions made in the two prior months.

Think ahead for a moment and consider if this were implemented in all orders. Milk would either stay pooled or ship to a distributing plant to return to the pool. Now, let's return to the practical, this can't happen over night. Such implementation would require additional hearings. So, if this were to happen which Order would be the right place to start? The order with the most generous pooling provisions, the market of last resort, as stated by one counselor the dumping ground, or said differently, the Upper Midwest Order. This is the right order for the Secretary to make a statement and begin righting the wrongs.

Proposal #4

Amend § 1030.12 by adding a new paragraph (b)(5) and (6) as follows:

§ 1030.12 Producer.

(b) * * *

(5) For any month of ~~December-February~~ through June, any dairy farmer whose milk is received at a pool plant or by a cooperative association handler described in § 1000.9(c) if ~~the any pool plant operator or the any cooperative association~~ caused milk from the same farm to be delivered to any plant as other than producer milk, as defined under the order in this part or any other Federal milk order, during the same month, any of the 3 preceding months, or during any of the preceding months of July through ~~November~~January, unless the equivalent of least ten days' milk production has been physically received otherwise as producer milk at a pool distributing plant during the month; and

(6) For any month of July through ~~November~~ January, any dairy farmer whose milk is received at a pool plant or by a cooperative association handler described in § 1000.9(c) if the any pool plant operator or the any cooperative association caused milk from the same farm to be delivered to any plant as other than producer milk, as defined under the order in this part or any other Federal milk order, during the month or the preceding month, unless the equivalent of least ten days' milk production has been physically received otherwise as producer milk at a pool distributing plant during the month.

Like in proposal number three we would look for the same changes in Sec. 1030.13 (d)(1).

Proposal #5

Amend Section 1030.13 by adding a new paragraph (f) to read as follows:

§ 1030.13. Producer Milk

* * *

(f) The quantity of milk reported by a handler pursuant to § 1030.30(a)(1) and/or § 1030.30(c)(1) ~~for July through November~~ may not exceed 115 percent of the producer milk receipts pooled by the handler during the prior month. Milk diverted to nonpool plants reported in excess of this limit shall be removed from the pool by the market administrator. Milk received at pool plants, other than pool distributing plants, shall be classified pursuant to § 1000.44(a)(3)(v) and § 1000.44(b)(3)(v). The handler must designate, by producer pick-up, which milk is to be removed from the pool. If the handler fails to provide this information, the market administrator will make the determination. The following provisions apply:

(1) Milk shipped to and physically received at pool distributing plants shall not be subject to the 115 percent limitation;

(2) Producer milk qualified pursuant to § _____.13 of any other Federal Order and continuously pooled in any Federal Order for the previous six months shall not be included in the computation of the 115 percent limitation;

(3) The market administrator may waive the 115 percent limitation utilizing;

(i) For a new handler on the order, subject to the provisions of § 1030.13(f)(3), or

(ii) For an existing handler with significantly changed milk supply conditions due to unusual circumstances;

(4) The market administrator may increase or decrease the applicable limitation for a month consistent with the procedures in § 1030.7(g); and

(5) A bloc of milk may be considered ineligible for pooling if the market administrator determines that handlers altered the reporting of such milk for the purpose of evading the provisions of this paragraph.

Proposal #6

Amend §1030.13 by adding new paragraphs (d)(1), through (4) and redesignating paragraph (d)(4) as paragraph (d)(5), to read as follows:

§ 1030.13. Producer Milk

(d) * * * *

(1) Milk of a dairy farmer shall not be eligible for diversion until milk of such dairy farmer has been physically received as producer milk at a pool plant and the dairy farmer has continuously retained producer status since that time. If a dairy farmer loses producer status under the order in this part (except as a result of a temporary loss of Grade A approval not to exceed 21 days in a calendar year), the dairy farmer's milk shall not be eligible for diversion until milk of the dairy farmer has been physically received as producer milk at a pool plant;

(2) The equivalent of at least two days' milk production is caused by the handler to be physically received at a pool plant in each of the months of July through November;

(3) The equivalent of at least two days' milk production is caused by the handler to be physically received at a pool plant in each of the months of December through June if the requirement of paragraph (d)(2) of this section (§ 1030.13) in each of the prior months of July through November are not met, except in the case of a dairy farmer who marketed no Grade A milk during each of the prior months of July through November.

(4) ~~Of the total quantity of producer milk received during the month (including diversions but excluding the quantity of producer milk received from a handler described in § 1000.9(c) of this chapter or which is diverted to another pool plant), the handler diverted to nonpool plants not more than 65 percent in each of the months July through November and 75 percent in each of the months of December through June.~~

We would like to couple this revised proposal number 6 with an alternative to Proposal one. Our suggested amendment to Proposal one would read as follows:

§ 1030.7. Producer Milk

(d) * * * *

(2) The operator of a supply plants may not include as qualifying shipments under this paragraph milk diverted directly from producer's farms pursuant to Sec. 1000.9(c) or Sec. 1030.13(c) to plants described in paragraphs (a), (b) and (e) of this section.

These two together we submit as our revised Proposal six.

Proposal #1

Dean Foods on principle must stand opposed to the limitation of transportation credits.

Accepting such is completely counter to all the arguments that we have submitted to the

Secretary in this hearing. I would refer to Exhibit 10, Table 9. This is the Market

Administrator's response to the following question: "Please provide the number of pounds that received a transportation pool payment that was hauled 400 or more miles since May 2002."

The answer as shown in Exhibit 10, Table 9, NONE. Proposals 1 and 2 attempt to prevent distant milk from receiving incentives for attaching for pooling purposes. The thought is correct, the solution is wrong. In place of proposal number one, the secretary should adopt proposal number six.

Why should the distance from the market make a difference? If the milk is needed it should be paid. The challenge is that there are so little other costs because of the loose pooling provisions, if milk could get assistance with the transportation tab it would connect. The compensation for moving milk should not be limited by distance. Instead, the amount of milk that can be pooled from serving a distribution plant should be reduced. This change will limit milk to serve the market to that which is needed and keep it closer. There will not be the reward available for milk moving long distances to move, unless it is needed. We urge the Secretary to disregard this request and implement proposal number six as presented instead.

Proposal #2

We oppose transportation credit that is consistent with proposal number one for the same reasons we oppose proposal number one. Like proposal one we offer proposal number six as an alternative. Being an equal opportunity opponent, we won't oppose purely based on the proponents. The language that is similar to proposal number five we oppose. Much of our opposition should be clear from our support for proposal number five.

There are a few areas we have serious concern for this proposal. First we feel that 125% is too loose. Again, it allows guessing to be less of a factor. Handlers are allowed a greater degree of slop for miscalculations in their estimates. The provision sets up allowing full pooling in August. This is almost a get out of jail free card for handlers. Why should handlers be offered such forgiveness for taking advantage of the system? I hate to continue to say the same thing in a different way, but the facts are what they are. The pool should be about ongoing equity, not about in when it is good and leave when it costs. We urge the Secretary to adopt proposal number five over this proposal. If the Secretary cannot find her way to do that, we would urge that the variations be removed to a constant percentage every month and possibly halfway between 125 and 115 as a compromise.

Proposal #7

We have worked with Mr. Kyburz and his staff a lot. We have leaned on them for help and counsel, excluding counsel on issues related to this hearing since the announcement of course. Mr. Kyburz has a top-notch staff that is extremely knowledgeable, helpful, and just great people

to work and deal with. Mr. Kyburz has clearly demonstrated his ability to efficiently manage the order in very difficult circumstances that were beyond his control. These difficult circumstances have created the need for this hearing. These difficult circumstances can be resolved by the Secretary. We believe something needs to be done to help with this difficult and historically unpredictable problem. If the Secretary will study closely the evidence of this hearing it will be clear that significant changes need to be made to stabilize the order.

We feel that we have offered proposals that the Secretary should adopt to stabilize this order relieving the market administrator this undue stress. When this action is taken I know from his track record that Mr. Kyburz will be able to execute those duties and manage a stable order effectively as he has done in the past.

If the Secretary needs to take action specifically on the administrative assessment, we would encourage language that would have the effect of charging for milk not in the pool the prior month a higher administrative assessment to recognize the costs incurred to keep the market administrator's office ready for the increase in milk. It is likely that tracking this every month is excessively burdensome, in which case possibly a three-month assessment for milk returning to the pool would cover the lost revenue in most cases.

Measures of Growth in Federal Milk Order Markets Selected Years, 1947 - 2002 *

Year	Number of Markets ¹	Population of Federal Milk Marketing Areas	Number of Handlers ¹	Number of Producers ²	Receipts of Producer Milk ³	Percentage of Producer Milk Used in Class I	Daily Deliveries of Milk per Producer
	Number	1,000	Number	Number	Million Pounds	Percent	Pounds
1947	29	----	991	135,830	14,980	65.5	302
1950	39	----	1,101	156,584	18,660	58.9	326
1955	63	46,963	1,483	188,611	28,948	62.3	420
1960	80	88,818	2,259	189,816	44,812	64.2	648
1965	73	102,351	1,891	158,077	54,444	63.5	944
1970	62	125,721	1,588	143,411	65,104	61.5	1,244
1975	56	150,666	1,315	123,855	69,249	57.9	1,532
1980	47	164,908	1,091	117,490	83,998	48.9	1,954
1985	44	176,440	884	116,765	97,762	43.2	2,294
1986	44	177,992	849	112,322	98,791	43.2	2,413
1987	43	180,374	797	105,882	98,182	43.7	2,542
1988	42	184,180	776	104,141	100,066	43.1	2,627
1989	41	185,919	748	100,291	95,871	45.2	2,614
1990	42	195,841	753	100,397	102,396	42.8	2,796
1991	40	198,409	722	100,267	103,252	43.6	2,821
1992	40	200,530	698	97,803	107,947	41.6	3,017
1993	38	199,604	675	92,934	103,979	43.1	3,073
1994	38	201,561	629	91,397	107,811	41.6	3,232
1995	33	207,548	571	88,717	108,548	41.5	3,350
1996	32	209,599	570	82,947	104,501	43.5	3,442
1997	31	208,379	570	78,422	105,224	42.7	3,676
1998	31	210,484	522	72,402	99,223	45.3	3,755
1999	31	212,118	487	69,008	104,479	43.3	4,148
2000	11	228,899	346	69,590	116,920	39.3	4,590
2001	11	231,487	350	66,423	120,223	38.2	4,959
2002	11	234,256	338	63,856	125,546	36.7	5,387

* Source: *Dairy Market News*, Volume 70, Report 16, AMS, USDA.

¹ End of year. The number of markets peaked at 83 in 1962. The number of handlers peaked at 2,314 in 1961.

² Average for year. The number of producers peaked at 192,947 in 1961.

³ Beginning in 1989, due to disadvantageous price situations in some markets, handlers elected not to pool milk that normally would have been associated with the order. This has reduced, sometimes substantially, the volume of producer milk receipts reported for some markets.

Conversion to Grade A Milk Continues

In 2002, the general trend from Grade B to Grade A milk production continued, as shown in the table below. For the year, 98% of milk sold to plants and dealers in the United States was Grade A, up from 74% in 1970.

Grade A milk output in each of the seven states in the Upper Midwest Order, as a percentage of total milk production, also increased significantly during the 32-year period. Grade A milk accounted for 96% of total milk production in Min-

nesota and Wisconsin, up from 29% and 54%, respectively, in 1970. Minnesota and Wisconsin, however, continue to account for nearly half of the 3 billion pounds of Grade B milk produced in the United States in 2002.

Grade A Milk Production as a Percentage of Total Milk Production

	<u>U.S.</u> %	<u>MI</u> %	<u>IL</u> %	<u>IA</u> %	<u>WI</u> %	<u>MN</u> %	<u>SD</u> %	<u>ND</u> %
1970	74	89	74	33	54	29	16	35
1975	80	95	79	47	64	45	20	36
1980	84	95	80	59	71	59	32	43
1985	87	97	83	67	75	67	43	48
1990	92	98	89	80	86	76	55	57
1995	95	98	94	88	92	89	58	57
1996	96	99	94	90	92	90	57	57
1997	97	99	95	94	93	92	60	59
1998	97	99	97	94	94	93	93	65
1999	98	99	98	96	94	94	93	69
2000	98	99	98	96	94	95	93	71
2001	98	99	98	97	95	95	93	73
2002	98	99	98	97	96	96	93	74

Source: "Milk Production, Disposition, and Income", NASS, USDA.

Upper Midwest Pool Statistics - April 2003

Market Class I Differential Rate	Pool Plants	Received at Pool Plants	Diverted to Pool and Nonpool Plants	Total	Location Adjustment to Producers	Class I Differential to Handlers
<i>Cwt.</i>	<i>Number</i>	<i>Pounds</i>	<i>Pounds</i>	<i>Pounds</i>	<i>Value</i>	<i>Pounds</i> <i>Value</i>
\$1.80	4	61,533,550	75,400	61,608,950	\$ 0	53,478,120 \$ 962,606
\$1.75	38	192,066,585	389,635,289	581,701,874	290,851	140,070,958 2,451,242
\$1.70	37	192,053,793	849,083,051	1,041,136,844	1,041,137	122,390,037 2,080,631
\$1.65	5	27,842,555	4,661,814	32,504,369	48,756	22,121,183 364,999
Other	0	0	145,805,028	145,805,028	291,346	0 0
Total	84	473,496,483	1,389,260,582	1,862,757,065	\$1,672,090	338,060,298 \$5,859,478