BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE AGRICULTURAL MARKETING SERVICE

In the Matter of	:	
	:	**Docket Nos.:**
Milk In The Pacific Northwest	:	**AO-380-A18; AO-368-A30**
	:	**DA-01-08**
and Western Marketing Areas	:	

Statement Regarding Proposals 1 & 2 & 9 & 10

Elvin Hollon
Dairy Farmers of America, Inc.

April 16, 2002
Salt Lake City, Utah

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Statement of Dairy Farmers of America

Dairy Farmers of America (DFA) is a member-owned Capper-Volstead cooperative of 14,964 farms that produce milk in 45 states. DFA pools milk on 10 of the 11 Federal Milk Marketing Orders including the Western Order. DFA members represent approximately 40% of the milk pooled on the Western Order.

DFA is a supporter of Federal Milk Marketing Orders and we believe that they are a benefit to dairy farmers' economic livelihood. Federal Orders are economically proven marketing tools for dairy farmers. The central issue of this hearing - providing for orderly marketing and economically justifying the appropriate performance qualifications for sharing in the marketwide pool proceeds - is the heart of the Federal Order system. If this issue is not addressed properly system wide, Orders will be jeopardized. That would be detrimental to all DFA members both in their day-to-day dairy farm enterprises and for the milk processing investments that they have made.

Summary of Proposals for This Hearing

We have an interest in the proposals being heard at this hearing and are the proponents of proposals three through nine.

Proposals 3, 4, 6 and 7 deal with our concern that performance standards in the Western Order are too permissive. These standards are causing such a reduction the blend price that milk production in the geographic area of the Order where Class I sales are the greatest is declining at an alarming rate. As this occurs the costs to serve the market increase and will ultimately drive up consumer costs. Proposal 6 deals with this directly by reducing the amount of milk that can be pooled by a handler on the Order. Proposals 3, 4 and 7 support the desired action called for by Proposal 6.

Proposal 8 addresses a situation where the cost of serving the Class I market is being borne disproportionately in the market. Specifically we seek to have all producers bear a greater share of the cost of assembling and balancing the Class I supply and also bear a greater proportion of the cost of transporting milk to Class I handlers.

Proposals 9 and 10 deal with the "open pooling" of large volumes of milk from locations distant to the market. Milk distant to the market needs to have additional performance requirements that are workable and consistent system wide with Federal Order policy. We advance proposal 9 and have no opposition to Proposal 10 and would not oppose the Secretary adopting it in addition to our own proposal.

Proposals 1 and 2 address similar concerns in Federal Order 124. We have the same position there as in we take in Order 135.

Proposals 6, 11, 12, 13 and 14 deal with the proprietary bulk tank handler provisions, which cause severe concerns in the market. A simple measure of the level of concern is to note that this issue generated five different proposals – the most of any issue to be heard. The concern here is the ability of industry to be certain that all handlers are paying minimum prices. Our position is to eliminate the provision all together. We feel any and all milk supplies that perform and pool on the Order can easily be accommodated within the remaining provisions and not cause any concerns as to minimum payments.

Proposal 15 is an attempt to clarify the dairy farmer for other market provisions. We support the intent of this proposal.

Proposal 16 is an attempt to clarify the ability of handlers to divert milk from the market. We support the intent of this proposal.

With regard to all proposals and the testimony and evidence that will be entered to support them, there will always be a tension between desire of each party here to ask questions about the data presented and the confidentially of such information to each individual business entity. We respect the right of each party, including ourselves, to decide what those limits ought to be and to proceed accordingly.

Proposals 1 & 2 and 9 & 10

With regard to Proposals 1 and 2 and 9 and 10 we note that the underlying issue is not just a local Order 135 issue. We have concerns identical to those expressed by the other proponents here and in the Central, Mideast and Upper Midwest and Pacific Northwest Federal Orders. There are volumes of milk being pooled but not performing for the market in a reasonable manner. We find this practice detrimental to our members, our customers and the entire Federal Order system.

Organizations, including DFA, have moved quickly to take advantage of these changes in Order rules effective January 1, 2000. Indeed, in the competitive dairy economy if a competitor makes a pooling decision that results in increased funds one must attempt to do the same or face a more difficult competitive position. Individual organizations can only "unilaterally disarm" at their own peril. It is our responsibility to maximize all of the opportunities afforded by the Order system to secure funds for DFA members.

That said, we think this process of extensive distant market open pooling is inconsistent with Federal Order policy and clearly disparaged in the Reform record. We have presented proposals, and testimony supporting our proposals, in hearings held in the Upper Midwest, Mideast and Central Orders. We are seeking solutions that are consistent and in line with Federal Order principles system wide.

The key issue, however, in our view, is not the simplistically posed banning of "double dipping." What needs to be determined is what level of performance should be required to share in the blend price. Opponents of our proposal characterize it as "pooling by zip code". This characterization is an attempt to divert attention from the real issue of requiring "performance" to define pooling. It is not important where "non performing" milk originates but that all milk meets reasonable and fair "performance standards" if it is to share in the blend price.

DFA members and their non-DFA neighbors, as they investigate why their blend price is lower than they expect, ultimately discover that the utilization on their Order is lower than it used to be. They soon figure out that large volumes of milk are being pooled on the Order but rarely if ever perform for the Order as their milk does. They question the fairness and equity of this practice. We note that they question not only DFA staff but also Dairy Programs staff persons. The Market Administrators in Orders 1, 5, 7, 30, 32, 33, 124, and 135 have all related similar discussions with producers about this topic to me. Producers' questions become even more difficult to answer when they come to understand that if the Order were not in place these "non performing milk supplies" would likely not supply the market because they could do so only at a negative or low return.

They have asked enough questions to understand "double dipping" knowing that it means drawing funds from both the Federal Order pool and the California State Order pool at the same time and on the same volume of milk. They have noted to us that it sounds like, "getting paid twice for coming to work once"! They agree with our view that it is basically unfair and should be corrected.

Producers also have come to realize that milk which pools without performing is like, "getting paid but never coming to work at all" and that, they tell us, is even a bigger and more widespread problem than "double dipping" and deserves to be corrected. They ask us why the Secretary seemed to ignore this in the Order 30 decision and we cannot provide a reasonable answer. Frequently they see the solution to the issue as having no Order at all.

Our customers ask about local milk supplies "going out of business" or "seeking other markets" where the blend price is higher. They have come to understand that blend prices "at home" are lower because there is a lot of milk being pooled on the Order that doesn't perform and did not "used to be there".

Our customers are beginning to understand that the supply to replace the local milk that goes out of business (or to the customer in the adjoining Order) will come from farther away and cost more to deliver. That means either consumer costs go up or their margins go down. As they investigate the details they too realize that much of this "non performing milk" would never move in the manner it does absent an Order due to negative or poor returns and that the problems it causes would not occur. So they too ask – why do we need the Order!

From a regulatory perspective the central issue in each case is the interface between the pricing surface, altered by Federal Order Reform (Reform) and the pooling provisions found in each Order. To deny this is to ignore the facts! Those relationships were changed by Reform. The link between performance and pooling was altered and needs review.

The Reform Decision noted that:

> Although not required by the 1996 Farm Bill, the legislation provided authorization for the Secretary to review the Class I price structure as part of the consolidation of the orders including the consideration of utilization rates and multiple basing points for developing a pricing system. In any event, the consolidation of orders requires the review of the pricing system because historically, Class I pricing provisions, as well as other Federal order provisions, have been reviewed primarily on an individual market basis. The reform effort provides the opportunity to consider and establish a nationally coordinated Class I pricing surface that uses location adjustments to the differential levels to price milk for fluid use in every county in the United States.

63 Fed. Reg. 16108 (April 2, 1999).

This discussion accompanies the discussion on the Class I Pricing structure and notes the authorization and instruction provided by Congress to the Secretary. We agree that with regard to the Class I pricing surface established by Reform the relationships between milk buyers is well structured and meets the criteria intended.

However this price surface also has a relationship to producer blend prices and herein is the disconnect. Many of the former Orders recognized the relationship of distance to the market and the value of milk and we find nowhere in the record any directions from Congress to change these relationships and no explanation by the Secretary for the results that have accrued from the interface of this price surface with the more permissive pooling provisions. Indeed had these types of results been detailed in the "pre final rule" decisions submitted to the industry for comment by the Secretary the industry would have argued against them just as loudly as it is now.

Provisions generally termed "zone out pricing" were a part of many Orders prior to Reform. In the former Great Basin Order sections 1139.52 described the construction of the "zone outs" and how milk values were reduced based on the distance away from, "the zones specified in paragraph (a) of this section". Section 1139.75 describes the interface between these distance related pricing reductions and payments for milk clearly linking the relationship between distance and milk value. In all cases the price relationship between milk produced within the Order boundary and that from outside the Order boundary was affected by a formula that reduced the producer price in a direct relationship to the distance from the market.

This pattern is no different within the Order boundaries as milk more distant from consumption centers has a lower value. In the Western Order milk supplies in Idaho carry a differential of $1.60 versus the $1.90 in the consumption center of Salt Lake City. No one complains about this because it is well rooted in economic theory and has been accepted Federal Order practice to recognize the location value of milk.

The following statements taken from the Final Rule seems to reflect this thought also:

> Because milk value varies by location, it is appropriate, in using a classified pricing plan, to establish Class I prices that reflect these location value differences.
>
> 63 Fed. Reg. 16117 (April 2, 1999)

The Final Rule went on to develop specific criteria to determine whether or not the Class I pricing surface met the objective. However, without any substantial discussion, the resulting price surface was applied to producer blend prices. When the Class I criteria are reviewed as criteria for *producer* location prices, the problems are clear. The Class I criteria used were:

> Finally, a Class I price structure must meet the requirements of the AMAA. The broad tenet of the AMAA is to establish and maintain orderly marketing conditions. For the Federal milk order program, this is achieved primarily through classified pricing and pooling. With regard to pricing, it is recognized that the objective of the AMAA is to stabilize the marketplace with minimum prices, not to set market prices. **The pricing criterion of the AMAA, § 608c(18), requires prices that are reflective of economic conditions affecting supply and demand for milk and its products. In this regard, consideration was given to whether the proposed prices would generate sufficient revenue for producers necessary to maintain an adequate supply of milk.** Equally important, the prices need to provide equity to handlers

with regard to raw product costs as required by § 608c(5) of the AMAA. (emphasis added)

Evaluation Criteria

In evaluating the final Class I pricing options, nine performance criteria, based upon regulatory objectives and requirements of the AMAA, were again used as they were in the PR. The evaluation criteria are divided into two categories, objective and administrative. The objective criteria are as follows:

1. Ensure an adequate supply of milk for fluid use. Class I price levels need to provide a sufficient price signal to maintain an adequate supply of milk for fluid use. This supply level can be achieved through either the movement of milk to where it is needed, increased production, or some combination of both.

2. Recognize quality (Grade A) value of milk. Grade A milk is required for fluid use. Additional costs of obtaining and maintaining Grade A status need to be reflected in Class I prices.

3. Provide appropriate market signals. A Class I price should send timely signals to the market regarding supply/demand conditions.

4. Recognize value of milk at location. Basic economic theory, validated by actual market observations and University-based research, affirms that milk for Class I use has a different value at different locations. This value needs to be reflected in the Class I price in order for the system to recognize and resemble the market rather than interfere with the market.

5. Facilitate orderly marketing with coordinated system of prices. A system of Class I prices needs to be coordinated on a national level. Appropriate levels of prices will provide alignment both within and among marketing areas. This coordination is necessary for the efficient and orderly marketing of milk.

> 6. <u>Recognize handler equity with regard to raw product costs</u>. Appropriate levels of Class I prices provide known and visible prices at all locations thereby ensuring that handlers are able to compete for available milk supplies on an equitable basis.

63 Fed. Reg. 16109-16110 (April 2, 1999).

We would hold that Criteria 3, 4, and 6 do not meet the test for producer location prices.

With regard to **Criteria 3. – an appropriate market pricing signal**, we would contend that producers are responding to low prices by going out of business – the ultimate production cutback. However the low price they are responding to, the price derived from their Order return, is one that is artificially depressed by an over supply of milk pooled on the Order – that would not be there except for the change in the price surface instituted by Reform **and** the overly permissive pooling requirements that accompanied it. No objective review of market conditions can term this an appropriate price signal. This is exactly the situation described in the Tentative Final Decision for Order 30:

> However, it is just as necessary to safeguard against excessive milk supplies becoming associated with the market through the diversion process. . . . Associating more milk than is actually part of the diverting plants milk supply only serves to reduce the potential blend price paid to dairy farmers.

67 Fed. Reg. 7051 (February 14, 2002).

No one can deny that blend prices in the Upper Midwest, Mideast, Central, Pacific Northwest, and Western Orders have been lowered since the inception of Federal Order Reform by milk pooled on the Order that is not an actual part of the diverting plant's milk supply. To this extent, **Criteria 3** is not being met by the current operation of the Reformed Orders.

Criteria 4 states that the pricing surface should recognize the value of milk at location. Again from the perspective of handler prices (covered by Criteria 5.) we think the criteria are satisfied. But from the standpoint of producer prices it fails mightily. Milk that is nearby to the market has a greater value than milk far away. It can deliver sooner and at less cost; it is likely to meet freshness and quality considerations better and it carries a lower balancing cost. It also adds the intangible value of "being from local farms" and that has consumer appeal.

There can be no denying that current producer prices do not recognize this factor. The order assigns an absolute value to a milk supply – the relationship between the two county differentials. But the real world truth is that a milk supply has a relative value – and one of those relative values is the distance between the production point and the processing point.

Every Order recognizes this, as there are "differentials" within the Order based on mileages between production and processing locations. The detailed explanations of the models used in the Reform process that underlie the pricing surface are mathematical derivatives of these distance equations.

The value to a Salt Lake City processor of milk produced from farms in Utah is greater than that of milk produced in California. The same is true for milk buyers in Minneapolis and milk supplies in California or milk buyers in Columbus Ohio and milk supplies in Wisconsin. The difference in these values in most cases is far more that the difference in the Class I differentials in the pricing surface.

The "zone out" provisions used by many pre Reform Orders exemplify this principle. They were instituted in those Orders for exactly the reason that Criteria 4 spells out. Every handler testifying here would agree that they would always choose the closest milk supply to their plant (assuming equal quality parameters) because it would be the most cost effective one. Equally so no supplier would seek out a distant market if the return was lower than the local one. Both of these factors recognize the location value of milk and current Order provisions should also recognize them. Indeed Criteria 4 indicates they were designed to do so.

Criteria 6 - **Recognize handler equity with regard to raw product costs** - also fails the post Reform review. Open pooling causes different handlers to have different costs. Some handlers gain additional revenue streams not available to all due only to their ability to exploit the provisions better than others. This is why handlers evaluate the "open pooling" opportunities and enter into them if they can. This fact has been amplified in each hearing this year and will likely be done here also. Some processors face additional costs in maintaining a milk supply because of the need to pay additional premiums to make up for lost blend dollars in order to keep producer in business. Others have to pay higher premiums to make up for wider than normal blend price spreads between Orders.

We do not believe that the "open pooling derby", the result of this price surface for producer milk, was anticipated by the authors of Order Reform. Additionally, each Order has precise terms that a supplier must follow in order to share in the blend proceeds. These provisions are known by the industry as "performance standards". They require that milk supplies deliver to and be available for the market in order to be

able to share in the returns form the market. This concept is explained, defended and endorsed in the Final Rule as follows:

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

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

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

"Open pooling" also discussed in the Reform Decision Final Rule was rejected with the following analysis:

> A suggestion for "open pooling," where milk can be pooled anywhere, has not been adopted, principally because open pooling provides no reasonable assurance that milk will be made available in satisfying the fluid needs of a market.

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

It is precisely the results foreseen but rejected by these two paragraphs that are causing us to discuss this issue today. Volumes of milk are being pooled on the Order that do not and will never perform for the Order in a manner similar to that of local milk. Distance and economics combine to prevent it. Yet due to current provisions they continue to draw down blend values and cause the exact type of disorderly marketing conditions described by Criteria 3, 4, and 6 that were to be avoided.

This is clearly seen by reviewing data published in the Final Rule on forecasted post Reform Order Class I utilization and the actual experience.

Exhibit __________ Table 1 details those expectations. These are the expected Class I utilizations as published in the Final Rule with the actual annual average results for each Order published by each Market Administrator for calendar years 2000 and 2001.

In CY 2000, the first year of Reform, when because of the narrowest time lag one would expect the forecast to have the best chance of accuracy, no Order even equaled its anticipated utilization. All Order Class I utilizations were below forecast. Excluding the Florida Order the closest estimate was a 4.6% miss in the Pacific Northwest Order and the shortfall among the Orders that have had hearings on this issue range from -19.7% in the Central Order, to -11.5% in the Mideast Order, to -6.6% in the Upper Midwest Order, to -4.6% in the Pacific Northwest Order and -7.5% in the Western Order. The scenario in CY 2001 worsened for many of the Orders and in no case did it equal or exceed the projections.

The point here is not to disparage the forecasting ability of USDA. I too do forecasts and understand that changes in assumptions always affect the outcome of projections. But clearly the end results are not matching the anticipated projections. Equally clear the Criteria are not being met and remedies need to be instituted.

The remedies proposed here have been proposed and discussed in prior proceedings. Again, we have no opposition to proposals 1 and 10 and would support their institution in both Orders. However, they do not go far enough to provide for other possibilities that have been demonstrated to exist. We can clearly see that the result sought by proposals 1 and 10 do not completely solve the concerns of our members and customers in other areas.

For that reason we offer proposals 2 and 9 for Orders 124 and 135.

Proposal 2 for Federal Order 124

Proposal 2 establishes performance standards for milk pooled on the Order from locations originating outside of the Order boundaries. It is justified on the following grounds:

1) Proposal 2 would achieve similar results to the outcome from "zone out" provisions found in the former Order 124. (Sections 1124.52 and 1124.74)

2) The concept is already in place in Federal Order 1 (Northeast Order) and was in place in Federal Order 2 prior to Reform. So it has already stood the test of time.

3) Enactment of Proposal 1 alone could migrate the problem from pooling California milk to other Orders. A more uniform application to all Orders, such as

expanding the Order 1 provisions, would solve or alleviate greatly this concern and is a superior choice. We understand that milk from California was reported in Order 33 in the March pool. It is a better solution to identify the issue and institute the remedy than to have to resort to future hearings to do so. Hearings are costly and it takes a long time to get a notice, a hearing, a recommended and final decision approved and implemented.

4) It recognizes the principles of both a marketing area and the performance aspect of market wide pooling.

5) It has a measurable economic consequence that is in line with existing Order principles that if the economics are positive regulation does not prohibit pooling. Yet it provides a reasonable and defensible hurdle for distant milk to overcome. As shown in **Exhibit ______ Table 2**, the provision that each state must be treated individually and perform as a stand alone entity under the same 20% performance standard as any other in area milk supply, provides a reasonable economic test of whether or not the market needs the milk supply for local Class I use. The economic return must be earned in the market place and not on the pooling report. At the 20% shipping level and the same PPD and delivery cost there are months of negative returns and some months of positive ones thus raising the hurdle of economic risk. By requiring performance like other local milk supplies the intangibles of rejected loads, bad weather and a variable demand from bottlers makes the return less dependable and the risk greater - but more like the decision making that local milk must pass under every day.

For the 26-month period January 2000 – February 2002 the PPD for Order 124 has averaged $1.48. If milk were to deliver regularly from California sources to Portland Oregon - Class I markets, it would earn a negative return of $0.23/cwt from Fortuna CA or a negative return of $1.30/cwt from Turlock CA. Certainly no one want that opportunity. However, by attaching to a local milk supply and then diverting a much higher return could be earned without achieving a reasonable performance standard. No accurate measure of this return is possible because of the many possible combinations. However, application of our proposal would reduce the return somewhat and in some months would cause it to be negative. This would force a more economic measure of whether or not the milk could associate and perform for the market. The performance would be based on the delivery of 20% of the volume, the same amount that a local milk supply would deliver. In the specific case of milk supplies originating in California, proposal 1 would intervene and dictate the final conclusion.

For the same 26-month period, a milk supply from Idaho would lose $1.77/cwt if it performed daily for the Class I market. Again, no one would seek that market. However, the institution of our proposal would require a 20% performance level and a shipment for at least six months out of twelve per the free ride provisions. This would establish a more reasonable measure for performance.

Ironically the provisions proposed in Seattle for Order 124 would place no limits on the ability of a supply plant to pool Idaho milk. No further qualifications were established and no changes were proposed to deal with the free ride period. At least the DFA proposal would establish some additional measure of performance for these milk supplies.

6) The individual state unit concept is an adequate and reasonable safeguard for a lower utilization Order in which tighter diversion limitations or supply plant restrictions might otherwise cause hardship. Furthermore the "no unit" provision prevents in area milk from qualifying distant milk. It also discourages distant milk from seeking a large volume supply from a nearby state and forming a unit to ease the performance requirement. We find schemes similar to this occurring in other Federal Orders and they disrupt orderly marketing practices there. We wish to avoid their spread.

7) The counties included in the "non unit" marketing area include those now present in the Order.

Thus, the language we would propose for Order 124 would be amend the pool supply plant and producer milk definitions to require that milk from specified locations be reported by individual state units, each of which would be subject to the performance standards applicable to supply plants and producer milk by adding a new paragraph (c)(5) in § 1124.7 and redesignating § 1124.13 paragraph (e)(5) as (e)(6) and adding a new paragraph (e)(5) to read as follows:

§ 1124.7 Pool Plant.

* * * * *

(c) * * *

(5) If milk is delivered to a plant physically located outside the State of Washington or the Oregon counties of Benton, Clackamas, Clatsop, Columbia, Coos, Crook, Curry, Deschutes, Douglas, Gilliam, Hood River, Jackson, Jefferson, Josephine, Klamath, Lake, Lane, Lincoln, Linn, Marion, Morrow, Multnomah, Polk, Sherman, Tillamook, Umatilla, Wasco, Washington, Wheeler, and Yamhill or the Idaho counties of Benewah, Bonner, Boundary, Kootenai, Latah, and Shoshone by producers also located outside the area specified in this paragraph, producer receipts at such plant shall be organized by individual state units and each unit shall be subject to the following requirements:

(i) Each unit shall be reported separately pursuant to § 1124.30.

(ii) At least the required minimum percentage and delivery requirements specified in § 1124.7(c) and (c)(1) of the producer milk of each unit of the handler shall be delivered to plants described in § 1124.7(a) or (b), and such deliveries shall not be used by the handler in meeting the minimum shipping percentages required pursuant to § 1124.7(c) **and (c)(1)**; and

(iii) The percentages of §1124.7(c)(**5**)(ii) are subject to any adjustments that may be made pursuant to § 1124.7(g).

* * * * *

Note:

1. We have added "and (c) (1) to further specify our intent.

2. We have made a text change to our proposal reflecting the renumbering of paragraphs.

§ 1124.13 Producer Milk.

* * * * *

(e) * * *

(5) Milk receipts from producers whose farms that are physically located outside the State of Washington or the Oregon counties of Benton, Clackamas, Clatsop, Columbia, Coos, Crook, Curry, Deschutes, Douglas, Gilliam, Hood River, Jackson, Jefferson, Josephine, Klamath, Lake, Lane, Lincoln, Linn, Marion, Morrow, Multnomah, Polk, Sherman, Tillamook, Umatilla, Wasco, Washington, Wheeler, and Yamhill or the Idaho counties of Benewah, Bonner, Boundary, Kootenai, Latah, and Shoshone. Such producers shall be organized by individual state units and each unit shall be subject to the following requirements:

(i) Each unit shall be reported separately pursuant to § 1124.30.
(ii) For pooling purposes, each reporting unit must satisfy the shipping standards specified pursuant to § 1124.7(c) and (c)(1), and such deliveries shall not be

used by the handler in meeting the minimum shipping percentages required pursuant to § 1124.13(e)**(1)**; and

(iii) The percentages of §1124.13(e)(5) are subject to any adjustments that may be made pursuant to § 1124.13(e)(6).

Note:

We have added some technical changes to the proposed language to further specify our intent.

Proposal 9 for Federal Order 135

Proposal 9 establishes performance standards for milk pooled on Order 135 from farms and plants located outside of the Order boundaries.

1) This concept is already in place in Federal Order 1 (Northeast Order) and was in place in Federal Order 2 prior to Reform. So it has already stood the test of time and legal challenge.

2) Enactment of Proposal 10 alone could migrate the problem from pooling California milk to other Orders. A more uniform application to all Orders, such as expanding the Order 1 provisions, would solve or alleviate greatly this concern is a superior choice. It is a better solution to identify the issue and institute the remedy than to have to resort to future hearings to do so. Hearings are costly and it takes a long time to get a notice, hearing, recommended and final decision implemented.

3) It recognizes the principles of both a marketing area and the performance aspect of market wide pooling.

4) It has a measurable economic consequence that is in line with existing Order principles that if the economics are positive regulation does not prohibit pooling. Yet it provides a reasonable and defendable hurdle for distant milk to overcome. As shown in **Exhibit ______ Table 3**, the provision that each state must be treated individually and perform as a stand alone entity under the same 30% performance standard (as offered in Proposal 5) as any other in area milk supply, provides a reasonable economic test of whether or not the market needs the milk supply for local Class I use. The economic return must be earned in the market place and not on the pooling report. At the 30% shipping level and the same PPD and delivery cost there are months of negative returns and some months of positive ones thus raising the hurdle of economic risk. By requiring performance like other local milk supplies the intangibles of rejected loads, bad weather and a variable demand from bottlers makes the return less

dependable and the risk greater - but more like the decision making that local milk must pass under every day.

For the 26-month period January 2000 – February 2002 the PPD for Order 135 has averaged $1.12. If milk were to deliver regularly from California sources to the Salt Lake City Utah - Class I markets, it would earn a negative return of $1.67/cwt from Turlock CA. Certainly no one want that opportunity. However, by attaching to a local milk supply and then diverting a much higher return could be earned without achieving a reasonable performance standard. No accurate measure of this return is possible because of the many possible combinations. However, application of our proposal would reduce the return from $1.12/cwt to $0.60/cwt and in some months would cause it to be negative. This would force a more economic measure of whether or not the milk could associate and perform for the market. The performance would be based on the delivery of 30% of the volume, the same amount that a local milk supply would deliver. In the specific case of milk supplies originating in California proposal 1 would intervene and dictate the final conclusion.

5) The individual state unit concept is an adequate and reasonable safeguard for a lower utilization Order in which tighter diversion limitations or supply plant restrictions might otherwise cause hardship. Furthermore the "no unit" provision prevents in area milk from qualifying distant milk. It also discourages distant milk from seeking a large volume supply from a nearby state and forming a unit to ease the performance requirement. We find schemes similar to this occurring in other Federal Orders and they disrupt orderly marketing practices there. We wish to avoid their spread.

The counties included in the "non unit" marketing area include those now present in the Order.

Thus, the language we would propose for Order 135 amend §§ 1135.7 and 1135.13 to establish state unit standards for milk from specified supply locations and add a new paragraph (c)(3) to the pool supply plant definition in § 1135.7, redesignate § 1135.13 paragraph (d)(6) as paragraph (d)(7) and add a new paragraph (d)(6) to the producer milk definition to read as follows:

§ 1135.7 Pool plant.

* * * * *

(c) * * *

(3) If milk is delivered to a plant physically located outside the Idaho counties of Ada, Adams, Bannock, Bear Lake, Bingham, Blaine, Boise, Bonneville, Camas, Canyon,

Caribou, Cassia, Elmore, Franklin, Gem, Gooding, Jefferson, Jerome, Lincoln, Madison, Minidoka, Oneida, Owyhee, Payette, Power, Twin Falls, Valley and Washington or the Nevada Counties of Elko, Lincoln and White Pine or the Oregon counties of Baker, Grant, Harney, Malheur, and Union or the state of Utah or the Wyoming counties of Lincoln or Uinta by producers also located outside the area specified in this paragraph, producer receipts at such plant shall be organized by individual state units and each unit shall be subject to the following requirements:

(i) Each unit shall be reported separately pursuant to § 1135.30.

(ii) At least the required minimum percentage and delivery requirements specified in section § 1135.7(c) and (c)(1) of the producer milk of each unit of the handler shall be delivered to plants described in § 1135.7(a) or (b), and such deliveries shall not be used by the handler in meeting the minimum shipping percentages required pursuant to § 1135.7(c) **and (c) (1)**; and

(iii) The percentages of § 1135.7(c)(3)(ii) are subject to any adjustments that may be made pursuant to § 1135.7(g).

* * * * *

<u>Note:</u> We have added "and (c) (1)" in Section 1135.7(c)(3)(ii) to further specify our intent.

§ 1135.13 Producer milk.

* * * * *

(d) * * *

(6) Milk receipts from producers whose farms that are physically located outside the Idaho counties of Ada, Adams, Bannock, Bear Lake, Bingham, Blaine, Boise, Bonneville, Camas, Canyon, Caribou, Cassia, Elmore, Franklin, Gem, Gooding, Jefferson, Jerome, Lincoln, Madison, Minidoka, Oneida, Owyhee, Payette, Power, Twin Falls, Valley and Washington or the Nevada Counties of Elko, Lincoln and White Pine or the Oregon counties of Baker, Grant, Harney, Malheur, and Union or the state of Utah or the Wyoming counties of Lincoln or Uinta. Such producers shall be organized by individual state units and each unit shall be subject to the following requirements:

(i) Each unit shall be reported separately pursuant to § 1135.30.

(ii) For pooling purposes, each reporting unit must satisfy the shipping standards specified pursuant to § 1135.7(c) and (c)(1), and such deliveries shall not be used by the handler in meeting the minimum shipping percentages required pursuant to § 1135.13(**d2**); and

(iii) The percentages of § 1135.13(d)(6) are subject to any adjustments that may be made pursuant to § 1135.13(d)(7).

Note: We have inserted "d2" versus "c2" in section 1135.13(d)(6)(ii) in order to refer to the correct section.