

**Testimony Of Carl Conover  
On Behalf Of Dean Foods Company  
d/b/a Meadow Gold Dairies In Support Of Proposals 11, 12, and 13**

*The PBT Handler Problem – The Reason Proposals 11 and 13 or 12 Are Needed*

My testimony is on behalf of Dean Foods Company doing business as Meadow Gold Dairies. The intent of Meadow Gold's Proposals 11 and 13, or 12 is to insure that all pool handlers regulated by federal Milk Order 135 pay at least the minimum class prices prescribed by the order for milk received at their plant and disposed of as fluid milk or milk products. Uniformity among handlers is required by section 608c(5)A of the Agricultural Marketing Agreement Act (the "AMA Act") which requires that prices established under a Milk Order must be uniform to all handlers except for specific and limited exceptions that are not applicable here. It has long been recognized by the Department that uniformity is meaningful only if it applies to all of the milk received at the plant.

As the 65 year history of milk regulation in this country shows if there is a crack in the system and an economic incentive for it to do so, milk will soon find its way through that crack. This proposal is aimed at repairing one such crack. A regulated handler operating a pool plant in this market may receive milk from a Proprietary Bulk Tank handler and not be required to pay the minimum order prices for such milk. This creates an untenable situation among competing handlers.

Certainly a major cornerstone of the milk order program, one that has allowed it to withstand attacks from many quarters, is the principle that the minimum prices are uniform to all parties. Without that requirement, the program would not have endured.

The provisions of Order 135 allow a person who operates a plant that produces milk products (Class II, III, and IV), and operates a truck that picks up the milk of producers to be a regulated handler and to participate in the pool under certain circumstances. Such a person is a Proprietary Bulk Tank Handler (hereafter "PBT handler") and as such is accountable to the pool

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for producer milk delivered in his truck to a pool plant or to a non-pool plant including his own. In order to qualify the milk going to the non pool plant for pool participation, a small portion of the milk must be delivered to a pool distributing plant. On this Order the PBT handlers are Class III plants. When Class III is eligible for a pool draw it is equivalent to the Producer Price Differential (hereafter "PPD"). Thus, on the milk delivered to the non pool plant and processed into milk products the PBT handler will generally receive a pool draw equal to the PPD. For 2000 and 2001 that value averaged \$1.45 and \$.90 per cwt, respectively. See Exhibit 6, Table 5 of the Market Administrator's Compilation of Statistical Material Federal Milk Marketing Order No. 135 Western Marketing Area (April 2002). This pool draw is the PBT handler's incentive to ship to a pool distributing plant to qualify its milk for pooling. The pool draw is money available to the PBT handler to procure a supply of milk in competition with other handlers that must pay at least the blend price.

In order to obtain this benefit, the PBT handler needs a pool distributing plant to serve as an outlet for a small portion of its milk. Since the pool plant is providing a service of sorts to the PBT handler by electing to take that milk, the pool distributing plant has bargaining power in the determination of price. It is not uncommon for pool distributing plants to charge for this service.

Indeed, this happens in other markets and could even happen in other transactions involving cooperatives on this Order. However, in other markets (or transactions involving cooperatives on this Order) there are regulatory and/or economic constraints on the ability of the pool distributing plant to negotiate a price that is lower than the classified price. For example, when cooperatives sell raw milk to the handler for their account, that milk is treated as producer milk received at the plant and must be accounted for by the plant as such. Also, when a supply plant sells raw milk, whether by diversion or transfer, even though the supply plant is the receiving handler, the higher shipping percentages associated with supply plants make it uneconomic for the supply plant to agree to lower than class prices.

In this market, however, where the truck operator is defined as a handler and the shipping percentage is very low, the situation is different. Here is an illustrative example of the economic

incentives that entice PBT handlers to accept less than the Class I price on sales to pool distributing plants. If the pool draw is say one-dollar, PBT handlers have a rational economic incentive to share up to 99-cents to get the benefit of 1-cent because they end up with 1-cent more per hundredweight than they would have without the cooperation of the pool distributing plant. Thus, without the requirement of minimum prices, an agreement to share in the benefits of the pool draw can result in prices that will be less than order minimums.

Such transactions provide pool distributing plants involved in such transactions with a significant competitive advantage over other pool distributing plants. The benefit to the pool distributing plant could be quite large. In fact, both plants would have the incentive to share in the benefits of the pool draw. As discussed above, the average Order 135 pool draw for cheese plants was \$1.45 and \$.90 during 2000 and 2001, respectively. Using the data for April 2001 from Exhibit 10, Table 1 of Statistical Material Prepared at the Request of Charles M. English, Jr. (April 2002) as an example, and assuming hypothetically that the 3 PBT handlers for that month each represented 1/3 of the volume pooled and that each shipped an equal volume to Class I distributing plants, then each PBT pooled 28,841,576 pounds and each Class I distributing plant received 1,523,200 pounds (we conclude that only a minimum amount of non-Class I milk is processed at the Class I distributing plants that are known as “juggers”). The PPD for April 2001 was \$1.35 on the non-Class I volume (Class III) so that the pool draw for each PBT in this hypothetical would be \$368,798 (\$1.35 times 273,318 cwt). If the PBT handler shared only \$24,371 (6.6%) of this PPD with the Class I distributing plant, the benefit to the Class I distributing plant would equal the \$1.60 Class I differential on this milk.

#### ***Specific Proposals To Address The PBT Handler Problem***

Without specific language in the order to require minimum order payments by specific handlers receiving or handling producer milk from PBT handlers, the administrator has taken the position that it will not enforce order prices. The purpose of proposal #s 11 and 13 or 12 is to provide the Market Administrator with Order language that will make clear his obligation to

ensure that minimum prices are being paid by pool distributing plants participating in these transactions.

The language as set forth in proposal #11 provides that the milk delivered by a PBT handler to a pool plant will be producer milk at the pool plant. As such the pool plant operator will be fully accountable to the pool for the value of the milk and for paying the producers whose milk was delivered to the pool plant. The pool plant operator would be responsible for paying the producers the order price, but could for the convenience of a single payment to each producer, hand the value over to the PBT handler for distribution to the producers.

The order of the proposals in the notice needs explanation. Proposal #s 11 and 13 should be viewed together. Together they make clear that the pool distributing plant operator is responsible for paying the producers and accounting to the pool for the minimum prices. Under this language the Market Administrator has authority to verify the payments to the producer settlement fund and to producers as he has on all other transactions between handlers and producers.

Proposal #12 is offered as an alternative and would not change the current flow of funds but would specify that the pool plant is obligated to pay the PBT handler at least the order prices. Statutory authority for such a provision in order to enforce minimum prices for raw milk can be found in Sections 608c(5)(C) and 608c(7)(D) of the Agricultural Marketing Agreement Act.

Indeed, section 608c(7)(D) permits the Secretary to add terms in marketing orders that are “[i]ncidental to, and not inconsistent with, the terms and conditions specified in subsections (5) to (7) of this section and necessary to effectuate the other provisions of such order.” With a gap in the uniform application of order prices as I have suggested, such a provision is “necessary to effectuate the other terms of the order”, “incidental to” and certainly “not inconsistent with” existing order provisions or the intent of the AMA Act.

Moreover, the AMA Act expressly authorizes the Secretary to provide a method for making adjustments in payments among handlers to ensure that handlers are paying the full minimum price for their milk purchases. Section 608c(5)(C) authorizes the Secretary to “provide

a method for making adjustments in payments, as among handlers (including producers who are also handlers), to the end that the total sums paid by each handler shall equal the value of the milk purchased by him at the prices fixed in accordance with paragraph (A) of this subsection.”

I think some comment on proposal #5 would be appropriate since adoption of it would eliminate any purpose for our proposals #11, 12, and 13. The provision for a PBT handler was introduced into the predecessor Southwestern Idaho Eastern Oregon Order at its inception over 20 years ago. The justification given in the decision was the absence of traditional supply plants in the marketing area and the desire to avoid imposing the cost of upgrading to Grade A facilities on existing manufacturing plants. The rulemaking decision implementing the provision suggested that the PBT handler concept was expected to facilitate the pooling of necessary market reserves in the absence of supply plants. Since the current order has manufacturing plants that are now capable of serving as supply plants and since USDA has implemented diversion provisions to accommodate the handling of market reserves from supply plants it is not a big step to conclude that the PBT handler provision is no longer necessary. As a result of the 1981 Decision, the Department has effectively granted manufacturing plants in the Western Order privileges and benefits similar to, and with respect to shipping percentages better than, that of a 9(c) handler without the corresponding obligation of collecting the minimum classified price. It is not surprising, therefore, that notwithstanding the existence now of a supply plant provision that permits diversions as qualifying shipments that no manufacturing plants has chosen to use that option. Therefore, while we have advocated the remedy proposed in proposals 11 and 13 or 12, Meadow Gold would not object to Proposal #5 if the Department in its wisdom determines that the problem with which Meadow Gold is concerned can best be remedied by removing the outdated and unnecessary PBT handler provision altogether.

### ***Double Pooling***

Finally, I wish to comment on Proposal 10 and although Meadow Gold does not have plants in Order 124, I would like my testimony to be considered as support for Proposal 1 as modified consistent with my proposed modifications to Proposal 10.

Meadow Gold believes that the Secretary should adopt a provision that would prevent double pooling by preventing milk from qualifying as producer milk on Order 135 while also participating in a market wide pool administered by a state. Double pooling creates disorderly marketing conditions. The pooling of milk that is not actually available to serve the Class I market because it is serving another market draws down the blend price for producer milk that is actually serving or available to serve the Class I market and is disruptive of normal economic signals. Moreover, pooling of milk that is used in non-fluid products assumes that such milk is a reserve supply for the market and is available to supply fluid distributing plants if needed. The same milk, obviously, could not be used to supply plants in another market while also being available to serve Order 135, regardless of whether that market is a federal or state market wide pool. It is therefore erroneous to presume that the same milk could be available simultaneously in more than one market and to use that as basis for sharing in more than one pool.

For this reason Federal order provisions have always, unless through oversight, been tailored to limit a producer to sharing in but one market order pool on the same milk. On occasion, when milk was reported and pooled on more than one market order, USDA auditors would disqualify the milk to the extent necessary to prevent double pooling.

While data measuring exactly how much milk from California is actually moved to Order 135 is not available, the California data in Exhibit 14, which is a Compilation of Official Documents of the California Department of Food & Agriculture, combined with my own

knowledge of milk receipts in the Western United States, suggests that almost all of the milk moved from California farms to non California plants can be accounted for as being received in Oregon, Nevada, and Arizona. Moreover, the Market Administrator's Analysis Of Hauling Charges And Producer Milk By Location And Size-Range Of Production (Exhibit 7) indicates that a substantial portion of milk reported on Order 135 is not actually moving to Order 135 plants. Pages 3 of Exhibit 7 demonstrates this pretty clearly. For the year 2001, it shows that per hundredweight hauling charges from Northern California into Southwestern Oregon averaged 66.51 cents, and hauling charges for Idaho milk serving Order 135 averaged 27.85 cents. Since the Idaho milk would be moving a shorter distance than the Northern California milk moving into Order 124, the smaller charge for Idaho milk makes sense since per hundredweight hauling charges necessarily increase with mileage. What does not make sense is that milk actually moving from South-Central California into Order 135 could be transported at a 30.55 per hundredweight charge. That rate is more consistent with a local haul rate. If all of the California milk being pooled on Order 135 was actually traveling the substantial distance required to reach a pool plant, the per hundredweight rate would have to be much higher.

Indeed, the Market Administrator's comments at page 2 of Exhibit 7 reinforce this conclusion by stating "California producers pooled on the Western Order in May 2001 are not a historical supply of producer milk for the Western Order. The California milk supply pooled on the Western Order is different than the milk historically pooled on the Pacific Northwest Order from Northern California." It follows from this evidence that a very small portion of the California milk pooled on Order 135 was actually received at Order 135 pool plants, and that instead that milk was shipped locally (as evidenced by the reported haul rates) and received at California plants thus making the same milk eligible for pooling through California's market

wide pooling program. In support of my conclusion that milk being received at a plant in California is participating in a state-operated order with market wide pooling, I rely in part on the prior testimony of California Department of Food & Agriculture Officials, Kelly Krug and Robert Horton from the Upper Midwest Pooling Hearing during 2001. See Exhibit 15. My prior knowledge of the California milk regulatory program when combined with my review of their testimony leads to this conclusion.

Double pooling is so troubling and inconsistent with Federal Milk Market Orders that the Secretary should address the issue immediately. This is particularly true since the problem is likely to become more pervasive upon final implementation of the Tentative Decision in the Upper Midwest, which will leave significant volumes of California milk that previously participated in the Upper Midwest pool while participating in the California program looking for a similar opportunity in marketing areas that have not adopted a provision prohibiting double pooling.

However, I believe the issue should be addressed with a modification of Proposal 10. No other proposal solves the problem of double pooling by California producers. The modification Meadow Gold supports was adopted by the Secretary in the Tentative Decision on Proposed Amendments to the Upper Midwest Order pooling provisions. *See* 67 Fed. Reg. 7040, 7053 (Feb 14, 2002) (the relevant change is reflected in the introductory language and (e) of amended § 1030.13). In Order 135, the provision would read as follows. At the beginning of the introductory language for the Producer milk definition, section 1135.13, insert “Except as provided for in paragraph (e) of this section,” and then insert new paragraph (e) which will read as follows “Producer milk shall not include milk of a producer that is subject to inclusion and

participation in a marketwide equalization pool under a milk classification and pricing program imposed under the authority of a State government maintaining marketwide pooling of returns.”

This proposal is designed to limit the pooling on Order 135 of only that milk that is being simultaneously pooled on another market wide pool. If milk from Western Montana, Western New York, Pennsylvania, if it adopts a market wide pooling program, or California is not priced and included in those pools, then it will remain eligible for pooling on Order 135. It is not the intent of this proposal to create a trade barrier or otherwise limit the movement or pooling of milk which does not obtain pooling benefits elsewhere. This proposal would not bar the pooling of milk that was actually moved to a pool distributing plant from a farm outside of the Order 135 marketing area, even if from California or any other state. Such milk in my view would not be included in any state operated market wide pool. I base this belief on the court decisions that found that states lack the power to regulate milk moving in interstate commerce. These are the very decisions that precipitated the passage of the Agriculture Marketing Agreement Act by Congress and the advent of Federal Milk Orders.