

**Prepared Testimony of
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Re: Proposals No. 3, 4, 6, & 7, "Preamble"

Federal Milk Market Order Hearing
Docket Nos. AO-368-A30; AO-380-A18; DA-01-08
April 16, 2002

My name is Daniel S. McBride. I am testifying on behalf of Northwest Dairy Association regarding the proposals which relate to pooling standards (Proposals 3, 4, 6, & 7). In earlier testimony I have introduced myself, as well as NDA and WestFarm Foods.

Before beginning my prepared testimony, on each of those proposals I would like to address several items that have come up during the first two days of this hearing.

Impact of "Reform". The so-called "Reform process" brought many changes to the Federal Order system. The people involved in this industry are an inventive group and have found many loopholes in the system that were quickly exploited. Part of the reason for this hearing is to deal with such issues, the most glaring of which are double dipping and pool loading (or distant pooling).

However, Reform also brought some very good things for producers. Among the most important of these is the "higher of III or IV" price mover for Class I. Consolidation of orders by definition put various previous pools together that had different Class I utilizations, thereby creating apparent "winners" and "losers". A classic example of this is the former Great Basin area that previous to Reform enjoyed a very enviable Class I utilization which was "watered down" by the combination of Utah and Idaho. If one were looking at only the Class I utilization, one can understand how Utah producers feel that they would have been better off if the map had been drawn differently.

However, the facts tell a different story.

The first thing that must be kept in mind is that even if the marketing area map had been redrawn to exclude the Magic and Treasure Valleys, there still would have been some milk from that area pooled on the Western order. The milk associated with the distributing plants in those two orders may still have qualified on the order, and in fact probably would have expanded sales into the Salt Lake City area in order to have

become pooled. Therefore, much of the "Idaho milk" would still be pooled. And in my judgment, that is entirely appropriate as a necessary reserve supply to the Salt Lake City plants. It is certainly more appropriate than the pooling of Idaho milk in the Midwest, or the pooling of Colorado milk in the Pacific Northwest.

A more interesting point is that the producers of Utah actually received more money relative to the Class III price in the two year period after Reform than they received in the two year period prior to Reform. That is primarily because of the dollars added to the system by "higher of" pricing. Another positive change for producers was that the Class II formula is now based on Class IV, rather than III. Because Class IV was higher than III for most of the past two years, it follows that the Class II price has also been higher since 1/1/2000 than it would have been under the old BFP-based system.

The average of the Weighted Average Differential in the Great Basin order (Order 139) for the years of 1998 and 1999 was \$.88 per cwt. The average Producer Price Differential in the Western Order (Order 135) for the years 2000 and 2001 was \$1.18. This is an increase in the PPD of \$.30 per cwt since Reform. The numbers for 2000 and 2001 are included in Table 6 of Exhibit 4. The numbers for the Great Basin order come from the annual summary (page 5 of the respective reports) prepared by the Market Administrator's office (copies attached).

Clearly the Western Order Producer Price Differential, the amount paid to the producer above Class III (which is sometimes called the "pool draw") has been greater since 1/1/2000. There has been some question about whether the Class III price itself has been higher or lower. Some of the early projections published during 1999 suggested the Class III would be lower. But when the final Class III formula was applied to the 1999 NASS market survey data, it was very close to the average Class III for 1999 under the old BFP system.

The testimony given by, and on behalf of Utah dairy producers suggests that the changes in the New Federal Order system that became effective 1/1/2000 have driven many Utah producers out of business. This is counter-intuitive to the facts, which show two things: First, the effect of the new pricing has been to partially overcome the depressed Class III and IV prices with a higher PPD than otherwise would have occurred under the old system. Second, producer prices were lower during 2000 because national Class III and Class IV prices were lower than in 1998-1999. That was because of depressed commodity markets that would have existed regardless of whether or not the "reform" changes had occurred in the Federal Order system.

When carefully analyzed, it is apparent that the argument made on behalf of Utah dairy producers amounts simply to a concern that the revised Federal order should have helped them even more than was actually the case.

We also note that although the numbers of producers leaving the industry in Utah seems significant on its own, in context of the entire industry they are quite ordinary. The reported facts over the 5 years from 1995-2000 are that Utah is losing producers at a lower rate (19.8%) than the average of all western states (23.7%). Indeed even the fast growing Idaho was losing producers at a higher rate (20.6%). This can be seen by looking at the numbers provided annually by USDA, NASS and reported widely in the dairy press.

The foregoing does not mean that Utah producers are not sincere. I have put the foregoing into evidence principally to demonstrate that the causes of their plight do not trace back to the “reform” process. Sure, the utilization is lower than under the old Great Basin order, but there are many more important factors to consider.

Pooling Standards. There has been a great deal of discussion about “performance” and what the appropriate pooling standards should be in a Federal order.

In the sections that follow, discussing each of the proposals, I will try to review some of those issues. But at this point I want to emphasize that pooling standards, like many of the other order provisions, must follow from the key statutory mandates that govern milk marketing orders. Specifically, orders must prevent (and not create) “disorderly marketing conditions”. And of course the classic vehicle for doing this is the creation of a “marketwide pool”, which results in a “uniform price” that shares the Class I and II returns among all producers so that there will not be an incentive for producers and producer groups to engage in cutthroat competition to elbow each other out of the way.

In Federal order theory, this “orderliness” comes from including all producers in the pool so that they all receive roughly the same amount of money for their milk. Knocking half the milk out of the pool, as DFA proposes, does not make the milk go away. One must assume that producers who are kicked out of the pool will react. Certainly we at NDA will ! And that is because we will have to, for competitive reasons. If the alternative is to lose our producers and die, we will fight for survival.

The evidence already indicates that DFA’s proposals could kick half the milk out of the current pool. Should that occur, the disorderly market conditions that we would see from the dispossessed producers will make the practices which are being complained about at this hearing seem tame by comparison.

For these reasons, an order must accommodate producer milk that can serve each major population center, and which seems to be realistically positioned to do so. This was the Dairy Division’s philosophy for years, and it should not change. Pooling

standards must not be set “too tight”. That is why the Federal Register over the years has seen many, many suspensions of diversion requirements and loosening of diversion requirements. Typically in these decisions USDA would point out that milk supplies had grown relative to the Class I needs of the market involved. The Department would note that unless the diversion limit was suspended or loosened, milk traditionally associated with the market would be removed from the pool. It would be noted that “unload/reload” techniques were being used to ensure pooling. It would be further noted that the milk marketing orders should not require such uneconomic movements of milk, and that actual “unload and reload” should not be required, because that process could damage milk quality. That was the rationale for many suspensions and changes in diversion limits, which were so common during the 1970s, 80s, and 90s as milk production in the country was growing.

Just as performance standards must not be “too tight”, they must not be “too loose” either. NDA submits that USDA must find some “real” evidence of willingness to serve the market or actual service to the market. For example, if a distributing plant is complaining to the Market Administrator that he has called on pooled milk supplies for service and found that milk will not be delivered, that Market Administrator would do well to consider an administrative reduction in the diversion percentage.

Some markets have “call provisions” for such circumstances. For example, the Pacific Northwest has such a provision for “cooperative reserve supply units” which normally are not expected to serve the market. However, they must do so if “called upon” by the market administrator to perform. I do not think such a concept would be objected to in this market, if it is within the scope of the current hearing notice.

In judging all this, the institutional factors in the market should be considered by the Department (or market administrator) in determining appropriate diversion limitations. In this case, as the evidence has already shown, DFA has locked up the Salt Lake City market with long term contracts to sell milk at low service charges, with the result that there is little room for someone to come into Salt Lake City and try to elbow DFA out of the way – little room to do so, except perhaps by selling milk below class prices. In effect the proposals if accepted would create what is almost a handler pool controlled by DFA.

That is one reason why “intent” has been discussed in this hearing. There is no way to demonstrate an “intent” or attachment, other than to say “we would if we could”.

If intent can be a factor to consider, surely our intent is clear. The history of our cooperative includes an emphasis on the Class I market. We are among the few cooperatives in the U.S. which own and operate bottling plants. Our Boise operation includes one of the country’s first major ultra-pasteurizing facilities, which since 1989

has distributed fluid milk all over the Western U.S. (for example, to all McDonalds stores in Idaho, Oregon, Washington, and Alaska). This actually creates new Class I sales for producers in this market, rather than just shift them around.

We do not propose that intent be a formal consideration in the order language, but it almost certainly must be part of the judgment that the Dairy Division and the Secretary must make. I want to be sure there is no doubt that Northwest Dairy Association is committed to serve market needs.

We at NDA submit that the current diversion percentages of the order have done a reasonably good job of balancing these considerations. This order is neither “too tight” nor “too loose”. More importantly, those rules are flexible, in that the percentages can be adjusted administratively by the Market Administrator if the need should arise.

I will be discussing these concepts in more detail with respect to specific proposals, but wanted to begin by providing this overview of our recommendations.

Table 2-139 Order 139 Price Data and Differences.

1999	Class I CWT (\$)	Class II CWT (\$)	Class III CWT (\$)	Uniform CWT (\$)	Difference Between I/III	Difference Between I/Uniform	Difference Between Uniform/III	Wght. Avg. Differential Per CWT (\$)
JAN	\$18.74	\$17.14	\$16.27	\$17.44	\$2.47	\$1.30	\$1.17	\$1.17
FEB	\$19.24	\$17.64	\$10.27	\$14.73	\$8.97	\$4.51	\$4.46	\$4.46
MAR	\$18.17	\$16.57	\$11.62	\$14.91	\$6.55	\$3.26	\$3.29	\$3.29
APR	\$12.17	\$10.57	\$11.81	\$11.76	\$0.36	\$0.41	(\$0.05)	(\$0.05)
MAY	\$13.52	\$11.92	\$11.26	\$12.27	\$2.26	\$1.25	\$1.01	\$1.01
JUN	\$13.71	\$12.11	\$11.42	\$12.66	\$2.29	\$1.05	\$1.24	\$1.24
JUL	\$13.16	\$11.56	\$13.59	\$12.84	(\$0.43)	\$0.32	(\$0.75)	(\$0.75)
AUG	\$13.32	\$11.72	\$15.79	\$13.11	(\$2.47)	\$0.21	(\$2.68)	(\$2.68)
SEP	\$15.49	\$13.89	\$16.26	\$15.39	(\$0.77)	\$0.10	(\$0.87)	(\$0.87)
OCT	\$17.69	\$16.09	\$11.49	\$14.06	\$6.20	\$3.63	\$2.57	\$2.57
NOV	\$18.16	\$16.56	\$9.79	\$13.72	\$8.37	\$4.44	\$3.93	\$3.93
DEC	\$13.39	\$11.79	\$9.63	\$11.34	\$3.76	\$2.05	\$1.71	\$1.71
AVG	\$15.56	\$13.96	\$12.43	<u>\$13.69</u>	\$3.13	\$1.88	\$1.25	\$1.25

.51
1.76
1.25

1999	Producer Protein Price Per Pound (\$)	Producer Butterfat Price Per Pound (\$)	% Protein In Producer Skim Milk	% Protein In Producer Skim Milk Used In Class II & III	Value Change of Skim Milk Util. In CL II & III Due to Compt. Pricing	Handler Protein Price Per Pound (\$)	Handler Butterfat Price Per Pound (\$)	Handler Skim Milk Price Per CWT (\$)
JAN	\$3.40	\$1.48	3.39%	3.39%	\$17,003	\$3.40	\$1.48	\$11.48
FEB	\$1.62	\$1.44	3.36%	3.37%	\$15,526	\$1.62	\$1.44	\$5.41
MAR	\$2.11	\$1.39	3.34%	3.35%	\$23,651	\$2.12	\$1.39	\$7.00
APR	\$2.57	\$1.03	3.33%	3.34%	\$17,381	\$2.58	\$1.03	\$8.49
MAY	\$2.25	\$1.18	3.29%	3.29%	\$6,983	\$2.26	\$1.18	\$7.38
JUN	\$1.78	\$1.67	3.23%	3.24%	\$12,800	\$1.76	\$1.67	\$5.79
JUL	\$2.78	\$1.43	3.20%	3.20%	\$568	\$2.80	\$1.43	\$8.90
AUG	\$3.41	\$1.47	3.24%	3.24%	(\$1,893)	\$3.43	\$1.47	\$11.03
SEP	\$3.56	\$1.38	3.32%	3.32%	\$936	\$3.52	\$1.38	\$11.85
OCT	\$2.21	\$1.18	3.42%	3.43%	\$13,490	\$2.19	\$1.18	\$7.64
NOV	\$1.75	\$1.13	3.46%	3.46%	\$6,655	\$1.75	\$1.13	\$6.05
DEC	\$1.94	\$0.93	3.43%	3.43%	\$10,261	\$1.94	\$0.93	\$6.62
AVG	\$2.45	\$1.31	3.33%	3.34%	\$10,280	\$2.45	\$1.31	\$8.14

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Table 2-139 Order 139 Price Data and Differences.

1998	Class I CWT (\$)	Class II CWT (\$)	Class III CWT (\$)	Uniform CWT (\$)	Difference Between I/III	Difference Between I/Uniform	Difference Between Uniform/III	Wght. Avg. Differential Per CWT (\$)
JAN	\$14.86	\$13.26	\$13.25	\$13.97	\$1.61	\$0.89	\$0.72	\$0.72
FEB	\$15.19	\$13.59	\$13.32	\$14.19	\$1.87	\$1.00	\$0.87	\$0.87
MAR	\$15.15	\$13.55	\$12.81	\$13.94	\$2.34	\$1.21	\$1.13	\$1.13
APR	\$15.22	\$13.62	\$12.01	\$13.60	\$3.21	\$1.62	\$1.59	\$1.59
MAY	\$14.71	\$13.11	\$10.88	\$12.88	\$3.83	\$1.83	\$2.00	\$2.00
JUN	\$13.91	\$12.31	\$13.10	\$13.41	\$0.81	\$0.50	\$0.31	\$0.31
JUL	\$12.78	\$11.18	\$14.77	\$13.42	(\$1.99)	(\$0.64)	(\$1.35)	(\$1.35)
AUG	\$15.00	\$13.40	\$14.99	\$14.70	\$0.01	\$0.30	(\$0.29)	(\$0.29)
SEP	\$16.87	\$15.07	\$15.10	\$15.86	\$1.57	\$0.81	\$0.76	\$0.76
OCT	\$16.89	\$15.29	\$16.04	\$16.42	\$0.85	\$0.47	\$0.38	\$0.38
NOV	\$17.00	\$15.40	\$16.84	\$16.67	\$0.16	\$0.33	(\$0.17)	(\$0.17)
DEC	\$17.94	\$16.34	\$17.34	\$17.51	\$0.60	\$0.43	\$0.17	\$0.17
AVG	\$15.44	\$13.84	\$14.20	\$14.71	\$1.24	\$0.73	\$0.51	\$0.51

1998	Producer Protein Price Per Pound (\$)	Producer Butterfat Price Per Pound (\$)	% Protein in Producer Skim Milk	% Protein in Producer Skim Milk Used in Class II & III	Value Change of Skim Milk Util. in CL II & III Due to Compnt. Pricing	Handler Protein Price Per Pound (\$)	Handler Butterfat Price Per Pound (\$)	Handler Skim Milk Price Per CWT (\$)
JAN	\$2.76	\$1.23	3.37%	3.38%	\$3,357	\$2.77	\$1.23	\$9.26
FEB	\$2.53	\$1.48	3.35%	3.35%	\$6,330	\$2.54	\$1.48	\$8.42
MAR	\$2.45	\$1.43	3.31%	3.31%	\$11,838	\$2.45	\$1.43	\$8.09
APR	\$2.15	\$1.49	3.32%	3.33%	\$15,954	\$2.16	\$1.49	\$7.04
MAY	\$1.45	\$1.80	3.29%	3.29%	\$5,435	\$1.45	\$1.80	\$4.78
JUN	\$1.69	\$2.23	3.25%	3.26%	\$3,429	\$1.69	\$2.23	\$5.51
JUL	\$2.18	\$2.30	3.23%	3.23%	\$4,047	\$2.19	\$2.30	\$6.97
AUG	\$1.98	\$2.51	3.25%	3.25%	(\$1,351)	\$2.01	\$2.51	\$6.42
SEP	\$1.12	\$3.29	3.31%	3.31%	\$2,190	\$1.12	\$3.29	\$3.73
OCT	\$1.91	\$2.79	3.41%	3.42%	\$7,730	\$1.91	\$2.79	\$6.49
NOV	\$3.10	\$1.89	3.43%	3.44%	\$10,063	\$3.10	\$1.89	\$10.61
DEC	\$3.71	\$1.45	3.44%	3.45%	\$4,843	\$3.72	\$1.45	\$12.72
AVG	\$2.25	\$1.99	3.33%	3.33%	\$6,155	\$2.26	\$1.99	\$7.50