**Prepared Testimony of**
**Daniel S. McBride,**
**Northwest Dairy Association**

**Re: Proposal No. 8, "Transportation & Assembly Credits"**

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 today on behalf of Northwest Dairy Association, which is usually referred to as "NDA". In earlier testimony I have introduced myself, as well as NDA and WestFarm Foods.

NDA Has Serious Concerns About Proposal No. 8. As we understand this proposal, the Western Order (Order 135) would be amended to provide both a transportation credit and an assembly credit. We at NDA presently see no justification for either. However, before taking a "hard" position, we will use this hearing as an opportunity to better understand the concept.

We will convey our conclusions and final position in the post-hearing brief. However, there are some important concepts and evidence for the hearing record.

Assembly Credits. The practical effect of this is to provide producers and/or cooperatives which supply distributing plants an additional $.05/cwt on the Class I portion of milk utilized at the plant, and it would do so at the expense of the other producers who share in the in the marketwide pool. NDA opposes this concept for the following reasons:

Today, only one Federal order has anything like this, the Upper Midwest order (Order 30). We note that market conditions there are quite different than in the Western order, where the "assembly plant" concept does not apply. Farms tend to be smaller in Order 30, but in the Western order it is not normally difficult to assemble a full load in most parts of the milkshed.

1. A fundamental problem with assembly credits is illustrated by the Order 30 requirement that it must be paid directly to handlers. In contrast, Proposal No. 8 would provide direct payments to the supplying producers and cooperatives. I suspect that the Department took that approach in Order 30 in order to maintain uniform pricing to handlers under that order. Consider what would happen in the Western order. As earlier testified, the proponent (DFA) has long term supply contracts with handlers, with stated service charges. If the assembly

61

credit is given to DFA, there is no reason for them to pass the credit on to their customer. In contrast, the Gossner plant (or any other hypothetical pool distributing plant that contracts for milk with its own producers) will achieve a cost benefit that it does not presently have. The effect will be to alter the uniformity of competing handlers' milk costs, in violation of statute.

2. However, if such a credit were paid to the producer or cooperative that "assembles" the milk, we note that it would provide an additional incentive for a producer (or a cooperative) to want to lock up Class I markets, thereby potentially creating the very sort of "disorderly marketing conditions" that orders are required by statute to prevent. We see no way out of this dilemma, except to reject the assembly credits concept.

3. The traditional concept of "assembly" is not applicable in this region. That concept is the gathering of milk from producers at an assembly point, so that it can be more efficiently transferred to the ultimate processing location. I can testify that in connection with my day to day activities, I have come to be aware of many producers in Southern Idaho who ship full tanker loads of milk at each pickup. Many ship over 70,000 lbs per day, which is our average load size. It would be ironic that a market which has so many large dairy farms which ship full tanker loads would be given a credit to "assemble" such milk!! More than ironic, it simply can not be justified.

4. Furthermore, such a credit is not needed to cover what assembly costs there are in this market. We follow the pricing of other Southern Idaho handlers very closely, and I can testify that in that area all producers pay a hauling rate that reflects at least some if not all of the cost of picking up their milk. Those hauling rates tend to be greater for smaller producers whose "assembly costs" must be combined with other producers on a tanker – such producers are paying for the assembly of their milk onto efficient tanker loads.

5. As can be seen from the foregoing, there is no reason to distinguish between "assembly costs" of pooled milk that is bottled and the milk which is made into Class II or III or IV products. There is no "intermediate assembly point" in either scenario. Furthermore, the costs of "assembly" are identical, regardless of which type of plant the tanker goes to when it leaves the farm. The only effect of this proposal would be to give Class I handlers and suppliers a competitive advantage in recruiting producers.

6. DFA testified that one rationale for assembly credits is to somehow cover balancing costs of the market. We at NDA are directly aware of those costs, from our experience in both orders in which we operate. They are real.

However, those costs are – for the most part – incurred by manufacturing plants, and not by the Class I plants. Proposal No. 8 would pay producers who ship to a Class I facility a "balancing charge", even if they do not have any interest in a manufacturing plant which balances the market. In fact, I can testify from our experience that the producers who market only to a distributing plant (whether directly or through a bargaining cooperative) have a seasonal pattern to their production which, in turn, must be balanced by <u>someone else's balancing plant</u>. It would be a travesty of justice for such producers to be rewarded for providing a service, when in fact they are the cause of the balancing problem. The <u>only</u> way this dilemma can be rewarded is to pay the balancing fee to the plant which actually bears the "opportunity cost" of this balancing.

7. Each market has a seasonal pattern to Class I and II sales, and a seasonal pattern to production. When these two figures are graphed, it is the difference between the two lines which demonstrates the amount of seasonal balancing that must occur during a month.

8. If we accept the notion that some seasonal balancing cost exists, which producers should bear its cost? If the balancing plant is balancing milk from outside the order area, that balancing cost should not be borne by producers in the Western Order market but by someone (anyone) in the other market. If a balancing plant within this market is handling milk that is produced within the Western order but pooled on another Federal order, the cost of balancing that milk should not be borne by Western order producers.

9. NDA believes that weekend balancing can best be addressed through a system of "even daily receipt credits". In such a system, distributing plants which take the same amount of milk each day of the week cause no "weekly balancing" costs, and pay no fee. Those plants which cause the problem, pay for it according to some formula that incentivizes a more regular pattern.

10. There is no justification for charging the producers in the pool an assessment to reimburse the costs related to field services or laboratory services or processing producer payrolls. A proprietary distributing plant which has its own producer milk supply has always had to bear those costs in the past <u>and</u> pay minimum prices. If the producers which supply such a plant are given an assembly credit which covers those costs, it will be a pure windfall. That is because the order will not permit the plant to assess producers for those costs and pay less than the Federal order class price. The plant will continue to pay those costs but receive no credit, while the producers who do not pay those costs would be given a credit.

11. Following up on that last point, the principle of uniform pricing requires that distributing plants supplied by cooperatives should not be put at a competitive disadvantage from a credit system. Yet that is exactly what would happen if the cooperative were to provide those services, charge the pool for them, and provide those services to the distributing plant for free.

Given those thorny problems just mentioned, we must closely examine whether there is any justification for assembly credits. We submit that the current order provisions are working well. We are aware of no difficulty that distributing plants presently have, in obtaining the milk they need. And we are aware of no unusual cost situations which exist today involving unique "assembly" challenges.

NDA believes that assembly and balancing costs can be, and should be, paid by the distributing plants, either directly (if they have their own producer milk supply) or indirectly (if they buy from cooperatives or supply plants which perform those services for them). Moreover, our understanding of the current service charge level in this Western Order market indicates that distributing plants are, already, bearing these costs.

We understand from conversations a couple of years ago with DFA that their service charges at Boise are comparable to NDA's service charge, which is 25 cents/cwt on Class I and II milk. We understand from (now-dated) conversations with DFA and its predecessor (Western Dairymen Cooperative, Inc.) that the service charge level in the Salt Lake City market is similar, or perhaps a bit less. Perhaps DFA can provide more current information, but all indications from the marketplace are that those service charges were written into long term contracts that are still in place.

We can understand why the proponent would like additional money from the pool for serving their customers, but we can see no other rationale to support this request.

<u>Transportation Credits.</u> As noted above, NDA understands that there can be a rationale in certain circumstances for a milk marketing order to provide transportation credits. We are not clear whether there is such a need in the Western order.

Three other Federal orders have transportation credits, but they work in much different ways than are proposed here.

In the Upper Midwest, the transportation credits are available only to transfers between plants. That market still has many small farms, and milk apparently is still "assembled" at country plants for shipment to distributing plants. As noted in our discussion of assembly credits, that is typically not the case in the Western order. This Proposal No. 8 applies to all milk, not just transfers between plants.

In two of the Southern markets, transportation credits are provided to move milk from outside the market area, to plants within the market. This is so different from what happens in the Western market, that it is not a useful precedent. The Southern United States is deficit, the Western order has very low Class I utilization. Indeed, Proposal No. 8 would not provide a credit to bring in milk from any point outside the marketing area.

NDA submits that Proposal No. 8 is so different in concept from the three current situations where a transportation credit is granted, this proposal would be unprecedented. It must stand on its own unique facts and justifications.

Proposal No. 8 is not only different in concept, it is also different in detail. It proposes a $.0038/cwt credit per mile, whereas the figure is only $.0028 in the Upper Midwest and only $.0035 in the South.

Without taking a position on what an appropriate credit is, I would like to provide the following information about what NDA feels are fair reflections of today's hauling costs:

| | Rate (total haul) | Road Miles |
|---|---|---|
| Line haul rates to Salt Lake City from: | | |
| Jerome | .75/cwt | 225 |
| Boise | 1.10 | 340 |
| Caldwell | 1.18 | 365 |

I should add that these bids are not all from the same hauler, so they are not necessarily comparable.

That said, it is important to stress that our numbers reflect the full cost of the haul, including farm pickup, road miles, and the cost of the 1-3 hours that it typically takes at the receiving plant (to wait in line, pump out, and cleanse the tank).

We are currently renegotiating our hauling costs with our major hauler. We believe that it typically takes over an hour on the farm to load a producer who ships a full tanker load. A 10,000 lb stop typically takes 30-45 minutes on the farm. There is other driving time between stops.

All these costs of pickup and delivery are included in the farm pickup costs we pay to haulers. The hauler's charges are approximately equal to what we charge back to our producer members, with variations based on volume per pickup.

It might be useful to put into evidence that this past winter had a competitive bid situation for hauling milk from a farm 66 miles from our Jerome plant. One hauler bid 30 cents per cwt for full 70,000 to 72,000 lb tanker loads each pickup, the successful bidder was at 28.

As you can see, for a short haul, where the producer milk is within a 30 mile radius, the proportion of the total cost is primarily in the time on the farm and at the receiving plant, not "over the road" miles. The longer the haul, the more those over the road miles become a factor, but there are still anywhere from 2-8 hours of other costly activity involved besides "loaded miles".

It is also worth noting for this hearing record that the Upper Midwest market has location value zones that, for the most part, differ by only $.15/cwt, whereas the Western market has a $.30 disparity to incent the movement of milk from Idaho into Utah. Given that existing incentive, it is not clear what would be accomplished by the proposed credits, nor is it clear exactly how they would be used.

To illustrate that last point, I can testify that NDA has members on farms in Baker County of Eastern Oregon that are more than 80 miles from the WestFarm Foods bottling plant at Boise. Normally, that milk is delivered to the Caldwell, Idaho plant. But if a credit were available, there would be plenty of incentive to move that milk right past Caldwell, another 20 miles or so to the Boise plant, while other milk near Boise is taken back to Caldwell. That would be inefficient, but profitable! Similarly, one must be concerned whether the effect of the proposal would not be to move milk from Southern Idaho in to Salt Lake City, while milk from nearer Salt Lake City stays in the area for use at the cheese plants at Smithfield and Beaver, Utah. The purpose should be to serve distributing plants, but the result may be to fill up one cheese plant at the expense of another.

On a related point it is important to note for the record that there are currently movements of milk from the Magic Valley (around Jerome and Twin Falls) to the Treasure Valley (Boise and Caldwell and Nampa). That means there is a backhaul potentially available to help move milk from the Treasure Valley to Jerome, and on to Salt Lake City. Yet the cost of that additional haul would be reimbursed at the full transportation credit.

A final point in our thinking is that we presently see no unfair cost disadvantage to those of us who supply the Class I market, which must be corrected through a transportation credit.

I will close this testimony by stating some general concerns that should underlie any such proposal:

1. It should benefit Class I only, and should not indirectly benefit manufacturing activities.
2. It should not create an economic incentive for artificial movements of milk,
3. It should not cover the full cost of hauling, and
4. It should not provide a "windfall" to cover other hauling expenses.

Summary. NDA suggests that these credits are fraught with policy problems, and therefore would be questionable public policy unless there is a clear justification. At this point, we see no reason to think they are needed, but we will analyze that further in our post-hearing brief.

I think it is important to close this discussion by testifying that, with respect to both assembly credits and transportation credits, we ourselves do not require these credits as an incentive to serve the Salt Lake City market from our Idaho milk supply (some of which is less than 200 miles from the City). If the proponent and other suppliers to the Salt Lake City market are not willing to continue supplying those markets under the current order provisions, without assembly and transportation credits, NDA stands ready and willing to do so.

I would be happy to answer any questions.

* * *