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**BEFORE THE UNITED
STATES DEPARTMENT
OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE**

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

BRIEF FOR DAIRY FARMERS OF AMERICA, INC. (DFA)

Date: August 21, 2002

I. INTRODUCTION

This brief is submitted by Dairy Farmers of America, Inc., to address all proposals at the hearing. The hearing proposals involve extremely important pooling issues and proposals providing for reimbursement from the federal order pool to handlers which provide services of marketwide benefit.

Order 135 as presently structured is not operating in the interests of orderly marketing.

It is imperative that the Secretary address these disorderly conditions.

II. FACTUAL BACKGROUND

Parties and hearing participants

1. Dairy Farmers of America, Inc., (DFA) is a Capper-Volstead cooperative association of 16,905 dairy farms producing milk in forty-six (46) states. DFA regularly markets milk on 10 of the 11 federal milk orders, including Order 135. (TR. 165; Exh. 18, p.1; TR. 165, 170, Exh 18 p.1; TR. 142; Exh. 8, p.1; Exh. 15, p.1).

2. Northwest Dairymen's Association (NDA) is a cooperative association marketing milk on behalf of approximately 600 producers on Order 124 and over 100 producers associated with Order 135. It operates, through its West Foods subsidiary, three bottling plants regulated under Order 124, as well as manufacturing plants at Chehalis, Issaquah, Linden and Sunnyside, all in Washington State. And in Order 135, West Foods operates a bottling plant at Boise, a nonpool drying plant at Caldwell, Idaho and a nonpool condensing plant at Jerome, Idaho. The Jerome plant is now being expanded into a drying plant. (TR. 126, Exh. 16, p.1.)

3. Glanbia Foods, Inc., formerly known as Avonmore West, Inc., is a dairy food company headquartered in Twin Falls, Idaho. Gambia Foods operates two cheese plants in Idaho. The Twin Falls plant converts about two million pounds of milk per day into cheddar, mozzarella, monterey jack, colby, colby-jack and pepper jack cheese. (TR. 746, Exh. 37, p.1) The Gooding, Idaho plant is one of the largest producers of barrel cheese in the world, processing over five million pounds of milk into 500-pound barrels of cheese. (TR. 747, Exh.

37, p.1) Glanbia received over 2.6 billion pounds of milk in 2001 from Idaho dairy farmers. (TR. 749, Exh. 37, p.3)

4. Davisco Foods, International, Inc., operates three cheese and whey facilities, one of which is a cheese plant in Jerome Idaho which processes up to 5 million pounds of milk per day. (TR. 682, Exh. 35, p.1; TR. 705)

5. Gossner Foods operates two plants on Order 135, one of which is a fluid milk plant that processes UHT aseptic milk. A large percentage of their fluid milk business consists of contracts with governmental agencies. (TR. 812, Exh. 39, p.1, TR. 813, Exh. 39, p1.)

The Market: Overview and demographics

6. Federal Order 135, the order regulating handling of milk in the western marketing area, effective January 1, 2000, is a product of the consolidation of two former orders: the Great Basin Order 1139 and the Southwestern Idaho - Eastern Oregon Order 1135. (TR. 114; Exh. 9 , p.2; Exh. 12, p.21; Exh. 13, p.1))

7. The order includes the state of Utah, and certain counties in Southern Idaho, Eastern Oregon, Nevada, and Wyoming. (Exh. 6, p. 21)

8. Order 135 was developed in the federal order reform process by application of a set of market definition principles set out in the final decision. See 64 Fed. Reg.16045 (April 2, 1999). Those principles included the concept that milk should perform for the market in order to qualify for pooling. "Open" pooling was specifically rejected as a basis for associating milk with federal order pools. (Exh. 18, p.2)

9. 80% of the Class I sales in the combined marketing area were represented by distributing plants regulated under the Great Basin Order. See 64 Fed. Reg.16079 (April 2, 1999)(TR. 158-160 ; Exh. 8, pp. 12-13; 64 Fed. Reg. at 16072; Exh. 5, Table 12) 10. The combined Class I utilization of the Western Order was estimated to be about 23 percent. (See 64 Fed. Reg.16079 (April 2, 1999). (TR 779)

12. The actual Class I utilization on Order 1135 averaged 22.09% in 2001. (Exh. 6, Table 3.)

13. The population of Order 135 on a state by state basis is: Utah – 65.37%; Idaho – 28.93%; Oregon – 2.73%; Nevada – 1.87%; and Wyoming – 1.11%. (Exh. 8, Table 2)

14. Nearly one-half of the total population of the order is in 4 counties in the growing Salt Lake City area of Utah. (Exh. 8, Table 2)

15. Milk production in Utah for the 10 year period from 1992 – 2001 increased 21.6% from 1.345 billion pounds to 1.635 billion pounds. (Exh. 33, Table 4)

16. Milk production in Idaho for the 10 year period from 1992 – 2001 increased 147.6% from 3.138 billion pounds to 7.759 billion pounds. (Exh. 33, table 4)

17. Class I utilization in the predecessor orders to the Western Order during the years prior to 2000 were:

<u>Year</u>	<u>Order 135</u>	<u>Order 139</u>
1996	7%	35%
1997	8%	37%
1998	13%	46%
1999	8%	51%

(Exh. 33, Table 6)

18. If all milk produced in the state of Idaho were pooled on Order 135, it would add 5.091 billion pounds to the pool resulting in a Class I utilization of 10.6%. (Exh. 33, Table 4; Exh 6, Table 3)

19. In 2001, 2.666 billion pounds of milk produced in Idaho were pooled on Order 135. (Exh. 6, Table 6)

20. In 2001, total milk production in Idaho was 7.757 billion pounds, only 34 % of which was pooled on Order 135. (Exh. 33, Table 4; Exh. 6, Table 3)

21. In 2001, 5.091 billion pounds of milk production in Idaho were not pooled on Order 135. (Exh. 33, Table 4; Exh. 6, Table 3)

22. Class I utilization in the Pacific Northwest Order 124 was 30.99% in 2000 and 29.23% in 2001. Pending changes in pooling provisions of that order will tighten the pooling

requirements and likely eliminate some Idaho milk from pooling on Order 124. (Exh. 5, Table 3)

23. The pooling terms of Order 135 presently allow the pooling of milk far in excess of any reserve needed for Class I uses. (TR. 753))

24. Proprietary bulk tank handlers in Order 135 presently pool milk with Class I utilizations as low as 3%. (Exh. 10, Table 1) The provisions of Order 135 allow pyramiding of shipments to distributing plants for pooling purposes, at an extremely high ratio, particularly with the ability to “pump-in and pump-out” milk deliveries. Proprietary bulk tank handlers have pooled milk using all these mechanisms.

25. Producers who actually supply the Class I market incur costs of such supply which are not incurred by all producers in the market. Those costs include: additional hauling expense; costs of absorbing daily and seasonal fluctuations in demand, administrative expenses relating to assembling and dispatching milk supplies tailored to the needs of the Class I buyer; and other costs. (TR 783, Exh. 43, p.1)

The Utah dairy industry

26. The dairy industry in Utah is dominated by multi-generation family farms, many of which have serviced the fluid market in Utah for generations.

27. Dairy farm numbers and milk production in Utah declined from 2000 to 2001, 13.9% and 3.1% respectively. (Exh. 33, Table 4)

28. Utah dairy farmers are a significant part of Utah’s economy, being catalysts for \$3 to \$4 billion in economic activity. In the view of the Commissioner of Agriculture for Utah, the current terms of Order 135 have created inequities in the marketplace and damaged Utah dairy producers and the Utah dairy industry.

29. Mark Gibbons from Cache county is a typical Utah farmer. He is a fourth generation dairyman, is President of the Utah Dairymen’s Association and milks 350 cows. (TR 331, Exh. 24, p.1)

30. Roy Remund is a fourth-generation Utah dairy farmer from the Weber Valley,

milking 170 cows. The current terms of Order 135 have had a financially devastating impact upon his farm and other dairy farmers in Utah. (TR 343, Exh. 25, p.1)

31. Ronald Stafford is a fourth-generation farmer in Weber County Utah. He owns 300 head of Holstein cattle in partnership with his brother. He has personally observed the financial impact of the current order provisions on farms in his locality.

32. Richard Eakle milks 250 cows in Utah, north of Salt Lake City. His farm was started by his grandfather in the Depression. The current diversion limits for Order 135 seriously impact his dairy. (TR. 396, Exh. 28, p.1)

33. Brian Hardy is a family farmer in Box Elder County Utah. His sons are the fourth generation on his farm. The provisions of Order 135 since federal order reform have seriously impacted his dairy. (TR. 410, Exh. 29 p.1)

34. Steve Frisknect is a dairy farmer in Sanpete County in Central Utah. He milks 150 cows and is chairman of the Utah Dairy Federation and the Utah Farm Bureau Dairy Committee. On behalf of his organizations, he urgently requests amendment of Order 135 regulatory loopholes, particularly the 90% diversion limits. (TR. 415, Exh. 30, p.1)

The Idaho dairy industry

35. Much milk production in Idaho is the product of new investment from within and without the state which was made for the purpose and with the intention of supplying the new and expanded cheese manufacturing plants in Idaho. (TR. 748; TR. 766)

36. Ninety (90%) percent or more of milk production in Idaho is dedicated to the manufacture of cheese. (TR. 747, Exh. 33, tbl. 4; Exh. 37, p.2)

37. Idaho is one of the fastest growing milk production regions in the country. (TR. 682, Exh35, p.1; TR. 453, Exh. 33, tbl. 3, Exh. 32, p.5))

38. Idaho is the home of several of the largest and most efficient cheese plants in the world, the Glanbia and Davisco facilities. (TR. 747, Exh. 37, p.1)

39. Producers have moved to Idaho and invested in new production facilities with the intention of producing milk for cheese manufacture. (TR. 461; TR. 706)

40. The purchase of milk from producers in Idaho, by Idaho cheese manufacturers is made on the basis of a cheese yield formula. (TR. 454, Exh. 32, p.5; TR 455, Exh. 33, Att. 8; TR 777)

41. Producers supplying the proprietary cheese plants in Idaho will be paid the same price for their milk whether or not it is pooled on a federal order. (TR. 711)

42. Idaho cheese manufacturers have pooled milk on Order 135 by delivering it to a pool plant and receiving it back for delivery to the cheese plant. The milk has not been “given up” for Class I utilization. The handler has simply incurred a limited cost to obtain the draw from the pool for infusion into the producer payroll. (TR. 86, Exh. 10, p.1)

43. There is a cost to a cheese plant when it gives up milk for Class I usage. That cost is not incurred when the milk is delivered back and used for manufacture of cheese.

(Williams)(TR796;792)

**III. THE SAME PRINCIPLES AND POLICIES SHOULD BE APPLIED TO
DETERMINE THE TERMS OF BOTH ORDERS 124 AND 135.**

This joint proceeding, involving both Orders 124 and 135 presents similar issues for resolution by the Secretary. DFA respectfully suggests that it is important for orderly marketing in the region and for the integrity of administration of the order program that the same principles be applied to each order. These orders have overlapping procurement and production regions and the major cooperatives operate in both orders and pool milk on both orders. We do not suggest that consistency will lead to identical order provisions; but we do believe that fairness and equity to all requires that consistent and uniform policies be adopted for all. For Order 124, there is a consensus within the industry, DFA included, which supports tightening of the existing pooling regulations. All of the reasons advanced by the marketing federation in Order 124 for tightening the requirements for pooling there apply equally to Order 135; but some parties have taken divergent positions, even opposite positions, with respect to Order 135.

In all of the hearings, concluded and ongoing, with respect to pooling provisions of the federal orders DFA has taken a consistent position that the orders must be amended to relate the pooling of milk to performance in service to the Class I market. DFA has advocated the use by

the Secretary of the same market definition principles to establish provisions in all orders and does so in this hearing also. This position has been in DFA's self interest in some cases, but not all, Order 124 being a conspicuous example where tightening the pooling provisions will mean that DFA can pool less of its Idaho milk on Order 124. DFA urges the Secretary to address the issues in these two orders applying the same standards and principles to each to assure orderly marketing conditions in the region.

IV. ORDERS 124 AND 135 SHOULD BE AMENDED THROUGH PROPOSALS 1, 2, 9, AND 10 TO LIMIT THE "OPEN" POOLING OF DISTANT MILK SUPPLIES.

The open pooling of distant milk supplies is testing the viability of federal milk orders, as evidenced by the record of this hearing and the several hearings in other orders which have gone before it in 2001 and 2002. There are four proposals in this hearing addressing this problem for Orders 124 and 135. DFA supports and advocates the adoption of Proposals 1, 2, 9 and 10 which together would address this problem in these two orders in a principled fashion consistent with federal order pooling principles which have stood the test of time.

A. "Double dipping" should be prohibited on both Orders 124 and 135.

DFA supports Proposals 1 and 10 which would address that element of open pooling of distant milk which prohibits the pooling on Federal Orders 124 (Proposal 1) and 135 (Proposal 10) of milk which is simultaneously pooled on a state order marketwide pool, i.e. California. DFA agrees with, and supports, the rationale of these proposals that milk should not claim a share of marketwide pool revenues in two markets at the same time. This deals with a part of the problem of open pooling of distant milk, but only part of the problem. Proposals 2 and 9 address the problem of open pooling of distant milk more comprehensively and should also be adopted.

B. Distant, out-of-area milk supplies should be required to perform for the market in the same manner, degree, and extent as in-area supplies by being reported in separate geographic state-based units.

_____ This hearing record demonstrates, as has the record in other recent hearings, that under the terms of Orders 124 and 135 as presently written, it is possible for handlers to pool distant

milk supplies, with little or no performance. The post-reform price surface¹ allows this milk to draw payments from the pool which are far in excess of any return which could be obtained by the handler on such milk supplies if the milk was actually delivered to the Class I market on a pro rata basis with milk supplies more local to the marketing area. This economic dis-connect was documented by Mr. Hollon's testimony (Exh. 18) and his calculations (Exhibit 19, Tables 2–4). Clearly the fact that a real world transaction would lose so much money and only occurs because of a quirk in the regulations must cause the Secretary to re-think the provision in question and adopt those proposals.

Allowing the pooling of distant milk without performance and at a blend price return which bears no relationship to what the milk could earn by delivery corrodes the integrity of the pool in the same manner as the pooling of milk which is “double dipping.” One might say that this milk, which is dedicated to manufacturing uses and doesn't have to “give up”, or share, any of that utilization by supplying the fluid market for any percentage of the time, is “double dipping” in a similar manner to milk which is in another marketwide pool. Testimony at the hearing demonstrates that this pooling does not meet the criteria for market definition and performance set out by the Department in the final decision on federal order reform, principles which DFA endorses. (Exh. 18, pp. 6-9). The reasonable solution is the adoption of Proposals 2 and 9.

Proposals 2 and 9 would not bar or forbid the pooling of milk from outlying, non-historical areas.² We recognize and support the fact that all milk must be eligible to supply and be pooled on any federal order, if it meets the performance requirements of the order which are

¹ DFA supports the Class I price surface adopted under federal order reform. However, in fine-tuning the orders post-reform it is essential to recognize that some adaptations may be necessary to make this new Class I surface work with the pooling terms of the post-reform consolidated markets. It is undisputed in this record (and others) that if milk distant from the Class I markets which provide the value to the orders was zoned-out in blend value on the basis of distance and transportation cost from those markets to recognize its location value to the demand points that it would not be economic to pool that distant milk as is being done.

² Similar provisions are presently part of Order 1 and this record shows that milk from Utah is pooled there. Milk from Minnesota and Wisconsin has also been pooled on Order 1.

tailored to the needs of the market. These proposals simply require that distant milk perform in the aggregate at the same rate as milk within the marketing area performs. We see no discrimination or inequity in this methodology. It simply requires a minimal connection with the market, which is not too much to ask of any milk which receives its pro rata share of the market's Class I revenues.

IV. THE TERMS OF POOLING IN FEDERAL ORDER 135 SHOULD BE ESTABLISHED ON THE BASIS OF MARKET PRINCIPLES REQUIRING PERFORMANCE IN SUPPLYING THE FLUID MARKETPLACE.

A. The Western Order Pooling Issues

This record presents the Secretary with some very stark data, and some unique marketing conditions, to consider in addressing the issues of the appropriate terms for pooling on Order 135. Some of those factors are: (1) Idaho has the largest pool of non-federal order Grade A milk in the country (not including California); (2) Dairy farmers (predominately from Utah) who supplied the Great Basin order (pre-federal order reform) have suffered the largest reduction in utilization under federal order reform of any order in the country; (3) If all the Grade A milk in Idaho were to be pooled on Order 135, the Class I utilization would be 10%, and dropping with the ongoing increases in production in Idaho; and (4) the present pooling provisions openly allow the pumping-in and pumping-out of milk for purposes of association with the order.

DFA urges the Secretary to revise the pooling provisions for Order 135 so that pooling requires greater service of the Class I market, and allows less diversions to nonpool plants; so that qualification requires net deliveries of milk to distributing plants; and so that the proprietary bulk tank handler provision is not a device for undercutting the Class I price in the market and pooling milk which is not given up for Class I use.

B. Proposal 6 should be adopted to reduce the diversion limits on Order 135

Order 135's current allowance of 90% diversion of producer milk to nonpool plants should be reduced to 70% with the adoption of Proposal 6. This is necessary to make association with the order relevant to service of the Class I market. The amendment is justified by the record and supported by the greatest number of participants in the marketplace.

The most essential purpose of federal orders is to provide for and assure the orderly marketing of milk for Class I purposes. The Class I handlers “make” the pool by providing the revenues which are shared. The Western order’s current pooling provisions bear no actual relationship to servicing the Class I market. Table 7 of Exhibit 33 demonstrates a very liberal calculation of the needs for a reserve for service of Class I and associated Class II uses in this market. It is clear from these calculations both that the present reserve which is pooled on the order is far in excess of that necessary for service of the market and that the reserve which would be accommodated by Proposal 6 would be more than adequate.

Unless the Secretary is going to provide such open pooling terms in Order 135 to accommodate all Grade A milk now produced in Idaho and Utah, and all future increases in production, the appropriate level of pooling standards must be related to the needs of the Class I market. There is not any other accepted standard for establishing the limits of pooling. The record here demonstrates that pooling all milk in the region should not occur for several reasons. First, we would note that the record of the hearing on Order 124 shows that there is broad support, and no opposition, to tightening the terms of that order so that some milk in Idaho which is now pooled on Order 124 will no longer be pooled there in all likelihood. DFA supports this position, although its own narrow interests will not be benefitted. This means that even more milk will be available for pooling on Order 135 than at present. Secondly, in 2001 there was more than 5 billion pounds of Grade A milk in Idaho which was not pooled on any federal order. If all this milk, plus the milk from Order 124, becomes pooled on Order 135, in all likelihood the utilization would fall below 10%. This would mean the end of the order in any meaningful sense, and could mean the end of the order in actuality because it would be quite possible that producers would not support it.

The damage which the present low utilization is causing to the dairy industry in Utah should be an important factor in this proceeding. Elected officials and individual farmers from throughout the dairy industry in Utah testified with substantial unanimity to the losses being suffered from the reduction in utilization in the order. At the same time, this is the segment of the industry in the region which has supplied and continues to supply the Class I market. Utah is

the area of greatest population and greatest Class I consumption. It is a growing area and an area of increasing consumption. The commitment of its dairymen to the Class I market has been maintained or increased, in contrast to the commitment of the industry in Idaho to cheese production. Tightening of the diversion limits on the order was the single most important issue addressed by the Utah witnesses, from the Commissioner of Agriculture on down.

The Idaho industry is a study in contrasts with dairying in Utah. Idaho's production is committed about 90 % to cheese production. It is evident that investment in farm and plant capacity has been for the production of milk for cheese and the production of cheese. To the extent that the cheese manufacturers are interested in pooling their production, the record establishes that the purpose is to directly subsidize their producer payroll, rather than to service the market. The cheese plants have shown that they will move on and off the pool with the cheese price, if that is an option. (Exh. 6, Table 3) The Idaho cheese industry is greatly to be commended in many ways for its growth and investment. But the Secretary should not establish terms of pooling for Order 135 which essentially allow billions of pounds of milk committed to cheese production to "ride" the pool through overly permissive diversion limits. The diversion limits should be tightened to 70%, a level which will accommodate a very ample reserve for the Class I market.

C. There should be "net shipment" provisions in the order applicable to both supply plants and producers (Proposals 3 and 7)

Hand-in-hand with the revision of the diversion limits should be adoption of Proposals 3 and 7 which establish net shipment provisions applicable to supply plants and to producers.³ There are few aspects of federal orders which are as subject to public derision as regulations which allow benefits to be derived from patently unproductive activity such as the pumping-in and pumping-out of milk for pooling. This record probably revealed as much use of this technique as any record in recent memory. It has been used and/or is being used by handlers in

³ Indeed, diversion limits lose significance without net shipment provisions because milk pumped-in and out is not "diverted."

Idaho and in Utah. We believe that openly allowing pooling to be achieved by this artifice is a marketing disorder in itself which must be ended.

As the Secretary recently made clear in the Order 33 interim decision (for which official notice is requested), the key to pooling is performance for the market. There is no performance when a pump-in and pump-out program earns pooling rights. Pooling must be earned on the basis of **the net** give up of milk for the fluid market. That is what Proposal 3 and 7 would accomplish and they should be adopted.

The language of the proposals is intended to give the Market Administrator the tools to determine what performance is “net” and what is not. We recognize that there may be challenges in administration of these provisions; but they are too important not to adopt on the basis of some administrative challenges. We suggest that the decision should make clear the intent of the provisions and allow the MA to administer them to carry out the intent, the most important points of which would be: (1) The measurement would take place on a monthly basis; (2) the measurement would apply to both producer milk and supply plant milk; and (3) the measurement would apply on a handler basis, although we would not oppose the MA having the authority to ferret out and “net” clear instances of triangulation of transactions among more than two handlers for purposes of qualification.

The net shipment provisions are critical for the integrity to the order. Without them, qualification for pooling does not require actual service of the marketplace. We urge the adoption of Proposals 3 and 7.

D. The performance required of a cooperative plant should be increased.

Cooperative plants should perform for the market, just as should proprietary handlers. Therefore, we support the adoption of Proposal 4 which would increase the performance required of a cooperative plant from 35% to 50% on a 12 month rolling average basis. This is in line with our requested decrease in the diversion allowances, and parallel with those requested changes. It is important to keep the relative performance for cooperative plants, and producers, in its current alignment and, therefore, DFA urges adoption of Proposal 4.

E. Summary on the pooling issues.

The pooling issues in this hearing present a clear policy issue for the Secretary to address: Whether pooling of Grade A milk is going to be considered an “entitlement” of the federal order program, so that any amount of such production will be accommodated or whether the performance provisions of the orders will be tailored to the requirements and reasonable needs of the Class I market and those who service that market. DFA believes the choice is clear that federal order pooling provisions must be realistically related to service of the Class I market. Our proposals in this hearing are intended to frame this policy issue and direct its resolution.

V. CERTAIN COSTS OF PROVIDING SERVICES OF MARKETWIDE BENEFIT SHOULD BE PARTIALLY REIMBURSED BY ADOPTION OF PROPOSAL 8

Proposal 8 requests the adoption for Order 135 of limited reimbursement to handlers of the cost of providing services of marketwide benefit. Reimbursement of such costs is authorized in the AMAA, 7 U.S.C. § 608c(5). The rationale for requesting these order provisions was summarized by Mr. Hollon for DFA, as follows (Exh. 43, p. 1)

The Class I market is where the additional revenues are generated that the Orders are designed to equalize between producers. Orders are structured with pricing surfaces and provisions designed to allow producers to share equitably in the returns from the market. Everyone gets the same blend price (adjusted for location) regardless of buyer. **Our concern in this area is that it costs more to service the Class I market and while all producers share equally in the returns of the market, not all share in the service costs.**

Areas of additional cost include transporting milk to the distributing plant locations from the production areas. The distributing plants are located in the population centers and away from the largest supplies of milk. The manufacturing plants are located in the production pockets. . . .

Secondly there are costs associated with meeting the varying demand for milk from the fluid market. Fluid processors, reflecting consumer-buying habits, do not have a weekly order pattern that matches. Procuring extra milk and processing the milk that is not needed during certain parts of the week have costs. Also all market participants do not share the costs of maintaining a quality milk supply necessary to meet the demands of the Class I market equally.

To address these issues, DFA proposes that two provisions be adopted in Order 135 to partially compensate those supplying the Class I market for their costs of such service. The proposals are for transportation credits and assembly credits, both of which are provided for in Proposal 8.

At the risk of repetition, we want to emphasize, the fundamental, and we believe indisputable, facts which are the basis for these proposals. First, there are costs which are involved in servicing the Class I market which costs are not incurred in service of the dedicated manufacturing uses. Secondly, when the Class I revenues are distributed among all producers in a marketwide pool, the benefits of the higher Class I price are shared equally. Third, this results in inequities in the marketplace among producers who bear the costs to generate the Class I revenues and those who do not bear those costs. The AMAA provides the solution in 7 U.S.C.

608c(5)(J), which authorizes order terms:

Providing for the payment . . . [from the pool to cooperatives and handlers] for services of marketwide benefit, including . . .

- (i) providing facilities to furnish additional supplies of milk needed by handlers and to handle and dispose of milk supplies in excess of quantities needed by handlers;
- (ii) handling on specific days quantities of milk that exceed the quantities needed by handlers; and
- (iii) transporting milk from one location to another for the purpose of fulfilling requirements for milk of a higher use classification or for providing a market outlet for milk of any use classification.

DFA's proposals are clearly authorized by this statutory-language and akin to credits authorized in other orders.⁴ While there is no such specific limitation in the AMAA, DFA endorses the view, embodied in these proposals, that any reimbursement of costs from the pool should be

⁴ Transportation credits have been used in the southeast, southwest and Order 30. Order 30 also has had a credit provided for delivery of Class I milk.

established at rates which provide less than 100% compensation to avoid any possibility of abuse. With those foundation points, we will discuss the proposed credits.

A. Transportation credits

The partial reimbursement of transportation costs has been the single most adopted marketwide service payment in the federal orders. It has been used in various orders both in the movement of Class I milk to market and the movement of surplus off the market. In this order, the record establishes clearly that the Class I handlers are not located near to the greatest areas of production. Therefore, as DFA demonstrated, there is more than market average costs involved in moving milk from production areas to consumption areas for Class I usage. Without any credits from the pool, this excess expense is borne solely by the supplying handler or producer.

DFA's proposal embodies several principles, summarized by Mr. Hollon, Exh. 43:

1. The transport credit should apply to Class I pounds only.
2. The credit should only apply to milk produced within the marketing area and processed in the area. There is no need to bring supplemental milk supplies into Order 135 so no need for the credit to apply to out of area sources.
3. In order to strive for the most economic efficiency, the credit should apply to milk picked up from the farm only. Most of the milk movements in Order 135 reflect this mode now. We do not see a need to apply the credit to supply plant milk as that mode has additional costs associated with it.
4. The credit calculation should recognize that a producer has a responsibility for a portion of the haul.
5. The credit calculation should recognize a typical transport volume for the market and typical cost per mile of transport operation. Because this rate is sensitive to gas prices and would have the propensity to be volatile we think the rate established should be on the low side of market experience.
6. The credit should recognize the location values already in the Order's price surface and thus reduce the total value of the calculation.

7. The credit should not apply if milk moves from a higher priced zone to a lower priced zone. This will require a modification to our original language as proposed and we will submit that language later in our testimony. However, we cannot find any rationale that would support moving milk out of the \$1.90 “zone” into a distributing plant in the \$1.60 “zone” so we would propose that that movement not receive a credit from the pool.

As should be apparent, the credit has been designed to be fair, conservative, and to have built-in safeguards to prevent abuse. As such, we believe that it reflects an appropriate device for bringing greater equity to this marketplace, as authorized by the AMAA.

B. Assembly credit

Proposal 8 also provides for an assembly credit, to reimburse fluid suppliers for a portion of the cost of assembling milk and making it available for the Class I market. DFA identified, and quantified, additional costs involved in serving the Class I market, which Mr. Hollon summarized:

Areas of additional cost that are separate from the transportation function include the cost of balancing the level of milk production with the demand of the fluid use market, maintaining a quality milk supply that meets the demands of the fluid use market, costs associated with reloading tankers, washing them and dispatching them and the overhead associated with tracking these functions.

An additional cost of balancing the fluid market is the reduction in income caused by diverting milk away from fluid plants, which are mostly in higher order price locations to manufacturing plants in the lesser priced zones. This cost is difficult to quantify and we have not attempted to quantify it but it is a loss none the less.

(Exh, 43, pp. 9-10). The elements of these costs are documented in Exh. 44, which provides detailed data from DFA’s business records for the costs of servicing this market. The order-

language necessary to implement the proposal is detailed in the hearing notice and in Mr.

Hollon's testimony. The credit would operate as follows (Exh. 43, p. 13):

1. The credit would only apply on deliveries to Class I use.
2. The credit would be paid to anyone making the delivery.
3. In order to make sure that the credit reflects only a portion of the costs we have reduced the credit to 10 cents. This is a modification of the original proposal. At this rate the cost of the credit to all milk would be 2.2 cents per cwt.
4. The reduction represents approximately 1/3 of the estimated total costs that we have outlined in the assembly and balancing function.

As with the transportation credit, the assembly credit is intended to be conservative with respect to the extent that it reimburses costs. It is not intended to fully compensate; it is intended merely to further equity in this marketplace via partial reimbursement from the pool of costs of servicing the Class I market, which service benefits all producers.

We want to address several reactions to the proposal at the hearing. First, the belated objection to Mr. Hollon's testimony with respect to assembly costs and balancing should not have been sustained by the Administrative Law Judge (Tr. 1274) and should be overruled by the Secretary as is appropriate under the rules of practice. As Mr. Hollon testified (Tr. 1090-91), in response to questions from Mr. Tosi, the matter of balancing versus assembly is a matter of "terminology" for which there is no carved-in-stone set of definitions anywhere. Consequently, it was erroneous to rule that by calling the credit an "assembly" credit, it eliminated from consideration costs which are also referred to as "balancing" costs. This ruling, upon an objection raised at the eleventh hour of the fourth day of the hearing, was ill-considered and invaded the province of the Secretary in the rulemaking process. The ALJ has the authority to rule in or out of the record evidence which is "immaterial, irrelevant, or unduly repetitious, or which is not of the sort upon which responsible persons are accustomed to rely." (7 C.F.R. § 900.8(d)) Nowhere, however, is there a grant of authority to the ALJ to determine for the

Secretary whether a “concept” is within the scope of the hearing, as the ALJ did here.⁵

Therefore, that “ruling,” which may in fact be of no consequence since it did not relate to evidence, should, nevertheless, be overruled and disavowed by the Secretary.

There were concerns noted that perhaps the assembly credit would go to parties who were not deserving of it and that it should be rejected for this reason. For instance, the observation was made that the handler for independent producers who regularly supplied a distributing plant could be entitled to greater credits than the marginal, balancing supplier since the credits are paid on Class I pounds actually delivered. In DFA’s view, while this is an arguable point, it should not defeat the credit because the credit is just one modest component of the attempt to address the huge inequities and disorder in this marketplace which derive from the fact that the producers and cooperatives which supply the Class I market day in and day out receive such a de minimus return on that effort. They share the same blended-down pool value as the dedicated cheese plant suppliers whose pay price is supplemented with pool revenues obtained through the various mechanisms presently in the order language which accommodate the near-open pooling of so much milk. Put another way, in DFA’s view, the proposed credit clearly furthers net equity in the marketplace between the suppliers of the Class I handlers and the rest of the market.

VI. THE PROPRIETARY BULK TANK HANDLER PROVISION SHOULD BE ABOLISHED OR RESTRUCTURED (PROPOSALS 5, 11, 12, 13, 14)

DFA urges the Secretary to eliminate the proprietary bulk tank handler provision in Order 135 through the adoption of Proposal 5. Failing that, the provision needs to be radically restructured (through Proposals 11 to 13) to assure that milk is not marketed for Class I uses at

⁵ The ruling did not rule in or out any evidence. The pronouncement was: “I rule that the request for an assembly credit does not include a credit based on balancing and that therefore the concept of including in the assembly credit a credit related to balancing is beyond the scope of this hearing.”

less than the minimum order price, thereby assuring the uniformity of handler cost which is so critical to the order system. In addition Proposal 14 needs to be adopted to make clear that qualification must be to a distributing plant.

The record demonstrates that (1) huge amounts of milk are being pooled through proprietary bulk tank units with minimal actual Class I usage and (2) that milk is being qualified by proprietary bulk tank handlers by pumping-in and pumping-out; and that (3) milk is being sold at less than Class I prices by proprietary bulk tank handlers. The combination of these factors suggests that the provision should be eliminated.

Exhibit 10, Table 1, documents that the Class I utilization of proprietary bulk tank handler milk (in the months when it can be revealed) is 3% to 5%. This can be “achieved” by: delivery to a distributing plant and receipt back of the milk, after pumping-in and out, to the limit of the distributing plant’s qualification under Section 1135.7(a) (25% route disposition) and diversion of producers so qualified at the maximum rate on the order of 90%. This pyramiding of qualification thus allows the proprietary bulk tank handlers to pool up to 20 or more loads of milk for every load given up for Class I usage.⁶ This system serves no purpose for this order.

The current proprietary bulk tank handlers – who are two of the three large proprietary cheese manufacturers in Idaho – urge retention of the provision as an efficient means for them to pool producer milk, by delivery from the farm rather than from a plant. They contrast this efficiency with that of assembly through a supply plant. Furthermore, they contend that their producers have the right to be pooled in the same fashion, to the same degree, and with the same ease as cooperative members. Their arguments have several deficiencies.

First, there is no “right” or entitlement to pooling on this or any other federal order. The fact is that the producers who are patrons of Glanbia and Davisco have, in large part, migrated to

⁶ The pyramiding math works this way: 4 loads of producer deliveries for qualification can be pumped in and out of a plant using 1 load for Class I. That will leave that plant with the required 25% Class I for a pool distributing plant. Then the 4 loads of producer milk qualified will each qualify 9 more loads of diversions pursuant to the current 90/10 diversion permitted. Thus, 1 load of Class I sales can theoretically qualify 39 additional loads of disposition to a nonpool plant.

Idaho in recent years and constructed new production facilities for the purpose of supplying milk for cheese production. While these producers have Grade A permits, so that the milk is eligible for fluid use, that is simply a characteristic of modern production and a requirement for various manufactured products, or customer specifications.⁷ These producers are set up to “cash flow” on cheese yield formula pay price schedules and are neither committed to, nor established for, the fluid market. As testimony demonstrated, Glanbia and Davisco (Jerome Cheese) basically use pool draw funds for their own bottom line: Their producers are paid the same price whether they are pooled or not.

Furthermore, Glanbia and Jerome made clear that they pool milk only when it is advantageous. When the Class III price is such that pooling is not economic, they do not pool the milk. To their credit, they were rather candid about the purpose and function of their pooling which is basically to draw whatever they can whenever they can from the pool. Without a commitment to service Class I, which one would not expect, there is no reason for the order to provide a mechanism – a special device – for these plant operators to pool a portion of their producer milk.

Without the proprietary bulk tank handler provision, any of the Glanbia or Jerome producers who wish to pool their milk can associate with a distributing plant directly or with another handler, cooperative or proprietary, which more regularly supplies the Class I market and pools its milk.

If the proprietary bulk tank handler provision is retained in the order, the Dean Foods’ Proposals, numbered 11 to 13, should be adopted. It is imperative that the integrity of the Class I minimum prices be retained. Without this assurance of handler uniformity, the federal order system is undermined. The record here is quite unequivocal: Milk can presently be sold for less than minimum Class I prices to distributing plants by proprietary bulk tank handlers, and that has occurred and, presumably, is occurring regularly. This is simply intolerable and the Dean

⁷ Davisco’s Jerome Cheese operation is a fully Grade A cheese and whey production facility for its own manufactured production purposes.

proposals for assuring the minimum Class I price should be adopted.

VII. THE TECHNICAL AMENDMENTS PROPOSED BY THE MARKET ADMINISTRATOR SHOULD BE ADOPTED.

The Market Administrator's office offered three proposed amendments to order language for purposes of clarity in administration. DFA supports adoption of Proposal 14 (if necessary), Proposal 15, and Proposal 16.

Proposal 14 needs to be considered if Proposal 5 is not adopted and the proprietary bulk tank handler provision remains part of the order. In that event, Proposal 14 should be adopted as appropriate. The proposal would require a proprietary bulk tank handler to be associated with the order through a distributing plant, not just any pool plant. Mr. Mykrantz testified that the existing language is the product of the amalgamation of the language of the prior Orders 135 and 139 which was not adapted. If proprietary bulk tank handler language remains in the order, this clarification to the language should be adopted.

DFA also supports adoption of Proposal 15. This proposal adds Class II to the manufacturing uses of milk at nonpool plants which a handler can elect to not pool, without the loss of qualification on the Order. This clarification puts nonpool Class II plants in the same status as nonpool Class III and IV manufacturing operations.

Proposal 16 should also be adopted. It amends the second sentence of Section 13(d)(1) of the order by changing "until" to "unless." The purpose of the change is to allow the diversion of the milk of a producer who goes off and comes back on the market because of a loss of Grade A status be pooled in the same manner as the milk of a producer who is new to the market. The producer's milk can be pooled for the entire month if a days' production is delivered at any time during the month to a pool plant.

VIII. THE ORDER SHOULD BE AMENDED ON AN EMERGENCY BASIS

DFA urges the Secretary to handle the issues in this hearing on an emergency basis by implementing any order changes without a recommended decision. Use of the interim rule process accommodates this procedure while allowing comments upon a tentative or interim rule. We believe that procedure is necessary and appropriate, as well as supported by the record.

This hearing, like those before it in other orders, is addressing urgent and disorderly marketing conditions which have undermined, and continue to undermine, the purposes of milk orders which are to foster and maintain orderly marketing conditions. The disorder in this market is causing great economic dislocation and loss among producers in Utah in particular, as the record starkly establishes.

Some of the disorder which requires immediate attention on this record includes the abusive pumping-in and pumping-out pooling practices which are prevalent, if not rampant in the order and which accommodate the pooling of huge amounts of milk supplies which are not serving the market in any real way. Furthermore, with respect to the proprietary bulk tank handler provisions there is undisputed evidence that Class I price equity among all distributing plants has been undercut. This is a disruption to a basic pillar of the federal order system which should be addressed in the most efficient manner possible.

We support emergency action on this hearing both in terms of an interim order and in terms of the implementation of an order without 30 days' advance publication.

DFA also continues to request and support contemporaneous amendment of orders. In this case Orders 124 and 135 should be amended at the same time to avoid the inadvertent creation of opportunistic pooling disorder resulting from changes in one without changes to the other.

IX. CONCLUSION

This proceeding presents the Secretary with the opportunity, indeed the duty, to conform this marketing order to the market principles so frequently enunciated relating to the supply of the Class I market. To achieve that objective, the pooling and performance standards must be revised to require reasonable association with the Class I market for all producers and plants. Furthermore, to provide for reasonable equity between producers who shoulder the responsibility for the fluid supply and those who share in the benefits of the market without directly bearing a proportionate share of the costs, provisions for payment of marketwide services in the form of transportation and assembly credits should be adopted. The choices which the Secretary must make will not be acceptable to all; but the results are directed by the AMAA's mandate that

orders provide for the orderly marketing of milk for fluid consumption.

Respectfully submitted,

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