August 21, 2002

Ms. Joyce Dawson,
Hearing Clerk
United States Department of Agriculture
Room 1081, South Building
1400 Independence Avenue, S.W.
Washington, DC 20250

Re: Milk in the Pacific Northwest and Western Marketing Areas
Docket Nos. AO-368-A30 and AO-380-A18 [DA-01-08]

Dear Ms. Dawson:

Enclosed please find an original and four (4) copies of the Post-Hearing Brief of Northwest Dairy Association for filing in the above matter. Please note that two of the copies are being mailed in a separate envelope.

Thank you.

Respectfully submitted,

Douglas C. Marshall,
Sr. Vice President

Enclosures

cc by email to:
Hon. Jill Clifton, ALJ
Gino Tosi
Clifford M. Carman
Marvin Beshore, Esq.
Charles M. English, Esq.
John H. Vetne, Esq.

UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

In the Matter of:	)	Docket Nos. AO-368-A30
	)	and AO-380-A18 [DA-01-08]
Milk in the Pacific	)	
Northwest and Western	)	Post Hearing Brief of Northwest
Marketing Areas	)	Dairy Association

This post hearing brief is submitted by Northwest Dairy Association, following the public hearing held in the above-identified rule making proceeding. The hearing was held from April 16-19, 2002, in Salt Lake City, Utah, before the Honorable Jill Clifton, Administrative Law Judge.

This proceeding considers a number of proposals and issues involving two Federal Milk Marketing Orders: the Pacific Northwest Order (Order 124) and the Western Order (Order 135). This brief will address the issues in the following categories:

I. Philosophy of Pooling Standards
II. Pooling Standards for Distant Milk
III. Pooling Standards for Milk Produced Within the Western Order Marketing Area
IV. Bulk Tank Handler Issues
V. Assembly and Transportation Credits
VI. Market Administrator Proposals

Northwest Dairy Association (NDA) is the proponent of two proposals that pertain to pooling distant milk (Proposals No. 1 and 10), and we are vitally interested in each of the other proposals. In addition, we would be affected – in some cases quite negatively – by each of the other issues being discussed at this hearing.

NDA is a cooperative association that markets the milk of approximately 600 producers (roughly 2/3 of the milk) currently pooled on the Pacific Northwest Order, and approximately 100 producers (roughly one-fourth of the milk) pooled on the Western Order. Background information about NDA and its operating company, WestFarm Foods, appears in the Transcript beginning at Page 126.

I. PHILOSOPHY OF POOLING STANDARDS

In this section of our brief, NDA offers a review of the relevant statutory provisions that govern pooling standards, and then outlines a method of analyzing how pooling provisions relate to the pricing provisions of an order. With that analysis, we develop the reasons which underlie the arguments we advance in the subsequent sections of this brief.

A. Statutory Overview. It is helpful to begin any discussion of pooling standards by referring back to the statutory framework which establishes the purpose of Federal Milk Marketing Orders.[1]

The fundamental goal of Congress in establishing all agricultural marketing orders was to ensure orderly marketing of agricultural commodities – as can be seen from the very first section of the enabling Act:

> **Sec. 601. - Declaration of conditions**
>
> It is declared that the disruption of the **orderly exchange of commodities** in interstate commerce impairs the purchasing power of farmers and destroys the value of agricultural assets which support the national credit structure and that these conditions affect transactions in agricultural commodities with a national public interest, and burden and obstruct the normal channels of interstate commerce.

This Congressional intent was repeated in the section which provided the specific authority for the Secretary to establish marketing orders:

> **Sec. 602. - Declaration of policy; establishment of price basing period; marketing standards; orderly supply flow; circumstances for continued regulation**
>
> It is declared to be the policy of Congress -
>
> (1) Through the exercise of the powers conferred upon the Secretary of Agriculture under this chapter, to establish and maintain such orderly marketing conditions for agricultural commodities in interstate commerce as will establish, as the prices to farmers, parity prices as defined by section 1301(a)(1) of this title.
>
> (2) *[not related to this discussion]*
>
> (3) *[not related to this discussion]*
>
> (4) Through the exercise of the powers conferred upon the Secretary of Agriculture under this chapter, to establish and maintain such orderly marketing conditions for any agricultural commodity enumerated in section 608c (2) of this title as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices. *[Note: Milk is one of the commodities enumerated in 608c(2).]*

The two quoted subsections provide strong guidance for the Secretary regarding how marketing orders should function. The first subsection identifies the linkage between

---

[1] The Agricultural Marketing Agreements Act is codified in Title 7 of the U.S. Code, beginning at section 600.

orderly markets and better producer prices – the alternative being "cutthroat competition" among farmers seeking to become the successful supplier to the choicest markets. The second subsection identifies a public benefit in "an orderly flow" of milk to market, a concept which may encompass the desirable goal of efficiency in milk movement. And the second subsection also establishes the goal of avoiding "unreasonable fluctuations in supplies and prices", so that both consumers and producers are well served.

The other key principle of the order program is to ensure an adequate supply of milk, so that consumers can be served. The Secretary's specific authority to regulate handlers is conferred in section 608c of the Act. Section 608c(5)(18) governs milk pricing:

> The Secretary of Agriculture, prior to prescribing any term in any marketing agreement or order, or amendment thereto, relating to milk or its products . . . [major portions omitted] . . . he shall fix such prices as he finds will . . . insure a sufficient quantity of pure and wholesome milk to meet current needs and further to assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs, and be in the public interest.

These statutory principles are echoed in USDA's own brief description of the purpose of milk orders, as published on the USDA web site:

> Program Objectives
>
> To stabilize market conditions, benefit producers and consumers by establishing and ***maintaining orderly marketing conditions***, and assure consumers of ***adequate supplies*** of pure and wholesome milk at all times. *[Emphasis added.]*

Most of the specific provisions regarding milk orders are set forth in section 608c(5). While that section has provisions that pertain to other issues in this proceeding, the only part of section 608c(5) applicable to this discussion of pooling is section 608c(5)(G):

> No marketing agreement or order applicable to milk and its products in any marketing area shall prohibit or in any manner limit, in the case of the products of milk, the marketing in that area of any milk or product thereof produced in any production area in the United States.

This provision requires that pooling provisions apply equally to all milk that seeks to be pooled, regardless of where it is produced. Nonetheless, milk orders have long recognized that the economics of transportation do impact the location value of milk, including milk produced outside an order's marketing area.

The last relevant statutory provision is section 608c(11)(C):

> All orders issued under this section which are applicable to the same commodity or product thereof *shall*, so far as practicable, prescribe such different terms, applicable to different production areas and marketing areas, as the Secretary finds necessary to *give due recognition to the differences in production and marketing of such commodity or product in such areas*. The price of milk paid by a handler at a plant operating in Clark County, Nevada shall not be subject to any order issued under this section. *[Emphasis supplied.]*

This provision just quoted permits (and perhaps requires) different pooling standards from order to order, to reflect different marketing conditions within each marketing area.

B. General Approach to Pooling Standards. Turning from that review of the key statutory guidelines for milk orders, this brief will now discuss NDA's view of how the principles that flow from the statute should govern eligibility for pooling.

NDA submits that an analysis of pooling standards must begin with a consideration of distance from an order's pool plants:

- Close In Milk. This is milk produced on farms which are close enough to the market that they are almost inevitably competitors to serve the pool plants, given the attractiveness of pool prices coupled with reasonable transportation costs of delivering to pool plants. The Department has traditionally set pooling standards to accommodate readily the pooling of producers in the milksheds near the pool plants. This is virtually mandated by the statutory requirement and the Department's policy of preventing disorderly marketing conditions, discussed earlier in this brief. We have defined this "close in" milk using on an economic test (cost of transportation), but we note that DFA's witness used a similar concept of "local" milk, which he suggested might be defined in terms of roughly a 200 mile radius from the pool plants.[2]
- Milk Further Out. The Department historically has not hesitated to accommodate the pooling of milk outside the marketing area when it is needed to ensure an adequate supply of milk to the market or when it is naturally associated with the market. It is an additional "reserve supply" to the market, along with the "close in milk". Prior to the creation of the Western marketing area, the predecessor Great Basin order's pool included many Idaho producers who were a natural reserve supply for the Salt Lake City pool plants even though they were then outside the marketing area.
- Distant Milk. For the most part, the pre-consolidation order language did not accommodate the pooling of milk produced at great distance from the market unless it was actually delivered on a regular basis to the market. Various mechanisms were instituted to accomplish this, including delivery requirements that remain in many of the post-consolidation orders. Historically, milk diverted to plants outside the order (near where it was produced) would draw a lower blend price[3], with the location-based adjustment reflecting the fact that milk is of less value to an order if it is not readily available to the market from which the pool dollars come. That changed with order consolidation and the national price surface, which opened up artificial association of producers with no traditional economic incentives to associate with the order.

---

[2] Testimony of Elvin Hollon, Transcript at p. 638.

[3] The location value of the producer milk involved was lowered in proportion to the distance of the receiving plant from the market.

Proposals No. 1, 2, 9, and 10 in this proceeding deal with what has just been defined as "distant" milk. Under our concept of distant milk, the producers are so far from the market's pool distributing plants that natural economic forces (even when coupled with the incentives provided by the milk order system) would not normally move that milk to those plants. Those producers have insufficient economic incentive to spend money to haul their milk to the Western Order pool distributing plants. Their delivery cost of acting as a reserve supply would be prohibitive. Accordingly, their association with the pool is merely for the purpose of collecting pool dollars, rather than serving the market. NDA characterizes this as "artificial pooling" or "paper pooling", and we urge the Department to limit it in all Federal orders.

Proposals No. 3 through 7 deal with the more traditional pooling standards (distributing plant and supply plant qualifications, and diversion limitations). They relate to what was defined above as the "close in" producers near the pool distributing plants and those "further out" who constitute an additional reserve supply. These pooling standards effectively determine the amount of milk that may be pooled.

In accordance with the statutory considerations advanced earlier, these standards should be liberal enough to allow pooling of close in milk (to prevent disorderly marketing conditions) and expansive enough to make an additional reserve supply of milk available <u>if it is needed</u> to ensure an adequate supply of milk. Historically, that is what the Department has done:

- Pooling standards were relaxed to accommodate growing supplies of the "close in" milk. During the 1980s and 1990s, it was common to increase the allowable diversions to accommodate growth of milk supplies that had been historically associated with the market – because a failure to do so would result in disorderly market conditions. In addition, we suspect there have been instances where pooling standards were loosened to attract an additional reserve supply to a regular affiliation with the market (in the South, for example).
- Pooling standards could be tightened if necessary to assure that milk being pooled is, in fact, delivered to the pool distributing plants which need it. We are not aware of a specific instance where this has been done to ensure service to bottlers, which probably speaks to the success of the Department's traditional approach in setting diversion limitations – it is not broken, and it does not need to be fixed!

The Department's practice of using pooling standards to balance between too much and too little milk was continued in the Final Rule, in which the following were observed[4]:

- "Marketwide sharing of the classified use value of milk among <u>all the producers in a market</u> is one of the most important features" of an order. Handler pools are no

[4] The items referenced can be found in the internet version of the Final Decision, within the page on Federal Order Reform. The Final Decision is on the internet in several parts. The part entitled "Provisions Applicable to All Orders" contains a discussion of pooling provisions, beginning on the first page. That discussion is entitled "The Concept of Pooling Milk Proceeds".

longer part of the milk order system. (As will be shown later in this brief, DFA's proposals would have an effect similar to a handler pool.)

- Commenters during the order consolidation process had felt that pooling "should be performance-oriented in meeting the needs of the fluid market". So-called "open pooling" was rejected "principally because open pooling provides no reasonable assurance that milk will be made available in satisfying the fluid needs of a market". One of the principal issues presented in this hearing is what "performance" means.
- In the Final Rule, the Secretary recognized the tension between requiring delivery to fluid plants, and risking disorderly markets by doing so: *"The pooling provisions for the consolidated orders provide a reasonable balance between encouraging handlers to supply milk for fluid use and ensuring orderly marketing by providing a reasonable means for producers within a common marketing area to establish an association with the fluid market."* The need to provide "a reasonable means" to associate with the pool is a key principle in avoiding disorderly marketing.
- This was done on a market by market basis with what appears to be consideration of Class I utilization percentages. Two examples were used in the Final Rule discussion: Florida, "where close to 90 percent of the milk will be used for fluid use" and the Upper Midwest market where "a relatively small percentage of milk will be needed for fluid use". NDA submits that the percentages being considered were based on all the milk produced within the marketing area's milkshed (close in and further out), not the percentage of pooled milk only. It should be recognized that much of the milk produced in the Western order area today is not pooled on the order – if the desire were to be sure that it were all pooled, the current 90% diversion limitation should be 95%.[5] As will be shown below in connection with Proposal No. 11, this is causing disorderly markets today.
- In addition, the market administrators were given authority to adjust the diversion percentages of each order, administratively. This was seen by some as a "call provision" which could be used to encourage deliveries to pool plants if needed.[6]

---

[5] During the order consolidation process, it was noted that the new Upper Midwest order would have about 15% of the milk produced within the order area eligible for pooling. The Final Rule established a 10% diversion limitation, because not all producer milk in the area would have "deliveries to pool plants" sufficient to qualify all producers for pooling (an uneven distribution of deliveries). In the Western Order marketing area, NDA estimates there is close to 800 million lbs produced monthly, yet during months when there is no depooling of regularly associated milk the amount pooled is typically less than 500 million lbs. If all 800 million lbs were pooled, the Class I utilization percentage would be about 10%. The 10% figure compares the 15% figure in the Upper Midwest. Following the same logic, if 15% utilization suggests a 90% diversion requirement in the Upper Midwest, then a 10% utilization figure in the Western order might have indicated a 95% diversion limitation. The Department's thinking during the consolidation process certainly would not have indicated today's proposed reduction in the diversion requirements of the Western order.

[6] Market Administrator discretion to adjust the percentages was characterized as a "call provision" in he Preliminary Report of the Dairy Division's Identical Provisions Committee, dated November 6, 1996, at page 11 of Section 3. A "call provision" more typically had been a specific provision allowing an Administrator to order

Also noteworthy were some things not included in the Final Rule. The earlier work of the Dairy Division's Identical Provisions Committee had recommended several provisions to discourage "opportunistic depooling", including a variation on NDA's proposal to lock milk into the pool for more than the traditional month-by-month period.[7] While there were complaints about opportunistic depooling at the hearing, it is allowed under current order provisions and there were no proposals to address this issue.

NDA submits that an analysis of pooling standards may need to extend to consideration of related pricing issues. To illustrate that interrelationship between pricing and pooling, consider a hypothetical situation where a bottling plant within one of today's larger, consolidated orders complains it is unable to attract milk. The Department could approach the complaint in different ways:

- If it is a general problem throughout the order, then to ensure an adequate supply of milk pooling standards may need to be relaxed (in a deficit market, to attract more reserve milk) or tightened (in a surplus market, where milk won't move to the city away from the manufacturing plants in the country). An alternative would be to use marketwide service payments which apply to all pool plants (as is the assembly credit being proposed in this proceeding) which effectively raises the price at distributing plant locations.
- If lack of milk is unique to one plant or sub-region within the order, tighter pooling standards may be the wrong answer for most of the market – but alternatively, an adjustment in the "pricing map" may be called for to establish a more effective price at that location. That same result (higher net price) could be achieved through a targeted marketwide service payment which applies only to that narrow sub-region (as is the transportation credit being proposed in this proceeding).
- On the other hand, if it is shown that that hypothetical situation relates to other factors (like poor credit, poor receiving facilities, etc.), then the solution may be to simply do nothing and let economic forces work outside the order to solve the problem. As a general rule, if milk is moving in an orderly fashion to all of an order's distributing plants, it may be unwise to use any of these potential tools, and a different case would have to be made to justify their use.

---

milk to move to fluid plants, such as the current Section 1124.11(b)(1) of the Pacific Northwest order. Formal call provisions also are available in the California state order, where there are no pooling standards because pooling is mandatory for California producers' milk delivered to plants located within that state.

[7] Preliminary Report of the Dairy Division's Identical Provisions Committee, dated November 6, 1996, Section 1 page 19, Section 2 pages 12-13, Section 3 pages 4-11. *"The Committee agrees that handlers should be discouraged from moving milk in and out of the pool and has made some recommendations to remedy this problem."*, quoting from Section 3, page 8. However, those proposals were rejected and not included in the Final Rule.

Continuing with NDA's thesis about the relationship between pooling standards and pricing, whenever some pooling or pricing situation is brought to the Department as a hearing proposal, it is useful to begin with a three-part analysis:

1. First, define "What is The Problem"?
2. Then consider whether "The Problem" exists because of price misalignment or because of a problem with pooling standards. If not, then it must be analyzed and addressed in some other fashion, or not at all. (For example, issues surrounding uniformity of pricing might be thought about using relatively narrow considerations of competitive equity.)
3. If "The Problem" does relate to price misalignment or to a problem with pooling standards, then the economics of the milk movement at issue can be considered in light of all of the potential pricing and pooling tools, to determine the best solution.

Pricing and pooling are interrelated, and need to be considered as a whole. The analysis just suggested a focus on the right solution, which may not necessarily be the proposed solution. *NDA will apply the foregoing analysis to each of the issues being addressed at this hearing, and to the specific proposals formally suggested to deal with them.*

C. Summary of Policy Considerations. NDA submits that the statutory considerations and other Federal order policy discussion lead to the following conclusions:

- As a general proposition, all producers who meet the "close in" definition must be allowed to pool, or else disorderly competition for deliveries to the market is extremely likely. In the Western Order, NDA submits that all farms within the marketing area are close enough to the market to fall within the definition of "close in" milk and therefore must be included in the pool. (This will be more fully explored in Part III of this brief.) If any of those producers is excluded from the pool, they will have a strong incentive to compete aggressively for the right to serve plants at one or more of those cities. Accordingly, the pooling provisions must be permissive enough to create and maintain orderly marketing.
- The pooling provisions should be tight enough to ensure that the bottlers in the marketing area are served.
- The Department should continue its balancing of the above two concepts, as pooling standards are revised based on hearings that indicate there have been changes in market conditions.
- The producers of the distant milk are unlikely to cause a disorderly market by aggressively compete for the right to deliver to pool distributing plants. It therefore does not need to be accommodated, and there is no other reason for any of it to be included within the marketwide pool. The statute does provide that the order can not impair the ability of producers to pool based on their location, so the producers within that distant zone should be free to market within the pool if they do indeed wish to

bear the actual cost of delivery. But there is no reason (statutory or otherwise) to establish order provisions which allow that milk to be pooled.

The purpose of the foregoing Part I of this brief is to offer and suggest a consistent method of analyzing all of the proposals regarding pooling standards, a method which is based on the statutory requirements for the milk order program and which also is grounded in sound economics. It has led to some tentative conclusions regarding the various pooling proposals, but each of them will be discussed further in the Parts of this Brief which follow.

In this proceeding, NDA and Dairy Farmers of America (DFA) have proposed and argue different pooling concepts. To some extent, we align philosophically with DFA, even though we reach different positions on what pooling standards are appropriate for the "close in" producers who are willing and able to serve the pool distributing plants. We feel that such "close in" producers should be pooled, under the theory of marketwide pooling, to prevent disorderly market conditions from developing -- rather than excluding close in producers from the pool under a theory that there is "more than an adequate supply". NDA submits that such thinking would be a huge stretch of the statutory guidelines, driven solely by a desire to create higher prices for a smaller group of producers who control access to pool plants.

The difference between the two cooperatives' philosophy can be seen in the cross examination of NDA's witness by Mr. Beshore, who tried to make the point that NDA had supported a diversion limit of 80% in the recent Pacific Northwest hearing (which is true). DFA sees 80% therefore being "fair" in the Western Order market. NDA sees the 80% in the Pacific Northwest as <u>allowing all the milk in that market to be pooled</u>, whereas we emphasize that 80% in the Western Order would eject from the pool substantial amounts of milk produced within the marketing area by producers who have traditionally been associated with the pool. NDA submits that DFA is asking the Department to do something that is unprecedented, and certainly not justified in light of the Pacific Northwest proceeding.

II. POOLING STANDARDS FOR DISTANT MILK

<u>A. General Comments on Distant Milk.</u> Proposals No. 1, 2, 9, and 10 all deal with what NDA describes as an <u>artificial</u> pooling of "distant" milk.

As suggested in the first Part of this brief, we begin by trying to determine "What is The Problem?" We identify "The Problem" as: *the practice of associating "distant" milk to the affected marketwide pools, which is inappropriate because it does not meet the normal concepts of service to the market and because it has created disorderly markets.*

We see this as a problem for several reasons. This is milk which has no association with the market. It is artificial because (thinking back to our definition of distant milk) the producer's location is such that economics never move it to plants within the marketing area being served by the market. It is associated with the market for the sole purpose of drawing money from the marketwide pool. It therefore does not benefit the market, it simply exploits a loophole.

Another problem is that it blends down the marketwide pool price, and thereby takes money away from the producers whose milk is needed to ensure an adequate supply of milk in the market. If the distant producers who "ride the pool" were in fact available as a reserve supply, then the potential danger of driving near-in producers out of business would be a non-issue in terms of the statutory standard of "ensuring an adequate supply". But they are not functionally part of the supply, and for that reason pooling such milk does not protect the market's supply, it actually damages it by reducing payments to the actual suppliers of the market.

Orders need pooling standards to prevent the artificial pooling of "distant" milk that would not be considered a "reserve supply" in any other context. If the pooling rules permit "distant" milk to be artificially pooled, disorderly marketing could follow:

- The ability to pool distant milk artificially means that it will happen whenever there is a greater financial incentive to pool than would otherwise be economically justified.
- If there is such an incentive, it encourages an entity which can take advantage of the situation to obtain <u>more</u> "deliveries to pool plants" so that <u>even more</u> milk can be pooled (more deliveries allow more milk to be pooled). Such incentives lead to "cutthroat competition" to obtain (or retain) those deliveries, and thereby create disorderly marketing.
- That also results in artificial incentives to obtain additional producer milk to "deliver to pool plants". Such an artificial competition for milk supplies also would be "disorderly", by sabotaging the basic concept of a marketwide pool which provides equal returns to all producers.

So <u>***that*** is "The Problem"</u> as we see it. These things have happened in both the Pacific Northwest order and the Western order, and the evidence shows they continue to happen. Clearly this situation is a problem, and the Department to its credit has taken steps to address similar problem situations in other Federal orders.

Following the analytical approach suggested in the first part of this brief, we must ask whether this is related to pricing and pooling standards, and if so what the best solution(s) may be. Clearly, "The Problem" is caused by an attractive price opportunity, and it is happening because the pooling standards have not previously anticipated this situation.

Proposals 1, 2, 9, and 10 all propose new pooling standards, developed to deal with this situation. Traditionally, milk orders relied on location value to measure whether the attachment of milk to a market was real or artificial. If it was actually delivered to plants located away from the marketing area being served by the order, it then had a lower location value in the eyes of the marketing area that the order served – the further away from the marketing area the milk was delivered for processing, the less value it had for the market, and the amount drawn from the pool was reduced accordingly. In what may have been an unintended consequence of the so-called "reform" process, this aspect of location pricing was removed from the milk marketing order system, and the phenomenon of artificially paper-pooling distant milk soon followed.

NDA submits that new pooling provisions are the <u>best</u> solution to address this situation, short of a complete review of the decision during the order consolidation process to establish a unified system of location values across the country, based on Class I supply-demand factors. There has been a lot of discussion within the industry that this should be reviewed, and that the Class I price surface should apply only to plant pricing, so that producer location values could be reduced on milk that is delivered to locations outside the marketing area (after all, if it is not functionally available to plants in the order to which it is attached, it has a much reduced location value). NDA did not propose that solution, because the Department seems to be focusing on this situation order by order. But in the end, it may still be appropriate to call a national hearing to discuss this.

Changes to the order's diversion limitations would not address this situation, and the proposals to tighten diversions were not advanced to address this problem. NDA submits that diversion limitations are not the primary cause for "distant" milk to be artificially attached to the market.

DFA has elected not to propose delivery requirements (so-called "touch base" provisions). That would be an alternative way to address this situation.

The only other tool available to address this situation would be new pooling standards. Proposals No. 2 and 9 (state unit pooling) would institute a delivery requirement for that out of area milk to be pooled. This would let the economics of each case determine whether or not the milk is pooled.

Proposals No. 1 and 10 (to end simultaneous double pooling of the same milk on both a state and federal order) would exclude from the pool producers who choose to stay within the alternative state order pool. We must assume that they would do so because the state order provides a higher return. We would define their milk as "distant", because those producers have insufficient economic incentive to spend money to haul their milk to the Western Order pool distributing plants.

<u>B. Proposals No. 1 and 10 should be adopted.</u> NDA was the original proponent of these two proposals, which received substantial support at the hearing from other parties. We know of no opposition to them.

NDA submits that the evidence is clear that distant milk is being artificially pooled on both the Pacific Northwest and Western order markets from California. It meets our concept of "distant" milk because – with the exception noted below -- the order program would not find a need to attract California milk as a reserve supply for either market. Furthermore, with today's pooling rules, a rational decision based on economics alone would not cause that milk to be delivered even on a reserve basis to either market. The exception is the group of California producers just south of Oregon, who regularly deliver to plants in the Pacific Northwest market, and who are justifiably pooled there – but those deliveries can not simultaneously be pooled on the California state order. A pooling standard should be developed to limit that practice by disallowing any milk to be pooled if it is pooled on the California state order pool or any other state order pool.

Proposals No. 1 and 10 are "twin" proposals, which would establish similar rules in the Pacific Northwest order (Proposal No. 1) and the Western order (Proposal No. 10). Both proposals would eliminate the practice known as "Double Dipping" – that is, pooling milk under a Federal order that is also pooled under a state order. Simultaneous pooling of milk (and drawing money form both pools on the same milk) would not be permitted if a producer were to be otherwise eligible for pooling on two Federal orders.

The effect of double dipping is to obtain greater financial advantage for the organization able to "double dip", and thereby to obtain a competitive advantage for that organization. Therefore, this practice presents a situation in which "disorderly marketing" can occur, as producers could theoretically scramble all over each other for the ability to take advantage of this potential windfall.

What makes this practice particularly indefensible is that the milk involved seems never to be actually delivered to the Federal order marketing area, from which the additional revenues are drawn (other than to meet any pool qualification requirements). This is done for the sole purpose of shifting revenues for the benefit of a cooperative or for the benefit of producers who take advantage of the scheme. Note that such a practice is easier for large cooperatives with producers in multiple regions, or those which can develop national alliances to carry out these schemes.

Such milk typically continues to be delivered to plants located near where it is produced, rather than being delivered to the market whose pool is being raided. Such pooling is "artificial" because it is pooled only on paper, opportunistically, for no reasons related to service to the affected market.

The intent of these proposals to implement a concept recently incorporated into the Upper Midwest Federal Order (Order No. 30), in a decision of which official notice was taken.[8] In that decision, the Secretary of Agriculture emphatically, and unambiguously, concluded that it was inconsistent with Federal order philosophy for milk to be pooled both on a

[8] Transcript, pp. 137-138.

statewide marketing pool that is outside the Federal order system, and simultaneously on a Federal Order.

Similar changes should be made in all other Federal orders, as soon as possible. It threatens to undercut political support for the marketing order program, due to the very unfair disadvantage the practice imposes on producers pooled in the "target" order on which the California milk is loaded.

If the Department wishes to have greater consistency in the various order provisions dealing with this issue, NDA would support such modifications of Proposals No. 1 and No. 10 as the Department feels may be appropriate to be consistent with the language of Order 30 and perhaps other orders. We note that the Order 30 change, which came out after our proposals were submitted, amends Section 13 (which defines producer milk), whereas we have proposed a change in Section 12 (which establishes qualifications to be a producer). Either approach is acceptable.

Proposals No. 1 and 10 are unopposed, consistent with Federal order philosophy, and prevent disorderly marketing conditions. Neither was opposed at the hearing, and strong support for the concept was expressed by numerous witnesses. Both Proposals should be adopted.

<u>C. Proposals No. 1 and 10 should be adopted on an emergency basis.</u> NDA was the original proponent of these two proposals, which received substantial support at the hearing from other parties.

Adoption of Proposal No. 1 on an emergency basis was supported by the only two parties from that order who participated in the hearing.[9]

Adoption of Proposal No. 10 on an emergency basis was supported by the following participants from the Western Order:

- River Valley Cooperative *[Rod Carlson, Transcript at pp. 263-264]*
- Jerome Cheese Company *[Jon Davis, Transcript at p. 730*
- Glanbia Cheese Company *[Jeff Williams, Transcript at p. 756]*
- Magic Valley Quality Milk Producers *[Alan Stutzman, Transcript at p. 959]*
- Gossner Cheese *[Dave Larson, Transcript at p. 828]*
- Dairy Farmers of America *[Elvin Hollon, Transcript at p. 1018]*

The evidence in this hearing record demonstrates that California milk is being "double dipped" on the Western order in great quantities. NDA computed that nearly $4 Million was diverted from the Western order pool, which reduced the producer blend price by an

---

9 Testimony of Dan McBride, Transcript, p. 140; Testimony of Elvin Hollon, Transcript, p. 1018.

average of 8 cents per cwt throughout the entire year.[10] This is a present emergency, and the trend is toward greater pooled volumes.[11]

While we were aware of no such double dipping occurring in the Pacific Northwest order at the time of the hearing, certainly a potential emergency situation existed then, for two reasons. First, the Pacific Northwest order adjoins California, and is a likely target for such activity. Second, as soon as this loophole that allows "double dipping" is plugged in other orders, the California milk currently being pooled on those orders will be available for pooling on orders that have not yet had this opportunity corrected.

Indeed, it appears that double dipping has begun in the Pacific Northwest since the hearing. A recent bulletin of the Milk Market Administrator reports that in May of 2002 (after the hearing), some 37.3 million lbs of California milk was pooled on the order[12], representing about 5.4% of the entire pool. That was a substantial increase from historic level of approximately 4.5 million pounds that has historically been associated on the Pacific Northwest market.[13]

Double dipping is a situation that must be corrected as soon as possible. Proposals No. 1 and 10 should be adopted on an emergency basis.

D. Proposals No. 2 and No. 9 Have Limited Usefulness. These proposals, offered by Dairy Farmers of America (DFA), would establish a new concept in Federal Orders, sometimes called "state unit pooling". That concept is based on the philosophy that milk produced outside the marketing area should be pooled, if the producers involved actually deliver to the market. That philosophy is neither new nor controversial. What would be new is the method of determining what "delivery to the market" should qualify that milk for pooling. DFA proposes to treat milk from each state much like a supply plant, and to require the state unit to deliver the same percentage of milk that a supply plant must in order to qualify. There is no other test of "performance" or service to the market.

These proposals are identical in concept. Proposal No. 2 would apply to the Pacific Northwest order. Proposal No. 9 would apply to the Western Order. In each case, pooling of milk produced outside the order's marketing area would have to be qualified by the entity which sponsors the pooling, using a new standard. Milk inside the marketing area is assumed to qualify for pooling if the current pooling criteria are met, whereas milk

---

[10] Testimony of Dan McBride, Exhibit 16, p. 3.

[11] Testimony of Dan McBride, Testimony, p. 140.

[12] *The Market Administrator's Report, Pacific Northwest, Arizona-Las Vegas, & Western Marketing Areas*, July 2002, p. 3.

[13] In December 2001, only 4.6 million lbs of milk produced in California was pooled on the Pacific Northwest order. *Compilation of Statistical Material, Pacific Northwest Federal Milk Marketing Order, Federal Order 124, 2000 and 2001*, published April 2002 by the Market Administrator's Office, Table 10, p. 10. The 4.6 million lb per month was typical until May of 2002.

from outside the marketing area would be allowed to qualify only if the new standard is met. So the threshold question is to develop a rational rationale for drawing a distinction between in-area and out-of-area milk.

There is a separate rulemaking proceeding pending with respect to these issues in the Pacific Northwest order, based on a hearing held in Seattle last December. The proposals there, which were unopposed at the hearing, would require actual delivery of a portion of each producer's milk to a plant in the order area. That is a better approach for that order and that market and it avoids the need to use a "state unit" approach such as is suggested b Proposal No.2. NDA strongly feels that Proposal No. 2 is not an adequate response to "double dipping", because if adopted as an alternative to the proposals heard at the Seattle hearing, it could continue to allow California milk to be pooled on both the state and Federal order.

NDA can support adoption of DFA's Proposal No. 9 in the Western Order. Orderly marketing would be promoted with an orderly, performance-based system of qualifying milk from out of area states. It is not an ideal solution. For example, hypothetical West Texas producers might be delivering to a pool plant in Utah, in order to qualify on the Western order. This proposal could give other producers in EAST Texas a "free ride" on the deliveries from West Texas milk, even though economics of hauling would make it highly unlikely the would ever actually deliver their milk to the Western Order.

In summary, NDA supports Proposal No. 9 for the Western Order, but would not support No. 2 as an alternative to the Pacific Northwest proposals heard in the earlier proceeding.

III. POOLING STANDARDS FOR MILK WITHIN THE WESTERN ORDER MARKETING AREA

A. Overview. In this Part III, NDA will expand the general discussion of pooling standards set forth earlier in Part I of this brief, into a discussion of the specific proposals seeking to change pooling standards in the Western Order (Proposals No. 3 through 7).

As suggested in the first part of this brief, it is useful to begin with a three-part analysis:

1. First, determine "What is The Problem"?
2. Then consider whether "The Problem" exists because of price misalignment or because of a problem with pooling standards. If not, then it must be analyzed and addressed in some other fashion, or not at all.
3. If "The Problem" does relate to price misalignment or to a problem with pooling standards, then the economics of the milk movement at issue can be considered in light of all of the potential pricing and pooling tools, to determine the best solution.

This part of our brief begins the discussion of the proposals to revise pooling standards by trying to understand ***"what is The Problem?"*** that the proponents are trying to resolve. That first step will then permit comparing and evaluating the potential solutions.

The second section of this Part III of NDA's brief discusses a general concern that must be considered when analyzing each of the potential order changes that have been proposed to solve "The Problem". Any change which makes it more difficult to pool will, correspondingly, increase the value of supplying pool plants. NDA's concern is that this will not necessarily benefit producers, but will instead provide an opportunity for the pool plants to extract that value from the producers who compete to supply those plants.

The succeeding sections of this brief discuss the specific proposals that are part of this administrative proceeding. We conclude, and urge the Department to conclude, that tighter pooling solutions would not "solve the problem" and would, instead, create greater problems. From that, we suggest that the only potential tools that could be used to address that problem (if it is felt to be a problem) are assembly and/or transportation credits, as discussed in the final part of this brief (Part V).

NDA further submits that the fundamental reason for the pooling proposals to further the larger DFA agenda of foreclosing others from participating in the pool. While logical from their standpoint, it is a self-serving approach that would be unsound public policy. Kicking a third to a half of the milk out of the pool would be the result – and that is not consistent with Federal order policy as illustrated in the Final Rule discussion of the Texas order diversion limits:

> The diversion limit in this final decision is continued at 50 percent of a handler's total milk supply. The total performance standard will <u>allow handlers to meet diversion limits</u> more easily with <u>more efficient movements of milk</u>. In addition, the increased percentage of allowable diversions will <u>assure that all of the producers whose milk would qualify for pooling under either of the two orders being consolidated will continue to meet pooling qualifications</u>. *[Emphasis supplied.]*

Admittedly, this logic was not carried forward in the Final Rule to the Western order, where the effect was to depool many producers who had been pooled under the prior version of Order 135. As demonstrated elsewhere in this brief, that has caused disorderly markets. Adoption of <u>any</u> of the proposed pooling standards would simply make that situation worse, and would be further at odds with the policy considerations identified in this brief.

<u>B. Identifying "The Problem".</u> As in medicine, it is appropriate to properly diagnose the disease, before prescribing a remedy. Following that medical analogy, it is appropriate recall also the saying that the first rule in treating a patient is to do no further harm. Sometimes the cure is worse than the disease, and that can be true in rule making as well.

The easy part of this analysis is to determine that "The Problem" is not an inability of the pool distributing plants in the Western Order to attract needed supplies of milk. No such inability was demonstrated at the hearing. NDA is not aware of any such problem. And as cited in an earlier portion of this brief, the proponent of tighter pooling standards (DFA) did not argue that there was any such inability to attract milk to pool plants, even when invited repeatedly to do so.[14]

At the hearing virtually all parties testified to their desire to serve the bottling plants. If the pool distributing plants are being adequately served, and if others stand ready to serve them should the need arise, then we must wonder just what is "The Problem".

A number of Utah producers testified that they had been disadvantaged by the Federal Consolidation that had been mandated by Congress and which became effective January 1, 2000. They make the following arguments:

- Those producers had been associated with the former Great Basin order, which had included Las Vegas within its marketing area. The Western Order does not, so they feel they have "lost" the ability to share in those Class I sales. At no point did they address the fact that milk from Utah typically is not delivered regularly to Las Vegas. NDA would have preferred that Las Vegas be part of the Western Order, but we also recognize that it was a decision of Congress to exempt Clark County, Nevada from Federal Order regulation, not USDA's decision. We respectfully suggest that this is not "The Problem" that this hearing can address.

- The former Great Basin marketing area included only portions of Southeast Idaho, although many Idaho producers outside the marketing area (typically those nearer to Utah) also were regularly pooled in that Order. The primary Idaho population centers (Boise and Twin Falls) were within the old Southwestern Idaho-Eastern Oregon Federal order marketing area. While much of the hearing testimony of producers who appeared was focused on the large quantities of milk from "Idaho" that are now part of the Utah producers' marketing order, NDA respectfully suggests that is not "The Problem" in the Western Order any more than it would be in any other Federal Order where a major milk supply is located away from population centers but close enough to deliver. If state lines are ignored (as they should be), Federal order marketing areas can be seen as a collection of population centers and the milksheds which serve them. Those milksheds are typically not all near those cities. All across the nation, producers nearer the cities complain that they serve the pool plants and that the producers in the more distant agricultural areas are just riding "their" pool. If all of the milk within such a milk shed is, in fact, able to serve the market, then the complaint about such a milk shed is simply that it contains too much milk. If USDA were to identify that situation as a "Problem", the Federal Order system would be

[14] Transcript, pp. 565-570. The closest DFA's witness was able to come to a "problem" with others being willing to serve the market was when DFA was discussing pooling arrangements with parties like Sorrento, and found they did not want to deliver milk to a bottler if they were being pooled by DFA. There was no statement that any bottling plant had, at any time, gone short of milk.

turned on its head. As discussed in the opening part of this brief, milk produced within a marketing area is typically able to serve that market, and excluding it from the pool would merely invite disorderly marketing.

- Order Consolidation produced a Western Order that included more Class I sales from Idaho, but proportionately even more milk in Class III and IV. The effect was a lower Class I utilization percentage. NDA believes that this lower Class I utilization was thought to be "The Problem" by the Utah producers who testified and by their political representatives who testified.[15] Those witnesses basically argued that more of the pool money should stay in Utah, rather than being shared with Idaho producers, however no real economic evidence was offered in support of that proposition. While those producers clearly would be better off if the Western Order Class I utilization were higher, NDA respectfully suggests that it is not appropriate for Federal Orders to be fashioned to redistribute money within an order market, and especially not for the purpose of overriding the impact of Order Consolidation -- that should not be accepted as "The Problem" that USDA should address in this proceeding.

- A related argument, which the Utah producers could have made -- but really didn't -- would have tracked more closely with traditional Federal Order theory. The enabling Act for the milk order program establishes as one of the program's goals to "ensure an adequate supply" of milk for the fluid market. ***If*** there were evidence that a higher price was needed to ensure an adequate supply for the market (not just for the state of Utah), that would be a legitimate argument. However, there is in this hearing record no evidence of an inadequate supply to serve the market, nor even evidence that there is insufficient milk produced in Utah to serve the Utah bottling plants – indeed, the evidence is to the contrary.[16] That said, NDA respectfully suggests that since, as noted above, there was no evidence that the market is not served and no such contention by the principal proponent, DFA, that can not be "The Problem" that this rulemaking proceeding is considering, under today's market conditions.

---

[15] For example, the testimony of Cary Peterson, Commissioner of Agriculture and Food for the State of Utah testified that there are "inequities and damage to Utah producers from the Western Order" *[Transcript at page 311, lines 22-23]* but the only numbers he cites in support of this proposition are the reduction of dairy farms (which is happening in every milk shed) and the lower Class I utilization that resulted from Order Consolidation – he cites utilization percentages of 45.79% in 1998 and 50.96% in 1999 under the old Great Basin order, which he compares to 22.1 percent in 2001 and 17.35% in 2002 under the new Western Order. This is not evidence of economic impact, and it may reflect a misunderstanding of the other factors that, in addition to Class I utilization, impact producer blend prices under a Federal Order. That misunderstanding seemed to have been confirmed in cross-examination *[Transcript, p. 317, line 17, through p. 318, line 14; and p. 321, lines 5-19.]*.

[16] The testimony of Greg Radmall included a table from the Market Administrator showing milk produced in Utah and pooled in Order 124, 131, and 135 during the year 2000. That total is 1,511,572,000 lbs of production. Class I utilization is shown in Exhibit #26, submitted by the same witness, which is a "Table 5" from some annual summary clearly prepared by the Market Administrator. It is entitled "Class I Producer Milk and Components, Western Order, Federal Order #135, 2000" That table shows total Class I sales for the order during 2000 were 1,014,180,965 lbs. That is for the *entire* order, including Idaho plants which we estimate to be about 250,000,000 lbs of the total, leaving roughly 750,000,000 lbs of Class I utilization in Utah plants annually. Clearly, far more milk is produced in Utah than is bottled there – perhaps twice as much.

The heart of the Utah producers' concerns was a feeling that they were economically disadvantaged by Order Consolidation. In fact, however, upon closer inspection it can seen that they were not disadvantaged, so much as they merely didn't obtain a greater advantage. Clearly, the combined effect of the "loss" of Las Vegas sales and the association of Southern Idaho's milk supply was to lower the Class I utilization below what it had been in the pre-consolidation Great Basin order. The utilization was also negatively affected by DFA's decision to ask that the former Western Colorado market, with its high Class I utilization, be consolidated with the Central Order to the east rather than with the Western order.[17]

However, as NDA's witness pointed out at the hearing[18], that lower utilization does not seem to have negatively impacted the Producer Price Differential (PPD) generated by the order pricing and class utilizations. Looking at the PPD is the best way to measure the net effects of the Federal Order changes, whereas looking at the blend price would misleadingly incorporate the general impacts of supply and demand on dairy markets.

NDA's witness testified that under the "old" Great Basin Order, PPD (then called the Weighted Average Differential) averaged $.88/cwt for calendar 1998 and 1999[19]. During Calendar 2000 and 2001, the PPD under the "new" Western Order for milk delivered to Utah plants averaged $1.18/cwt. (Note that those values would be reduced by 30 cents on milk delivered to Idaho plants.) It is clear from this analysis of the PPD that Utah producers have been better off under the new Western Order than they were under the former one.

While this improvement in the PPD traces to a number of factors, it is clear that at least five other changes that occurred in the milk order system as part of Order Consolidation have provided advantages for Utah producers which offset some of the disadvantage they perceive from Order Consolidation, including:

1. The new 'movers' for Class I and II;
2. The price enhancing impact of the Class III formula (which is based on the sale of cheese and whey from Grade 'A' milk sources, rather than the old Grade B "M-W" survey, which regularly had been hammered prior to 2000 whenever market conditions were difficult for cheesemakers);
3. The 30 cent location differential between Idaho and Utah, which effectively gives Utah producers a 30 cent greater pool draw;
4. Expansion of the marketing area to include areas of Class IV use, which has had an enhancing effect on the blend price (the Great Basin area had no Class IV); and

---

17 Transcript at p. 550.

18 Testimony of Dan McBride, Exhibit 56, p. 2.

19 Testimony of Dan McBride, Exhibit 56, p. 2.

5. The practices known as "pool loading" and "double dipping" (discussed earlier in this brief in connection with other proposals, but further discussed below).

Across the country, order consolidation brought both Class I dilution and price enhancing changes. NDA respectfully suggests that the fundamental concern being raised by those producers was the revenue sharing mandated by Congress, so it can not be overturned in this administrative rulemaking proceeding just on the basis that order consolidation had an impact. Congress decreed (for reasons never clarified to NDA's satisfaction) that larger order marketing areas were "better" public policy. Some sharing of gains and losses was inevitable result of order consolidation, and fully understood at the time.[20] NDA can sympathize with the puzzlement of Utah producers over what Congress was trying to accomplish (the Chair of the House dairy subcommittee was pushing for a single national pool, but didn't have the votes … so Order Consolidation was probably a compromise between that extreme position and the old *status quo*). But the law's the law, whatever one may think of it, and the Utah producers should at least join with NDA in applauding the Department for developing a new system that (at least partially) offset some of the sharing of pool dollars that Congress (not USDA) asked producers in many high utilization markets to share with their neighbors. As indicated at the hearing, it was clear during the consolidation process that Utah producers understood (and were not pleased with) the dilution of their utilization percentage. They made a case then but did not prevail. They are now trying to make a case again, but at the hearing they did not cite relevant changes in market conditions since consolidation, and they did not justify their proposals under normal Federal order concepts. Unless there is some theory beyond a desire for "more", a loss of Class I utilization resulting from the mandated order consolidation can not be "The Problem" which USDA should be asked to correct.

Many of the Utah producers who testified also recognized the need to end the "double dipping" of California milk on their order, and supported NDA's Proposal No. 10. While we at NDA appreciate their support for eliminating "double dipping", and the support of DFA, the above discussions about what order consolidation did to their "price" should be read with full recognition that double dipping and pool loading were part of what lowered their post-consolidation blend price. DFA, which represents most of the milk in Utah including the complaining producers, made millions by pool loading and double dipping. If DFA has returned that "double dipping" money to their own producers (in the form of over-order payments), those producers would have received much more the announced

[20] As part of the order consolidation process, the Department prepared a "Regulatory Impact Analysis", a copy of which is published on USDA's web site. The Appendix includes a series of maps, the first of which (at page 68) shows – in color – the expected changes in all milk prices at various locations. Throughout the country there are locations with expected increases (shown blue) and decreases (shown in red). Salt Lake City showed a red "–1.8%", indicating that a lower price in Utah was the intended result, based on evidence and policy considerations at the time. Sharing within larger pools was common: in the Northeast, the Boston and New York areas were up while Philadelphia was down. In the Central Order, Denver and Kansas City were down while Omaha and Des Moines were up. The subsequent action of Congress to alter the Class I price surface raised the overall price surface, but clearly the sharing of pool revenues between higher and lower utilization pre-consolidation orders was an inherent and intended part of the consolidation process.

PPD numbers shown above for 2000 and 2001. If DFA did not do so, that is an internal problem that is for them (not USDA) to address.

Clearly, Federal Order Consolidation in 2000 did not bring about the financial disadvantage perceived at first blush by the Utah producers. But even if it were, the utilization effects of Order Consolidation can not by themselves be "The Problem" that this proceeding seeks to undo. A more specific rationale should be demonstrated before making order changes. And upon close examination, the Utah producers have offered no rationale except that they want more money. Producers all over the country want more money, and if they can't point to Order Consolidation as the reason for their economic distress they can point to low milk prices, to high taxes, to the costs of environmental compliance, to every aspect of their P&L. But those are not by themselves sufficient bases to amend milk orders. There must be more.

Finally, it is important to note that the views of Idaho producers may have been more loudly heard on this subject had the hearing been held in Idaho, rather than in Salt Lake City. For that reason, NDA respectfully urges the Department to give great weight to the post-hearing comments of Idaho's director of agriculture, Pat Takahashi. They were prepared with input from Idaho dairymen, including the Idaho Dairymens Association. As noted therein, dairying is important to Idaho's economy (just as it is to Idaho's). Idaho producers have a right to be pooled (just as do Utah's). The issues in this proceeding should be resolved based on the relevant statutory provisions and traditional Federal order policy – not on politics between the states.

We continue this discussion (in which we are still trying to identify "The Problem" that USDA can address by tightening pooling standards), by turning from the narrow concerns expressed by the Utah producers who testified, to the additional points offered by the proponent (DFA) to justify its proposals. In discussing DFA's proposal to tighten diversion limitations, Mr. Hollon's testimony offered six "considerations" that presumably state or suggest DFA's view of "The Problem"[21]:

1. *In Utah, there is more bottling and consumption of bottled milk.* NDA estimates roughly 20-25% of the bottling occurs in Idaho, but even if all of the bottling were to occur in Utah, that still would not pose a "Problem" that USDA should recognize. One of the important features of Federal order is that they ignore state lines and recognize natural, economic markets. In every Federal Order in the country, producers near the population centers could make the same argument that they deserve more of the Class I dollar and that more distant produces should be kicked out of the pool. But a calmer analysis would conclude that even though bottling plants tend to be built near population centers, it is not true that only producers near those plants can serve them. When the market structure does permit the nearby milk to go first to those bottling plants, that promotes economic efficiency, it is not a "Problem" to be solved in a Federal Order proceeding.

---

[21] Exhibit 32, page 8; Transcript beginning at p. 460.

2. *Farm count and prices are declining in Utah*. We observe with some interest that no evidence was offered to show that these declines are proportionally different than in other areas of the country – in fact, some witnesses acknowledged that it was part of a general trend. NDA offered testimony that Utah was losing producers at a lower rate then the rest of the West.[22] The executive director of Utah Dairymen's Association acknowledged that some of this decline in farm numbers was simply due to urbanization[23], which of course is a common situation all over the country. Again, this long term trend of declining farm counts is not, by itself, the type of "Problem" that can or should be solved in a Federal Order proceeding. But if it were, kicking half the milk out of the pool could simply exacerbate it. One of the concerns of the Order program is to ensure that the regulatory structure is not damaging to small businesses. Most of the dairy farms in <u>both</u> Idaho and Utah are "small businesses". Surely it would not be appropriate to address the declining farm count of Utah's small dairy businesses, by lowering returns to Idaho dairymen and thereby lowering the farm count of Idaho's small dairy businesses.

3. *DFA's third point was that "Utah production is closest and best situated to supply the market providing milk supplies to consumers at the most reasonable prices".* (Remember this point, in considering other proposals. First, it supports NDA's contention that distant, out of area milk also should not be pooled under any circumstances, even if it is delivered to pool plants. In that respect, it is certainly an argument against paper pooling of out-of area milk, even in state by state units that find a way to squeeze into the market with minimal performance. Furthermore, this logic suggests, and NDA generally agrees, that transportation credits should not provide an artificial incentive for more distant milk to move inefficiently to market, rather than nearby milk.) By making this point, DFA seems to support the important concept that milk orders should "avoid unnecessary and uneconomic movements of milk", which has been part of the rationale over many years for <u>suspending</u> (not tightening) diversion limitations. NDA agrees that it is economically efficient for bottling plants (and other plants, for that matter) to be served by the nearest milk supplies. However, it does <u>not</u> follow logically that this means that <u>only</u> the nearby milk should be allowed into the pool. Such thinking would ignore the fact that production in Idaho does and can serve the Salt Lake City market, and is geographically located in a position to create disorderly marketing conditions if it is excluded from the pool. Moreover, as production continues to decline in Utah more milk will need to come from Idaho to serve the Utah plants. As to the goal of economic efficiency, there is evidence in the record to demonstrate that today's order provisions are actually causing inefficient movements of milk (for example, we see extra deliveries to pool plants in order to increase pool access). So clearly economic efficiency is not "The Problem" which DFA asked USDA to address by hearing the proposals to tighten pooling standards.

---

[22] Testimony of Dan McBride, Exhibit 56 (Preamble), p. 3.

[23] Testimony of Greg Radmall, Transcript, p. 364-366.

4. *DFA then argues, "Idaho milk supply has grown, not for the purpose of being a reserve supply for the Western Order, but rather for the purpose of manufacturing cheese. Furthermore, the Idaho milk supply is being used in cheese manufacture in a greater and increasing percent".* Interestingly NDA's analysis of the available data indicates that nearly half of the Utah milk production is used to produce cheese.[24] If DFA's point of offering this "consideration" is to suggest that all Class III milk should be excluded from the pool, that would be an astonishing proposition to pose to USDA as "The Problem" that justified hearing these proposals on pooling requirements. If, on the other hand, DFA is suggesting that Idaho milk is not readily available as a reserve supply, then it has failed to offer evidence of this allegation. NDA submits that it would be consistent with Federal Order pooling theory to ask for a hearing to tighten pooling requirements if "The Problem" is that the evidence indicates that a pooled reserve supply is not in practice readily available to the pool distributing plants. However, when cross-examined after presenting this point, DFA's witness repeatedly refused many invitations to testify about any problems experienced serving the needs of pool distributing plants.[25] This hearing record shows no such difficulty, while many other parties (John Reitsma, Mike Roth, Jeff Williams, Jon Davis) indicated their willingness to supply the Salt Lake City market.

5. *"The data show that the reserve supply decreases in its ability to supply the market at just the time it is most critically needed and returns to the market at just the time it is needed least." This penalizes the year around supplier.* It is not clear whether DFA's witness was simply referring to the contra-cyclical seasonal patterns of production and fluid milk consumption, that are common in many parts of the country. If so, NDA is at a loss to see this as "The Problem" that justified asking for a hearing on tighter diversion requirements. Since Mr. Hollon was qualified as an expert on dairy marketing, we will give him the benefit of the doubt and interpret this as headed toward something more interesting than the obvious point of seasonality. Had he developed his point, he perhaps could have proceeded to demonstrate that some Class III milk moves out of the pool in the fall, when cheese prices tend to be higher. If that point is shown by the statistics, NDA might be supporting DFA in fashioning a provision which addresses the phenomenon of "depooling" Class III milk when the Class III price exceeds the blend. During the informal rulemaking that preceded Order Consolidation, NDA took a formal position urging USDA to address "opportunistic depooling". Regrettably, not a single other member of National Milk Producers Federation supported us, and there was no reaction from USDA to our proposal anywhere in the Proposed Rule. Note that even cooperatives with commitments to the fluid market engage in depooling, including both NDA and DFA

---

[24] Total milk production in Utah during 2000 was 1,511,572,672 lbs, as shown in Testimony of Greg Radmall, Exhibit 26. Total cheese production in Utah during 2000 was 74,795,000 lbs, per *2001 Utah Statistics*, page 65. Assuming the cheese production represents 10 lbs of milk used to produce each pound (a commonly used cheese yield ratio), one calculates that milk used to produce cheese in Utah during 2000 used 49.5% of the milk produced in the state. It is not known how much of the milk used at Utah cheese plants came from other states.

[25] See footnote 14.

– not just the proprietary cheese plants at which DFA seems to have been pointing when they offered this "consideration" at the hearing. Since there was no follow up testimony on that issue, and since a "lock in" or other remedy to end opportunistic depooling probably would not be within the scope of the Hearing Notice, we must presume that opportunistic depooling is not "The Problem" which DFA was hoping USDA would address when they submitted proposals to tighten pooling requirements.

6. *The 70% provision still would provide "an over abundance of reserve supply".* Even if true, this argument is founded in the assumption that the only milk which should be pooled is that which is <u>needed</u> as a reserve supply. If that were part of Federal Order thinking, <u>there would never be a Federal Order with a diversion percentage higher than 70%</u>. Interestingly, if that is "The Problem" here, it would also have been posed as a "Problem" to be fixed in other orders in which DFA is a participant, such as Order 30. (We note that Order 30 recently held a hearing on pooling standards, and that DFA did not make such a proposal there.)

Interestingly, that last point is precisely what is highlighted by DFA's witness, in the opening paragraph of his statement in support of tighter pooling requirements:

> *"Proposals 3, 4, 6, and 7 deal with our concern that performance standards in the Western Order are too liberal. The current standards allow far more milk to be associated with the market than can be considered a necessary reserve and this results in such a reduction in the blend price that milk production in the geographic area of the Order where Class I sales are the greatest is declining." [Exhbit 32, Page 1, opening paragraph.]*

While those themes are repeated in DFA's testimony, there was no <u>evidence</u> presented to support the contentions that performance standards are "too" liberal, or that there is milk being pooled that should not be. NDA accepts the testimony that milk production is declining right near the urban areas where the Class I routes are – but that's true all over the country, and it is <u>not</u> "The Problem" as long as there is an adequate supply of milk to serve those routes. The implication of DFA's argument is that there is (or may soon be) inadequate milk for the Class I market – but they did not go on to make that argument, there was no evidence that the plants are not being served, and indeed they acknowledged that is <u>not</u> the basis for their requested change. Inasmuch as nearly half the milk produced in Utah is used to produce cheese, that would be a tough argument to make!

In addition, as previously noted, there was no evidence presented indicating that milk production was declining in Utah faster than anywhere else. Nor that the declines that occur there (and everywhere else) are due to the blend price, rather than other factors such as suburbanization, and increasingly stringent environmental requirements. Nor that economic factors (such as lower feed costs) that may make it possible to produce milk in Idaho and haul it to Salt Lake City for a lower total cost than producing it in the once-agricultural areas near Salt Lake City and the other cities on the Wasatch Front.

In short, ***DFA SIMPLY HAS NOT MADE ITS CASE FOR TIGHTENING POOLING STANDARDS!!*** Perhaps more importantly, they failed to offer evidence that the current order provisions are not working. They failed to address the potential concern that kicking substantial numbers of producers out of the marketwide pool would lead to disorderly marketing conditions. That is such a fundamental principle of Federal order theory, and one which was so widely cited to relax diversion limits in the past, that it would seem incumbent upon them to at least address that potential concern.

NDA respectfully submits that an analysis of potential disorderly marketing conditions must lead the Secretary to reject all of the proposed changes in pool qualification standards. Any one of them would cause some milk to lose pooling privileges even though it is produced within the marketing area and has been traditionally associated with the market -- a traditional concern of Federal order decisions for years, one which is grounded in the statutory directive to maintain orderly markets, as well as philosophies adopted during the Final Rule of order consolidation.

All such milk meets the "close in" concept developed in the introductory sections of this brief, in which we argued that failure to pool such milk will foster disorderly markets. That can be seen even by applying DFA's 200 mile definition of "local" milk (discussed above). All producers in Idaho's Treasure Valley are well within 200 miles of two bottling plants at Boise, as is all milk produced west of Twin Falls in the heart of Idaho's largest milk producing valley, the Magic Valley. All milk in the Magic Valley and in Eastern Idaho is within road 200 miles of the Meadow Gold bottling plant at Pocatello. Twin Falls is only 183 road miles from the closest of the Salt Lake City bottling plants, at Ogden, and 218 from the furthest, at Salt Lake City proper. Rupert, in the eastern part of the Magic Valley milk production area, is only 143 road miles from Ogden and 179 miles from Salt Lake City. In contrast, the DFA balancing plant at Beaver, Utah, is 201 road miles from Salt Lake City and 238 miles from Ogden. And the major milk producing area at Delta, Utah, is about the same distance away as Rupert: 136 miles from Salt Lake City and 173 to Ogden. Virtually all of the farms within the order area can ship readily to one of the pool plants at Boise or Pocatello or Salt Lake City, not to mention some of the very small handlers in the Magic Valley and in Utah.[26] Given their reasonable proximity to the Salt Lake City market, it is no wonder that most opponents of the DFA proposals stated at the hearing their willingness to deliver milk to the Salt Lake City market – and we believe they are serious!

Cutting through all the clutter, DFA's primary argument boils down to a self-serving belief that because they are delivering much of the Class I milk to market, their producers somehow deserve to keep more of the money in the "marketwide" pool than the others whom they feel are just riding the pool. DFA's secondary argument seems to be that DFA and others who serve the pool distributing plants are providing services to the market that are not being properly reimbursed by pool distributing plants.

---

[26] All mileages are derived using commercially available software known as PC Miler.

Dealing first with the unreimbursed services argument, there are two ways reimbursement might be addressed other than by kicking producers out of the pool and starting price wars over the right to be pooled.

One approach might be a marketwide service payment from the pool. DFA's argument <u>might</u> justify a request for a marketwide service payment, <u>***if***</u> sufficient evidence had been presented to demonstrate that there is a problem. An argument for proposing marketwide service payments must be based on a different statutory concept than the traditional considerations of uniform pricing, marketwide pooling, and avoiding disorderly marketing conditions – all of which have been part of the Act for decades. The ability to apply for marketwide service payments was conferred by Congress in the 1985 Farm Bill, in a separate statutory provision. Proposals to institute such payments (in this proceeding, assembly and transportation credits) must be analyzed in a different context, as will be done in Part V of this brief. That said, NDA emphasizes that <u>proposals to tighten pooling standards are far different than marketwide service payments</u>, and the two must be justified differently. The statutory amendment providing for marketwide service payments did not disturb the traditional concepts of uniform pricing, marketwide pooling, and avoiding disorderly marketing conditions – and it is those statutory concepts with which the proposed pooling revisions are in conflict.

The second way for a seller to obtain reimbursement for services to the market, instead of taking marketwide service payments out of the pool, would be to negotiate them "from the market". As will be explained more fully in the section which follows, basic economic analysis suggests that the tighter the pooling standards of the Order (relative to the quantity of milk which wishes to be pooled), the less likely it will be that milk sellers can negotiate over-order charges. Yet, producers (and their cooperatives) who feel they need "more" revenue for serving such a market may be reluctant to agree to loosen pooling requirements, because they fear that to do so might reduce their Class I utilization of "their" pool, and they don't want to share that. They want the best of both worlds, by having producers within the pool not compete in ways that drive down over-order service charges, and then they want to kick those same potential competitors out of the pool so they can have higher blend prices. Both dreams would mean more money if they could be accomplished, but it is naïve to think the other competitors are going to stand for that.

In this proceeding, DFA is complaining about their inability to negotiate service charges from the market, and asking USDA to provide additional compensation through marketwide service payments. In effect, they are trying to have it both ways: an artificially high Class I utilization which drives down over-order service charges, <u>plus</u> market service payments to make up what can not be negotiated in the marketplace. In a way, that is precisely "The Problem" that DFA is asking USDA to solve in this proceeding. The current market structure won't allow over-order charges (so give up on them, and try to obtain "more" by making the structure even tighter) – and then ask USDA to solve "The Problem" by instituting marketwide service payments.

As a point of contrast, we note that in the Pacific Northwest, the consensus of the (perhaps *unusually* harmonious) industry has been to seek Federal Order pooling provisions which for decades have allowed every producer within the marketing area to qualify for pooling. For that reason, there has been little pressure for producers and cooperatives to compete in order to qualify for the pool. At the same time, cooperatives in the market have accepted the obligation to ensure that the Class I market is well served. With that comfortable balance, the processors have proven willing to negotiate reasonable over-order service charges that help move milk to deficit markets and reimburse some of the service costs.

This is an appropriate point to observe that in addition to NDA's belief that loosening pooling standards will encourage the market to cover the costs of servicing it, three additional alternative approaches could be considered to find adequate compensation for serving the market:

1. Raise the amount of money going into the pool, by adjusting the Class I price surface;
2. Reduce the amount of milk that can be pooled, so that those who are pooled share in more dollars; or
3. Institute marketwide service payments which redistribute the pool amount dollars among currently pooled producers, without increasing the pool amount.

The first approach would be beyond the scope of this proceeding, and may now require an act of Congress. The second approach may be appropriate where the impact is on "distant" milk that can not realistically be delivered to the market's distributing plants, however (as is discussed at length in this brief) that approach would invite disorderly marketing conditions if applied to milk within the marketing area. The third approach (marketwide service payments) is both possible, and less likely to be disruptive – and, it can accomplish much the same thing as would an adjustment in the Class I price surface. However, as will be shown in Part V of this brief, there must be sufficient evidence that the payments would reward a service that is needed.

As we think through these approaches, they cry out the question of what the Cornell model would have shown, if it had been updated for consideration at this hearing. As will be discussed again later in this brief, there have been changes in production and consumption since the 1995 time frame in which Cornell developed its data base. Have the changes in Utah that were cited at the hearing been so vast that they would justify a higher location value than the current $1.90? Or would the Cornell model recognize the double-digit rates of growth in Idaho since then, and compute that a lower location value would be indicated? A good guess is that the Cornell model would allocate the Cache Valley milk first to supplying the Salt Lake City bottling plants, then would consider the amount still remaining for cheese plants, and would conclude there is too much milk in the Cache Valley and Idaho, together, to justify an increase in the $1.90 price.

Turning back to the primary DFA argument, that DFA members somehow deserve a larger share of the pool dollars, there simply is no rationale for doing so. While marketwide service payments may arguably be justifiable, the proposed pooling standards boil down to a brute attempt by DFA to wrestle pool dollars away from others, by trying to convince USDA to kick a third to half the current producer milk out of the pool[27] without evidence that they are unwilling to serve the bottling plants. NDA respectfully submits that this can not be "The Problem" which this hearing was called to address.

A close review of DFA's presentation at the hearing indicates they never defined a "problem" in traditional Federal order terms, they offered no evidence to support the need, and they offered no convincing rationale to demonstrate why tightening pooling restrictions would be good public policy. And most important of all, no evidence was offered to suggest that there would not be the "disorderly marketing conditions" that traditional Federal Order theory would predict would occur, in a situation where a substantial amount of unpooled milk neighbors pooled producers.

In contrast, at the hearing NDA outlined the theory of disorderly marketing and how it could occur:

- One example cited was the incentive for an operation to subsidize the bottling portion of its business, so that its bottling operation can expand its market share, in order that the entire operation's producer milk can be pooled.[28] Since the hearing, this has arguably occurred and NDA is prepared to demonstrate that it has.[29]

- Another then-hypothetical example that was cited at the hearing was the incentive for organizations which could not pool all of their milk to engage in disruptive marketing tactics to displace the current sellers of raw milk to pool distributing plants[30] Again, NDA is prepared to demonstrate that this process has begun since the hearing, and that

---

[27] The current 90% diversion limitation (a 9-to-one ratio) allows up to 9 lbs to be pooled for every pound delivered to a pool distributing plant. The proposed 70% means a 7/3 ratio, allowing only 2.33 lbs to be pooled for every pound delivered. Thus the maximum theoretical amount that can be pooled goes from 10 times the amounts delivered (the 1 delivered plus the 9 diverted) to 3.33 times the amount delivered (the 1 delivered plus the 2.33 diverted). In other words, the theoretical maximum amount of milk in the order is reduced by 2/3.

However, note that the maximum amount which theoretically could be pooled is, in fact, not being pooled. At the hearing, it was testified that the DFA diversion proposal alone would probably eliminate from the pool about 150,000,000 lbs, per the estimate of the Market Administrator's office as prepared for, and testified to by, Jeff Williams *[Transcript at page 753, lines 11- 20]*. Of course the combined effect of the entire package of tighter pooling standards would be even greater.

Note also that even a reduction of the diversion limitations from 90% to 80% -- as suggested at the hearing by the River Valley cooperative *[Testimony of Rod Carlson, Transcript at p. 840]* -- could theoretically remove half the milk from the pool. An 80% diversion ratio (allowing 4 pounds to be pooled for every 1 delivered) allows only 5 pounds to be pooled, versus the current 10.

[28] Testimony of Dan McBride, Exhibit 59, p. 2.

[29] Later in this brief, NDA formally requests a reopening of this hearing proceeding to place into evidence the post-hearing evidence of disorderly marketing conditions that have already developed in the Western Order and in the Pacific Northwest order.

[30] Testimony of Dan McBride, Exhibit 59, p. 6.

disorderly marketing conditions are likely to break out as soon as the pool plant operators who would benefit wish to take advantage of the situation.

NDA submits that the reason for proposing tighter pooling standards is to further the larger DFA agenda of foreclosing others from participating in the pool. While logical from their standpoint, it is a self-serving approach that would be unsound public policy, as demonstrated elsewhere in this brief. Note that the effect of this would be to establish something more like a handler pool – now rejected from Federal orders, because they create inherently unstable (and potentially disorderly) marketing conditions.

It is bad enough that access to the pool plants has been in part foreclosed to organizations other than DFA.[31] It would be much worse public policy to allow them to further leverage that advantage into controlling the ability to pool – which gives them a competitive advantage in acquiring producer milk, which gives them the ability to profit by selling pooling rights, and which could force others into arrangements they otherwise might prefer not to enter into. This is precisely the sort of thing that has caused the Department of Justice and various state Attorneys General to examine developments in the milk industry closely. The Department of Agriculture also should be sensitive to those larger policy concerns.

C. Tighter Pooling Standards Benefit Processors, Not Producers. The intent of the order program is to benefit milk producers, which NDA appreciates. In addition, USDA has a policy of assisting and promoting cooperatives, based on other statutory guidance from Congress. We at NDA also appreciate that.

In this case, the NDA cooperative sincerely believes that the prospect of tighter pooling requirements is NOT in the best interests of producers, nor of their cooperatives, anywhere within the Western Order market. NDA's view on this is explained in the paragraphs which follow. We recognize the irony of suggesting that these proposals are not in the best interests of the proponent, and we have explained our thinking to DFA directly. We feel (they may still disagree) that their proposals are not good for producers, for two reasons:

1. The prospect that producers and producer groups will not have access to the pool simply increases competition to deliver milk to pool plants, a classic case of disorderly marketing conditions.
2. Following from that in a ripple effect, the secondary effect is that the tighter pooling standards will create value, but eventually that value will be captured by pool distributing plants, rather than benefiting producers. This is especially likely in a market – like the Western Order – with a low Class I utilization (lots of milk seeking a way to pool, and relatively few places to pool it).

[31] Testimony of Dan McBride, Exhibit 58, pp. 4-5.

Our concern is based on the undeniable fact that <u>any</u> tightening of pooling requirements (and certainly the draconian changes that DFA has proposed) would over time create a much higher blend price for those producers who are able to become pooled. Indeed, that seems to be DFA's intent. However, that very likely would result in a blend price that is much greater than what is received by unpooled producers within the marketing area. The greater that difference, the more incentive there is for the unpooled producers to find a way to get pooled.

Since the Western Order market is predominantly a cheese market, we observe that for producers who ship to a cheese plant, the value that can be obtained from pooling is roughly equal to the producer price differential (PPD), which is the difference between the blend price and the Class III price. If Class III prices are generally lower than the other class prices (as has been the case the past several years), there will be a positive PPD, and the ability to pool will carry with it an economic value.[32]

NDA's experience tells us that when a significant difference in producer pricing develops within a milk shed, there is a reaction within about a year. That scenario played out within Idaho's Treasure Valley over the 2000-2001 period, and the result was the purchase of pooling by and for the producers who ship to the Sorrento cheese plant at Nampa, Idaho.[33] Similar events also occurred in the Magic Valley, and was the direct cause of the issues that have led Meadow Gold to offer Proposals No. 11-13 in this proceeding (discussed in more detail elsewhere in Part V brief).[34]

In both those Idaho valleys, the low Class III prices (relative to the blend price) led the cheese plants to work hard, at significant expense, to get their producers pooled. NDA is confident that tightening up the pooling requirements will not stop them from taking such action (unless the PPD drops). The more likely result is that tighter pooling requirements would simply make the cheese plant producers (or cooperatives they may form, as the River Valley cooperative was formed) work harder to develop an opportunity to deliver to pool plants already served by those producers who now seek the tighter pooling standards, or to build a bottling plant that will compete against the present bottling plants served by those producers who now seek the tighter pooling standards. Certainly that is what NDA will do, and indeed we have begun those efforts in earnest since the hearing. A classic illustration of disorderly marketing conditions has developed in the Western Order, as a direct result of this proceeding and the April hearing.[35] Clearly, tighter pooling

32 During Calendar 2000, the Western Order PPD for milk delivered to Utah plants averaged $1.45/cwt. During 2001, it was $.90. During the first half of 2002, it has averaged .69 cents. That value is reduced by 30 cents on milk delivered to Idaho plants.

33 Testimony of Rod Carlson, Transcript, p. 257.

34 In the Market's other large milkshed –the Cache Valley of Northern Utah and Southeastern Idaho – we have not witnessed such disorderly market conditions, simply because both the major handlers in the Cache Valley (DFA and Gossner) have been able to pool all their producers.

35 Later in this brief, NDA formally requests a reopening of this hearing proceeding to place into evidence the post-hearing evidence of disorderly marketing conditions that have <u>already</u> developed in the Western Order and in the Pacific Northwest order.

requirements can be counterproductive to the proponents, and indeed to all producers in the market.

This pressure to pool leads to the sale of pooling rights. Pooling rights obtain value by an act of government, in much the same way as value is created by a "quota" system[36]. As was testified to at the hearing, the sale of pooling rights is common.[37] For some reason, it is something the participants are reluctant to talk about![38]

NDA has many concerns about the practice of selling (or perhaps we should say renting) Federal Order pooling rights. A major one is that it can not be defended with a straight face to members of Congress (nor their staffs), who wonder why the government would establish a program that promotes buying and selling of a pooling privilege established not by private parties but by USDA. Such stories, when they reach Capitol Hill, tend to weaken political support for the Order program.

That experience is similar to the now-extinct Federal Order "base" plans, under which the right to receive the Class I differential (or a portion of it) was allocated to producers, who then had the ability to buy and sell that shipping right. Congress had specifically authorized "base" or "quota" plans, but that authority was removed in the early 1980s. There is no reason to believe that current Members of Congress would approve of a government program that creates transferable value that is available only to a few.[39]

More fundamentally, NDA urges the Department to recognize that when pooling rights acquire value sufficient to lead to their purchase and sale, that itself is an indication of the existence of the very disorderly marketing conditions which USDA is required under the Act to prevent. That disorderly markets must exist can be seen from the fact that, if it were not for the purchase of pooling rights, the buying producer or producer group would have an incentive to achieve pooling through disruptive marketing tactics. In that sense, the sale of pooling rights can be seen as a seller's way of "buying off" the potential competitor, by offering the competitor a chance to pool in a manner which is less expensive to the seller than cutthroat price competition. Of course this means the seller profits by selling a privilege conferred by order, and that is bad social policy.

---

[36] These discussions are not unique to agricultural settings. The economic textbooks often use taxicab license programs to demonstrate how government can create a license with economic value by limiting the number of licenses it issues.

[37] See Testimony of Rod Carlson, Transcript, p. 858. The seller of pooling rights, Dairy Farmers of America, refused to discuss this practice on the record (Transcript at pp. 571-572).

[38] At this hearing, DFA was reluctant to acknowledge its activity in this regard *[Cross Examination of Hollon, Transcript at p.572].*

[39] At one time, Congress enabled USDA to institute quota systems within Federal orders. The old Puget Sound Order had a "Base" program, for example. It was very controversial, in part because the "base" was transferable and was regularly bought and sold. There was regular dialogue between this cooperative and the then-director of the Department, Herb Forrest, to institute a more limiting quota system. He refused to do so, in part because he felt it to be poor public policy for USDA to artificially create monetary value associated with quota.

Moreover, NDA submits that the more and more widespread practice of buying and selling pooling rights is not only a reflection of disorderly marketing conditions, it is also a cause of disorderly market conditions. That is because the seller can use the funds received to achieve competitive advantages not available to others, and the result would be even more disruption of the market.

In addition to being bad public policy, NDA urges the Department to recognize that the creation of artificial value from pooling rights is not always to the advantage of producers and cooperatives, but it is always of potential value to the pool plant operator whose purchases of raw milk generate the pooling ability. In the Western Order market, DFA and NDA each have subsidiaries which operate pool plants (National Dairy Holdings at Ogden, and WestFarm Foods at Boise), but the majority of the deliveries to pool plants are controlled by Dean Foods (the Meadow Gold plants at Salt Lake City, Pocatello, and Boise) and the Kroger Co. (near Salt Lake City). NDA knows both parties to be sophisticated buyers of milk.

Milk which is pooled must either be delivered to a pool plant, or diverted to non-pool plants; and diversions are based on deliveries to pool plants. So in both cases, the value of pool access is created by the pool plant operator when he accepts a delivery. And that value is dispensed at the discretion of the pool plant operator, who may accept deliveries from Source A, Source B, or Source C, as he sees fit. If the ability to pool is limited, then that plant operator has the power to confer the economic advantage of pooling on A, or B, or C, as he sees fit. In a market where more producers try to be pooled than can be pooled, this puts tremendous leverage in the hands of the pool plant operator. And that is precisely what would happen if any of the DFA pooling proposals are adopted.

Operators of pool plants have been quick to perceive this value and to negotiate for a corresponding advantage. In NDA's experience, pool plant operators explicitly recognize the value that pooling creates, and explicitly use it to negotiate for lower over-order service charges. In surplus markets such as the two in which NDA operates, it is easily predictable that if pooling becomes more difficult, the value of pooling will increase, and in turn there will be tremendous pressure to sell milk at prices under minimum class prices – which would be one type of disorderly marketing conditions.

Indeed, there was evidence in the hearing record that under-order pricing has already been occurring (proof, we suggest, that disorderly marketing is occurring even with the current 90% diversion limitation). This under-order pricing led Dean/Meadow Gold to propose that one variant of that practice be specifically addressed in this proceeding. One can not blame them. Organizations which believe themselves to be observing minimum prices will have two predictable reactions upon learning that others have found a loophole in the minimum pricing provisions: one reaction is to get the problem fixed (which Meadow Gold to its credit is attempting), and the other reaction might be "if I can't beat them I'm going to join them".

The Meadow Gold proposal addresses only one of many possible loopholes in the minimum pricing structure. Unless USDA can plug all the loopholes, there will be pressures and incentives for pooling partners to institute secondary, "seemingly separate" transactions that, with a wink and a nod, transfer value from the party that is (back in the raw milk transaction) selling milk to the party that is buying it. The larger the PPD and the tighter the pooling standards, the more creative buyers and sellers of raw milk will become. Perhaps that creativity will lead to a "good deal" on buying back surplus cream, or a special ad allowance on cheese sold between different departments of the same two organizations. Perhaps it is an "arrangement" by which a national buyer obtains "preferred supplier status" to a customer around the country, by paying cash. If any of these "arrangements" should be discovered and ruled illegal, desperate sellers simply will find more imaginative ways to make the sale.

It may be useful to note that, in such a scenario, the potential distributing plant customers would be what the business school professors call a "strong buyer", and we would be what they term a "weak seller". The business schools teach that whenever a weak seller approaches a strong buyer, all potential sources of financial advantage are likely to end up in the hands of the strong buyer who has leverage, not the weak seller who needs the strong buyer. Strong buyers make money, weak sellers do not.

USDA simply does not have the manpower or the enforcement ability to address those "seemingly separate transactions" by which the pooling value could be transferred to the pool plants, if the diversion limitations give them power to control who gets pooled and who does not. Should such a transaction occur, USDA will have failed in its statutory mission in three respects:

1. The transaction itself will result from the existence of "cutthroat competition" in the raw milk marketplace that exemplifies the disorderly markets that the statute was created to prevent;
2. The secondary result of those disorderly marketing conditions in the raw milk marketplace is to create another set of disorderly market conditions in the wholesale market, where a handler who has extracted an unfair advantage competes against those who pay minimum prices (and haven't yet found the loophole); and
3. The creation of under-order pricing violates another key statutory concept, that milk orders should establish "uniform prices" to handlers (rather than fostering a system by which some obtain unfair advantages over their competitors).

Clearly, these three conditions would occur because of factors which USDA is directed by statute to prevent. The statutory requirements to prevent disorderly markets and to ensure uniform pricing to handlers dictate that the pooling standards not be set so tightly that they benefit processors rather than producers. NDA submits that any tightening of any of the pooling requirements would do precisely that, and should therefore not be adopted.

D. The Pool Supply Plant Delivery Percentages Should Be Reduced. Proposal No. 3 would establish a "netting" provision for pool supply plants. There currently are no supply plants in the order today, however NDA strongly urges that this proposal for a netting provision be rejected for the same reasons that Proposal No. 7 be rejected, as will be discussed later in this brief.

In addition, NDA suggested at the hearing that the 35% delivery requirement for pool supply plants be reduced.[40] We hereby make that request in this brief, and urge that the correct percentage should be 10%. The pool supply plant requirement of the order is currently the same as the requirement for a cooperative pool plant, and they both should be adjusted similarly. The justification for this will be discussed in the next section of this brief, pertaining to cooperative pool plants.

E. The Cooperative Pool Plant Delivery Percentage Should Be Reduced. Proposal No. 4 would revise the cooperative pool plant provision to require that 50% (rather than 35%) of a cooperative's milk be delivered to pool plants. NDA suggested at the hearing that this percentage should be reduced to 10%.[41]

In the Final Rule that consolidated the orders, a 10% standard was instituted for supply plants in the Upper Midwest market. That market also has a 90% diversion limit, just as does the Western Order market. The Identical Provisions Committee had recommended that the supply plant percentages in each order should reflect the difference between 100% and the diversion limits. While that was not formally adopted, the thinking can be seen in the discussion of the Upper Midwest shipping percentages:

> The 10 percent shipping requirement adopted in this decision is approximately 5 percentage points less than the anticipated Class I percentage for the consolidated Upper Midwest order. The 10 percent shipping standard is greater than the current individual supply plant shipping standard and equal to the maximum shipping percentage required of pool units during the qualifying period in the current Chicago Regional order. The standard under the current Upper Midwest order, which uses the Class I use percentage of the same month in the previous year as the supply plant shipping percentage, would exceed the adopted percentage.
>
> Also under the current Upper Midwest order, a reserve supply plant must ship 10 percent of its receipts to pool distributing plants during January through June, and the marketwide Class I percentage for the same months of the preceding year for the months of July through December.
>
> Several handlers, including a large cooperative association, a cheesemakers' organization, and a fluid milk handler, filed comments stating that the 10 percent shipping standard for supply plants is too high for this market with a Class I utilization percentage that rarely would exceed 20 percent. The 10-percent shipping percentage is below the estimated Class I percentage for the consolidated Upper Midwest order and should be appropriate, even in view of the fact that many distributing plants have a

---

[40] Testimony of Dan McBride, Exhibit 57, p. 3.

[41] Testimony of Dan McBride, Exhibit 58, p. 3.

> supply of milk from their own producers. In September 1997, approximately 27 percent of the milk pooled or received at distributing plants in the Chicago Regional order was pooled as producer milk with the distributing plant operators as the handlers, rather than as producer milk pooled by cooperatives and other handlers. The milk pooled by distributing plant handlers accounted for approximately 12 percent of the total milk pooled in September 1997 (or approximately 5 percent of the total milk that would have been pooled if all of the milk eligible to be pooled in September 1997 had been pooled).
>
> Approximately 7 percent of the Class I producer milk, or approximately 2 percent of the total producer milk, pooled under the Upper Midwest order is pooled by distributing plant operators. The combination of the supply plant shipping percentage and the percentage of milk pooled directly by distributing plant handlers would appear sufficient to meet anticipated Class I needs in the consolidated Upper Midwest order. The 10 percent supply plant shipping percentage also should be appropriate to avoid unnecessary and uneconomic shipments.

Any consistent application of that reasoning to the Western order would lead to adoption of a shipping standard for pool supply plants and cooperative pool plants of no more than 10%. The facts in the Western order are similar, and the policy considerations are identical.

As NDA testified at the hearing, even the present 35% requirement is not achievable in the Western order.[42] DFA has utilized supply agreements to lock up most of the delivery needs of the market's major bottlers. Until those agreements expire, it is unrealistic for any other organization to have a supply plant or cooperative pool plant.

<u>F. Tighter Diversion Percentages Should Not Be Adopted.</u> The need for Proposal No. 6 has not been demonstrated by the proponents, and it should not be adopted. Indeed, no tightening of the diversion limitation can be justified based on this hearing record.

Today, even with the present 90% diversion limitations, there is a tremendous quantity of unpooled milk produced <u>within</u> the marketing area.[43] There would be, therefore, a tremendous incentive for such milk to serve the market's pool distributing plants if any opportunity were to arise. Today, there is nearly twice as much milk produced within the state of Utah than is needed at the Salt Lake City bottling plants. If there were someday to be a shortage of milk in Utah, the logical reserve supply area would be the Magic Valley, which spans the South-Central part of Idaho and which is also that state's area of greatest milk production.

---

[42] Testimony of Dan McBride, Exhibit 58, pp. 3-4.

[43] NDA presented evidence that during December of 2001, some 656 million lbs of milk were produced in Idaho, citing the publication entitled "Milk Production", which is published monthly by the National Agricultural Statistics Service, and of which official notice was taken. By comparison, the Market Administrator's Exhibit, Exhibit No. 6, indicates that only 277 Million lbs of Idaho milk was pooled on the Western Order during that month. So it is clear that <u>more than half</u> of the Idaho's milk is either pooled elsewhere, or not at all. That is a huge pool of milk.

Most of the milk produced in the Magic Valley goes to four outlets: Glanbia Cheese and Jerome Cheese (both proprietary operations) and Magic Valley Quality Milk Producers and NDA (both cooperatives). The Magic Valley Quality Milk Producers cooperative presently serves the Utah Class I market. At the hearing, the other three organizations all testified that we would do so, if needed. Indeed, there was substantial testimony that the primary reason milk from the Magic Valley region does not regularly move to the Salt Lake City plants is that DFA already supplies them and is reluctant to let the rest of us serve those customers. It is not unwillingness to serve the market that is at play here, rather it is an <u>inability</u> to serve the market – because there isn't a big enough market.[44]

In recognizing this, the witness for Glanbia Foods urged that "the only change that can rationally be justified in pool performance requirements ... is a modification of diversion limits to 95%".[45] NDA has stopped just short of endorsing such a change, because we can live – although just barely -- within the present order provisions. However, we would – and do – urge adoption of a 95% diversion limitation <u>if</u> the Department considers favorably <u>any</u> of the other, related proposals to tighten diversion limitations.

And ironically, in the end the proponent DFA could face the same problem. We estimate DFA members' production within the Western Order marketing area to be around 200 million lbs per month. If the Department grants the 70% diversion ratio DFA is seeking, they would have to deliver 60 million lbs per month to pool distributing plants to pool their milk. They control access to only one pool plant (National Dairy Holdings, at Ogden). We estimate that plant's volume to be less than 20 million lbs per month, a far cry from what they would need if the price war they are inviting should turn against them.

They are taking a huge gamble that they "may get what you ask for". The only rational basis for their taking such a gamble would be if they feel the Dairy Division and the Secretary of Agriculture will later cover them, if they lose – by administratively modifying, or by suspending and then formally modifying, the diversion limitations they are now asking USDA to implement.

Well, NDA would be in roughly the same situation. If we do not "win" the price war that DFA has already started, by successfully continuing our efforts to expand our deliveries to pool distributing plants, then we also will quickly be asking the Dairy Division and the Secretary to cover us, by modifying the diversion limitations.

And so too, we would guess, will be the Magic Valley Quality Milk Producers cooperative. While we do not speak for that cooperative, we note that between them and us, we represent nearly as much milk in the Western Order as DFA does.

---

[44] See, for example, the testimony of Mike Roth, Transcript at p. 647.

[45] Testimony of Jeff Williams, Exhibit 37, p. 6 (Transcript, p. 753).

Even if hypothetically the three cooperatives in the market (DFA, NDA, and Magic Valley) were to take advantage of the order provision which allows us to combine our diversions, it would be difficult with a 70% diversion limitation to pool all of our milk. We estimate that the three cooperatives collectively represent in the neighborhood of 400 million lbs, roughly speaking. To qualify all of that milk with a 70% diversion limitation would require that we collectively sell 120 million lbs/month to pool distributing plants. The Market Administrator's numbers indicate that there were only about 110 million lbs of Class I and II milk processed by Western Order plants during June of 2001, and some of that is controlled by a non-cooperative with its own milk supply (Gossner Foods). Even assuming that there were 100 million pounds of "deliveries to pool plants" available to the three cooperatives, it can be seen that <u>DFA's proposal would inevitably prevent pooling by – and severely damage -- at least one of the cooperatives in the market</u>, and would likely hurt all of the producers for proprietary plants that wished to pool with the possible exception of Gossner Foods (which has its own Class I production). Alternatively, such a change may encourage a dramatic expansion of the Stokers and Falconhurst operations, or a new startup bottling plant – all because of pressure on producers to find ways to pool.

Even if an 80% diversion standard were adopted (as proposed by the River Valley cooperative), there would be problems for cooperatives. To pool its 200 million lbs, DFA would need 40 million lbs of deliveries to pool plants (which is more than it controls at National Dairy Holdings). Even with a combining letter, the three cooperatives would need 80 million lbs to pool all the cooperatives' milk. That is conceivably attainable <u>if</u> the cooperatives could capture the <u>all</u> the pool distributing plant business – but we almost certainly would be competing against Kraft, Jerome Cheese, Glanbia, etc. for that very same business.

Clearly, this proposal invites disorderliness in the sale of producer milk, from farms to plants. In addition, there would inevitably be political ramifications that could, we fear, jeopardize the milk order program.[46]

While that is important to us, the fundamental issue is making the correct decision under the statutes and traditional milk order theory. We note that DFA testified that they were not able to obtain support from the Market Administrator for lowering the diversion limits administratively.[47] After going to a hearing to make a case, we submit that nothing has changed, it still would be a bad idea.

Before concluding our discussion of the diversion Proposal, we note that the witness for the River Valley proposed a technical correction to the present language of the present

---

[46] Testimony of Dan McBride, Exhibit 56, p.2.

[47] Transcript, p. 635.

order.[48] The Market Administrator's witness testified that the proposal is consistent with current interpretation of the order. NDA can support this change, if it is deemed appropriate by the Department.

G. The "Net Diversions" Proposal Should Not Be Adopted. Proposal No. 7 (like Proposal No. 3) would require that any transfers of "bulk" fluid milk products would be subtracted from the milk physically received at a pool distributing plant, when computing the allowable diversion percentages.

Adoption of this provision would be extremely damaging to NDA. It would reduce the amount of milk available for pooling below the amount of milk currently produced by our producers. Our cooperative and its producers have been continuously associated with the pool for many years, and all the milk is produced within the marketing area. There is no justification for kicking us out of the pool, especially given our substantial participation in the Class I market already and given our testimony that we are very willing and indeed very anxious to supply more of the Class I market – if that opportunity comes available.

The present limitations and the prospect of a further reduction in what can readily be pooled by diversion has led us to deliver more Class I milk by vigorously competing for route distributions by our subsidiary, the WestFarm Foods plant at Boise. As argued elsewhere in this brief, some might see that as disorderly marketing of milk, but that is what the current (and the proposed) pooling standards require us to do.

If there is any logic to this proposal, it lies in the fact that milk is sometimes received by a pool distributing plant and transferred out – an artificial process that adds no value. However, NDA respectfully points out that the products made at the Boise plant include skimmed milk and cream. That processing does add value, and allows us to meet the needs of our other facilities and external customers.

NDA therefore requests that if any "netting" language is added to the order, the language of the proposal should be modified to apply only to "bulk transfers except cream or skimmed or condensed milk".

Still, NDA strongly urges that no "netting" provision is called for, and that Proposals No. 3 and 7 both should be rejected. No other orders presently have such a provision, although one may be instituted upon finalization of the recent decision in the Mideast order. Unlike the present proceeding, there was little or no opposition at the hearing to

[48] Testimony of Rod Carlson, Exhibit 41, p4: "We further propose that section 1135.13 (d) (1) be amended to identify that *"milk of a dairy farmer shall not be eligible for diversion unless the equivalent of at least one day's milk production of such dairy farmer has been physically received as producer milk at a pool plant and the dairy farmer has continuously retained producer status since that time "*.

that proposal. In contrast, the proponent received no support from other organizations in the Western order hearing.

Such transfers have long occurred in the milk order program. Over the past 2-3 decades, as milk supplies were growing across the nation, the cooperatives who found diversion limitations pinching them would resort to moving milk into, and back out of, a pool distributing plant in order to continue to meet the diversion limitations. This was never objected to by the Department, as a practice – but it was recognized by the Department that this reflected disorderly (or potentially disorderly) markets and was bad social policy. So the solution was to reduce the diversion limitations.

Whenever these scenarios resulted in a cooperative asking for a relaxation of the diversion limitations so that these transfers would not be necessary, the Department would grant suspensions or reductions of the diversion limitations. The Secretary would cite the needs to:

- Preserve orderly markets,
- Keep milk historically associated with the market pooled,
- Eliminate inefficient movements of milk (the artificial ones into and out of the plants), and also
- Avoid damaging milk quality in that process. (The more often milk is handled, the more chance there is for bacteria to be picked up.)

NDA is not aware of <u>any</u> situation in which the Department simply turned its back and allowed the producers involved to become disassociated with a pool. Here, DFA is asking the Secretary to not only do just that, but to affirmatively squeeze out of the pool producers located within the marketing area who have been historically associated with the pool – producers who wish to be associated with the pool.

There is no better evidence of how strongly these producers want and need to be pooled, than the fact that net shipments are a frequent occurrence in the Western order. This process is costly, an expense that would only be absorbed because of the inability to be pooled in any other way. As was pointed out at the hearing, well over 90% of a proprietary bulk tank handler's milk supply has been pooled in this fashion. It demonstrates that they will do whatever is necessary to pool. And if this avenue is foreclosed, they can be expected to find more disorderly avenues.

Proposal No. 7 would simply limit the ability of a plant to maximize the utilization of its pooling base, by throwing into the Western order calculation a "netting" provision that does not exist in any of the other milk orders. Federal order theory <u>has permitted</u> a pool distributing plant to ensure an adequate reserve supply by fully utilizing the 25% route delivery requirement (one fourth of the plant's receipts must be distributed on routes within the marketing area).[49] Such plants are permitted in all orders (this was a standard

---

[49] Quoting from the Final Rule in the order consolidation process:

provision) to pool 4 times their deliveries on routes, multiplied by the diversion privilege applicable in their order. The effect of the disqualifying the transfers that are at issue in this proposal would be to reduce a plant's ability to ensure its supply by utilizing the full 75% of deliveries for other uses than Class I. Fully utilizing their pooling ability allows them a measure of independence, which they seem to value. Inasmuch as many of these plants are small businesses, the impact on them should be fully considered before making such a change.

Furthermore, NDA respectfully suggests that adopting a "net shipments" proposal would be, implicitly, a change in USDA policy regarding the traditional rule that only 25% of a plant's deliveries must be on routes within the marketing area. In effect, it would increase that percentage for some plants. If the Secretary determines to adopt the "net shipments" provision, we respectfully urge that the Secretary publish a clear statement of why some plants would no longer have the ability to pool as much milk as others across the nation.

Tightening these standards will only make pooling more valuable, and will increase the intensity of efforts to pool – inviting even more disorderly marketing within the Western order area. The "net shipments" provisions should not be adopted.

H. Summary of NDA Views on DFA Pooling Proposals.

We conclude this discussion of NDA's concerns by coming back to where it starts. Any tightening of pooling standards will create intense competition among producers and producer groups to deliver milk to pool plants, in order that their milk can be pooled. The more prudent alternative is for the Department to maintain the philosophy it has developed over the decades, of establishing pooling standards which ensure that milk which has been regularly associated with a pool continues to be pooled. NDA has followed USDA's rulemaking dockets over the recent decades, and we know they contain literally dozens (perhaps hundreds) of decisions in which pooling rules were first suspended, and then modified, in order that "milk historically associated with the market" could continue to be pooled. The cited rationale was always to prevent disorderly market conditions from developing.

> Even for orders without any diversion limits, there is **a practical limit to how much milk may be diverted from a pool plant because of the pooling standards that must be met.** For a pool supply plant, for example, there is a standard computed by dividing the amount of milk shipped to distributing plants by a plant's total receipts. As provided in the orders, "receipts" include milk that is physically received at the plant as well as diverted to nonpool plants. This inclusion of diverted milk in a plant's receipts **automatically limits the amount of milk that may be diverted** by those plants. Thus, the maximum quantity of milk that such plants would be able to divert and still maintain their pool plant status would be 100 percent less the pool plant shipping standards for the month.
> *[Quoted from Final Decision, pages 17 and 18 of "Acrobat" internet version, in the section entitled "Provisions applicable to all orders". Emphasis in bold supplied.]*

Interestingly, some of the producers who had been pooled under the pre-consolidation orders were initially unable to pool under the Western order, and some were able to pool only with much struggle. The problem of sales below Class I price (Proposals No. 11-13) were a direct result of this pressure. These formerly pooled producers will haunt competitive relationships in the Western order market until adjustments are made to allow them all to pool.

The current rulemaking proceeding has already drawn considerable attention, because it is unusual for USDA even to hold a hearing to consider proposals which would boot a third to a half of the milk out of a milk order pool50 – in this case (unlike the recent Mid-East proceeding), it is milk located within the marketing area and historically associated with both the Western Order and its predecessor orders. The fact that USDA has held this hearing, and even considered this potential result, has the Western Order market in a turmoil and has impacted the marketing of milk in the nearby Pacific Northwest Order and perhaps in other orders.[51]

NDA urges the Department to issue a Recommended Decision in this proceeding which strongly rejects the DFA proposals, using a line of thinking which clearly reaffirms the traditional approaches taken over the years to prevent disorderly marketing by allowing milk within the marketing area to be pooled.

IV. Bulk Tank Handler Issues

Proposal Nos. 5, 11, 12, & 13 address what might be categorized as the "Bulk Tank Handler Issues" because they relate to the "proprietary bulk tank handler" provision of the order.

Meadow Gold has identified as "The Problem" the fact that a loophole in the proprietary bulk tank handler provision allows such an entity to sell milk to pool plants at less than the minimum class price. Meadow Gold argued that this violates the uniform pricing provisions of the statute, and therefore is a "problem" which must be addressed. NDA agrees with the proponent that they have identified a legitimate problem, and that the statute does require that it be addressed.

---

[50] At the hearing, it was testified that the DFA diversion proposal alone would probably eliminate from the pool about 150,000,000 lbs, per the estimate of the Market Administrator's office as prepared for, and testified to by, Jeff Williams *[Transcript, page 753, lines 11- 20]*. Of course the combined effect of the entire package of tighter pooling standards would be even greater.

[51] Later in this brief, NDA formally requests a reopening of this hearing proceeding to place into evidence the post-hearing evidence of disorderly marketing conditions that have already developed in the Western Order and in the Pacific Northwest order.

NDA would add the additional point that when the uniform pricing concept is avoided, the differential in raw milk costs between competing handlers creates a whole new set of "disorderly market conditions" in the wholesale market. While the statute focuses primarily on orderly marketing of "agricultural commodities" in raw, unprocessed form, there is no exclusion of processed commodities. And any distinction between processed and unprocessed milk quickly blurs when cooperatives like NDA and DFA own their own bottling operations. If a bottler is able to buy milk for less than the Class I price and uses that advantage to compete in the wholesale market, it backs up onto NDA and DFA producers in precisely the same way as competition in the raw milk market.

As testified at the hearing, NDA supports the notion that all pool plants should be accountable to the pool for the minimum class prices. We do not feel that is a guarantee that uniformity of pricing will actually be achieved, for the reasons set forth elsewhere in this brief where the possibilities of "seemingly separate transactions" can be used to overcome the minimum payment provisions of an order. "The Problem" here (selling milk below class prices) is driven by the seller(s)' need to pool their producers. Their producers are neighbors to DFA and NDA producers who are pooled, and they need to pay competitively. Adopting this proposal will at most make pooling more difficult, but it will not stop the need to pool so it must be anticipated that other avenues for pooling will be achieved. This will likely lead to disorderly markets, unless (as suggested by Jeff Williams) the diversion requirements are loosened to 95%. The reality is that disorderly market conditions are invited unless pooling standards allow all milk within the delivery range of the pool plants to be pooled.

With that qualification regarding the expectable result of these amendments, NDA supports the concepts advanced by Meadow Gold Dairies in Proposals No. 11, 12, and 13. We recognize that Proposals 11 and 13 are seen by Meadow Gold as a package, and that Proposal No. 12 is seen as an alternative.[52] We have no preference as to these approaches, and will leave it to the wisdom of Department to determine the best approach if they find that such a change is necessary.

NDA sees no reason to delete the entire "proprietary bulk tank handler" provision from the order. There was no showing that there is "A Problem" associated with the provision itself, other than the problem that would be addressed by the Meadow Gold proposals. We therefore oppose Proposal No. 5.

V. Assembly and Transportation Credits

A. Statutory Basis for Credits. Proposal No. 8 would provide credits (essentially payments from the marketwide Federal Order pool) to organizations which assemble milk

[52] Testimony of Carl Conover, Transcript at p. 1201.

for the Class I market, and also for those organizations which transport it long distances to the Class I market.

As with pooling standards, it is useful to begin by reviewing the statutory basis for these credits. Section 608c(5)(J) of the Act authorizes milk orders to contain terms and conditions …

> **(J)** Providing for the payment, from the total sums payable by all handlers for milk (irrespective of the use classification of such milk) and before computing uniform prices under paragraph (A) and making adjustments in payments under paragraph (C), to handlers that are cooperative marketing associations described in paragraph (F) and to handlers with respect to which adjustments in payments are made under paragraph (C), for **services of marketwide benefit**, including but not limited to -
>
> > **(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.

As an initial point of statutory analysis, we note that the overriding purpose of all order programs – which is to "establish and maintain orderly marketing conditions" (as appears at the outset of the Act) -- is not repealed by the addition of language deep within the Act which authorizes payments from the pool for "services of marketwide benefit". Accordingly, any such service payments should foster orderly marketing, and should never create disorderly marketing.

NDA urges the Secretary to interpret this provision as permitting such payments (termed "credits" in Proposal No. 8) only if there is evidence that they are needed to accomplish one of the goals specifically set forth in subsections (i), (ii), or (iii) – or (since the purposes include but are "not limited to" those three concepts) if they clearly accomplish the general purpose of reimbursing for a "marketwide benefit".

Put a different way, NDA urges that such payments – which come at the expense of all producers in the pool – should be granted only if there is evidence that a service is needed which meets one of those four tests, and only if there is evidence that the proposed credit would result in the needed service being provided.

The statute provides four potential justifications for this type of reimbursement from the marketwide pool:

1. The first potential justification that a proponent might offer is that the assembly or transportation credit would *"provide facilities"* to furnish needed milk or to handle

excess milk. Neither the assembly credit nor the transportation was advanced for that purpose, and neither would do so.

2. The second potential justification that a proponent could offer is that these credits would help *"handle on specific days quantities of milk that exceed the quantities needed by handlers"*. Neither the assembly credit nor the transportation credit was advanced for that purpose, and neither would do so.

3. The third potential justification that a proponent could offer is that they would *"transport milk"* in certain ways. Clearly the proposed assembly and transportation credits must be analyzed under this third concept, and NDA will do so after analyzing the fourth concept.

4. The fourth potential justification that proponents could offer is that the proposed credits would provide some <u>other</u> *"service of marketwide benefit"*. DFA's primary point seemed to be that giving those of us who supply the Class I market some additional compensation would more fairly allocate some unidentified "burden" of serving that market.

NDA submits that there is an additional criteria, implicit in the statutory concept of a "service", that for a service to provide the required marketwide benefit, it must be a type of service that is not normally being provided to the market already, or is being provided only under some economic duress. Examples of the latter category would be the first two specified in the statute -- the need to build a new facility or to otherwise handle unusual quantities of milk not needed by handlers.

<u>B. Proponents Have Not Shown What Cost Should be Reimbursed.</u> The primary justification offered by the proponents for instituting these credits was that they believe that "not all of those *[assembly or transportation]* costs are recovered in the marketplace".[53] They also complain that the costs they incur in serving the pool distributing plants are not being equitably shared in the marketplace. Neither, we respond, are the benefits of pooling that DFA obtains today while others struggle to obtain them. If DFA wants help serving the market, they should share with the others who supply the pool the benefits that are obtained from serving that market.

If the current pooling provisions of the order were so lax that pooling was automatic, pooling rights would have no value and it is conceivable that assembly and transportation costs might prevent suppliers from serving the pool plants. IF that were the case, and if there were evidence plants were not getting served, we could follow DFA's logic. If nobody else was willing to serve the market, we could support their request for reimbursement of the unusual costs they are forced to incur. But there is no evidence that others are unwilling to serve the market, and no evidence that DFA is incurring a net loss

---

[53] Testimony of Elvin Hollon, Transcript, p. 1029.

by serving the market -- indeed, the evidence shows that by serving the market, DFA has generated income by selling pool access to the River Valley cooperative.

DFA refused to disclose in this rulemaking proceeding its service charge structure, or even how much of its assembly and transportation costs are recovered from market premiums.[54] Nor would they discuss the amount of money extracted from other producers in the market, for pooling rights.[55] DFA agreed that if assembly and transportation costs were recoverable from the market, via service charges, there would be no need for assembly or transportation credits.[56] But we can not know for sure whether that is the case today or not, because DFA refused to put any numbers into the record.

In addition to the unquantified service charge amounts that are being provided by the bottlers to reimburse these services, DFA also extracts a pooling benefit that allows them to sell pooling rights. DFA also refused to disclose on the record any information that would help the Department evaluate that benefit.

NDA submits that if a market wide "service" is not being reimbursed, then the cost of that service should be documented as part of an application for service payments from other producers in the pool. Such a documentation should include both what those services cost <u>and</u> how much of that cost is already being reimbursed (through service charges and the benefits of pooling). DFA acknowledges as much, and yet admits that if the market service charge structure were to improve to such a degree that over-order charges did cover those costs, there would be no way to know whether or when that would become the case.[57] NDA submits that this is <u>not</u> sufficient evidence of a need for those credits. What is being requested is essentially an open-ended and unaudited expense account!

NDA respects the general principle that some information is proprietary and that it should not be mandatory that such information be disclosed. However, the party which asserts that privilege runs the risk that the hearing record will not be adequate to demonstrate the point at issue. When NDA sought a proposal which negatively impacted the marketwide pool in an unrelated proceeding a decade ago, we opened up the books and we answered every question. <u>When other produces in the pool are being asked to bear an expense, it is incumbent on the party asking for relief to prove not only that there is a need, but also to be open about the financial impact that justifies the proposal.</u>

DFA's witness specifically testified that the inability to recover these costs via service charges to handlers was because the Salt Lake City market is so competitive.[58] If the market is so competitive that pool plant operators are able to force DFA to absorb the cost

---

54 Transcript, p. 1034.

55 Transcript, p. 571.

56 Transcript, p. 1030.

57 Transcript, p. 1034.

58 Testimony of Elvin Hollon, Transcript, p. 1032.

of assembling and transporting milk to the market, it follows that other potential competitors to supply those plants must be either have the ability to provide that service at a lower cost, or they must be able to serve those markets within the current economics of the supply relationship. Either way, there is no justification for providing an incentive for doing what the marketplace proves suppliers are willing to do anyway.

NDA testified that we are anxious to serve the Salt Lake City pool plants. Part of the economic considerations were related to the ability to pool our milk (as discussed in connection with the pooling proposals). We recognize that there is a cost associated with delivering to pool plants to obtain pooling rights, but there is also a benefit. DFA seeks to obtain the benefit without suffering the cost.

Under those circumstances, it is hard to imagine that this is a question of economic duress (like the two types of service payments indicated by Congress in the statute).

C. Proponents Have Not Qualified Under the Statute. For there to be a reimbursement for a "service of marketwide benefit", there must be a "service" and the benefit must be "marketwide". NDA submits that if a service is being willingly provided to the market (or can be), then there is no "service of marketwide benefit" that must be encouraged through a service payment. One must conclude that there is no "service" for which a reimbursement is being sought.

Even if the proposal in this proceeding meets the test of proving a "service" is being provided, it also must meet a second statutory test that the benefit must be "marketwide". The "market" that the statute anticipates might benefit could only include producers, handlers, and consumers.

- Would producers benefit marketwide? No, only a portion of the producers in the market would benefit (those that delivered to Class I plants).[59]
- Would handlers benefit marketwide? There is no evidence offered in the hearing record to demonstrate that any handler would benefit – indeed, DFA's witness did not even claim that handlers are not being well served.

---

[59] DFA's witness was asked by the USDA marketing specialist about this, in the following exchange, at page 1086 of the transcript (to which there was no followup):

```
      Q And it's your testimony then that the -- your
proposal conceptually would benefit all producers in
the market?
      A The way the proposal is designed, any
producer who -- who fills that role collects for the --
collects the credit for the service. So, it's anybody
who serves the Class 1 market could collect the credit.
```

This exchange reveals a misunderstanding of the marketwide benefit that the statute requires, which is not a program that each producer has the opportunity to use, but a service which provides some value for all producers in the market whether they are actually involved in providing the service or not.

- Would <u>consumers</u> benefit? No such suggestion was made at the hearing, and it is hard to see how consumers would benefit unless there were some benefit to handlers.

NDA submits, then, that there is no general "service" being provided that is "marketwide". DFA bases its argument not in the statutory criteria, but in a belief that the costs of serving the Class I market should be allocated more equally among all who benefit from the pool. Even assuming DFA had demonstrated those costs (which we have argued, above, that they have not), NDA submits that they have not proven that they fall inequitably up on DFA.

NDA acknowledges that in the Final Rule, the Secretary granted similar credits in the Upper Midwest. A close reading of the Final Rule indicates that its purpose was to help handlers who apparently had shown that the market was not supplying them:

> A transportation credit and procurement credit are incorporated in the order to assist handlers in supplying the Class I market. These transportation and procurement credits, to be paid on Class I milk only in combination with the Class I price surface discussed elsewhere in this final decision, <u>will help handlers</u> move milk to the fluid market by distributing the cost of supplying the fluid market to all market participants who share in the marketwide pool. Handlers and producers who supply the Class I market on a regular basis should not be expected to bear the entire cost of supplying the Class I market while handlers and producers who meet only the minimum requirements derive the benefits of marketwide pooling. Incorporation of a transportation credit and procurement credit on Class I milk in the marketwide pool will assure that at least some of the cost of supplying the Class I market is shared among all market participants. *[Emphasis supplied.]*

In this proceeding, however, there is no complaint from a fluid handler that handlers need such help moving milk to the fluid market. No evidence of such a difficulty was even offered by DFA, even though they were repeatedly invited to provide it. As noted earlier in this brief, a fairer allocation of the cost of supplying the Class I market must be based on a showing that there <u>is</u> such a cost, after consideration of service charges and other benefits. There was no evidence presented that there is such a <u>net</u> cost – and implicit in the fact that the Class I market is being served is the suggestion that any such costs are being compensated by the market.

<u>D. The Proposals **Do Not** Qualify as "Transportation Credits".</u> To qualify, the statute provides that they must provide a "service of marketwide benefit" by "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".

NDA submits that this statutory test can only be met <u>only if</u> the proponent can show that the "transporting" which is being reimbursed has a "marketwide benefit". In other words, <u>it is not sufficient</u> to qualify for the payment merely by "transporting milk from one location to another", the "transporting" must provide a marketwide benefit. As indicated earlier, the proposals in this proceeding fail to meet that test.

The statute also would require that the proponents demonstrate either of two specific qualifying conditions which might justify the payment:

1. That statutory test might be met if the transporting was needed "for the purpose of fulfilling requirements" for Class I handlers. However, proponents have acknowledged that there is no shortage of milk to meet the "requirements" at any of the pool distributing plants. They have failed to meet that statutory test.

2. The other statutory test would be met if the transporting was for the alternative purpose of "providing a market outlet for milk of any use classification". This language would allow payments to cover movements of surplus milk out of the market when there is insufficient processing capacity within the market (doing so would provide a "marketwide benefit" by avoiding the disorderly marketing conditions that can result if too much milk chases too little capacity). But in this proceeding there was no evidence offered by the proponent, and no argument made by them, that the transportation credit is needed to "provide an outlet" in Utah for the Idaho milk that would qualify for that credit. If they do make that argument on brief, it should be rejected, for two reasons. The first reason is that there is no evidence in the record (or even an argument) that moving producer milk from Idaho to Utah is necessary to provide an outlet for those Idaho producers. The second reason is that this second test, like the first, requires that any such credit must provide a marketwide benefit and there is no benefit to the market of moving milk long distances when there are nearby outlets for it in Idaho.

In short, neither the proposed assembly credit nor the proposed transportation credit can meet the standard for a marketwide service payment, simply because in this case – in this market, on the evidence in this proceeding – there is no evidence that any of the statutory tests for the credit have been met. NDA could see a marketwide benefit if there were a shortage of milk at one or more of the processing locations – but proponents admit there is not. NDA could justify a marketwide service payment if the cost of assembling needed supplies were unusually high – but there was no evidence offered to suggest that it is. NDA could justify a marketwide if there were in the Western order market (as is the case in Order 30, where there is presently an assembly credit) additional costs of assembling milk at "country plants" and then reloading it onto larger transport vehicles for delivery to the distributing plants in the cities – but in the Western order market virtually all the milk moves directly from farms to plants.[60]

E. The Proposal Lacks Merit. Even though NDA has demonstrated why no assembly or transportation credits meet the statutory tests that must be met, if the Secretary rules that

[60] Testimony of Dan McBride, Exhibit 61, pages 1 and 2.

they do, the proposals still must be considered on their own merit. NDA offers the following additional comments on the merits of these particular proposals:

- The logic of using an assembly credit to move milk to a distributing plant would differ little from the logic needed to justify an increase in the Class I price surface at that plant site. The effect of a 5 (or 10) cent assembly credit at distributing plant locations would be to provide suppliers with an additional 5 (or 10) cents to deliver there; a similar economic incentive could be achieved by increasing the Class I differential at those locations by that same 5 (or 10) cents *divided by* the Class I utilization percentage.

- Similarly, any transportation credit will increase the location value. But it would do so in a less precise way than an assembly credit, simply because the amount of the proposed transportation credit would vary with the distance traveled.

- NDA notes that the current Class I price surface was developed from 1995 data that went into the Cornell computer model, which computed the location value of milk, based on transportation costs (and only transportation costs) of moving milk from farms to plants and moving packaged products from plants to consumers. In that respect, any transportation credit added to a Federal order would interfere with the assumptions of the Cornell model. The Cornell model included locations and quantities of milk production, broken down for geographic areas that were smaller than states; and it included population data. We note that the 1995 data will at some point become obsolete, as milk production locations change and as population shifts. At some point, an adjustment to the Class I pricing surface will be needed. Assembly and transportation credits will be proposed by some as a vehicle for accomplishing these fixes. It is important that USDA consider proposals such as these in that context, and to ensure consistency of philosophy and consistency of economic incentives.

- As part of the analysis suggested above, it is important for USDA to keep in mind that the practical effect of either credit will be to provide a competitive advantage in pooling milk to the party which already makes the Class I sales which qualify that party for the premium. If a hypothetical proprietary plant wished to use such a provision to develop its own milk supply, its producers would receive a very high percentage of the assembly credit (depending on the plant's Class I utilization). This would provide the distributing plant with a competitive advantage in competing against a cooperative which was "merely" paying the full blend price.

- Similarly, because the assembly credit payments would be made to cooperatives, we need not distribute them back to the supplying producer members. This allows the money to be used to obtain competitive advantages everywhere, not just in the region where the milk is produced. During cross examination of DFA's witness, this was explored[61], and DFA's response was that the opportunity to obtain the money from the

[61] Transcript, pp. 1051-1053.

pool would be available to everyone, therefore no competitive advantage would be conferred. That argument does not hold water in the Western order market. If the potential competitors were reluctant to serve the market without the credit, and if the credit encouraged them to serve the market by offsetting the costs of doing so, the argument would hold water. But the Western order market is – as DFA admits – one in which there is vigorous competition to serve the Class I market. If anything, the credit would reinforce DFA's grip on that market.

- This potential for additional bottom line revenue and/or competitive advantage could provide a cooperative with an incentive to "lock up" a market. Those opportunities would, in turn, create the potential for "disorderly marketing conditions" as different cooperatives competed vigorously for the opportunity to obtain those dollars and the potential competitive advantage they offer.

- NDA's biggest concern is that, as proposed, these transportation credits could lead to an abuse of the statutory intent. They would basically be available only to move Idaho milk to Utah distributing plants. In so doing, such milk would be moving south, past the nearby Cache Valley milk which goes to the two cheese plants there but which is actually closer to the Salt Lake City pool plants than is Idaho. There is plenty of near-in Utah milk, but it goes to cheese plants (as noted earlier in this brief, nearly half of the milk produced in Utah is used to produce cheese). As proposed, these two credits would give DFA more money to compete to draw milk away from Idaho cheese plants, so it could deliver <u>that</u> milk to the Salt Lake City pool plants, while keeping Utah milk in the Cache Valley or at Beaver so that DFA's two cheese plants operating at optimum capacity. The effect would be far different than the intended statutory purposes of these credits, which is to move milk to a higher-valued class of utilization. In this case, we fear the effect will be to move milk from Idaho cheese plants so that DFA can keep its Utah cheese plants full.

- As a general proposition, the Department should guard against adopting a marketwide service payment which subsidizes economic inefficiency and discourages that inefficiency to be corrected. As DFA's witness agreed, some plants are more efficient to deliver to than others. Transportation costs to serve a plant can be considerably reduced if the plant receives milk 7 days per week, so that it can be supplied each day from the closest nearby milk. If the plant does not operate weekends, then the nearby milk may have to be hauled at great expense to manufacturing plants, and then the next week if the nearby supply is inadequate to meet each day's needs milk may have to be hauled in from distant locations. The market premium structure apparently does include incentives to deal with that situation.[62] In addition, some receiving bays are quick, allowing the transportation equipment to get back out on the road and be productive, while other receiving operations are slow and force idle down time for the equipment used to haul milk. <u>The danger here</u> is that a credit might be requested from the pool, to subsidize such inefficiencies. If the supplier is being reimbursed from the

[62] Transcript, pp. 1035-1038.

pool, the supplier has no incentive to pass back to the plant a charge for the expenses that the plant operator is causing. And the plant operator has no incentive to change his operations or to invest in facility upgrades. *Is that the situation here?* We don't know, and we can't know, because the evidence offered to support Proposal No. 8 is simply not sufficient. NDA urges the Department, as a general proposition, to undertake close scrutiny of the cost basis for any marketwide transportation credits with these considerations in mind, and to demand full and disclosure of all the costs needing reimbursement – and to reject those that amount to subsidizing inefficiencies.

- If a transportation credit is to be adopted, the language should provide for two safeguards against what NDA sees as potential abuses. One must safeguard against the situation described in the preceding bullet point, in which the pool would pay to keep DFA's cheese plants full. The other must safeguard against a pool plant supplier using the credit to bring distant milk to the market, rather than closer-in milk which is willing and able to serve the needs of distributing plants, given the opportunity to do so. The order language should be amended to require that the transportation credit be available only if the organization which applies for the credit had no nearer milk it could have moved to the pool plant; and the credit should be available only if there is no closer milk Grade "A" available to the pool plant than the milk which the pool is being asked to help move. These two safeguards would not only promote a more "orderly" movement of milk to market, they would create economic efficiencies that milk orders should promote as a matter of social policy. They are good economic policy, and furthermore are the only way to be fair to a near-in producer who is willing to serve the market be allowed to do so instead of being forced to pay (through the pool's transportation credit) for a more distant and less efficient milk movement. And it would be only fair to a near-in Grade "A" producer who has not been able to find a way to pool his milk, to be given a chance to demonstrate his ability to serve the market before more distant producers are given that chance. NDA believes that such a provision could be administered in an efficient manner.[63]

---

[63] A procedure should be established for the organization which applies for the credit to certify (subject to audit) that these two conditions have been met. It should be a simple matter for a party which anticipates applying for the transportation credit to identify all parties with closer-in milk, and to ask them if they would accept or reject an opportunity to fill the "marketwide" need for milk movement that would qualify for the transportation credit. If they so indicate, they have waived their right to do so. If they are interested, then the applicant need only contact those few parties who have expressed an interest, and document their response. Upon receiving the applicant's certification that those inquiries were made, the Market Administrator could automatically make the payment, without further administrative worry <u>until</u> a near-in party objects. To ensure that all parties play fairly, the Market Administrator could publish the destinations of milk receiving transportation credits, and the miles traveled for which application is made (pounds of milk may not be necessary). Such information should be public knowledge, much like grants for public funds are made public, becausee it is the money of the entire pool that is being applied for and paid out with this credit. An application form could easily be developed by which the party who feels it is performing this marketwide service <u>certifies</u> (1) that each specific movement of milk from farm to plant was closer than any other milk which was picked up and diverted to nonpool plants during a 12 hour period prior to the pickup for which reimbursement is being sought; and (2) that any cooperative or proprietary plant with milk that is nearer to the destination plant has either been offered and refused a general opportunity to move their milk to the destination plant instead of the applicant's more distant milk, or that the

- Three other Federal orders have transportation credits, but they work in much different ways than are proposed here.[64] In the Upper Midwest, it applies only to transfers between plants (an inherently less efficient process than the direct shipments which DFA proposes to reimburse in the Western Order market). In the other two cases, they apply to movements from outside the marketing area to plants within the market, whereas Proposal No. 8 would not provide a credit to bring milk from 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 presently granted, adoption of Proposal No. 8 would be unprecedented. It must stand on its own unique facts and justifications, if it can be justified at all.

- It is also worth noting 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 encourage the movement of milk from Idaho into Utah. Given that different incentive from zone differentials, the economics of transportation are different. The Upper Midwest transportation credit formula is therefore not appropriate here.

We close this review of the implications of Proposal No. 8 by repeating from our hearing testimony 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.

<u>F. Balancing Costs Should NOT Be Considered.</u> In the prepared testimony of the proponent, DFA's witness attempted to introduce at the hearing evidence supporting the need for assembly credits and the amount of those credits, by introducing the cost of operating balancing plants and asking that those costs be considered. Plant balancing costs can be a legitimate basis for marketwide service payments. However, they can be adopted only if proper procedures are followed.

DFA was unable to clarify why plant balancing costs should be calculated into assembly costs .[65]

---

marketer of such closer milk had expressed a general interest in moving its milk to the market instead of the applicant's more distant milk but had refused the opportunity to do so in this particular case.

[64] Testimony of Dan McBride, Exhibit 61, page 5.

[65] DFA's witness had an opportunity to address this, but entirely missed the point. The following is the entire cross examination of DFA's witness by the Department's marketing specialist on this subject:

```
          Q Okay. What does balancing in and of itself
     have to do with assembling milk to make it available to
     service the Class 1 market? I mean, hasn't the milk in
```

NDA objected to any evidence being considered regarding plant balancing costs, because that concept is outside of the scope of the hearing record. There is nothing in Proposal No. 8 (or anywhere else in the hearing notice) that put NDA on notice that this hearing would consider those costs. We have studied carefully in our own plants just what those costs are, and we could have come prepared to discuss them, or at least to cross examine the proponents' figures. However, we did not have any indication from the proponent that they would argue balancing costs were "assembly" costs, and indeed we did not receive a copy of their testimony on the subject until just as their witness took the stand. "Trial by ambush" is not only unfair, but with a complicated subject like this it extends a hearing by causing the other parties to take unnecessary time in cross-examination and to do a poorer job in eliciting facts for the hearing record.

NDA's objection was sustained by the presiding Administrative Law Judge. Judge Clifton ruled 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.[66]

In the event DFA seeks to overturn this ruling, it should be sustained for the following reasons.

1. Judge Clifton correctly ruled that as a general proposition, milk assembly is quite different from balancing, and that balancing was not within the scope of the proposed assembly credit. Assembly involves gathering up a milk supply so it can go to market, and it includes such activities as ensuring Grade "A" compliance, bringing milk to a central facility for redistribution, etc. It does NOT necessarily involve balancing, which in fact often may be done by another party with no reimbursement

---

effect already been assembled and the milk has a choice with DFA, for example, as a marketing agent to decide, you know, is it demanded by my customers in the Class 1 market or I'm going to leave it in my cheese plant? I mean, the milk has already been assembled and maybe we're arguing semantics here, but it -- it would seem to me that another form of a marketwide service payment in other places sometimes is referred to as a balancing credit.

A I know, you know, debate over that. The assembly credit is -- is a term that's used in Chicago. I just adopted that, but the -- the --

Q You're equating assembly and balancing sort of in the same light then.

A I would say conceptually, there's a transport function that to me is -- is -- is identifiable under the method that I chose, and there's one set of costs that are there, and there were other costs that I tried to break out and identify, and I gave them the label of assembly, but it can have service -- I'm not hung up on the terminology.

[66] Transcript, p. 1274, line 18.

from the producers who would receive the credit. In contrast, balancing involves plant operations and perhaps transportation costs which, together, vary with the seasonality of milk production and Class I demand.

2. In addition, the hearing notice warned potential parties that the concept was based on reimbursements to the producer or cooperative which supplies milk to a Class I facility. In contrast, the statute which authorizes marketwide service payments for balancing – to quote the pertinent parts – provides:

   > A "payment for services … of marketwide benefit, including .. 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 *[and]* handling on specific days quantities of milk that exceed the quantities needed by handlers".

   The statute clearly contemplates a service by a balancing plant operator and a payment to that operator – not a payment to every producer or cooperative who happens to supply milk to a Class I facility. Therefore, the concept laid out in the hearing notice could never have been a payment for balancing.

If the hearing notice had called it an "assembly and balancing credit", the problem of scope might have been adequately addressed, but the proposal would still not meet the statutory criteria. Nor would it be good public policy. There is no question in NDA's mind, from our experience in both orders in which we operate, that balancing costs can exist to one degree or another. However, Proposal No. 8 would not reimburse those plants for those balancing services, which is what the statute would contemplate. Instead, Proposal No. 8 would pay the assembly credit to the producers who ship to a Class I facility, even if they do not have any interest in the manufacturing plant which balances their milk or the market in general.

NDA's witness testified from his 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 someone else's balancing plant.[67] Typically the distributing plant balances by using the cooperative – by purchasing more or less milk as seasonal needs dictated. Even if the bottling plant reim

burses that cost – and there is no evidence that it is in the Western Order – the proposed service payment from the pool would go to producers who ship to that bottling plant (even if the bottling plant does the reimbursing). 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 rather than the balancer. The only way this dilemma can be dealt with is to pay the balancing fee to the plant which actually bears the "opportunity cost" of this balancing, as envisioned by the statutory provision (quoted above) which would authorize that type of payment.

---

[67] Testimony of Dan McBride, Exhibit 61, page 3.

For all these reasons, the costs associated with balancing should not be considered in determining the applicable amount of reimbursement for an "assembly" credit.

G. Summary of NDA Views on Proposal No. 8. NDA reacts with a mixture of sympathy and misgivings to the argument made by DFA that they and others who serve the pool distributing plants incur costs that are not recovered from the market. As a cooperative which serves a very substantial portion of the Pacific Northwest market, we do understand the costs of serving that market. We also understand that in return for that service, a cooperative is allowed to pool a substantial additional quantity of diverted milk.

In the Pacific Northwest, we have not felt it necessary to apply for any type of marketwide service payment -- such as transportation or assembly credits -- because (as outlined in earlier discussions in this brief), the pool distributing plants pay a reasonable service charge that makes it attractive to provide that service.

One of the ironies of this rulemaking proceeding is that the DFA proposals to institute these credits in the Western Order become more justifiable with looser pooling requirements, and less justifiable if the proposals to tighten the Order's pooling standards are adopted.

NDA would benefit from Assembly Credits, on the Class I portion of our milk. That would be nice, but it is hard to justify. Candidly, our cost of assembling milk used to serve the Class I market is no different than our cost of assembling milk for our Class II, III, and IV uses. And it is already a low-cost assembly process, since so many producers provide 70,000 lbs per pickup.[68] Moreover, NDA already has an incentive to expand NDA's "deliveries to pool plants" to enable our members' milk to be pooled under the current pooling requirements, so we do not need an additional incentive to move milk to bottling plants.

Even though little NDA milk presently moves over the 80 miles that would be necessary to become eligible for the proposed Transportation Credit, NDA also would potentially benefit from it as opportunities arise to serve the Salt Lake City market.

NDA went into the hearing somewhat interested in these assembly and transportation credit proposals. However, now that we have closely analyze them in a statutory context, we do not feel they are consistent with the spirit of the "marketwide" service payments that Congress authorized a few years back. We could live with them, because we would benefit from them. In other words, they do meet our "economic advantage" test, if not the statutory test.

VI. Market Administrator Proposals

[68] Testimony of Dan McBride, Exhibit 61, page 2.

There are three proposals in the hearing notice suggested by the Market Administrator (Proposals No. 14, 15, and 16).

All three clarify the order language. None is thought to be controversial.

NDA supports adoption of these three proposals.

VII. SUMMARY & OVERVIEW

This hearing was originally called for the purpose of considering the practice of "double dipping", pooling milk on the Federal Orders which is already pooled on the California state order. The evidence is clear, there is ample precedent in the Order 30 decision. That change should be made, by adopting Proposals No. 1 and 10 on an emergency basis.

NDA supports Proposal No. 9, which would establish a "state unit pooling" rule designed to protect the Western Order from distant pooling. We object to adoption of the same concept in the Pacific Northwest Order (Proposal No. 2), simply because it is not needed if the Department adopts in a separate proceeding the proposals unanimously supported by the industry at a hearing in Seattle last December.

NDA recognizes the statutory requirement that orders should provide uniform pricing, and therefore supports the concept that pool plants which buy from proprietary bulk tank handlers should pay full Class I prices. While we therefore support the Meadow Gold proposals, we are under no illusion that it would by itself guarantee uniformity of pricing. If pooling provisions are so tight that producers who are anxious and able to supply pool plants still can not do so, they will find ways to defeat the uniformity of pricing which Meadow Gold seeks.

NDA has no enthusiasm for the proposed Transportation and Assembly Credits, but we can live with them. Such credits may be appropriate in certain circumstances, to move milk to where it is needed, but before they are adopted the Department should require evidence that milk is not moving to where it is needed. And we also respectfully urge the Department to require in any proceeding where such credits are requested that the proponents demonstrate that their proposal meets the statutory standard of benefiting the entire market (rather than just the proponents).

NDA would benefit immediately from the assembly credit. And even though little NDA milk presently moves more than the 80 miles that would be necessary to become eligible for the proposed Transportation Credit, NDA also would potentially benefit from it as opportunities arise to serve the Salt Lake City market. The credit would be especially helpful in the event the Secretary were to grant any of the DFA proposals that tighten pooling requirements.

It is important for the Secretary to understand that adopting any of those proposed pooling changes would mean that, at least initially, we could not pool all of our milk in the Western Order market. If we were unable to pool, our cooperative would soon lose its milk supply to whatever other cooperatives or proprietary organizations were successful in obtaining the pool distributing plant sales that would allow them to take on more producers. And without sufficient milk of our own, and/or if we had to buy it at an over-order price from others, the NDA cooperative could quickly find that the plants in which we have invested so much money could no longer be operated economically. Faced with that potential scenario of no milk to fill our plants, or having to purchase milk at higher costs in order to fill our plants – either of which would be extremely burdensome to our cooperative (and, we presume, to others). We surely would have no alternative but to attack the Salt Lake City market to obtain more "deliveries to pool plants" – and to attack with all the vigor we posses, and with whatever means our creativity (and the creativity of our potential customer) can devise.

In that ugly scenario of cutthroat competition and disorderly marketing conditions, it would indeed by nice to be able to count on Assembly Credits and Transportation Credits to offset some of the costs we would incur to get our milk pooled. However, as discussed in this brief, the sophisticated buyers who operate the proprietary pool plants in the Western Order could easily turn these credits into an opportunity to extract additional concessions. They may not even need to figure it out for themselves, because we – and many others who will all face the same problem of needing to qualify for pooling – we all will be falling all over ourselves to find a way to use the money we receive from those assembly and transportation credits to creatively offer incentives for the pool plants to buy from us instead of someone else.

Since this is a brief, we will hammer home the obvious legal point that such a scenario would be one which the Agricultural Marketing Agreements Act would require that USDA correct (and not create) through the order program. As detailed in the introductory section of this brief, the purpose of agricultural marketing orders is:

> . . . to establish and maintain such orderly marketing conditions for agricultural commodities … as will establish [specified] prices to farmers; [and such] as will provide an orderly flow of the supply thereof … to avoid unreasonable fluctuations in supplies and prices.

The pooling proposals would not promote prices to farmers, at best they would just move money around and at worst they would create a price war that lowers farmers' prices. They would not "provide an orderly flow" of milk, they would instead cause milk to move in artificial ways. And there was not even an argument made that they would promote more stable supplies or prices.

The pooling proposals are more than "disorderly", they are a recipe for disaster. They should not be adopted in any form -- none of them! There was no support for the proponent from any of the other cooperatives or handlers in the market. In fact, Glanbia Foods suggested that there is more of a rationale to increase the diversion limitation to 95% than it would be to decrease it, and NDA agrees. There are more supporters in favor of liberalizing the pooling requirements, than in support of tightening them – and collectively we represent more milk within the order area than does the proponent.

If the Department has any doubt whatsoever that the proposed pooling proposals are a recipe for disaster, we urge that the hearing record be reopened to take additional evidence of the disorderly marketing conditions that have arisen (and are still arising) in the Western order market just because there has been a hearing on these proposals – a hearing which has spooked the industry into altered marketing behavior both inside and outside the Western order area.

Given that larger industry interest in this proceeding, NDA strongly urges the Secretary to make its thinking very clear in the Recommended Decision, so all stakeholders understand whether the wisdom of past USDA administrations in avoiding disorderly marketing conditions will be reaffirmed – or whether, instead, there are new "rules of the game". We also stress the importance of clearly stating the rationale for any change from prior policies, and where it is changing, so that participants who work under Federal Orders throughout the country can fully understand the new approaches being adopted.

NDA appreciates the opportunity to submit this post-hearing brief, and the Department's consideration of our views.

Respectfully submitted,

NORTHWEST DAIRY ASSOCIATION, by:

____

Douglas C. Marshall,
Sr. Vice President