

TESTIMONY IN OPPOSITION TO PROPOSAL NUMBER 4 (DEAN FOODS)

This testimony is presented on behalf of Arkansas Dairy Cooperative Association; Dairy Farmers of America, Inc.; Dairywomen's Marketing Cooperative, Inc.; Lone Star Milk Producers, Inc.; and Maryland & Virginia Milk Producers Cooperative Association, Inc. in opposition to Proposal Number 4 as included in the Notice of Hearing.

As we understand Proposal Number 4, each month during the Transportation Credit Balancing Fund payment period, on a handler by handler basis, the market administrator would compute whether a handler's total receipts of producer milk was greater than or less than 130 percent of that handler's physical receipts of producer milk at the handler's pool distributing plant or plants. If the handler's ratio of total milk pooled to pool distributing plant receipts is greater than 130 percent, then if the handler is eligible to receive a Transportation Credit Balancing Fund payment, such payment would be reduced by the handler's ratio of total milk pooled to pool distributing plant receipts versus 130 percent. So for example, again as we understand the proposal, if a handler's receipts of producer milk was 60 percent more than the handler's pool distributing plant receipts, then the handler would have its Transportation Credit Balancing Fund payment reduced by one-half, that is, the ratio of 30 percent over 60 percent.

As we have pondered on Proposal Number 4, we perhaps see some rational basis for the intent of the proposal, but find the proposal as written unacceptable and unfair.

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 Deponent _____
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We can see, in theory, that if a handler has sufficient milk to allow it to divert to nonpool plants more than some reasonable reserve above the handler's actual receipts at its pool distributing plants, then it may make some sense to limit that handler's ability to receive Transportation Credit Balancing Fund payments. The issue with the proposal as written however, is interpretation, application, and degree.

The proposal as written seems to suggest the milk world operates on averages; that every handler every month will seek to exactly balance their supply to no more than some stated maximum **level** of reserve supply, and that every handler can in fact accomplish this balancing act. This works nice in theory, but goes out the window in the real life world of milk marketing. A thirty-percent balancing **reserve** may fit an Order in total, maybe in one month, but it may not fit an individual handler's needs in that month. Thirty percent may be inappropriate in some months at the Order level too.

Differences at the plant level in the type of customers the plant serves; the receiving and storage capacity of individual plants; the daily fluctuations in demand and supply; the monthly fluctuations in demand and supply; the seasonal nature of the demand at the customers the plant serves; and the seasonal nature of the plant's producer supply all combine to make a handler specific **picture** of that handler's individual reserve requirement. As an example, a handler whose customer base contains schools will have a fundamentally different seasonality to its demand base, and thus its reserve requirements, than would a handler focused solely on serving supermarkets. In addition, there exist across the marketing areas differences in

seasonality of milk supply which further complicates this desire to have a one-size-fits-all reserve requirement.

The substantial milk deficit condition of the southeast is an overriding factor in decisions on how much milk a handler **must** procure from outside the southeast to cover the handler's projected deficit in the short season. Simply put, because the southeast requires so much supplemental milk in the short season no one can afford to be caught short. The cost of purchasing spot milk in the middle of August is so burdensome that almost everyone makes their commitments for supplemental supplies well in advance, ~~often~~ by the end of the preceding calendar year. This means there is sometimes seven or eight months of time elapsed between the commitment to purchase supplemental supplies and the time they are really needed. Much can change in a handler's supply and demand dynamic between November of one year and August of the next. In addition, the purchase agreements for supplemental milk may contain assumptions or agreements for the supplier of the supplemental milk to receive Transportation Credit Balancing Fund payments. Suppliers factor in **certain** expected returns on the sale of the milk which may be dependent upon the receipt of the Transportation Credit Balancing Fund payments. To penalize a supplier of supplemental milk when the buyer has overestimated its need for milk is patently unfair. We must also remember, if the supplemental milk purchase agreement is for the short supply ~~season~~ only, the supplemental milk supplier has been **saddled** with the responsibility of balancing those supplies through the long season.

Exhibit ____ demonstrates, for the months of January 2004 through October 2005 the ratio of the monthly highest day of pool distributing plant receipts to the lowest day of pool

distributing plant receipts for **Orders** 5 and 7. These data were excerpted from data already introduced at this hearing by the market administrators. In the Appalachian Order during the 22 month period, the ratio of the highest day of pool distributing plant receipts to the lowest day of pool distributing plant receipts exceeded 1.30 eighteen times. In the Southeast Order during the 22 month period, the ratio of the highest day of pool distributing plant receipts to the lowest day of pool distributing plant receipts exceeded 1.30 sixteen times. The simple average ratio of the simple average of highest **day's** receipts to the simple average of lowest day's receipts was 1.35 and 1.38, respectively for Orders 5 and 7. Clearly, there are many months when a 30 percent reserve factor is not sufficient to cover intra-month balancing.

Proponents further analyzed intra-month pool distributing plant balancing requirements, using market administrator data for February 2005. February was selected because there are exactly four of each days of the week. Also, February's total ratio of highest day of pool distributing plant receipts to the lowest day of pool distributing plant receipts was near the 22 month average for each Order.

The daily variation in milk deliveries to pool distributing plants during February 2005 in Orders 5 and 7 are presented in calendar fashion. As can be seen from the exhibit, pool distributing plants received a greater portion of their volume of the total monthly receipts on weekdays, and a **disproportionately** low volume of the total monthly receipts on Saturdays and Sundays. The difference in the four Wednesday receipts, which is the often the high day of receipts for a week, and the four Sunday receipts which is the typical low day of receipts for a week, was approximately 19 percent in Order 5, and approximately 21 percent in Order 7, with the difference in the highest single day and the lowest single day's receipts of 32 to 33 percent,

depending on the Order. Also, a within-the-month pattern is evident. In Order 5, receipts by pool distributing plants in the first seven days of the month exceeded the second seven days by 7.5 percent, exceeded the third seven days by 8.2 percent, and exceeded the fourth seven days by 6.0 percent. In Order 7, receipts by pool distributing plants in the first seven days of the month exceeded the second seven days by 1.5 percent, exceeded the third seven days by 2.7 percent, and exceeded the fourth seven days by 6.3 percent. The within-week and within-month **delivery** pattern shown for February 2005 is fairly typical of most months, with pool distributing plant receipts being greater in the first of the month and then trailing off as the month progresses. In fact, February may be a month with less than average variation since schools are typically in session the whole month, and the one holiday is a lesser observed holiday.

When comparing the actual daily receipts at pool distributing plants, and making judgments regarding what a reasonable level of marketing reserve requirement should be, the maximum highs and lows must be factored in. As we mentioned earlier, the real life world of milk marketing does not work on averages, it operates on extremes. Milk has to be available to cover the needs of plants on the highest day of the week, the month, the season, and the year.

In the market administrator data, the average swing from lowest day of pool distributing plants receipts to highest day exceeded the reserve requirement factor suggested in Proposal Number 4. The 35 to 38 percent swing in pool distributing plant deliveries does not even account for any necessary reserve over and above the highest **day's** delivery. Clearly, the 30 percent reserve requirement suggested in Proposal Number 4 is **insufficient**.

Again looking at the high and low days of receipts by pool distributing plants, we can see that December typically experiences a very low day of deliveries, and January is a month when the high delivery day is often very high. We are not aware of dairy cows taking Christmas Day off, and then working over-time in January.

It should be noted that the scheduling of milk receiving at a distributing plant, the volumes per day received, and the raw milk storage capacity at these plants are issues almost completely under the control of the plant operators. It is unfair to penalize the marketers of raw milk for erratic and uneven receiving schedules, when milk less-than-uniform receiving is a major contributor to increases in balancing and reserve requirements.

Further exacerbating the problem of the large necessary reserve to balance pool distributing plant supply and demand is the expansion of the milk-shed for the southeast. Milk moves into the southeast from more than half the states in the nation. As a milk-shed expands relative to the processing area, reserve requirements increase. Put another way, the farther a milk supply is from its processing destination, the greater the impact the daily variations in supply and demand impact the necessary reserve and the cost of maintaining that reserve.

If the proposal as written is applied to cooperative associations as handlers of milk in determining whether the cooperative is adequately or more than adequately supplied versus the cooperative's deliveries to pool distributing plants, the proposal would advantage the operators of pool distributing plants to the detriment of cooperatives.

Cooperative associations handle the predominant volumes of reserve supplies for the two Orders. For plants that receive all of their milk from cooperative associations, the cooperatives handle 100 percent of the reserve. Depending on the method of interpretation of the Proposal 4 provision, cooperative associations, which handle the predominant volumes of supplemental supplies, could be left with virtually no opportunity to collect Transportation Credit **Balancing** Fund payments. As a practical application, the market administrator should only count a delivery to a pool distributing plant once in determining whether the plant or handler is adequately or more than adequately supplied.

The location of handlers relative to reserve supplies may cause handlers to be treated differently in the reimbursed cost of transport on supplemental milk. Handlers nearer the edge of the southeastern Order areas could benefit, since theoretically their access to reserve supplies would be easier and therefore require a lesser reserve level.

The Orders already have safeguards against attaching too much additional milk to the Order pools. During the Transportation Credit payment months in Order 5 the maximum diversion percentage is 25 percent of deliveries to pool plants in July through November, and forty percent in December; while in Order 7, the maximum diversion percentage is 33 percent of deliveries to pool plants in July through December. Thus, the ability to pool milk by diversion on the Orders is essentially at the limits proposed in Proposal Number 4.

Proposal 4, as we read it, would compute the percentage reserve requirement based on deliveries to pool distributing plants only, while diversions are computed based on deliveries to all pool plants, including pool supply plants. Since pool supply plants in the Order 5 and

Order 7 areas tend to be manufacturing facilities, Proposal 4 seems to be aimed at limiting the use of Transportation Credits to supply these manufacturing facilities. The current Transportation Credit provisions allow a Transportation Credit payment based on the lesser of the Class ■ utilization of the plant at which received, or the market administrators' monthly estimate of marketwide Class ■ use. If a pooled manufacturing plant has no Class ■ use during the month, even if milk is received from a producer whose milk is Transportation Credit eligible, no Transportation Credit will be received on the milk. No additional safeguard is necessary to prevent Transportation Credits being used to supply pool manufacturing facilities. The analogous is true for diversions to nonpool plants. Since Transportation Credits are not available on deliveries to nonpool plants, even if the plant has Class ■ use, Transportation Credits cannot be used to supply plants for any use in the manufacturing classes.

On rare occasions, milk is received at a pool supply plant and held over weekends before being transferred to pool distributing plants, because as testified to earlier, pool distributing plants receive substantially less milk on weekends than on weekdays. This activity in the use of pool supply plants for weekend storage is almost exclusively a function taken on by cooperatives. As proposed, Proposal Number 4 would penalize the cooperative for using pool supply plants as a vessel for short-term storage of milk during the short supply season, because the delivery of milk to the pool supply plant would count as a delivery to a plant other than a pool distributing plant.

In **summary**, the reserve requirements as stated in Proposal Number 4 may be **insufficient** based on receipt patterns of pool distributing plants weekly, monthly, and seasonally; may be

insufficient based on production patterns of producers; and may be insufficient based on the distance milk must move to supply Class ■ needs. The current **Order** provisions prevent the use of Transportation Credits for supplying milk for manufacturing uses, and the Order diversion limits prevent **pooling** milk on the Orders in quantities substantially in excess of what is suggested by Proposal Number 4. In addition, the application of the provisions has the potential for falling disproportionately on certain segments of the industry.

For the above reasons, Proposal Number 4 should not be adopted.

This concludes my prepared statement regarding Proposal Number 4.