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BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE

In the Matter of

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: **DOCKET NO. AO-166-A68; DA-01-04**

**MILK IN THE MIDEAST
MARKETING AREA**

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**BRIEF OF CONTINENTAL DAIRY PRODUCTS IN SUPPORT OF AMENDMENTS TO
THE POOLING PROVISIONS OF ORDER 1033 THAT WILL LIMIT MILK POOLED
TO THAT REASONABLY ASSOCIATED WITH THE MARKET**

This brief is submitted on behalf of Continental Dairy Products, Inc. in support of provisions to modify the pooling standards for Order 1033. This brief also incorporates the arguments of Dairy Farmers of America on this issue.

I. Introduction and summary of position

Continental Dairy Products, Inc. is a qualified milk marketing cooperative with members located in the marketing area of the Mideast Milk Marketing Area. Producers are located in Ohio, Indiana, and Michigan. The prices these members receive depends upon the blend price announced by the market administrator for the Mideast Order.

Continental strongly supports modifying the pool, producer, and milk definitions of 7 C.F.R. Part 1033 to require that milk qualified on the order show a reasonable association with the order and the ability to serve the market as needed. Rules that permit unlimited pooling of distant milk and large quantities of milk that has no historical or practical association with the marketing area need to be corrected. These include as follows:

1. Increase the percentage of milk that a supply plant must deliver to a distributing plant to qualify.

2. Eliminate “free” months of qualification for supply plants.
3. Decrease the percentage of milk a distributing plant can divert
4. Increase the number of days a producer must touch base with a pool plant
5. Require producers who do not qualify during September through December to touch base each month of January through August.
6. Eliminate “split plant” provisions for supply plants
7. Require that qualifying direct shipments for supply plant qualification come from plants in the area or more distant than the supply plant. A supply plant can still qualify by shipping all milk from the plant.

The proposed changes are interrelated. They together, as now written, have caused the problems to be addressed, and their modification together, not partially, are necessary for their correction.

II. Argument

A. The Problem

Producer blend prices in the Mideast Milk Marketing Order have been reduced by as much as 8 million dollars in a single month due to inadequate pooling requirements. Exhibit 10. The losses run from 25 to 85 cents per hundredweight. Exhibit 9. The amount of milk not historically associated with the order has exceeded 480 million pounds in some months. Exhibit 10. None of this milk is needed in the market, none of it has any association with the market.

The lax requirements for pooling do not really require a physical or economical connection with the marketing area. This enormous amount of milk that has been recently attached to the Mideast Order has only been able to do so because of lax to non-existent pooling limitations for supply plants located outside of the marketing area. **Under current rules, none of the distant milk**

that receives order 1033 blend prices need ever come to a distributing plant that services the market. The amount of milk which a supply plant is less a function of its ability to serve the needs of the market, than its ability to build upon the usual and ordinary milk supplying plants to attract distant milk to the supply plant's, not the order's, needs for milk. Mileage, or distance from the market place, has little bearing on the amount of milk that can be pooled.

This excessive pooling of milk that cannot serve the needs of the Mideast Market is the result of the compounding of the supply plant qualifications (7 C.F.R. §1033.07(c)) ("Qualifying Percentages"), limited qualification periods for qualification (7 C.F.R. §1033.07(c)(4)) ("Qualification Period"), minuscule delivery requirements for individual producers (7 C.F.R. §1033.13(d)(2)) ("Touch Base"), the ability to qualify the plant by deliveries to distributing plants in other orders (7 C.F.R. §1033.07(c)(1)(iv)) ("Split Plant"), and the ability to use local, close in milk, to qualify the distant supply plant.(7 C.F.R. §1033.07(c)(2)) ("Direct Delivery"). The focus of the argument is on these provisions though others will need to be adjusted slightly. Correcting all of these provisions is necessary to solve the problem.

In the past, prior to 2000, the limitation on pooling milk was a combination of performance standards and pricing through "zone backs" and a steeper pricing grid north and west of the marketing area. The national pricing scheme imposed by the FAIR Reform has all but eliminated pricing as a component of milk pooling limitations. Instead, the entire task falls upon regulations.

Current regulations fail in this regard.

Milk is attached to a supply plant by "paper" more than physical receipts. For the five qualifying months distributing plant can divert 70% of the milk or milk products it receives. 7 C.F.R. §1033.7(a) That percentage can be treated as diversions from a supply plant. There are no restrictions as to where a supply can be located and it need only ship 30% of the milk attached to it

to a distributing plant. 7 C.F.R. §1033.7(c). As a result for every one hundred pounds of milk distributed as bottled milk, the supply plant can use 70 pounds of the milk going into the distributing plant to qualify 233 additional pounds of milk on the order. By this compounding, the actual amount of milk diverted by the distributing plant is less than thirty percent (100/323).

To meet this qualification, the supply plant only has to physically receive and ship 10 percent of the qualifying milk to a distributing plant. That means that only 2.7% of the milk pooled off of the supply plant has to physically go from the supply plant to a distributing plant. In the example 2.7% of 233 pounds is only 7 pounds.

The financial implications of this are self apparent. The “cost” of qualification for the five months is a delivery of only 3% of the milk to the market. **This cost when distributed over all of the beneficial milk means that for every \$1.00 cwt of cost to move milk, a producer is only suffering as little as three cents on all of the milk!** Though actual experience may not be as egregious, the example shows ample savings for any qualifying scheme. The generous provisions also provide funds to pay for the use of the diversion.

This amount can be reduced even further. An additional oddity in the Mideast Order allows the supply plant to qualify the plant by meeting one half of the delivery requirement with deliveries to pool distributing plants **in orders other than the Mideast.** 7 C.F.R. § 1033.7(c)(1)(iv). In other words a supply plant virtually has no need to deliver a single pound of milk into the Mideast order to receive the benefits of that blend. In the simple example it is about 1% of its total milk pooled.

Current regulations impose no shipping requirements for the months of March through August if qualification has been made the previous months. **Thus the cost of the small shipping requirement is further spread over additional milk resulting in costs of just more than a penny a hundredweight to qualify the plant for the year!** Couple this with the split plant provision and

the cost is almost non-existent.

Actual producer requirements are equally minuscule. Currently a producer only has to deliver one day's production to the market for each of three months to qualify. 7 C.F.R. § 1033.13. That requirement can be met by delivering to the supply plant and obviates the need to go to the marketing area. The rest of the month, and the entirety of the remaining nine months the producer does not need to do even that. For producers who did not qualify for the "free months", they need to only ship one day's production to qualify for nine months' benefit or less than one half a percent of their milk need touch a pool plant and that can be the distant, out of the marketing area, supply plant. It is no wonder, then, that producers from as far away as Montana, Kansas, and the Dakotas have shown up as producers on Order 1033. Exhibit 7

The effect of this additional pooled milk is a reduction in the producer blend price by over 50 cents cwt with no benefit to the Mideast Marketing Area or its producers.

B. The Solution

The solution can be stated simply—develop standards for producer and milk qualification that demonstrate that the milk seeking blend payments can reasonably be expected to supply the market to the degree that its incorporation is necessary to assure stability in the marketing area. Performance standards must be adequate to show that the milk seeking payment can economically compete for the milk supply in the Mideast Order. Because current regulations permit the qualification of distant milk without requiring any of that milk to come to the market place, there are effectively no performance standards.

The "Qualified Percentages" for diversions of distributing plants would be reduced by requiring 40 percent of milk received be used in fluid sales during August through April and 35% the remaining months.

The “Qualified Period” for supply plants needs to be year round. There is no justification for providing a “free” period during seven months of the year. If the milk cannot demonstrate an association with the market during that period of time, then it should not benefit from the pool.

The provision for “Split Plants” should be eliminated. This provision is a carryover from the predecessor Order 40 provision that recognized that supply plants in the Southern Michigan Order routinely supplied handlers pooled on the Indiana and Ohio orders. Rasch, Exhibit 15. There is no justification for that provision today. If not changed a supply plant can be established in Idaho, for example, qualify off of shipments to plants in Salt Lake City and then draw the blend for producers in Idaho or further west without any shipments to the Mideast. That is patently absurd

“Touch Base” provisions need to be tightened. A producer should deliver at least two days production to qualify. Some suggest more, but in reality, with the distant supply plant as a qualified plant, the touch base provision has little impact on the overall abuse of th system. Tighter requirements will increase the costs to producers who are servicing the market with little benefit. Requiring a producer to deliver six days during September through November or two days every month the rest of the year is also needed. There is no justification for a producer, a distant producer, to benefit from the Mideast Pool for seven months by making one delivery in one month.

The “Direct Delivery” requirement must also be redefined. In the past supply plants qualified by actual receipts and shipments from the plant. The Secretary has wisely recognized that pumping in and pumping out merely for qualification purposes is inefficient and reduces the quality of the milk. Direct shipment is more efficient. However, the use of milk that would never use the supply plant as a means of qualification was not intended result of that loosening. Today, as explained above, a distant supply plant can qualify milk from producers who never have to deliver any of their milk to the market. This practice of using local milk to qualify distant plants is unfair to the local

producers. The evidence shows that it cost them over 50 cents in pay prices and they received no benefit.

All of these proposed changes are within the scope of the hearing. Although the language concerning producers must be near the supply plant was not in the proposed language, it is clearly within the scope of the hearing notice. The hearing made it clear that qualification requirements for supply plants was at the core of the issues to be addressed and that the problem was associated with large amounts of milk from outside the marketing area. Anyone who had an interest in preserving the benefits of lax qualifications knew that such were at risk.

All of these changes and those recommended by DFA and the other cooperatives must be done. Doing some but not others will not correct the problem. In particular requiring a supply plants direct ship milk from milk near the supply plant is essential to protecting the order.

III. Advance Payment

Continental supports the adoption of rules that increase the advance payment to 105% of the current formula. We understand that is what is being proposed by DFA and supported by Kroger.

IV. Conclusion

In order to preserve the Mideast Market changes are needed in the pooling of milk. Thus the Secretary should change the regulations so that

1. A pool distributing plant can only divert 60 percent during August through April, and 65% during May through July.
2. Require supply plants to qualify every month and eliminate the “free months”.
3. Eliminate the “split plant” provision.

4. Require direct shipments of qualifying deliveries come from farms near the supply plant or more distant from the marketing area.
5. Increase the touch base requirements for producers and require every month qualification for producers who did not qualify during September through November.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that an accurate photostatic copy of the foregoing was served upon the following this 12th day of December 2001, by facsimile, email and ordinary United States Mail service, postage prepaid.

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