UNITED STATES DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE
(DAIRY PROGRAMS)

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Milk in the Mideast	: Docket Nos.:
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Marketing Area	: DA-01-04
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BRIEF FOR LAND O' LAKES, INC.

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Introduction and Background

This brief will address the second hearing in the post federal order reform era related to pooling performances and distant milk supplies. Federal order reform was instituted in January, 2000 following a Congressional mandate in the 1996 Fair Act. Regional conflicts have divided the dairy industry since Class I differentials were enhanced in the 1985 Farm Bill.

The Class I price surface instituted by USDA in January 2000 was the result of a great deal of discontent over an extended period of time. It should come as no surprise the transition to the new surface, coupled with a consolidation of the number of federal orders, a product-driven four class system, and uniform provisions would create new equilibrium points. It has taken the better part of two years for dairy farmers and the industry as a whole to recognize incentives/disincentives and react to them. The shift toward equilibrium has for the most part been accomplished. USDA has always recognized the utility of blend price differences and the effect on producers to change markets.

The Secretary explained after the previous national hearing review and reform process in 1990:

> Producers make their production and marketing adjustments on the basis of changes in blend prices and differences in blend prices among orders. It is not uncommon for supply areas of individual orders to expand or contract in response to the blend price changes over time. Also, because milk is free to move to handlers regulated under different orders, it is not uncommon for milk to shift from one order to another in response to blend price differences that result from changes in supply and demand conditions under different orders.

59 Fed. Reg. 424722, 42426 (August 17, 1994).

The Second Amplified Decision stated:

Blend price changes (and differences in blend prices among orders) provide the economic signal for producers to make production decisions and for making marketing decisions.

61 Fed. Reg. 49081, 49086 (September 18, 1996)

The Proposed Rule issued January 1998 stated overlapping route disposition and milk procurement are the most important criteria to consider in the consolidation process. The criterion of overlapping route disposition was given greater weight than overlapping areas of milk supply. The Secretary also recognized that differences in Class I utilization rates, to the extent they result in differences in blend prices paid to producers, provide an incentive for milk to move from markets with lower Class I utilization percentages to markets with higher Class I use.

In addressing pooling issues, the Secretary stated that "the pooling of producer milk should be performance oriented in meeting the needs of the fluid market. Proposed provisions provide a balance between reasonable and needed performance criteria and a liberal pooling policy. Pooling provisions for the consolidated orders are overall less restrictive in the movement of milk between orders and make it easier for producers to become associated with and pooled on a market. Additionally, the provisions are more market oriented because they allow milk to become pooled and price where the greatest needs are exhibited for satisfying fluid demands. Additionally, there is enhanced flexibility in how plants can be pooled without diminishing the ability of the regulatory plan to satisfy the fluid demands of a market."

Based on the criteria applied by the Secretary and the limited amount of time which has transpired since implementation of order reform, the regulatory system is working quite well and as anticipated. There are two issues arising from this hearing which need to be addressed.

Issue 1:

Distant vs. local milk supplies. The concept of "distant" versus "local" supplies of milk is no longer a relevant or meaningful distinction. With the implementation of consolidated orders, what is referred to as local milk, that produced within the market order boundaries, may be more than 1000 miles from end to end in the case of the Central Order which stretches from Indiana to Utah. Similarly, the Mideast Order stretches 450 miles from east to west and 800 miles from north to south. To apply performance provisions to "local" milk, i.e. that which is produced within the order boundaries, on a different basis than for "distant" milk, which historically has meant milk produced outside the order boundaries defies logic. This is especially true given that USDA has indicated overlapping route sales was given the most weight of the seven consolidation criteria. To carry this to an extreme, milk could be diverted from a supply plant to a pool distributing plant several hundred miles away with the producers being located at any number of varying points in between, while a supply plant located just outside the marketing area would be restricted to qualifying only by transfer even though the distributing plant was in the vicinity of both the supply plant and the producer supply of milk. Proponents would have you believe there is a difference in performance standards predicated by a marketing order boundary. Having said that, the DFA witness testified "performance standards are universal in their intention – to require a level association to a market marked by the ability and willingness to supply that market." For this reason, pooling provisions need to be "performance oriented" rather than "location oriented." The Secretary has acknowledged that federal order boundaries do not preclude route sales or producer milk from crossing from one marketing area to another.

Land O' Lakes (LOL) strongly reaffirms the concept of performance oriented pooling provisions as a basis for regulation as opposed to location based provisions.

Issue 2:

Paper Pooling vs. Performance.

A number of references by witnesses referred to "paper pooling." The inference was that milk was being associated with the market without serving the fluid needs of the market. The inference was also made that milk produced outside the order boundaries was being pooled by a variety of methods referred to as "paper pooling." These methods included diversion by distributing plants, associating large volumes of milk during periods of "free ride" when no qualifying shipments need to be made, and back-hauling milk after it was delivered to a distributing plant to be used for manufacturing. Some witnesses did acknowledge that milk which served the market based on performance criteria on a year round basis is deserving of sharing in the producer value and does not fall within the scope of "paper pooling." The fact is that LOL is performing on a regular basis with a pool supply plant located at Kiel, Wisconsin with a procurement area largely outside the boundaries of the Mideast marketing area.

Land O' Lakes, Inc. agrees that serving the Class I needs of the market is the parameter which determines performance requirements and pooling provisions.

In addition to that concept, LOL recognizes the historical philosophy of USDA that all Grade A milk will have the opportunity to be pooled. Order provisions have consistently recognized this fact. Given that parameter, restrictive pooling provisions merely provide that milk will be associated as reserve supplies on a different federal order, which is probably already carrying an excess of reserve supply. So the question ultimately becomes, which order(s) are going to carry the reserve supply?

LOL believes the pooling requirements should require that Class I needs are met at a minimum and beyond that, let economics and the theory of location dictate equilibrium points between orders.

LOL offers the following responses to the proposals:

Proposal No. 1: Support

Proposal No. 2: Opposed.

Land O' Lakes currently supplies milk on a year round basis to a number of Dean distributing plants from the pool supply plant located at Kiel, Wisconsin. Consistently, greater shipments are made to Order 33 distributing plants than other order distributing plants. However, Dean redirects our committed supplies and spot shipments on an "as needed" basis dictated by market conditions. The provision to qualify based partially on shipments to other order distributing plants is a long standing provision and is not new to order reform. Additionally, it was in place in predecessor orders to current Order 33 and used as indicated by the Michigan Milk witness. All producers in Order 33 share in the Class I value of the other order shipment so it benefits the order and increases the producer price differential. The ironic thing is that had Orders 49, 32, 50 and 30 been consolidated, the Michigan handler would probably continue to be using this provision just as he has done in the past.

The Michigan Milk witness indicated that Order 40 has always been a reserve supply market. However, currently some volumes of milk are pooled on Orders 5 and 7. The result is no sharing of Class I utilization with Order 33 producers, despite the fact this provision allows that opportunity to enhance Class I value in the Mideast Order.

One of the witnesses indicated that the provision should be retained for supply plants located inside the marketing area only. Again performance standards should not be based on outside versus inside milk.

LOL does not support this proposal as written because this proposal actually requires an increase in shipping percentages. Virtually all distributing plants have some transfers or diversions due to weekend or holiday milk. This net shipment provision would require that all qualifying shipments be increased to cover the percentage of each shipment that is discounted due to net shipments. LOL recognizes this may be a market issue if supply plants are shipping milk for qualification and back-hauling a similar volume of milk from the plant. To address this issue, the provision should net out those qualifying shipments by the volume which is returned to the same plant which made the shipment. In this manner, those handlers who are performing and leaving 100% of the shipments at distributing plant for Class I use are not penalized.

Proposal No. 3: Support.

LOL is currently shipping milk on a year round basis. If the Department feels strongly that abuses are taking place by adding additional milk during "free ride" periods then LOL would support this proposal for purposes of equity.

Proposal No. 4: Support

Proposal No. 5: Opposed.

This provision has historically recognized commingled Grade A and Grade B in procurement areas and provided that commingled Grade A milk be diverted to the non-pool plant for manufacturing. Additionally, the Grade A milk for qualifying shipments is segregated, and either diverted or transferred from the supply plant for qualification.

Additionally, removing this elective designation would provide for full plant accountability including shrinkage and overage in the manufacturing portion of a plant with used to produce being the only process in the plant. This would entail very burdensome and costly record keeping for both the handler and market administrator with no benefit to the producers and industry. It is apparent from testimony this proposal is intended for purposes of restrictive pooling. LOL further believes that proposal 3 achieves the necessary result relative to paper pooling. It is obvious from testimony this proposal is retaliatory in nature since the witness stated that should the proposal not be adopted, then proposal 3 would not be supported since it would cause unnecessary and uneconomical movements of milk.

LOL is opposed for these reasons.

Proposal No. 7: Opposed.

Proposal No. 9: Opposed.

Respectfully submitted,

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