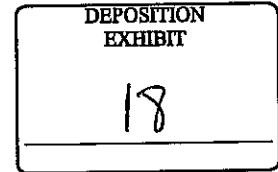


**Testimony of  
Dean Foods Company by Evan Kinser  
Mideast Milk Marketing Order Hearing  
Docket No. AO-166-A77; DA-08-06  
Cincinnati, OH  
August 20, 2008**



**I. Introduction**

Hello, my name is Evan Kinser. I am employed by Dean Foods Company as Director of Dairy Policy and Commodities. Dean Foods owns and operates 11 distributing plants regulated by the Mideast Milk Marketing Federal Order. Three of the 11 distributing plants stand to be directly and adversely affected by Proposal 1. I am appearing today to oppose the Proposal being considered at this hearing and to oppose the issuance of any emergency decision.

Let me begin by saying I was wrong. I thought it would take at least a year before this hearing was convened as a direct consequence of the Southeast hearing and the decision there to depart from a national price surface, even temporarily.

The Federal orders impose regulatory authority over the marketing of milk. They are not, in today's marketplace, the market. Thus, when the Secretary takes action exercising his regulatory authority it changes the marketplace, but it does not set the market. For example, when the Upper Midwest and Central Orders' regulations were changed to prevent milk from being simultaneously pooled on both a state marketwide pool and a Federal order, mainly to address California produced milk that was not delivered to a federal order plant; it did not eliminate California dairy farmers from producing milk. It changed how those responsible for California milk transacted the marketing of milk. The same is true when the Upper Midwest changed pooling provisions, which significantly reduced the economic incentive to pool milk from Idaho on the Order but diverted to Idaho. This did not eliminate Idaho dairy farmers from producing milk or prohibit them from pooling their milk

where economically feasible. It just changed how those marketing Idaho milk did their business. The most extreme example of the impact on markets as opposed to being the market is the Western order. In this example dairy farmer opted to oppose the final rule and the order was eliminated. There continues to be a healthy dairy industry and consumers continue to have products.

This being the case, because markets are complicated things, they are influenced by many forces. While the Secretary through Federal orders attempts to manage those forces, he certainly does not control them. Thus, when considering changes to the regulation it is complicated to think through every potential outcome that might occur. Often times things happen beyond industry's, including the Secretary's, expectations. These things have been referred to as unintended consequences. Unintended consequences are, however, also sometimes predictable – and this hearing was both predictable and predicted.

When the Secretary raised the Class I differentials in the Southeast effective May 1, 2008, the market in the Southeast was not magically cured. Those who handle milk and marketing milk under those Federal orders are adjusting their businesses to play by the new rules. Those regulatory changes did not set the market, however they did impact milk values. It is my opinion that this proceeding is a direct product of the Secretary's action in response to the proponent's success in the Southeast. If not by virtue of economics, then by the belief they found a sympathetic ear in the Secretary.

The Secretary has the responsibility to guard over the industry and enact decisions which fulfill the intentions of the Act including setting minimum prices that are high enough to bring forth an adequate supply of milk, and to protect the interests of consumers. The Secretary's responsibility is not an easy one. When contemplating a decision there is a mountain of information. This information is in the form of fact, arguments and opinions. The Secretary must focus on the facts to

guide his judgment, all the while being bombarded with biases as to the handling of the facts. This proceeding will be no different. However a witness' track record should be weighed when contemplating how the Secretary treats their opinion of the market's reaction to new rules.

## **II. Bad Policy**

From where I sit it appears the Secretary has begun to walk down a road toward a bad end. I see no reason to abandon the past practice of the Secretary, namely the logic behind the nationally coordinated Class I price surface the Secretary proposed for Federal Order reform. Furthermore, like the Southeast, a decision to change minimum prices in this proceeding will not occur in a vacuum.

### **a. National price surface**

In reading the Secretary's decision regarding the Class I differential in the Final Rule published in the Federal Register on April 2, 1999. It seems clear to me the Secretary was concerned about local, regional and national implications of the Class I price surface. The secretary went so far when commenting about industry's comments to state

“These comments provided valuable information about particular markets but generally did not consider the feasibility or impact of a local or regional issue on a national basis. While remaining mindful of local and regional concerns, USDA has also evaluated alternative Class I pricing structures from a national perspective, as should be expected, given the national concerns expressed about milk pricing.” (64 Fed. Reg. 16026 at 16109-16110).

In the discussion about the process the Secretary provided 9 key criteria used to guide the decisions.

#### *1. Ensure an adequate supply of milk for fluid use.*

As long as the Mideast order is going to be configured as it is today, I do not see any evidence in this record to suggest there is anything but an ample supply of milk.

*2. Recognize quality (Grade A) value of milk.*

Again, with the record of Grade A milk supply growth in the Mideast it seems obvious that quality is being addressed.

*3. Provide appropriate market signals.*

This is where the proposal before us today begins to break down. While I know the proponents argue the southern portion of the marketing area may not have a correct market signal, their focus of raising minimum prices in that area may provide other inappropriate market signals. I would suggest that will happen, as it seems at least part of the justification for this hearing is a reaction to Secretary's adjustment in Southeast price signals.

*4. Recognize value of milk at location.*

This has to be very closely linked with the prior point. Milk definitely has value at a location, but that value is a function of its alternative value at another location. In the Southeast hearing, a lot of time was spent trying to illustrate the implications of what was referred to in the Federal Order reform as shadow pricing. Thus, changing a local value has more than a local effect. It has the potential to impact the value at another location. This is why nationally coordinated pricing is so important.

*5. Facilitate orderly marketing with coordinated system of prices.*

This is definitely a part of any Federal Order decision. One must acknowledge the intent of the act to facilitate orderly marketing. Anything else will lead to chaos (such as multiple emergency hearings). However, going back to the Southeast proceeding, changing values begins to have secondary impacts. It seems to be the Secretary's

approach will gradually create a situation where the foundation for the first decision is changed because raising prices outside that region will alter economic decisions for supplying that market. At that time the circle will be complete and the industry will be caught in a continuous loop which feeds on itself. The line will quickly blur between the beginning of the loop and end of the loop. The only clear outcome will be ever increasing prices for plants and consumers. While the proponent witness acknowledged this being problematic, it doesn't mean that attempts wouldn't be made to correct the misalignment with yet other tweaks to order provisions. We urgently need a return to nationally coordinated pricing without further disruption of individual markets.

The most recent changes to the Transportation Credit Funds administered in FO #5 & #7 affect how producers qualify. Clearly from Exhibit 9, milk is moving from the impacted area into FO #5. It is more difficult to tell given the restricted response provided in Exhibit 10 about milk is moving from the impacted area into FO #7. The existence of the FO #5 & #7 Transportation Credit Funds is an important consideration for the Secretary for two reasons. First, the proposed increase to this market will assist milk in getting milk "disassociated" from FO # 5 or #7 to continue to qualify for future transportation credits on FO # 5 or #7. The second concern is the impact this will have on Transportation credit payments. I am not sure the proponents' proposal is clear on the subject. It appears to me this will change the zones used in calculating the transportation credit in the FO # 5 or #7 in such a way as to increase the payout for the same

haul. This is likely to decrease the fund faster. To the degree the Secretary believes the proposal is unclear, Dean Foods would advocate that this temporary change have no additional adverse effect on FO #5 & #7 transportation credit calculations. Regardless, these two points illustrates how adoption of this proposal exposes the Southeast to yet another future hearing.

*6. Recognize handler equity with regard to raw product costs.*

I believe this is an area that was highlighted in the Southeast hearing. The concerns raised were not given any weight in the Secretary's findings. In fact, it appears to us that the concerns were dismissed as being speculative. Well our "speculation" was accurate as shown by the call of this Hearing. Since the implementation of Southeast prices has only been in place going on its 4<sup>th</sup> month and at best 2 months of incomplete data has been made available to this record, it is too early to tell if the decisions provided handler equity. On the surface it appears there is exposure, but I will concede given the quickness of this hearing I have no additional data with which to argue my point. Of course, proponents don't have additional data to prove their case either – this hearing was called too early.

*7. Minimize regulatory burden.*

This seems to be a mute point in this proceeding, other than there is a cost to change and cost to plants are inconsistent, increased minimum prices.

*8. Minimize impact on small businesses.*

Again, there is cost to change. I have not seen any information applying the impact of this change on small verses large businesses. I have also

seen no analysis to address the impact on consumers, namely, WIC and school lunch programs.

*9. Provide long-term viability.*

This depends on ones perspective of what needs to be viable. If it is dairy farmers, clearly a revenue increase can't be a bad thing. At least it seems as such on the surface, but let us be clear. The proposal has no impact at best on milk prices when considering the market wide pool. Admittedly some dairy farmers will benefit more than the negative impact to the market wide pool. However, there will be a negative impact to 11 plants. These plants will have higher costs. The competitive structure will change in the region. There is downside exposure in that some plants will not survive.

**b. Unseen unintended consequences**

The changes in Federal Order rules impact milk values in such a way to either motivate milk to move in certain directions, or to discourage such movements. Again, the Federal Orders are not the market, just an influence on the market. Thus, my testimony in the Southeast and comments today of only being surprised about the timing, is not that I'm psychic. Knowing that money moves milk, it wasn't a stretch to see the 'new' money of the Southeast Class I differential affecting milk movement beyond the Southeast.

I am not yet convinced that the proponents where not already aware that this problem would arise as they were testifying at the southeast hearing. Yesterday's discovery suggests all the more they cooperatives expected this impact. Again following yesterday it seems they were pretty quick to be working with the department before the rule had even been published. While it is possible they

overlooked this possible consequence, I have more respect for them than to believe they were slow in knowing. Rather, I think they went to a soft spot looking for a win. Now having got one they are looking to leverage it for more. I strongly believe that action on increase differentials in response to proponents will have impacts beyond the area of change.

If the proponents' proposal is adopted, the increased price could be more than is needed to provide economic incentive to cause milk moved from the north to stop and stay in the southern area of the Mideast order. This would then bring about the circular logic I mentioned above because southeast minimum prices may need to rise to dislodge that milk from this region. I am not convinced that will be the proponents' next step. Rather, I have my eye on the Federal orders 1, 32 and 126. I think their southeast changes could lead them to make a case that holding milk in the southeastern edge of Federal order 1 has been compromised by the change in the southeast. I think St. Louis Missouri was also affected all the more by the change in the southeast. While this isn't a new thing, it could be a tipping point that forces cooperatives in that market to request relief. Finally I think eastern Texas has to be on their radar. If milk in northern Mideast is "jumping" the southern region to enter the southeast, it seems hardly a stretch to think of the milk situation in western Texas "jumping" the Dallas market to be in the southeast. Thus, increased class I differentials are likely going to be proposed as needed. What might make the Texas suggestion an error is the low differential values of milk in west Texas might be low enough to provide incentive for ample surplus to move east. Therefore all the milk would want to be in the Southeast it is content to move to Dallas, rather than staying in west Texas.

### **III. Marketing conditions are different**



The proponents have changed the rationale for why the Class I price needs increased in this proceeding from the rationale that was used to support the Southeast Proposal. This was wise, as the marketing conditions are different in the Mideast.

In the Southeast temporary Class I proceedings, Dean Foods acknowledged the exhibits that demonstrated deficit milk supplies in those markets overall. Here no such market data has been provided to the record. The only argument for a deficit that exists in this record is data involving subjective regions defined by the proponents further complicated by their definition of milk supply. Dividing the market order into regions for analysis is a very different case than looking at a full market order as was done in the Southeast. I will admit that Dean Foods has not helped this record because in our attempt to simplify an already crunched data request schedule I blindly followed the data request structure of the proponents. I want to make clear that as it relates to the deficit in the south region of the MidEast order, I do not subscribe to their lines. I believe there is insufficient data to critically evaluate the different possible ways lines could have been drawn. However, I will concede they have intended if not helped to draw a structure of three different sub regions in the existing Federal Order.

While this point was ignored by the Secretary in scheduling a hearing on Proposal 1 only, I challenge him to consider the idea again, to see if there are enough things different about this market to take a different action to a very similar request to disregard historic policy.

#### **IV. Actions to be considered**

It is clear from the Proponents' testimony that the marketing conditions in the Southeast, where a similar request was granted and the Mideast are different. Knowing different marketing conditions exist, the Secretary must consider the possibility of a different solution. From my vantage point the Secretary has several paths which must be considered before offering a decision. Otherwise, it is a

bit like noticing your hair is getting long, after having trimmed your finger nails and deciding, the fingernail clippers are handy and using them to cut hair. While it can be done, it has implications that are undesirable and unsightly.

**a. Reverse the decision of the Southeast.**

I would like to take advantage of this opportunity to remind the Secretary that the action in the Southeast could still be reversed especially since it is “temporary”. This proceeding is evidence that the Secretary’s action in the Southeast had consequences that reached beyond the area where the price was changed. Furthermore, if this proceeding is a result of the Southeast as predicted, how many more requests will come (or are even in the works) should the Secretary adopt this proposal? Where has the nationally coordinated Class I price surface gone? These impacts become like the ripples in a pond after a rock has been tossed in. They just keep spreading and spreading. Soon, we will have completed the circle and we’ll be back in the Southeast looking for more relief – but not coordinated price levels. The Secretary should return to a national view of the Class I price surface and abandon the Southeast adjustment in temporary Class I differentials in his decision.

**b. Deny the proponents’ request.**

In looking over the data I think it would be reasonable for the Secretary to conclude there is insufficient evidence at this time to take action on the Proponents’ proposal and should reject their proposal.

Yesterday the Proponents reminded the Secretary of the decision regarding Mideast order transportation credits. I amplify their reminder to highlight the Secretary’s conclusion that the cooperatives are able to get increased costs out of the marketplace. It seems they have simply

changed the numbers and are here hat in hand asking for transportation relief again. Their own testimony admitted they have a fuel adjustor that is a part of the over order premium calculation.

Rejecting this proposal would clearly be the correct outcome if the Secretary would abandon the Southeast adjustment in temporary Class I differentials. It is still the correct decision to make in light of their “chief” complaint is a function of the SE change. Moreover, we have only limited data of the marketplace under the new rules because little is available to this record. If we learned anything from FO reform surely the industry learned that it takes more than a couple months for handlers to get used to new rules before they begin changing their marketing strategies.

**c. Suspend the hearing until data is available to understand the real implications of the Southeast.**

If flat out rejecting the proposal does not set well with the Secretary, it could be that the evidence of this hearing has at least piqued a curiosity in the mind of the Secretary that something needs to be done. If this is the case, we would ask the Secretary to first consider suspending the hearing without closing it today to allow for more data to be gathered and alternative proposals to be proposed and considered.

This hearing was asked for on an expedited basis by the cooperatives. Again, the data is limited especially relating to the impact of the Southeast Class I differential change. Thus, it would be wise of the Secretary to suspend this hearing for one year (or at least until one year of data is available) to allow for more data to see exactly what the market looks like and how (or indeed whether) milk is actually moving. I am sure the Proponents are going to say: “the proposed change is temporary.” Yes, I would agree that word is used, but they have provided no timeline with which to change it, or any other mechanism other than through proceedings such as this. The use of “temporary” and

requests for expedited action by the Proponents does not in any way lessen the burden on the Secretary to make a fact based decision. Rushed judgments on the part of the Secretary could lead to more proceedings and other administrative efforts that could be avoided through the exercise of a bit of patience and administrative restraint.

At a minimum, the lack of data presently available regarding surrounding markets impacts prevents any emergency decision. How can the Secretary make the right decision when a primary reason for this hearing has no data backing it up? We urge denying emergency consideration of this matter. If the request is not denied outright it should at least be suspended until sufficient data can be provided to document the impact the Southeast Change has had on milk movements in the MidEast.

**d. Divide the Mideast order into three smaller orders.**

In the process of considering any proposal, the Secretary has an obligation to look for an appropriate outcome that satisfies all his obligations under the AMAA, even if such an outcome is not within the scope of the hearing. Admittedly, the Secretary could not adopt that outcome without an expansion of the scope of the hearing. This need for expansion of the hearing notice to reach a *legal outcome should not prevent the Secretary from considering real and justifiable possibilities* that arise during the course of the hearing.

If the Secretary sees as clearly as I do the data presented by the Proponents, I believe a natural consideration would be to examine the implications if the Mideast order were divided into three orders as the Proponents have divided the sub regions. I am not offering this as an alternative proposal, as I know that such a proposal is beyond the scope of this hearing. However, it is well within the intent of the Proponents' request for the hearing. It has merit to address the issues they have made in presenting their case with much less impact on consumers. It could have a positive

impact on dairy farmers, particularly in the southern region of the Mideast order that is purportedly deficit.

While, this is not a proposal for this record, I wish to provide the Secretary with some insight on what such a decision could look like and how it addresses the concerns of the Proponents and does so without having negative consequences on consumers or unintended consequences to all industry participants because the nationally coordinated price surface has been abandoned. Basically, it only changes how the dollars are distributed among the dairy farmers.

**e. Lower Class I differentials in the milk surplus areas.**

Should the Secretary conclude he only wants to consider action with the Class I differentials and not explore the possibility of alternative proposals, I would offer an alternative to the Proponents' proposal that is within the scope of this hearing.

The Proponents have discussed the merit of increasing the Class I differentials to help enhance the attractiveness to delivery to the Southern regions plants. Their examples rely heavily on the price spreads between the reserve supply areas and the southern region. They conclude that the action to be taken is to increase the Class I differentials in the south. A very similar outcome could be achieved by reducing the differentials in the north. With more freedom of consideration I might have offered a more creative proposal. However, we were not given an opportunity to submit an alternative proposal, so my proposal must be made within the scope of the hearing record. Thus, I would propose the lowering of the northern Class I differentials to increase the price spread from north to south to help attract the milk to the south. This is a logical action as the price spread is important and helps to move milk and such action will widen the spread.

Option 1A establishes a \$1.60 per hundredweight fixed differential for three surplus zones (Upper Midwest, West, and Southwest) within a nine-zone national price

surface, and for the other six zones, an added component that reflects regional differences in the value of fluid and manufacturing milk. This option emphasized current supply and demand conditions with the USDSS model output. (64 Fed Reg. 16110)

The dairy industry has changed since Federal Order reform. This change includes the shifting of milk supply and continued shift in population. Considering that \$1.60 was applied to “surplus zones” at the time of reform it seems the secretary needs to consider the definition of surplus and the price level of northwestern portion of the Mideast order.

## **V. Conclusion**

The decision before the Secretary is a complicated one. The clearest action would be to reverse the action in the Southeast and to deny this request. Should the Secretary conclude the Mideast requires action, I would reiterate that there is risk for unintended consequences, of the same variety that provoked this hearing. Thus, the Secretary should consider all the possibilities including exercising patience and exploring alternative proposals. The first alternative proposal that should be considered is dividing the MidEast order into smaller orders something akin to the proponent’s data request. However, if the Secretary concludes some action needs taken immediately I would advocate the Secretary complement the decision in the Southeast by lowering the differentials in the milk surplus area of this reserve supply order.