

**STATEMENT**

**ADCNE**

**HEARING PROPOSAL NO. 7**

**MARKETWIDE SERVICE PAYMENTS**

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ON BEHALF OF

NEW YORK STATE DAIRY FOODS, INC.  
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AT HEARING HELD SEPTEMBER 10, 2002

ALEXANDRIA, VIRGINIA

BASIC POSITION:

The NYSDFI members and non-members alike, hereinafter listed individually, oppose the adoption of proposal No. 7, as presented in the official Notice of Hearing, calling for the establishment of marketwide service payments exclusively for Northeast Federal Order No. 1. The undersigned are opposed in principle to the use of pool monies paid by all pool producers for unrestricted uses. We do not think it wise to set-up what amounts to a corporate welfare fund labeled as balancing service payments. As written, we believe the adoption of Proposal 7 would lead to divisive and disorderly milk procurement practices, promote inequities among handlers, lessen competition (particularly from small business enterprises), and not be in the public interest.

**Proposal 7** provides for pool payment to qualified organizations @ \$0.06 per hundredweight for rendering unspecified balancing services for the fluid market. To qualify:

- \* Handler must pool at least 3 percent of the market "pool producer milk" (approx. 61.4 million lbs. out of 2.05 billion lbs. market milk per mo.); or
- \* Handler "pools" and/or operates a pool manufacturing plant (class 3 or class 4 use) or a pool distributing plant located in the defined Northeast marketing area, handling at least 1 million lbs. milk daily; and
- \* Handler transfers or diverts to distributing plants not more than 65 percent of the total quantity of milk "pooled" by the handler.

SOME OF THE ISSUES INVOLVED THAT HAVE NOT BEEN SATISFACTORILY ADDRESSED IN THE PROPOSAL ARE AS FOLLOWS:

**1. SCOPE OF THE PROPOSAL IS UNREALISTIC AND DISCRIMINATORY.**

Proposal 7 more appropriately should be considered in a national rather than a regional hearing, especially in view of the Department's desire to achieve more uniformity in regulatory provisions among the Orders. Although precedent for co-op service payments existed under the former NY-NJ milk marketing Order, the plan was not the same and was not adopted under the "Reform" Orders. Because the proposed pool deduction in Order I is significant (close to \$1 million monthly), it would be expected to have far-

reaching impact on inter-market competition. For example, if the funds were used to subsidize plant operations or defray plant losses in regional manufacturing of such end-use products as butter, NFDM, or cheese, this use of the funds would give Northeast cooperatives a special competitive advantage over their counterparts in other regions—who compete in the same national and international markets. Clearly, this is contrary to USDA efforts to make the class 3 and class 4 milk pricing formulas uniform throughout the Federal Order system. Having the ability to use marketing service monies in only one region to lower production costs, makes a farce of the uniform "make allowances" in the manufacturing milk price formulas now contained in all the Orders.

Proponents unrealistically assume that market premiums, competitively determined aren't doing the job they now are asking the pool to absorb. After all, buyer handlers aren't forcing the cooperatives to accept or handle more member milk than they need. And several fluid handlers are paying higher premiums now than they were only a few years ago—for balancing privileges as well as for other costs of milk assembly.

Proposal 7 is unrealistic too, from the standpoint of its obvious "exclusivity" for ADCNE cooperatives. While claiming participation could be available to both cooperative and proprietary handlers, proponents have clearly drafted the qualifying standards (referenced above) for themselves and to exclude others. Few, if any, proprietary handlers would qualify for service "payments", even though some are performing valuable "balancing" services for the fluid market and could do more "balancing", given the regulatory tools and incentives to do it. We also note that, none of the small co-ops in the market can

qualify on their own, regardless of the relative level of balancing services they may perform for their fluid customers. Clearly, the proposal discriminates against small business enterprises-both proprietary and cooperative.

## **2. PROPOSAL PROMOTES INEQUITABLE COMPETITIVE ADVANTAGE IN PROCUREMENT.**

In previous testimony, we pointed out that, because of changes in cooperative 9 C unit provisions under order reform, favorable to the ADCNE cooperatives, we find that Order 1 9C unit milk now enjoys market share exceeding 80 percent, even though total cooperative membership share is less (See NYSDFI TABLE 2). The prime reason co-op 9 C unit milk has captured so great a share of the market, comes from the new-found ability to "pool" other non-member producer milk (both independent and smaller co-op producers) in their 9 C units. We are of the opinion that proposal No. 7, if adopted, would greatly accelerate this trend to larger market share in co-op 9C milk--dominated by the larger cooperatives qualified as recipients of the marketing service payments.

Why do we expect accelerated growth in co-op 9C milk, were proposal 7 to be adopted? The answer is made clear from past performance in the former NY-NJ Order 2, prior to reform. We are aware of instances where larger cooperatives secured "affiliation agreements" such that a smaller co-op could participate in service payments from the Order 2 pool. This was accomplished by virtue of special contract, allowing the smaller 'affiliate' to draw service payments, albeit indirectly via the "larger cooperative" without the smaller "affiliate" unit losing its separate identity or marketing autonomy.

To qualify as a "partial" participant under the new proposal for pool cooperative service payments, a non-qualifying cooperative needs only to agree to become pooled under the larger cooperative "9 C umbrella" unit and make a deal similar to that previously used in the NY-NJ order, to once again share in the service payments generated from the transaction. The incentive to make this sharing arrangement would be much greater under this plan; however, because the rate of payment and the amount collected is so much greater.

TABLE 3, attached hereto, clearly demonstrates this fact. While the average "rate" per hundredweight is increased about two (2) cents; the volume to which it would apply is increased more than two-fold (225%) and total deduction from pool monies is increased three-fold (338%) -- from about \$3 million a year to more than \$ 10 million, when compared with that which applied in former Order No.2.

**3. PROPOSAL LACKS PERFORMANCE STANDARDS TO JUSTIFY  
EARNING SERVICE PAYMENTS FROM THE MARKET POOL.**

We believe the adoption of the ADCNE plan, as drafted, could easily result in increased share of "qualified" milk and monthly pool payments exceeding \$1 million-all without guidelines as to how these monies are to be used.

Unlike the former co-op payment provisions in Order 2, which did set forth conditions to be met by recipients, proposal 7 contains no meaningful performance standards for „earning" the higher payments proposed to be deducted from market pool proceeds.

There appears to be no restriction regarding the sharing of market-pool co-op service payments with smaller cooperatives, who otherwise would not qualify. We believe this situation, if approved by USDA, would lead to rapid conversion of the "smaller" 9 C units into the larger ones who fully qualify. This would give substantial power to the „majors" to solicit the "minors" using pool monies. Such actions would seriously diminish competition and tend to be contrary to the very "service" aspect ostensibly intended by proponents. We think this detrimental to handler competition in milk procurement and contrary to the purposes of the Act requiring that minimum uniform prices be paid all market producers. There is also no restriction against recipients using part or all of the monies to enhance net pay to their own members, or to other independents who might decide to "join" the cooperative. Use of the funds in this manner would, in effect, raid the "pool" to boost a membership advantage at the expense of those who choose not to join. We think the market needs to be protected from such unwarranted use of pool monies. Under these circumstances, one might question whether such authority was intended for cooperatives pursuant to the Capper-Volstead Act. Why grant "carte blanche" to recipients from such a large Pool of money?

At the very least, proposal 7 should have been designed to include more players, proprietary and cooperative alike, who can demonstrate, in accordance with specified „guidelines", that they indeed are equipped and able to do the daily work of balancing



their fluid customers— in both the "flush" and "short" supply seasons. Relative "size" of the payment recipient is not as important as actual balancing performance. The proposal lacks a "fair" performance criteria. Simply because a major cooperative or a Federation pools more than three (3) percent of total market milk, or has a large manufacturing plant, doesn't necessarily mean it has capacity enough or sufficient milk to balance the needs of others; except at steep discount rates or at very high "spot" handling charges.

Membership needs may rank first and foremost, despite the "pool" service payments coming from all market producers ostensibly for "balancing" the entire market. Under such circumstances, the "pool assessment" is wasted.

The data in TABLE 3 demonstrates the large sums that would be made available to ADCNE cooperatives relative to that paid earlier. Yet, there is very little required of the group in the way of specified performance services to be rendered in return. While the proposed order language does contain provision that recipients may be the first enlisted to meet any increase in milk shipping requirements established under a "call" by the market administrator, it doesn't go far enough, in our opinion. Recipients don't have to meet a higher shipping performance standard in the fall months when milk is needed most. In fact, they can sell almost unlimited milk to the southeast or to other markets; irrespective of the needs here.

We think a higher shipping standard would be appropriate for recipients to "earn" in return for the direct payments received from pool funds. Service payment recipients should have to answer to a higher standard to assure that the priority needs of Order I

fluid milk handlers are fully met. At minimum, recipients should be required to meet the increased shipping requirement proposed by NYSDFI in proposal No. 3 submitted at this hearing. In addition, recipients should be required to provide "waiver" in full supply agreements with manufacturers enabling milk to be diverted for fluid use, if needed in the fall qualifying months. Such requirement used to be provided in the New England Federal Order.

We also question whether a "recipient" should be entitled to charge a fee to another cooperative for the "privilege" of guaranteed "full pooling" in the umbrella 9 C unit operated by the larger cooperative collecting marketing service payments. The problem, with such pooling arrangement, from our perspective, is that it gives strong incentive for the smaller co-op to become a reluctant dragon, when pressed by the larger one or other handlers to furnish milk to the primary fluid market. If the reluctant supplier is fully covered for pool qualification purposes, why release any milk? They may not want to, unless required to by the Order or paid a spot milk price sufficient for them to do so.

It doesn't make sense to draw pool funds for so-called balancing services -- on milk made difficult to release to the fluid market sector. Moreover, it adds insult to injury, if the larger co-op collects from both ends of the spectrum--from the pool for marketing services and from the smaller cooperative "payer" for pool qualification. This situation is but another example of "double-dipping" for funds, which should not be authorized under proposal 7, in our opinion.

Finally, we are concerned that the "service payments" might tempt handlers to "ride" the northeast pool by withdrawing large volumes of pool milk to southeastern orders in the fall and re-pooling the milk in Order 1, December through June. Proposal 7 provides the



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means to "double-dip" for pool payments from both markets. This leaves producers in Order I the dubious privilege of carrying the reserve supply for other Order markets.

Thank you, this concludes my statement on proposal 7.