

Good Day Ladies and Gentlemen. My name is Warren Schanback and I am Vice President of Friendship Dairies, Inc., a family owned and operated business with one Plant which is currently regulated by the Northeast Order as a Partially Regulated Distributing Plant. Our company, with fewer than 500 employees, is a small business under the Regulatory Flexibility Act. The dairy farm patrons that market their milk to Friendship are also small business enterprises under the Regulatory Flexibility Act.

For the 40 years or so of Market Order 2's existence, we had been a fully regulated Pool Plant. After "Reform", we were initially regulated as a Pool Supply Plant until a dramatically revised set of economic factors forced us to change our Pool Status to a Partially Regulated Plant. Our dairy farmer patrons no longer have the opportunity they enjoyed for four decades to participate as pool producers through the Friendship Dairies' plant.

Our plant is unique in that it manufactures products that fall into every Class in Federal Market Order One. The vast majority of milk received at our plant in Friendship, New York is used as Class 11 to manufacture Cottage Cheese, Sour Cream and Yogurt, with much smaller quantities going into products considered Class III. We also produce a significant amount of Class I Cultured Buttermilk; and Nonfat Dry Milk to balance our milk supply. We are also somewhat unique in that we purchase approximately two thirds of our plant's milk supply under contract from about 125 Independent Dairy Farmer Patrons who insist that we are the best outlet for their milk. The remainder of milk we use is purchased from dairy cooperatives.

The following testimony is in support of our proposals 8, 9 and I 0. Proposal 11 is withdrawn.

## **PROPOSAL 8**

When the Federal Orders were reformed in late 1999, much attention was given to the fluid differential issue and just about every other issue seemed to take a back seat. For the old Order 2, there were so many changes being considered that it was impossible to determine their effect until they were adopted. Since we were a pool plant from the Order's inception, we naively failed to identify changes to the Order language that would dramatically affect our status, such as the adoption of new performance requirements in § I 00 1. 7 (c), and the extraordinary amount of additional milk represented by those new requirements for our producers to be able to associate with the milk pool. These new shipments were not due to any new demand for fluid milk.

For as many years as I can remember we had milk supply contracts with Class I handlers in anticipation of meeting the somewhat regular late summer "Call". We understood that at any moment there was the possibility that we would need to ship milk to Class I operations (now defined as Distributing Plants) but it was a new concept to us that the Order would have a substantial minimum amount written into it. We also failed to identify that the severe burden that the odd manner used to calculate this amount would create for us, because it dramatically increased the amount of milk that would be required to establish our performance.

When we consulted with the Department, we were informed that in the grand scheme of things (including uniform provisions across all Federal Orders) our objections were immaterial. It was explained that even though this facet of the performance provision was new to the Northeast, it had pre-existed in at least one other Federal Order and was therefore justified. While we

believed that our plant was different from other "manufacturing" plants because of our location on the Western reaches of the Order and the extra value that our high Class 11 utilization - provided to the pool, we could not convince anyone in the Department that this justified a "Grandfather" exemption. We exhausted every avenue to no avail.

The Order language states that "...such shipments must equal not less than 10 (or 20) percent of the **total quantity of milk that is received at the plant or diverted from it** pursuant to § 1001.13 during the month;" (emphasis added). This was a dramatic shift from the old Pool Unit Concept. Since the advent of "Reform" not only do we need to "qualify" the independent producer milk that we receive, we also have to ship milk based upon the amount of 9(c) milk that we are receiving from Cooperatives. As applied, the current pooling rules require redundant performance on Cooperative supplied 9(c) milk and erect economic obstacles to manufacturing plants receiving milk from Independent Producers from achieving pool status. Because the merged Order did not create any new Class I demand by Northeast consumers, these newly-required shipments merely displaced local milk that had previously been supplied to distributing plants and a new need to transport displaced milk to other plants for disposition.

Sales trends are relatively constant and over time we had carefully cultivated a milk supply to match our sales through our Patrons and Cooperative suppliers. While we could have gone out and gotten a distributing plant account, that still would have been a business decision that we were in control of. What we were unprepared for was such dramatically changed Federal Order Language that created an artificial need to supply so much more milk, virtually overnight.

Fortunately for us, our Cooperative suppliers were there to help get through this crisis. For a handling charge, they would provide as much milk as we needed to replace the "extra" milk we had to ship. But there was a catch. Every pound of milk we brought into our plant to replace what we were required to ship, increased the amount of milk upon which we needed to calculate what we were required to ship. In essence, the wording in § 1001.7(c) had created a never-ending escalation or "Pyramiding" of shipments, displaced milk, and replacement milk.

The following calculations illustrate the problem a 15 Million pound per month Supply Plant would encounter under the existing § 1001.7(c). The plant receives 10 Million pounds of milk per month from Independent Patrons and 5 Million pounds of milk per month from Cooperatives. Pre Reform, a 20% "Call" would have been considered a "worst case" scenario. Post Reform it has become "normal" for September through November.

**Pre Reform 20% Call**

Total Milk Supply	15,000,000 lbs./Month
Independent Milk Supply	10,000,000 lbs./Month
	<u>X 20% Shivvinjz Requirement</u>
	<b>2,00,000 lbs. to Class I</b>

**Post Reform §1001.7 (c) (2)**

Independent Milk Supply	10,000,000 lbs./Month
Total Milk Supply	15,000,000 lbs./Month
	<u>X 20% shivDing Requirement</u>
	<b>3,000,000 lbs. to Distributing Plant</b>

Replacing the Additional 1,000,000 lbs./Month  
Independent Milk Supply 10,000,000 lbs./Month  
Total Milk Supply 16,000,000 lbs./Month  
X 20% shipping Requirement  
3,200,000 lbs. to Distributing Plant

Replacing the Additional 200,000 lbs./Month  
Independent Milk Supply 10,000,000 lbs./Month  
Total Milk Supply 16,200,000 lbs./Month  
X 20% shipping Requirement  
3,240,000 lbs. to Distributing Plant

Replacing the Additional 40,000 lbs./Month  
Independent Milk Supply 10,000,000 lbs./Month  
Total Milk Supply 16,240,000 lbs./Month  
X 20% shipping Requirement  
3,248,000 lbs. to Distributing Plant

Replacing the Additional 8,000 lbs./Month  
Independent Milk Supply 10,000,000 lbs./Month  
Total Milk Supply 16,248,000 lbs./Month  
X 20% shipping Requirement  
3,249,600 lbs. to Distributing Plant

Replacing the Additional 1,600 Lbs./Month  
Independent Milk Supply 10,000,000 lbs./Month  
Total Milk Supply 16,249,600 lbs./Month  
X 20% shipping Requirement  
3,249,920 lbs. to Distributing Plant

Replacing the Additional 320 Lbs./Month  
Independent Milk Supply 10,000,000 lbs./Month  
Total Milk Supply 16,249,920 lbs./Month  
X 20% shipping Requirement  
3,249,984 lbs. to Distributing Plant

Replacing the Additional 64 Lbs./Month  
 Independent Milk Supply 10,000,000 lbs./Month  
 Total Milk Supply 16,249,984 lbs./Month  
 X 20% shipping Requirement  
 3,249,997 lbs. to Distributing Plant

**3,249,997=162.5% of Shipments to qualify  
 2,000,000 plant's patron milk.**

**Even by current definition, a so called "20% Performance Requirement" has effectively created a 33% shipping requirement!**

And that is if all things work perfectly and receipts are exactly as you anticipate. In fact considering the consequences of missing the required percentage by a few pounds, any reasonable Handler would add a few more percentage points to the minimum requirement just to be safe.

Proposal 8 solves the pyramiding problem by specifically omitting § 1000.9 (c) milk and dairy farmers described in § 100 1. 12 (b) as has been done in other Federal Orders. It does this while maintaining reasonable performance requirements because it bases the calculation on the amount of milk produced by dairy farmers that is pooled through association with the Supply Plant (whether or not it was diverted from that Plant).

#### PROPOSAL 9

As I stated earlier in my Direct Testimony, Friendship has many characteristics that are unique. One is the ability to produce Nonfat Dry Milk to balance our milk supply as well as a portion of the milk of our Cooperative Supply Partners. Another is the production and Route Disposition of a Class I product, Cultured Buttermilk. Post-reform, it was this product that caused the Plant to retain its designation as a Partially Regulated Distributing Plant.

Ironically, during the period of time when the plant was considered a Pool Supply Plant, the amount of milk "disposed of as route disposition or (are) transferred in the form of packaged fluid milk products to other distributing plants" was not able to be applied to the § 1001.7 (c) requirements for shipments made to a Distributing Plant but **was still** considered as part of "the total quantity of milk that is received at the plant" for the exact same section.

This is patently unfair and ignores the history of the Market Order in recognizing that this product satisfies an established Class I demand. Pre-Reform, pool manufacturing plants met performance requirements on the basis of Class I use or allocation of milk, and the volume of our Class I buttermilk was therefore credited against the Plant's "Call" performance. No testimony was received at the earlier hearings supporting a change in this aspect of the Order. Now, however, Friendship can qualify its plant only by fulfilling someone else's needs for Class I (and Class 11) milk, without receiving any credit for its own contribution to the Class I market or for its contribution of Class I prices to the market-wide revenue pool.

It is not our intention that conventional distributing plants, dedicated primarily to the

production and distribution of Class I products, which are not now fully regulated under Order I should become inadvertently regulated under § 1001.7 (c) by virtue of our proposal. It appears from data assembled by the Market Administrator that some of the partially-regulated distributing plants of this kind, identified on Exhibit 5 (pages 9-10, 13-14, and 17-18), also have distribution of Class I products sufficient to meet the supply plant definition under a literal reading of Friendship's proposal. It is our understanding that all plants aggregated in the data on Exhibit 5, page 61, are conventional distributing plants -- that is, plants with at least 25% of milk receipts at the plant processed and disposed of in the form of packaged fluid milk products. These plants are not now fully regulated because less than 25% of their total

What we had in mind when we wrote Proposal 9 was the conventional characteristics of a supply plant and a distributing plant, as described in the beginning of UDSA's Milk Marketing Order Statistics publications, and in separate web site document entitled: "Quantities and Utilization of Regulated Milk -- Description," as follows: "...distributing plants [are] plants primarily engaged in processing packaged fluid milk products, and supply plants [are] plants primarily engaged in producing manufactured dairy products."

To exclude the possibility of a conventional distributing plant becoming fully-regulated through the back door of § 100 1. 7 (c), and to focus on the primary function of supply plants in manufacturing dairy products, we modify our proposal with the following clarification to be added as a new subsection 100 1. 7 (c)(6), as follows:

"(6) Route disposition from the plant and transfers of packaged fluid milk described in foregoing subsections (1), (2), and (3) shall not count toward qualification as a supply plant of any plant at which less than 50 % of the quantity of milk physically received at the plant is used to produce Class 11, III or IV products."

With this clarification, eliminating the possibility of dedicated distributing plants from becoming pooled as supply plants, Friendship would be the only Supply Plant with Route Disposition or transfers in the form of packaged fluid milk product to Distributing Plants in this Market. Proposal 9 would restore the intent and historical practice of the Order without detriment to the Pool, but with substantial relief to Friendship, its dairy fanner patrons, and cooperative suppliers.

It is Friendship's intent that all of a supply plant's Route Disposition be applied to the § 1001.7 (c) (1), (2) and (3) requirements whether or not the product was disposed of within the Northeast Federal Milk Marketing Order, just as the old Call provision was interpreted to include all Class I milk.

## PROPOSAL 10

As you can tell from my testimony, I am not a big proponent of "Reform" or any other artificially created changes to the Federal Market Order. This is because these changes occur overnight and are extremely disruptive to the market until all of the parties adjust. One of the more onerous changes that was incorporated in the Northeast Order, was the setting of a fixed amount of milk that must be shipped to Distributing Plants in order for a Supply Plant to remain

pooled. Pre-reform, a temporary crisis resulting from the shortage of available milk for the Class I market was satisfied in every instance through an established process known as the "Call". In fact, since every participant was aware that the Market Administrator could require them to supply milk for Class I use or face being de-pooled, there were many instances where the official process of holding a meeting to consider the appropriate level of shipments was not even necessary to create enough supply to meet demand.

Why then would this amount be set at 10 and 20 percent, and why would there be a need to ship milk all year round? There was and is no shortage of milk to meet demand at Distributing Plants. There was no testimony heard that would indicate this amount was necessary. The truth is that these percentages were picked arbitrarily because they were cardinal numbers, not because they were systematically evaluated.

I understand that the Department identified the possibility that distant plants not generally associated with the Northeast Order could "ride the pool". They reasoned that creating a performance requirement was one method to dissuade this activity. But why then would 5 and 10 percent not have been sufficient? This amount should have been set at the minimum level that would have accomplished the stated intent without causing any additional unnecessary and uneconomic movement of milk by Supply Plants solely for the purpose of ensuring that dairy farmers have access to the local market revenue pool.

After all, market wide sharing of revenues among all Producers in the milk-shed, is the primary objective of the Federal Milk Marketing Order Program. This objective is defeated when performance rules, by design or in effect, result in: (a) the exclusion of some Producers from the Pool; or (b) in Producers without access to a Class I outlet having to buy market access from those who dominate the Market's Class I milk supply; or (c) in shipments of unneeded milk over long distances for the sole purpose of performance, resulting in displacement of other milk supplying Class I plants that must then be shipped for manufacturing uses at additional transportation costs.

The reasoning in Support of proposals 3, 5 and 6 indicates that while 10 and 20 percent requirements may not have been sufficient to create a disincentive to distant "pool riding" Plants, increasing this amount would not have been more effective nor would decreasing it have been less effective. We believe that now is the appropriate time to adjust these percentages to a more reasonable and less market distorting amount of 5 and 10 percent. Furthermore, if any of Proposals 3, 5 and 6 are adopted, it is our testimony that the Department absolutely must not pass up the opportunity to adjust the percentages used in § 100 1. 7 (c) downward in an effort to reduce the burden on plants that should be associated with and create value for the pool such as ours.

A simple analysis of the data provided by the Market Administrator postulates that reducing these percentages as we have proposed would have an insignificant effect especially if *any* of Proposal 3, 5 or 6 were adopted in one form or another. However, if there is ever a need to increase these amounts to accommodate a milk shortage, the Market Administrator still retains the authority as granted in § 100 1. 7 (g) to consider and make such adjustments.

Thank you for the opportunity to address the Department and all assembled here today.