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Before the United States Department
of Agriculture
Agricultural Marketing Service

In the Matter of :Docket No.
Milk in the Pacific Northwest :AO-368-A29
Marketing Area :DA-01-06

Statement In Support Of
Proposals 1 and 2

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on behalf of
Northwest Milk Marketing Federation

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Seattle, Washington

I. Introduction

This hearing has been called at the request of Northwest Milk Marketing Federation (NMMF) to amend certain provisions of the Pacific Northwest Order (PNO) as described in Proposals 1 and 2 in the Notice of hearing. NMMF is a federation of four dairy marketing cooperatives and 48 independent producers who have joined together to engage in the collective marketing of milk to PNO regulated handlers as authorized by the Capper Volstead Act. The cooperative members of NMMF include Northwest Dairy Association, Tillamook County Creamery Association, Farmers Cooperative Creamery, and Northwest Independent Milk Producers. In addition NMMF has a separate pricing agreement with all but one of the producers who are members of DFA and with one other independent producer who is not a member of NMMF.

Collectively, NMMF and its associated producers in Feb 2001, the last month in which NMMF priced milk, represented 98% of the producers who historically have supplied milk to the PNO marketing area and which account for 97.5% of the milk pooled under the order. NMMF was organized for the purpose of establishing a cooperative marketing structure to enhance the returns to its associated producers who constitute the historic source of supply of milk to handlers regulated by the PNO.

II. Need for Amendatory Action

Proposals 1 and 2 are designed to correct what appear to be unintended consequences of basic changes wrought by federal order reform in the manner in which the producer location value of the milk is determined. The AMAA authorizes the Secretary to adjust the "uniform prices for all milk delivered" by producers in each federal order to reflect "the locations at which the delivery of such milk is made". Prior to reform, adjustments to the producer blend prices based upon distance from a basing point specified in the order acted as an effective means of defining the producers who constitute the reliable source of milk for each marketing area's handlers.

The January 1, 2000 reform amendments brought a fundamental change to the federal order pricing system. Utilizing a computer generated "model" of the nation's dairy industry, the reform decision determined what it described as the "spatial" value of milk at several hundred local supply and demand locations across the country. Based on the model, Federal order Class I differentials were established for milk delivered to plants in every county in the nation to reflect the counties supply and demand value of milk - rather than distance from an order's basing point. This same Class I location value system is also used to adjust pool draws on all milk, regardless of use.

Under the new system, milk diverted from plants in the marketing area and delivered hundreds of miles distant can now be "valued" at the same price as milk at the plant from which the milk was diverted. Distance is only adjusted by differences in Class I differentials applied based on where the milk is actually delivered. Using a somewhat unlikely example we can illustrate the lack of economic consistency in this new system.

Assume a producer located in Ithaca, New York (the home of the pricing model) is “paper pooled” in the PNO but has his milk delivered (called diverted in Federal Order language) to a local cheese plant in the Tompkins County, New York area. This producer because he is hypothetically pooled in the PNO will get the blend price of the PNO plus sixty cents which is the difference between the Class I differential in the PNO (\$1.90) and Tompkins County (\$2.50). Not only did the PNO producers have Class III usage added to their pool they also have the honor of paying out a share of the PNO’s PPD and the exceptional honor of paying an additional sixty cents per hundredweight. It is exactly this kind of arrangement that has allowed millions of dollars to be transferred from the PNO to producers located in southern Idaho and Utah. This outcome is difficult to explain and even more difficult to justify.

Though the Secretary specifically considered and rejected “open pooling” during the rule-making process that culminated in the reform amendments, elimination of the pre-reform producer location adjustment, coupled with loose or no “touch base” diversion provisions, has none-the-less permitted the pooling on the PNO of milk from sources far removed from the PNO historic milk supply. Though “open pooling” was rejected by the Secretary, the reform amendments brought about what can only be described as something very close to “open pooling” in a number of the 11 federal milk orders. As a result, the milk order system is now undergoing the consequences of what should have been, but apparently was not, predicted.

The same need for corrective action which the Secretary has already recognized and undertaken to address in three of the 11 federal orders must also now be recognized and addressed in the PNO. An examination and comparison of the pre and post reform sources of producers and pounds of milk pooled in the PNO establish beyond controversy the need for changes to order provisions which now operate to undermine the purpose for which a federal order is established.

A. The Pre-Reform PNO Milkshed

The pre and post reform PNO marketing area is almost identical. The reform amendments added one unregulated southwest Oregon county to the PNO marketing area. The marketing area now consists of all of Washington’s 39 counties, 30 counties in Oregon and six counties in northwestern Idaho.

Prior to reform, over 98% of the milk pooled in the PNO was produced within the marketing area (64 Fed. Reg. at 16081). Of the less than 2 percent of the pooled milk produced outside the marketing area, the major portion was produced by producers in two northern California counties who accounted for 90% of the pooled milk produced outside of the PNO marketing area. Except for producers located in the six Idaho counties within the marketing area (northern Idaho panhandle), no Idaho or Utah milk was pooled on Order 124 (See, The Market Administrator’s Report, Pacific Northwest & South-Western Idaho – Eastern Oregon Marketing Area, July, 1999, p. 5). Please note that production in the northern panhandle of Idaho is very modest. The major supplies of

Idaho milk are produced several hundred miles to the south in the Treasure Valley (Boise area) and the Magic Valley (Twin Falls area).

B. Post Reform Expansion in PNO Pooled Milk.

Within a few months following the January 1, 2000 implementation of the reform amendments, a dramatic expansion occurred in the pounds of milk pooled on the PNO and the geographic area from which that milk production was drawn. The reason for the expansion is not difficult to understand. First the relatively high Class IV usage in Order 124 compared to Order 135 made blend prices in Order 124 high compared to order 135. Secondly, the PNO is unique among the 11 federal orders in requiring no individual producer prior delivery to a pool plant to qualify for diversion. Absence of such a requirement plus no "touch base" provision, coupled with a 99% March through August and 80% September through February diversion limitation constitutes virtually an invitation to "open pooling" of milk for which the PNO blend offers a more attractive return than the alternative adjacent Order 135.

Market Administrator data show that prior to July 2000, no Southern Idaho or Utah milk was pooled on the PNO. From July 2000 through September 2001 a dramatic change occurred that continues up to this time. During that fifteen month period a total of 475,896,568 pounds of (almost exclusively) Class III milk, originating from Southern Idaho and Utah sources beyond the PNO historic milk-shed, have been "paper pooled" on the PNO. The term "paper pooled" means milk that is not historically associated with the PNO, milk that is not delivered to plants in the PNO, and milk that is not needed currently nor in the foreseeable future to meet the Class I needs of the PNO.

Exhibit 7 is our estimate of the loss to the Order 124 producer price differential and blend price resulting from the "paper pooling" of Southern Idaho and Utah milk. This translates into an estimated 15 month aggregate loss of \$6,625,000 to the producers who constitute the historic source of supply to the PNO handlers.

The Secretary's April 2, 1999 Final Decision which consolidated the then existing 31 orders into 11 separate orders was based on his determination that "overlapping route disposition and milk procurement area are the most important criteria to consider in the consolidation process" (64 Fed. Reg. 16045). The pooling of distant milk and producers located beyond the historic PNO procurement area is in conflict with the Secretary's consolidation criteria. It results in a transfer of pooled Class I dollars away from producers in the PNO's traditional procurement area to another area's producers contrary to the basic statutory purpose for which the FMMO system was established.

Section 608c(18) of the AMAA directs the Secretary to establish prices to producers that reflect "the price of feeds, the supply of feeds and other economic conditions which affect the supply and demand for milk in the marketing area to which the marketing order relates." (Emphasis added). The flawed reform amendments that permit the artificial "paper pooling" transfer of PNO pooled dollars from producers for whose benefit the

PNO was established to producers totally unassociated with the PNO marketing area is contrary to the 11 separate order structure established by the Secretary. It is contrary also to the statutory 608c(18) requirement that producers who actually supply the “demand for milk in the marketing area” receive a price that reflects the pooled proceeds arising from that demand.

NMMF submits that amendment of the PNO is necessary to insulate the PNO pool proceeds from their unwarranted dilution in violation of the pricing standards of the AMAA. The amendments that we propose are designed to insure that the producers whose milk constitutes the daily and reserve supply for the marketing area’s demand for milk receive the price that reflects that demand.

III. Summary Explanation of Proposed Amendments.

Proposals 1 and 2 in the Notice of Hearing propose changes to existing provisions of the PNO relating to pool plant and producer milk definition aimed at curing the present “paper pooling” problem that has plagued the operation of the order.

A. Change Diversion Limits.

Proposal No. 2 proposes amendment of Section 1124.13 to change the existing 80% September through February and 99% March through August diversion limits to not more than 80% during each month of the year in the quantity of producer milk received during the month that a handler may divert to nonpool plants. On Jan 4, 2001 the PNO Market Administrator, acting pursuant to Section 1124.13 (e) (5) decreased from 99% to 80% the percentage of producer milk that may be diverted to nonpool plant during each month from March through August, 2001. Our Proposal No.2 would simply continue in effect, permanently, the Market Administrator’s temporary revision.

B. Addition of “Touch Base” Provision.

The proposal to add to the “producer milk” definition of Section 1124.13 a condition that “milk of a dairy farmer shall not be eligible for diversion unless at least 6 days production of such dairy farmers production is physically received at a pool plant during the month” is designed to insure that any milk pooled be held to at least the same performance standard as the 20% shipping requirement of pool supply plants. The 20% shipping requirement coupled with an 80% diversion limit will require not less than 20% of a plant’s receipts to be delivered to pool distribution plants each month. The six (6) day delivery requirement for each producer is intended to equate (20% x 30 days) to the 20% standard for supply plants. The six (6) day “touch base” delivery requirement for each dairy farmer’s production to qualify as “producer milk” will affect the total quantity of milk received at a supply plant to determine whether it has met the 20% minimum shipping requirement for pool plants. Under our proposals, the Market Administrator will

continue to have the authority, now granted by the PNO, to increase or decrease not only the diversion limits of the PNO but also the proposed delivery day requirement to qualify as a “producer”.

C. Addition of Cooperative Pool Manufacturing Plant Definition.

Prior to reform it was not necessary to use a “touch base” provision in the PNO. The market area ran smoothly with limited requirements because the producer location adjustment rules largely discouraged the attraction of out of area milk. The addition of a “touch base” provision however makes it necessary to add provisions for a Cooperative Pool Manufacturing Plant. These provisions will identify cooperative manufacturing plants within the marketing area as pool plants which alone or as part of a system of plants must meet pool delivery requirements by delivering 20% of cooperative member milk to distributing plants. This will allow the cooperatives operating these plants to divert “close in” member milk to the fluid plants while member milk close to the manufacturing plants can be delivered there. This will allow the already quite efficient system to continue to function without the disruption of moving each producer’s milk to a fluid plant six days a month. The proposed cooperative pool manufacturing provision is similar to the provision in other orders, see, e.g. Section 1131.7(d), Arizona-Las Vegas Order and Section 1135.7(d), Western Order.

D. Delete From Pool Supply Plant Qualifying Shipments Milk Delivered Directly to Pool Distributing Plants Pursuant to 9(c) Or Diverted to Another Pool Plant.

With the addition of Cooperative Pool Manufacturing Plants, the current supply plants in the PNO will change their status to the new definition. It will no longer be useful to count, as a qualifying movement for pool plant qualification, a Supply Plant handler’s class diversions to pool plants or cooperative 9(c) deliveries. In addition, this change is proposed to prevent the creation of supply plants in areas outside the PNO market area that could associate themselves with the PNO as supply plants without delivering any milk to the market from the supply plant and then use that supply plant’s diversion rights to pool additional milk that is otherwise not associated with the PNO.

E. Addition Of Provisions For Unit Pooling Of A System Of Plants Operated By Cooperatives.

The purpose of this addition is to allow Cooperative Pool Manufacturing Plants to combine as a system to meet pool delivery requirements. This will allow the current system to continue to run efficiently. This provision also allows the Market Administrator flexibility in adjusting the delivery requirements without going to a full hearing.

IV. Emergency Conditions Warrant Omission Of A Recommended Decision

NMMF submits that the existing PNO diversion provisions have caused, and continue to cause, the NMMF associated producers significant and irreparable economic loss that only the prompt implementation of corrective amendatory action can cure. The NMMF proposed amendments are submitted on behalf of 98 percent of the producers historically associated with the PNO. No opposing, conflicting or additional proposals have been noticed for consideration at this hearing. Prompt action on NMMF's proposals is needed to abate the economic loss that currently is being suffered by the producers who are the intended beneficiaries of the PNO.

V. Extension of Jan 4, 2001 Temporary Decrease in Diversion Limits.

It cannot be predicted how long it will take to reach a decision in the matters presented at this hearing. Therefore NMMF proposes that the reduction of diversion percentages from 99% to 80% established in the Jan 4, 2001 action of the PNO Market Administrator be extended through at least August 2002.

VI. Producer milk being double pooled.

NMMF is deeply concerned with the "loophole" in reform Federal order rules that allow producers from California who are pooled in the California pooling system can also, in some circumstances, be pooled in some Federal orders. This practice has not occurred in the PNO. While it appears there is some protection in the definition of a "dairy farmer for other markets" found in 1124.12(b)(5), NMMF suggests that the Secretary review this issue and adopt clarifying language that disallows the pooling of the same milk in two orders, whether state or Federal.

This concludes our prepared testimony.