

**Prepared Testimony of  
Daniel S. McBride,  
Northwest Dairy Association**

**Re: Proposal No.1**

Federal Milk Market Order Hearing  
Docket No. AO-368-A32, AO-271-A37: DA-03-04

My name is Daniel S. McBride. I am testifying today on behalf of Northwest Dairy Association, which is usually referred to as "NDA". My title is Director, Milk Pricing Programs for NDA. I am responsible for coordinating all types of matters pertaining to Federal Orders, and have done so since leaving the Market Administrator's office to join the NDA staff in 1986.

My role at NDA includes working with other departments of our organization that deal with milk marketing. For purposes of this testimony, I have relied on my experience working with the group that markets raw milk to regulated plants, including those of NDA's subsidiary, WestFarm Foods ("WFF"). I also have relied on my experience working with another group within WestFarm Foods that markets milk processed at our bottling plants, including the cost-accountant for that group.

Proposal No. 1 NDA is the proponent of proposal No. 1 to revise the Producer – Handler provision of the Pacific Northwest marketing order, limiting the exemption for producer handlers to 3,000,000 pounds of bottled milk sales per month.

For purposes of this hearing, I participated in a team which developed an in house study of historical cost and production numbers at the WestFarm Foods Medford bottling plant. We developed the attached chart showing the cost per gallon at the various levels of capacity. The study was done over a ten-year period using the gallons processed and the costs associated with the plant. The Medford plant has a capacity of 12 million pounds per month and is currently processing 4-5 million per month. And at times in the past, the volume at that plant has been below the 3,000,000 pound per month level.

In this study, "plant cost" includes the labor and overhead at the plant. It does not include packaging, marketing, or distribution costs. Nor does it include certain costs that are retained at a corporate or division level, in our cost accounting system.

For confidentiality reasons, WestFarm Foods prefers not to release such details as the degree of overhead covered or capital costs. This exhibit is offered simply to show the difference in variable costs between a plant processing less than 3 million pounds per month in size, compared to the larger volumes of regulated plants.

The points of this study that are most important to our discussion are:

- The numbers generated within WestFarm Foods Medford plant are quite similar to those prepared by Mr. Carl Herbein and testified to at the Phoenix phase of this proceeding. Like his numbers, ours clearly support a cost trend line that shows costs decrease as plant size increases.
- The variable cost decreases on a per gallon basis, as the Medford plant moves from less than 3 million per month plant to processing over 3 million per month. That decrease in variable processing costs is in excess of 10 cents per gallon. At 5 million pounds the variable costs decrease an additional 5 cents per gallon.
- A plant below 3,000,000 pounds per month on this scale has a disadvantage in the cost of processing of approximately the same amount as the advantage roughly 15 cents per gallon, which the Producer Handler exemption allows (as developed in Mr. Van Dam's earlier testimony).

I would now like to discuss the impact Producer Handlers have had in the Pacific Northwest (Order 124) market, on WestFarm Foods and our customers.

During the past five years or so, Producer Handlers have been becoming more aggressive in taking additional business away from regulated handlers, including the three bottling plants that WestFarm Foods operates in the Pacific Northwest market. Producer handlers are not fully regulated, they could sell product below the equivalent Federal Order Class prices. Interestingly, they sometimes offer multi month fixed price contracts, which is something Congressional policy does not allow regulated bottling plants to do under forward contracting programs with producers (which are permitted for other classes of milk, but not for Class I).

Of the Producer Handler group, only Smith Brothers has been involved in significant school milk sales in the past, but Edaleen Dairy recently has put in a half pint machine and is supplying school milk to one of their distributors. This seems to represent an expansion of the traditional market for Producer Handler operations.

WestFarm Foods supplies many milk distributors with all or a portion of their dairy products. These distributors, sometimes known as "jobbers", are independent businesses who buy consumer-packaged dairy products from one or more sources, and distribute them to various types of customers that they serve.

I want to describe in this testimony how competition from Producer Handlers has impacted that section of our business. Before doing so, it is important to note that since the Phoenix phase of this hearing, one of the Producer Handlers in the market lost his plant in a fire. I refer to Country Morning Dairy near Othello, Washington (in the central part of the state). We do not know if he plans to rebuild, but for purposes of this hearing we will continue to view that operation as a competitor.

The following summarizes the relationship between WestFarm Foods and its major distributors:

- Associated Grocers, based in Seattle, WA, is our largest distributor, a wholesale grocery warehouse with distribution in Washington and Oregon. Their dairy program is built around sales of WestFarm Foods products, but in recent years that program has lost approximately 1 million gallons per year to Mallories Dairy on gallons of milk. This occurred from one Oregon store owner who shifted four of his stores from full participation in the Associated Grocers dairy program to direct purchase of Mallories gallons. Three of the stores were lost about 2 years ago, as follows: Food 4 Less - Salem, Shop N Kart - Albany & Shop N Kart - Lebanon (total: approximately 750,000 gallons per year). About six months ago, that owner purchased the Shop N Kart in Woodburn, Oregon, which cost us another 250,000 gallons per year. Previous to the purchase of the Shop N Kart in Woodburn, it was one of our top 5 volume retail stores through the Associated Grocers program at the time we lost the store.
- Dairy Valley Distributing, Mt. Vernon, WA – This Northwestern Washington distributor purchases gallon, half gallon and half pint school milk from Edaleen Dairy (a Producer Handler), and purchases most of the rest of their products from WestFarm Foods. They were a spin-off of our former WestFarm Foods distribution network, and were formed in 1997 by former employees when we closed our distribution branch in Mt. Vernon. Initially they were mostly distributors of our “Darigold” and other brands, however that has changed as a direct result, they told us, of their ability to get cheaper product from Edaleen. We were told that had they not done so, their competitor distributors in that area would have bought from Edaleen and would then have had a competitive advantage over them.
- Iversen, Mt. Vernon, WA – based in Northwestern Washington, this distributor purchases gallons from Country Morning in Othello, WA (a Producer Handler which uses the Dairilicious brand), and the smaller items from WestFarm Foods. Iversen purchased its gallons from Edaleen, but has switched to Dairilicious. Since the Country Morning fire they are purchasing their gallons from WestFarm Foods.
- MeadowSweet, Seattle, WA - they have historically not been a major Darigold distributor, but buy some from us. Their major suppliers are Smith Bros. (also a Producer Handler) and Edaleen. They also operate in the Portland market, and supply Edaleen products into that market.
- Dairy Fresh, Olympia, WA - our primary distributor in SW Washington and the Portland markets, currently buys no producer handler milk.
- Arland Wholesale, Walla Walla (in Eastern Washington) buys from WestFarm Foods and until recently from Country Morning in Othello, WA (the Dairilicious

brand). Since the Country Morning fire, Arland has been purchasing product from Inland Northwest Dairies

- Terry's Dairy Colville, WA (in Northeastern Washington) buys from WestFarm Foods and until the fire, they also purchased Dairilicious brand from Country Morning in Othello, WA. Since the Country Morning fire, they have been purchasing product from Inland Northwest Dairies.

Only two of our long time distributors remains primarily distributors of our products: Jim Aimonetto, and Gary White, both in Seattle.

WestFarm Foods used to supply many of the other distributors with all of their dairy products, but now we are supplying many of them with just the items they cannot purchase from others. We have lost much of the gallon and half-gallon business to Producer Handlers.

In addition to the distributor business described above, we also face Producer Handler competition for direct delivery to major retail outlets. The WestFarm Foods Oregon sales people have provided me with a list of 11 major retail stores supplied by Mallories, who shares the store dairy cases with WestFarm Foods or with one of the other "traditional" regulated bottlers in Oregon (Alpenrose Dairy in Portland or Umpqua Dairy in Roseburg). The total annual volume of these 11 stores was estimated by our area sales manager at 940,000 gallons per year (roughly 8 million pounds per year). Again, this is direct competition for the same types of accounts that we (and other "traditional" bottlers) have historically served.

Our sales people have told me that some of the Producer Handlers obtain a competitive advantage from being able to offer a less volatile price than regulated handlers whose costs must reflect the volatility of the Class I price mover. In our region, when the Federal order Class I prices are low, the producer handler wholesale price tends to be about 15 cents per gallon lower than the WestFarm Foods price. But when Class I prices rise, the difference can be as much as 45 cents per gallon. Our sales people indicated that Edaleen hardly ever raises the price to their customers. In fact, there are indications they recently went 16 months without a price change, thereby giving their customers assurance of being able to maintain a constant gallon price for many months.

One of the issues in this hearing may be how Producer Handlers balance their supply. At times, NDA supplies milk to the only bottler in Alaska, Matanuska Maid (at Anchorage). Alaska is outside any Federal Order marketing area, and so that plant is not a regulated pool plant. However, most of the other bottled milk to Alaska is supplied by pool plants regulated under the Pacific Northwest Order. We are aware that at times, when Producer Handler milk is available, Matanuska Maid purchases raw milk from Producer Handlers. In this fashion, then, excess Producer Handler milk can be pushed back onto the pool (in this case, NDA) by backing out our normal sales to Matanuska Maid.

As the above demonstrates, Producer Handlers in the Pacific Northwest market have become strong, direct competitors against our regulated WestFarm Foods bottling operations. They have hurt us in the marketplace.

We believe that this same situation was a reason for the recent demise of Vitamilk Dairy in Seattle, a small family owned business that bottled (we estimate) about 6 to 8 million pounds per month.

Like the rest of the bottlers, Vitamilk was hurt by the consolidation of the retail grocery industry, losing two of their chain customers when they were acquired by larger grocery chains who have their own bottling plants. That left Vitamilk (like WestFarm Foods) with a gradually increasing dependence on individual stores, smaller chains and independent distributors.

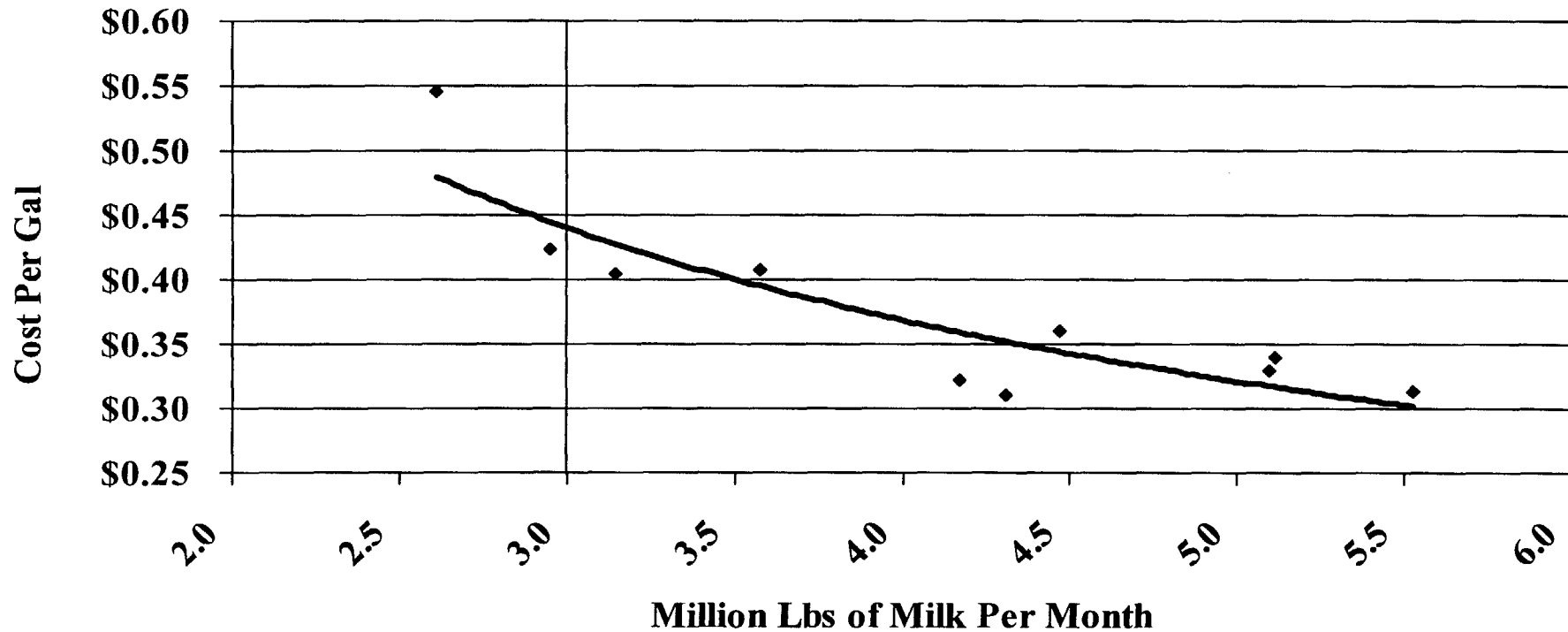
As we understand the marketplace, Vitamilk had five major distributors. In three of the five cases, Edalean supplied the gallons: Brink in Bellingham, Riverside in Burlington, and Glacier in Pt. Angeles. In a fourth case, Wilkinson Family Dairy in Central Washington, Country Morning Farms supplied their gallons. We heard many times from the owner of Vitamilk that the Producer Handlers were a major issue for them. We know from our own experience that this must have been true.

The intent of the foregoing testimony has been to demonstrate my belief that the larger Producer Handlers in the Pacific Northwest market compete successfully against regulated plants, including ours and (formerly) Vitamilk's. We believe each of the Producer Handlers mentioned (Smith Brothers, Edalean, and Mallories,) each exceeds (or is at least getting close to) the 3,000,000 per month threshold for regulation that NDA proposed in Proposal No. 1. They have an advantage, they are using it successfully, and unless Proposal No. 1 is adopted, they will inflict more harm on regulated handlers in the future.

I should add that as a supplier of raw milk, NDA feels pressure to lower our raw milk costs to WestFarm Foods and our other raw milk customers. Of course NDA has a substantial investment in the four WestFarm Foods bottling plants in the Order 124 and 135 markets, and in the end we need to ensure that they are competitive. While competition from Producer Handlers has not currently led NDA to subsidize any of our customer plants with below-order pricing, that is the likely next step if this unfair competitive situation is not resolved. Because we need Class I sales to ensure that our producers can remain pooled, it will make sense for us to subsidize the Class I market in order to fend off a significant competitive challenge from Producer handlers.

That would, of course, be the ultimate demonstration of disorderly market conditions. We urge the Secretary to adopt Proposal No. 1, so that situation does not occur.

# Plant Processing Costs Exclusive of Packaging



For confidentiality reasons, WestFarm Foods prefers not to release such details as the degree of overhead covered or capital costs. This exhibit is offered simply to show the difference in variable costs between a plant processing less than 3 million pounds per month in size, compared to the larger volumes of "regulated plants".