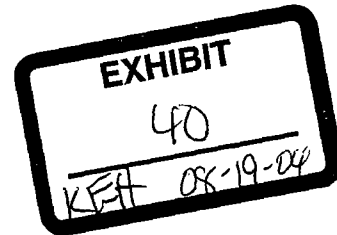


United States Department of Agriculture

Agricultural Marketing Service

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Milk in the Upper Midwest Marketing Area

(Public Hearing Minneapolis, Minnesota, August 16, 2004)

I am Neil Gulden, Director of Fluid Marketing for Associated Milk Producers Inc. (AMPI). My office address is 315 North Broadway, New Ulm, Minnesota, 56073.

My testimony is in opposition to Proposals. 2 (part 1), 3, 4 and 5. I am joined in that opposition by Alto Dairy Cooperative, Bongards' Creameries, Ellsworth Cooperative Creamery, Family Dairies USA, First District Association, Davisco Foods, Valley Queen Cheese Company and Wisconsin Cheesemakers Association.

This coalition, including 30 members of WCMA, represents 11,250, or 71.3%, of the producers on the order and 1.34 billion pounds, or 62.9 % of producer milk on the Upper

Midwest Order based upon December 2003 pool information supplied by the Market Administrator.

The option of pooling or not pooling milk delivered to a nonpool plant has been a mainstay of the federal order system and it should remain so. Class I prices have for decades been based on the value of milk used in manufactured products, plus a differential. At the insistence of fluid milk processors, regulated Class I prices are calculated and announced by USDA in advance, before the beginning of the month, based upon previous manufacturing milk values. Regulated milk prices for manufactured product uses, however, are based on current values and announced retroactively, after the marketing month has passed. This also has been true for decades. Under pricing formulas employed for decades, there is always a lag between changes in the value of milk, and changes in the advance Class I price. As a result, a sharp increase in the current value of milk for manufactured products will periodically produce a Class III (or Class IV) price that exceeds the statistical “uniform” or “blend” price, and on occasion will exceed the Class I price. This has also been true for decades. Exhibit \_\_\_-A, Federal Milk Order Market Statistics for 1989, table 12, for example, shows that considerable milk was voluntarily depooled in nine federal order markets during the latter part of 1989 because the blend price “was at or below the Class III price.” During the first half of 2004, similarly, milk in 10 of 11 federal milk markets was depooled because the blend price was below the Class III price. Exhibit \_\_\_-B.

The occasional inversion of the relationship between Class I or blend prices, and Class III (or IV) values, is caused by advance pricing for milk used in Class I and II products, at the request of fluid milk processors. As a result, regulated producer prices do not reflect the current value of milk in these products. There is good reason to reconsider whether advance pricing for Class I and II products continues to be good policy from a regulatory standpoint. Rather than look to remedy the cause of price inversion -- advance Class I pricing - or take an additional step towards letting the marketplace govern, proponents of repool limitations prefer to treat the result of price inversions: depooling. Proponent's approach further insulates the federal milk order system from marketplace realities.

The fact that the federal order pricing system periodically results in Class I prices so low that blended federal order returns are lower than Class II, III or IV prices does not make a case for punishing milk not pooled by limiting repooling. The proposals limiting repooling are a bad idea for Order 30 or on any milk marketing order. It is a particularly bad idea to consider placing depool-repool limitations in Order 30 when the 'problem' of price inversion and voluntary depooling is national in scope. A proposal addressing the same issue is pending for Order 32 (Exhibit \_\_\_\_\_ C), and Order 33 interests have also advocated a similar amendment. (Exhibit \_\_\_\_\_ D and E). Members of our coalition, and others, have responded to USDA's invitation for proposals in Order 32 with a request,

equally applicable here, that these issues should only be heard in a national hearing. Exhibit \_\_\_\_.

The federal order formula for Class III milk simply establishes a value for cheese milk based on commodity prices. The Class III price (Class IV if it is higher) has a differential value added to it to determine the Class I price. The differential value (\$1.80 in order 1030) is a legally set, artificially high, subsidized price for milk used in Class I. Cheese milk gets no such subsidy from the federal order because its prices are obtained entirely from the market place. Cheese milk receives no benefit from the federal order unless the money created by the differential value results in a blended value that is higher than the Class III price.

The Class I price is determined approximately two weeks prior to the month for which it is applicable, using the formula described above and the commodity prices at that time. At the end of the applicable month the final Class III price is set using the same formula. This results in about a six week lag between Class I and Class III prices in which the market value can rise or fall, depending on market conditions. For April 2004, the market value of Class III, during this six week period, rose \$6.02 per hundredweight, completely eclipsing the \$1.80 differential value. This caused the estimated value of the blended federal order return to be substantially less than the estimated Class III price, resulting in most Class III milk being depooled. In effect the federal order created no benefit to the

cheese maker because the market value of cheese milk was higher than the subsidized Class I and resulting federal order blended value.

Proponents of Proposals 2 and 5 contend that this Class III milk should be penalized by limiting the amount that can be pooled the following month if market conditions warrant. We disagree strongly with this radical change in historical federal order pooling philosophy.

Limiting repooling of milk forces a cheese plant to decide whether it is more cost effective to depool, to remain pooled in order to avoid future limitations or to do a combination of both. In either case, estimating federal order blended values or producer price differentials is not an exact science. Undoubtedly some milk would end up depooled when it should have been pooled and vice versa, causing losses in revenue. Cheese plants should be free to make business decisions without future months being affected by limiting repooling of milk on the federal order.

Any forced pooling of cheese milk when Class III prices are higher than the blended federal order return is simply a transfer of money from market driven cheese plant returns to other order participants, whose business leans more toward shipping a higher percentage of their milk to the Class I market. The federal order should be sharing money derived

from Class I handlers, not taking money from one group of producers (cheese milk) and using it to offset a low Class I price created by the orders' own pricing system.

Exhibit \_\_\_\_-G shows an example of what happens when the cheese values (Class III price) increase dramatically and actually overtake the Class I price during the six week time period from when the Class I price is set and the final Class III is set.

In January '04 a positive PPD was available for all producers because the Class I mover changed very little between 12/19/03, when the advance Class I price was announced, and 01/03/04, when the Class III price was announced. This created an effective differential between Class I and Class III of +\$2.04. This resulted in a return of 37¢ (PPD) from Class I revenues which should be shared with all milk pooled.

In April '04 the effective Class I differential was negative \$4.22 because of the rapidly increasing cheese market between 03/19/04 and 04/30/04. That resulted in a negative PPD of \$4.11 and caused most of the Class III milk to be depooled. That doesn't mean Class III handlers did anything wrong or took any money they weren't supposed to from the pool, in fact they took nothing from the pool. It simply means that Class I values were too low relative to Class III and the return from milk going to Class I (fluid use) was not very competitive with milk used to manufacture cheese. The point is that cheese milk should not be forced to pool or be threatened with limits on what they can pool the following

months just because the order pricing system isn't generating enough Class I money to produce a positive PPD.

Arguments that depooled milk is not serving the fluid market or is not available to the fluid market just don't hold water. First, in order to pool milk in any month, a block of milk must be shipping the federal orders' required 10% to a distributing plant or be a part of a unit of supply plants that is doing so. If milk is depooled there is no reduction in distributing plant sales because contract commitments to fluid milk plants assure a continuous supply of milk to meet their needs. Even depooled milk serves the market. The milk is available for Class I use during the month in which it is marketed. It is only depooled after the end of the month. And depooled milk is just as valuable to the market as any other milk, in terms of additional seasonal sales and balancing functions.

Depooling and negative PPD's, which prior to 1996 would have been the equivalent of the federal order blend price minus the Class III price, are not new revelations. Class III prices have been higher than the federal order blended price many times as cheese values rose faster than Class I prices. Exhibit \_\_\_\_\_-G. shows the months from 1990 through 1999 when this occurred in old federal order 1068.

Since I started working with federal orders in the early 1970's, this negative PPD effect has occasionally occurred and depooling was often the result if you estimated that the

Class III price was going to be higher than the blend price. When there was Class I revenue to share, all milk pooled received its share. Plants added this revenue to their market returns, be it cheese or fluid, and paid producers as best they could. Over this time period there have been times when cheese was a better return and times when selling to fluid customers was much better than cheese. However, we don't or can't change our business plans for short term advantages and risk losing our customer base. We all compete for producers based on how we have structured our respective businesses.

We fully recognize the competitive problems caused by the federal order Class I pricing structure. However, forcing cheese plants to subsidize the other milk in the federal order pool is the wrong way to solve this problem. The solution, if one is needed, is to price all milk on the basis of the current value of milk.

If depooling is as a big a problem as proponents say, then the timing of the Class I price might be a better place to find a solution. This would get the money out of the marketplace instead of taking it from one farmer and giving it to another.

In fact, the large negative PPD's in April and May 2004 for order 30 will have been recovered through the cooperation of several common marketing agencies, who set over-order premiums charged to distributing plants, by the end of September 2004. This is one



way to get the money out of the marketplace, but it does cause competitive problems if not adopted in surrounding federal order areas.

Proposals 3 and 4 state that if a producer loses association with the order during certain months they will not be permitted to be a producer in that month or future months depending on which month they lost association (including depooling), unless the producer ships at least ten days milk production to a distributing plant during those months.

Because these proposals affect the ability to depool milk, we oppose them based on my testimony regarding Proposals 2 (part 1) and 5. In addition, Proposals 3 and 4 make no provision for repooling (as soon as possible) milk that loses Grade A status, milk converting from B to A or milk missed because of human error. As published and modified, the proposal is not a repooling standard. There is no practical means of compliance with Dean's 'preferred' Proposal 3 (as modified) option. Dean would punish individual producers for pooling choices made by their handlers, without regard to the reasons for which a producer's milk may have been depooled. A rule that operates as an effective barrier to pool participation for a producer, as does this one, is simply a disguised means of erecting an absolute barrier. Proposals 4 and 5, as modified, also create effective barriers, but in different ways.

Creating federal order rules that force handlers to make decisions on pooling or depooling, where it's only a matter of degree which one causes more economic harm, will make federal orders less and less appealing to more and more dairy farmers. I wouldn't want to see more federal orders jeopardized because of issues that have nothing to do with sharing Class I money, as intended. This would be a tremendous set-back to dairy farmer income.

Proponents have asked the Secretary to consider and decide the proposals limiting repooling on an emergency basis. This would be entirely irrational. Price inversions and depooling have been with us for decades. It has been a factor in marketing decisions, business development decisions, and regulatory decisions for the course of those same decades. A change in regulatory policy departing as far from past agency practice as the one proposed, to treat the consequences of price volatility and Class I pricing lag that have long been a feature of the system, requires the benefit of a recommended decision, with opportunity for industry briefing and exceptions, before a change is made.

That concludes my statement.