

Statement of Elvin Hollon
Dairy Farmers of America, Inc.

I am Elvin Hollon. I am employed by Dairy Farmers of America as the Director of Fluid Marketing and Economic Analysis. My office is located at 10220 Ambassador Drive, Kansas City Missouri, 64153. I am testifying today on behalf of Dairy Farmers of America, Inc.

Dairy Farmers of America (DFA) is a member-owned Capper-Volstead cooperative of approximately 10,500 farms that produce milk in 49 states. DFA pools milk on 9 of the 10 Federal Milk Marketing Orders. The majority of DFA's farmer members have fewer than 100 cows. DFA is a supporter of Federal Milk Marketing Orders and depends on them to provide orderly marketing conditions for the marketing of its members' milk.

The issue

At issue in this hearing is in what manner the Secretary should extend the limitations on producer-handlers, as initially done in Orders 124 and 131, to the other Orders in the Federal Order system. In its December 14, 2005, final decision for the Arizona and Pacific Northwest Markets, USDA stated that,

EH
Warrant

“Review of the intent of the producer-handler provision and the marketing conditions arising from this provision in these orders could ~~warrant~~ finding that the original producer-handler exemption is no longer valid or should be limited to 150,000 pounds per month Class I route disposition limit. However, the hearing notice for this proceeding constrains such a finding to a level of not less than 3 million pounds per month of Class I route dispositions.” (70 FR 74186)

We also feel that the view as determined in the above mentioned proceeding should be further defined by:

- eliminating the producer-handler provision from all Orders (except for a special class of exempt plants);
- increasing the exempt plant definition volume limitation currently in place in Federal Orders from 150,000 pounds to 450,000 pounds;
- providing that the volume measure for the exemption be based on all route disposition, in any geographic area;
- specifying that in order to maintain the exemption a plant may package only in a unique label, or labels, not used by others;

- creating, within the subset of exempt plants, a special class of plant for those operated as producer-handlers which were in business as producer-handlers in 2008. These plants could maintain that status so long as their route disposition volume is less than 3,000,000 pounds (or a lesser number as selected by the Secretary) and subject to other business definition specifications (in the language of Proposal 26).

These definitions and other specific language are contained in Proposals 1, 2 in the Notice of Hearing proposed by the National Milk Producers Federation (NMPF) and the International Dairy Foods Association (IDFA); and Proposal 26 offered by NMPF.

DFA-Observed Market Conditions

1. Customer concerns

In many of the Orders in which we market milk, we face concerns with producer-handlers expressed both by our customers and our members. In some cases the issues are actual “current day” pricing issues where we have to consider price adjustments to meet competition from producer-handlers and in other cases the concern relate to the possibility of producer-handler activity. In my testimony, I’d like to outline some of the concerns we are dealing with currently.

As has already been testified to by other witnesses, the individual companies in the various segments of the milk marketing processing, distributing and retail sector are very knowledgeable and sophisticated. The dairy industry has a very transparent pricing mechanism. Federal Order regulations are publicly available and come with a ready made free tutor in the form of the Market Administrator office staff who are available to explain and interpret the Orders for interested parties.

Since the decision modifying the producer-handler-provisions in the Arizona / Pacific Northwest Orders, I have had conversations with many DFA fluid milk processing customers about producer-handler regulation and marketing. Several of our largest customers have inquired about competitive factors in their markets or of the status of producer-handler regulation. When many DFA customers bring a similar concern to us, it becomes an issue which we must investigate and work to address. This issue is not a “what if” issue any more; it is a day to day business concern. It is either happening to a customer’s current market or the customer is concerned it will happen in the immediate future.

2. Expansion of large farms and their potential impact

One of the specific concerns I hear frequently is how many large farms could become a producer-handler. The industry understands that it is much less costly to add a plant to an existing farm to become a producer-handler than it is to add a large farm to an existing plant. This point was well developed by Mr. Wilcox.

The concern with the actual availability of large farms is borne out by the USDA/NASS Census of Agriculture for 2007 which was released February 4, 2009. (www.agcensus.usda.gov) The Census contains a detailed profile of the 57,318 U.S. dairy farms identified as primarily involved in "Dairy cattle and milk production". The summary of farms by herd size notes that there are 3,259 farms with more than 500 cows in the United States. Every state has at least one farm in this size bracket except Alaska and Rhode Island and every Federal Order has a significant number of large farms. Eight states - California, Idaho, Michigan, New Mexico, New York, Texas, Washington and Wisconsin - have over 100 farms each in this size bracket. Clearly, there are a substantial number of large farms that have the potential to be producer-handlers. This gives credence to the concern that the number of large producer-handlers could easily grow if the regulatory cloud that now exists over the longevity of the producer-handler exemption is cleared up.

A second example comes from Order 33 where DFA recently developed data for a plant expansion project. In Michigan we found that there were 115 farms with milk production of more than 1,000,000 pounds per month. The 115 farms averaged 2.7 million pounds per month. This documents the fact that there exist a number of farms in Order 33 that have the potential to become large producer-handlers.

A large producer-handler easily has the potential to become a producer price issue within Order 30. In Wisconsin, where the Ag Census showed 272 farms with over 500 cows in their herd, it has already been testified to that a dairy has been permitted for a herd of 8,000 cows. Based on the following data:

1. 2008 NASS / Wisconsin average production per cow - 19,546 pounds;
2. $(19,546 / 12) * 8,000 = 13,030,667$ per month - projected milk production from this farm;
3. 2008 average monthly Class I pounds in Order 30 = 373,860,393;
4. The 8,000 cow farm, as a producer-handler and assuming a 90% Class I use in a distributing plant, would result in 11,267,600 pounds of Class I use at the producer-handler facility and would account for 3% of an average month's Class I use in Order 30.
5. The 11,267,600 pounds would represent the Class I pounds of 490 average sized Order 30 farms.
 - 2008 average daily production per farm in Order 30 - 4,951 pounds;

- 2008 Order 30 average Class I use - 15.9%;
- $(4,951 * 30.5 \text{ days per month}) * 15.9\% = 23,934$ pounds of Class I use per farm per month;
- $11,267,600 \text{ pounds of} / 23,934 \text{ pounds per farm} = 490$ farms;

The largest Order 30 pool in terms of total milk pooled in the last 12 months was the January 2009 pool with 2,750,570,460 pounds. Six farms at the 8,000 cow limit could begin to affect the volume of milk that could be pooled in the Order even given the 90% diversion limit in Order 30. Also with the smaller percentage of Class I use in Order 30 the impact on the blend price of large producer-handlers absorbing Class I volume will be felt sooner than in Orders with a higher Class I use. Many farms, especially the smaller ones depend on the Order for price stability and without correcting the problems we see with large producer-handlers the level of price stability could erode.

3. Current Marketplace Issues

A. Order 32

In Order 32 the large farm producer-handler model has been shown to be effective as noted by the rapid growth of Heartland Dairy. According to its web site, Heartland Dairy started production on April 7, 1997 and experienced unprecedented growth from its original 20 cows to more than 3,000 cows at the end of 1998. Only four months after its launch, it became the largest dairy in the state. Currently the Dairy has about 4,500 cows milking, with several thousand more cows in the fields. They began processing milk in April 2005. (www.sharpeholdingsinc.com)

This farm has become a factor in the local marketplace. We have received questions about price level from several customers who compete with Heartland Dairy and all indicate the milk price they face is very difficult to compete with. In one retail store that I am familiar with - the Hy Vee Food Store chain -- gallons of milk from Heartland Dairy appeared in the dairy case about a year ago. As is the general practice in this store, Hy Vee had marketed three labels in this main dairy case section for many years prior. Since its inclusion in Hy Vee, the Heartland label has always been the lowest priced brand and occasionally by a price greater than the spread between the two lower priced labels and the premium brand. There is no other competitive factor noted in the dairy case other than price. Also noted on the Heartland Dairy web site, their distribution ranges across four states and to more than 100 retail locations - including nearly 100 Hy Vee Food Stores, a major Midwest regional chain.

B. Order 33

The producer-handler model is also proving to be effective in Order 33 where Country Dairy has a growing business. Detailed competitive issues relating to Country Dairy were outlined by Mr. Wernet of Bareman Dairy. I want to again point out the widespread distribution network of Country Dairy. Based on data from their website there are 10 pages listing retail locations for their product in cities throughout Michigan.

C. Order 126

In Order 126 several of the competitive issues with GH Dairy were noted by Mr. Carrejo, from Dean Foods, who outlined potential plant capacities and distribution areas in his testimony. Mr. Traweek noted price issues faced by milk suppliers in dealing with this same processor. We have had many inquiries from customers relative to pricing issues with GH Dairy. Initially the marketplace was unsure whether this facility would be a fully regulated plant or a producer-handler. It appears the plant will operate as a producer-handler. Mr. Carrejo testified to many details about the nature of price competition in the marketplace. At the cooperative level I can say that we have made price concessions that have eliminated much of the premium structure within the western markets in Order 126 and discounted premiums by as much as \$1.00 per hundredweight in other markets within the Order. I asked our marketing / analyst group in the Southwest Area to calculate the impact on a typical month's revenue relative to competitive issues with GH Dairy being a producer-handler. They were able to compute that effect as \$0.20 per hundredweight on all milk in the producer pool.

Mr. Carrejo testified to competitive issues basically ranging from El Paso County Texas westward to the New Mexico border. We have documented sales presence eastward into Texas with product (verified by product code 48 1034 (The IMS code for GH Dairy as noted in the FDA publication located at <https://info1.cfsan.fda.gov/milk/mkex/ims/imsss-sw.cfm>) in the Dallas Ft Worth area at 99 Cents Only stores. 99¢ Only Stores is a unique deep-discount retailer of primarily name-brand consumable general merchandise. <http://www.99only.com/about/index.htm>) Again, this demonstrates that large volume producer-handlers are not small scale, limited sales outlet, small market impact processors. Other DFA Texas - New Mexico fluid processing customers have expressed concerns to us about competitive factors relating to GH Dairy.

D. Other Orders

Braum's Dairy testified to having retail locations in Order 32, Order 126 and Order 7 with 275 stores in Texas, Oklahoma, Kansas, Arkansas, and Missouri. Their web page lists store locations. It seems clear that the producer-handler model is successful for Braum's Dairy and they compete aggressively for dairy product sales in a very wide geographic area with many retail grocery businesses in the region.

Aurora Dairy in Colorado processes organic milk from a milking herd of 15,000 cows and distributes its fluid milk customers from coast to coast in direct competition with three fully regulated national distributors of organic fluid milk products. If Aurora Dairy were to become a fully regulated distributing plant on Order 32, we estimate they would contribute more than 15 million pounds per month of Class I volume.

Labeling Limitations

The language proposed by NMPF / IDFA that deals with the labeling limitation is a key component of the set of proposals. Without it, the essence of the size limitations proposed to solve the marketing issues as raised will be greatly debilitated. There would be a very real incentive for an integrator to daisy-chain a group of producer-handlers in order to process the same label for the same store chain. Mr. Wilcox has already testified to being "recruited" to be a producer-handler, and several existing producer-handlers have already testified to processing private labels as a part of their current distribution system. We are aware of one such integrator scheme having been discussed in Federal Order 5. This constraint will in no way prohibit a producer-handler from producing multiple labels - as long as they are not duplicated by any other processor. Several producer-handlers testifying so far have lauded the personal benefits of promoting their own brand and the loyalty of their consumers for their brand. The language we support will not minimize that effect in any way. If the benefit of providing non-unique labels to the marketplace proves lucrative enough, any producer-handler can give up his exemption and pursue that opportunity. We request that the Secretary address this issue now by including this language in any final rule, and avoiding the need to address the problem in the future with another costly and lengthy Hearing. We intend to rely on the Market Administrator to apply this regulation so that the objective of foreclosing the integrator model is met. The burden of proving compliance will ultimately fall to the producer-handler.

The Secretary may decide to propose additional constraints to define the packaging and distribution relationships to meet this standard. We would support a more stringent standard should the Secretary define and find for one.

Other Provisions of the Proposal

1. Route sales definition. It is important that the language defining the measure of route sales apply to all the sales of a producer-handler or exempt plant and not only the sales in an individual marketing area. To allow the route sales volume measure to only be in a marketing area will give too much latitude to a plant with sales patterns purposefully subdivided into differing Order marketing areas and unregulated areas in order to avoid regulation. There are areas of the country where this is a real possibility. A single aggregate sales standard will also simplify audit and enforcement of producer-handler status.
2. Elimination of the producer-handler category. We support the complete elimination of the producer-handler limitation (except for the inclusion of a special class for grandfathering 2008 producer-handlers) and the selection of 450,000 pounds as the proper size limitation for the newly defined exempt plant status. The elimination of the producer-handler definition will clearly define the policy intention of the Secretary - to eliminate the special class of producer-handler -- and will greatly simplify the future enforcement activities of the Market Administrator for this section of the Order. Additionally it will reduce or eliminate the need to entertain future modifications to producer-handler language. Many of the supporting reasons for the 450,000 pound limit were outlined by Dr. Cryan. I would note that Exhibit 14 makes clear that many producer-handlers have maintained their businesses within the 150,000 pound limit and the proposal to triple the size exemption would allow for many of these operations to have a reasonable path to expand if they choose. Furthermore, this level will provide an opportunity to test this marketing concept for the majority of dairy farmers; and if they are successful and wish to grow their business beyond this level, then they can be regulated the same as any other handler. Exhibit 13 makes it clear that all current producer-handlers and exempt plants have been very able to meet all the requirements to maintain their regulatory status. There were only two months of the five years detailed in this exhibit that a producer-handler "missed" the exemption status of being either a producer-handler or an exempt plant.
3. Preserving status of some current plants. For those above the proposed 450,000 pound limit but under the 3,000,000 size level the proposed grandfathering provisions will give their businesses the same status as it has currently. This language creates a unique class of exempt plants that are defined by size and business history. For those that meet the size limitations and were in business as a producer-handler in 2008, as

demonstrated by their historical monthly Market Administrator filings, they may elect to retain their producer-handler status. We note that the language does give the Secretary the option to choose a lesser volume for the size limitation and that several have been proposed and testified to here.

Comments on Other Proposals

1. Individual Handler Pools

We oppose proposal 25 which would establish individual handler pools within Federal Orders. We see no way that individual handler pooling proposals are compatible with the basic tenets of minimum Order prices for both producers and handlers. This view was substantiated in the Federal Order Reform process when the concept was completely eliminated from Orders. That Decision noted that the individual handler provisions in the only remaining individual handler pool that was functioning before Reform, the Michigan Upper Peninsula Order, would not be carried forward to any future reformed Order. In an individual handler pool, producers do not receive the same Federal Order announced blend price in similarly situated areas. Additionally, an individual handler pool would place considerable market power in the hands only a few handlers - those who operate Class I processing plants. They would have increased ability to pit suppliers against one another for the opportunity to supply the higher valued Class I market. This was the exact type of behavior that led to the institution of market-wide pooling provisions. It would not be beneficial to return to that type of pooling mechanism.

2. Partially regulated distributing plants.

Proposal 23 suggests that producer-handlers be treated as partially regulated distributing plants. We oppose this proposal. Partially regulated handler status should not be granted by fiat. A producer-handler can be treated like a partially regulated handler if it meets the requirements as currently outlined. If any distributing plant does not have more than 25% of its route disposition in any single Federal Order it is then regulated as a partially regulated handler. A producer-handler, today, who becomes a regulated pool distributing plant as a result of this Hearing, could have partially regulated status if its distribution meets the standard.

3. "Soft cap" proposals

Finally, there are proposals which suggest that a "soft cap" pricing proposal might be appropriate for producer-handlers. A "soft cap" means that the regulated price would be waived on a portion of the milk used by that handler. We would oppose any provisions that would institute a "soft cap" in any way. With a

soft cap, market buyers of milk would never have a clear reading of the Order minimum price. Milk purchasers would always think one (or many) of their direct competitors was benefitting from the price waiver of the “soft cap”. Milk suppliers would continually be forced to respond to that possibility and would likely have far more concerns expressed about competitive volumes needing attention than the quantity of “soft cap milk supplies” that actually exist.

The Need for a Proactive Response by the Secretary

Based on prior hearing deliberations and the ongoing one here, the issue of producer-handler regulation is a difficult one for the Secretary of Agriculture and the Order system. Order hearings deal with change and there are always divergent opinions with regard to change. In order to deal with the issues raised in this hearing the Secretary will need to act in a proactive way. Often times, that seems difficult for regulatory authorities to do. We’d ask the Secretary to take note of the following:

- 1) The Secretary has indicated that large producer-handlers can be disruptive to federal Order markets.
- 2) He has questioned whether the producer-handler exemption is still valid and that if it is to be retained, should perhaps be no more than 150,000 pounds per month of Class I route distribution.
- 3) The largest processor and the largest producer organizations think the changes they have proposed are important to the dairy industry. It is unusual that both of these organizations take a similar position on marketing issues so that should alert the Secretary that the issue being addressed is of high importance to most of the dairy industry.
- 4) We note that minimum and uniform pricing issues for producers and handlers, market-wide pooling and concerns over the viability of Orders are being discussed here. These are very key components of all Orders and should be critically examined by the Secretary.
- 5) Producers from every Order either directly or through their cooperatives or trade associations have expressed their concerns that producer-handler regulation needs to be modified.
- 6) Fluid milk processors from every Order either directly or through their trade associations have expressed their concerns that producer-handler regulation needs to be modified.
- 7) The 2007 Census of Agriculture provides data that support the contention that farms, large enough to be a disruptive producer-handler - more than 500 cows, exist in 48 out of 50 states

with eight states having over 100 farms each with greater than 500 cows. These farms have the potential to become producer-handlers so the possibility of an even greater impact is more than just theoretically possible.

8) Changes to producer-handler regulation have proceeded in an evolutionary manner. This proposal is another incremental step and it should be as forward-looking as possible.

9) Most of the proposals that have been offered at this hearing detail some limitation to the size of producer-handlers. This should indicate to the Secretary that there is broad industry consensus that some limitation should be instituted.

10) The combination of these facts should be reason for the Secretary to be proactive in reviewing these proposals.

Summary

In summary DFA supports proposals 1, 2 and 26. We feel that these proposals will add stability to the Order system. These three proposals will help assure milk purchasers that their competitors pay Order minimum prices and that producers share more equally in the proceeds of the pool. We note that producer-handlers who may become regulated as a result of this process will be in the exact same position with regard to their farm as any other producer in the Order; they will share in the same minimum blend price. A producer-handler who may become regulated as a result of this process will be in the exact same position with regard to their plant as any other plant operator in the Order; they will pay the same minimum class prices for milk.

This record confirms the concerns of regulated handlers that producer-handlers do not pay the difference between the Class I price and the blend price and as such have different minimum prices than other similarly situated handlers with which they compete. And of equal importance, that the large producer-handlers are not minimal competitors in the marketplace and have wide spread product distribution within many Orders, in many cases in multiple states and in some cases multiple Orders. They are active competitors in the marketplace and should draw the attention of the Secretary.

We also note that this proceeding is being held under the revised rules of practice as set about by the Farm Bill. The dairy industry is well aware of these new rules and that they call for strict timelines for briefs from the Hearing participants and timelines for the Dairy Programs staff and the Secretary to act on the Hearing record. We look forward to complying with the rules and seeing the results from the Hearing in the timely manner prescribed by the rules.