BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE AGRICULTURAL MARKETING SERVICE

In the Matter of Milk in California; Notice of Hearing on a Proposal to Establish a Federal Milk Marketing Order

7 CFR Part 1051

Docket No.: AO-15-0071;

AMS-DA-14-0095

Clovis, California, September 22, 2015

Testimony of Elvin Hollon
(Second statement)

In Support of Proposal 1 of California Dairies, Inc.,

Dairy Farmers of America, Inc., and Land O'Lakes, Inc.

Proposal to Establish a Federal Milk Marketing Order for the

State of California

Cooperatives' Exhibit 5

My testimony today concerns the pooling provisions contained in the cooperatives' proposal, Proposal One. It will explain those pooling provisions, demonstrate how they operate, and indicate why the Cooperatives believe these provisions are both proper and necessary for inclusion in a California Federal Milk Marketing Order ("FMMO"). Our proposal is designed to address the wide disparity in producer and handler prices that we have identified in previous testimony and exhibits and to restore equity and fairness to both producers and handlers.

I. Designing a Proposal Which Addresses the California Marketplace.

In order to design the proper pooling provisions, we start our analysis with estimated historical pool blends using the California State Order ("CSO") Class utilizations and prices and FMMO prices.

A. Methodology for Blend Price Estimation

We have converted the published price and use data into estimated producer blend prices for the period January 2000 to July 2015, using the following methodology.

1. We used prices as published by the FMMO.

a. Cooperatives' Table 5.A (6 pgs.), "Announced Class Prices FMMO and CSO 2000 to July 2015" recaps the FMMO Class I Mover prices, a population weighted Class I differential for California and the Class II / IIII / IV prices used in this process.

b. We used CSO published Class usage (total solids basis) for each monthly estimated blend price calculation. (Cooperatives' Table 5.C.)

c. We constructed a weighted average statewide Class I differential of $1.92 per hundredweight by using each county's population as a percentage of the total state population, multiplying each county weighting times that county's differential and then summing the total weightings of per hundredweight values for the state. We also computed the weightings

for both the CSO Northern pricing zone and the Southern pricing zone. The detail of this calculation is outlined in Cooperatives' Table 5.B (2 pgs.), "Calculation of Population Weighted Average FMMO Class I Differential, California Marketing Area, 2015."

d. An estimated FMMO blend price was calculated by multiplying each Class price by its CSO Class Use percentage. This is shown in Cooperatives' Table 5.C "Blend Price Estimate Calculation Using CSO Utilization Rates (Total Solids) and CSO and FMMO Class Prices 2000 – July 2015."

2. We used prices as published by the CSO.

a. We used Class 1, Class 2 and Class 3 for Northern and Southern California and Class 4a and Class 4b prices. (Cooperatives' Table 5.A)

b. We used CSO published Class usage (total solids basis) for each monthly estimated blend price calculation. (Cooperatives' Table 5.C)

c. We used the population data to weight the Class 1, 2 and 3 uses by the two California pricing zones. (Cooperatives' Table 5.B)

d. The weighted average result was 52% for Southern California and 48% for Northern California. (Cooperatives' Table 5.B)

e. An estimated CSO blend price was calculated by multiplying each Class price by its Class Use percentage. (Cooperatives' Table 5.C)

B. Results of Blend Price Estimates

Cooperatives' Table 5.C (6 pgs.), "Blend Price Estimate Calculation Using CSO Utilization Rates (Total Solids) and CSO and FMMO Class Prices 2000 – July 2015," displays the results of the estimated blend prices that result from the price multiplied by utilization process.

I want to highlight the data in several columns. Column H is the result of using CSO pricing and the Utilization rates and Column I is the FMMO based. Column J is the monthly change in value defined by subtracting the CSO price from the FMMO price.

These calculations are "top line" prices with no deductions for any reason applied to either the CSO blend price or the FMMO blend price.

Note that the Class I (Column C) use averages 15.2% for the entire 2000 – July 2015 period and in recent months it has fallen to near 12%. Class II use (combine CSO Class 2 and 3 - Columns D and E) averaged 8.69%; below the 12% average for all FMMOs. So the higher price use Classes represent a small proportion of the total pool usage.

There is a calculation for each month. Our summary calculations show that the 2000 – July 2015 blend price using CSO pricing (Column H) results in a $14.65 per hundredweight blend price and a FMMO blend price (Column I) estimate of $15.22. The average difference (FMMO less CSO) is an increase in the producer price of $0.57 per hundredweight – Column J. We have provided summary totals for ten periods on this table; including annual summaries for each year 2010 – 2014 and a year to date summary through July 2015. The CSO estimated blend price has always been lower that the proposed FMMO price for each period measured.

These differences are not trivial. For the period August 2012 to July 2015, a period of much higher than average whey prices, the average difference between the estimated blend prices resulting from the use / price calculation of the two systems is $1.02 per hundredweight. The peak monthly difference for this period occurred in May 2014 at $1.58 per hundredweight. As whey prices have declined, the differences have narrowed and year to date through July 2015 the spread has been ~~$0.88~~ $0.86.

Of these 36 months, there were no times that the CSO estimated blend prices were above the FMMO estimated prices. Every month, the difference was more than 25 cents per hundredweight, 35 times more than 50 cents per hundredweight and 17 - half the period observations, the difference was more than $1.00 per hundredweight.

Based on the estimated blend prices calculated, a California FMMO will bring California milk prices into alignment with the national grid as they will be computed using similar product price formulas, announced based on the same timing sequence, derived from the same underlying national commodity prices, and computed on methods similar to all other FMMOs. In order to achieve these blend prices, the proposed California FMMO's pooling provisions must include all of the Class price values.

C. Impact of the Quota program on Blend Prices

The California FMMO must recognize the integration of the state's quota program. Based on calendar year 2015 calculations, the payments to quota holders will reduce monies available to pay through the marketwide pool by approximately 37 cents per hundredweight each month. The proposed California FMMO presents a combination of low utilization in the higher use classes and the presence of the California quota system. No other FMMO has this combination of marketing factors.

In order to grasp the monetary impact of the quota and other marketing programs on the proposed California FMMO blend price we will first review historical CSO pool and price results.

Cooperatives' Table 5.D (6 pgs.) "Comparison CSO Announced Class 4a, 4b and Overbase Price 2000 – July 2015." The overbase price is comparable to the FMMO blend price. Columns C, D and E are the CSO Class 4a, 4b and overbase price as announced each month

from 2000 to July 2015. Of the 187 months of published data, the overbase price is greater than both the 4a and 4b price only 17 times or 9 percent of the time.

Of the 91 percent of the months in which the overbase is lower than either 4a or 4b, that is 171 observations, 78 times Class 4b is higher than the overbase price and 92 times 4a is higher than the overbase price. Absent California's current strict pooling requirements, significant volumes of milk would exit the pool an estimated 91 percent of the time, resulting in different minimum prices to producers depending on which Class was higher.

When the overbase price (or in the FMMO, the blend price) is greater than the manufacturing prices the manufacturing milk will benefit from being pooled. That is, it draws monies from the blend pool to meet producer payment obligations. If the manufacturing class price is higher than the blend price the incentive is to exit the pool, if that is an option, and retain the gained value. This situation creates unequal minimum prices among handlers. The exited use class would be able to pay a higher standardized blend price than the milk remaining in the pool and the prices paid to similarly situated producers would not be uniform. Because of the likely frequency of depooling, and the attendant negative impact on marketing conditions, our proposed pooling provisions are the only solution.

There is a common misconception that in FMMOs milk is depooled to clear the market of distressed milk when prices are low. That is never true. If possible, a handler will always try to pool distressed or lowest price milk in order to obtain the pool draw. Milk is depooled in FMMO markets due to the loss of Grade A status or the failure of meeting some level of performance standards or to retain the higher class value when the manufacturing class value is greater than the estimated blend price.

D. Pooling incentives and disincentives

To further define what pooling provisions are required for the proposed California FMMO we evaluated the incentives to pool milk by analyzing the differences between the calculated blend prices as show in Cooperatives' Table 5.E (8 pgs.) "Blend Price Estimate Calculation Using CSO Utilization Rates (Total Solids) and CSO and FMMO Class Prices 2000 - July 2015, Columns ~~L, M, and N~~ K, L, and M Adjusted for Quota Premium Payment (estimated 37 cents/cwt) and the Transportation Allowance (estimated 9 cents/cwt), and the RQA Adjustor (estimated at 3 cents / cwt)."

Looking to Table 5.E we can evaluate the expected incentive to pool or not pool milk for the manufacturing classes in the California FMMO pool by looking at Columns K, L, and M which compare the blend prices to the Class II, III, and IV prices.

Column C is the FMMO estimated blend price obtained by multiplying the FMMO Class price times the Class utilization from Cooperatives' Table 5.C.1-6. Columns E, F, and G are the FMMO Class prices for Class II, III and IV. Columns K, L and M represent the estimated blend price less an average 37 cents per hundredweight estimated cost to pay for the quota premium (Column H) and less nine cents per hundredweight estimated cost to pay for the transportation pool (Column I) and adding back three cents per hundredweight for the value of the RQAs (Column J). Thirty-seven (37) cents per hundredweight represents the average cost to fund the quota premium for the first seven months of 2015, and nine cents the cost of the transportation allowance system. Three cents per hundredweight is added back to the pool to reflect the contribution of the RQAs. A negative difference in the table indicates that if allowed, the Class would choose not to pool.

As shown on page 8 of Cooperatives' Table 5.E, for the 187 months from January 2000 to July 2015 130 months or 70% of the time Class II would choose not to pool. In 111 months or 59% of the time Class III would choose not to pool and in 80 months or 43% of the time Class IV would choose not to pool.

Looking to the 36 month period from August 2012 to July 2015, the number and percentages of the times that a particular use Class would choose to depool are shown. In 24 of the 36 months (67% of the time) Class II would choose not to pool; in 19 of the 36 months (53% of the time) Class III would choose not to pool; and in 17 of the 36 months (47% of the time) Class IV would choose not to pool. Over the entire period 34 of the 36 months (94% of the time) either Class III or Class IV would choose to be out of the monthly pool.

The Class 4a / IV utilization for the 36 month period was 33% and the Class 4b / III utilization was 46 percent. Thus, there would be significant volumes of milk (one or the other class) choosing to exit the pool 94% of the time (34 out of 36 months). The result of this constant in and out decision making would make producer milk pricing very unstable and the goal of uniform minimum prices to producers unlikely.

Additionally, without the proposed pooling provisions and with the high frequency of incentives for Class III and IV to be out of the pool, the situation is prime for gaming the pool by creating a permanent "non-pool class of producers." In the milk dense counties of the Marketing Area there are significant volumes of producer milk produced on farms with nearly identical delivery cost to Class III and Class IV plant(s) owned by the same handler (or perhaps a pair of different handlers.) With little or no additional cost, these handlers could designate a block of producer milk to deliver to whichever plant / use Class that was incented not to pool each month and switch that block back and forth depending on the price relationships. This would be

relatively easy to arrange and for the pooling handler the financially correct marketing decision. Handlers without the easy ability to game would likely seek some type of arrangement with a second handler to create a gaming situation to gain a portion of the incentive monies though likely at a lesser rate, as they may have to share a portion of the gain.

The Mid-Western Orders provisions that establish pooling limits based on prior month pooling volumes would not in any way prevent this "gaming" scenario from occurring because this milk would never seek to return to the pool.

E. Necessary Pooling Provisions

The combination of low FMMO Class I and II use, the very high and near equal volumes of Class III and IV use and the unique presence of the Quota system combine for a very different marketing condition that calls for specific and unique solutions. In order to accumulate and retain all the revenues necessary to provide for the blend prices proposed and to create an orderly milk market, this proposal requires that all milk delivered to plants located in the Marketing Area from farms located in California must be pooled each month. Without the proposed pooling provisions the incentives to depool will be so great as to render blend prices unstable at best. Month to month producer milk pricing would have significant variation as the majority of months either Class III or Class IV would elect to depool and then repool in a subsequent month. Producer prices would vary depending on the volatility of class pricing and reduce the desired benefits of marketwide pooling tremendously. The ability to forecast prices would be extremely difficult and impact business planning for producers, processors, lenders and those desiring an improved risk management strategy. Unstable market conditions would prevail.

II. Proposed Pooling Compared to Other Orders: The Commonality and Uniqueness of Pooling Provisions in FMMOs.

The FMMO system has shown that it is capable of creative, innovative and necessary solutions to unique and changing marketing conditions over time, in different regions of the country and at the system-wide level when necessary. The proposed pooling provisions will make the California FMMO different from any existing Order but they are necessary in order for the California FMMO to operate in an orderly manner.

Pooling standards are common and necessary in all Orders but they differ in their exact specifications in each Order as they establish the terms of trade necessary to fit the unique marketing characteristics of a given marketplace. For example, the Southeastern Orders have a high number of touch base days per month while the Upper Midwest Order has "once per ever," so long as the farm does not get pooled on another Order. Several Orders prevent pooling a diversion of a producer's milk "until" that producer has "touched base" while other Orders prevent pooling a diversion "unless" there has been a touch base delivery. The result of this language is very different for the pooling handler. The Northeast, Central, Mideast and Upper Midwest Orders have special pooling provisions which apply solely to milk supplies located outside the marketing area.

While the pooling terms of each Order stand on their own and are developed to meet the needs of the particular Order, there is consensus in the industry that completely unrestrained depooling destabilizes the marketplace, is not orderly and should not be allowed. So, the question becomes, what are the correct provisions for the particular Order? For the proposed California FMMO, the answer is the pooling provisions we have proposed. Limitations on depooling currently vary from Order to Order in the system. All Orders have addressed the issue

of proper pooling provisions and have crafted provisions that were proposed, heard and accepted for those Orders.

Some examples of those would include dairy-farmer-for-other-markets provisions in Orders 1, 124 and 131 as well as the state unit pooling provisions of Order 1. Orders 30, 32 and 33 have percentages limiting the amount of milk that can be pooled in any given month to a percentage of the milk pooled in the previous month. Additionally these same Orders have provisions (different from all the other Orders) that further govern the ability of an out of area plant to pool milk by requiring the deliveries for the qualifying volumes associated with that plant be delivered directly from the supply plant attempting to qualify producer milk and not allow any 1000 (9) (c) diversions to be included in the calculations qualifying the plant. Order 124 chose instead of the percentage limitation provision to increase the touch base days for regaining pool status for a ~~producers~~ producer whose milk was depooled.

While some of these provisions are rooted in market conditions that predate the FMMO Reform process, the provisions for percentage limitations and not allowing (9) (c) diversions to assist in qualifying a plant were "new" and "unprecedented" in the system of post-Reform Orders. In a similar vein, the pooling provisions proposed here are necessary in order for the California FMMO to function properly and should in no way be dismissed simply because they are new or unusual.

III. Order Language Which Fits California Marketing Conditions Pool Plant, Producer and Producer Milk Provisions

A. Section 1051.7 – Pool plants

The specific language necessary to define the pool plant definitions is found in Section 1051.7 ~~1151.7~~ (a) through (f), titled "Pool Plant." These provisions define which plants are regulated in the proposed California FMMO. Pool plants serve different functions. All serve to process milk

from producers who will share in the marketwide pool and thus generate revenues to be shared by producers. These plants are involved in the production of Class I and fluid associated products and also are plants that produce Class II, Class III and IV products.

Some plants may provide a mix of uses and also serve to balance the needs of other plants across all the Class uses in the market. As plants become more specialized and process larger volumes, the need to have plant capacity dedicated in whole or in part to balancing all sectors of the market becomes more common and necessary.

Our proposal pools all Grade A milk delivered to a plant in the marketing area and produced on a farm located in the marketing area. The inclusion of performance standards for in area milk found in many Orders, such as touch-base requirements, free ride periods or diversion limits is not needed. With limited exception, all Grade A milk produced in the marketing area is pooled no matter to which type of plant it delivers.

In addition there are provisions that provide for milk delivered from outside the marketing area to be pooled. Further, milk from outside the marketing area may be associated with the pool even if not delivered to the marketing area if such milk is substantially related to deliveries to §1051 (7) (a) and (b) plants.

> *§ 1051.7 Pool Plant.*
> *Pool plant means a plant as specified in paragraphs (a) through (d) of this section, but excluding a plant specified in paragraph (f) of this section. The pooling standards described in paragraphs (d) of this section are subject to modification pursuant to paragraph (e) of this section:*
>
> *(a) A distributing plant, other than a plant qualified as a pool plant pursuant to paragraph (b) of this Section or Section ----.7(b) of any other Federal milk order, from which during the month 25 percent or more of the total quantity of fluid milk products physically received at the plant (excluding concentrated milk received from another plant by agreement for other than Class I use) are disposed of as route disposition or are transferred in the form of*

packaged fluid milk products to other distributing plants. At least 25 percent of such route disposition and transfers must be to outlets in the marketing area.

This language outlines how a plant becomes qualified as a pool distributing plant. The proposal requires that, "during the month 25 percent or more of the total quantity of fluid milk products physically received at the plant (excluding concentrated milk received from another plant by agreement for other than Class I use) are disposed of as route disposition or are transferred in the form of packaged fluid milk products to other distributing plants." Proponents consider the 25 percent packaged fluid milk standard to be reasonable for this market. Of the plants meeting this standard, if at least 25 percent of the deliveries are made in the marketing area, the plant will be a pool distributing plant in the California FMMO. This standard should be sufficient to pool plants with a significant distribution presence in the marketing area but will not capture plants that do not have significant sales in the marketing area.

(b) Any distributing plant located in the marketing area which during the month processed at least 15 percent of the total quantity of fluid milk products physically received at the plant (excluding concentrated milk received from another plant by agreement for other than Class I use) into ultra-pasteurized or aseptically-processed fluid milk products.

This language serves to lock a plant located in the marketing area that processes at least 15% percent of the total quantity of fluid milk products physically received at the plant (excluding concentrated milk received from another plant by agreement for other than Class I use) ultra-pasteurized or aseptically-processed fluid milk products. These types of plants generally have much more diverse distribution patterns due to the extended shelf life of the product. It is not uncommon for these types of plants to have significant production for a specific geographic distribution in one month and then have much less (to none) for the next month. It is difficult to supply plants with this type of production / distribution as the FMMO

blend price may change depending on the area (or Order) in which the plant may become regulated and the milk supplier would be faced with the unforeseen consequence of a lower minimum price for milk or the buyer a higher price than expected. Additionally, California's proximity to the Pacific Rim export markets makes it more likely to have business in those markets and perhaps a greater need for this provision to have a reasonable standard and a consistent raw materials cost.

> *c. A plant that is located in the marketing area which during the month receives milk from a producer located in the marketing area.*

insert on back

This provision provides that all other plants located in the marketing area that receive milk from a producer located in the marketing area be pooled. There is no allowance for this type of plant not to pool all the milk it receives. This is the key provision to provide for orderly marketing of milk in the proposed California FMMO. With this provision the operation of the California FMMO will be more orderly[1].

Notes on back

c(1)

> *~~d~~. A plant located in Churchill county Nevada* ***~~that~~ which during the month*** *receives milk from* ***producer(s)*** *in Churchill County or in the marketing area.*

insert on back　　located

This provision allows for the deliveries to a plant located in Churchill County, Nevada to also be fully pooled on the California FMMO by receiving milk from producers located in the marketing area and/or from Churchill County. Any milk delivered to this plant will be pooled and paid the announced California FMMO producer prices. The producers in this Nevada milkshed have been affiliated with the California market for many years and still ship milk to a distributing plant that has distribution in the proposed marketing area. Any milk pooled would be subject to the full pooling provisions as called for in section 7 (c).

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[1] The presence of underline and **bold** indicates a proposed language modification from the Hearing Notice.

or from a cooperative marketing the milk of a producer located in the marketing area pursuant to § 1051.9(c).

or from a cooperative marketing the milk of a producer located in the marketing area or in Churchill County pursuant to § 1051.9(c).

(d)

(~~e~~) A supply plant located outside the marketing area (except a plant subject to (7)(c)(1)) from which the quantity of bulk fluid milk products shipped to (and physically unloaded into) plants described in paragraph (a) and (b) of this section is not less than 50 percent of the Grade A milk received from dairy ***farmers*** *and handlers described in §1000.9(c), including milk diverted pursuant to §1051.13, subject to the following conditions:*

(1) If milk is delivered directly from producers' farms that are located outside of the marketing area such producers must be grouped by state into reporting units and each reporting unit must independently meet the shipping requirements of this paragraph; and

(2) Concentrated milk transferred from the supply plant located outside the marketing area to a distributing plant shall be excluded from the supply plant's shipments in computing the percentages in paragraphs (d) (1).

This provision provides for the qualification of a supply plant on the proposed California FMMO. A California FMMO will have a low Class I utilization. Nevertheless, where a plant located outside the marketing area provides a substantial and consistent supply to California FMMO §7(a) and (b) plants it should be in the pool. The shipping requirements for a supply plant establish that if the milk supply is truly needed and economically justified, it will be accommodated.

Furthermore, if the milk that is delivered from producers' farms that are located outside of the Marketing Area and in more than one state, the producers and milk supplies must be accounted for individually by state and independently meet the shipping requirements described in §1051.7(d). Also we do not want to allow concentrated milk transferred from the supply plant located outside the marketing area to a distributing plant to be a part of any computation made to determine if the supply plant can meet the requirements of this section.

Our language does not allow for a split plant for which we see no economically justified function.

(e)

~~(f)~~ The applicable shipping percentages of paragraphs (d) of this section and § 1051.13(d)(2), and (d)(3) may be increased or decreased, for all or part of the marketing area, by the market administrator if the market administrator finds that such adjustment is necessary to encourage needed shipments or to prevent uneconomic shipments. Before making such a finding, the market administrator shall investigate the need for adjustment either on the market administrator's own initiative or at the request of interested parties if the request is made in writing at least 15 days prior to the month for which the requested revision is desired effective. If the investigation shows that an adjustment of the shipping percentages might be appropriate, the market administrator shall issue a notice stating that an adjustment is being considered and invite data, views and arguments. Any decision to revise an applicable shipping or diversion percentage must be issued in writing at least one day before the effective date.

This provision allows for modification of the shipping percentages by the Market Administrator if needed to best serve the market and warranted by an investigation of market conditions. We support this provision and the methodology outlined.

(f)

~~(g)~~ The term pool plant shall not apply to the following plants:

(1) A producer-handler as defined under any Federal order;

(2) An exempt plant as defined in § 1000.8(e);

(3) A plant located within the marketing area and qualified pursuant to paragraph (a) of this section which meets the pooling requirements of another Federal order, and from which more than 50 percent of its route disposition has been in the other Federal order marketing area for 3 consecutive months;

(4) A plant located outside any Federal order marketing area and qualified pursuant to paragraph (a) of this section that meets the pooling requirements of another Federal order and has had greater route disposition in such other Federal order's marketing area for 3 consecutive months;

(5) A plant located in another Federal order marketing area and qualified pursuant to paragraph (a) of this section that meets the pooling requirements of such other Federal order and does not have a majority of its route distribution in this marketing area for 3 consecutive months or if the plant is required to be regulated

under such other Federal order without regard to its route disposition in any other Federal order marketing area;

(6) A plant qualified pursuant to paragraph (c) of this section which also meets the pooling requirements of another Federal order and from which greater qualifying shipments are made to plants regulated under the other Federal order than are made to plants regulated under the order in this part, or the plant has automatic pooling status under the other Federal order; and

Paragraph (f) describes the special situations for which pool plant status does not apply. We support the situations as listed. The situation of a producer-handler in § (f) (1) and as described in § 1051.10 would not be a pool plant. A producer handler plant has special provisions relative to its ownership, operation, milk supply, milk processing and distribution and does not qualify as a pool plant. An exempt plant as described in § (f) (2) and as described in § 1000.8(e) has special provisions that describe its ownership, operation, milk supply, milk processing and distribution and it does not qualify as a pool plant. The unique situations set forth in §§ (f) (3) through (6) describe plants designated individually by location, regulatory status and the length of regulatory status and refer to situations which cause a plant that has been regulated as a pool plant on this proposed Order to lose its pool plant status and become regulated on another Order. In each case we support the provision and concept as outlined.

(g) Any plant that qualifies as a pool plant in each of the immediately preceding 3 months pursuant to paragraph (a) of this section or the shipping percentages in paragraph (c) of this section that is unable to meet such performance standards for the current month because of unavoidable circumstances determined by the market administrator to be beyond the control of the handler operating the plant, such as a natural disaster (ice storm, wind storm, flood), fire, breakdown of equipment, or work stoppage, shall be considered to have met the minimum performance standards during the period of such unavoidable circumstances, but such relief shall not be granted for more than 2 consecutive months.

Paragraph (g) describes the situation where circumstances beyond the control of the handler prevents the handler from complying with the regulations that establish pool plant status and, accordingly, allow the Market Administrator to make special accommodations under the given circumstances.

B. Section 1051.12 – Producer

This language and testimony outlines our proposal for the definition of a producer.

> *§ 1051.12 Producer*
> *(a) Except as provided in paragraph (b) of this section, producer means any person who produces milk approved by a duly constituted regulatory agency for fluid consumption as Grade A milk and whose milk* ***(or components of milk)*** *is:*
> *(1) Received at a pool plant directly from the producer or diverted by the plant operator in accordance with §1051.13; or*
> *(2) Received by a handler described in §1000.9(c).*

The term "producer" defines those dairy farmers whose milk is a part of the pool. Producer status under the California FMMO should be provided to any California dairy farmer who produces milk approved by a duly constituted regulatory agency for fluid consumption as Grade A milk and whose milk or components of milk is received at a pool plant directly from the producer's farm or is marketed by a cooperative.

Producer status also should also be accorded to dairy farmers located outside the state of California who deliver milk to pool plants as defined by §1051.7 and whose milk meets the requirements of §1051.13.

> *(b) Producer shall not include a dairy farmer described in paragraphs (b)(1) through (5) of this section. A dairy farmer described in paragraph (b)(5) of this section shall be known as a dairy farmer for other markets.*
>
> *(1) A producer-handler as defined in any Federal order;*

(2) A dairy farmer whose milk is received at an exempt plant, excluding producer milk diverted to the exempt plant pursuant to §1051.13(d);

(3) A dairy farmer whose milk is received by diversion at a pool plant from a handler regulated under another Federal order if the other Federal order designates the dairy farmer as a producer under that order and that milk is allocated by request to a utilization other than Class I;

(4) A dairy farmer whose milk is reported as diverted to a plant fully regulated under another Federal order with respect to that portion of the milk so diverted that is assigned to Class I under the provisions of such other order; and

(5) A dairy farmer who having had a Grade A permit has marketed milk as other than Grade A milk for more than 30 consecutive days shall not be a producer until 12 consecutive months have passed from the time non-Grade A status started.

The producer definition proposed specifically excludes producer-handlers as defined in any Federal Order, and dairy farmers whose milk is delivered to exempt plants (unless the milk is diverted in accordance with §1051.13 (d)). Since these operations are exempt from the proposed California FMMO's pricing and pooling provisions, milk which is excess of the needs of these operators should not be treated as producer milk when it is moved directly from the farms of these operators to a pool plant. Milk delivered to a pool plant from such operations would be other source milk.

In addition, provision is made to preclude the possibility of a dairy farmer being a producer under two Orders with respect to the same milk. The producer definition excludes a dairy farmer with respect to milk which is received at a pool plant under this proposed Order by diversion from a pool plant under another Order if the dairy farmer is a producer under the other Order with respect to such milk and the milk is allocated to Class II or Class III use under this Order. Also, the definition excludes a dairy farmer with respect to milk which is diverted to a

pool plant under another Order from a pool plant under this Order with respect to the portion of such person's milk assigned to Class I milk under the other Order.

A dairy farmer for other markets provision is added to insure that a producer who loses his Grade A permit for less than thirty days does not lose his pool status upon the reinstatement of his permit. However, where a permit is given up for more than thirty days the producer is not eligible for pool status until 12 consecutive months have passed.

Section (12) (b) (5) has been inserted to deal with the historical practice in the California market of producers volunteering to give up their Grade A status to avoid being pooled. Producers who voluntarily degrade must remain out of the pool for at least twelve consecutive months. Producers can lose Grade A status occasionally due to issues beyond their control and, therefore, we want to allow the producer the ability to regain pool status when this occurs. It is our expectation that such incidents are correctable in a thirty day period.

C. **Section 1051.13 – Producer Milk**

This language and testimony outlines our proposal for the definition of producer milk.

> *§1051.13 Producer milk.*
>
> *Except as provided for in paragraph (e) of this section, Producer milk means the skim milk (or the skim equivalent of components of skim milk), including nonfat components, and butterfat in milk of a producer that is:*
>
> *(a) Received by the operator of a pool plant directly from a producer or a handler described in § 1000.9(c). All milk received pursuant to this paragraph shall be priced at the location of the plant where it is first physically received;*

This provision defines the status of the majority of the milk included in the pool. It defines milk received directly at pool plants, whether directly from producers or marketed by

Cooperatives. It is our intention that no location value be applied to payments for producer milk but location prices will apply to the handler value of milk used as Class I.

> *(b) Received by a handler described in §1000.9(c) in excess of the quantity delivered to pool plants;*

This provision allows cooperatives to pool milk not delivered to pool plants provided all other requirements of producer milk are met.

> *(c) Diverted by a pool plant operator to another pool plant. Milk so diverted shall be priced* ***to the handler*** *at the location of the plant to which diverted; or*

This provision allows pool plant operators to pool milk not delivered to their own pool plant provided all other requirements of producer milk are met. This will allow the operator of any pool plant to divert milk supplies to another pool plant and retain the producer milk status and payroll responsibility for such milk. Without this provision, a plant operator who wants to retain regular producers on the plant's payroll for the entire month would have to physically receive the milk of such producers into the plant (so that it will be considered "producer milk"), then pump it back into the truck and deliver it to the other pool plant. Such milk would then be considered a transfer from one plant to another with the transferor-handler accounting to the pool for the milk and paying those producers as well. This practice is obviously uneconomic, resulting in unnecessary and costly movements of milk. In addition, the unnecessary pumping of milk is damaging to its quality. Permitting diversions of milk between pool plants will promote the efficient handling of milk.

> *(d) Diverted by the operator of a pool plant or a cooperative association described in §1000.9(c) to a nonpool plant subject to the following conditions:*

This provision, which defines the qualifications for diversions to nonpool plants, concerns primarily deliveries to plants located outside the Marketing Area as any delivery from a producer located inside the Marketing Area to a plant located in the Marketing Area is to a pool plant. Diverted milk must meet all of the following criteria (paragraphs 1 – 5) as applicable.

> *(1) Milk of a dairy farmer shall not be eligible for diversion until at least five days production of such dairy farmer is physically received as producer milk at a pool plant during the first month the dairy farmer is a producer. If a dairy farmer loses producer status under the order in this part (except as a result of a*

temporary loss of Grade A approval or as a result of the handler of the dairy farmer's milk failing to pool the milk under any order), the dairy farmer's milk shall not be eligible for diversion until at least five days production of the dairy farmer has been physically received as producer milk at a pool plant during the first month the dairy farmer is re-associated with the market;

To be eligible for diversion five days production of a dairy farmer's milk must first be received at a pool plant.

(2) The quantity of milk diverted by a handler described in §1000.9(c) may not exceed 50 percent of the producer milk receipts reported by the handler pursuant to §1051.30(c) provided that ***the quantity of milk diverted may not exceed*** ~~*not less than*~~ *50 percent of such* ***cooperative's*** *receipts* ~~*are*~~ *delivered to plants described in §1051.7(a) or (b). These percentages are subject to any adjustments that may be made pursuant to §1051.7(e); and*

(3) The quantity of milk diverted to nonpool plants by the operator of a pool plant described in §1051.7(a) or (b) may not exceed 50 percent of the Grade A milk received from dairy farmers (except dairy farmers described in §1051.12(b)) including milk diverted pursuant to §1051.13; and

Diversions as defined by (2) and (3) above are limited by the producer receipts reported and the shipments to plants described in §1051.7(a) or (b) – pool distributing plants. We chose this measure as the best choice to demonstrate a need for reserve milk supplies in the California market. Deliveries to these plants usually contribute the highest value to the pool and thus are a valid measure that the milk is needed by the market. The standards as proposed will insure that those deliveries are truly needed as the cost of meeting the standards will not be trivial.

However, the diversion standard of 50% does recognize a balancing component of the Class I and II market and would not require uneconomical shipments of milk in order to qualify for the sharing of market proceeds. The need would have to be present and met each month. This is a strict requirement but the California market appears to have an adequate reserve supply for the

Class I market, the chosen standard for measure, and so the demonstration of need must also be strict. The combination of an initial five day touch base and the fifty percent diversion limitation should be a valid measure.

The performance standards can be modified by the discretion of the Market Administrator if needed. As evidenced by this hearing, the California market is well represented by both producer and processor interests so the investigation required by the provision would be well researched and reviewed.

> *(4) further such **diverted** milk is subject to the pooling requirements of §1051(7) (d) (1); and*

Diverted milk is subject to the state unit provisions as described in §1051(7) (d) (1). [The sub-paragraph divider "(4)" was not inserted correctly before the foregoing language of "(5)" when submitted for the Hearing notice. It was incorrectly placed as the end of (3) and the word "diverted" was omitted.]

> *(5) Diverted milk shall be priced **to the handler** at the location of the plant to which diverted.*
>
> *(e) Producer milk shall not include milk of a producer that is subject to inclusion and participation in a marketwide equalization pool under a milk classification and pricing program imposed under the authority of a State government maintaining marketwide pooling of returns.*

This provision denies producer milk status to milk that could possibly be dual pooled in both a state Order and an FMMO. This provision is included in all FMMOs.

> *(f) The quantity of milk reported by a handler pursuant to either §1051.30(a) (1) or §1051.30(c) (1) may not exceed 115 percent of the producer milk receipts pooled by the handler during the prior month. Milk diverted to nonpool plants reported in excess of this limit shall be removed from the pool. Milk in excess of this limit received at pool plants, other than pool distributing plants, shall*

be classified pursuant to §1000.44(a)(3)(v) and §1000.44(b). The handler must designate, by producer pick-up, which milk is to be removed from the pool. If the handler fails to provide this information, the market administrator will make the determination.

The following provisions apply:
(1) Milk shipped to and physically received at pool distributing plants in excess of the previous month's pooled volume shall not be subject to the 115 percent limitation;
(2) The market administrator may waive the 115 percent limitation:
(i) For a new handler on the order, subject to the provisions of §1051.13(f) (3), or
(ii) For an existing handler with significantly changed milk supply conditions due to unusual circumstances;
(3) A bloc of milk may be considered ineligible for pooling if the market administrator determines that handlers altered the reporting of such milk for the purpose of evading the provisions of this paragraph.

1051.13

§~~1051.~~3 (f) regulates the volumes of milk that this type of handler may pool on the proposed Order from month to month. The provision limits the volumes to be pooled to not more than 115% of the volume pooled in the previous month unless the Market Administrator waives the limitation, provides for an allowance for a new handler or determines that the supply conditions of the reporting handler had a significant change.

§1051.13 (f) prescribes procedures to be followed in case a handler reports milk in excess of the percentages allowed by the proposed Order. The excess quantity of milk would not qualify as producer milk and would not be priced under the Order or would be down allocated for pricing purposes. Where possible, the reporting handler would be required to designate the dairy farmer deliveries that should not be considered producer milk. Absent such designation the Market Administrator will make the determination.

D. Pooling of Milk from Outside the Marketing Area

The proposed Order primarily involves the marketing and pooling of milk in the state of California and the requirements for equal pricing to producers and handlers. Producers and plants outside the state can clearly participate in the pool, but as in other Orders with different benefits and burdens. Benefits may include the price improvement generated by the California FMMO pool versus the local market and burdens may include the high level of delivery necessary to share in those returns.

Qualified distant reserve supplies may choose to pool or not pool depending on advantageous price relationships without causing the extent of disorderly marketing conditions that such behavior would result in if practiced within the Marketing Area.

E. Section 1051.11 – Grade A Milk and Market Milk

We propose to utilize the reserved §1051.11 to add a definition of Grade A milk and market milk, in order to assure that these terms which are used in the proposed Order and in California law and regulations are properly interpreted in the FMMO.

1051.11

§ ~~1050.11~~ Grade A Milk

"Grade A milk" shall mean milk approved by a duly constituted regulatory agency for fluid consumption as Grade A milk or as "market milk" as defined under California law and regulations.

Under California law the term "market milk" is the term used to define milk eligible for fluid consumption and is generally synonymous with the FMMO term "Grade A milk". Section 11 was a reserved section of the proposed Order and to prevent any possible conflicts with terms and definitions going forward, the Cooperatives propose to insert this language for the proposed California FMMO into §1051.11.

IV. Examples of Major Changes in Federal Order Regulations Over the Years.

The adoption of pooling terms for the California order which are different from any presently existing in other FMMOs is just one example of how federal orders under the AMAA are able to meet the needs of the marketplace as it inevitably changes over time. We note here just a few significant changes in FMMO regulations over the past several years.

A. Elimination of Individual Handler Pools in Favor of Marketwide Pools

In the early periods of milk order regulation, the use of individual handler pooling regulation was neither unusual nor rare. For example, in 1961 there were 67 Federal Order markets with marketwide pools and 14 Federal Order markets with individual handler pools. However, as the FMMO system evolved, the presumed benefits of individual handler pools, as viewed through the lens of orderly marketing, became less acceptable, and the number of individual handler pools decreased over time.

The Secretary discussed individual handler pools extensively in the Final Decision of the 2010 Producer Handler hearing, noting their place and use in the Orders and the ultimate elimination of that class of handler:

> The marketwide sharing of the classified use values of milk among all producers supplying a marketing area is an essential feature of the Federal milk marketing order system. It ensures that producers supplying a given marketing area receive the same uniform price for their milk, regardless of its end use. In combination with classified pricing, marketwide pooling has, among other things, successfully mitigated price competition between producers seeking the higher-valued fluid outlets for their milk. Abandonment of the marketwide pooling system in favor of an individual handler pool system would reverse the stability achieved by its adoption in all Federal milk marketing orders.
>
> . . .
>
> **Over the years, USDA has repeatedly concluded that marketwide pooling promotes orderly marketing conditions more completely and is one of the most important marketing order tools used to ensure uniformity in prices to producers.**

> **In markets where much of the milk is handled by operating cooperatives and large surpluses of milk are unevenly distributed among handlers, conditions observable today, marketwide pooling best ensures orderly marketing.**

(75 Fed. Reg. 10122, 10148 (2010)) (emphasis added).

Individual handler pools had been a viable part of the FMMO system for many years. As individual handler pools gradually fell out of favor due to the rise of larger markets and more complex pooling issues, the Secretary concluded that they no longer served the purpose of orderly marketing and made the significant decision to eliminate them. The last Individual Handler pool was in the Michigan Upper Peninsula Order (Order 44) and was eliminated in Order Reform. Undoubtedly, the handler in this Individual Handler pool was very opposed to the change in no small part due to the economic implications it brought. But the Secretary nevertheless concluded that the broader benefits to orderly marketing outweighed any negative consequences and thus made the change.

Similarly, as we have documented, without the pooling provisions proposed by the Cooperatives, the benefits of marketwide pooling will be greatly impaired. In the many months where either Class III or Class IV would not be pooled, the resulting scenario would greatly resemble the deficiencies of an individual handler pooling system.

B. Regulation of Large Producer-Handlers

In 2010, the Secretary issued a Final Decision that substantially changed the FMMO regulations governing producer-handlers. In particular, the Final Decision amended "the producer-handler definitions of all Federal milk marketing orders to limit exemption from pooling and pricing provisions to those with total route disposition and sales of packaged fluid milk products to other plants of 3 million pounds or less per month." (75 Fed. Reg. 21157 (2010).)

The Producer-Handler hearing was lengthy, with substantial testimony noting there was a longstanding tradition of treatment of producer-handlers that was significantly different from what was being proposed; that the discussion of the issue was legitimate; and that the proponents' proposal would have significant negative economic impacts on the opponents (large producer-handlers). The Secretary recognized these points in the Final Decision, noting that the historical exempt status provided to producer-handlers had been "based on the premise that the declared policy and objectives of the AMAA, namely orderly marketing, could be achieved without the extension of full regulation to this category of handler." (75 Fed. Reg. 10122, 10146 (2010).) The Secretary determined that this significant change was necessary because "USDA found the activity of large scale producer-handlers to be a source of significant and measurable disorder in the Arizona and Pacific Northwest marketing areas." (Id. at 10147.) With regard to economic impact, the Secretary noted: "While this may cause an economic impact on those entities with more than three million pounds of total monthly sales that are currently considered producer-handlers under the Federal order system, the impact is offset by the benefit to other small businesses." (Id. at 10122.)

Of course, the economic impact referenced by the Secretary would be a negative impact. The results of the Hearing Decision would increase some costs to the largest producer-handlers. But the overall effects of the change were deemed by the Secretary to be beneficial to the market as a whole, in part because the new provisions made the operations of producer-handlers more similar to the other pool distributing plants that competed within the market for sales. The Decision thus resulted in more orderly marketing conditions.

C. Adoption of Multiple Component Pricing Plans

Since the early days of federal orders in the 1930s, producers were paid and handlers were billed on the basis of skim milk and fat produced / purchased. But since the late 1980s, multiple component pricing (MCP) of milk has been used in the FMMO system, and it has become the predominant system of pricing.

Generally the adoption of MCP in an Order serves to improve the price signals to producers and processors. Both parties pay or receive a price more targeted to their production and processing requirements. While four of the existing ten orders still use some type of skim / fat-oriented pricing, the majority of all FMMO regulated milk is priced on a MCP basis (as is milk regulated under the current California milk marketing system).

In 2013, 86% of the 132 billion pounds of producer milk under FMMO regulation was subject to an MCP plan by which dairy farmers are paid for the valuable solids content of farm milk – butterfat, protein, and other non-fat solids. The move from fat/skim to MCP in federal order pricing was a sea change in producer and handler relations, changing a system which had been in place for literally decades, if not more than a century in most markets.

MCP was first introduced in the FMMO program following a 1986 hearing for the Great Basin Order. (53 Fed. Reg. 686 (1988).) In the following years, MCP was adopted for the Mid-Atlantic market (56 Fed. Reg. 57850 (1991)), the Ohio and Indiana markets (58 Fed. Reg. 33347 (1993)), the Pacific Northwest and Idaho markets (59 Fed. Reg. 8546 (1994)), five of the Upper Midwest markets (60 Fed. Reg. 41833 (1995)), and the Southern Michigan market (60 Fed. Reg. 43066 (1995)). The Federal Milk Marketing Order Reform Decision provided a uniform, protein-based MCP plan for all seven markets outside of the southeast and Arizona. (64 Fed. Reg. 16026, ~~16015~~ 16105 (1999).)

MCP plans are markedly different from the specifics of the traditional skim / fat payment plans. The following three examples involving two different Orders and the Reform Decision highlight both the differences as well as the benefits resulting from the changes. First, in a 1994 Decision made for the Pacific Northwest and Southwestern Idaho-Eastern Oregon orders, the pricing basis was shifted from skim / fat to a component basis, but the actual components of choice in the two side-by side Orders were not identical. "Under the Pacific Northwest order, the components to be priced will be nonfat milk solids and butterfat. Under the Southwestern Idaho-Eastern Oregon order, the components to be priced will be protein and butterfat."
(59 Fed. Reg. 8546, 8547 (1994).)

Second, just one year later in 1995, five of the existing Orders in the Upper Midwest region (Orders 30, 65, 68, 76, and 79) adopted a MCP system that replaced the long-standing skim / fat method for paying producers. Notably, the choice of component alternatives was not identical to the 1994 Decision for the Idaho / Oregon / Washington markets. Rather, these Upper Midwest Orders determined that "[p]roducers would be paid on the basis of the pounds of butterfat, protein and other nonfat solids (solids-no-fat other than protein) in their milk . . ." (60 Fed. Reg. 41833, 41834 (1995).) Further, the variations in MCP plans were noted in the Decision in which these changes were made, as follows:

> The multiple component pricing plans considered thus far for inclusion in Federal milk orders have been developed and proposed by the industry participants in the affected marketing areas. The plans have tended to be modified from one proceeding to the next, with ideas about the most appropriate provisions evolving as time goes on, and to reflect individual marketing conditions.
>
> ...
>
> Unlike the multiple component pricing plans adopted previously in other Federal Milk Marketing Orders, this decision recommends the adoption of a pricing plan for milk based on three components rather than two.

(Id. at 41838.)

Lastly, in the Federal Order Reform Decision of 1999, several key changes were made that unified rather than diversified the component pricing provisions. MCP provisions were adopted for six of the ten currently remaining reformed orders with the difference being the inclusion of a somatic cell premium / deduction component in four of those six Orders.

> Under this final rule, producers in most Federal order markets will be paid on a multiple component basis since the basic formula price replacement is based on individual milk component prices. Producers will be paid for the pounds of butterfat, pounds of protein, pounds of other solids, a per hundredweight price known as the producer price differential, and a per hundredweight somatic cell adjustment. The producer price differential returns to producers their pro rata share of the proceeds of the classified pricing system. The butterfat, protein, and other solids prices paid to producers will be the same as the prices for those components announced for Class III use regardless of the utilization of the milk. Handler obligations and producer payments under the Federal orders that do not provide for component pricing will be based on hundredweight prices computed from these component prices.

(64 Fed. Reg. 16026, 16105 (1999).)

This Decision collected the various MCP plans and formulated what the Secretary considered to be a superior alternative for all markets that utilized a MCP plan at that time. In formulating this alternative, the Secretary provided the following reasoning: "The formulas are relatively simple to use and can be applied uniformly. The formulas are transparent and the Class III and Class IV formulas meet the sound economics criterion." (64 Fed. Reg. 16026, 16096-16097 (1999).) The basic product price formulas were, and remain, the same for all markets. Further, the price values of the formulas are all derived from national, rather than regional, prices. In the MCP markets, the price formulas play out in the form of individual component values, while in skim / fat markets they play out in the form of butterfat and skim

values. All of the Orders (both MCP and skim/fat) calculate all prices from the same basic formula constructs.

D. Development of Transportation Programs to Meet Market Needs

The development of transportation programs in the FMMO system also provides an example of the type of variation that can exist from Order to Order, in terms of implementation, change, and significance.

The transportation credit programs were a result of the 1985 Farm Bill which allowed marketwide service programs to be implemented in the Orders if justified by a Hearing. Transportation credit programs are currently present in Orders 5, 7, and 30 to address specific needs of procuring both local and supplemental milk for the market by allowing partial recovery of transportation costs. The Order 30 model has been unchanged since implementation, while the Order 5 and 7 model has been modified several times in response to changing market conditions.

The transportation credit provisions in Orders 5, 7, and 30 are similar in that they are transaction-based, mileage-based and subject to audits. They differ markedly, however, in how they are funded and what milk qualifies for payment. In particular, the Order 30 provisions are funded from the blend pool, while the Order 5 and 7 provisions are funded via an assessment on Class I pounds.

Interestingly, the first transportation program after the 1985 Farm Bill was authorized by the 1988 decision in the (pre-FMMO Reform decision) Texas Milk Marketing Area. That program was not included in the (post-FMMO Reform decision) Southwest Order. Unlike the existing transportation credit programs that are currently in place in Orders 5, 7, and 30 which

assist in getting milk supplies to market, this Decision assisted in moving surplus milk out of the market.

The 1988 Texas Order Decision reversed the USDA mindset with regard to marketwide service payments for transportation assistance and granted them for dealing with surplus milk supplies.

> This final decision would provide transportation credits to handlers for hauling excess producer milk to nonpool plants located outside the State of Texas. The credits would represent a partial reimbursement of hauling costs from the orders' marketwide pool. Such credits would apply during the months of March – June and the last half of December and would be limited to milk going into Class II and Class III uses. The credits would be computed at a rate of 2.4 cents per 10 miles. Credits would be limited to handlers who transfer milk from plants located in Zone 1 of the marketing area while credits on milk that is moved directly from farms to nonpool plants would be limited to milk produced in northern Texas and southern Oklahoma. Handlers would also receive a credit to recognize costs associated with hauling milk from higher to lower prices areas. The amount of milk to which transportation credits apply would be reduced to the extent that a handler or affiliate of the handler caused milk from outside the State of Texas to be received at plants in the marketing area.

(53 Fed. Reg. 36321 (1988).)

> ...
> There are a number of significant differences that distinguish the Texas situation from that described in the decision denying the issuance of such credits for the several southeastern markets. The primary differences are the geographical limitation of the proposal and the fact the reserve milk supplies for other markets are generally processed at El Paso Texas and do not displace Texas order producer milk at plants in the major production areas of northern Texas and southern Oklahoma.

(53 Fed. Reg. 36321 (1988).)

This Decision is notable because it implemented a new practice--a transportation credit concept--that had been recently denied in the Southeastern Orders, but that was determined to expressly meet market needs, market data and testimony in the Texas Order.

One year prior, in 1987, several proposals regarding transportation programs were made with regard to the Southeastern Orders. (52 Fed. Reg. 15951 (1987).) Two of the proposals were to provide transportation assistance for transporting milk supplies into the market and for transporting surplus milk out of the market. The hearing on these proposals was terminated with no Decision. Later, in the 1990s, USDA allowed transportation credits for procuring supplemental milk supplies to the Southeastern markets as the proposals were refined to match unique and specific market needs.

E. Modernizing the FMMO System in Federal Order Reform

The Federal Order Reform decision was clearly a status quo altering decision. In one decision, the number of Orders was reduced from 31 to 11, and multiple modifications were made to the remaining Orders. The differential pricing surface was altered all across the country, the price discovery system was changed from one drawn from a competitive survey to a product formula basis, product classification definitions were changed, transportation credit systems were modified, pooling provisions were altered, and producer payment methodologies were restructured into basically two methods driven by the same underlying set of formulas and based on nationally-derived prices. However, many provisions were made more uniform through "Part 1000," in which many components of Order provisions were declared the same for all Orders. Definitions, price formulas and price discovery methodologies were a few of the features that were made uniform.

If we were to review every FMMO Hearing over time, we would find that most Hearings are about a short list of similar topics. Common are the decisions that modify performance standards, adjust an existing payment amount, or make a change to a boundary. But there are also clear-cut examples of significant policy shifts such as eliminating a type of order (e.g., the

individual handler pool), making significant changes to a handler definition (e.g., the definition of producer-handler), implementing an entirely new producer payment scheme with many subtle differences but very common underlying principles (e.g., MCP plans), and transportation assistance programs that modify the pricing surface but not the differential surface itself. The FMMO Reform Decision made substantial changes to the existing system and standardized many key foundational provisions and principles that are common to all Orders. The FMMO Reform Decision thus provided a foundation that was national in scope while, at the same time, allowing for more unique provisions tailored to individual markets.

F. Conclusion

These examples show that the Secretary has a history of making decisions that alter the status quo, some of which have been adopted as written, and some of which have been tested in the courts. Therefore, the fact that some of the concepts offered in the Cooperatives' proposal may become the next status quo altering decisions should not weigh against their adoption, especially in the face of the supporting data submitted by the Cooperatives in this Hearing.

The AMAA provides many tools and great flexibility for fashioning the pooling terms of a milk market order. It does not prescribe the rules for defining who is in and who is out of a marketwide pool. That is left up to the hearing process. The proposed California order provisions for pooling, although different from pooling provisions in other FMMOs, are designed to meet the marketplace, just as provisions for handler pooling, component pricing, transportation, and many other previously unutilized provisions have evolved over the years to address changes in the marketplace and thus become part of the federal order system today.