

FOR-2287

LAND O'LAKES, INC. -- Arden Hills, MN
Milk Procurement/Operations Divisions



FAX COVER PAGE

DATE: 6-3-97

No. of Pages
(including cover page)



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Land O'Lakes Dairy Foods

June 2, 1997

Mr. Richard McKee, Director
Dairy Division, AMS-USDA
PO Box 96456
Room 2968 - South Building
Washington, D.C. 20090

Dear Mr. McKee,

This letter presents the views of Land O'Lakes, Inc., with respect to Federal Milk Order reform. It is a response to the series of reports issued by your division and supersedes all earlier submissions of views by Land O'Lakes.

We are participants in the Association of Dairy Cooperatives in the Northeast (ADCNE) and the Midwest Dairy Coalition (MDC). We support the basic proposal of each group but choose to make exceptions to each. In particular, we support a system of Class I prices that is compatible with the ADCNE proposal and pooling provisions that are compatible with the MDC proposal. We also reserve an opinion on the transportation credits offered in the MDC proposal, and will advise you later of our position on such credits.

A general outline of our recommendations is as follows:

1. Adopt the Northeast marketing area proposed by ADCNE. This proposal includes Area 6 subject to the Pennsylvania Milk Commission, while the USDA map does not. It is especially important to include in the Northeast order all the areas now regulated by the Pennsylvania Milk Commission.
2. Adopt liberal pooling provisions that do not create barriers to the association of Grade A milk in any area with its most favorable market. Shipping requirements for supply plants should be flexible to fully satisfy the Class I needs of the market without inducing unneeded or uneconomic shipments of milk.

Mr. McKee

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3. Establish intermarket Class I price differences on the basis of the location value of milk for fluid use. These price differences should approximate the output of the Cornell Dairy Simulation Model, representing an efficient geographic allocation of milk to all uses.

Adopt price zones within markets that reflect the advice of local market participants. Do not employ mileage based location adjustments as they tend to create economic barriers to the efficient movement of milk, and tend to destroy the incentive for additional milk to associate with some markets.

4. Adopt Class III-A pricing that applies to milk used to produce both nonfat dry milk and dry whole milk. So long as California maintains its Class 4a pricing program, producers of dry milk products under Federal Milk Orders will be harmed. Therefore, Class III-A pricing is needed to promote competitive equity among dry milk processors.
5. Adopt the Midwest competitive A/B price adjusted for quality and volume premiums as the basic formula price. This survey price measures the value of milk rather than products, and is determined by competitive forces. Prices under Federal orders should reflect the results of vigorous competition, and not weak competition. Also, there is no need to worry about which products to include in a pricing formula, which yields, or which product prices to use. All of these factors are automatically and simultaneously taken into account when midwest buyers of milk pay their farmers.

To avoid the problem of regulatory circularity, it will be necessary to reduce or eliminate the Class III and blend prices in the Midwest market so they are lower than the competitive level. The simplest way to do that is to set the Class III price at zero, and let the blend price represent the weighted average value of the Class I, Class II and Class III-A differentials.

6. Adopt assembly credits and balancing payments. Assembly credits would provide reimbursement for the costs of field service, quality enforcement, laboratories, producer payrolls, producer-recordkeeping, and Federal Order compliance that are a normal part of milk assembly. A handler who buys direct from farmers incurs these costs. One who buys from cooperatives or other handlers does not. Assembly credits would reduce the difference in costs experienced by handlers who do and do not buy directly from producers.

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Balancing credits would provide reimbursement for the fixed cost of idle manufacturing plant capacity that results from servicing the fluid market. Without such credits, handlers who fill the seasonal gaps between Class I demand and producer deliveries are worse off than those who do not. Balancing credits would reduce this disadvantage that arises from servicing the Class I market.

7. Set the date for filing handler reports on the 10th of the month. This is a practical date that will give handlers enough time to assemble the complex data needed to file reports of receipts and utilization.

The document attached to this letter outlines the Land O'Lakes recommendations, section by section.

Sincerely,



Paul G. Christ
Vice President, Dairy Planning & Analysis
Dairy Foods Products Division

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LAND O'LAKES
FEDERAL ORDER REFORM PROPOSALS

100X.2 Marketing Area

- Northeast Order. Territory defined by proposal of the ADCNE consolidation.
- Midwest Order. Territory defined by the final report by USDA on order consolidation.
- For all orders, define pricing zones in section 100X.50(a), Class I prices, rather than in the marketing area definition.

100X.3 Route Disposition

- Adopt the recommendation of the Uniform Provisions Committee.

100X.4 Plant

- Adopt the recommendation of the Uniform Provisions Committee.

100X.5 Distributing plant

- Adopt the recommendation of the Uniform Provisions Committee.

100X.6 Supply plant

- Need a definition of "received"

"Fluid milk products are received if they are physically transferred in total into the plant from a bulk tank truck or from another plant."

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100X.7 Pool Plant

- Identify only two types of pool plants: distributing plants and supply plants.

"Pool plant means a plant specified in paragraphs (a), (b), (d) or (e) of this section or a system of plants as specified in paragraph (c) of this section, but excluding a plant specified in paragraph (h) of this section. The pooling standards described in paragraphs (b) and (c) of this section are subject to modification pursuant to paragraph (b) of this section".

- (a) "A distributing plant..

Northeast Order. Delete the following language at the end of sub-paragraph 100X.7(a)(1):

"... or diverted therefrom by the plant operator pursuant to Section 100X.13...."

- This change will limit the amount of milk that an individual handler pool distributing plant under state regulation (Maine and Virginia) can distribute in a Federal Order area without becoming fully regulated.

All other orders. Adopt the recommendation of the Uniform Provisions Committee

- (b) "A supply plant from which the volume of fluid milk products delivered to pool distributing plants as a percent of the total Grade A milk received at the plant from dairy farmers during the month (including milk delivered to the plant for the account of a cooperative association and milk diverted from the plant by the plant operator but excluding milk diverted to the plant from another pool plant.) is not less than 25 percent (Northeast), 10 percent (Midwest), during each month of August through November and 10 percent (Northeast), 3 percent (Midwest), in other months; subject to the following conditions:

(1) "These shipping percentages may be increased or decreased by the market administrator if the market administrator finds that such revision is necessary to encourage needed shipments or to discourage uneconomic shipments. For the purposes of this sub-paragraph, "uneconomic shipments", means the required shipment of milk from a greater distance than the distance from which an adequate supply of milk is available for Class I use, plus an adequate reserve for that month. Before making such a

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finding, the market administrator shall investigate the need for revision either on the market administrator's own initiative or at the request of interested parties. If the investigation shows that a revision of the shipping percentage might be appropriate, the market administrator shall issue a notice stating that the revision is being considered and invite data, views, and arguments. Any request for revision of shipping percentages shall be filed with the market administrator no later than the 15th day of the month prior to the month for which the requested revision is desired effective;

(2) "The market administrator may designate separate "call areas" from which the level of required shipments by pool supply plants may differ from the level of required shipments by pool supply plants located in other call areas or outside of any call area, if such designation is likely to increase economic shipments and decrease uneconomic shipments."

- The above changes help open the pool to an adequate supply of milk, and encourage shipments from the most favorable sources to the most favorable destinations.

- There are no geographic barriers to the pooling of milk.

(3) "A cooperative association that operates a supply plant may include as qualifying shipments milk it delivers to pool distributing plants directly from farms of producers pursuant to 100X.9(c)

(4) "A proprietary handler may include as qualifying shipments milk diverted to pool distributing plants pursuant to 100X.13(d)"

- Allowing the use of diversions to qualify a plant improves efficiency.
- Delete the "reserve supply plant" provision and redesignate paragraph (d) as paragraph (c).

(c) "Two or more supply plants which are operated by one or more handlers may qualify for pooling as a system by meeting the applicable percentage requirements of paragraph 100X.7(b) in the same manner as a single plant if the handler or handlers submit a written request to the market administrator prior to the 15th day of July, requesting that such plants qualify as a system for the immediately succeeding period of August through July."

"The request shall list the plants to be included in the system in the sequence in which they shall qualify for pool plant status based on the minimum deliveries required. If the deliveries made are insufficient to

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qualify the entire system for pooling, the plant last on the list shall be excluded from the system, followed by the plant next-to-last on the list, and continuing in this sequence until remaining plants on the list have met the minimum shipping requirements. Each plant that qualifies as a pool plant within a system shall continue each month as a plant in the system through the following July unless the plant fails subsequently to qualify for pooling or the handler(s) submits a written request to the market administrator

prior to the first day of the month that the plant be deleted from the system or that the system be discontinued. Any plant that has been so deleted from the system, or that has failed to qualify in any month, will not be part of the system for the remaining months through July."

- Unit pooling adds to efficiency.

(d) Redesignate paragraph (e) as paragraph (d)

- Adopt the recommendation of the Uniform Provisions Committee.

(e) Redesignate paragraph (f) as paragraph (e)

- Adopt the recommendation of the Uniform Provisions Committee.

Delete paragraphs 100X.7(g) and 100X.7(h)

- Adjustment of shipping requirements has been taken care of in 100X.7(b)

(f) Exempt plants

- Redesignate paragraph (i) as paragraph (f).
- Adopt the recommendation of the Uniform Provisions Committee, except,

(5) Change the month in the last sentence from "June" to "July"

100X.8 Nonpool Plant

- No change, adopt as proposed.

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100X.9 Handler

- No change, adopt as proposed.

100X.10 Producer-Handler

- No change, adopt as proposed.

100X.12 Producer

Northeast Order: Adopt the proposal of the ADCNE

Other orders:

- Adopt paragraphs (a) and (b)(1), (2) and (3)
- Delete proposed sub-paragraphs (b) (4) (5) These provisions seem unduly complex. The issue is which pool the milk is to be included in. This can be taken care of in the Producer Milk section.

100X.13 Producer Milk

- Adopt paragraphs (a), (b), and (c) as proposed.
- Choose the first option of sub-paragraph (d) (1). This is the least burdensome and most efficient way to qualify producer milk.
- Delete sub-paragraphs (d) (2), (3), (4) and (5). There is no need for diversion limits if there are shipping requirements. Diversion limits can and do create inefficient movements of milk.

100X.14 Other Source Milk

- Adopt the existing provisions of 1004.14 and 1068.14.

100X.15 Fluid Milk Products

- Adopt the recommendation of the Classification Committee

100X.16 Fluid Cream Products

- Adopt the recommendation of the Classification Committee.

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100X.17 Filled Milk

- Adopt the recommendation of the Classification Committee to eliminate the provision.

100X.18 Cooperative Association

- Adopt the recommendation of the Uniform Provisions Committee.

100X.30 Reports of Receipts and Utilization

- Change the day that reports are due from the eightth day after the end of the month to the tenth day after the end of the month.
- Otherwise adopt the recommendation of the Uniform Provisions Committee.

100X.31 Payroll Reports

- Adopt the recommendation of the Uniform Provisions Committee.

100X.40 Classes of Utilization

(a) Class I Milk

- Adopt the recommendation of the Classification Committee, with the possible exception of low solids beverages

(b) Class II Milk

- Adopt the recommendation of the Classification Committee, with the exception of cream cheese

(c) Class III Milk

- Do not include skim milk and butterfat used to produce nonfat dry milk and dry whole milk.

- (d) Class III-A. "Class III-A milk shall be all skim milk and butterfat used to produce nonfat dry milk and dry whole milk"

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100X.41 Shrinkage

- Adopt the recommendation of the Classification Committee.

100X.42 Classification of Transfers and Diversions

- Adopt the recommendation of the Classification Committee.

100X.43 General Classification Rules

- Adopt the recommendation of the Classification Committee.

100X.44 Classification of Producer Milk

- Adopt the recommendation of the Classification Committee.

100X.45 Market Administrator's Reports and Announcements Concerning Classification

- Adopt the recommendation of the Uniform Provisions Committee.

100X.50 Class Prices

(a) Class I Price

- Adopt a base Class I differential of \$1.60, plus a variable amount applicable at each fluid milk processing location that represents the relative shadow value of milk, as calculated by the Cornell Dairy Model.

(b) Class II Price

- Adopt the existing provision of 1068(b).

(c) Class III Prices

- Midwest Order: "The Class III price shall be zero."
 - Adopt no price to facilitate the collection of a competitive pay price that is not influenced by regulatory effects.

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- Northeast and all other orders

"The Class III price shall be the basic formula price for the month".

(d) Class III-A Price

- Adopt the existing provisions in each respective order area

100X.51 Basic Formula Price

"The Basic Formula Price shall be the average price per hundredweight for producer milk under this order and manufacturing grade milk f.o.b. plants located within the Midwest marketing area (The Midwest Competitive A/B Price) as reported by the Department for the month, adjusted to a 3.5 percent butterfat basis and rounded to the nearest cent. For such adjustment, the butterfat differential pursuant to section 100X.74 shall be used."

100X.52 Plant Location Adjustments for Handlers.

- (a) "For milk received at a plant located inside or outside marketing area from producers or from a handler described in 100X.9(c) and which is classified as Class I milk, the Class I price shall be the price specified in 100X.50(a).
- (b) "The Class I price applicable to other source milk shall be the same as if the transferor plant was a pool plant."

100X.53 Announcement of Class Prices

- Adopt the recommendation of the Uniform Provisions Committee.

100X.54 Equivalent Price

- Adopt the recommendation of the Uniform Provisions Committee

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100X.55 Transfer Credits on Class I milk

“(a) Transportation credits.

- Land O'Lakes reserves its opinion on transportation credits at this time. We will advise USDA at a later date of our position.

“(b) For each handler who transfers milk from producers or from a plant to a pool distributing plant (or plants) an assembly credit shall be computed by the market administrator at the rate of 8 cents per hundredweight of such handler's transfers of milk that are classified as Class I milk.”

“(c) For each handler described in paragraphs 100X.9(a) and 100X.9(c) who received producer milk or transfers milk to a pool distributing plant (or plants) a balancing credit shall be computed by the market administrator as follows:

“(1) Determine for each such handler the hundredweights of milk classified as Class III and Class III-A during the immediately preceding month during which the marketwide percentage of Class III and III-A utilization was greatest.

“(2) Calculate a seasonal index of producer milk for the market.

“(3) Multiply the hundredweights of Class III and Class III-A milk for each handler determined in subparagraph (1) above, times the respective seasonal index determined in subparagraph (2) above for each of the 12 months succeeding the month in which the marketwide percentage of Class III and Class III-A utilization was greatest. Each such product shall be the base manufacturing volume for each handler.

(4) For each month, determine the hundredweights of milk delivered or transferred by each such handler to pool distributing plants.

(5) For each month, subtract the hundredweights of milk classified as Class III and Class III-A milk from that handler's base manufacturing volume for the same month.

(6) Multiply the lesser of the hundredweights of milk calculated in subparagraphs (4) or (5), above by \$.70.”

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100X.60 Handler's Value of Milk for Computing Uniform Price

Midwest Order

For the purpose of determining each handler's pool obligation, the market administrator shall determine for each month the value of milk of each handler with respect to each of his pool plants and of each handler described in §1068.9 (b) and (c) with respect to milk that was not received at a pool plant, as follows:

- (a) Multiple the pounds of producer milk and milk received from a handler described §1068.9(c) in Class I, Class II and Class III-A as determined pursuant to §1068.43(a) and §1068.44(c) by the difference between the applicable class prices and the basic formula price and add the resulting amounts.
- (b) Add the amounts obtained from multiplying the pounds of overage subtracted from Class I, Class II and Class III-A pursuant to §1068.44(a)(14) and the corresponding step of §1068.44(b) by the difference between the respective class prices and the basic formula price, as adjusted by the butterfat differential specified in §1068.74, that are applicable at the location of the pool plant;
- (c) Add the amount obtained from multiplying the difference between the Class III price for the preceding month and the excess of the Class I price over the basic formula price applicable at the location of the pool plant or the Class II price, as the case may be, for the current month by the hundredweight of skim milk and butterfat subtracted from Class I and Class II pursuant to §1068.44(a)(9) and the corresponding step of §1068.44(b);
- (d) Add the amount obtained from multiplying the difference between the Class I price applicable at the location of the pool plant and the basic formula price by the hundredweight of skim milk and butterfat assigned to Class I pursuant to §1068.43(e) and the hundredweight of skim milk and butterfat subtracted from Class I pursuant to §1068.44(a)(7)(i) through (iv) and the corresponding step of §1068.44(b), excluding receipts of bulk fluid cream products from an other order plant and bulk concentrated fluid milk products from pool plants, other order plants and unregulated supply plants.
- (e) Add the amount obtained from multiplying the difference between the Class I price applicable at the location of the transferor-plant and the basic formula price by the hundredweight of skim milk and butterfat subtracted

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from Class I pursuant to §1068.44(a)(7)(v) and (vi) and the corresponding step of §1068.44(b);

(f) Add the amount obtained from multiplying the difference between Class I price applicable at the location of the nearest unregulated supply plants from which an equivalent volume was received, and the basic formula price, by the pounds of skim milk and butterfat in receipts of concentrated fluid milk products assigned to Class I pursuant to §1068.43(e) and §1068.44(a)(7)(i) and the pounds of skim milk and butterfat subtracted from Class I pursuant to §1068.44(a)(11) and the corresponding steps of §1068.44(b), excluding such skim milk and butterfat in receipts of bulk fluid milk products from an unregulated supply plant to the extent that an equivalent amount of skim milk or butterfat disposed of to such plant handlers fully regulated under any Federal milk order is classified and priced as Class I milk and is not used as an offset for any other payment obligation under any order;

(g) Subtract, for a handler described in §1068.9(c), the amount obtained from multiplying the Class III price for the preceding month by the hundredweight of skim milk and butterfat contained in inventory at the beginning of the month that was delivered to another handler's pool plant during the month,

(h) Subtract, for reconstituted milk made from receipts of nonfluid milk products, an amount computed by multiplying \$1.00 (but not more than the difference between the Class I price applicable at the location of the pool plant and the basic formula price) by the hundredweight of skim milk and butterfat contained in receipts of nonfluid milk products that are allocated to Class I use pursuant to §1068.43(e);

(i) Exclude, for pricing purposes under this section, receipts of nonfluid milk products that are distributed as labeled reconstituted milk for which payments are made to the producer-settlement fund of another order under §1068.76(a)(5) or (c), and

(j) For pool plants that transfer bulk concentrated fluid milk products to other pool plants and other order plants, add or subtract the amount per hundredweight of any class price change from the previous month that results from any inventory reclassification of bulk concentrated fluid milk products that occurs at the transferee plant. Any such applicable class price change shall be applied to the plant that used the concentrated milk in the event that the concentrated fluid milk products were made from bulk unconcentrated fluid milk products received at the plant during the prior month

All other orders.

- Adopt the provisions of the Upper Midwest Order (1068)

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All orders:

- add the following paragraph

“(h) Subtract an amount equal to any credits applicable pursuant to section 100X.55.”

100X.61 Computation of Uniform Price

- Adopt the provisions of the Upper Midwest Order (1068).

100X.62 Announcement of Uniform Price and Butterfat Differential.

- Adopt the recommendation of the Uniform Provisions Committee.

100X.70 Producer Settlement Fund

- Adopt the recommendation of the Uniform Provisions Committee.

100X.71 Payments To The Producer Settlement Fund

- Adopt the recommendation of the Uniform Provisions Committee.

100X.72 Payments From The Producer Settlement Fund

- Adopt the recommendation of the Uniform Provisions Committee.

100X.73 Payments to Producers and to Cooperative Associations

- Adopt the recommendation of the Uniform Provisions Committee with the following addition.

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100X.74 Butterfat Differential

- Adopt the recommendation of the Uniform Provisions Committee with the following correction and addition:
- Correction: replace "... for manufacturing grade milk in Minnesota and Wisconsin..." with "for Grade A and manufacturing grade milk in the Midwest Marketing area".
- Addition: "The butterfat differential applicable to Class I milk shall be the butterfat differential for the second preceding month."

100X.75 Plant Location Adjustments for Producers and on Nonpool Milk

"(a) The uniform price shall be adjusted according to the location of the plant at which the milk was physically received. The rate shall be the amount by which the Class I price at the location of the plant differs from the weighted average location price. The weighted average location price shall be calculated by the market administrator by

(i) summing for all plants the product of the hundredweights of producer milk received at each plant and the Class I price at the location of such plant, and,

(ii) dividing by the total hundredweights of producer milk received at all plants."

"(b) The Uniform price applicable to other source milk shall be adjusted at the rates set forth in paragraph (a). above "

100X.76 Payments by a handler operating a partially regulated distributing plant

- Adopt the recommendation of the Uniform Provisions Committee

100X.77 Adjustments of Accounts

- Adopt the recommendation of the Uniform Provisions Committee