

BEFORE THE SECRETARY
UNITED STATES DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

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In the Matter of
Milk in the Pacific Northwest Marketing Area;
Docket No. AO-368-A24; DA-01 -06

PROPOSED FINDINGS, CONCLUSIONS
AND BRIEF

On Behalf of

Northwest Milk Marketing Federation

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PROPOSED FINDINGS AND CONCLUSIONS

Preliminary Statement

A public hearing was held upon proposed amendments to the marketing agreement and the order regulating the handling of milk in the Pacific Northwest marketing area. The hearing was held pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601-674), and the applicable rules of practice (7 CFR Part 900), at Seattle, Washington on December 4, 2001, pursuant to a Notice of Hearing issued on November 14, 2001 and published November 19, 2001 (66 F.R. 57889).

The material issues on the record of the hearing relate to:

1. Pooling standards for supply plants operated by a cooperative or other plant operator;
2. Establishing pooling standards for a manufacturing plant located in the marketing area and operated by a cooperative or its wholly owned- subsidiary;
3. Adding a provision to permit cooperative pool manufacturing plants, operating as a system of two or more plants, to qualify for pooling as a unit;
4. Reducing the amount of milk that a pool plant may divert and adding a delivery requirement for a dairy farmer to be eligible for diversion;
5. Whether emergency conditions exist with respect to the several issues,

The following proposed findings and conclusions on the material issues are based on evidence presented at the hearing and the record thereof:

1. Pooling standards for supply -plants. Section 1124.7(c) of Order 124

provides that the term "pool plant" includes a supply plant from which not less than 20 percent of the total quantity of milk that is physically received at such plant from producers (excluding milk received as diverted milk), or diverted to another plant, is shipped to a pool distributing plant as a fluid milk product. Section 1124.7(c)(2) provides that a cooperative association that operates a supply plant may include as a qualifying shipment its deliveries to pool distributing plants of 9(c) milk directly from farms of producers. Section 1124.7(c)(3), similarly, provides that the operator of a pool supply plant may include as a qualifying shipment milk diverted to a pool distributing plant.

Proposal 1, proposed by Northwest Milk Marketing Federation (NMMF), proposes the deletion from the Order of the qualifying shipment provisions of Sections 1124.7(c)(2) and 1124.7(c)(3) and the amendment of the Order by the adoption of a new pool plant designation for plants which supply the fluid requirements of distributing plants.

2,3. Pooling standards for manufacturing plants located in the marketing area and operated by a cooperative

Proposal 1 also proposes that the "Pool plant" definition of the Order be amended to include a manufacturing plant located in the marketing area and operated by a cooperative association or its wholly owned subsidiary. Such a plant would qualify as a pool plant if, during the month, or the immediately preceding 12-month period ending with the current month, 20 percent or more of the producer milk of members of the

cooperative, plus nonmember milk marketing by the cooperative, is shipped to and received as bulk milk by pool distributing plants either directly from farms or by transfer from a supply plant owned and operated by the cooperative or its wholly owned subsidiary. The Proposal provides, also, that two or more such cooperative manufacturing plants may, pursuant to a written request to the market administrator, operate as a system to qualify for pooling as a unit by meeting the 20 percent shipping standard of the proposal.

Proposal 1 should be adopted. NMMF, the proponent of the Proposal, explained that its adoption was needed to facilitate the efficient delivery of milk to the market area's pool plants while, at the same time, permitting the inclusion in the Order of a more stringent six day "touch base" delivery requirement for "producer milk" eligible for diversion, as explained below in Proposal No. 2 (Van Dam. Tr. 57-58). As the NMMF witness explained, adoption of the cooperative manufacturing pool plant definition:

will allow the cooperatives operating these plants to divert "close in" members milk to the fluid plants while milk close to the manufacturing plants can be delivered there. This will allow the already quite efficient system to continue to function without the disruption of moving each producer's milk to a fluid plant six days a month. (Tr. 58).

The NMMF Proposal No. 1 was supported by witnesses for Northwest Dairy Association (McBride, Tr. 75), Washington State Dairy Federation (Jensen, Tr. 147), Tillamook County Creamery (Schild, Tr. 148), and Dairy Farmers of America (Hollon, Tr. 158). The proposed cooperative pool plant provision is similar to comparable

provisions in other orders. See e.g. Section 1005.7(d) (Appalachian Order), Section 1006.7(d) (Florida Order), Section 1007.7(d) (Southeast Order), Section 1032.7(d) (Central Order), Section 1033.7(d) (Midwest Order), Section 1126.7(d) (Southwest Order), Section 1131.7(d) (Arizona-Las Vegas Order), Section 1135.7(d) (Western Order). The reason for the adoption of what has now become the typical cooperative pool plant provision lies in the obvious flexibility that it affords the cooperative in achieving optimal efficiency in organizing its milk assembly and delivery operations.

4. Amendment of the Order's diversion provisions.

Section 1124.12(a)(1) includes within the term "producer" a dairy farmer whose milk is "received at a pool plant directly from the producer or diverted by the plant operator in accordance with Section 1124.13." Under Section 1124.13(e)(i), the term "Producer milk" includes milk:

Diverted by a pool plant or a cooperative ... subject to the following conditions: (1) of the quantity of producer milk received during the month (including diversions but excluding ... milk from [a9(c) handler], the handler diverts to non-pool plants not more than 80 percent during the months of September through February and not more than 99 percent during the months of March through August.

Order 124 is unique among the eleven federal orders in imposing no individual prior delivery "touch base" requirement by a producer to qualify for diversion (Van Dam, Tr. 51; Hollon, Ex. 9).

Proposal 2, proposed by NMMF, proposes the amendment of Section 1124.13(e) by providing, as an eligibility condition for diversion, the physical delivery to a pool

plant of at least six days production of a dairy farmer during the month and by limiting to not more than 80 percent of the quantity of producer milk received during the month (including diversions, but excluding the receipt of 9(c) milk) the amount that a handler may divert to non-pool plants.

Proposal 2 should be adopted. As the NMMF proponent witness testified:

Proposals 1 and 2 are designed to correct what appear to be unintended consequences of basic changes wrought by federal order reform in the manner in which the producer location value of the milk is determined. The AMAA authorizes the Secretary to adjust the "uniform prices for all milk delivered" by producers in each federal order to reflect "the locations at which the delivery of such milk is made" Prior to reform, adjustments to the producer blend prices based upon distance from a basing point specified in the order acted as an effective means of defining the producers who constitute the reliable source of milk for each marketing area's handlers.

The January 1, 2000 reform amendments brought a fundamental change to the federal order pricing system. Utilizing a computer generated "model" of the nation's dairy industry, the reform decision determined what it described as the "spatial" value of milk at several hundred local supply and demand locations across the country. Based on the model, Federal order Class I differentials were established for milk delivered to plants in every county in the nation to reflect the county's supply and demand value of milk rather than distance from an order's basing point.

Under the new system, milk diverted from plants in the marketing area and delivered hundreds of miles distant can now be "valued" at the same price as milk at the plant from which the milk was diverted.

Though the Secretary specifically considered and rejected "open pooling" during the rule-making process that culminated in the reform amendments, elimination of the pre-reform producer location adjustment, coupled with loose or no "touch base" diversion provisions, has none-the-less permitted the pooling on the PNO of milk from sources far removed from the PNO historic milk supply. though "open pooling" was rejected by the

Secretary, the reform amendments brought about what can only be described as something very close to "open pooling" in a number of the 11 federal milk orders. As a result, the milk order system is now undergoing the consequences of what should have been, but apparently was not, predicted. (Van Dam, Tr. 47-48)

The NMMF witness explained that prior to the implementation of the January 1, 2000 federal order reform amendments, 98 percent of the milk pooled in the PNO was produced within the marketing area. Of the less than two percent of the pooled milk produced outside the marketing area, almost all was produced in two northern California counties by producers with a long and consistent association with the PNO marketing area. The only Idaho milk pooled in the PNO marketing area originated within the six Idaho counties of the marketing area.

The NMMF witness testified, further, that within a few months following the implementation of the reform amendments a dramatic expansion occurred in the pounds of milk pooled on the PNO, produced in geographic areas, and by dairy farmers, far removed from any prior association with the PNO marketing area. According to the NMMF witness:

Market Administrator data show that prior to July 2000, no Southern Idaho or Utah milk was pooled on the PNO. From July 2000 through September 2001 a dramatic change occurred that continues up to this time. During that fifteen month period 475,896,568 pounds of (almost exclusively) Class III milk, originating from Southern Idaho and Utah sources beyond the PNO historic milk-shed, have been "paper pooled" on the PNO. The term "paper pooled" means milk that is not historically associated with the PNO, milk that is not delivered to plants in the PNO, and milk that is not needed currently nor in the foreseeable future to meet the Class I needs of the PNO.

Exhibit 7 is our estimate of the loss to the Order 124 producer price differential and blend price resulting from the "paper pooling" of Southern Idaho and Utah milk. This translates into an estimated 15 month aggregate loss of \$6,625,000 to the producers who constitute the historic source of supply to the PNO handlers. (Van Dam, Tr. 52 -53)

The reason for the enormous expansion of pooled, but undelivered, milk on the PNO, and the \$6.625 million loss to the producers who constitute the historic supply source for the marketing area's handlers, stems from the two-fold impact of the Federal order reform "nationally coordinated Class I pricing surface" (64 F.R. 16108) and the "loose" diversion provisions of the PNO. The reform "Class I price surface" structure adopted a location value for "milk", without reference to its use, with the result that "Producer milk" diverted for manufacturing can assume a "value" higher or lower than the order blend depending upon the location of the plant to which the milk is diverted. The PNO's "loose" diversion provision is unique among the 11 Federal orders in the absence of any prior delivery requirement by a producer as a condition for diversion eligibility. The result should have been predictable. The reform irrational pricing structure, coupled with the PNO's no "touch base" requirement and 99 percent March through August diversion provision, "constitutes virtually an invitation to 'open pooling' of milk for which the PNO blend offers a more attractive return than the alternative adjacent Order 135." (Van Darn, Tr. 51-52)

As the NMMF witness noted:

The Secretary's April 2, 1999 Final Decision which consolidated the then existing 31 orders into 11 separate orders was based on his determination

that "overlapping route disposition and milk procurement area are the most important criteria to consider in the consolidation process" (64 Fed. Reg. 16045). The pooling of distant milk and producers located beyond the historic PNO procurement area is in conflict with the Secretary's consolidation criteria. It results in a transfer of pooled Class I dollars away from the PNO's procurement area producers to another area's producers contrary to the basic statutory purpose for which the FMMO system was established. (Van Dam, Tr. 54)

That the "paper pooling" provisions of the PNO are inconsistent and in conflict with the separate marketing area mandates of the AMAA is clear from the language of the Vermont federal court decision in St. Albans Co-op Creamery v. Glickman, 68 F. Supp 2nd 380 (D. Vt. 1999). The court's decision in that case states:

The AMAA statutory system mandates local regulation tailored to particular marketing conditions. 7 U.S.C. Section 608c(11). The AMAA directs the Secretary to "give due recognition to the differences in production and marketing" of milk in each production area. -Specifically the Secretary is directed ... to establish prices to "re flect the price of feeds, the available supply of feeds and other economic conditions which affect the supply and demand for milk in the marketing area to which the marketing order relates. 7 U. S.C. Section 608c(18). (68 F. Supp. 2d at 383)

The flawed reform amendments and loose diversion provisions of the PNO that permit the artificial "paper pooling" transfer of PNO pooled handler revenues from producers for whom the PNO was established to producers totally unassociated with the PNO marketing area is contrary to the AMAA Section 608c(11) requirement that order provisions be tailored to differences in production and marketing in each production area. The PNO "open pooling" and loose diversions provisions are in conflict, also, with the statutory 608c(18) requirement that producers who actually supply the "demand for

milk in the marketing area" receive a price that reflects the pooled proceeds of that demand.

The NMMF proposals 1 and 2 to amend the PNO are designed to correct flaws in the order provisions resulting from the unanticipated consequences of federal order reform. Adoption of NMMF proposals will insure that producers whose milk constitutes the daily and reserve supply for the marketing area's demand for milk receive the price that reflects that demand.

5. Emergency conditions warrant omission of a recommended decision.

The NMMF proposals are submitted on behalf of 98 percent of the producers who, historically, have supplied milk to the PNO handlers and who account for 97.5 percent of the milk pooled on the order (Van Dam, Tr. 45-46). The NMMF Proposals 1 and 2 are supported also by all of the participants who appeared at the hearing (see above). No conflicting, additional or opposing proposals were considered or offered at the hearing.

The existing PNO diversion provisions have caused, and continue to cause, the NMMF associated producers significant and irreparable economic loss that demands prompt amendatory action. Until such action is implemented, the market administrator's January 4, 2001 temporary decrease in diversion limits to 80 percent in all months, offering some slight remedy, should continue in effect.

Under 7 CFR Section 900.12(d) a recommended decision may be omitted "if the

Secretary finds on the basis of the record that due and timely execution of [her] functions ... require such omission.” All of the record evidence in this proceeding not supports the adoption of Proposals 1 and 2; the record evidence, by all participants, supports omission of a recommended decision.

Since the only evidence presented in the hearing record is in support of Proposals 1 and 2, adoption of the proposals and amendment of the PNO is virtually under the formal rulemaking provisions of sections 556 and 557 of the Administrative Procedure Act, that governs these proceedings, and by Section 608c(4) of the AMAA. Clearly, the adoption of the NMMF proposals "will tend to effectuate the declared policy of" the AMA (608c(4)). Issuance of a recommended decision could serve no statutory purpose.

Accordingly, NMMF requests that a final decision and order issue at the earliest possible time amending the PNO in conformity with Proposals 1 and 2.

Respectfully submitted,

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by: Sydney Berde

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