

BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

MILK IN THE CENTRAL)	DOCKET NO: AO-313-A48; DA-04-06
MARKETING AREA)	
)	
HEARING ON PROPOSED)	
AMENDMENTS TO)	
POOLING PROVISIONS)	

Brief of Select Milk Producers Inc. and Continental Dairy Products Inc.

I. Introduction

Select Milk Producers Inc. and Continental Dairy Products Inc. submit this brief and proposed findings of fact and conclusions of law in support of certain proposals to address the problems associated with de-pooling in the Central Marketing Area. Select and Continental are Capper-Volstead cooperatives which market milk in the Federal Order system. Select has members located within the Central Marketing Area, and some of the milk of Select is marketed in the Central Marketing Area.

Select and Continental support the adoption of Proposal Six above those other proposals offered to address the issue of de-pooling. Continental also supports the adoption of certain aspects of Proposal One that address loose pooling problems in the Central Order.

The problem of de-pooling and the associated problem of loose pooling have been adequately described by several witnesses who testified at the hearing. Any amended Order should be that which the Department deems most effective in protecting the interest of producers and consumers in an orderly supply of milk to the consumer market. *See 7 U.S.C. §608c(4); Kinser Tr. 623-34.* To that end, Select and Continental support proposals which eliminate or curtail the ability of plants to de-pool and re-pool at will. Among alternatives, those proposals which most comprehensively or substantially address the problems facing the producers in the Central Order should be adopted.

In addition, Select and Continental support changes to regulations which promote efficiency of milk movements, efficiency of producer operations, efficiency in milk procurement, and close true loopholes.

II. Select and Continental Support Regulations to Limit De-pooling.

A. The Problem of De-pooling

Addressing the true causes of price inversion and negative PPDs are issues which are national in scope and beyond the scope of this hearing. However, the problem posed by the ability to exacerbate a negative PPD through de-pooling is critical and pervasive and must be addressed in the best way possible.

Depooling is a problem because it results in different returns from the Order for milk sales. Milk is only depooled when the result means more money for the handler who depools. Since by definition Class I milk cannot depool, then the Class I sale is always disadvantaged when milk is depooled. The handler with Class I sales must draw from margins in order to pay a competitive pay price because his regulated

return is less than the depooling handler. If he cannot or does not, he will lose his milk supply to a handler who does depool. Thus, handlers in common procurement areas face widely different returns from the regulated pricing scheme. This is the ultimate in irony - that the source of additional value to the pool, Class I milk, is unable to be competitive with other class sales due to depooling.

Hollon Tr. 235-36.

The current regulations permit milk to move in and out of the pool at will, without consequence. The statistics provided by the Market Administrator demonstrated that in a typical month, 1.5 billion pounds of milk are pooled on the Central Order but in months when the Class I price is less than the blend price, de-pooling reduces that figure by approximately half. When prices return to “normal,” the de-pooled milk returns. Ex. 10, p. 18. *See also* Hollon Tr. 237. The only economic consideration for the handler of non-Class I milk is whether the instant monetary return would be greater at the blend price or the Class price. Pool distributing plants and the producers who supply them are the only order participants left without the opportunity to make this decision, and are accordingly, disadvantaged.

To allow pool plants to leave the pool and re-enter at will causes disruptive marketing conditions and adversely effects producers who are unable to de-pool. As the market statistics established, “in April 2004 the published PPD of negative \$3.974 would have been \$0.87 more if the pool had contained 25 percent more Class III milk. If all of the de-pooled Class III milk would have been included, the pool would have been \$2.15 greater.” Hollon, Tr. 239 (describing Ex. 10, p. 14). If manufacturing plants wish to share in the higher value uses when prices are high then they should also be required to absorb negative returns in those instances when price inversions occur. It is a matter of equity and fairness. Though pricing and pooling are month-to-month occurrences, the costs of balancing milk supplies and serving the market are borne continuously.

B. Proposal Six offers the best available solution to the problem of de-pooling.

Because de-pooling is a problem for producers and adversely affects the ability of all producers to share in the returns from sales in the marketing area, the problem should be addressed as strongly as possible. *See e.g.* Kinser Tr. 662-63 (criticizing past actions as “tweaks or small patches when more concise and meaningful action was needed”). Four proposals have been offered to address the problem. Of the four alternatives, Select and Continental support the single proposal which most comprehensively addresses the issue. Proposal Number Six, which would establish a one year “dairy farmer for other markets provision” applicable to those plants that de-pool is the most comprehensive of the alternatives.

If indeed de-pooling is the problem that has been portrayed, which Select and Continental believe it is, then any action of the Department which only partially addresses the problem is an incomplete and, therefore, inferior solution. Proposals Two, Seven, and Eight only incrementally address de-pooling and should not be adopted as long as Proposal Six is a viable alternative.

Proposal Two would limit the pounds of milk a handler could pool to 125% of the amount pooled in the previous month. Accordingly, the handler could de-pool 20% of its milk without penalty in any given month. Ex. 10, p. 16. If the price inversion were to last for two or three successive months, as occurred in 2003 and 2004, the handler could de-pool half of its milk or more—to the detriment of producers. Ex. 10, p. 16, 18. As DFA’s witness testified, Proposal Two “will not eliminate depooling” but represents a “modest . . . reasonable position to control the problem.” Hollon Tr. 242. De-pooling is not a modest problem for producers, it is a serious problem and demands a serious solution. While Proposal Two represents an improvement over the status quo, there are better alternatives which more vigorously address the problem.

Proposal Eight is similar to the Proposal Two as it limits de-pooling by applying a percentage limitation to pooled milk. Because the limitation is set at 115% of the previous month's pooled milk rather than 125%, it more restrictive, and therefore more attractive as a solution. Proposal Eight would still permit limited de-pooling without consequence. Ex. 10, p. 16. (A 115% limitation would have permitted de-pooling of one-third of pooled milk for periods of price inversions in 2003 and 2004). It too, should be rejected in favor of a change that moves more toward the elimination of de-pooling, rather than reducing it.

Proposals Two and Eight are not solutions to de-pooling, they could be more accurately described as limitations on de-pooling. To permit a plant to de-pool some of its milk and then re-pool the following month, as Proposals Two and Eight allow, would send the message that de-pooling in moderation is a permissible tool to enhance income for a subset of pool producers. While de-pooling of non-Class I milk cannot be prohibited, it certainly should not be encouraged, it is detrimental to long-term producer interests.

Proposal Six establishes a dairy farmer for other markets provision that establish the kind of long-term consequences for de-pooling that are required. As hearing testimony explained:

[When faced with a dairy farmer for other markets provision,] handlers have to evaluate more than the current month's economic impact. This requirement causes them to behave differently than handlers pooling milk on [the Central] order, who only have to consider the immediate implications. They do not have to consider any possible future missed opportunities.

Kinser Tr. 653-54. By having to consider the long-term impact of a twelve month lock-out, handlers inclined to de-pool milk will be less likely to exploit short-term fluctuations in price by removing their milk from the pool. Additionally, any milk locked out is not absolutely prohibited from being pooled. As the Proposal is worded and the proponent's witness testified, any handler delivering

milk the fluid market may re-enter after de-pooling. This provides some leniency to the non-pooled handler but does not detract from the other positive aspects of Proposal Six.

Proposal Seven, which would establish a two to four month lock-out for plants that choose to de-pool, is a more appropriate solution than the permissive options presented by Proposals Two and Eight, but even Proposal Seven, is comparatively weak relative to Proposal Six in presenting an economic disincentive to de-pooling.

III. Only Milk that can Supply the Central Order's Class I needs should be Permitted to Pool on the Order.

A. Select and Continental support aspects of Proposal One.

Proposal One addresses the current laxity in the regulations that allows milk with little association to be pooled. The pooling qualifications need to be tightened, and certain portions of Proposal One should be adopted to achieve this end. As the Department stated the last time Central Order pooling was addressed, “[P]ooling milk on the Central order without demonstrating actual performance in servicing the Class I needs of the market area is neither appropriate nor intended.” 68 Fed. Reg. 51646 (August 27, 2003), *See also* Hollon Tr. 231. However, the goal of the Department should be to ensure that milk pooled on the Order actually is serving the Order, without focusing on the actual geographic origin of the milk or the location of the plant to which it may be diverted.

Select and Continental support the aspects of Proposal One which would increase the amount of milk a supply plant would need to ship to a pool distributing plant to be pooled. The evidence supports the need for this change. *See* Hollon Tr. 263-67 and Ex. 18, p. 34-35 (evaluating the returns to a distant shipper for various scenarios contemplated by Proposal One against current provisions).

Select and Continental also support the increase in the touch-base standard proposed and the proposed reduction in diversion limits. Again, testimony presented articulated the need for and intended effect of these provisions. *Id.*

Select and Continental oppose the proposed change that would limit geographically the non-pool plants to which a supply plant may divert its milk. Select and Continental believe that such territorial restrictions, while well-intentioned, will only be subject to scrutiny and challenge and may not reflect the reality of the marketplace as time goes on. In addition, the need to restrict diversions to near-in plants may prove unnecessary if the other aspects of Proposal 1 are adopted. Increasing shipment requirements, strengthening touch base standards and reducing diversion limits will make it less economically feasible for milk located great distances from the marketing area to be pooled unless it serves the market.

Select and Continental believe that the changes suggested in Proposal One, and many of the proposals offered by other Proposals to address association with the market would be unnecessary if the Department were to consider a “zone-out” or “zone-back” scheme that would price distant milk based in a way that reflects its location value and the cost to bring it to market. In fact, the department was asked to include proposals for hearing in Order 30 and Order 33, but declined to do so. Perhaps this was because the issue needs to be addressed nationally. Regardless, such provisions would be a great step toward limiting the reach of distant milk.

B. Select and Continental support regulations to prevent split-plant and supply plant abuses that dilute the Central Order blend price.

Proposals Four, Five, Nine, Ten, Eleven, Twelve and Thirteen also address the ease of pooling on the Central Order, but in the context of supply plant and the split-plant provisions of the Order.

The evidence presented is insufficient to demonstrate a need for the drastic action of eliminating all supply plant provisions, as suggested by Proposal Four. Properly used, supply plants provide an economical and efficient tool for maintaining a reserve supply of milk for the market. When used incorrectly, supply plants have the opposite effect of fostering inefficiency. In the Central Order, approximately 5% of Class I milk is shipped through supply plants which indicates that the supply plants are serving their purpose. Hollon Tr. 287. These plants represent an important tool in marketing the milk of numerous producers, and to eliminate them completely would do a disservice to those farmers.

Proposal Five, which is offered as an alternative to the elimination of supply plants, would increase supply plant shipping standards to 35% for July through January and to 25% for the remainder of the year and increase the touch-base standard to four days. Select and Continental support the goal behind Proposal Five, that is to curtail pooling abuses made possible by lax supply plant regulations. Those contained in Proposal Five, however, are excessive. The aspects of Proposal One that increase shipping standards to 25% for August through February and 20% for other months and establish a one day per month touch-base standard are sufficient to tighten the amount of distant milk brought into the Central Order. *See* Hollon Tr. 263-67 and Ex. 18, p. 34-35.

The elimination of split-plants suggested by Proposal Nine should not be adopted. Manufacturing handlers should be permitted to not pool their milk. The fact that a handler bottles milk and operates a separate facility from the same plant for manufacturing purposes should not

place that handler at a disadvantage to the market. Proposal Nine would do just that. Split plants, however, should be prevented from gaming the system to take advantage of their manufacturing plant.

Proposal Ten would prevent such abuse by split-plants. By requiring a split-plant to elect non-pool status for a twelve-month period, it would prevent them from de-pooling for short-term economic gain. Proposal Ten is consistent with Proposal Six in the duration of the ramifications resulting from de-pooling. Select and Continental support Proposal Ten as a realistic effort to curb de-pooling and split-plant status abuse.

Select and Continental oppose Proposals Eleven, Twelve, and Thirteen which would eliminate or modify supply plant systems. The testimony presented suggested that, “[supply plant systems are] typically a convenience to handlers to pool additional milk on orders without making shipments to the market.” Kinser Tr. 661, Ex. 34, p. 24. While this may be true, there was no evidence to support this assertion. Absent verifiable evidence to support the argument that supply plant systems do not serve the Class I market, Select and Continental must oppose the adoption of these proposals.

IV. Transportation and Assembly Credits, if adopted, should foster efficiency in the Order.

Proposal Three would impose a transportation credit and an assembly credit provision in the Central Order. Select and Continental oppose transportation and assembly credits generally. The Federal orders should set Class I differentials at a level sufficient to attract enough milk to the area and should limit the amount of milk pooled on the Order to a reasonable reserve supply. The fact that the blend price in the Central Order is insufficient to attract enough milk is evidence that these pay factors are out of balance.

Select and Continental do not contest the facts cited by the proponents which, they assert, demonstrates the need for such credits. Select and Continental, however, oppose the imposition of transportation credits as noticed and as proposed by Foremost Farms at the hearing. Foremost's proposal, as noticed and as amended, fails to pay transportation credits for milk shipped to a distributing plant direct from the farm and is, therefore, incomplete and promotes inefficiency.

Direct farm shipment is a more efficient alternative, and should be encouraged by the Federal Orders, not discouraged. The modification of Proposal Three testified to by the DFA witness is a transportation credit that Select and Continental can support. As the DFA witness stated:

We cannot support a credit for one portion of the supply and ignore the balance within the same market. Especially when that "ignored" balance is delivered in a more efficient mode of transportation. Our proposed modification would add a payment for direct-shipped milk that delivers to a pool distributing plant for Class I use. We would allow the payment for milk that is reloaded also, but at the same rate as milk that is not reloaded. This should recognize the service but provide the market with a "carrot" to move to the most efficient manner of delivery - farm direct.

Hollon Tr. 287. On cross-examination, the DFA witness stated that DFA opposed Proposal Three as noticed, and only supports the proposal as modified by DFA. *Id.* at 511-12. The proponent from Foremost Farms agreed that DFA's proposal would achieve the same results for the proponents as the Foremost proposal and that his organization had no preference as to which was adopted. Weis Tr. 593. Select and Continental concur that any transportation credit must be applied to all milk shipped for Class I use.

V. Summary

Select and Continental support Proposal One, except for the proposed changes to 7 C.F.R. § 1032.13(d) limiting supply plant diversions geographically.

Select and Continental oppose Proposal Two, unless Proposals Six, Seven, and Eight are rejected by the Department.

Select and Continental oppose Proposal Three as noticed. If the Department were to adopt a version of Proposal Three, Select and Continental only support a version that would compensate direct-shipped milk, as well as that shipped from supply plants.

Select and Continental oppose Proposals Four and Five.

Select and Continental strongly support Proposal Six, and support Proposals Seven and Eight only as less-effective alternatives to Proposal Six.

Select and Continental support proposal Ten, but oppose Proposals Nine, Eleven, Twelve, and Thirteen.

Select and Continental neither support nor oppose Proposal Fourteen.

Respectfully submitted,
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