

BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

MILK IN THE MIDEAST)	DOCKET NO: AO-166-A72; DA-05-01
MARKETING AREA)	
)	
HEARING ON PROPOSED)	
AMENDMENTS TO)	
POOLING PROVISIONS)	

Brief of Continental Dairy Products, Inc.

I. Introduction

Continental Dairy Products, Inc. (“Continental”) submits this brief and proposed findings of fact and conclusions of law in support of its proposal to eliminate depooling in the Mideast Marketing Area. Continental is a Capper-Volstead cooperative and markets milk in the Federal Order system, including in Order 33. All of Continental’s members are located within the Mideast Marketing Area, and some of the milk of Continental is marketed in the Mideast Marketing Area.

Continental supports the adoption of Proposal Five above all other proposals offered to address the problem of depooling.

The problem of depooling and the associated problem of loose pooling have been adequately described by several witnesses who testified at the hearing. Any amendment to the Order should reflect the Department's assessment of the most effective means to protect the interest of producers and consumers in an orderly supply of milk to the consumer market. *See* 7 U.S.C. §608c(4). To that end, Continental's proposal was drafted with the goal of eliminating the ability of plants to depool and re-pool at will. Among alternatives, the Department should adopt Continental's proposal because it will most substantially curtail the incidence of depooling in the Mideast Order.

In addition, Continental supports proposal one's "double dipping limitation" and opposes the transportation credit in proposal nine and the various permutations offered at the hearing. Continental neither opposes nor supports proposal two, but instead urges the Department to hold a national hearing on Continental's zone-out proposal which "is being held in abeyance."

II. Continental supports regulations to eliminate depooling.

A. The Problem of Depooling

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 depooling is critical and pervasive and must be addressed in the best way possible:

Depooling is a problem because it results in different returns 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 that of the depooling handler. If it cannot or does not meet the depooled competition, the Class I handler risks losing its milk supply to a depooling handler.

Gallagher Tr. 244.

Current regulations permit milk to move in and out of the pool at will, without consequence. In a typical month, 1.5 billion pounds of milk are pooled on the Mideast Order but in months when the Class I price is less than the blend price, depooling reduces that figure by approximately one-third. When prices return to “normal,” the depooled milk returns. Ex. 6, Table 5. 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 adversely affects producers who are unable to depool. In April 2004 the Order PPD would have been \$1.67 more if an economic disincentive to depooling Class III milk had been in place. Ex. 7, Request 5. Similar positive benefits would have accrued to Order 33 producers in January 2003 (\$0.01), March 2003 (\$0.01), July 2003 (\$0.07), August 2003 (\$0.42), September 2003 (\$0.16), October 2003 (\$0.08), May 2004 (\$0.74), and December 2004 (\$0.29). *Id.* The “real world” impact of these losses was testified to by a parade of Order 33 producers who feel the impact of depooling in their monthly checks.

As a matter of equity and fairness, manufacturing plants that pool when they take money from the pool should also pool when they need to pay-- share and share alike.

B. Continental’s proposal five offers the only complete solution to the problem of depooling.

Because depooling 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. 949-50 (criticizing past actions as “tweaks or small patches when more concise and meaningful action was needed”).

The true question the Department must answer is whether to provide an end to depooling or a reduction in the amount of milk that may be depooled. The industry has presented the Department the usual litany of alternative proposals to deal with the ease of reattaching depooled milk to the order. The various proposals all have, ostensibly, the same goal. The differences among them concern the degree to which each prevents depooling from occurring.

If depooling is the problem that has been portrayed, which Continental believes it is, then any solution that only partially addresses the problem is incomplete and, therefore, inferior. Among the alternatives, only Continental’s proposal five comprehensively addresses the issue. The other proposals only incrementally address depooling and should not be adopted as long as proposal five is a viable alternative.

Continental’s proposal would prevent a producer who depooled from reentering the pool for one full year. Unless the producer lost his Grade A permit or was a new producer, no exception would be permitted. Market administrator’s exhibits and testimony established that if proposal five were in place in 2004, milk that had depooled in April would have remained out of the pool and in subsequent months the PPD would have been higher by as much as \$0.61. Ex. 10, Request 9. Of course, that milk might have never depooled in the first place. For April 2004, that would have had a positive impact of \$1.66 on the PPD. *Id.* Either scenario is an acceptable outcome for the producers who derive their income from the Order 33 pool.

No other depooling proposal can boast such an impactful result. The other proffered alternatives permit some degree of depooling without penalty or an avenue for reentry into the pool.

The exact impact on the PPD has not been calculated, but the negative impact of depooling that proposals four, six, seven, and eight would allow would be greater than the impact of any depooling under proposal five.

In that they would keep milk out of the pool for a fixed period of time, proposals four and eight are facially similar to Continental's proposal. However, the ability to deliver ten days production to a distributing plant provides a way back into the pool for many who might depool. Where large segments of the market are controlled by a small number of players with substantial Class I access, the opportunity for significant depooling remains:

Q. Would you agree that even if it's a requirement that they deliver ten days' production for an entire year for a -- for an organization that has a large percentage of Class I deliveries, probably more than a third of their milk, it does allow them some flexibility to, as you say, play games with the Order?

A. That is a possibility.

Q. That they would -- if there were, for instance, 40 percent Class I milk deliveries, they would be able to, perhaps, depool and then over the next 12 months have those farmers re-pooled back?

A. I think you may have some challenges in -- on that scale because you're -- all the farms are going to have to have 10 days of milk production get to a distributing plant. So you only have a 30-, 31-day window, and in February then you have a 28-day window, so I think there's going to be some challenges. It's not a wide open door, but I would agree it is also not perfect.

Q. It wouldn't be easy and it wouldn't work for everybody, but with a handler with access to Class I plants, a large amount of access to Class I plants, there is some room for games for shift (sic, gamesmanship) to be had under Proposal 4?

A. Yeah. They shuffle the trucks, that could be done.

Kinser Tr. 1021-22.

Proposals six and seven limit depooling by applying a 115% percentage limitation to pooled milk. These proposals would still permit limited depooling without consequence. Ex. 7, Request 12 (A 115% limitation would have permitted depooling of one-third of pooled milk for periods of price inversions in 2003 and 2004). In addition, proposals six and seven would permit any depooled milk to reenter the pool by delivering to a distributing plant. Proposals six and seven are not solutions to depooling; they could be more accurately described as limitations on depooling. To permit a plant to depool some of its milk and then re-pool the following month sends the message that depooling in moderation is a permissible tool to enhance income for a subset of producers. Depooling should not be encouraged; it is detrimental to long-term producer interests. The very fact that these options were designed with the intent that some depooling be permitted should be sufficient reason to reject them.

Given the chance, the industry will depool milk, though dairy producers demand different behavior. Everyone who can depool does so because it makes them money. The industry has proven time and again that where a regulation can be exploited, exploitation will follow. One needs only to look at this hearing record for evidence of such behavior.

- “DFA, MMPA, Dairylea and NFO, depool milk when economically advantageous to our members and logistically feasible.” Gallagher Tr. 209.

- DMS evaded the relatively strict depooling limitations in Order One by shifting milk to Order 33 when locked out of the Northeast. Gallagher Tr. 326-27.
- “DFA has an obligation to its members to maximize the returns to those members based on all legal methods available to it including whatever provisions are in one Order or between Orders that allow it to maximize the revenues for its members.” Gallagher Tr. 408.
- “My cooperative [DFA] is criticized when we depool. Our members expect that we will act in their best interest at all times. We have to play by the rules as a defensive move when others depool and have the ability to pay higher prices to their producers.” Croner Tr. 480.
- “Since we have diversions of surplus milk to stand alone manufacturing plants, we depool when it is advantageous. Although we do this, we do not feel that doing so is in the best interest of Federal Order.” Lee Tr. 492.
- “Stop me before I kill again.” Lee Tr. 507 (describing the industry’s seemingly irreconcilable positions of depooling when advantageous but requesting depooling restrictions).

So, faced with a serial killer pleading for intervention, what is the Department to do? The answer is simple. Take away the weapon; don’t simply exchange a knife for a gun. Whereas proposals four, six, seven, and eight are different weapons downgrades, proposal five is as close to disarmament as we can get.

Dairy producer witnesses asked for stringent reform. In fact, many demanded that the depooling solution ultimately adopted be as strict as possible:

- “[W]e would tend to support the most rigorous of standards for access to the pool and penalties to dissuade local milk handlers from capriciously exiting and re-entering the pool, within practical limits.” Wolfe (Ohio Farmer’s Union) Tr. 174.

- “[W]e are not in support of any quick reentry into the pool. In other words, if -- it's our position that it ought to be -- if you leave the pool, it ought to be six months before you get back and so forth.” Lausin (Ohio Farm Bureau) Tr. 390.
- I like the more stringent [depooling proposals]. In other words, like, once you depool that you stayed out longer. Rohrer Tr. 397.

In contrast, the witness testifying in support of proposal seven indicated a desire for only limited reform. Gallagher Tr. 207 (goal of proposal seven is to “mitigate” depooling); 252 (proposal seven does not eliminate depooling but is a “modest” solution). In effect, these organizations requested that the bleeding be reduced, not stopped. Presumably, the more limited reforms will leave these organizations the ability to depool by removing only a percentage of their milk from the pool, structuring their deliveries, and moving milk between markets as has been done in the past. Assuming that the cooperatives could help themselves, those who did not depool when it was to their financial advantage would be breaching their fiduciary obligations to their membership. Those producers in Order 33 who do not have such flexibility will remain disadvantaged.

Accordingly, when asked the question, “Should we ‘mitigate’ depooling or should we should implement the strongest possible solution to prevent depooling altogether?,” the answer must be that we act with strength.

Continental’s proposal provides the greatest economic disincentive to depooling and is the strongest available solution. Accordingly, we urge the adoption of proposal five.

III. Continental urges a prompt hearing on its zone-out proposal.

Continental takes no position on proposal two because we believe that the changes suggested in proposal two would be unnecessary if the Department were to consider a “zone-out” or “zone-

back” scheme that would price distant milk in a way that reflects its location value and the cost to bring it to market. In fact, the Department was asked to include such a proposal for this hearing but declined to do so. Instead, the proposal was “held in abeyance.” Ex. 30, p. 36. Now is the time to announce such a hearing.

IV. Continental opposes the Transportation Credit in proposal nine.

Continental opposes transportation and assembly credits generally. The Federal Orders should set Class I differentials at a level sufficient to attract milk to the area where it is needed and should limit the amount of milk pooled on the Order to a reasonable reserve supply. The fact that the pricing surface in the Mideast Order may be insufficient to attract enough milk to fluid plants is evidence that suggests these pay factors are out of balance.

Continental opposes the transportation credits outlined in proposal nine. The evidence suggests that the credits, as conceived, would benefit primarily the few cooperatives who introduced and testified in support of the proposal. Those close-in producers supplying a plant will support, through reduced blend prices, more distant producers. This is in clear and direct violation of the “nearby” differential prohibition of *Zuber v. Allen*, 396 U.S. 168 (1969). Though in a negative sense, the purpose is to make milk more valuable based on its proximity. Close-in producers receive little benefit from a credit that excludes milk shipped less than 75 miles. In Order 33, this includes a substantial number of independent producers shipping to Superior Dairy and Smith Dairy. Rohrer Tr. 395; Steiner Tr. 880; Soehnlén Tr. 1096. In addition, at least one witness testified that the convoluted scheme would actually foster inefficient movement of milk to capitalize on the credit. Lee Tr. 498-99.

Most problematic, however, is that the credit would be retained by the handler in those cases where the milk is shipped from a non-cooperative producer. This intended result is inequitable on its face and will have the effect of driving independent producers to cooperatives. While Continental and its members obviously believe in the benefit of well-run cooperative associations, the choice of any individual producer to join or to refrain from joining in cooperative marketing should be one made freely. Continental opposes any measure that in purpose or effect eliminates producer choice in marketing milk.

Proponents of the transportation credits suggested that paying the credits to the handler was appropriate because the independent producer presumably negotiated a transportation cost in making a decision to ship his or her milk. Gallagher Tr. 535-39. But wouldn't the cooperative have made a similar decision? In fact, the cooperative should have done so and also probably received an over-order premium in addition to the federal order minimum price. Rasch Tr. 597-99. This premium would include the cost of supplying (i.e. transporting milk) to the plant. If not, then the over-order agency and the cooperatives should do so instead of saddling all producers with the cost.

Proposal nine benefits a privileged few at the expense of all.

V. Summary

Continental supports proposal one on "double-dipping."

Continental takes no position on proposal two and urges the Department to notice a national hearing on a zone-out provision for all federal orders instead of tightening pool qualifications order-by-order.

Continental opposes proposals four, six, seven, and eight regarding depooling as they will only foster additional gamesmanship.

Continental supports its own proposal five as an effective depooling disincentive.

Continental opposes proposal nine regarding transportation credits.

Respectfully submitted,
YALE LAW OFFICE, LP

BENJAMIN F. YALE
KRISTINE H. REED
RYAN K. MILTNER
527 North Westminster Street
P.O. Box 100
Waynesfield, Ohio 45896
(419) 568-5751
(419) 569-6413 Fax