December 15th, 2008

To: Northwest Dairy farmers and interested parties.

RE: Concerned about Milk Pricing? What you **can** do...

The net effect in October due to de-pooling and pool-loading activity and the effect of changes in the make allowance was to drop the Pacific Northwest blend price by approximately $1.00/cwt. November looks like more of the same. It is time for producers to take actions to change; this letter is a request for such action.

Over the past months numerous producers from across the Northwest have grown increasingly alarmed about the impacts on milk checks from changes and actions occurring under Federal Order Rules. Specifically farmers across the Northwest are concerned about the Make Allowance, De-pooling and amount of milk being pooled on the Pacific Northwest Market from Southern Idaho (pool-loading).

The Make Allowance changes were the result of a lengthy process, while the rules resulted in a drop in producer prices, the rules were well vetted before adoption and these changes are generally viewed as consistent with the historical principles and purposes of the Federal Order.

De-pooling Rules currently allow milk to be pooled or "de-pooled" monthly with out limitation, changes have been made in other orders and proposals considered here but these rule changes must go through a full Federal Order rule change hearing process. There are several Federal Orders (and the California State Order) that restrict re-entry of De-pooled milk but any reform process will take a lengthy amount of time.

Pooling rules however have a different process for making changes; hence the purpose of this letter is to:

- Build an understanding of the pooling rules among dairy producers in Oregon and Washington.
- Build support for a letter sent by January 12th, 2009 to the Federal Market Administrator, asking him to look at existing rules regarding pooling of milk on the NW Federal Milk Marketing Order (PNWO)

The pooling of milk from Southern Idaho, in the months when pooled, represents an approximate 10% increase in the milk drawing from the pool in the Pacific Northwest. The concerns are two fold:

- The financial drain on the farmers across the Pacific Northwest by this pooling of Idaho milk.
- This milk is being pooled with little of it actually meeting the expected outcome of rulemaking in 2002. One goal of that rule making was well understood by many folks; to prevent distant pooling of milk that provided little in the way of service to the market. The rules established by that process instituted "performance standards" that were expected to prevent this kind of distant loading of milk. The rules we operate under here in the Pacific Northwest many believed then, as now, must limit this type of pooling lest it undermine the purposes and principles of a Federal Order.

It is our hope and desire you sign in support the attached letter by January 12th. It asks the Federal Market Administrator in Seattle to evaluate the Pooling conditions and move to take new action. Changes in the rules must ensure that milk pooled and drawing from the pool has reasonable performance standards.

Below is:

1. A brief outline of the basics of pooling
2. A historical and current summary of the pooling rules.
3. An analysis of the effects of this additional pooled milk.

Milk Pooling Basics

To illustrate federal or state milk marketing pooling:

Divide a group (Pool) of nine farmers into three categories;

- 3 produce butter and powdered milk,
- 3 produce cheese and
- 3 supply a bottler of milk.

For simplicity each produces 100 pounds of milk a month and all participate (pool their milk) in the Federal Order.

The fluid milk is worth $15, paid in to the pool; the Butter/Powder Producers milk is worth $10 and they choose (according to the rules of the order) to participate so the proceeds from their milk is pooled as well and finally the Cheese producers also choose to participate and their milk is worth 13 dollars. So the math for the pool this month is this:

- 3 times 15 = 45
- 3 times 10 = 30
- 3 times 13 = 39
  Total pool receipts = $114

Dividing total receipts by the 9 hundred weights equals 12.67 (the blend price), which goes to each producer for the 100 pounds of milk they produced for the month.

Historical Summary of Pooling Rules

The historical problems pooling attempts to solve (and still to this day) were this: farmers supplying a fluid bottler usually received a higher price than farmers producing for manufacturing purposes, but because cows are not able to Start and stop milk production, one farmer was often pitted against other farmers by fluid processors to lower prices and thus a processor could gain advantage in the retail market over another processor, this is the essence of "disorderly marketing". To prevent this disorderly marketing, the federal system was designed to create a "pooling arrangement" to give each producer that provides meaningful service to the fluid market a share of the pool. This allowed anyone that could show that they could and would serve the fluid market to draw from the pool the blend of proceeds that were received from the market. So the proceeds went into the pool from all the producers that choose to "pool" their milk and could meaningfully supply that fluid market. Since different classes of milk that "could" supply the fluid actually end up in other products there are different classes and prices for those classes of milk. The total pool proceeds represents the sum of the different values of received from the market from those different classes of milk, (values established by the Federal milk pricing system, based on monthly market prices from NASS). So to make short a very long, complicated story about a durable and worthwhile system…

If producers are in a Federal Milk Marketing Order and produce milk that goes for fluid a bottler in the marketing area they are automatically in the pool, the other producers of other classes of milk can choose according to the current rules of the Order if they want to participate in the pool (even if they are outside the geographic boundaries of the Marketing order). At the end of the month the processor for the various classes of milk pay into the pool; a fluid processor pays in the full value of the established value of fluid milk (class 1) but the producer of that fluid draws the same amount from the pool as everyone else that is "in the pool" and drawing their share from the pool (blended price).

There are simple principles but complicated rules to this process.

So how does milk get pooled? There are rules established for each federal order as well as uniform national rules that establish pooling rules. Rulemaking in 2002 determined for the Pacific Northwest Order the current pooling performance standards. An example of a national rule is the recently instituted rule to increase the make allowance on milk, the amount a processor is allowed to keep before paying the proceeds to the market administrator. The Make allowance rule takes into consideration the various costs for manufacturing a farmer's milk into the finished commodity.

The premise and principle of pooling is, first and foremost, to prevent disorderly marketing of milk. So determining when and if a producer's milk is "in the pool" is based on whether or not a producer is 'serving' the fluid milk market. This was of much discussion in the 2002 rule hearing; the performance requirements are the rules that establish if milk is adequately 'serving or performing' or available to serve the fluid needs of the market. In 2002 Dairy Farmers of America (DFA) was "loading" milk on the Pacific Northwest Order from Utah. There was unanimous agreement that it was legal to do, but there was also unanimous agreement it should not be continued to be allowed. Testimony by every Cooperative and Trade Association supported the need to change and "tighten" the Pooling rules and requirements. Changes were made and for a couple of years the milk pooled on the PNO was milk which was traditionally associated with the market and "performing" as expected by the rules, some milk from Northwestern Idaho and Northern California was pooled, but this milk has traditionally traveled in to the PNO market area.

The Problem

Back to the illustration, let's say an "additional" producer can join the pool (outlined above). If this producer is pooled by a butter/powder processor, the math for the monthly pool now works out like this:

- 3 times 15=45
- 4 times 10 = 40.30 – (additional producer of Class IV with the location adjustment)
- 3 times 13 = 39
  Total pool receipts = $124.30
  But total milk receipts are now divided 10 ways so the blend drops to **$12.43**

"Normal" pooled volume in our federal order, without pooled milk from southern Idaho, is about 560 million pounds. The typical volume of milk pooled from Southern Idaho in 2008 (excluding January when pooling did not occur because of high powder prices) has been about 60 million pounds. So this ratio of 9:10 is close to the ratio of pooled southern Idaho milk. There are some adjustments that alter this number slightly; because the milk is in Idaho the Federal Market administrator applies a "location adjustment" to the pooled milk in Idaho (a 30 cents deduction per hundred weight on the milk pooled in Idaho, or 3 cents weighted average effect on blend). Assuming a 24 cent (12.67-12.43=0.24) drop in the total blend from the now larger pool of milk (620,000,000 with the new milk) divided by 100 is 6,200,000 hundred weight times a draw of 24 cents cent per hundred weight draw is an approximately $1.488 million additional draw off the pool per month.

The current rules for the Pacific Northwest Order regarding pooling performance were established after a hearing in 2002. A complete record of the hearing, proposed rules and other documentation is on the Market Administrators web site at:
http://www.ams.usda.gov/AMSv1.0/ams.fetchTemplateData.do?template=TemplateO&navID=IndustryMarketingandPromotion&leftNav=IndustryMarketingandPromotion&page=FMMOrder10e

The desire in 2002 was to prevent milk not reasonably serving the fluid needs of the market from being pooled on the market and thereby dropping the blend of those producers actually serving the market. This is not what is currently happening today. The pooling rules implemented actually allow a small amount of milk, at least 1%

actually must travel to a fluid plant here in the Northwest Market, to qualify an additional 99% or about 60,000,000 pounds per month. So, currently (on an annual basis) every one load of milk actually delivered to supply the fluid market in the Pacific Northwest results in an additional 99 loads of milk qualified to draw out of the pool. It was the stated expectation and goal of every party in the 2002 rule making to increase the pooling requirements such that 20% of the milk pooled would actually have to be physically delivered to a fluid plant. (Pooling performance was not the only subject of the hearing, there are additional items added to this set of rules in the hearing, such as cooperative pooling arrangements, etc). But the general expectation in 2002 was these pooling rules, when implemented, would "***...prevent what we call "artificial" pooling of out of area milk - by which we mean, the pooling of milk on Order 124 that is not attached to that market by the traditional measures of attachment, but which is "artificially" pooled on the order for the sole purpose of drawing money out of the Order 124 pool.***" (From: NDA Letter, January 22, 2001 to Hearing Clerk and USDA Secretary of Agriculture; http://www.ams.usda.gov/AMSv1.0/getfile?dDocName=STELPRD3107303)

Summary

The milk from Southern Idaho is being pooled legally under the current rules on the Pacific Northwest Order and it results in higher returns currently for one cooperative (approximately 1.5 million dollars per month).

There is no argument that:

- The current pooling is legal under existing rules.
- Any Cooperative able to add this milk, may for fiduciary reasons, take advantage of the legal means at its disposal to make profits for its members.

There is also widespread agreement it is time to look at these rules and evaluate if:

- They are fair and equitable to ALL the producers that participate in the pool.
- These rules are in keeping with the long held principles of "reasonable performance to be associated with a federal order pool"

There is no disagreement that under the current rules:

- The Federal Market Administrator has a process to "investigate" this very issue.
- Any interested party in the Regulated Federal order has the right, and may exercise that right, to request the Federal Market Administrator in Seattle undertake an investigation of the pooling and the performance of milk pooled on the order.
- That following the investigation, the Federal Market Administrator may request and consider proposals and has the discretion to modify performance standards, specifically the touch-base requirements and the diversion limits.

There is no disagreement that the pooling of Southern Idaho milk is impacting producers **unequally**. (Depending on who a producer ships to may mean a higher milk check or a lower milk check)

We respectfully request your support for this request for investigation.

If you cannot support this request, we hope for your understanding that it is the right and responsibility of producers in the Pacific Northwest to exercise their option to request this process when they believe the Federal Order needs changes. We hope this will lead to a productive discussion regarding the performance requirements for milk to be associated with the Federal Order market.

Attached (below) is a letter to the market administrator we hope you will consider signing and submitting before January 12th, 2009.