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Lamers Dairy, Inc. • N410 Speel School Road • Appleton, WI 54915

March 27, 2019

Victor J. Halverson
Market Administrator
Upper Midwest Milk Marketing Federal Order 30
1600 West 82nd Street, Suite 200
Minneapolis, MN 55431-1420

Re: Lamers Dairy, Inc. Response to Requested Reduction of Shipping Requirements and Increased Diversion Limits as Presented by Central Milk Producers Cooperative (CMPC) and the Upper Midwest Marketing Association (UMMA)

Dear Mr. Halverson,

Lamers Dairy, Inc. would like to formally respond to the request for comment dated March 4, 2019 and made my Central Milk Producers Cooperative (CMPC) and the Upper Midwest Marketing Agency (UMMA) on behalf of their members, dated February 27, 2019.

While the market conditions of decreased fluid milk consumption and Class I utilization in conjunction with increased farm milk production have long been trending in their respective trajectories, Lamers Dairy Inc. feels that reducing shipping requirements to Class I to 6% and inversely adjusting diversion limits to 94% will result in a continued state of increased production coupled with decreased fluid milk consumption. The economic impact of such a policy would result in a decreased statistical uniform price and lower producer price differentials (PPDs).

The purpose of the Class I differential seemingly makes Class I utilization more attractive to producers, but does nothing to increase fluid consumption. Simply put, if consumption is falling in a market where oversupply conditions exist, tightening the fluid supply would likely increase the rate in which demand is eroded due to increased cost, assuming the price equilibrium is met. However, these economic principles haven't held, as demand for fluid milk has continued to drop despite retail prices (specifically in Northeast Wisconsin, for example) routinely being offered as low as $1.48 per gallon. One could argue that the continually decreasing price, along with decreasing demand, is an example definition of disorderly market conditions.

As such, Lames Dairy, Inc. strongly believes that a further restricted supply to the fluid market along with increased limits to volumes eligible to be pooled, places an increased burden on producers (especially small producers) by lowering statistical uniform prices, reducing utilization differentials (PPDs), continues to oversupply an already flooded market by incentivizing greater volumes to be pooled, reduces the "pro-rata" nature of the funds available via the pool to producers, and negatively impacts demand for fluid consumption.

Request Made Using Arbitrary Data as Evidence

In the request made by CMPC and UMMA, the proponents state the volume of their combined cooperative system (the System) as 80% of the pooled supply of milk in the Order, along with serving of 12 of the 15 distribution plants in the Order (as of October 2018). Lamers Dairy, Inc. is one of the few distribution plants not served by the System (in December 2018, there were 13 distribution plants). The request also illustrates the following attributes of the System as described by the proponents:

- The System allows maximum flexibility, timeliness, and marketwide balancing services to the Order in the most economical manner.
- All milk buyers have been able to secure all milk demanded at desired quality standards and delivered in a timely manner.
- All milk suppliers have been able to pool milk on the Order as desired.

Despite these current attributes, the proponents feel the market will change to the extent that these attributes will also change. The proponents state that "pooling strategies of rational handlers" will encourage growth of Class III producers in future years to the extent that the market cannot accommodate the supply that is wished to be pooled. This concern exists despite the proponents openly stating that **in 2018, all milk that was pooled met the current 7.5% standard, and they were not aware of any milk that wished to pool but was unable.**

To illustrate this concern, the proponents use July 2018 (the largest pooling month of the year with the second lowest qualifying shipments, primarily due to schools being out) as the Pooled Milk baseline (3.252 billion pounds), and December 2018 (due to the closures of 2 Dean's Foods plants in Huntly and Thief River Falls) as the Qualifying Shipments baseline (255.4 million pounds). Exhibit 4 of the request further extrapolates their baselines to a degree of incremental increases in Pooled Milk versus incremental decreases in Qualifying Shipments.

The methodology of choosing arbitrary data points using the high and essentially a "new normal" low to construct future "what-if" scenarios has no basis in actual trend analysis and attempting to set new qualifying criteria using best/worst case data correlations is at best flawed logic, using data manipulation to attempt to achieve the desired result.

Using the same methodology, one could also use the annual average of Pooled Milk (2.777b pounds) versus the annual average of Qualifying Shipments (274.2m pounds), which yields 9.88%. One could also look at only the fourth quarter of 2018, which saw average Pooled Milk at 2.770b pounds and average Qualifying Shipments of 266.9m pounds, which yields 9.64%. These data points would be more consistent and less arbitrary than the ones used by the proponents and are well above the current 7.5% requirement.

There are several underlying factors which affect not only the data points chosen, but also the validity of using Qualifying Shipments and Pooled Milk statistics in general. The information in these statistics does not actively reflect the following issues:

- Qualifying Shipments of an Order does not necessarily reflect consumer demand, merely what/where it was produced
- Pooled Milk is an especially flawed data point, as de-pooling allowed 1.095 billion pounds to be removed from the pool between July 2018 and September 2018.
- July 2018's 3.252 billion pounds, even when disregarding September 2018 in which significant de-pooling occurred, appears to be a significant deviation from the rest of 2018 (see Exhibit 3 of the request). Removing these two outlier months showed average Pooled Milk to be 2.791 billion pounds in 2018. July's Pooled Milk is nearly 17% ABOVE that average.
- While the proponents site the closure of 2 distribution plants in the Order as contributing to the decrease in Qualifying Shipments, consumer demand must still be met. As stated by the proponents, it appears the System operated effectively to meet consumer demand despite the closures, rendering the fact of the closures essentially a moot point.

These points are just a few examples of the issues with using these data points, and conclusions drawn from them certainly does not necessarily address underlying industry supply/demand issues contributing to depressed market prices, or illustrate disorderly marketing conditions.

The Impact of Increased Diversion Limits to Producers

The Order previously relaxed diversion limits April 1, 2017. Prior to the amendment, the Administrator also asked for commentary, with Lamers Dairy, Inc. and Dean's Foods responding with dissenting opinions. The comments made in 2017 by both parties are no less true today, and the initial 2.5% decrease in shipping requirements has not provided any financial relief via shared pool revenue to producers.

Consumption of fluid milk continues to drop, meaning the availability of revenue from the sale of Class I continues to shrink. By relaxing diversion limits, the Order effectively encourages new supply into the Order, as it can be pooled for revenue sharing. The net impact of more volume wishing to share a smaller pool of funds is a decreased Statistical Uniform Price, decreased Producer Price Differential, and lower prices paid to producers. This is an economic FACT.

Given the realities of the consumer market conditions and the policies previously set, changes to these limits can only further harm producers. That said, Lamers Dairy Inc. finds it difficult to support a policy that, despite the apparent request of the cooperatives members, would not benefit the overall producer community, and also negatively impact consumers of fluid milk.

Lamers Dairy, Inc. is a small Distribution Plant that employs 35 honest, hardworking people. We support several small (under 400,000 pounds per month) FAMILY OWNED farms. Both our Producers and our Plant are the definition of Small Businesses to be considered under the Regulatory Flexibility Act (5 U.S.C. 601-612).

The impact we have on the fluid market, while small statistically, is significant in our community. Our brand is prominent in Northeast Wisconsin and can be found throughout the state and into Northern Illinois. We have won awards for our products at the World Dairy Expo in Madison, WI. Our business was the Heart of the Valley Chamber of Commerce Small Business of the Year in 2018. Our small farms have been consistently recognized by the Wisconsin Department of Agriculture for their consecutive years of exemplary audit scores & high quality standards. Our business, brand, and farmers matter to this industry.

We are at a time when countless small farms are continuously weighing the positives and negatives of continuing to be a part of this industry, large Distribution Plants are either consolidating or closing, and even prominent regional and national brands are in peril. A history of USDA policies promoting excess production in conjunction with the burden placed on fluid handlers to subsidize this production through an outdated and inflated differential mechanism has led us to the current market conditions. We urge the Market Administrator to consider broad changes to the Order, rather than a second round of an approach that harms small farmers and small processors. Any policy that increases supply fundamentally will decrease the value of Class I in the pool, which decreases the value to producers. Small farms such as ours cannot survive lower pricing. Large operations, with the efficiencies to scale up production due to low overhead costs, can simply waiting for small farms to go out of business, buying the animal assets at extremely reduced costs compared to just a few years ago. The net result is simple: the large farms get bigger, many more small farms must cease operations, and the market is continually oversupplied, albeit with many, many fewer players that now control even more market share.

In addition to the peril our small farms face, the pool itself must now use 6% of the volume to subsidize the remaining 94%. This cost is paid for directly by fluid consumers through the processing plants, which are also dwindling in numbers & volume. Frankly, there are only two types of entities that stand to gain from changes made in this proposal: large producers that have an interest in gaining added market share & pooling capacity, and the Market Administrator fund which can collect $0.03/cwt on the added volume pooled. The burden of this cost is exclusively on the small producers, consumers, and Distributing Plants that cannot choose to pool or de-pool Class I milk to utilize "pooling strategies".

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Conclusion

Given the effects outlined by our response, including the arbitrary data used to frame the proponents' request, Lamers Dairy Inc. urges the Market Administrator to reject the request to reduce shipping requirements and increase diversion limits. We further would call on him to consider holding hearings for more broad-scale changes to the Order itself. One such example would be language changes to exempt all small processors (under 3,000,000 pounds, for example) from the mandated pooling of Class I milk. This exemption is already in place for Producer/Handlers, but some how a Handler with multiple producers is still required subsidize the rest of the class market. Exempting small handlers from pooling requirements could encourage newer participants and supply the market with more alternatives.

The current trajectory of oversupply and diminished demand will continue to hurt <u>all</u> producers. Some larger producers will survive. Most small producers will not. As illustrated by the proponents, the competition between Distribution Plants that are not served by the cooperatives is nearly non-existent. Ultimately the closure of the Huntley and Thief River Falls plants, while an inconvenience for the producer cooperatives to "efficiently" shift milk within the System to manipulate supply and take advantage of class pricing within the order, is less of a problem to the cooperatives than it is to the consumer. The volume has shifted to other plants, but if other large Distribution Plants should close due to new plants in other Orders opening, there may exist regional monopolization of supply, serving only cooperative controlled Distribution Plants, and effectively creating much higher consumer prices due to decreased competition for warehouse, grocery, and school milk bids. The U.S. Department of Justice has taken notice of this condition in recent years, specifically with concern for school milk bids. The policies in place have already seriously limited competition to just a few major entities, and this proposal would only hasten the fall of the small farm and small agri-business. For the sake of competition and in the spirit of the AMS requirements to protect and encourage small businesses, we urge the Administrator as a steward of the Marketing Order to consider changes to help stabilize prices and strip away regulations that prohibit small business entry & growth.

Thank you greatly for your time and consideration.

Sincerely,

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Lamers Dairy, Inc.

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Lamers Dairy, Inc.

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