History of the California Milk Pooling Program

Background and Justification

The milk marketing laws passed in the 1930s, especially the Young Act of 1935, helped to stabilize the economy of the California dairy industry. These laws established a means of regulating the minimum price paid for market grade milk (Grade A milk) by processors to producers. Basically, producers received at least the minimum price announced by the California Department of Food and Agriculture (Department) according to how their milk was used. Class 1 utilization, which was used for beverage (fluid) products, commanded the highest price. Progressively lower prices applied to milk devoted to the manufacturing classes of milk. (For more details on milk pricing, classes of milk, and product categorization, refer to “Milk Pricing in California”, DMB–SP–101.)

However, establishing minimum prices did not address the concerns of equitable prices among producers for compositionally similar milk. Plants processed an array of products, and consequently, class utilization among plants varied. Some plants processed 100 percent of the milk received as Class 1 products, but other plants processed little or no milk as Class 1 products. These groups of plants represented the extremes, and it was more typical to find plants with moderate Class 1 utilizations. Nonetheless, a producer shipping to a plant with all Class 1 utilization fared well financially while a neighboring producer selling milk of like quality to a plant with low Class 1 utilization typically received a considerably lower price.

In the late 1950s and early 1960s, disparate prices among producers in the same region were a source of frustration and led to disorderly marketing practices. Clearly, a producer's financial welfare was impacted by his or her ability to secure a contract with a handler with high Class 1 utilization. This placed producers in a weak position to bargain with handlers, and many would agree to excessive haul charges or make other (sometimes illegal) concessions to obtain or retain the coveted sales to Class 1 handlers. The lack of long–term commitments between producer and handler added to the instability in the milk market. Most contracts were subject to cancellation by either party upon thirty-days' notice.

It was difficult for producers to obtain new contracts, especially with plants that maintained high Class 1 utilization year round. Not surprisingly, the loss of a contract to an individual producer was a severe economic blow. Producers often accepted contracts with handlers that gave the handler the permission to divert milk shipments to manufacturing facilities.

Prior to pooling provisions, contracts were required for all milk sale transactions between producers and handlers. Some of the contracts were referred to as “one

pound" contracts because any milk received in excess of one pound was designated as surplus milk and was not covered under the terms of the contract. As such, handlers engaged in these types of contracts were authorized to divert a producer's milk to another plant, and the hauling costs were charged to the producer.

Besides receiving a significantly lower milk price, producers were also expected to pay for the additional cost of hauling their milk to the designated plant. An alternative was to locate another fluid milk plant that was accepting milk but this did not eliminate the high cost of shipping the milk from the dairy to a distant plant. The uncertainty of obtaining or continuing favorable contracts restricted many producers' future planning horizon and financing capability.

During the early and mid-1960s, several events combined to place even more pressure on producers. Some dairy processors began to alter the traditional framework of the milk production sector by acquiring herds and supplying their own processing facilities with milk, thereby reducing the number and volume of Class 1 contracts available to existing producers. Furthermore, a federal court ruled that the federal government could not be required to pay minimum resale prices on milk purchased by military enclaves. This ruling gave handlers the freedom to bid on government contracts at prices that were often less than the Class 1 price. Producers bore the economic brunt of this competitive bidding as some producers received less than the manufacturing milk price for milk sold as Class 1 to the military.

Producers realized the necessity of developing a system that would bring relief to their problems and provide a more equitable allocation of the revenues generated from Class 1 milk sales. The market-wide pooling systems in some federal orders were viewed as a possible basis for such a system. Producers and producer organizations concluded, however, that such a system could be brought about only through legislation and introduced a number of milk pooling bills into the California Legislature. These early efforts to establish a revenue distribution program were not successful because the producer and processor communities could not agree on the basic concepts of the program.

In 1967, Assemblyman Joseph A. Gonsalves introduced AB 910. After a series of amendments, the Legislature passed the Gonsalves Milk Pooling Act (Act), and it became law on November 8, 1967. This Act required the Department to formulate a Pooling Plan and submit it in referendum to all eligible market milk producers for their approval or disapproval.

The Act was quite specific regarding certain permissive and restrictive provisions that the Plan must contain. For example, the Act required the Department to appoint market milk producers and representatives of producers to serve as members of a formulation committee. These members were to represent all geographical areas to be included in the proposed Plan. The function of the committee was to advise and assist the Department in the development of a proposed Pooling Plan, which was to be presented for public hearing within 90 days of the effective date of the Act.

After considerable research, revisions, and testing, the committee and the Department prepared a draft of the proposed Pooling Plan that went to public hearings held in

several locations throughout the State in February 1968. Testimony indicated the proposed Plan needed refinement, and the hearing was continued until May 1968. An amended proposal was submitted to producers for referendum on September 10, 1968. The referendum was officially closed and tallied on November 8, 1968. Producers gave overwhelming assent to the Plan.

Production Base and Pool Quota

During the preliminary stages of formulating a plan, basic milk production data were gathered to establish two benchmarks for each eligible producer — a production base and pool quota. A producer's history was based on his or her production and Class 1 usage during July 1966 through December 1966 or the 1967 calendar year. The producer was permitted to select the more favorable period. Producers located South and East of San Gorgonio Pass, a region principally covering the Imperial Valley, had the special option of having their pooling history computed on the basis of four times the production and usage for December 1966, and January and February 1967. Another option given to all producers in establishing their production base was to choose between their prevailing contract amounts during the selected base period and actual production. (Any production in excess of a producer’s base and pool quota would constitute overbase production.)

Production base and pool quota were established for each producer by milk fat and solids-not-fat (SNF) on an average daily basis. The production base was computed by dividing the total production during the base period by the number of days market milk was produced. Pool quota was established as 110 percent of the Class 1 utilization accounted for during the base period divided by the number of days in that period the producer actually had Class 1 utilization. The amount by which the production base exceeded pool quota was designated as daily base. A pooling certificate was issued to each eligible producer which carried the producer's identifying number, the production base and pool quota amounts, and the effective date of allocation.

The Act and Plan provided that a producer who purchased or otherwise acquired all or a portion of another producer's business prior to the operative date of the Pooling Plan would gain that same proportion of the producer's production base and pool quota. There were many such transfers between the beginning of the first base period and the effective date of the Plan.

Accounting Procedure

Because of the complexity of the accounting procedure of the pooling system and the interrelationships of handler activities, the Department determined that a computerized data processing system was the most feasible and sensible approach to implementing the Pooling Plan. The historic production data, procedural calculations and systems procedures were developed with assistance from a consulting firm, and the Department contracted with the State Board of Equalization to perform monthly data processing services.[1] The Milk Pooling Plan became operational on July 1, 1969.

The pool area affected by the Plan initially consisted of all marketing areas of the state except Inyo-Mono, Northern Sierra, and Siskiyou. The producers of Northern Sierra and

Siskiyou marketing areas later petitioned to be admitted to the pool. After a public hearing, Northern Sierra was brought into the pool area effective December l, 1970. Siskiyou was included in the pool area effective October l, 1973. Inyo-Mono was included in the pool area effective September 1, 1976 when it became part of the Southern California marketing area.

With the institution of the Pooling Plan, producers are no longer paid directly in accordance with the class utilization of the contracting handler. Instead, producers are paid on the basis of his or her allocated quota, base, and overbase at prices which reflect the poolwide utilization of all classes. The monthly quota and base quantities are computed for each producer to the extent he or she produced these quantities. The maximum monthly quantity of quota is determined by the current quota allocation. The maximum monthly quantity of base is the difference between production base and quota. Any production in excess of the total of these two figures constitutes overbase production.

Pool Prices and Pool Obligations

Each handler submits to the Pooling Branch a monthly report detailing the amounts of milk purchased from producers and other handlers and the amounts used in the various classes. The total value of each class is determined by multiplying the class utilization by its appropriate class price for each handler in the pool. Summing these respective amounts across all pool handlers gives the value of the pool.

The Department prepares and mails a statement for each handler on or before the 28th of each month showing the gross amount the handler owes each producer. The statement itemizes the handler's class utilization and the gross amount the handler is directed to pay producers for their quota, base, and overbase milk. The statement does not include authorized deductions the handler may claim. One such deduction is the hauling charge. (The hauling charge reflects the distance from the producer's ranch to the plant first receiving the milk.)

If the total value of the milk used by the handler is greater than the amount owed the producers for their milk, the handler pays what is owed the producers, and the handler pays the difference into the pool equalization fund. On the other hand, if the amount owed producers is more than the value of the milk used, the handler pays what is owed the producers and the pool equalization fund pays the difference to the handler.

Prior to 1994, the quota price was primarily determined by the Class 1, 2 and 3 prices, while the overbase price was primarily determined by the Class 4a and 4b prices. Thus then, the difference between the quota and overbase prices varied from month-to-month. Since January 1994, there has been a fixed $1.70 per hundredweight difference between the two prices. Thus now, both the quota and overbase prices are equally affected by changes in all five class prices.

Incentives to Supply Fluid Markets

The virtues of pooling milk receipts notwithstanding, the elimination of contractual arrangements between producers and handlers removed the incentive that existed for producers to ship their milk to a fluid plant. Instead, producers were inclined to ship to local plants, which, in general, tended to be manufacturing plants. As these changes in milk movement patterns evolved, fluid milk handlers were faced with the task of attracting adequate milk supplies, a responsibility that was exacerbated during the months of low milk production.

Location Differentials

When pooling was instituted in 1969, location differentials were established to encourage the movement of quota milk to Class 1 plants. Location differentials were added to or deducted from quota payments to producers and were determined by the location of the plant that first received the milk. Location differentials applied only to the hundredweight milk equivalent of quota. In following the traditional movement of milk from supply areas to deficit areas, the higher hauling cost tended to be offset by a more favorable location differential. Conversely, if milk was needed locally for Class 1 usage, a lower location differential tended to be offset by a lower haul cost.

Transportation Allowances and Regional Quota Adjusters

Over time, overbase milk became a larger and larger share of the milk produced by individual producers. Consequently, location differentials based solely on quota milk were no longer able to ensure that adequate milk supplies were made available to Class 1 plants. In June 1983, location differentials were replaced by transportation allowances and regional quota adjusters (RQAs). Transportation allowances partially compensate producers for the cost of hauling milk from a producer's ranch to qualified plants in defined deficit areas. These allowances apply to all market milk moving from dairy farms to processing plants that are in deficit areas and that process more than 50 percent of their production into Class 1, Class 2, and/or Class 3 products. In addition, cooperative members receive transportation allowances on shipments to their plant if the plant is located in a deficit area and if the plant supplies 40 percent of its receipts for Class 1 usage.

The purpose of RQAs is less transparent because they do not provide any direct incentive to move milk to Class 1 plants. They were developed to address equity issues arising out of the elimination of the location differentials and are deducted from the quota payments to producers. RQAs are determined by the geographical location of the producer's dairy farm and apply to the hundredweight milk equivalent of quota produced. Presently, these rates range from a minus 5¢ per hundredweight for dairy farms located in Northern Coastal counties to a minus 27¢ per hundredweight for dairy farms located in Fresno, Kings, and Tulare counties. There are no RQAs assigned to dairy farms located in the southernmost part of the State.

Producer–Handler (PH) Exemptions

The Act provides that some producer–handlers (PHs) may be exempt from the Pooling Plan provided they meet certain requirements. The producer-handler is required to exercise complete ownership over both the production and processing entities. Additional requirements vary for the two types of exemptions: Option 66 and Option 70. Generally, Option 70 PHs are larger than Option 66 PHs.

PH Option 66

Producer–handlers may be exempt from the Pooling Plan under option 66, provided they meet the qualifying requirements:

- Farm production must average less than 500 gallons per day during each 12-month period, September 1 through August 31;
- Sales must average less than 500 gallons per day during each 12-month period, September 1 through August 31; and
- Ninety-five percent of the farm production and 95 percent of the sales must be disposed of to retail or wholesale outlets (other than market milk handlers).

PH Option 70

Producer–handlers who do not meet the qualifying requirements for full exemption operate under option 70 exempt classification. This option does not impose any restrictions on retail sales or purchases from outside sources. Producer–handlers operating under this option have their original pool quota plus any quota purchased prior to March 1, 1995 deducted from their qualifying Class 1 sales. A further daily deduction of 150 pounds fat and 375 pounds solids-not-fat is made from such sales provided the producer–handler has not transferred production base and pool quota after February 9, 1977. The remainder of all production and usage is subject to pool accountability. Qualifying Class 1 product consists of processed retail and wholesale sales, including sales to sub–handlers, but excludes sales of packaged Class 1 purchased from other handlers and bulk and packaged Class 1 sales to other handlers. Any exempt quota that cannot be deducted participates in the pool only as base or overbase.

Prior to January 1, 1978 the option 70 exempt producer–handlers could deduct original quota from their Class 1 sales. Any purchased quota could not be deducted. These provisions were added by statute in 1978. In 1994, the producer–handlers were allowed to exempt the quota they had purchased after January 1, 1978. This window of opportunity was closed March 1, 1995.

Allocating New Quota

One of the declared purposes of the Act is to equalize gradually the distribution of Class 1 and 2 utilization[2] among California producers. Allocation of new quota based on Class 1 and 2 growth was a necessary provision instrumental in attaining this goal. Class 1 and 2 sales for the most recent 12–month period, September through August, is compared to that of the previous highest identical 12–month period to determine the amount of increase necessary. [3] The resulting amount is made available for allocation as new quota. New quota allocation to existing producers is made effective January 1, following the 12–month period during which the available new quota is determined.[4]

When new quota is issued, it is allocated:

- Forty percent to unequalized producers,
- Forty percent to equalized producers, and[5]
- Twenty percent to qualifying new producers.

Unequalized Producers. Forty percent of the new quota available is allocated to producers holding unequalized production base and pool quota. Unequalized means that the quota held by a producer is below 95 percent of the production base. The allocation is based on a formula that gives a higher percentage of new quota to those producers having low quota in relation to production base. No quota can be allocated to an unequalized producer that would be in excess of that needed to bring quota to the equalized level. Any such excess quota is reallocated to the qualifying producers still below the equalization point.

The unequalized quota are those allocated to new producer entrants after the start of the pooling program. All of the original issue of production base and pool quota was brought to equalization effective July 1, 1978 as directed by statute amendment. This one–time direct issue of quota was not conditioned on any increase in Class 1 sales.

Equalized Producers. Forty percent of available quota is allocated to equalized producers (those producers whose quota is 95 percent or more of production base) prorated according to the quota held by each.

New Producers. Twenty percent of the new quota available is allocated to qualifying new producer applicants who do not have production base and pool quota. In order to apply for this allocation, a new producer must have been in continuous production for one year, and on the date of application must be shipping market grade milk to a pool handler. Available quota is allocated to these producers on a priority basis, first priority being determined on the basis of the date the application is received. Ties are broken by the longest period in continuous commercial production, and further ties are decided on the basis of the longest period in market grade production. In addition, any quota that has been forfeited after April 30, 1981, is allocated on a continuing basis to qualifying new producers.

The amount of quota to be allocated to new producers is based on the daily average of fat and solids-not-fat produced during the most recent three month period from September through November. A maximum of 150 pounds of fat and 375 pounds of solids–not–fat can be considered. Allocation is made at either 95 percent of the

qualifying production of each component, or 60 pounds of fat and 150 pounds of solids-not-fat, whichever is less. If a producer enters at the equalized 95 percent level, he or she is given the qualifying production as production base, and only qualifies for further quota allocation as an existing equalized producer. If the producer enters at less than the 95 percent level, production base is granted at 111 percent of the quota allocated.[6]

After holding this initial allocation for a minimum of one year, a new producer qualifies as an existing producer to participate in future allocation of new quota. In the subsequent allocations, the qualifying period production will be used in determining the amount of quota received. Additional production base will be allocated equal to 111 percent of the additional quota until the producer eventually has quota equal to 95 percent of the qualifying period production. At that point, the qualifying period production will be assigned as production base.

Transferability of Production Base and Pool Quota

Subject to certain restrictions, production bases and pool quotas are transferable. These restrictions are imposed to prevent quota from becoming a commodity for speculation. A producer may sell to another producer in the pool area, or change locations within the pool area and carry the quota to the new location. All transfers must be approved by the Department before the transfer can be made effective. All transfers are made effective on the first day of the month.

In order to purchase production base and pool quota, a producer must be in active production of market grade milk and ship to a pool handler. The average price per pound of quota solids–not–fat (without cows) reflects the true value of the quota sold. Although the price is expressed in terms of quota solids–not–fat, the transaction carries with it the related production base solids–not–fat, production base fat, and quota fat. Since the establishment of the $1.70 differential in 1994, the overbase and quota fat prices have been the same.

Producer Review Board

The Act required the Department to appoint a Producer Review Board consisting of 12 producer members. The function of this Board is to hear appeals of producers seeking hardship relief due to conditions beyond their control and make recommendations to the Director to either approve, disapprove, or modify the request.

The Board, now consisting of 12 producer members and 1 public member, also gives counsel, assistance, and recommendations on administrative matters and problem areas of the pooling program. Annually, it reviews the budget for the Milk Pooling Branch. Since its formation, it has made numerous recommendations on producer appeals and administrative issues.

Producer Responsibility

Although producers have gained considerable independence through pooling, they are still charged with responsible performance. A producer must produce milk of the required quality standards or lose quota entitlement as a consequence. For each day milk is rejected for not meeting the quality standards specified in the contract, the monthly quota eligibility is reduced by one day's quota amount. Rejected milk is still eligible to be accounted for in the base pool.

A producer may not have quota and simply hold it without producing milk. Failure to ship milk through a pool handler for a period of 60 days shall result in the forfeiture of all production base and pool quota. A proportionate amount of monthly quota entitlement will be lost for any milk shipped directly to a nonpool plant.

Verification of Records

Personnel within the Milk Pooling Branch perform comprehensive audits of the records of handlers to determine their compliance with the reporting and payment procedures required by the Milk Stabilization and Pooling Plans. Monetary adjustments are made to a handler's account to correct discrepancies revealed by the audit with such adjustments being reflected in the quota price calculation. The payments to producers are also monitored to ensure that payments are made in the correct amount and at the proper intervals and that no unauthorized deductions are made.

Milk Producers Security Trust Fund

The Milk Producers Security Trust Fund (Trust Fund) was created by state law in 1987 to protect producers from handler payment defaults on their milk purchases. It is administered by a seven-member board of industry representatives (producers, processors, and co-operative management) appointed by the Secretary. Currently the fund contains $51 million.

Under the original legislation:

- Security charges (assessments) were collected for on all milk processes as Classes 1, 2 and 3, including milk that was not covered by the Trust Fund.
- The Trust Fund was to collect assessments until there was sufficient amount of money to cover 110% of one month's milk purchases by the milk handler with the largest monthly producer payment obligation.

The Trust Fund was amended in 2006 by AB 2343:

- Assessments are now collected for the Fund's from assessments on all milk, Classes 1, 2, 3, 4a and 4b if the balance in the Fund falls below $30 million.
- Handlers with producer liabilities beyond $30 million or whatever is in the Trust fund currently whichever is greater, are required to submit acceptable financial instruments to the Department to cover these liabilities that are over the higher of $30 million or the amount that is in the Fund.

Trust Fund was amended by AB 2284 effective August 1, 2008:

- Financial Instruments held by the Department shall have a life of two years rather than five.
- Limits the coverage for milk delivered by a producer (who has a valid contract on file) to a handler a maximum of five days after the purchasing handler is been placed on the in-eligible list for coverage under the Trust Fund. This is for milk delivered after notice of non-eligibility is given to a handler by the Department. The maximum time before was 45 days.

The Trust Fund was amended by AB1910 effective January 1. 2011.

- Assessments can now only be collected on milk that is covered by the Trust Fund.
- Clarification of steps to be taken by the Department before transferring funds from the Trust Fund to the Milk Pooling Equalization Fund, if a handler defaults on their obligation to the Pool.

Assessments

The Milk Pooling system is the market grade producers' own program, and its administration is financed entirely by producer assessments. Producers provide financing in the form of a Pool Administrative Fee which is deducted each month from their milk payment. Initially, this fee was 2¢ per hundredweight of market milk produced; the current rate is, however, 1.1¢ per hundredweight of market milk produced.

Summary and Conclusions

The pooling program has passed beyond its developmental stage and should now be considered to be in the phase of refinement. During its existence, it has experienced problems and disappointments as expected in any new venture, but it should be recognized that progress has been made toward achieving its stated goals. Studies and analyses of pertinent issues are perpetually underway by capable individuals and organizations to seek steps toward further fulfillment of the purpose of the Gonsalves Milk Pooling Act.

END NOTES

[1] Since September 1974, the State Franchise Tax Board has performed the data processing service. By 2008, the California Agricultural Statistics Service will take over data processing.

[2] Prior to 1997, new quota allocation was based on Class 1 utilization only.

[3] Prior to January 1, 1985, the amount new quota to be allocated was determined by comparing Class 1 sales for the most recent September through August period to that of the preceding period. The increase was then adjusted for the estimated Class 1 requirements of the succeeding year, less such estimate made the prior year and further adjusted to add standby requirements.

[4] Because of a lack of growth in Class 1 and 2 utilization, no new quota allocation has been made since 1992 (1997 for qualifying new producers).

[5] Prior to January 1, 1979, 80 percent of available quota was allocated to unequalized producers. Equalized producers were not allowed to participate in the allocation.

[6] Prior to January 1, 1977 the maximum allocated to new producers as production base was the average daily production during the 12–month period preceding the application, or 90 percent of the average production base of all existing producers, whichever was less. The maximum quota that was allocated was 20 percent of the allocated production base, or the lowest percentage of pool quota to production base of all existing producers, whichever was less.

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