The Story of California's Milk Stabilization Laws

From Chaos to Stability in the California Milk Industry

WILLIAM J. KUHRT
Coordinating Author

ADDENDUM

TO

THE STORY OF CALIFORNIA'S MILK STABILIZATION LAWS - From Chaos to Stability in the California Milk Industry

California Department of Agriculture Bulletin Vol. 54, No. 4 entitled "The Story of California's Milk Stabilization Laws - From Chaos to Stability in the California Milk Industry" was published in 1965. Since then, several changes in the programs affecting the Dairy Industry have occurred.

The purpose of this Addendum is to update the information in this Bulletin.

The few changes to Chapters 5 and 6 are listed in the Addendum. Chapters 7, 8, and 9 are rewritten and new Chapters covering the California Milk Producers Advisory Board, Chapter 8A; the California Manufacturing Milk Advisory Board, Chapter 8B; Dairy Service, Chapter 13, and the Milk Pooling Plan, Chapter 14, are included in this Addendum.

CHAPTER 14

THE MILK POOLING PLAN
(Added July 1972)

Need for Legislation

The early milk laws, especially the Young Act of 1935, did much to stabilize the economy of California milk producers. These laws assured that a producer would receive a minimum price for his milk according to its use in the various classes, with Class 1 usage commanding the highest price and progressively lower prices applying to milk devoted to Class 2, 3, and 4 usages.

There was wide divergence in class usage among plants. Some had as high as 100 percent Class 1 usage, while others had only 15 percent to 20 percent, with the balance falling into the lower classes. Most plants had usage some place in between these two extremes.

A producer shipping to a plant with all Class 1 usage fared well financially. However, his neighbor producing and selling milk of like quantity and quality to another plant, could receive considerably less because his production was utilized in the manufacture of Class 2, 3, and 4 products. It was highly likely that the cost of production was the same for both producers. Thus, one can easily see that a producer's financial welfare was directly related to the type of contract he could negotiate with a distributor.

Because of the difference in the level of usage among plants and the resulting differences in blend prices received by producers, a sharp competitive scramble developed to secure high Class 1 usage contracts. This placed the producer in a weak bargaining position with distributors, and many would submit to excessive haul charges or make other concessions to obtain or retain the coveted Class 1 market. Most contracts were subject to cancellation by either party upon thirty-days' notice.

Since it was very difficult for a producer to obtain a new contract, especially one with a favorable Class 1 guarantee, the loss of contract was a severe economic blow. He would often have to ship to a manufacturing plant under a so-called "one pound" contract and receive $1.70 a hundredweight below the Class 1 price, or ship to a distant plant and pay a high haul to obtain even a mediocre Class 1 contract. The uncertainty of gaining or continuing a contract at a favorable usage level restricted many producers' future planning horizon and financing capability.

During the early and mid 1960's, some distributors acquired herds and entered the production side. They supplied their own distributorship under contracts that yielded a 100 percent Class 1 return, thereby reducing Class 1 usage available to existing producers. Another development detrimental to producers was a court decision that ruled the Federal Government cannot be required to pay minimum resale prices on milk purchased by military enclaves. This left distributors free to bid contracts at whatever price they chose. Since distributors accepted contracts which were less than the Class 1 price, producers bore the economic brunt of this competitive bidding. Some producers received as low as

$3.00 a hundredweight 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 apportionment of the Class 1 market among them. Producers and producer organizations concluded that such a system could be brought about only through legislation. During the 1960's a number of milk pooling bills were introduced into the California Legislature by producers. These early efforts were not successful because the basic concepts were unacceptable to all sectors of the producer community.

In 1967, A. B. 910 was introduced by Assemblyman Joseph A. Gonsalves. After a series of amendments, the Gonsalves Milk Pooling Act was passed in compromise form by the Legislature and signed by the Governor on July 27, 1967. It became law on November 8, 1967.

This Act required the Director 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 in certain permissive and restrictive provisions that the Plan must contain.

The Act required the Director to appoint fluid milk producers and representatives of producers to be members and alternate members of a formulation committee. These members were to reasonably represent all geographical areas to be included in the proposed Plan. The function of the committee was to advise and assist the Director in the development of a proposed Pooling Plan which was to be presented for one or more public hearings 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 which went to a public hearing 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 when an amended proposal was presented. As a result of this hearing, the final proposed Pooling Plan was submitted to producers for referendum on September 10, 1968. They were given 60 days in which to cast their ballots.

The referendum was officially closed and tallied as of November 8, 1968. Producers gave overwhelming assent to the Plan, far surpassing all the required percentages for its approval.

<u>Production Base and Pool Quota</u>

Even during the stages of preliminary draft formulation, steps were taken to gather the basic data necessary to establish a production base and pool quota for each eligible producer. A producer's history was based on his production and Class 1 usage during one of two base periods, July 1966 through December 1966, or the calendar year 1967. The producer was permitted to select the base period more favorable to him. Producers located South and East of San Gorgorio 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. Further option was given to all producers to choose their prevailing contract amounts during the selected base period rather than actual production in establishment of their production base.

Production base and pool quota were established for each producer by milk fat and solids-not-fat on a daily average basis. The production base was computed by dividing the total production during the base period by the number of days fluid milk was produced during the base period. The Class 1 usage base was developed by dividing the total Class 1 usage accounted for during the base period, including sales of Class 1 items to governmental installations, by the number of days in that period the producer actually had Class 1 usage. In any event, a producer who had production or Class 1 usage for 30 days or less during the period would have his respective totals divided by 30. The Class 1 usage base was multiplied by 110 percent to determine pool quota. The amount by which production base exceeds pool quota is designated as daily base.

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 succeed to 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.

A pooling certificate was issued to each eligible producer which carried his producer number, his production base, his pool quota, and the effective date of their allocation.

Accounting Procedure

Because of the complexity of the accounting procedure of the pooling system, and the inter-related effect one handler's activity has on another, the department determined the most feasible approach to implementation was a data processing system. The department engaged the services of a consulting firm to assist in the programming of historic data and procedural calculations into such a system. After the basic information and systems procedures were stored into the designed program, the Bureau contracted with the State Board of Equalization to perform the monthly on-going data processing services. These developments had to be accomplished before the Pooling Plan could be put into operation. With a degree of apprehension by the Bureau of Milk Pooling and the enthusiastic support of producers, the Milk Pooling Plan became effective 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 the Northern Sierra later petitioned to be admitted to the pool. After public hearing on this request, Northern Sierra was brought into the pool area effective December 1, 1970.

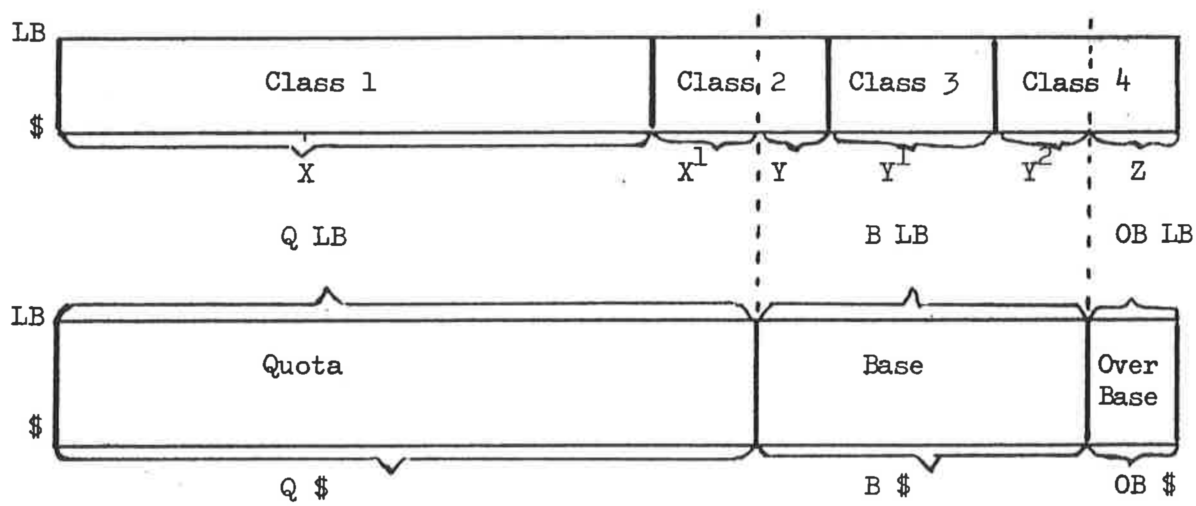
Under the Pooling Plan, the producer is no longer paid directly in accordance with the class usage of his contracting handler. Rather, he is paid on the basis of his allocated quota, base, and overbase amounts at prices which reflect the poolwide usage of all classes. The monthly quota and monthly base amounts are computed for each producer to the extent he has produced these amounts. His maximum monthly quota amount is determined by his current quota allocation and his maximum monthly base is determined by the difference between his production base and quota. Any production in excess of the total of these two figures constitutes overbase production.

Each handler submits a monthly report to the pool containing the amount of milk he purchased from producers and other handlers and the amounts he used in the various classes. The total class value is determined by multiplying the class usage by its appropriate class price for each handler in the pool, and then adding these respective amounts for all pool handlers. This results in the poolwide usage for each class and its related value. Minimum class prices are announced by the Bureau of Milk Stabilization as explained in Chapter 5.

Determination of Pool Prices

The highest usage available is allocated first to the quota pool, next to the base pool, and last to the overbase pool. The quota value is further adjusted by the sum of location differential amounts.

The following illustration demonstrates in graphic form the basic development of quota, base, and overbase prices from the poolwide class usages and values. The top portion represents the poolwide class usage in lbs. and dollars. The lower portion represents the composition of the pool in lbs. and dollars.



If we assume for simplicity that production equals utilization (i.e. no changes in inventory), the pounds scale of both portions of the illustration are identical. The next step is one of translating the class values to quota values. Graphically, this is done by extending the lines dividing quota from base and base from overbase through the top portion. This divides the top into 3 segments and shows that the class value associated with the quota pool is composed of all dollars in the left segment. The class value associated with the base pool lies in the middle segment and the overbase pool, the right segment.

To state it differently:

$Q\$ = X + X^1$ (all of Class 1 value and a portion of Class 2 value)

$B\$ = Y + Y^1 + Y^2$ (Remaining Class 2 value, all of Class 3 value and a portion of Class 4 value)

$OB\$ = Z$ (Remaining Class 4 value)

The pool prices are calculated by dividing the value in each pool by the corresponding pounds in that pool. The value in the quota pool, Q$ is divided by the pounds in the quota pool Q LB. giving the quota price. There is a locational differential and an equalization pool adjustment made to this quota value before this step is performed. The base and overbase prices are calculated similarly without adjustment. The quota, base and overbase prices by milk fat and solids-not-fat components are computed and announced to the industry on or before the 24th of each month.

Obligations

A statement is prepared showing the gross amount the handler owes each producer. This statement does not include authorized deductions the handler will make but does provide a space for the handler to enter them. One of these deductions is the haul charge. This charge is limited to the haul from the producer's ranch to the plant first receiving his milk. The statement is submitted to the handler for his use.

Handler obligation statements are computed and mailed to each pool handler on or before the 28th of each month. These statements take into account the handler's class usage and the gross amount he is directed to pay producers for their quota, base, and overbase milk. If the total value of the class usage is greater than the amount the handler owes the producers for their quota, base and overbase, adjusted for location differentials, he pays the difference into the pool equalization fund. However, if the amount he owes producers is more than the value of his usage, he receives this difference from the equalization fund.

Location Differentials

The location differentials that are added to or deducted from the quota payments due producers are determined by the location of the plant that first receives the milk from producers. These rates apply to the hundredweight milk equivalent of quota milk, and they presently range from a minus 30 cents per hundredweight for certain plants located in the San Joaquin Valley to a plus 19 cents per hundredweight for some plants located in the southernmost part of the State. The rates applying to shipments to other plants in the pool área vary between these two figures depending on their location from the two basing zones, San Francisco and Downey.

These differential rates are designed to provide the incentive for producers to make milk available to plants that require it for Class 1 usage. In following the natural movement of milk from supply areas to deficit areas, the higher hauling cost will tend to be offset by a more favorable location differential adjustment. Conversely, if milk is needed locally for Class 1 usage, the higher charge in location differential tends to be offset by a lower in-haul cost. A producer located in the Central part of the San Joaquin Valley, for example, should net out approximately the same return for his quota regardless of whether he ships to a local processing plant or to one in the Southern California area.

These offsetting features occur, however, only when milk is moved in the traditional flow from supply areas to usage areas. It would be detrimental to a producer's return to ship milk from a Southern California ranch to a plant in the San Joaquin Valley. Such a movement will result in a higher haul charge to the more distant location compounded by a higher differential charge against his quota milk.

Producer-Distributor Options

The Pooling Plan gives special consideration to producer-distributors who meet specified requirements. Those who on January 1, 1968, exercised complete ownership over both the production and processing entities and who did not, on an annual average, receive from sources other than their own farm production, more than 5 percent of their total fluid milk sales (or an annual average of 50 gallons per day, whichever was greater), and who had retail sales for their own account of no less than 66-2/3 percent of their total Class 1 sales, and who continued to qualify under these requirements, were given the option to operate outside the pool as exempt producer-distributors. If they exercised this choice, they were not allocated production base and pool quota.

Those producer-distributors who during the twelve months preceding the effective date of the Plan had production and distribution which averaged less than 200 gallons per day and who received no fluid milk items from sources other than their own production, and who disposed of no fluid milk items in any form to other handlers and who continued to meet these requirements were also permitted to operate as exempt producer-distributors without allocation of production base and pool quota. This same option was granted to those producer-distributors who began operations after the effective date of the Pooling Plan and met these same requirements.

Those who operate as exempt producer-distributors and who either elect later to come into the pool, or who lose their exempt status because of failure to meet the qualifying requirements, are brought into the pool and assigned the production base and pool quota established during the base period or that based on their production and usage during the twelve-month period preceding their entry into the pool, whichever is less.

A producer-distributor who qualified at the outset to be exempt from the Plan, but who elected instead to be assigned his production base and pool quota and enter the pool, had the right to have his pool quota deducted from his inplant class usage, beginning with Class 1, and be accountable to the pool for the balance of usage. This option also is revokable by failure to continue to meet the special requirements. Upon revocation of this status, the producer-distributor would continue to hold the production base and pool quota as originally assigned and would participate in the pool like any other producer.

The Act was amended in 1968 to give an additional option to those who qualified as producer-distributors because of common ownership of the production and distribution entities. This option does not impose any restrictive percentage requirements pertaining to retail sales or purchases from outside sources. Within this elective the producer-distributor's original pool quota can be deducted from qualifying Class 1 usage with the remainder of all usage subject to pool accountability. Qualifying Class 1 usage consists of processed retail and wholesale sales, including sales to subdistributors, but exclusive of sales of purchased packaged fluid items and sales of bulk and packaged fluid items to other handlers. Any original quota that cannot be so assigned shall participate in the pool only as a base or overbase.

Equalization and New Entry

One of the declared purposes of the Gonsalves Milk Pooling Act is to equalize gradually the distribution of Class 1 usage among the producers of this State. Included in the process of attaining this goal is the allocation of new quota based on Class 1 growth. During the months of September and October of each year, an estimate of increased Class 1 sales must be made. This consists of two parts: First is the amount of increased Class 1 usage not previously accounted for during the prior year; Second is an estimate of the increase during the coming year. This total new Class 1 usage is allocated in the form of new quota, 80 percent to existing producers, and 20 percent to new producers.

The allocation to existing producers is based on a formula that gives more favorable apportionment to the producers having low pool quota in relation to production base. A producer whose pool quota is equal to or greater than 95 percent of his production base does not participate in the allocation. Producers who have pool quota in this percentage are considered to be at the equalization point. No new quota is allocated to a producer in excess of that needed to bring his pool quota to 95 percent of his production base.

Production base and new quota are to be allocated to new producers on a priority basis. The maximum that can be allocated as production base is the average daily production of the producer during the twelve-month period preceding his application, or 90 percent of the average production base of all existing producers, whichever is less. The maximum quota that can be allocated is 20 percent of the allocated production base, or the lowest percentage of pool quota to production base of all existing producers, whichever is less. New quota will be issued for the first time under the Pooling Plan this year (1972).

Transferability

Production bases and pool quotas are completely transferable. A producer may sell to any other producer in the pool area or change locations himself within the pool area. All transfers must be approved by the Director before they can be made effective. 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 plant. A producer who buys cannot sell for one year and one who sells cannot buy for one year.

There have been 1219 separate transfers of production base and pool quota during the first thirty-month period of pool operation. The average prices have ranged from $276 to $660 per pound quota fat. It has been noted that quota sold without cows consistently brings a higher price than that sold in conjunction with the cows. Although financial settlement on transactions has been in terms of quota fat, it carries with it the same proportion of production base fat, production base solids, and quota solids.

Producer Review Board

As required by the Milk Pooling Act, the Director appointed a Producer Review Board in March 1969, 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. Any production base and pool quota awarded through this Board cannot be sold or transferred until two years after such award.

The Board also gives counsel, assistance, and recommendations on administrative matters and problem areas of the pooling program. Since its formation, it made numerous recommendations on producer appeals and administrative issues.

Although the producer has gained considerable independence, he is still charged with responsible performance. He must produce milk of the required quality standards or lose quota entitlement as a consequence. For each day his milk is rejected for not meeting the quality standards specified in his contract, his monthly quota eligibility will be reduced by one day's quota amount. Such rejected milk is still eligible to be accounted for in the base pool. For each day a producer's milk is degraded according to regulations of a public regulatory or health authority, he loses both quota and base recognition for that day. He must produce milk up to the quota amount of fat and solids-not-fat during the months of September, October, and November or permanently lose an amount of production base equal to that shipped below quota in either component. A producer may not have quota and simply hold it without producing milk. His failure to ship market milk through a pool handler for a period of 60 days shall result in the forfeiture of all his production base and pool quota. A producer must still find his own market and negotiate his own contract. He will lose a proportionate amount of monthly quota entitlement for any milk he ships directly to a nonpool plant.

Verification of Records

Within the organizational structure of the Bureau of Milk Pooling, there is an Audit Section whose function is to perform comprehensive audits of the records of handlers to determine their compliance with the reporting and payment procedures required by the Milk Stabilization Orders and the Milk Pooling Plan. Monetary adjustments are made to a handler's account to correct discrepancies revealed by the audit. The payments to producers are also monitored to insure that payments are made in the correct amount and at the right intervals, and that no unauthorized deductions are made.

Assessments

The Milk Pooling system is the producers' own program and its administration is financed entirely by that segment of the industry. Initially, the Pooling administrative fee was two cents per hundredweight of market milk produced.

This rate was reduced to one cent per hundredweight effective August 1, 1971. Handlers deduct these fees from the producer settlements and remit to the Department.

The Milk Pooling Program is still in its development stage. It has experienced problems and disappointments as expected in any new venture. Substantial progress has been made since its beginning. Studies and analyses of pertinent issues are perpetually underway by capable individuals and organizations to seek the steps toward fulfillment of the purpose of the Milk Pooling Act to bring about equity to the producers of California.