



CHERRY INDUSTRY ADMINISTRATIVE BOARD



September 22, 2010

The Honorable Tom Vilsack,
Secretary, United States Department of Agriculture
The Honorable Kathleen Merrigan
Deputy Secretary, United States Department of Agriculture
The Honorable Rayne Pegg
Administrator, Agricultural Marketing Service
United States Department of Agriculture
Washington, D. C. 20250

Re: Formal & Official Request for Hearing for Amendment of 7 CFR Part 930
Sections and parts relating to the Optimum Supply Formula and Grower
Diversion Activities

Dear Secretary Vilsack and Deputy Secretary Merrigan and Administrator Pegg,

The tart cherry industry often has an excess of cherries compared to the demand for them. An option under the order to deal with this oversupply is the diversion of cherries in the orchards by growers in lieu of harvesting them for processing. Choosing to exercise this option can be beneficial to both individual growers and the industry since it removes excess supply of cherries while avoiding costs associated with the harvesting, packing and storing fruit for which there is no current need. Use of this option by growers also avoids the downstream consequence of the price depressing effect that added and unsold inventory inevitably has on grower prices in subsequent seasons.

Unfortunately, there is a structural flaw in the order that prevents maximal use of grower in-orchard diversions. As the crop size increases, restriction under the order increases. However, grower in-orchard diversions become increasingly less worthwhile as a compliance option as the restriction percentage increases. This incongruous outcome discourages the use of orchard diversions as a means to deal with excess production in any given year. In-orchard diversions should be encouraged rather than discouraged as a compliance mechanism especially as the restriction requirement increases and becomes burdensome.

The problem flows from how accounting is made for grower in-orchard diversions under the present construct of the order. Handlers must account for grower diverted cherries just as though the cherries had been delivered for processing and sale; handlers are charged with restriction on the fruit that growers left in the orchard. As the harvest gets larger, the restriction percentage required of handlers increases and the surcharge on the diverted cherries increases, as well. The handler ends up with increasingly fewer net diversion credits to apply to its overall restriction.

A solution to this dilemma was proposed by the industry to representatives of the Agricultural Marketing Service. The proposal contemplated restructuring how accounting would be made for the cherries diverted in the orchards. Representatives of the tart cherry industry had various and lengthy discussions with many employees in the Marketing Order Administration Branch, the Fruit and Vegetable Division and the Agricultural Marketing Service about this matter. The industry could not convince USDA representatives that there is authority in the order for treating grower in-orchard diversions as, what in the industry are called, "bottom line" diversion credits.



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We have been informed that the language in the order and the text in the relevant Recommended Decision simply does not authorize treatment of grower in-orchard diversions differently than as they are presently treated and as proposed by the industry. We also have been told that the only way to resolve the matter is for the order to be amended to account for grower in-orchard diversions in a manner different they are presently treated. Fortunately, we were told that this amendment, if expedited, could be accomplished within eighteen (18) months of its inception. This would allow the change to be in effect for the 2012 harvest.

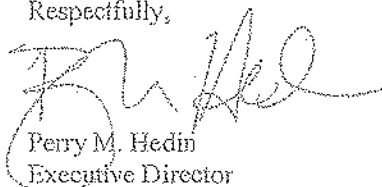
Treatment of grower in-orchard diversions in a fashion similar to handler post-harvest diversion activities, i.e. making grower certificates "bottom line" diversion credits, is a very important change to our industry and especially to growers. It will provide growers with a stronger incentive to divert cherries when the need to do so is the greatest, it will not penalize handlers for encouraging and using orchard diversion activities and it will help offset the price depressing effect of larger than necessary inventories. Furthermore, a different treatment of in-orchard diversions could provide the basis for improvement in the overall quality of the harvested cherries by also serving as the mechanism for targeted quality improvement programs encouraging the removal of orchards.

This change to the treatment of grower diversions needs to be put in place as quickly as it can be done. It is important enough that it be undertaken right away and that it is undertaken without confusion of a multitude of other, extraneous issues.

The industry is attempting to deal with its surplus production issues particularly in those years where there is significant excess production. The USDA has requested that the industry find effective means to deal with its surpluses. Accordingly and on behalf of the tart cherry industry, we respectfully and officially request that the USDA commence the hearing process for an amendment of 7 CFR Part 930, particularly §§10 and 58, and related elements, that this amendment be undertaken as an expedited procedure and that it is not delayed.

The industry is prepared to act on this amendment and will do so as soon as the process can be commenced.

Respectfully,


Perry M. Hedin
Executive Director


Tom Facer
Chairman

Cc: Mr. David Shipman, AMS, USDA
Mr. Robert C. Keeney, AMS, USDA
Mr. Michael Durando, MOAB, AMS, USDA
Mr. Ken Johnson, MOAB, AMS, USDA

FORMAL RULEMAKING JUSTIFICATION OF PROPOSAL

1. **What is the purpose of the proposal?** The goals of the proposal to restructure the Optimum Supply Formula (OSF) to make the order less confusing, make the order more equitable to growers and to make the equilibrium between supply and demand more easily obtained.

At its duly convened meeting of September 10, 2010, the CIAB unanimously adopted the motion that the marketing order be amended so that grower in-orchard diversion certificates not be included in the Optimum Supply Formula, that the hearing be undertaken right away and that the process be “fast tracked”. The vote on this motion was unanimous.

The means to accomplish this end is for:

- the clause “...or obtain grower diversion certificates issued pursuant to §930.58...” to be deleted from §930.10 (a),
 - the clauses “...which, otherwise upon delivery to a handler, would become restricted percentage cherries” and “...as though there were actual harvested cherries.” be deleted from §930.58 (a)
 - The leading sentence of §930.58 (a) be rewritten to state: “(a) *In general.* Any grower may voluntarily elect to divert, in accordance with the provisions of this section, all or a portion of his or her cherries.” and
 - any additional, necessary and conforming changes needed to accomplish this end be made.
2. **What problem is the proposal designed to address?** The CIAB was asked by the USDA to figure out how to bring supplies and demand into closer equilibrium and to avoid excessive surpluses of tart cherries. One of the tools suggested to the industry to accomplish this end was the removal of cherry orchards thereby reducing supply both in the shorter and intermediate terms.

The order has no provision authorizing the pulling of cherry orchards. As the board sought to accomplish the concept of reducing cherry orchards, it concluded that the best way to accomplish this end was to offer diversion certificates to growers for the removal of their orchards. For this proposition to work, diversion credits needed to be as worthwhile as they could be. To induce growers to remove orchards, diversion credits needed to be “bottom line” credits like post harvest diversion credits that would provide handlers with a more worthwhile compliance tool. This, in turn, highlighted an underlying problem and concern with orchard diversion credits.

Under the terms of the OSF as interpreted by the USDA, grower in-orchard diversion certificates must be included in each processors gross handle for the year. This causes each handler’s gross production to be larger, it causes the industry’s total production to be larger and it causes the gross restriction calculated under the OSF to be higher.

As the restriction percentage increases under the OSF, the worth of grower diversion certificates as a compliance tool decreases proportionately. In such situations handlers must use an increasingly greater portion of the in-orchard grower certificates against the obligation created by

them. For example:

"Worth" of In-Orchard Diversions for Compliance			
Diverted ##	Restriction %	Restricted ##	Unused ##
100,000	25%	25,000	75,000
100,000	50%	50,000	50,000

This phenomenon does two things. It confuses both growers and handlers about how in-orchard certificates are used. It also discourages the use of in-orchard diversions as a compliance tool. Handlers are less interested in acquiring in-orchard certificates because (1) their "worth" as a compliance tool is unpredictable and tend to be less worthwhile to handlers than other types of diversions and (2) the effective cost per pound increases along with the restriction percentage.

Effective Cost of In-orchard Diversion Certificates				
Assumed 5¢ per Pound Purchase Price				
Diverted ##	Restriction %	Restricted ##	Unused ##	Effective Cost / #
100,000	25%	25,000	75,000	\$ 0.067
100,000	50%	50,000	50,000	\$ 0.100

Because of these phenomena, handlers often prefer to have fruit delivered and processed in lieu of accepting in-orchard diversion credits. They prefer the predictability of post-harvest diversion activity knowing that these will not generate a variable result for compliance with restriction.

The board proposed what it believed to be a workable and acceptable solution to the dilemma of the treatment of in-orchard diversion credits. This solution would have solved the accounting problem for orchard diversion credits and would have addressed both the question for the tree-pull proposal and for the general treatment of and confusion about in-orchard diversion activities.

Unfortunately, the USDA concluded that the board's proposal was inconsistent with the terms of the order and of the Recommended Decision that supported the original implementation of the marketing order. This decision brings the industry to the need for amendment of the order to solve the problem at hand and to revise the manner by which orchard diversions are treated under the marketing order.

3. What are the current requirements or industry practices relative to the proposal? As noted in answer to question #2, inclusion of in-orchard diversions on the supply side of the OSF causes the gross restriction to be increased.
4. What are the expected impacts on producers, handlers and consumers?

Producers: Producers will be placed in a better position with the recommended change.

- They will be more inclined to exercise in-orchard diversions knowing they will receive bottom line credits.
- They will be better able to exercise independent decisions about whether or not to divert fruit in the orchard.
- They will undoubtedly receive better returns for their diversion activities either through direct payment from purchasing handlers or indirectly through better returns from their own processors. These prices will be more equivalent to payments made for post harvest diversion credits.
- Growers will avoid unnecessary harvest costs for the orchards they choose to divert.
- Growers will be far less confused by the methods by which accounting for in-orchard diversions are made under the order.

Handlers: Handlers will also experience impacts, as well.

- Handlers will have assurance that the in-orchard diversion certificates that they acquire are a known quantity that can be used against their diversion requirement. The credits will have a known "worth".
- Handlers will not incur any cost for processing and/or storage of cherries for which there is no market. Grower returns should be advanced as a result.
- Handler inventories should be reduced to the extent that orchard diversions are employed. This will reduce the price depressing effect that excessive inventories will have at the grower level.
- Handlers, especially those that do not have other effective means for dealing with restriction will be more inclined to utilize in-orchard diversions as a compliance option.

Consumers: It is very difficult to predict what consequence this proposal will have on the consumer. One can postulate that there should be not be any detrimental impact to the consumers for this internal change.

5. How would the proposal tend to improve returns to producers? As noted above, grower returns should increase since there certificates would possibly garner more return and their returns for processed cherries could improve.
6. What are the expected effects on small businesses? With respect to growers' interests, there will be little, if any difference, between small and large growers. They will reap the same benefits from the proposal.

There could and may well be a differential impact of the proposal for small as compared to large handlers. Larger handlers tend to have more opportunities and options to comply with restrictions on the crops. Therefore, such handlers may be less inclined to use in-orchard diversions as a compliance tool or to increase the use of this option with the change.

However, smaller handlers will be quite positively impacted by the change. These handlers tend to have fewer options for compliance with the restriction. They will be much more likely to adopt increased use of in-orchard diversions since their "worth" as a compliance tool is increased. This will be quite positive for the smaller handler.

7. Would the proposal increase or decrease costs to producers, handlers, committees and/ or USDA? Costs of operating or overseeing the administration of the marketing order would not change. The CIAB currently administers the orchard diversion process and has done so for many years. This would remain in place and in effect without appreciable cost changes to either the board or the USDA.

The same is true for the compliance efforts of handlers for the annual restriction. Handlers currently comply with the annual restriction in any number of ways including in-orchard diversion. This would continue to be an option for compliance by handlers. If there is any administrative impact for handler, it would probably entail an increased use of in-orchard diversion activities.

8. How would the proposal be implemented? Incorporation of the proposed change would not require any special activity or change to current procedures. The order would operate in the same fashion with the exception that the supply side of the OSF would not include the pounds diverted in the orchard.
9. How would compliance with the proposal be effected? All orchard diversion activities and compliance with the required procedures are already in place. Handler use of in-orchard diversions is also already in place. The current procedures in these areas would continue to be followed.