July 18, 2005

Hearing Clerk

United States Department of Agriculture

STOP 9200-Room 1083

1400 Independence Avenue, S.W.

Washington, DC 20250-9200

Milk in the Appalachian and Southeast Marketing Areas

Docket No. AO-388-A15 and AO-366-A44; DA-03-11

Comments on Partial Recommended Decision

SOUTHERN MARKETING AGENCY, INC.

Comments Regarding Merger of the Appalachian and Southeast Marketing Areas

These comments pertain solely to the issue of the Secretary's Partial Recommended Decision denying proponents request to consolidate the Appalachian and Southeast Federal Milk Marketing Orders. Comments have been filed by individual cooperative associations regarding other elements of the Partial Recommended Decision which recommend the installation of certain amendments to the two separate Orders. Nothing in these comments should be construed as being in opposition to those recommended changes to the two separate Orders, and no comments filed here are intended to be contrary to the comments filed on those other elements of the recommended decision as filed by the individual cooperative associations.

Further, nothing in these comments should be construed as being in opposition to the request as filed by the individual cooperative associations desiring an expedited final decision. Southern Marketing Agency, Inc. wholeheartedly supports the issuance by the Secretary of an expedited final decision on those elements of the Partial Recommended Decision which recommend the installation of certain amendments to the two separate Orders. Southern Marketing Agency, Inc. asks that the Secretary's attention to the matters upon which comment is made in this submission not impede in any way the issuance of any such expedited final decision.

Position of Proponent Cooperative Associations: Arkansas Dairy Cooperative Association; Dairy Farmers of America, Inc.; Dairymen's Marketing Cooperative, Inc.; Lone Star Milk Producers, Inc.; Maryland & Virginia Milk Producers Cooperative Association, Inc.

The principal problem at issue in the hearing was whether or not to merge two Federal Milk Order marketing areas in the southeastern United States, namely the Appalachian and Southeast Orders. The inherent problem facing the marketers of milk in the southeast is that the continued existence of two Federal Milk Marketing Orders across a single fluid milk marketing area inhibits marketing efficiency in supplying and balancing the marketing area, creates unjustified blend price differences, encourages uneconomic movement of milk, and results in inequitable sharing of the Class I proceeds of the single marketing area.

The southeast region (the geographic area basically covered by Orders 5, 7 and the Florida Order No. 6) has for many years experienced continual declines in milk production, coupled with increases in population. Milk must be imported into the region year around to cover the milk deficit. These milk imports increase every year. Logistical and marketing efficiency in supplying this supplemental milk is of paramount importance to area producers, to processors of milk and ultimately to consumers. These structural changes in the supply-demand dynamic have led to the need to consolidate Federal Orders in the region.

Substantial and compelling evidence was submitted at the hearing by the proponents in support of the merger. The evidence in support of merger is summarized as follows:

(1) Cooperative associations serving the two Order areas market milk and balance supply and demand as if the area were one marketing Order. While this process has leveled the returns to cooperative member producers across the area, this has not recognized for other producers the significant differences which can still exist between the two Orders' blend prices. The cooperative proponents of Order merger represent and market more than 80 percent of the producer milk pooled on the two Orders. The view of the size of a fluid milk marketing area, and the actual manner in which such a large majority of the milk is marketed must be given serious weight by the Secretary. When 80 percent of the milk in a geographic region is marketed as if there was a singe Federal Milk Order, where two actually exist, such simply cannot be ignored. Cooperative service area is one of the criteria used in determining Order consolidation, and should be recognized prominently in the Secretary's decision.

(2) There is substantial overlap of raw milk supplies for the two Orders from producers located outside the marketing areas. In particular, these supplemental milk suppliers are from large farms located in the Southwest Order area and the Mideast Order area. This out of area supplemental milk represents approximately 20% to 25% of the milk pooled on the two Orders annually, and is available to, and is pooled on both Orders. The ebb and flow of this milk changes seasonally, and serves an important balancing function for the southeast's fluid milk needs.

(3) Large volumes of milk located outside the two areas serve both Order areas. Logistical difficulties occur when raw milk suppliers must market milk from the same supply areas across a single fluid milk demand area which is divided by a Federal Order border. In many parts of the country Federal Milk Marketing Orders cover one or more distinct areas of fluid milk demand and supply, while only in the southeast is a single fluid milk marketing area dissected by two Orders.

(4) If the two Orders were merged, additional hauling and logistical efficiencies could be gained by rolling milk from reserve supply areas to deficit areas in a domino pattern. For example, milk could move from northern Indiana to Louisville, Kentucky; then milk located near and regularly delivered to Louisville could move to Nashville, and the Nashville local milk could move to Atlanta. Because of Federal Order pool association and producer qualification requirements, these efficiencies can not be fully accessed under the current two-Order structure.

(5) There is substantial overlap in Class I packaged fluid milk sales between the Appalachian and Southeast Order areas. There is relatively little overlap in Class I packaged fluid milk sales between plants pooled on the two Orders and other neighboring Order marketing areas. Plants regulated by the two Orders supply more than 95 percent of the Class I packaged fluid milk products distributed in the Order 5 and 7 areas. Class I packaged fluid milk sales by Order 5 plants into the Order 7 area represented almost two-thirds of all sales in the Order 7 area from nonpool plants, and two-thirds of the fluid milk processing plants pooled on the Appalachian Order sell milk in the Southeast Order area. Proponents are hard pressed to understand what measure of Class I distribution overlap between two Orders could be more compelling than two-thirds of the fluid milk distributing plants pooled in one Order having Class I sales in the adjoining Order.

Proponents are interested in what objective standard or standards, e.g. quantity, proportion, value, number of plants, etc., of Class I distribution overlap the Secretary applied in determining that sufficient overlap did not exist to signal a merger of Orders. The recommended Decision's statement that sufficient overlap does not exist was not supported by any statement of what measure of Class I overlap <u>would</u> in fact, signal sufficiency. Lack of any communicated objective standards in the determination of sufficient Class I overlap, the criteria for Order consolidation deemed most important, seems atypical. If Class I distribution overlap is going to continue to be used as the primary consideration for signaling Order merger, then an objective standard must be developed and communicated. Otherwise any determination of sufficiency or insufficiency appears arbitrary and capricious.

The Secretary's recommended decision places great weight on the fact that no plants have switched regulation between the two Orders, and thus disorder in the marketing areas is absent. This is simply not the case. Proponents heartily agree that plants switching regulation is a form of, or manifestation of, disorderly marketing conditions, but to imply that such is the preeminent form of disorderly marketing misses many of the complexities of the marketplace.

The purpose of a Federal Milk Marketing Order is to establish the ground rules for who gets to share in the Order's Class I, II, III and IV revenues; the other things Orders do are all about supporting that. To ignore the disorder and out-and-out unfairness which exists when classified revenues, particularly Class I revenues, are improperly shared undermines the purpose and industry confidence in the Order program.

(6) The sales of Class I packaged fluid milk sales from Appalachian Order plants into the Southeast Order area continues to increase. From 2000 to 2003 these sales increased 11.1 percent, with the sales increasing each year over the previous year. One eighth of the Class I milk processed by Order 5 handlers is sold in Order 7.

(7) The provisions of the two Orders themselves already acknowledge the interplay of supply and demand in the area. Producers located in either the Appalachian Order area or the Southeast Order are specifically excluded from eligibility for their milk to receive Transportation Credits on their "home" Order and the other Order. The supplemental milk provisions of the Orders in this way consider the supply area for the two Orders to be integrally linked.

(8) The Secretary's recommended decision mentions the fact that blend price differences between the two Orders have decreased over time. The decision reckons that lower blend prices differences are a good thing owing to reduced incentive for plants to switch regulation, and since the blend price differences have become smaller, no merger of the two Orders is necessary. Proponents find incongruent the simultaneous argument that smaller blend price differences between the two Orders are desirable, but the zero blend price difference which would occur if the Orders were merged is not.

(9) The disparity in the payout rates between the Appalachian Order and Southeast Order Transportation Credit Balancing Funds has led to inequitable treatment of costs to supplemental milk suppliers, and has resulted in uneconomic movements of milk. The record is replete with evidence of the disorderly marketing which has and can occur as a result of the existence of two

Transportation Credit Balancing Funds with differing effective payout rates. These disorderly marketing conditions should not be ignored.

(10) A substantial portion of the handlers and producers regulated by and serving the Class I and raw milk needs of the Orders supported Order merger. These are Arkansas Dairy Cooperative Association; Dairy Farmers of America, Inc.; Dairymen's Marketing Cooperative, Inc.; Lone Star Milk Producers, Inc.; Maryland & Virginia Milk Producers Cooperative Association, Inc.; Southeast Milk, Inc.; and The Kroger Company, Inc.

No producer cooperative associations with producers pooled on the Orders opposed the merger of Orders 5 and 7, and only negligible opposition was expressed to the merger by milk processing companies. Dean Foods, Inc. / Prairie Farms Dairy supported the establishment of smaller orders by breaking apart Order 7. The testimony presented by Dean / Prairie Farms, and repeated in their post-hearing brief, dealt almost exclusively with procurement problems for plants located in the St. Louis metro area, regulated by the Central Federal Milk Marketing Order No. 32. In plain terms, Dean / Prairie Farms sought through their proposal to solve an Order 32 problem by messing up the southeast Order areas. A hearing on Order 32 issues has been held, which included proposals addressing the St. Louis milk procurement problem, and the Department should address those problems by amending Order 32, not making problems worse for Orders 5 and 7.

Proponents wholeheartedly support the Secretary's decision not to recommend the establishment of a Mississippi Valley Order.

(11) There is no evidence in the record supporting merging of either Order 5 or 7 with any other Order. The conclusion may be drawn that the outside-the-area location of a significant portion of the source of supply for the southeast region signals the need to merge one or more of the southeast area Orders with an Order where these supplemental milk supplies reside. This would be a wrong conclusion. The milk deficit condition of the southeast necessitates the importation of the milk from wherever it happens to be available. The milk is currently available in the mideast and the southwest, and that's why those areas supply the southeast. During 2003, producers located in 28 states served handlers pooled in Orders 5 and 7. Using this logic for outside-the-area location of the reserve supplies as a single criterion for Order merger would signal a much broader consolidation than just Orders 5 and 7. Hence, the location of this out of area milk needed to serve the fluid milk needs of the southeast does not signal the need to merge areas beyond Orders 5 and 7. The daily interplay of the supply from those outside-the-area locations with both the Order 5 and 7 areas does demonstrate the absolute need to merge those two Orders, however.

(12) The cooperative proponents considered numerous ideas for amending the current two orders which would offer help in addressing the problems of marketing area inefficiency, blend price differences, uneconomic movement of milk, and inequitable sharing of Class I proceeds.

Alternatives to Order merger which were considered included: the merger of the Transportation Credit Funds of the two Orders, other amendments to the Transportation Credit Fund provisions of the two Orders, development of provisions for reciprocal producer qualification on the two Orders, adjusting diversion limits in the two Orders so that they are the same all months, adjusting producer qualification requirements in the two Orders so that they are the same all months, and amending the pool distributing plant provisions of the Orders.

Each of the alternatives considered could have perhaps answered one of the elements or a part of one of the elements of the area's Federal Order marketing problems, but none of the alternatives could answer all of the elements of the disorder which exists, particularly the need for equity in the distribution of Class I proceeds. Only a merger of the two Orders solved all of the elements of the area's Federal Order marketing problems. Additionally, in evaluating the various alternatives to merger, the evidence which would have been submitted in support of the alternatives was the same evidence that supports merger. In other words, the evidence for amending the current Orders and keeping them separate all pointed to merger too, and merger was the only proposal that fixed all the issues inherent in the area's marketing problem, thus Order merger was selected as the solution to pursue.

In summary, the testimony presented at the hearing by the cooperative proponents of Order merger, which was further analyzed and explained in the post-hearing brief, and which has been briefly summarized here, completely answered all of the Department's seven stated criteria for Order consolidation as used in Order Reform: overlapping route disposition, overlapping areas of milk supply, number of handlers within a marketing area, natural boundaries, cooperative association service areas, provisions common to existing Orders, and milk utilization in common dairy products.