

TESTIMONY IN OPPOSITION TO PROPOSAL NUMBER 5 (DEAN FOODS)

This testimony is presented on behalf of Arkansas Dairy Cooperative Association; Dairy Farmers of America, Inc.; Dairymen's Marketing Cooperative, Inc.; Lone Star Milk Producers, Inc.; and Maryland & Virginia Milk Producers Cooperative Association, Inc., in opposition to Proposal Number 5 as included in the Notice of Hearing.

In Proposal Number 5, the location adjustment on milk diverted to plants outside the combined marketing areas of Orders 5 and 7 would be computed based on the location adjustment at the nearest pool distributing plant located with the marketing area, less a zone-out of four cents per ten miles or fraction thereof. This process may offer certain incentives to reduce the amount of milk pooled by diversion to plants located outside the marketing areas, which in theory might raise Order blend prices, but the onerous impacts of the proposal negate any perceived positive impacts.

Since almost one half of the milk pooled on the Appalachian and Southeast Orders originates from farms outside the marketing areas, it is patently unfair and just plain unreasonable to ask this milk to accept a markedly lower blend price when diverted to a plant located outside the marketing area than is now the case. Prudence in marketing milk dictates that the more distant milk should be the last milk brought into the marketing area to service in-area demand. If marketers of milk are going to minimize the miles milk moves, which is the

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primary **efficiency** in milk routing, the logical process is to use in-area milk first, and then supplement that milk with out-of-area produced milk. Maybe this is why it's called "supplemental milk". The impact of the location adjustment zone-out suggested in Proposal Number 5 will fall disproportionately on the milk produced outside the marketing areas. These out-of-area reserve supplies are critical to the supply of milk for Class I use in the southeast, and these out-of-area producers deserve to be treated no different than producers located inside the marketing area.

There are milk marketing ills which could accrue from the Proposal 5 location adjustment process. Proposal 5 would encourage the uneconomic movement of milk, and would encourage the development of pool supply plants located outside the marketing area.

We call to your attention ~~Exhibit~~ which calculates the financial incentives which would be present to move milk produced outside the marketing area into the marketing area for manufacturing into surplus product. In the example, October 2005 data are used to calculate whether a reserve load of milk produced in Rensselaer, Indiana, a town very near an important reserve supply location for the southeast Orders, would be diverted to a manufacturing plant at Goshen, Indiana, or would be hauled into the Order 5 marketing area for surplus processing. The potential processing location inside the Order 5 marketing area is Leitchfield, Kentucky, the site of a nonpool manufacturing plant. The milk is presumed to be eligible for diversion on Order 5.

In the Exhibit ____ example, under the current location adjustment structure, that is producer location adjustments the same as differences in Class I prices, the net revenue after hauling

costs for the delivery to **Goshen**, Indiana, 104 miles from Rennselear, would be \$7,032. If the same load were diverted to **Leitchfield**, Kentucky, which is 291 miles from Rennselear, the net revenue **after** hauling cost would be \$6,891. The dispatcher would seek to place the load in **Goshen**, because the fewer miles the milk would travel would leave a greater net return.

In the October 2005 example, the Order 5 uniform price is estimated to increase \$0.15 per hundredweight due to the reduced location adjustments on milk diverted to plants outside the marketing area.

Under the location adjustment structure detailed in Proposal 5, the net revenue after hauling cost for the delivery to **Goshen**, Indiana, would be \$6,788, an amount reduced from the current system due to a negative location adjustment that would be increased by \$0.68 per hundredweight. The net value for the load **if** delivered to Leitchfield increases slightly, because the Order 5 uniform price would theoretically increase. In this example, the net revenue after hauling cost for the delivery to Leitchfield would be \$6,963. Under the Proposal 5 location adjustment process, the dispatcher now would seek to place the load in Leitchfield, because the net return there would exceed the net return for the diversion to **Goshen** by \$175. Since the relationship in prices between Leitchfield and **Goshen** is **fixed**, the incentive would remain for milk to move to Leitchfield, unless haul ~~costs~~ increased substantially. In the example cites, the cost per **loaded** mile of hauling would have to increase to more than \$3.25 per loaded mile before the economics of the movement would again make the shorter distance movement the most advantageous.

As shown by the example, the location adjustment changes resulting from Proposal 5 would encourage uneconomic movements of milk. The Federal Order program should not be in the business of promoting milk to move longer distances for use in manufacturing. The southeast already spends massive amounts of money moving milk for Class I use; we don't need Federal Order location adjustment incentives which encourage manufacturing milk to move longer distances too.

Delivery of milk direct from the farm to plants has long been considered the most efficient method for assembling and delivering milk. When pool supply plants are used for the receipt of milk and then the milk is transferred to other plants the process is costly. Some supplemental milk does continue to come to the southeast as milk transferred from other order plants, and occasionally producer milk is received at pool supply plants in the southeast and then is transferred on to pool distributing plants. These receipts at pool supply plants occur most often as a result of holding milk over weekends when pool distributing plants are not receiving as much milk. By and large, however, farm-direct delivery is preferred as the most efficient and cost effective method of assembling milk for delivery to its final destination.

Proposal 5 could encourage the return to using pool supply plants outside the southeastern Order marketing areas. Exhibit ____ shows for a hypothetical pool supply plant located in Portales, New Mexico, how the location adjustment structure as detailed in Proposal Number 5 would encourage the receipt of producer milk into a pool supply plant located outside the marketing areas and then a transfer of milk to pool distributing plants. All of the pool distributing plants pooled on Orders 5 and 7 are located within the two marketing areas. In the Exhibit example, 20,000,000 pounds of milk is located near Portales, and each month

10,000,000 pounds is needed to supply pool distributing plants in Order 7. The Order 7 uniform price used is the actual uniform price from October 2005. If half the milk was shipped farm-direct to Order 7 pool distributing plants and half the milk was diverted to the Portales plant using the Proposal 5 location adjustment process, the net return on the 20,000,000 pounds of milk would be \$3,044,000. This computation is shown in the upper portion of Exhibit . However, if the Portales plant became an Order 7 pool supply plant, the plant would not be subject to the Proposal 5 zoned-out location adjustment, rather it would have a location adjustment determined based on the differences between the Class I price applicable at base zone of Order 7, \$3.10 per hundredweight, and the Class I differential applicable at Portales, which is \$2.10 per hundredweight. If all the 20,000,000 pounds of producer milk were received at the Portales plant and then half the milk was shipped to pool distributing plants in Order 7, the value of the milk would be \$3,198,000, which exceeds the half-farm-direct shipment and half-divert system by \$154,000. This leaves \$1.54 per hundredweight available to operate the receiving and transferring operations on the 10,000,000 pounds which were shipped to Order 7 pool distributing plants. Such a financial difference resulting from Proposal Number 5 would certainly lend itself to establishing pool supply plants outside the marketing area versus taking the loss on producer milk diverted to those out of area plants if the plant was a nonpool plant, which would occur under the Proposal number 5 location adjustment structure.

It should be noted that 50 percent of the plant's physical receipts of milk is the shipping requirement for plants to qualify as a pool supply plant pursuant to sections 1005.7 (c) and 1007.7 (c). These shipping requirements are subject to market administrator discretion in raising or lowering the stated percentages.

The issue of the relative value of milk delivered by location is an issue of national scope, and should be dealt with in a national hearing context. It is inappropriate for the southeast Orders to experience such drastic changes in their milk values on certain milk deliveries without benefit of viewing this issue in its broadest perspective. This is particularly true since almost half of the producer milk supply for the southeast **originates** outside the Order 5 and 7 marketing areas.

A discussion of the relative values of diverted milk by location brings into play the entirety of the analysis of the Federal Order Class ■ differential surface. These options in this analysis will undoubtedly include raising Class ■ prices in some areas, lowering Class ■ prices in some areas, leaving some areas alone, and every permutation and **combination** of these. Since no party will likely offer itself up as the ox to get gored, the Secretary must take the lead in these discussions and begin a process of evaluation which is scientific and free of the bias of industry self-interest if this is to be served up as a realistic option.

In summary, the location adjustment computation processes as proposed in Proposal Number 5 would be unfair to an important source of producer milk for the southeast; would lead to uneconomic movements of milk; could lead to uneconomic use of pool supply plants for receiving and transferring milk; and raises issues which, if they are indeed in need of addressing, should be addressed on a national scope. For the above reasons, Proposal Number 5 should not be adopted.

This concludes my prepared statement regarding Proposal Number 5.