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**BEFORE THE UNITED STATES DEPARTMENT  
OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE**

**In the Matter of** :  
**Milk In The Mideast** : **Docket Nos.:**  
**Marketing Area** : **AO-168-A68 et al;**  
: **DA-01-04**  
:

**Statement Regarding Proposals 1 – 3 & 5**

**Elvin Hollon**  
**Dairy Farmers of America, Inc.**

**October 23, 2001**  
**Wadsworth, Ohio**

## **Statement of Proponents**

The proponents of proposals 1 – 5 are Continental Farms Cooperative, Inc., Dairy Farmers of America, Michigan Milk Producers, Inc. and Prairie Farms Cooperative, Inc.

Continental Farms Cooperative, Inc. (CF) is a member owned Capper Volstead cooperative of 12 farms that produce milk in 3 states. CF members pool milk on 3 of the 11 Federal Milk Marketing Orders including the Mideast Order.

Dairy Farmers of America (DFA) is a member owned Capper Volstead cooperative of 16,905 farms that produce milk in 46 states. DFA pools milk on 10 of the 11 Federal Milk Marketing Orders including the Mideast Federal Order.

Michigan Milk Producers Association (MMPA) is a member owned Capper Volstead cooperative of more than 2,600 members that produce milk in 4 states. MMPA pools milk on 3 of the 11 Federal Milk Marketing Orders including the Mideast Federal Order.

Prairie Farms Cooperative (PF) is a member owned Capper Volstead cooperative of 800 farms that produce milk in 6 states. PF pools milk on 2 of the 11 Federal Milk Marketing Orders including the Mideast Federal Order.

The proponents are ardent supporters of Federal Milk Marketing Orders and we believe that without them dairy farmers economic livelihood would be much worse. Federal Orders are economically proven marketing tools for dairy farmers. The central issue of this hearing - providing for orderly marketing and economically justifying the appropriate performance qualifications for sharing in the market wide pool proceeds of an Order is the heart of the Federal Order system. If these issues are not addressed properly system wide, Orders will be jeopardized. That would be detrimental to all the members of our group both in their day-to-day dairy farm enterprises and the milk processing investments that they have made.

### **Summary of Proposals for This Hearing**

The proponents have an interest in the proposals being heard at this hearing. These amendments are being requested by producers due to the present day dynamics surrounding the pooling of milk in Federal Milk

Marketing Orders. We are the proponents of proposals 1 – 5 and will present testimony and evidence to support them at this hearing.

Proposals 1 – 3 and 5 deal with the “open pooling” of large volumes of milk from locations most of which are so distant to the market that we question if they would ever regularly serve the market in any capacity. We note that the proponents of proposals 6, 7 and 9 share the same interests that we do - that is distant milk needs to have additional performance requirements that are workable and consistent system wide with Federal Order policy. We however, have a different concept of how best to achieve that end result.

Proposal 4 reflects the position that the use of the lowest prior month’s Class price to set the advance payment to producers is no longer a reasonable mechanism.

Proposal 8 seeks to limit the access to a blend draw from producers who regularly supply the market that are associated with manufacturing plants who periodically withdraw from the pool for economic reasons due to price inversion. We will oppose this proposal.

Our witnesses and their topics are as follows:

Mr. Hollon – Need for the hearing, structure set by Federal Order Reform, submission of and testimony referring to various exhibits and comment on the Market Administrator exhibits;

Mr. Lee – Specific concerns from a cooperative handler with bottling plant operations;

Ms. Rady – Specifics of daily milk marketing in the “old Order 49” area;

Mr. Stromski – Specifics of daily milk marketing in the “old Order 33 & 36” area;

Mr. Rasch – Specifics of daily milk marketing in the “old Order 40” area;

Mr. Rasch – Specifics and the intent of our proposal language;

Mr. Hollon – Opposition to proposal 8, support for proposal 4, summary of proposals and the need for an emergency decision.

## **Not Just a Federal Order 33 Issue**

With regard to **Proposals 1 – 3 and 5** we note that the underlying issue is not just a local Order 33 issue. We have concerns identical to those expressed by the other proponents here and in the Pacific Northwest,

Western, Central and Upper Midwest Federal Orders - that milk from distant areas is pooling on the Order and drawing down the blend price but not serving the market in any regular form. We find this practice detrimental to our members, our customers and the entire Federal Order system. We plan to express that concern in other Federal Order hearings and seek a solution that is consistent and in line with Federal Order principles system wide.

The central issue in each case is the interface between the pricing surface, altered by Federal Order Reform (Reform) and the pooling provisions found in each Order. Those relationships were changed by Reform. The link between performance and pooling was altered and needs review. Organizations, including DFA and many of the other proponents of these proposals here, have moved quickly to take advantage of these changes in Order rules. Indeed, in the competitive dairy economy if a competitor makes a pooling decision that results in increased funds you must attempt to do the same or face a more difficult competitive position. Individual organizations cannot unilaterally disarm! We think this process of extensive distant market open pooling is inconsistent with Federal Order policy and clearly disparaged in the Reform record. We are offering proposals here and will be offering proposals in the scheduled Order 32 hearing and are supporting similar proposals that have been submitted in the proposed Order 124 hearing that reflect this philosophy. We have already offered proposals in the Order 30 hearing consistent with the principles advanced here.

## **Federal Order Reform**

The Final Rule published on September 1, 1999 in the Federal Register culminated the Federal Order Reform process. It was a lengthy process but produced needed beneficial results for the industry - which could not have been accomplished without the informal rule making process. Through it the number of Federal Orders were reduced from 31 Orders / marketing areas down to 11. It provided clear rules for what constitutes a market. The pricing provisions were improved, modernized and made more uniform and transparent across the Federal Order system. A more common classification system and standardization of the provisions common to all Orders was instituted. The Option 1 - A differential surface that was the result of extensive computer modeling that was extensively evaluated by university, government and industry persons, a superior Class I advance price mechanism, the "higher of" pricing mechanism and common multiple component pricing provisions across all Orders using

component pricing were all valuable improvements to the Federal Order program.

Even though the process was lengthy and thorough, the dairy industry is dynamic and changing and we currently find that provisions of the Order system need review and alteration. Areas that need review include the pricing provisions that were addressed in the Class III and IV hearing held last spring. (AO-14-A69, etc) The combination of an absolute versus a relative price surface that we now have and its interface with the prevailing pooling provisions is an issue that is now plaguing the industry and is being addressed at this and other hearings.

## **Federal Order Benefits and Principles**

Federal Orders offer benefits to both producers and handlers and have always operated in a deliberate and organized manner guided by basic economic principles. Two primary benefits of Orders are to allow producers to gain from the orderly marketing of milk and to share the proceeds of market wide pooling. Orderly marketing embodies principles of common terms and pricing that attracts milk to move to the highest valued market when needed and clears the market when not needed. Market wide pooling allows **qualified** producers to share in the returns from the market equitably and in a manner that provides incentives to supply the market in the most efficient manner.

## **The Concept of a "Market"**

Fundamental to Federal Order principles are the concepts of a marketing area (market) and the concept of "performance to the market" in order to be qualified to share in the returns from that market. The Federal Milk Order Market Statistics Annual Summary defines a marketing area as, "...a *designated trading area within which the handling of milk is regulated by the Federal Order.*" It is clearly an identified geographic area and defined deliberately by a set of rules and for a specific purpose. In every set of Federal Order Regulations, Section 2 defines the geographic area of the marketing order.

Federal Order Reform sought out industry comment on marketing areas, established seven criteria for their establishment and then used those criteria to divide much of the lower 48 states into 11 Federal Order markets. The criteria and the Department's explanation of them, taken directly from the Final Rule are as follows:

"The same seven primary criteria (**the set of rules**) as were used in the two preliminary reports and the proposed rule were used to determine which markets exhibit a sufficient degree of association in terms of sales, procurement, and structural relationships to warrant consolidation (**the specific purpose**). The Final Rule explained the criteria are as follows:

**1. Overlapping route disposition.** The movement of packaged milk between Federal Orders indicates that plants from more than one Federal Order are in competition with each other for Class I sales. In addition, a degree of overlap that results in the regulatory status of plants shifting between orders creates disorderly conditions in changing price relationships between competing handlers and neighboring producers. This criterion is considered to be the most important.

**2. Overlapping areas of milk supply.** This criterion applies principally to areas in which major proportions of the milk supply are shared between more than one Order. The competitive factors affecting the cost of a handler's milk supply are influenced by the location of the supply. **The pooling of milk produced within the same procurement area under the same order facilitates the uniform pricing of producer milk.**<sup>1</sup> (**emphasis added**) Consideration of the criterion of overlapping procurement areas does not mean that all areas having overlapping areas of milk procurement should be consolidated. An area that supplies a minor proportion of an adjoining area's milk supply with a minor proportion of its own total milk production while handlers located in the area are engaged in minimal competition with handlers located in the adjoining area likely does not have a strong enough association with the adjoining area to require consolidation. For a number of the consolidated areas it would be very difficult, if not impossible, to find a boundary across which significant quantities of milk are not procured for other marketing areas. In such cases, analysis was done to determine where the minimal amount of route disposition overlap between areas occurred, and the criterion of

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<sup>1</sup> Milk Procurement areas were considered as a criteria for Order 33 boundaries and the distant areas in question here were not found to be a part of the Order's Marketing area.

overlapping route disposition generally was given greater weight than overlapping areas of milk supply. **Some analysis also was done to determine whether milk pooled on adjacent markets reflects actual movements of milk between markets, or whether the variations in amounts pooled under a given order may indicate that some milk is pooled to take advantage of price differences rather than because it is needed for Class I use in the other market.<sup>2</sup> (emphasis added)**

**3. Number of handlers within a market.** Formation of larger-size markets is a stabilizing factor. Shifts of milk and/or plants between markets becomes less of a disruptive factor in larger markets. Also, the existence of Federal order markets with handlers too few in number to allow meaningful statistics to be published without disclosing proprietary information should be avoided.

**4. Natural boundaries.** Natural boundaries and barriers such as mountains and deserts often inhibit the movement of milk between areas, and generally reflect a lack of population (limiting the range of the consumption area) and lack of milk production. Therefore, they have an effect on the placement of marketing area boundaries. In addition, for the purposes of market consolidation, large unregulated areas and political boundaries also are considered a type of natural barrier.

**5. Cooperative association service areas.** While not one of the first criteria used to determine marketing areas, cooperative membership often may be an indication of market association. Therefore, data concerning cooperative membership can provide additional support for combining certain marketing areas.

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<sup>2</sup> "Open pooling" was reviewed and was not considered to be criteria for deciding marketing area and certain areas were not put together as markets if their basis of commonality was for "economic paper pooling" versus meeting the criteria established. Additional analysis was done to make sure whether or not milk supplies that were associated with an Order (including those that were "paper-pooled") really should be a factor in determining the Marketing Area. In the case of Order 33 the distant milk in question here was not included in the marketing Area.

**6. Features or regulatory provisions common to existing orders.** Markets that already have similar regulatory provisions that recognize similar marketing conditions may have a head start on the consolidation process. With calculation of the basic formula price replacement on the basis of components, however, this criterion becomes less important. The consolidation of markets having different payment plans will be more dependent on whether the basic formula component pricing plan is appropriate for a given consolidated market, or whether it would be more appropriate to adopt a pricing plan using hundredweight pricing derived from component prices.

**7. Milk utilization in common dairy products.**

Utilization of milk in similar manufactured products (cheese v. butter-powder) was also considered to be an important criterion in determining how to consolidate the existing orders.”

*64 Fed. Reg. 16045 (April 2, 1999).*

The Final Rule went on to describe Federal Order 33 geographically and how the seven criteria were applied to form the boundaries for the marketing area.

**“MIDEAST** - current marketing areas of the Ohio Valley, Eastern Ohio-Western Pennsylvania, Southern Michigan and Indiana Federal milk orders, plus Zone 2 of the Michigan Upper Peninsula Federal milk order, and most currently-unregulated counties in Michigan, Indiana and Ohio. \*One partial and 3 entire counties in north central Ohio are left unregulated, since they represent the distribution area of a currently-partially regulated distributing plant (Toft Dairy in Sandusky, Ohio).

Major criteria for this consolidation include the overlap of fluid sales in the Ohio Valley marketing area by handlers from the other areas to be consolidated. With the consolidation, most route disposition by handlers located within the Mideast order would be within the marketing area. **Also, nearly all milk produced within the area**



**would be pooled under the consolidated order.<sup>3</sup> (emphasis added)** The portion of the Michigan Upper Peninsula marketing area included in the Mideast consolidated area has sales and milk procurement areas in common with the Southern Michigan area and has minimal association with the western end of the current Michigan Upper Peninsula marketing area.

## **MIDEAST**

The consolidated Mideast marketing area is comprised of the current Ohio Valley (Order 33), Eastern Ohio-Western Pennsylvania (Order 36), Southern Michigan (Order 40), part of the Michigan Upper Peninsula (Order 44), and Indiana (Order 49) marketing areas plus 6 currently unregulated Indiana counties, 2 whole and 3 partial currently unregulated Michigan counties, and 3 whole and 2 partial currently unregulated Ohio counties. There would be 301 whole and 1 partial county in this consolidated area. Three whole and one partial currently unregulated Ohio counties that were proposed to be part of the Mideast area are not included.

### **Geography.**

The Mideast market is described geographically as follows:

Indiana - 72 counties (64 currently in Order 49, 2 currently in Order 33, and 6 currently unregulated on the western edge of the State, just south of the northwest corner)

Kentucky - 18 counties (all currently in Order 33)

Michigan - 77 counties. Two whole and 3 partial counties currently are unregulated. The rest of the area currently is included in Orders 40, 44, 49, and 33. Of the total 83 Michigan counties, only 6 in the western end of the Upper Peninsula are not included in the consolidated Mideast marketing area.

Ohio - 84 whole and 1 partial county. Three whole and 2 partial counties to be included currently are unregulated. All of the State currently is included in Orders 33 and 36, except for 3 partial and 6 whole counties.

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<sup>3</sup> The analysis done concluded that none of the milk from the distant locations under consideration here should be included in the marketing area.

Pennsylvania - 12 whole and 2 partial counties, currently in the Order 36 area.

West Virginia - 37 counties; 20 currently in Order 33, 17 currently in Order 36.

The consolidated Mideast marketing area lies directly south of the Great Lakes, with the State of Michigan enclosed on the east and west sides by Lakes Huron and Michigan. On the eastern border of the marketing area, between the Mideast and Northeast marketing areas, is Pennsylvania State-regulated territory and the Allegheny and Appalachian Mountains. On the northeast border is the Western New York State order area.

The east-to-west distance across the consolidated marketing area is approximately 450 miles, from locations on the eastern edge of the area in western Pennsylvania to the border of Indiana and Illinois. Northwest to southeast, from Marquette, Michigan, in the Upper Peninsula to the northeast area of Kentucky in the marketing area is just over 800 miles. From the northern tip of lower Michigan to southern Indiana the more direct north-south distance is 530 miles.

The consolidated Mideast marketing area is contiguous to 3 other consolidated marketing areas. The consolidated Central marketing area would provide the western border of the Mideast marketing area along the Indiana-Illinois border, and the consolidated Appalachian area would provide the southern boundary. The western end of Michigan's Upper Peninsula, part of the consolidated Upper Midwest area, would adjoin the Mideast portion of the Upper Peninsula.

In terms of physical geography, most of the consolidated Mideast marketing area is at low elevations, and relatively flat. The climate and topography are favorable to milk production, with dairy being the number one agricultural commodity in terms of financial receipts in the State of Michigan in 1996. Dairy also ranks high in terms of financial receipts in the rest of the area; 3<sup>rd</sup> in Ohio and West Virginia, and 5<sup>th</sup> in Indiana.

### **Population.**

According to July 1, 1997, population estimates, the total population in the consolidated marketing area is 31 million. The 34 MSAs in the consolidated Mideast marketing area include 79.8 percent of the area's population. Over 55

percent of the area's population is contained in the 8 most populous MSAs, which each have over 950,000 people. Two-thirds of the population is located in the states of Michigan and Ohio.

The Mideast area's largest and 7<sup>th</sup> largest of the 34 MSAs are located in Michigan. Detroit-Ann Arbor-Flint, with 5.4 million population, is the largest MSA, and is located in the southeast portion of the state between Lakes Huron and Erie. Grand Rapids-Muskegon-Holland is the 7<sup>th</sup> largest Mideast MSA, is located approximately 150 miles west-northwest of Detroit, and has a population of 1 million. These two MSAs contain two-thirds of the population of Michigan. There are 5 other MSAs in Michigan. Two have approximately 450,000 population each, one has approximately 400,000 population, and the other two average approximately 160,000 apiece. Eighty-four percent of the population of Michigan is located in these 7 MSAs, all in the lower half of southern Michigan.

Four of the 8 largest Mideast MSAs are located in the State of Ohio. These are: (1) Cleveland-Akron, the second-largest, with a population of 2.9 million, located on Lake Erie in northwestern Ohio; (2) Cincinnati-Hamilton, OH-KY-IN, the 4<sup>th</sup> largest, with a population of 1.9 million, located in the southwest corner of Ohio; (3) Columbus, the 6<sup>th</sup> largest, with a population of 1.5 million, located approximately midway between Cincinnati and Cleveland; and (4) Dayton, the 8<sup>th</sup> largest, with a population of .95 million.

There are 6 additional MSAs in Ohio, 2 with populations of approximately .6 million each, 1 with a population of .4 million, and 3 that average just over 150,000 each. Eighty-two percent of the population of Ohio is located in MSAs, most in the northern part of the State.

The third-largest MSA in the Mideast area is Pittsburgh, Pennsylvania, with a population of 2.4 million. Pittsburgh is 127 miles southeast of Cleveland. There are two smaller MSAs in the Pennsylvania portion of the consolidated Mideast marketing area, having an average population of about 200,000 each. Eighty-seven percent of the population of the Pennsylvania portion of the Mideast area is located in MSAs.

Indianapolis, Indiana, is the 5<sup>th</sup> largest MSA in the consolidated Mideast marketing area, with a population of 1.5 million. Indiana contains 9 additional MSAs, 2 with populations of .5 and .6 million, and 7 others that average 155,000 population. All but 2 of the 9 smaller MSAs are located north of Indianapolis. Seventy-four percent of the population of the portion of Indiana that is in the consolidated Mideast area is located in MSAs.

The portion of West Virginia that is within the consolidated Mideast area contains 4 MSAs, 3 of which are located on the West Virginia-Ohio border, along the Ohio River. The population of these MSAs averages just over 200,000. Forty-five percent of the population of the West Virginia portion of the consolidated Mideast area is located in MSAs.

#### **Fluid Per Capita Consumption.**

Estimates of fluid per capita consumption within the consolidated Mideast area vary from 18.75 pounds per month for Michigan to 20.4 pounds per month for Indiana. Use of 19 pounds per month as a weighted average results in an estimated 589 million pounds of fluid milk consumption for the Mideast marketing area. Mideast handlers' route disposition within the area during October 1997 totaled 544 million pounds, with another 36 million distributed by 23 handlers fully regulated under other orders. An additional 4.5 million pounds was distributed by partially regulated handlers, producer-handlers, and handlers that would be exempt under this rule on the basis of each having less than 150,000 pounds of route disposition per month.

#### **Milk Production.**

**In October 1997, nearly 11,000 producers from 335 counties in 12 states pooled 1 billion pounds of milk on Federal Orders 33, 36, 40, 44 and 49. Over 90 percent of this producer milk came from Mideast marketing area counties. The States of Indiana, Michigan, Ohio and Pennsylvania supplied 95 percent of the milk (13%, 39.6%, 30.6% and 11.9%, respectively), with 90 percent coming from counties that would be in the consolidated Mideast area. Just**

**over two-thirds of the milk pooled under these orders was produced in Michigan and Ohio counties located within the consolidated marketing area.**

**Other states pooling milk on the orders consolidated in the Mideast area were Illinois (0.5%), Iowa (0.1%), Kentucky (0.1%), Maryland (0.4%), New York (2.7%), Virginia (0.1%), West Virginia (1.0%), and Wisconsin (0.1%). These states contributed a total of 4.9 percent of the milk pooled on the 5 orders.<sup>4</sup> (emphasis added)**

Sixty-two of the counties that had production pooled under the five current orders supplied more than 5 million pounds of milk each during October 1997. Six of the counties were in northern and northeast Indiana, over 100 miles from Indianapolis; 11 were in western Pennsylvania - 7 of them within 100 miles of Pittsburgh, and the others, including those with the most production (10-22 million pounds), in the northwest corner of the state, within 100 miles of Cleveland, Ohio. Twenty-eight Michigan counties pooled more than 5 million pounds each under the 5 orders, including 14 counties with more than 10 million pounds and 4 counties with more than 20 million pounds. All of these counties are located within 110 miles of Detroit or Grand Rapids, the two largest MSAs in Michigan. The heaviest milk production area of Ohio is the northeast quadrant of the State and within 50 miles of the Akron-Cleveland MSA, including 5 counties supplying over 10 million pounds each during October 1997, and 1 county pooling over 40 million pounds. A smaller production area in Ohio is located in the central portion of the western edge of the State within 80 miles of the Dayton MSA, and includes two counties with over 10 million pounds production and 1 county with over 20 million. The only population centers of the marketing area that do not appear to have adequate supplies of nearby milk are Indianapolis and Cincinnati, in the southern portion of the area.

### **Distributing Plants.**

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<sup>4</sup> After extensive analysis, which clearly considered some of the milk from distant locations in question at this hearing, none were included in the marketing area of Order 1033.

Using distributing plant lists included in the proposed rule, with the pooling standards adjusted to 25 percent of route disposition as in-area sales, updated for known plant closures through January 1998, 72 distributing plants would be expected to be associated with the Mideast marketing area, including 51 fully regulated distributing plants (all currently fully regulated), 4 partially regulated (all currently partially regulated), 4 exempt plants that would have less than 150,000 pounds of total route disposition per month (all currently fully regulated), and 13 producer\_handlers (all currently producer-handlers). Since October 1997, 5 distributing plants (1 fully regulated plant in Indiana and 1 in Michigan; 2 partially regulated plants in Pennsylvania; and a producer-handler in Pennsylvania), have gone out of business.

There would be 40 distributing plants in the 8 Mideast MSA's that each have over a million people (including Dayton-Springfield which has .95 million). Twenty-seven of these plants would be pool plants -- 5 in the Pittsburgh area, 6 in the Detroit area, 4 in the Cleveland area, 3 each in the Grand Rapids, Indianapolis and Cincinnati areas, 2 in Columbus and 1 in Dayton. Nine of the plants in the large MSA areas would be producer-handlers, 3 would be exempt on the basis of having less than 150,000 pounds of milk per month in Class I route dispositions, and 1 would be partially regulated.

Of the remaining 29 distributing plants located in the marketing area, 18 would be located in other MSA's as follows: 5 pool plants and 1 producer-handler in Ohio; 4 pool plants in Indiana; 4 pool plants in Michigan; 2 pool plants in Pennsylvania; 1 pool plant in Kentucky; and 1 pool plant in West Virginia. The ten remaining distributing plants located in the marketing area would not be located in MSA's. Three of these pool plants and 2 producer-handlers would be located in Michigan; 2 pool plants and 1 plant exempt on the basis of size would be located in Ohio; 2 pool plants would be located in Indiana; and 1 producer-handler would be located in West Virginia.

There are 3 distributing plants that would be outside the marketing area. These would be 1 partially regulated plant in Pennsylvania, and 1 in Virginia. In addition, a small

pocket of unregulated area within Ohio would contain one partially regulated plant.

The in-area route disposition standard, proposed to be 30 percent of route dispositions, will instead be 25 percent -- the same percentage as in other consolidated orders. This percentage should not result in the full regulation of any handler not currently fully regulated unless they increase sales in the marketing area.

### **Utilization.**

**According to October 1997 pool statistics for handlers who would be fully regulated under this Mideast order, the Class I utilization percentages for the Ohio Valley, Eastern Ohio-Western Pennsylvania, Southern Michigan, Michigan Upper Peninsula, and Indiana markets were 58, 58, 55, 89, and 70 percent, respectively. Based on calculated weighted average use values for (1) the current order with current use of milk, and (2) the current order with projected use of milk in the consolidated Mideast order, the potential impact of this consolidation on producers who supply the current market areas is estimated to be: Ohio Valley, a 4-cent per cwt increase (from \$13.46 to \$13.50); Eastern Ohio-Western Pennsylvania, a 4-cent per cwt decrease (from \$13.51 to \$13.47); Southern Michigan, a 6-cent per cwt increase (from \$13.27 to \$13.33); Michigan Upper Peninsula, a 25-cent per cwt decrease (from \$13.34 to \$13.09); and Indiana, a 11-cent per cwt decrease (from \$13.52 to \$13.41). The large decrease for Michigan Upper Peninsula is a result of changing from its current individual handler pool provisions to a marketwide pool (very little reserve milk is pooled under Order 44 -- instead, it is pooled on the Southern Michigan order). For October 1997, combined Class I utilization for Orders 33, 36, 40, 44 and 49 was 58.7 percent based on 601.6 million pounds of producer milk used in Class I out of 1.025 billion total producer milk pounds pooled. The weighted average use value for the consolidated**

**Mideast market is estimated to be \$13.42 per hundredweight.<sup>5</sup> (emphasis added)**

The Mideast is one of two consolidated marketing areas that has a significantly higher-than-average percentage of its milk used in Class II. Currently, the Southern Michigan, Ohio Valley and Indiana markets have Class II utilization over 20 percent. When the markets are combined the average for the consolidated market will be just under 20 percent.

### **Other Plants.**

**Also located within the Mideast marketing area during May 1997 were 59 supply or manufacturing plants: 1 in Charleston, West Virginia, 4 in Pennsylvania, 18 in Michigan, 9 in Indiana and 27 in Ohio. Nine of the 59 plants are pool plants. Of these pool plants, 6 are supply plants -- 1 manufactures primarily Class II products, 3 manufacture primarily powder, and 2 have no primary product, only shipping to distributing plants. Three pool plants are manufacturing plants, manufacturing primarily cheese. Of the 50 nonpool plants in the Mideast marketing area, one is a supply plant that manufactures primarily cheese. The other 49 nonpool plants are manufacturing plants. In this area of high Class II use, 28 of the nonpool plants manufacture primarily Class II products. In addition, 1 manufactures primarily butter, 1 manufactures primarily powder, 27 manufacture primarily cheese, and 2 manufacture primarily other products.**

**There are also two manufacturing plants in the currently-unregulated area of Ohio — a nonpool plant that manufactures primarily Class II products in the unregulated county of Erie, Ohio and a nonpool plant that manufactures primarily cheese in the**

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<sup>5</sup> Neither the utilization calculations nor the resulting blend calculations included the milk from distant locations in question here as a part of Federal Order 33.



**unregulated area of Sandusky, Ohio.<sup>6</sup> (emphasis added)**

### **Cooperative Associations.**

In December 1997, 20 cooperative associations pooled member milk under the 5 orders to be consolidated (considering Milk Marketing, Inc., and Mid-America Dairymen, Inc., as one entity - DFA). Two of the cooperatives pooled milk on the four principal orders, 3 cooperatives had member milk pooled on 3 of the principal orders, 3 cooperatives pooled milk on 2 of the principal orders, and 12 of the cooperatives pooled milk on only one of the orders. The percentage of cooperative member milk pooled on each of the orders varied from 44 percent under Order 36 to 86.5 percent under Order 40. Of the total milk pooled on the 5 orders in December 1997, 68 percent was marketed by cooperative associations.

### **Criteria for Consolidation.**

Overlapping route disposition, overlapping production areas, natural boundaries, and multiple component pricing are all criteria that support the consolidation of these current order areas into a consolidated Mideast marketing area. Handlers who would be fully regulated under the consolidated order distribute approximately 90 percent of their route dispositions within the consolidated marketing area, and 93 percent of the milk distributed within the marketing area is from handlers who would be regulated under the order.

Many of the counties from which milk was pooled on the individual orders supplied milk to three or four of those orders. For instance, milk from a number of the same Michigan counties was pooled on the Ohio Valley, Indiana and Southern Michigan orders; milk from several of the same Indiana counties was pooled on the Ohio Valley, Southern Michigan and Indiana counties; and milk from some of the same Ohio counties was pooled on the Ohio Valley, Indiana, and Southern Michigan orders.

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<sup>6</sup> None of the supply plants from the distant locations in question here were ever given consideration as being part of the market during the Federal Order Reform analysis.

**The Great Lakes serve as natural boundaries on the northern edge of the area and on the eastern and western sides of Michigan, as do the mountains in central Pennsylvania.<sup>7</sup> (emphasis added)** All of the orders involved in the consolidated Mideast area contain multiple component pricing provisions. Instead of the Southern Michigan component pricing plan, proposed for the consolidated Mideast order in the proposed rule, the same component pricing provisions adopted for the other consolidated orders have been incorporated in the Mideast order.

### **Discussion of Comments and Alternatives.**

Prior to issuance of the proposed rule, alternatives to the consolidation of the Ohio Valley, Eastern Ohio-Western Pennsylvania, Southern Michigan, Indiana, and partial Michigan Upper Peninsula marketing areas that were considered included the addition of Pennsylvania Milk Marketing Board (PMMB) Area 6 to the consolidated Mideast area, with some consideration being given to the addition of currently-unregulated areas of Maryland and West Virginia, and moving the southern part of Ohio and part of West Virginia to the Appalachian order area.

Ten comments that pertained specifically to the consolidated Mideast marketing area were filed by 8 commenters in response to the proposed rule. Three of the comments, from Michigan Milk Producers Association, United Dairy, Inc., and DFA, plus a very large number of comments that did not specifically mention the Mideast area, addressed the inclusion of unregulated areas in consolidated Federal order areas. The DFA comment included the signatures of 600 producers to a "Petition to Eliminate all Unregulated Market Areas in Pennsylvania." Although the large number of comments that did not specifically mention the Mideast area were unclear about exactly what additional area should be added to the marketing area, they appeared to favor the

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<sup>7</sup> The source of much of the milk from distant locations under consideration at this hearing were specifically excluded from the Mideast marketing area by natural boundaries. This exclusion would have been based on the fact that these supplies could not regularly serve the market.

addition of PMMB Area 6, with perhaps some western Maryland and West Virginia territory, to the eastern edge of the Mideast area.

As stated in the introduction to the consolidation discussion, consolidation of the existing orders does not necessitate expansion of the consolidated orders into currently-unregulated areas, especially if such expansion would result in the regulation of currently-unregulated handlers. Therefore, PMMB Area 6 and the unregulated portions of Maryland and West Virginia should not be added to the consolidated Mideast order area.

Two comments from DFA recommended including Charleston, West Virginia, and areas of West Virginia south of Charleston, as well as the Ohio counties surrounding Cincinnati and the northern counties of Kentucky, in the Appalachian market to help provide an economic incentive through the expected higher blend prices to producers to supply milk to the plants in that area. A comment by Trauth Dairy in Newport, Kentucky, also urged the inclusion of the northern areas of Kentucky in the Appalachian area instead of the Mideast area. These comments are addressed in the description of comments and alternatives considered for the Appalachian order area.

Schneider's Dairy suggested that a pass-through provision similar to that of the current New York-New Jersey order be incorporated in the Mideast order to assure that regulated handlers distributing fluid milk products in unregulated areas where they compete with unregulated handlers are not disadvantaged. As discussed in the section of this decision dealing with Northeast regional issues, Class I prices are determined by the need to attract milk supplies to the location of the processing plant, and not by where the fluid products are distributed. Therefore, a pass-through provision is not incorporated in either the Northeast order or this order.

Independent Cooperative Milk Producers Association and Schneider's Dairy supported the consolidation of order areas to form the Mideast area as proposed.

## **The Concept of Pooling Market Proceeds**

All Federal milk orders today, save one, provide for the marketwide pooling of milk proceeds among all producers supplying the market. The one exception to this form of pooling is found in the Michigan Upper Peninsula market, where individual handler pooling has been used.

Marketwide sharing of the classified use value of milk among all producers in a market is one of the most important features of a Federal milk marketing order. It ensures that all producers supplying handlers in a marketing area receive the same uniform price for their milk, regardless of how their milk is used. This method of pooling is widely supported by the dairy industry and has been universally adopted for the 11 consolidated orders.”

*64 Fed. Reg. 16130 (April 2, 1999).*

Additionally, each Order has precise terms that a supplier must follow in order to share in the blend proceeds. These provisions are known by the industry as “**performance standards**”. This concept is explained, defended and endorsed in the Final Rule as follows:

“There were a number of proposals and public comments considered in determining how Federal milk orders should pool milk and which producers should be eligible to have their milk pooled in the consolidated orders. Many of these comments advocated a policy of liberal pooling, thereby allowing the greatest number of dairy farmers to share in the economic benefits that arise from the classified pricing of milk.

A number of comments supported identical pooling provisions in all orders, but others stated that pooling provisions should reflect the unique and prevailing supply and demand conditions in each marketing area. **Fundamental to most pooling proposals and comments was the notion that the pooling of producer milk should be performance oriented in meeting the needs of the fluid market. This, of course, is logical since a purpose of the Federal milk**

**order program is to ensure an adequate supply of milk for fluid use.<sup>8</sup> (emphasis added)**

**A suggestion for "open pooling," where milk can be pooled anywhere, has not been adopted, principally because open pooling provides no reasonable assurance that milk will be made available in satisfying the fluid needs of a market.<sup>9</sup> (emphasis added) Proposals to create and fund "stand-by" pools are similarly rejected for the same reason.**

**The pooling provisions for the consolidated orders provide a reasonable balance between encouraging handlers to supply milk for fluid use and ensuring orderly marketing by providing a reasonable means for producers within a common marketing area to establish an association with the fluid market. Obviously, matching these goals to the very disparate marketing conditions found in different parts of the country requires customized provisions to meet the needs of each market.**

**For example, in the Florida marketing area, where close to 90 percent of the milk in the pool will be used for fluid use, pooling standards will require a high degree of association with the fluid market and will permit a relatively small amount of milk to be sent to manufacturing plants for use in lower-valued products.**

**In the Upper Midwest market, on the other hand, a relatively small percentage of milk will be needed for fluid use. Accordingly, under the pooling standards for that order smaller amounts of milk will be required to be delivered to fluid milk plants and larger amounts of milk will be permitted to be sent to manufacturing plants for use in storable products such as butter, nonfat dry milk, and hard cheese. The specific pooling provisions adopted for each order are discussed in detail in the sections of this**

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<sup>8</sup> The concept of a performance standard is fundamental to the Federal Order System.

<sup>9</sup> "Open pooling" was totally rejected by the Reform deliberations.

**document pertaining to each of the consolidated orders.”**

*64 Fed. Reg. 16130 (April 2, 1999).*

We find no compelling reason to change this guideline. Open pooling is a cause for concern from our group's members in Federal Order 33. They are concerned when milk from distant areas shares in the blend price pool but does not perform – that is does not deliver regularly nor balance the market. The cost of providing those services to the market always falls back on the local milk supply. And if current practice is not amended it will guarantee a continuing lower return for the local dairy farmers who supply the local Class I market! The resulting draw of blend price funds to distant producers who do not perform is not reasonable. It was analyzed and excluded by Order Reform and thus is an “end run” that should not be allowed now.

Performance standards are universal in their intention – to require a level of association to a market that is marked by the ability and willingness to supply that market. However, they are individualized in their application. Each market requires standards that work for the conditions that apply in that market. The Reform record develops and defends this concept.

We have noted a new phenomenon occurring in the area of performance standards. Several of the entities that have established distant supply plants and associated milk supplies outside of the marketing area are now soliciting milk in the marketing area to be used to qualify milk from outside of the marketing area. The additional “local supplies” then support even more milk to be attached through the distant supply plant. This practice does not bring any new “local milk” and no more milk than the absolute minimum necessary seems to ship through the supply plant. The only result is a trading of its' local pooling handler. No truly new money is available to local producers. The “inducement” is only a redistribution of the lowered blend price back to them. Surely this result was not an intended result of Federal Order Reform.

This practice is abetted by the provision that allows a supply plant to use direct deliveries from farms to satisfy up to 90% of its performance requirement. (1033.7(c)(2) ) This is another standard that is a good practice inside the marketing area but not good for milk supplies located outside of the area. It is difficult to consider this practice as “orderly marketing” and perhaps should be changed in this proceeding. In principle this limit should be very low for milk outside of the marketing area – perhaps even zero because of the rationale used in establishing the

nationwide price surface. This practice never happened in the “pre – Reform” days because the blend price that outside the area supply plants drew was zoned out from the market. Typically a reduction in the blend price was computed that related the distance to the market from the supply plant.

The principles underlying the models that formulated the price surfaces assumed that supplies of milk associated with a demand point and aggregated into a market, actually shipped from the counties they were located in to the population centers where the demand points were fixed. To the best of our knowledge there were no provisions in the mathematical equations for those models allowing for milk to be associated with a market if it did not actually ship to or supply the market. The current practices clearly exploit that price surface and if we are to retain it, which we support doing, we must structure the regulations to parallel the model!

This means that using direct deliveries from inside the marketing area to qualify supply plants and milk supplies from outside the marketing area should be greatly limited if allowed at all. The principle of allowing direct ship milk to qualify a supply plant was instituted to allow achievement of the economies of direct shipped milk - saving the cost of reload and pump over. It is now being used for another purpose – to substitute milk produced in the market for supplies located out of market in the qualification equation. This runs counter to the initial intent of the provision and to the principles that formed the pricing grid.

For supply plants that are located outside the marketing area direct ship milk volumes that are used to qualify those plants should originate from farms that are located in the same county as the plant or from distances that are farther away than the plant.

This way, the principles that underlie the pricing surface could be adhered to but still allowing for the economies that come from direct ship milk. The accounting for this practice would be no more difficult to administer than similar practices that govern transportation credits in Orders 5 and 7 or the surplus milk pricing adjustments that existed in the Texas Order prior to Reform.

A review of the various Federal Order performance standards shows the diversity of standards, but the common requirement of performance to the market in order to share in the blend price pool. During the Reform process as individual Order performance standards were being evaluated many times a particular standard was chosen from one of the predecessor

Orders. Frequently the most lenient standard was selected from among a group of available choices. This attempt, however good in its intent, has not always proven to be workable and is one of the reasons for this proceeding.

Exhibit 13 , Table 1 is a comparison of Federal Order producer milk standards.

Note that while the intentions of the various standards are the same – to establish the requirements necessary to share in the Orders proceeds, the specifics vary from Order to Order.

Exhibit 13, Table 2 is a comparison of Federal Order pooling standards.

Again, note that while the intentions of the various standards are the same – to establish the requirements necessary to share in the Order proceeds, the specifics vary from Order to Order. Note that several Orders call for an automatic pool qualification period commonly referred to as a “free ride period”. This term means that some level of performance in a prior period grants the performer a benefit in a future period that does not require a performance during that time frame. Several times in our statement we refer to the “free ride” period and this is the definition of that term.

Exhibit 13 , Table 3 shows a table of annual classified usage for all Federal Orders. Note that Federal Order 33 has the 2nd largest volume of Class I usage in all Orders. Clearly Federal Order 33 represents a major market for Class I milk and the performance requirements associated with it should reflect that by providing for sufficient association and performance to the market in order to share in the blend price. We note that several other markets with smaller total Class I sales volumes have more restrictive pooling standards.

Exhibit 13 , Table 4 shows a table of pounds pooled by month on Federal Order 33 from January 2000 to date taken from monthly Order statistical publications. Exhibit 13 , Chart 1 drawn from this data details this information on an indexed basis. For each month, Class I and Class II usage is combined, converted to a pounds per day basis and then indexed with January 2000 as the base. Identical computations for Class III and Class IV utilizations are made. Class I and II usage represent the products from which added value is derived for the pool. Class III and IV represent the products that maintain the reserve supply for the added value products and serves to balance the fluctuating demands of the market. Clearly the volume of Class I and II usage has changed little in the 21 months of Reform for Federal Order 33. In fact, if anything, the



market has lost Class I and II sales volume. But the supply of "reserve" has grown astronomically. It will be difficult to justify the need for a near 250% increase in the reserve associated with the market.

Exhibits \_\_\_\_\_ furnished by the Market Administrator, illustrates the source and volume of distant milk in a geographic sense that is pooling on Order 33. MA Exhibit \_\_\_\_\_ details the volume of milk by state by month for each month that the Reformed Order 1033 has been in existence. MA Exhibit \_\_\_\_\_ details the same information except from the standpoint of farm count instead of volume of milk. The maps labeled Milk Marketing's on the Mideast Federal Order for the periods December 1998 and December 2000 and May 2000 and May 2001 exhibit this detail graphically. MA Exhibit \_\_\_\_\_ delineates this same data from the standpoint of sourced from "inside the marketing area" versus "outside the marketing area" for the period December 1998 and December 2000 and May 2000 versus May 2001. These months were requested in order to show a pattern that existed well before any influence of Reform and for the same geography after Reform.

Several conclusions can be drawn from these data:

- 1) The states with significant increased poolings Illinois, Iowa, Kansas, Minnesota, New York, North Dakota, South Dakota and Wisconsin are all located primarily outside of the marketing area.
- 2) There was a learning curve to the "art" of "open pooling" as best evidenced best by the Wisconsin data. Clearly, poolings slowly increased as handlers realized the potential "income opportunity" and the ease of obtaining it. Once the methodology became understood the volume pooled increased heavily.
- 3) The "free ride" months (March - August) became a temptation that could not be ignored. This is again best exhibited by the data from Wisconsin and South Dakota where volumes increased markedly beginning in March and in Minnesota where there were no volumes pooled at all except in the free ride period of 2001. Additionally, the list of pooled handlers filing reports from August 2001 versus September 2001 shows that Bongard's Creamery in Bongard's MN, Cass Clay Creamery in Fargo MN, Ellsworth Cooperative Creamery in Ellsworth WI, Family Daries USA Madison WI and Midwest Dairyman Rockford IL did not pool

at all when there was no free ride to take advantage. This means that their qualifying agent likely maxed out their own diversion limit and could not qualify them in the non free ride month.

- 4) From the reportable data, only one state, Kentucky showed an increase in poolings from locations within the marketing area – but on a small volume of milk. Many of the “distant locations” such as Kansas, Iowa and Wisconsin, showed substantial increases - most from a zero base.
- 5) In the aggregate the volume of milk pooled on the Order produced on farms located outside the marketing area increased by 395.66%. This represents 430,222,763 pounds. This amount is far greater than any reasonable calculation of a reserve supply.
- 6) As best evidenced by the maps, much of the distant milk is from such long distance that it cannot serve the market easily on a regular basis.

Exhibit \_\_\_\_\_ from the Market Administrator data points out the source and volume of the distant milk from the perspective of the pooling provisions that allow it to associate with the market. The volumes are identified as “producer milk from outside the historical procurement area” and from plants identified as “split plants”. Exhibit \_\_\_\_\_ is derived from these data and computes the percentage of the total deliveries from split plants with the assumption that the balance is taken mainly from small qualifying deliveries to distributing plants and large diversions off of those deliveries.

Several conclusions can be drawn from these data:

- 1) The volume of deliveries started small at 16 million pounds in June of 2000 but grew to large proportions, peaking at 480.5 million pounds in June of 2001.
- 2) The percentage of the volume that delivered thru split plants ranged from 69 to 179 million pounds for the months of January 2001 – August 2001.

- 3) The proportion of milk that originated in a "split plant" ranges from 23% to 48%.
- 4) The balance represents milk that originates primarily from diversions off of distributing plants.
- 5) The actual deliveries that supported these poolings were small. On a volume basis the range was 50,000 pounds up to 14.6 million pounds. On a percentage basis the amount ranges from 0.14% up to a maximum of 6.6%.
- 6) Clearly the liberal pooling provisions allow too much milk to be associated with the market for such a small level of performance.

Exhibit \_\_\_\_\_, Table 5 lists the mileages and the necessary hauling rate per hundredweight needed to transport milk from certain points in the distant areas noted by the mapped data. The points selected represent the location of supply plants pooled on the market and listed in Market Administrator data. The choice of Springfield, OH as a destination point represents a location central to the market and considered to be a receiving location for quantities of "open pooled" milk. The rate per mile used in the calculation is \$1.90 and a reasonable proxy for one-way transportation costs. This cost does not include any procurement, assembly or reload costs – just the transportation component. Inclusion of these other costs would raise the cost to deliver the milk to market. The distance from Black Creek, WI to Springfield OH is 479 miles or \$1.82 per hundredweight in transport cost. Kiel, WI is 440 miles from Springfield and that represents a \$1.67 per hundredweight cost. Stockton, IL is 417 miles from the bottling plant or \$1.58 per hundredweight in transport cost. Elkhorn, WI is 368 miles from Springfield or \$1.40 per hundredweight away in transport costs. These costs would have to be recovered from the sale of milk in addition to the procurement, assembly and reload costs before any profit could be generated from the sale of milk to an Order 33 bottler in Springfield.

These supply plants exist as "split plants" a new term to Federal Order 33. It became effective in this Order as a result of the "uniform provisions" efforts of Reform. Its' insertion in Federal Order 33 was not explained in the Final Rule only noted, so no justification was given for its' inclusion. A "split plant" is the designation described under 1033.7(h)(7). A split plant is usually, but not always, a manufacturing plant. It has multiple silos on the premises and has designated one of those silos and the associated pumps and piping as the "pool" plant while the remainder of the plant is designated as the non pool plant. Each Market Administrator provides the

local Order with guidelines that they enforce as to the definition of a "split plant" This designation was common in "pre Reform" days for Orders with lower differentials and low utilizations such as the former Order 30 or 68. Its initial purpose was to accommodate grade B milk. However in recent "pre reform" history its purpose has been to afford the supply plant the ability to make "pooling for economic reasons" decisions more easily. We would argue that this provision has validity in low utilization – low differential Orders but does not have a reason for existence in higher differential – higher utilization order such a Order 33. The "split plant " serves no purpose for Federal Order 33 and there were no provisions supporting it in the predecessor Orders and no plant inside the Order 33 marketing area makes use of it. It has become a tool to attach distant milk to the market that performs little if any in serving the market.

Exhibit \_\_\_\_\_, Tables 6 - 8, depict the return from deliveries from these distant supply plants to Federal Order 33 using the Stockton, IL plant as a basis. The volumes chosen indicate easy arithmetic and are not intended to represent any of the supply plants actual receipts. However, the per-unit calculations would be representative. The comparison uses the mileages and transport calculations developed in Exhibit \_\_\_\_\_, Table 5.

It shows the return if the milk was delivered to the market every day – which is the most typical practice for local milk and is shown in the column labeled "Monthly Return All Delivered to Bottler". This return is calculated by netting the difference in the two Order blend prices at the supply plant location against the transport costs. The effect of additional procurement costs and market premiums are ignored. If this milk were delivered to the market every day the blend price gain would not even be enough to pay the transportation costs. No rational supplier would make this business decision to lose \$3.4 million dollars or approximately 56 cents per hundredweight.

Table 6 of Exhibit 13 further details this calculation utilizing the current supply plant

pooling standards and showing the effect of the split plant. The current supply plant standard, from Reform, calls for a 30 percent delivery in six months of the year and if that performance standard is met no additional shipments are needed to be made in order for the supply plant to be afforded complete pooling status. The split plant status affords the supply plant the ability to segregate its intake into a single day 1,000,000- pound volume for the purpose of computing the months shipping requirement. While preserving the remaining 30,000,000 pounds for manufacturing use but more importantly not having to qualify the remaining days of the months' production. Furthermore a plant may divert up to 60% of its

poolings in the “qualifying months” and has no diversion limit in the “free ride” months. This standard is unreasonable for Federal Order 33. The application of this standard in our example shows that the shipment of only 300,000 pounds per month for only six months of the year would allow 190,000,000 pounds to be pooled on the Order. This combination turns a **56 cent per hundred weight loss** from an every day supply decision into a **\$0.94 per hundredweight gain** when maximizing the provisions to their fullest - a practice shown to be real by Market Administrator Exhibits \_\_\_\_\_. There can be no rational explanation why this practice is a good idea for the market. In this hypothetical example 3.6 million dollars is drawn away from the pool by “open pooling” abetted by loose performance standards and the use of the split plant provision.

Table 7 of Exhibit \_\_\_\_\_ shows the affect of instituting the shipping and diversion standards envisioned by proposals 1 - 5. In this example the split plant provision is still in effect. Here, due to the every month 30% shipping requirement, the supply plant must continue to ship some volume every month – a reasonable requirement in order to share in the blend price and have some limit on its’ diversions in the flush months. The presence of the split plant does allow for the continued segregation of the majority of the plants volume but the institution of these two provisions reduces the total dollar draw on the blend pool by 30 fold. (\$3,552,570 million / \$112,224) On a per unit basis however the return is profitable.

Table 8 of Exhibit \_\_\_\_\_ shows the effect of instituting the proposed every month shipping and diversion standard. However, in this example the split plant provision is no longer in effect. Again, in this example the supply plant continues to ship some volume every month – a reasonable requirement in order to share in the blend price and it has some limit on its’ diversions. The removal of the split plant means that the supply plant does not have the ability to “ride the pool” by segregating its receipts but must make the decision to perform based on the same economic factors that local milk must use – that is what is the return for its’ entire milk supply and not an artificially segmented slice that is not totally available to the market. Clearly the blend price gain is not enough to overcome the transport costs and if this milk is to deliver to the market it must receive some additional negotiated premium. In other words the Order 33 market must bid the milk away from Order 30 all the time. This would be an intentional economic decision not one made by exploiting a regulatory loophole.

The arrangements necessary to exploit these provisions are a source supply that can be associated with a “split plant” and a destination point that can qualify producer milk in Order 33. Furthermore the “pool side” of

the "split plant" functions as an "outpost for qualifying producers" on Order 33. Touch base deliveries can be made to the supply plant – in this case 400 miles from the market and never even deliver in the marketing area – hardly servicing the market! While this combination sounds unique the huge volumes of "distant milk" indicate that it is not hard to accommodate.

So why is this milk becoming associated with the market? The pooling requirements for Order 33, which work well for milk produced in the marketing area, do not work well when applied to milk produced out of the area. This coupled with the change in the pricing surface makes "open pooling" very lucrative. The elimination of the "zone out" provisions makes "open pooling" economically feasible and may require this area to be revisited in the near future. The Order 33 standards of touch base are easy to meet and even more so when coupled with the existence of a "split plant".

The "split plant" provision makes retaining qualification relatively easy because an extremely low volume of milk can associate a huge volume of diversions and any economic loss associated with the "pool side" of the "split plant" is easily over ridden by the gains from diversions from the "non pool" side. The provision that allows a supply plant to meet up to 90% of its qualification requirements with diverted milk is another factor that is involved in this decision making process. As shown in our exhibit the economic burden of the delivery cost becomes a small factor in the total business decision.

Local producers, however, continue to serve the local market, balance it weekly and seasonally for a decreasing return. Indeed under this scheme the only way milk would cease attachment is with a negative PPD. But with the split plant provision even this impact can be minimized in order to retain market association.

A proxy for the estimated costs to the Federal Order 33 blend pool of the distant milk can be seen in Exhibit \_\_\_\_\_, Table 9. These costs were estimated for four months – June and December 2000 and March and June of 2001. The impact of the distant milk on the June 2000 poll was estimated to be a reduction of 4 cents per hundredweight or \$471,000. December 2000 was estimated to be a reduction of 71 cents per hundredweight or \$7,100,000; May 2001 a reduction of 57 cents per hundredweight or \$5,700,000; and June 2001 a reduction of 34 cents per hundredweight or \$3,700,000. These impacts are sizable! No dairy farmer would think a 71 cents reduction in their own blend price was a small matter. This is an important issue.

