

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

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| In the Matter of: | : | Docket Nos: |
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| Proposed Amendments to the Mideast Federal Milk Order (7 C.F.R. §1037) | : | AO-166-A77; DA-08-06 |
| | : | |

**POST-HEARING BRIEF ON BEHALF OF MICHIGAN MILK
PRODUCERS ASSOCIATION, INC., (MMPA), FOREMOST FARMS USA,
COOPERATIVE (FFUSA), DAIRYLEA COOPERATIVE INC.
(DAIRYLEA), NATIONAL FARMERS ORGANIZATION, INC. (NFO),
DAIRY FARMERS OF AMERICA, INC. (DFA)**

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Inc., National Farmers
Organization, Inc., and Dairy
Farmers of America, Inc.**

Date: October 10, 2008

I. INTRODUCTION

This hearing concerns proposals to address the urgent need to increase minimum Class I differentials in the southern region of Federal Order 33. The hearing was called on proposals submitted by the dairy farmer Cooperatives¹ on whose behalf this brief is filed: Michigan Milk Producers Association, Inc. (MMPA), Foremost Farms USA, Cooperative (FFUSA), National Farmers Organization, Inc. (NFO), Dairylea Cooperative Inc. (Dairylea), and Dairy Farmers of America, Inc. (DFA) (collectively the “Cooperatives”).

Multiple compelling factors including the extraordinary escalation of milk transportation costs, driven by increases in the price of diesel fuel, the structural imbalance of milk production and distributing plant demand in the southern region of Order 33, and Class I differential increases in the contiguous Order 5 market to the South, require that the Class I differentials for plants in southern Ohio and West Virginia be reviewed and adjusted upward in accordance with Proposal 1. The proposal does not purport to increase differentials to account for *all* of the increased cost of delivering necessary milk supplies to those plants; but requests modest and limited, but important, price increases which will assist in procurement of milk for the affected plants and improve appropriate price alignment among those plants and plants to their immediate South.

¹ Land O’Lakes, which was a proponent on the hearing notice, withdrew as a proponent at the hearing as it does not presently pool any milk on Order 33.

II. FACTUAL BACKGROUND

A. Proponents and other hearing participants

1. Michigan Milk Producers Association, Inc. (MMPA) is a member-owned Capper-Volstead cooperative of 1,520 farms that produce milk in 4 states. MMPA pools milk on 5 of the 10 Federal Milk Marketing Orders including the Mideast Federal order.

2. Foremost Farms USA, Cooperative (FFUSA) is a member-owned Capper-Volstead cooperative of 2,375 farms that produce milk in 7 states. FFUSA pools milk on 5 of the 10 Federal Milk Marketing Orders including the Mideast Federal Order.

3. Dairylea Cooperative Inc. (Dairylea) is a member-owned Capper-Volstead cooperative of 2,400 farms that produce milk in 9 states. Dairylea pools milk on 3 of the 10 Federal Milk Marketing Orders including the Mideast Federal Order.

4. National Farmers Organization, Inc. (NFO) is a member-owned Capper-Volstead cooperative of 1,500 farms that produce milk in 19 states. NFO pools milk on 6 of the 10 Federal Milk Marketing Orders including the Mideast Federal Order.

5. Dairy Farmers of America, Inc.(DFA) is a member-owned Capper-Volstead cooperative of 10,500 farms that produce milk in 49 states. DFA pools milk on 10 of the 11 Federal Milk Market Orders including the Mideast Federal Order.

6. The proponents, individually and through common marketing agencies, market in excess of 50% of Order 33 pooled milk.

7. Dean Foods Corporation is a national milk and dairy products processor with twelve fluid milk bottling (distributing) plants regulated by Order 33.

8. National Dairy Holdings Company is a national dairy processor with two distributing plants regulated by Order 33.

9. The Kroger Corporation is a vertically integrated supermarket chain with three fluid milk bottling (distributing) plants fully regulated by Order 33 and additional fluid milk bottling (distributing) plants regulated by Order 5.

10. Continental Dairy Products is a cooperative of a small number of large dairy farms located in the states of Michigan, Indiana and Ohio.

11. United Dairy is a proprietary company with three fluid milk bottling (distributing) plants fully regulated by Order 33 located in Uniontown, Pennsylvania, Martins Ferry, Ohio and Charleston, West Virginia.

12. The Nestle Corporation is an international food and dairy products company which operates a fully regulated distributing plant in Order 33 at Anderson, Indiana.

B. Market Conditions in Order 33

13. The Mideast Marketing Area, Federal Order 33, 7 C.F.R. §1033, reaches from Indiana in the west to west-central Pennsylvania in the east; from Michigan in the north to north central Kentucky in the South. Order 33's Class I sales of approximately seven million pounds annually ranks at the second largest Class I utilization order in the federal milk order system.

14. The Order 33 marketplace has differing localized supply and demand characteristics within it. These differences can be analyzed and understood by subdividing the market into supply and demand regions as follows: the Northwest Region; the Northeast Region; and the Southern Region. Those regions were defined by the proponents on the basis of their

knowledge of marketing conditions in Order 33. The areas defining those regions are depicted on Exh. 5 (Response to DFA et al. Requist 1-A and 1-B).²

15. Using the most recently available data, which is for the month of April 2008, the supply and demand characteristics of these regions of Order 33 were detailed in information presented by the Market Administrator in Exhibit 5 (Response to DFA, et al Request 3-A). For April 2008, the Northwest region had 41.1% of the demand for milk at distributing plants and 62.4% of the available supply within the region; the Northeast region had 28.5% of the demand at distributing plants and 31.2% of the available milk supply within its counties. In contrast, the Southern region of the Order had 30.4%³ of demand at distributing plants but only 6.4% of the available⁴ milk supply.

16. The supply and demand characteristics within the Order do not vary materially

² See Attachment 1 to this brief.

³ The demand from distributing plants in the Southern region is understated in the data available for the hearing because it does not include the volumes coming on line at the new Nestle plant in Anderson, Indiana. While the intended volumes of that plant are not part of the record, the Secretary can fairly infer that a plant built for national distribution of specialty product lines would process sufficient volumes to capture economies of scale which justify the capital expenditure of \$350– 400 million. (Stroup, Tr. 572, 578) Mr. Hollon reported that according to “industry estimates” the plant will process at least 1,000,000 pounds of milk per day; and that Nestle already has announced plans for its expansion in 2011. (Exh. 14, p.11; Tr. 185)

⁴ “Available” local milk in the region was defined on the Exhibits (and explained by Ms. Uther) as milk produced in the region and pooled on Order 33 or delivered to Order 33 distributing plants in the region (irrespective of where pooled). Data in Exh. 5 (Response to DFA et al. Request 3-A) indicates that in May 2007, 25.8 million pounds of milk produced in the southern region was pooled on other orders, principally Order 5. Thus, even if this milk is considered “available” to Order 33, the structural supply-demand imbalance remains since the monthly deficit of demand over supply averages about 115 million pounds (Exh. 5 (DFA et al Request 3-A)) .

from month-to-month throughout the year, as the comparable data for representative months throughout 2007 and early 2008 presented by the Market Administrator demonstrate. For January 2007, the Northwest region had 42.40% of the demand for milk at distributing plants and 62.30% of the available supply within the region; the Northeast region had 28.25% of the demand at distributing plants and 30.69% of the available milk supply within its region; and the Southern portion of the Order, however, had 29.35% demand at the distributing plants, but only 7.01% of the available milk supply. For April 2007, the Northwest region had 42.34% of the demand for milk at distributing plants and 62.01% of the available supply within the region; the Northeast region had 28.27% of the demand at distributing plants and 30.93% of the available milk supply within its region; and the Southern portion of the Order, however, had 29.39% demand at the distributing plants, but only 7.06% of the available milk supply. For August 2007, the Northwest region had 42.32% of the demand for milk at distributing plants and 61.41% of the available supply within the region; Northeast region had 28.30% of the demand at distributing plants and 31.86% of the available milk supply within its region. The Southern portion of the Order however had 29.38% of the demand at distributing plants but only 6.73% of the available milk supply. For November 2007, the Northwest region had 41.67% of the demand for milk at distributing plants and 61.94% of the available supply within the region; the Northeast region had 29.21% of the demand at distributing plants and 31.44% of the available milk supply within its region. The Southern portion of the Order, however, had 29.12% of the Order's demand at distributing plants but only 6.63% of the available milk supply. For January 2008, the Northwest region had 41.82% of the demand for milk at distributing plants and 62.10% of the available supply within the region; the Northeast region had 28.75% of the demand at

distributing plants and 31.27% of the available milk supply within its region. The Southern portion of the Order, however, had 29.43% of the Order's demand at distributing plants but only 6.63% of the available milk supply.

17. The lack of local milk supplies for the southern tier distributing plants is also revealed in the data provided by the Market Administrator showing the percentage of distributing plant supplies originating within each region of the Order. See Exh. 6 (Requested by Dean Foods). For the six months for which data was presented January, April, August and November 2007, and January and April 2008, the southern plants sourced only 26% to 32% of their needs from within the southern area. The northwest plants obtained 98% of their needs locally; and the northeast plants, 68% to 78% from dairy farms in local counties.

18. On an absolute volume basis, the shortfall (deficit) of available local supply for distributing plant demand in the southern region ranged from 101.7 million to 119.1 million pounds per month during the six sample months, as calculated by the Market Administrator on Exh 5 (Response to DFA et al. Request 3-B). It is important to note that the demand for milk to supply southern distributing plants, **including diversions**, is nearly 100% Class I and II usage and not diluted with lower-class diversions. (Exh. 7, pp. 1-2 (Supplemental Request of Dean Foods)). The southern distributing plants have the highest Class I utilization percentage of the three regional groupings of plants. (Exh. 7)

19. The lack of available local milk supply to Southern region distributing plants means that milk is transported on average nearly twice as far from farms to distributing plants in the South in comparison with the other regions in the Order. (Exhibit 5 DFA request 4-A). For January 2007, the average distance milk was required to be shipped to supply the Southern region

distributing plants was 138 miles versus 73 miles for the Northwest and 82 miles for the Northeast; for April 2007, the Southern region required deliveries from an average of 135 miles versus 73 miles and 74 miles for the Northwest and Northeast plants respectively. For August 2007 it was 140 miles to the Southern region distributing plants, 74 miles and 72 miles to the Northwest and Northeast plants respectively. For November 2007, 131 miles to the Southern plants, 68 miles to Northwest plants and 69 miles to Northeast plants. For January 2008, 133 miles to the South, 69 miles to the Northwest plants and 64 miles to the Northeast plants. For April 2008, 118 miles to the Southern plants, 73 miles to Northwest plants and 59 miles to Northeast plants. The simple average difference in miles required to be traveled for the six months of available data shows 133 miles on average to the Southern plants, 70 miles on average to the Northeast plants and 72 miles on average to the Northwest plants. (Exhibit 5 (DFA et al. Request 4-B)).

20. With an weighted average additional distance traveled of 62 miles, it costs an average of \$.42 per hundredweight more to deliver **each and every** hundredweight of milk from farm to plant in the Southern region than in the rest of Order 33. Viewed another way, using January 2008 data as an example, when the southern distributing plants have reached out as far as the rest of the distributing plants in the market for milk – an average of 73 miles – they only have acquired about 60% of their needed supply. The remaining 40% of their needs must come from distant sources and the average hauling expense is \$1.08 **more** per hundredweight than the costs of the average delivery to distributing plants in the northwest and northeast regions of Order 33.⁵

⁵ This cost was calculated using January 2008 data from Exh. 5 (DFA et al. Request 4-A) which details the distances from which milk moved to Order 33 distributing plants. In each 20 mile range, the milk was assumed to originate from the mid-point mileage. The MEMA cost of

The additional \$1.08 on 40% of the milk supply averages out to \$.42 on all milk.

21. The current differences in Class I differential prices in Order 33 allow no more than \$.20 from the northern area of Ohio to the southern area of Order 33 and no more than \$.40 from points in central Michigan to the southern tier of Order 33, distances for which the cost to haul milk exceeds the allowable location adjustment by amounts which average in excess of \$1.75 per hundredweight.⁶ (Exhibit 15, p. 39).

22. The recent amendments to Order 5 increased the Class I differentials and applicable Class I transportation credit balancing fund charges at plant locations contiguous to Order 33 to these levels: At Louisville Kentucky, the differential is \$2.30 with a transportation credit balancing fund assessment of \$.15 for an effective⁷ differential of \$2.45. At Holland Indiana the differential is \$2.30 with transportation credit balancing fund assessment of \$.15 for an effective differential of \$2.45. At Winchester Kentucky the differential is \$2.60 with a transportation credit balancing fund assessment of \$.15 for an effective differential of \$2.75. At Madisonville Kentucky the differential is \$2.60 with a transportation credit balancing fund assessment of \$.15 for an effective differential of \$2.75. At London Kentucky the differential is

moving milk was used. (Exh. 15, pp. 37-38) These calculations are detailed on Attachment 8.

⁶ The \$1.75 average cost compares favorably with the median cost-over-location allowance from the 11 identified potential surplus supply areas to the southern region distributing plant locations which is \$1.78, Exh. 15, p. 39.

⁷ The “effective” differential, as testified to by Mr. Hollon, is the total charge per hundredweight of Class I milk which the plant incurs under the Order. It is the sum of the Class I differential and the transportation credit balancing fund payment charged on every hundredweight of Class I usage at the plant. The transportation credit assessment can be waived. However, it has not happened and is not likely to happen with the market’s demand for supplemental milk.

\$2.90 with a transportation credit balancing fund assessment of \$.15 for an effective differential of \$3.05. At Somerset Kentucky the differential is \$2.90 with a transportation credit balancing fund assessment of \$.15 for an effective differential of \$3.05. (Exhibit 13 p. 48).

23. One effect of the increased differentials in Order 5, contiguous to the Order 33 southern tier plants, is to make delivery to Order 5 plants much more attractive than delivery to nearby Order 33 plants, thereby exacerbating the problem of attracting milk to the Order 33 plants. (Hollon, Tr. 178)

24. These and other changes to those Orders will increase blend prices in the Southeastern Orders. For example, in testimony by the Federal Order 5 Market Administrator the change in location adjustments in Order 5 were projected to increase the Uniform Price at location (weighted average) by approximately 25 cents if applied to market conditions in 2004 – 2006. Similar testimony from the Order 7 Market Administrator indicated the changes could increase blend prices by 64 cents there. (Hollon, Tr. 169)

C. The Cooperatives' Proposal

25. The Federal Order Reform Decision declared, “The purpose of the minimum Class I differential is to generate enough revenue to assure that the fluid market is adequately supplied.” (63 Fed.Reg. 16102 (April 2, 1999)).

26. In evaluating the need for increased Class I differentials in the Southern area of Order 33, the Cooperatives evaluated the cost to supply these plants from alternative supply points in and nearby Order 33. The cost to supply the distributing plants from the supply points was calculated both on the basis of the transportation cost formula used by the Department in the Order 5 and 7 decision and on the basis of the actual current cost of delivering milk as incurred

by the cooperatives supplying the Order 33 plants.

27. The methodology used by the Department in the recent Orders 5, 6, and 7 hearing decision (see Exh. 15, pp. 40-41) results in a current cost of moving milk of \$.0055 per hundredweight per mile. The Cooperatives applied this rate to the distances between six (6) potential supply areas and the distributing plant locations in the southern tier of Order 33 with the acquisition costs resulting shown on Exh. 15, pp. 42–47. (Hollon Tr. 195–200)

28. The Mideast Milk Marketing Agency (MEMA) is a common marketing agency of cooperatives in Order 33. Its activities include coordinating movements of milk from farm to plant for most efficient service of the market. MEMA's current cost of moving a 48,000 pound tanker of milk over the road in Order 33 is \$3.23 per loaded mile or \$.0067/cwt per loaded mile. The MEMA cost is based upon a base cost of \$2.20 per hundredweight and a fuel adjuster formula which moves with the cost of diesel fuel as published by the United States Energy Information Administration. Using this cost, Exhibit 15, p. 38, shows the cost of transport from the eleven (11) supplemental supply locations to the distributing plant locations in the southern region of Order 33. (Hollon Tr. 189–195; Exh. 14, pp. 13–15)

29. The Federal Order Reform price surface resulted in a very flat price surface across Order 33. For example from southern Michigan to Cincinnati the current differential spread is only 40 cents. A reasonable representation of today's transport rate is \$3.23 per hundredweight per loaded mile. To travel the 229 miles between Lenawee County, Michigan, a county that regularly supplies fluid handlers with milk, and Cincinnati would cost \$739.67; using a 48,000 pound payload would result in a \$1.54 per hundredweight cost – far more than the current differential spread. The forty cents differential only represents 26% of the \$1.54 cost. Or doing

the calculation a different way and using the same constants, 40 cents would move the 48,000 pound load only 59 miles – far short of the intended destination. (Hollon, Tr. 188)

30. The alternative costs to supply plants in the southern tier from supply points in and nearby the Order are summarized on Exhibit 15, p. 39.⁸ All of the costs were calculated net of the transportation allowed by the Order and averaged more than \$1.75 per hundredweight over the order allowance, with the average *minimum* additional cost in excess of \$.66 per hundredweight.

31. For those plants in the \$2.00 zone the average of the minimum shortfall is \$.57 and in the \$2.20 zone \$.80. The Charleston, West Virginia, plant is an outlier within the current \$2.20 zone with a \$1.17 minimum shortfall. (Exh. 15, p. 39)

32. For Marietta, Ohio, Wayne County, Ohio was the least cost alternative supply area at \$2.52 per hundredweight. When compared to the current differential of \$2.00 a suggested temporary adjustment could be \$0.52 per hundredweight. (Exh. 15, p. 39)

33. For Charleston, West Virginia, Wayne County, Ohio was also the least cost alternative at \$2.89 per hundredweight. When compared to the current differential of \$2.20 a suggested temporary adjustment could be \$0.69 per hundredweight. (Exh. 15, p. 39)

34. The cost of supplying plants in the south of Order 33 from the least cost alternative supply area using the “southeastern model” cost and the “MEMA” cost are tabulated on Exhibit 15, p. 48.⁹ The Class I differential changes in Proposal 1 have the following relationship to the **lowest** calculated cost-over-differential: At Cincinnati, an increase of \$.20

⁸ Attachment 2 hereto.

⁹ Attachment 3 hereto.

versus a lowest possible model cost of \$.34; at Charleston, West Virginia, an increase of \$.40 as compared to a lowest model cost difference of \$.69; at Indianapolis, Indiana, an increase of \$.15 as compared to a lowest additional cost of \$.55; at Marietta, Ohio, an increase of \$.15 as compared to a lowest cost increase of \$.52; at Newark, Ohio, an increase of \$.15 as compared to a lowest additional cost of \$.29; and at Springfield, Ohio, an increase of \$.15 as compared to a lowest additional cost of \$.40. (Exhibit 15, p. 48).

35. In addition to mileage and haul costs, market conditions are important and need to be considered in establishing Class I differential. Graphic depiction of the more than ample competition for milk supplies inside Order 33 from nonpool plants (each denoted by a number) is on hearing Exhibit 5 (DFA et al. Request 5 – C).¹⁰ Reviewing the legend key indicates that there is a wide mix of Class II, III and IV plant operations all competing for the milk supplies in the Order. On this Exhibit the black dots represent locations for milk supplies. Each dot represents 500,000 pounds of milk per month. More dots mean more milk. The milk supply is concentrated in the central to northern regions of the Order and many of the nonpool plants are located close to the milk supply. This means that the differential structure in the southern regions of Order 33 must not only bid milk away from the manufacturing plants but must “up the ante” to overcome the transportation cost advantage of the nearby buyer. (Hollon, Tr. 177–178)

36. When price alignment is considered with Federal Order 5 to the south, the suggested temporary adjusted differential of \$2.60 aligns well with the effective differential of the nearest three competitors, Dean Foods at Louisville Kentucky with an effective differential of \$2.45; Winchester Farms Dairy, Winchester, Kentucky with an effective differential of \$2.75;

¹⁰ Attachment 4 hereto.

and Flav-O-Rich Inc., London, Kentucky's effective differential of \$3.05. (Exh. 15, p. 48; Tr. 202)

37. All of the changes in Proposal 1 are significantly less than the lowest model-calculated cost of attracting additional milk from the nearest supply point in the Order. The proposals are modest and limited adjustments in differentials which will increase orderly marketing within the marketplace by providing under the Order a greater portion of the cost required to get milk to the plants.

38. Using the latest information available from the Cornell dairy sector simulator research on the distribution cost for packaged milk, the proposed Class I price changes were analyzed to determine if it would result in any changes in plant price competitive relationships that would be incentives for uneconomic movements of milk. The results of this analysis were presented by Mr. Hollon, Exh. 14, p. 21. The study revealed no uneconomic conditions or incentives were created. There was no testimony by any handler witnesses challenging this analysis. (Hollon Tr. 203–205)

IV. THE CASE FOR PROPOSAL 1

The case for proposal 1 is compellingly made by several data sets submitted by the Market Administrator's Office. First, the supply and demand situation in the Southern region of Order 33 is starkly shown on Exhibit 5 (DFA et al. Requests 3-A, 3-B, 4-A). The gross availability of milk in the Southern region of Order 33 is less than 50% of the volume demanded by the region's fully regulated distributing plants. (Exh. 15, DFA et al. Request 3-B) This data establishes beyond question that necessary milk supplies for the Southern region distributing

plants must be “imported” into the region from distances to the North. The actual distances to which suppliers must reach to supply the Southern region distributing plants is documented on Exhibit 5 (DFA, et al. Request 4-A). This data demonstrates that suppliers to the Southern region distributing plants must reach nearly twice as far on average to supply the Southern region’s distributing plants as the distance required to acquire supplies for the Northwest and Northeast region plants. Underscoring the supply situation, the data on Exhibit 6 also compiled by the Market Administrator, at the request of Dean Foods, shows that the Southern region distributing plants receive only from 26% to 32% of their supplies from within the region. This is in stark contrast to the Northwest region plants which receive 98% of supplies from local sources and the Northeast region plants which receive more than 70% of their supplies from local sources. The necessary, and inescapable, conclusion from this data is that it is substantially more expensive to supply the Southern region distributing plants than those in the other areas of Order 33.

To evaluate the costs involved in supplying Southern region distributing plants, and the extent to which the Class I differentials do not provide reasonable cost recovery under the Order so as to attract an adequate supply of milk to those locations, the Cooperatives provided detailed analysis of the potential areas for supplemental supplies to the Southern region distributing plants and two models for calculating acquisition costs of milk from these supply areas to the plants. The locations of potential alternative supplies were identified by reference to areas of concentrated milk production within and nearby Order 33. See Exhibit 5 (DFA et al. Requests 2-

A, 2-B). From those potentially available supply areas¹¹, the cost to deliver milk supplies to the Southern region distributing plants was calculated using both the formula and costs utilized by the Secretary in the Decision for Order 5 and 7 differential changes and the actual costs incurred by the proponent cooperatives in the common marketing agency programs currently under Order 33. The cost to supply the Order 33 Southern tier plants on the basis of those two calculated cost models were summarized and analyzed on Exhibit 15, page 48 (Attachment 3 hereto). Utilizing the lowest cost alternative in all cases, the average cost of acquisition of supplemental milk supplies in excess of the current Class I differentials under the Order ranges from \$.45 to \$1.17 using the MEMA costs; and from \$.29 to \$.69 using the southeastern model. This data demonstrates again in a compelling and substantially undisputed fashion that the current Class I differentials at the Southern region distributing plants are insufficient to meet the standard required under the Orders to attract a sufficient supply of milk. Therefore, increases in the differentials are appropriate.

The proposed increases in differentials are \$.15 per hundredweight in certain locations; \$.20 per hundredweight in other locations and \$.40 at one location. See Exhibit 15, pp. 49–50, (Attachments 5 and 6) which are maps of the current and proposed differential areas. Proposal 1 establishes a new band of Class I differential at \$2.15 which covers areas of south central Indiana and south central Ohio and affects plants at Indianapolis, Indiana; and Marietta, Newark, and Springfield, Ohio. Further south, an area of differential increases of \$.20 per hundredweight would establish a band at \$2.40 which would affect plants in the Cincinnati area. Finally, the

¹¹ Attachment 7 is Hearing Exh. 15, p. 51, which identifies by name and location the potential supply areas.

Charleston West Virginia plant, which is clearly the most expensive plant in Order 33 to supply and the most extended geographically from any supply area, would be priced at a differential of \$2.60, an increase of \$.40 from the current \$2.20. The proposed differentials do not in any instance provide a sufficient price standing alone to attract supplemental milk supplies to the Southern region plants. However, they represent an important increase in price at these plants which, if adopted, will be of assistance in supplying the plants with an adequate supply of Class I milk. Finally, as shown on Exh. 15, page 48 (Attachment 3 hereto), it is important to recognize that the differentials at these locations would tend to align these plants more reasonably with the plants to the South in Order 5 where the effective differentials have been increased by the Order 5 and 7 decision.

V. DISCUSSION OF OPPOSITION TO PROPOSAL 1

The Cooperatives' proposal was opposed by a number of proprietary handlers which would be affected by the price increases. In the face of the record documenting the problem in supplying the southern tier plants at current differentials, the opposition contended no action need be taken or that alternative actions would be preferable to address the problem of attracting milk to the southern region of Order 33. We will attempt to address these objections and alternative suggestions, as we understand them. We will first discuss the contention of Kroger, NDH and Dean Foods that current price relationships should not be disturbed. Secondly, we will discuss the argument of Dean Foods and others that Class I prices should be not be changed, except in the context of a national hearing. Third, we will comment upon the argument of Kroger and Dean Foods that the problem of getting milk to these plants should be addressed by

fractionating the Order into multiple, smaller Orders. Fourth, we will discuss the argument that prices should be reduced in the northern areas of Order 33 rather than increased in the south of Order 33. Finally, we will discuss the specific concerns raised by United Dairy with respect to the appropriate price at the Charleston, West Virginia location.

A. **The contention that existing price relationships should in essence never be disturbed is without basis.**

The contention was made by several handlers that adoption of Proposal 1 would change the existing minimum price relationship between plants affected and plants not affected by these changes. The explicit, or implicit, argument is that the existing relationship between plants must be retained. We would offer several comments with respect to this position.

First, the contention that price relationships should remain in essence frozen in place at relationships established in 1985 (or, perhaps, in 2000) should fall of its own weight. The cost to supply fluid plants is not frozen in time and the minimum prices applicable to those plants should likewise not be frozen either. In fact, the competitive relationship among plants changes without any changes in the minimum federal order price when transportation costs change. In other words, if two plants are 100 miles apart and the cost of moving packaged fluid products 100 miles increases by \$.10, it has become \$.10 more expensive for either plant to compete at the location of the other. Their competitive relationship has changed with the cost of transportation. The minimum milk prices applicable at these plants should change as well, if the location of the plants is such that the increase in transportation costs has changed the relative cost of supplying the plants with raw milk. There is no justification in freezing one aspect of the competitive relationship of the plants (raw milk cost) when the costs of the marketplace are naturally

changing the inherent competitive relationship based on geographic location. In other words, the competitive relationship among plants today is not the same as it was in 1985 solely because of increases in transportation costs. Dairy farmers should not be frozen into a minimum delivered price relationship established in 1985.

Furthermore, the price relationships of the Order 33 plants to points South has changed with the changes to minimum prices in Order 5. This change is of great competitive benefit to the plants in Order 33, with or without the changes in Proposal 1. The changes in Order 5 make retaining milk in Ohio for delivery to local plants that much more difficult because Southern point prices have increased substantially. The changes in Proposal 1 will both further the fundamental federal order principle of appropriate price alignment between plants on an inter-Order basis and assist Order 33 plants in obtaining an adequate milk supply.

Because the cost of moving milk has increased since 1985 and prices in contiguous markets to the south have increased, the 1985 price relationships among plants in Order 33 should not dictate the 2008 price relationships.

Finally, with respect to handlers' desire to maintain existing price relationships, it is important to point out that much of the basis for this is a desire to be able to move packaged product from South to North **against** the underlying milk price grid. Handlers in the Federal Order system are free to distribute packaged milk wherever they choose. However, the Federal Order system, and particularly the dairy farmers who supply milk to these plants, have no obligation to provide assistance to the plants with respect to the cost of moving packaged milk products as they choose. This is particularly true when the plant, for whatever reason, chooses to compete in areas of lower milk cost. This type of competition was described by the witness for

National Dairy Holdings, the witness for United Dairy, and the witness for Kroger. There is simply no basis in Federal Order policies or practices for producers to be asked to take on some responsibility for these packaged milk movements by keeping prices low at plants in southern areas which wish to move processed dairy products back north. In essence, producers would be paying to transport milk in both directions: to the plant for processing, then back north for distribution. These arguments for maintenance of existing prices in the southern region of Order 33 should not be given any weight.

B. Changes in Prices in the Southern Tier of Order 33 Should Not Await a National Hearing.

The arguments made by witnesses for Dean Foods, Kroger, and perhaps others, that no changes in Class I prices should be made in any Order, or this one in particular, without a full national hearing should be rejected. As Mr. Hollon testified (Exh. 14, pp. 4-5; Tr. 171-172), there is no proposal for a national hearing yet presented; the independent study which the industry understands is ongoing as a possible premise for the national hearing is not yet complete; and even once there is such a hearing its duration and timing is not known but results are certainly a matter of years, rather than months, away. Thus, while cloaked in the national hearing justification, this argument by handlers is in actuality nothing more than a request for delay in updating prices¹² for an indefinite period of time.

The proposals on the table for adjustments in a portion Order 33 do not have national

¹² It is well understood that the ultimate “updating” of Class I prices will result in price increases, and not decreases, reflecting the increases in energy and transportation costs now embedded in the system.

implications. The relationships affected by these price changes are with those plants already subject to price changes in Order 5 and among plants in Order 33. As among the plants in Order 33, the data demonstrate that the plants which would have price changes are those which require additional servicing in the form of transportation expense in order to get milk to market. The additional costs (and the necessary price changes to reflect those costs) are fully justified on the basis of local market conditions and have nothing to do with national supply and demand conditions or national price levels.

C. The Suggestions of Dean Foods and Kroger that One or More New Orders Should be Created to Address the Problem of Supplying Milk in the Southern Portion of Order 33 Should be Rejected

There are any number of reasons to not accord any weight in the decision making process for this hearing to the calls for creation of multiple Orders from the current Order 33. We wish to note three points.¹³

First, the economic logic of these arguments must be understood: The handlers wish to defray the increased cost of supplying milk to their plants by pooling the prices-paid-revenues among fewer producers. In other words, to cover cost increases, rather than increasing market prices, they propose to cover the costs by taking the money to pay some producers from other producers who are currently receiving it through the marketwide pool. In a classified price system with pooling, it is simple arithmetic that the blend price increases when the Class I

¹³ We will not dwell on the fact that the proposed new orders cannot be the result of this hearing because they are not part of the hearing notice; but that fact in itself should eliminate any serious consideration of the suggestions.

utilization increases. If milk is eliminated from the pool, the remaining producers' price goes up. This is all that the suggestions made by Mr. Hitchell and Mr. Kinser will do: eliminate Class III use and producers from the pool for Southern Order 33. The remaining producers would receive a higher price at the expense of the producers eliminated from the pool. When one Order is broken up into three, the person creating the new orders can generate, on paper, any difference(s) in price which are desired simply by hypothesizing differences in utilization between the new Orders without changing any Class I values. This is, in essence, what has been done with Mr. Kinser's hypotheticals.¹⁴ The new blend price of one dairy farmer in Ohio, whose milk goes to southern Ohio plants, is increased at the expense of his neighbor whose milk is pooled on the "new" Northern Ohio Order rather than the "new" Southern Ohio Order. Creating the multiple Orders does absolutely nothing to address the underlying problem which is that the cost to deliver milk to the plants in southern Ohio has increased and the minimum order price has not.

Secondly, the hypothetical creation of multiple Orders in Order 33 does not conform in any respect to the criteria which the Secretary has established for creating Federal Order pools in the first place.¹⁵ The Federal Order reform decision which created Order 33 did so by applying the criteria there set forth. These criteria for creating Orders were properly applied in creating Order 33. The hypothetical multiple Orders suggested by Mr. Kinser or Mr. Hitchell would on

¹⁴ This is true for the hypothetical orders presented at the hearing, as well as those submitted post-hearing via Mr. English's email. Irrespective of the Class prices used, the blend price differences are creatures of the new orders' Class I utilization which is 'plugged' by Mr. Kinser at levels which generate the blend price differences desired. Of course, the ultimate Class I handlers' dream is an individual handler pool where the handler(s)' Class I utilization is unshared with producers marketwide.

¹⁵ See 63 Fed. Reg. 16044-45 (April 2, 1999).

their face, conflict with the established criteria by: (1) not recognizing the overlapping distribution of handler sales; (2) failing to recognize the common procurement/supply area for the plants in the proposed-separated orders; (3) failing to take into account common supplying cooperatives; and (4) failing to take into account common balancing facilities and common marketing agencies. The handler witnesses advocating separate orders did not attempt to justify those orders pursuant to the Department's announced, established criteria. Moreover, all of the handler witnesses emphasized the overlap of plant route distribution which is the first and most important criteria supporting the formation of a single order.

Finally, as was appropriately noted at the hearing in questions from the USDA representatives, differences in blend prices at plant points can be created, and are created, as readily with changes in Class I differentials as with the creation of new Orders with different utilizations and, therefore, different blend prices. (Tr. 546). Consequently, while the assertion that differences in blend prices are what moves milk is correct, the differences in blend prices which would be created under Proposal 1 are exactly what will assist in moving milk to plants in the Southern tier of Order 33 in contrast with the status quo.

D. Prices in the Northern Area of Order 33 Should Not be Reduced.

One of the suggestions made at the hearing by Mr. Kinser for Dean Foods (perhaps supported by the witness from NDH) was that the answer to the additional costs to get milk to plants in the Southern Order 33 is to reduce prices to dairy farmers in the Northern sections of Order 33 so that a greater incentive is created to move milk to southern points. The Cooperatives

totally reject this suggestion and urge the Secretary to give it no serious consideration.¹⁶

The very premise that the increased cost of supplying milk to handler locations could be covered not by increasing the price at the handler locations but by reducing prices to dairy farmers elsewhere should be rejected. The entire Federal Order program is built upon the proposition that handler location prices should be set as necessary to attract milk to those demand points. It is indisputable that the cost to deliver needed supplemental milk from locations in Michigan, and northern Indiana, to southern distributing plants which demand the supplies has increased. Since January 2000, when current Order 33 was instituted, the price of diesel fuel has increased from \$1.3010 to \$4.3530. (EIA data on Exh. 15, p. 32 and 34) These diesel fuel cost increases mean that the cost of moving milk from supply points in Michigan to demand points in Southern Ohio has increased more than the increase from \$2.20 per loaded mile in the 2003 base period (Exh 14, p. 14; Exh. 15, pp. 1– 31) to \$3.23 per loaded mile currently (Exh. 14, p. 15; Exh. 15, p. 38). On a 300 mile run, the **increase** in cost per hundredweight from 2003 to 2008 is \$.64. Dean Foods is, in effect, saying to the Michigan dairy farm suppliers of the Ohio plants' supplemental needs: "Since you are losing so much [because of transport costs] in supplying milk to our plants, we will help you out by making it even less profitable to keep your milk home." There is simply no justification for reflecting this increase in suppliers' costs by reducing the suppliers' price!

Ironically, the Dean Foods' proposal to reduce prices in the northern area of Order 33, particularly in Michigan, is a proposal which has far more ramifications in terms of the national

¹⁶ We note that Mr. Kinser himself identified this as the last priority option in his cafeteria of alternatives to Proposal 1.

price grid than does the limited proposal of the Cooperatives for localized Class I differential changes. The National Class I differential grid has minimum values and relationships between production areas in different parts of the country based on these values. To reduce the price in Michigan below current differentials would implicate those regional relationships. That is not something that should be taken up in this hearing, particularly where it was not even part of the published hearing notice.

E. Discussion of the price at Charleston West Virginia United Dairy

The Charleston, West Virginia, plant is a geographical outlier in Order 33. As a consequence, the cost to supply that plant from any potential supply area is greater than the cost to supply any other plant in the market. To supply Charleston from the Wayne County, Ohio, the closest potential supplemental supply area, milk must travel 85 miles beyond the closest alternative distributing plant which is the Broughton Foods plant at Marietta, Ohio. (Exhibit 15, pp. 42, 45). Presently, the difference in the cost to supply the Charleston plant location and the value allowable under the current Class I differential is \$.69 per hundredweight, using the Southeastern model, and a greater amount using actual current costs in Order 33. It costs \$.37 per hundredweight **more** to supply milk from Wayne County Ohio to Charleston, West Virginia than to Marietta, Ohio. (Exhibit 15, pp. 42, 45). Under any analysis which utilizes the cost of attracting milk to a demand point, the minimum price at Charleston, West Virginia, should be greater than that at Marietta, Ohio, and any other demand point in Order 33.

The Cooperatives' proposal at the Charleston plant was for an increase of \$.40 per hundredweight from the current \$2.20 differential to \$2.60. The increase of \$.40 will not bring

the minimum price at Charleston up to the acquisition cost, using the lowest cost supply area and the lowest cost hauling model i.e. the Southeastern model. On this basis, the Cooperatives believe that the \$.40 increase is a reasonable one supported by the record. If, nevertheless, the Secretary were to conclude that the price at Charleston should not be increased \$.40 per hundredweight, the Cooperatives suggest that the record plainly establishes that Charleston's minimum price must be higher than the price at any other location in the marketplace to reflect the indisputable geography and cost to supply this location.

VI. NEED FOR EXPEDITED ACTION

These issues need to be addressed on an expedited basis. If the Department follows the schedules set-out in the 2008 Farm Bill, although those statutory time periods are not technically applicable to this proceeding, that would be satisfactory to the Cooperatives. Otherwise, the proposals should be adopted on an emergency basis without the issuance of a recommended decision.

VII. CONCLUSION

On the basis of all of the foregoing, and the testimony and evidence at the hearing, the proponent Cooperatives respectfully submit that Proposal 1 should be adopted in its entirety.

Respectfully Submitted,

Date: October 10, 2008

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