

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

**In the Matter of** :  
**Milk In The Northeast** : **Docket Nos.:**  
 : **AO-14-A70 et al;**  
**Marketing Area** : **DA-02-01**  
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**POST-HEARING BRIEF AND PROPOSED FINDINGS  
SUBMITTED ON BEHALF OF THE ASSOCIATION OF  
DAIRY COOPERATIVES IN THE NORTHEAST  
("ADCNE")**

**Date: January 31, 2003**

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## Table of Contents

- Tab A Post-hearing Brief and Proposed Findings Submitted on Behalf of the Association of Dairy Cooperatives in the Northeast (“ADCNE”) (Part I – Proposal 7)
- Tab B Post-hearing Brief and Proposed Findings Submitted on Behalf of the Association of Dairy Cooperatives in the Northeast (“ADCNE”) (Part II – All Other Proposals)
- Tabs 1-19 Appendix of Selected Hearing Exhibits

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**POST HEARING BRIEF AND PROPOSED FINDINGS SUBMITTED ON BEHALF OF  
THE ASSOCIATION OF DAIRY COOPERATIVES IN THE NORTHEAST ("ADCNE")  
(PART I)**

**I. INTRODUCTION AND OVERVIEW OF ISSUES AND PROPOSALS**

This brief is submitted on behalf of ADCNE, the Association of Dairy Cooperatives in the Northeast, with respect to the proposals heard September 10–13, 2002, in Alexandria, Virginia, for amendments to Order 1. ADCNE, as the proponent of a number of the proposals, wishes to reiterate its appreciation for the opportunity to be heard with respect to these proposals which are so critically important to these cooperatives and their dairy farmer members.

The ADCNE cooperatives represent in aggregate more than 65% of the Order 1 pool. Following is a brief description of their operations in Order 1.

Agri-Mark, Inc., headquartered in Methuen, Massachusetts, has approximately 1350 members located in the six New England states and New York. It markets about 2.5 billion pounds of milk annually. Agri-Mark owns and operates three manufacturing plants including a dedicated cheese plant in Middlebury, Vermont, a cheese and other dairy product plant in Cabot, Vermont, and a butter and powder plant in West Springfield, Massachusetts.

Dairylea Cooperative Inc., headquartered in Syracuse, New York, represents 2,400 dairy farmers, most of whom are pool producers under the Northeast Order. Dairy Marketing Services is the pooling handler for Dairylea and the Northeast Area Council of Dairy Farmers of America, its members.

Dairy Farmers of America, Inc. (DFA) is a national cooperative whose northeast area council operates in Order 1. The DFA Northeast Area Council represents 2,200 dairy farmers, with most being Order 1 pool producers. DFA owns two Order 1 pooled powder plants under the name of Deitrich's Milk Products, LLC.

Land O'Lakes, Inc., is a cooperative with a national membership base. In the Northeast, Land O'Lakes has over 2,200 members who are pooled on Order 1. LOL owns and operates an Order 1 pooled butter/powder plant located in Carlisle, Pennsylvania.

Maryland and Virginia Milk Producers Cooperative Association, Inc., headquartered in Reston, Virginia, consists of approximately 1600 producers in 11 states in the east and southeast. It owns and operates an Order 1 pool plant at Laurel, Maryland, which has butter/powder manufacturing capacity.

O-AT-KA Milk Products Cooperative, Inc., is a federated cooperative owned by Upstate, Dairylea, and Niagara Milk Producers Cooperative, Inc., of Niagara Falls, NY. O-AT-KA owns and operates the butter/powder plant at Batavia, New York.

St. Albans Cooperative Creamery, Inc., is a Capper-Volstead cooperative with 600 members headquartered in St. Albans, Vermont. It owns and operates an Order 1 supply plant which includes facilities receiving, separating, condensing and drying milk.

Upstate Farms Cooperative, Inc., is headquartered in Buffalo, New York, and has 342

member dairy producers the majority of whom are pooled on Order 2. Upstate owns and operates a pool distributing plant at Rochester and is a member owner of the O-At-KA butter/powder plant in Batavia, New York.

This brief and proposed findings will be divided into two main parts: The first part (“PART I”) will address solely Proposal 7, ADCNE’s proposal for marketwide service payments. The second part (“PART II”) will address the other issues and proposals in the hearing.

## **II. ADCNE PROPOSAL 7 FOR MARKETWIDE SERVICES PAYMENTS<sup>1</sup>**

### **A. The Order 1 marketplace**

To appreciate the balancing services required in Order 1, it is helpful to have an overview of the marketplace, its size, scope, and consumption demands.

1. The Northeast Federal Order was created from the merger of the New England, New York-New Jersey and Middle Atlantic Federal Orders during the Federal Order Reform process. It has a number of characteristics that make it unique among Federal Orders.

2. The Order 1 milk shed includes most of the states of New York and Pennsylvania, the 3rd and 4th largest milk producing states in the United States, as well as the state of Vermont, the 13th largest milk producing state. On a milk production per square mile of land mass basis, these three contiguous northeastern states make up the densest milk production region of its size in the country.

3. The Northeast Order’s marketing area is depicted on the Federal Order map shown as Exhibit 11, Figure 3. The Northeast Order includes the eastern seaboard metropolis

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<sup>1</sup> On January 30, 2002, Agri-Mark indicated it would not be joining the ADCNE position on Proposal 7. On January 31, 2002, Land O’Lakes indicated that it is neutral on Proposal 7.

that takes in the cities of Boston, New York, Philadelphia, Baltimore and Washington.

Approximately 51.6 million people live within the geographic boundaries of the marketing area.

This region has the largest population base of any Federal Order in the country. It contains 20 million more people than the next most populous federal order marketing area. See Exhibit 11, Table 1.<sup>2</sup>

4. The Northeast Order handlers, and the cooperatives that provide the service of assuring that the marketing order functions properly and efficiently, serve the largest Class I market in the country. During 2001, 10.6 billion pounds of milk were pooled as Class I under the Northeast order (see Exhibit 11, Table 2). This was almost 60 percent more Class I milk than the next largest Class I market and larger than the entire quantity of milk pooled (regardless of class) in 7 of the remaining 10 Federal Orders.

5. The Northeast Order is also the largest Class II market in the United States. It pools twice as much Class II milk as the next largest Federal Order Class II market. (see Exhibit 11, table 3). Many pool distributing plants in Order 1 process Class II products, such as cream based products. In 2001, handlers under the Northeast Order distributed 775.8 million pounds of fluid cream products.<sup>3</sup> This was the largest fluid cream product volume under any Federal Order, making up nearly 50% of all fluid cream products in the Federal Order system and representing

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<sup>2</sup> Throughout this brief, exhibits from the hearing will be referred to by their number and page (or other identifying characteristic) e.g. "Exh. 11, Table 2". Selected hearing exhibits are attached to this brief for convenient reference, at tabs # 1 to 19. In addition to being referred to by the hearing Exhibit number, this brief will reference the documents which are attached as, e.g., "Appendix 5."

<sup>3</sup> Class II is much more than fluid cream. For instance, New York and Pennsylvania are leading producers of cottage cheese, yogurt, and candy and confectionery products, all Class II products.

more than 4 times the volume produced and pooled under any other Federal Order (see Exhibit 11, Table 4).

6. Unlike other Class I markets (specifically, the Appalachian, Southeast and Florida Orders), the Northeast is also home to a strong manufacturing sector. The Northeast Order ranks 1st among all Federal Orders in the volume of Class IV milk pooled and ranks fourth in Class III pool pounds (see Exhibit 11, Tables 5 and 6).

7. The diversity and demographics that exist in the Northeastern United States has provided a favorable economic environment for a very strong processing and manufacturing sector. Presently, there are 75 pool plants and 184 nonpool plants serving the Order 1 market.<sup>4</sup> A handful of these plants are operated by dairy cooperatives. The remaining plants are owned and operated by proprietary businesses. Although the make up of the operators within the industry has changed over time, historically, the Northeastern Federal Orders have had a very large number of proprietary milk plants.

8. Relative to other Federal Orders, the Northeast has more pool handlers, 62<sup>5</sup>, and more distributing plants, also 62, than any other Federal Order (see Exhibit 11, Table 7). The Northeast Order has 26 percent more distributing plants than any other Order and has more than double the number of distributing plants than the orders with the highest Class I utilization rates. (Exh. 11, Table 7)

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<sup>4</sup> Taken from: (1) Order No. 1 Northeast Area Pool Handler Location Index June 2002 (includes pool distributing plants, pool supply plants, partially regulated plants and other Federal Order plants located in a state the makes up the marketing area, Maine or West Virginia) and (2) the Northeast Marketing Area Non-Pool Manufacturing and Other Order Pool Plant Location Index, December 2001, Hearing Exhibit 5.

<sup>5</sup> A single pool handler can, of course, operate more than one plant, either pool or non pool.

9 An additional characteristic that makes the Northeast quite different from the dairy industry in any other part of the county or any other Federal Order is the large quantity (and proportion) of milk that is not marketed through dairy cooperatives.

10. In the Northeast, a dairy farmer does not need a dairy cooperative in order to have a milk market. The large number of competing proprietary milk plant operators and the even larger number of plants they operate has created an environment where there are a huge number of competitive marketing options for dairy farmers. Historically, proprietary plant operators have developed their own dairy farmer milk supplies to meet a majority of their milk needs. In the Northeast, this still holds true today.

11. Presently, in Order 1 approximately 32 proprietary handlers have their own milk supply (see exhibit 11, Table 8). Of these, 27 operate Class I distributing plants.<sup>6</sup>

12. Exhibit 5, Appendix 17<sup>7</sup>, "Cooperative and Non-Cooperative member Share of Producer Receipts and Producers, January 2000-June 2002" depicts the number of and volume produced by cooperative member and non-cooperative producers. In June 2002, 4,310 dairy farmers, whose milk was pooled under the Northeast Order, did not belong to dairy cooperatives. This represented 25.3 percent, more than one-quarter of the producers under the Order. Their milk production was 503.4 million pounds. For 2001, almost 5.9 billion pounds of milk was delivered to handlers under the Northeast Order by producers that were not members of dairy cooperatives. The Northeast Order has more milk produced by non-members than any other Federal Order in the country.<sup>8</sup>

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<sup>6</sup> Please note, a few handlers operate more than one distributing plant.

<sup>7</sup> Appendix 4 to this brief.

<sup>8</sup> In fact, the amount of milk supplied by non-members to proprietary plants under the Northeast Order represents more milk than was pooled in three Federal Orders in 2001 – the



13. It must be noted that the plethora of marketing options for dairy farmers in the Northeast also includes independent dairy cooperatives. The Northeast is home to about 78 of the 208 dairy cooperatives in the United States – almost 40 percent.<sup>9</sup> Each of these 78 cooperatives compete in their own way to maintain or grow their membership rolls. Each cooperative is active in the Northeast Order’s milk procurement arena. Between dairy cooperatives and proprietary handlers, dairy farmers in the Northeast have about 110 different business entities to choose from when looking for a milk market.

14. The 78 cooperatives and 4,310 non members provide 4,388 sources from which the 259 milk plants (75 pool plants and 184 non pool plants) can purchase their milk.<sup>10</sup>

15. Many Order 1 cooperatives have fewer than 100 members, a number have fewer than 20. Some of these cooperatives have joined Dairylea or Allied Federated Cooperatives or another larger cooperative as member cooperatives, or remain independent but ship their milk through a cooperative organization. However, others, such as Boonville Farms Cooperative, Oneida-Lewis Cooperative, HP Farmers Cooperative<sup>11</sup> and Middlebury Cooperative, to name just a few, are truly independent marketers which place their milk out to bid and market to the highest bidder. Usually, cooperatives such as these contract with a Class I proprietary plant, and ship their milk to that plant just about every day.

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Western, Arizona-Las Vegas and Florida orders.

<sup>9</sup> Taken from Order 1 Cooperative List, Exhibit 5, and the USDA, RCBS publication, “Farmer Cooperative Statistics, 2000”.

<sup>10</sup> Actually the plant purchasing options are much greater when considering that in any given month, on average, 1,000 dairy cooperative members could exercise their option to leave the cooperative and change their milk market.

<sup>11</sup> The operation of a small cooperative such as the HP Cooperative was described by Mr. Finn, one of its officers. TR. 578–581. HP sells its 40 million pounds of milk per year to one buyer; it was formerly marketed to cooperatives, but Elmhurst (Worcester Creameries) pays them a higher premium.

## **B. The Order 1 Market's Need for Balancing Services**

### **1. Seasonality and Class I use patterns**

16. Northeast Order Class I sales run along a predictable seasonal pattern. They are at their highest levels when schools are in session and at their lowest levels in the summer. Exhibit 11, Figure 4 graphically depicts this showing Class I deliveries per month, divided by the days in each month, for 2000 and 2001. By looking at average deliveries per day pooled as Class I, the seasonal nature of the Northeast Order's Class I demand can be seen.

17. The seasonal nature of Northeast Order producer deliveries that are pooled in Classes III and IV is counter-cyclical to the Class I demand. This is shown on Exhibit 11, Figure 5, which graphs average deliveries per day pooled in the two manufacturing classes.

18. Exhibit 11, Figure 6 combines data to show, for 2001, both average daily deliveries pooled as Class I and average daily deliveries pooled in Classes III and IV. As average daily Class I receipts decline in the spring and summer, average daily Class III and IV receipts increase. In the fall, as average daily Class I receipts rise, average daily Class III and IV receipts decline. Especially during the autumn months, huge divergences and different delivery patterns exist for the two uses.

19. Exhibit 14, Figure 1 (Appendix 2 to this brief), shows producer receipts per day classified as Class I under Order 1 from January 1, 2000 to June 2002. Figure 2 shows total producer receipts per day during the same period and Figure 3 shows the difference between the two. These figures used the data compiled by the Market Administrator's office (Exh. 5, p. 5), divided by the number of days in each month. The monthly variation is clear from these graphs. There are times of the year when, without question, the volume of milk in excess of Class I needs

is far greater than other times of the year and that milk must find a home.

20. Exh. 14, Figure 4 (Appendix 3 to this brief), shows the Class IV volume of milk in the Federal Order. The data from this table is based on Exh 5, page 5. The extreme volatility in Class IV use can clearly be seen in both the figure and the Exh. 14, Table 2 (Appendix 17 to this brief). Class IV producer receipts are at or significantly above 249 million pounds for the first five months of year 2000 but were at or below 100 million pounds during August through November of 2000.

21. In 2000, total milk receipts in the Northeast Order were one billion and seventy-six million pounds higher in the first six months of the year than in the last six months. This was a 9.4% difference. During that same year, Class IV receipts were 901 million pounds higher between the two time periods. Class IV plants absorbed 84% (901/1076) of the difference in producer receipts even though Class IV milk averaged less than 10% of total producer receipts during the year. Class IV volume had to fluctuate by 126% between the two halves of the year in order to accommodate the change in total producer receipts.

22. In 2001, total milk receipts in the Order were only 266 million pounds higher during the first six months of the year than in the last six months. This was a 2.2% difference. During the same year, Class IV receipts were 215 million pounds higher during the same time periods. Class IV once again absorbed more than 80% of the difference in producer receipts even though it averaged less than 9% of producer receipts for the year 2001. Class IV volume had to fluctuate by only 22% between the two halves of the year. While that may look like a better economic situation for Class IV plants in 2001, it was actually a far worse year since total Class IV volume was down nearly 200 million pounds during the year and plants had far less volume

over which to spread their fixed costs.

23. In 2001, Class IV receipts peaked at 230 million pounds in the spring and were below 150 million pounds throughout the late summer and fall. The volatility was less in 2001 because volatility of total milk receipts was less.

24. In 2002 (at the time of the hearing), Exh 5, Table 5 showed Class IV pounds during the first six months of 2002 totaling 469 million pounds above the same months in 2001 and even 35 million pounds above 2000.

25. Balancing these production and demand patterns in Order 1 is required across the entire milk supply and marketplace.

## 2. Cooperative member and nonmember marketings

26. Cooperatives and their members have played the primary role in balancing the northeast order market for more than sixty years and the costs of that balancing have been borne by the cooperatives and their members. One of the key issues cooperatives face is the huge number of milk producers who do not belong to a cooperative, sometimes called nonmembers. They number in excess of 4000 according to MA data and market about 6 billion pounds of milk annually (See Exh. 5, Appendix Table 16).

27. Nonmember numbers and volume are important in balancing because there are dramatic differences in the Northeast relative to how cooperative member and nonmember milk is used. Most of the nonmember milk is dedicated to supplying distributing plants on a year-round basis. As shown in Exh. 5, Appendix 15<sup>12</sup>, the average classification of nonmember milk in Order 1 is about 80% Class I despite the fact that the Northeast is less than a 45% Class I

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<sup>12</sup> Appendix 5 to this Brief.

utilization market year round. The milk from these nonmember farms is received at Class I distributing plants nearly all the time. (TR.583–588 (Byrne Dairy producer Arie Scholte))

28. Nonmember farms shipping to Class I processors make no special efforts to balance the seasonal or daily needs of their handler or the Class I market. Class I handlers do not limit the volume of milk picked up from those nonmembers in any significant way. Class I handlers do not ask those shippers to store milk from low demand days to high demand days. Those handlers do not refuse to accept their milk when schools go out of session or demand producers expand their herd in the fall and reduce it in the spring.

29. What Class I processors who buy milk from nonmembers usually do is buy a volume of farm milk that is no larger than their low month needs and use cooperative milk to balance their needs in the high usage months. Exh. 14, Table 1, takes the MA data from Exh. 5, page 5, regarding producer receipts classified as Class I and compares that with the product of multiplying the volume of non-cooperative producer receipts (Exh 5, App. 17; Appendix 4 to this Brief) times the percentage of proprietary handler producer milk receipts delivered to distributing plants (Exh. 5, App.15; Appendix 5 to this brief). The difference is a proxy for the amount of Class I milk that must be handled by nonmembers during each month.

30. Exh. 14, table 1, also gives the volume per day for non-cooperative and cooperative producers as a percentage of the low month during the eighteen month period. For non-cooperative producers, the low point of receipts per day was August 2001. The level of milk provided per day ranged from that low point to 12 percent higher in March and April of 2002. It is significant that the high point of deliveries of nonmembers was in the spring when Class I sales tend to be less than in the fall. Cooperative member receipts in the Class I market was at a low

point in July 2001. However, their deliveries needed for the Class I market peaked in November and needed to be 35 percent above the July low point. The seasonal high - low volatility of the cooperative receipts for the Class I market was 23 percentage points higher and occurred at a point when total milk production is usually at a seasonally low point. Clearly cooperative milk balances the Class I market.

### **C. ADCNE Balancing Services in Order 1**

31. The economic return for providing milk under the Northeast Federal Order for producer members of cooperatives who balance the Class I market is less than that of producers who do not participate in providing balancing services. This inequity has existed for many years but has grown since the current Order was effective on January 1, 2000.<sup>13</sup>

32. Exh. 5, App. Table 14 (Appendix 10 to this brief), shows total receipts of milk and cream at the seven butter/powder plants operated by the cooperative members of ADCNE. Information for the months of May and November between 1992 and May of 2002 is provided. These plants perform a variety of activities including reloading milk, and skimming milk (and to a lesser extent cream) for sales to other handlers. Those activities, as well as the production of specialized products, including on-demand specialized milk powders which tend to be more valuable products, are a priority at the plants. The least priority is making skim milk powder and butter. Those are the two products in these plants that balance the Class I market.

33. For the seven ADCNE plants, the average production of nonfat dry milk in each May since 1992 is 220 million pounds. The amount in November is about 97 million pounds but is closer to 100 million pounds when the thirty days in November are adjusted to 31

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<sup>13</sup> Old Order 2, pre-2000 had cooperative payments which provided a very limited reimbursement for balancing.

days such as in May. Overtime, the amount of nonfat dry milk production in May is more than double the production in November. The extremes during that time were 60 million pounds in November 1993 and 286 million pounds in May 2002, a difference equal to nearly 2 billion pounds of milk.

34. For the ADCNE plants, butter production volatility can be directly attributed to the Class I market. Class I sales averaging about 2% fat need to balance skim milk and butterfat from producer milk since producer milk averages nearly twice the butterfat level. For example, when Class I sales peak in the fall and larger amounts of milk are needed for that classification, the producer milk received at distributing plants must be separated to generate milk averaging 2% butterfat. This separation produces a large volume of cream that is not needed for Class I. The column marked “total cream receipts” in MA Appendix 14, Exh. 5 (Appendix 10 to this brief), reflects that occurrence. Most of that cream is coming from Class I distributing plants. Product manufactured into butter at the ADCNE plants averaged 14.2 million pounds in May and 8.3 million pounds in November (or 816 million pounds in November when adjusting for a 31 day comparison). Thus, on average there was 66% more butter made in May than in November at the ADCNE plants.

35. The ADCNE Cooperatives seek the lowest cost method to balance Class I markets and reserve milk supplies. The seven butter/powder plants, whose usage has been summarized, are used for balancing by ADCNE cooperatives. In addition, a “portfolio” of supply arrangements with cheese plants and other processors is used by Dairylea and DFA and sometimes the other ADCNE members.

36. DMS (the Dairylea–DFA joint venture) markets, on average, 650 loads of

milk a day, to more than 100 milk plant locations for over 7,000 dairy farmers. A significant number of these plants package fluid milk for route delivery. DMS is the largest seller of milk to Class I distributing plants in the Northeast.

37. A milk marketer does not need to own a plant in order to render balancing services. DMS employs a balancing strategy which uses a portfolio approach to balancing member and customer milk needs. The portfolio is made up of the region's manufacturing plants, most of which are not owned or operated by DMS, Dairylea or DFA.<sup>14</sup> DMS's balancing costs are at least as great as those of balancing plant owners, but come in different forms.

38. The under Class price discount is a real business cost involved in balancing milk supplies. When a balancing load becomes available, the load generally falls outside of a supply contract's pricing. In such a case, the load is priced on the 'spot' market, determined by that particular day's supply and demand dynamics. These loads also carry another demand characteristic that undermines the load's value, referred to as "opportunistic" pricing. The "spot" and "opportunistic" price for a balancing load is often below the class price of the milk under the order.

39. Another aspect of DMS's costs in balancing is the cost of lost handling on balancing loads. In many cases, the weekend balancing milk carries a reduced or, in some cases, no handling charge for the sale. Again, this is for the same reasons described in the under-Class pricing discussion about spot milk and opportunity pricing. Since the producers will still be paid premiums for the milk on the load, regardless of whether or not it is balancing milk, the cost of foregone handling to cover the premiums paid to the producers becomes a real business cost.

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<sup>14</sup> DMS has no ownership interest in plants, while Dairylea has limited interests. DFA has more substantial balancing plant ownership and commercial interests than Dairylea.



40. Under-Class pricing and lost handling charges are balancing costs of DMS associated with maintaining the necessary reserve supply of milk to meet Class I customers' fluctuating, daily, weekly, seasonal and holiday demands.

41. Another cost of "renting" rather than owning plant capacity, is tolling – the charges incurred when DMS uses other plants from time to time to process milk at a fee. Plants, such as Queensboro Milk Products, will toll because they do not want to have to take any responsibility of trying to sell the product from that milk, and yet have capacity available at their plants to manufacture and are willing to rent it to a marketer, for a price. That rental price is in excess of a \$1.00 per hundredweight.

42. Another DMS balancing cost occurs when there are unreimbursed delivery costs associated with diverting milk to a manufacturing plant from its usual home at a distributing plant.

43. DMS also balances, in part, through plants owned by one or both of the member-partners. Dietrich's Milk Products, LLC operates two pool manufacturing plants in Pennsylvania – one in Reading and the other in Middlebury Center. The costs of operating these plants, and the associated balancing costs, fall back to Dairylea and DFA's Northeast Area Council via a charge by Dietrich's to Dairy Marketing Services. Dairy Marketing Services then passes those costs back to its individual cooperative owners. The primary purpose of these plants is to balance the Class I needs of DMS customers, and the Northeast milk market in general.

44. Exhibit 19, Table 3 (Appendix 18 to this brief) summarizes DMS balancing costs for January-July 2002, by component, and for the entire year of 2001. Through July of 2002, DMS expended more than \$9.1 million balancing the Northeast's milk markets. This cost

is net of any turn back fees and any cost involved with balancing milk pooled on the Southeast orders. It is also net of any revenues from the sale of specialized powder products. This cost amounts to 20 cents per hundredweight on the Dairylea and DFA-Northeast Area Council member milk supplies through July. On a full year's production, this will likely average about 12 cents per hundredweight to the members. By component, DMS balancing costs include: \$4.9 million at Dietrich's; underclass pricing – \$586,000; unreimbursed hauling — \$ 715,000; and lost handling — \$ 2,838,000.

45. Agri-Mark operates a large, dedicated cheddar cheese plant in Middlebury, Vermont in addition to its butter/powder facility in West Springfield, Massachusetts. It also has a mixed products plant in Cabot, Vermont. Agri-Mark rarely balances milk at the Middlebury plant due to the costs involved in doing so and the type of market it has for the products produced there. The costs and type of products produced at West Springfield are much preferable for balancing.

46. The overhead costs per hundredweight for Agri-Mark's cheese and butter/powder plants are \$1.02 per hundredweight at the Middlebury cheese facility and \$.61 per hundredweight at the West Springfield butter/powder plant. Thus, Agri-Mark incurs lower costs of balancing by \$.41 per hundredweight by using its butter/powder plant. In addition, butter and powder are far more generic products than many cheese products.

47. In addition to the lower overhead costs, an advantage to using a butter/powder plant to balance milk supplies is that it can also balance milk components. The average butterfat test of Class I milk in the northeast is about 2%. When Class I sales fall when schools go out, large volumes of milk averaging 2% butterfat are available. At a butter/powder facility, you can

just make proportionately more skim milk powder than butter from that milk than you would from producer milk typically containing 3.5 to 4.0% butterfat. It would not be possible to make standard cheddar from 2% milk nor could one make a very high fat cheddar in September when proportionately more skim milk is needed than butterfat to accommodate the increase in Class I use of milk averaging 2% butterfat.

48. Table 2, Exh. 14 (Appendix 17 to this brief), depicts information on volumes of milk manufactured at Agri-Mark's West Springfield, Massachusetts plant. This plant has a manufacturing capacity of about 2.2 million pounds of milk per day. It was essentially at full capacity in April 2000 when it used 65.4 million pounds of milk in that 30 day period. The low point that year, and for the 2000–2002 period, was 19.4 million pounds in November 2000 when it operated at less than 30% of capacity.

49. Milk production patterns usually shift in the Order during the early fall of each year and are usually a function of the quality (and to a lesser extent, the quantity) of feed produced in the region. Price levels can also play a role in a farmer's decision to purchase outside grain or feed. Feed quality from the year 2000 harvest was relatively poor and farmers had experienced relatively low milk prices for much of the year. Supplies tightened and milk available for manufacturing at the Agri-Mark plant in November was less than a third of that handled in March and April of that same year. Production stayed tighter during the winter and early spring of 2001, but recovered later in the year. The reverse happened in the fall of 2001. Prices had been very good for much of the year and feed quality was better than a year earlier in most areas. Milk production increased as did the need to balance markets.

50. Table 2 shows the volume of milk to manufacturing at West Springfield as a

percentage of full capacity. In 2000 it ranged from running at 99% capacity in April to 29% capacity in November. In 2001, the spring peak was 75% capacity in May; but it later peaked even higher at 81% capacity in December. The low point was September 2001 at 37% capacity. The peak (at the time of the hearing) in 2002 was at 92% capacity in June. Figure 6 reflects that information shown in Table 2.

51. Land O'Lakes owns and operates a major Order 1 balancing plant at Carlisle, Pennsylvania. The LOL Carlisle plant is one of the plants in the 7 plant aggregate data, Exh. 5, App. 14 (Appendix 10 to this brief). The volatility of capacity utilization at LOL's plant is similar to that for Agri-Mark. (Exh. 17, Table 5; Appendix 15 to this brief.) In 2001, the plant's capacity utilization ranged from 50% to 77% on a monthly average utilization basis. The DFA Deitrich's plants have similar or greater volatility. Exh. 19, Figures 1-4; Appendix tabs 11-14.

52. Cooperatives which balance the Class I market have been unable to recoup the costs of balancing these markets. Class I processors will not pay any more than they have to in order to obtain a milk supply and many believe that they pay a high enough price with the Class I differential, particularly after Option 1A became effective in place of the recommended Option 1B on January 1, 2000.

53. Class I processors have alternatives to procuring their milk from cooperatives. There are more than 4,000 nonmembers in the region and those producers supply more milk than is pooled in several other federal orders. Class I processors can balance their seasonal needs by adding or dropping producers when needed. This is what occurred prior to the AMAA of 1937. Those "balancing" methods created disorderly marketing then, and would do the same now if widely employed.

54. One of the greatest problems in dairy markets is that price setting is extremely sensitive to the last hundredweight of milk on the market. If that milk does not have a willing home, it will depress all milk prices, both over-order and class prices. This can be seen both nationally and regionally when milk production in 2002 was just over 2 percent above 2001 in a market with stagnant demand. At most, the supply/demand situation reflected from two to five percent more milk and milk products than 2001. Yet, milk prices have fallen more than 25% as those additional supplies of milk and dairy products have sought a home.

55. Federal order prices are specifically meant to be minimum prices. When small amounts of milk are without a home, any existing over-order price is the first to go. Class prices are set nationally, but if no one is willing to provide a ready home for the milk, that milk is sold below the class price. The only thing worse than a low price for milk is no price for the milk. Cooperatives provide a home and protect the integrity of class prices to the greatest degree possible. All producers benefit from this orderly marketing.

56. Cooperatives have balanced over the years because it helps create an orderly marketing environment that allows everyone to sell milk at or above Federal Order minimums. Coop members benefit from this action; but the benefit comes with costs that are not shared equitably with farmers in the Order who incur no balancing costs but receive the fluid price and over-order premiums.

#### **D. Balancing milk markets and the AMAA**

57. Producer milk destined for Class I use is neither better nor worse than milk destined for any other class use at the time that the milk is produced, at the time it is shipped from the farm, or at the time it is received at a Class I distributing plant. That milk only receives

its higher value under the Order when made and sold as a Class I assigned product. Prior to the existence of federal Orders, producers competed in an attempt to capture the higher Class I value and leave the lower value uses for the milk of their neighbors. However, this strategy consistently failed as Class I distributors could and did obtain supplies from neighboring producers who were shipping to plants with lower value uses and were willing to accept a price only pennies above what they received at the manufacturing plants. Any producer who believes that the current Class I price represents the value of his specific milk because it is received at a Class I distributing plant is mistaken. In the absence of the Federal Order, he would receive essentially the same price as his neighbor who shipped to a manufacturing plant.

58. Assuring that the Class I needs of the market are met is a primary purpose of the Federal Order as defined in the AMAA of 1937, as is the objective of maximizing the price to all farmers who provide milk to the marketing area. This not only means having a sufficient total volume of producer milk available annually to meet the annual Class I sales, it also means having the Class I milk available as it is needed on a daily basis all year long. One of the intents of Class I differentials is to assure an adequate supply of milk. These differentials tend to be higher in higher Class I utilization markets. A part of the reason they are higher is because more money is needed to assure an adequate supply each day all year long. Balancing is part of that assurance and to some extent is included in the Class I differential. However, the value of the higher Class I differential accrues to all farmers in the marketplace through a higher uniform price. While producers are crucial in providing for an adequate year round supply of milk to meet total Class I needs, producers by themselves do not balance Class I supplies in any way. Producers ship as much or as little milk as they wish to each day and produce milk in a seasonal production pattern

that actually runs counter to the Class I demand pattern. That part of higher Class I differentials that reflects balancing costs and is paid out through the blend price does not go to the parties that provide that balancing service in the market place. That problem needs to be corrected and is one of the primary purposes of this hearing.

59. Congress and President Reagan recognized this fundamental equity problem when they passed the Food Security Act of 1985 and specifically authorized marketwide service payments under Federal Orders. The decision of May 1, 1987 (52 Fed. Reg. 15951) (Docket Nos. AO-366-A28 et al., proceedings involving proposed marketwide service payments for seven orders in the southeastern United States) explained this authority, as follows:

Payments for services of marketwide benefit are specifically authorized under the Food Security Act of 1985. That law amended Section 8c(5) of the Agricultural Adjustment Act, reenacted with amendments by the Agricultural Marketing Agreement Act of 1937, by adding the following provisions: '(J) Providing for the payment, from the total sums payable by all handlers for milk . . . To handlers that are cooperative marketing associations described in paragraph (F) and to handlers with respect to which adjustments in payments are made under paragraph (c), for services of marketwide benefit, including but not limited to (1) Providing facilities to furnish additional supplies of milk needed by handlers and to handle and dispose of milk supplies in excess of quantities needed by handlers; (ii) Handling on specific days quantities of milk that exceed the quantities needed by handlers; and (iii) Transporting milk from one location to another for the purpose of fulfilling requirements for milk of a higher use classification or for providing a market outlet for milk of any use classification.'

60. Market balancing activities, such as disposing of surplus milk and obtaining supplemental supplies for handlers, are clearly identified in these provisions as services of marketwide benefit. The law also provide that payment made under the order program for the purpose of reimbursing the handlers who provide those services are to be made from the total sums payable by all handlers for milk. Thus, the objective under marketwide service payment

provisions is that the minimum uniform price to all producers would be evenly affected (reduced) and all would share in the cost of providing the services. In this way, some market participants would not be able to maintain an advantage gained by receiving benefits but not having to pay the costs thereof. They would cease to be 'free-riders'.

61. All producers who pool their milk under the Northeast Federal Order benefit from services that balance the Class I market which facilitate their "ride" to a higher uniform price for their milk. However, not all producers currently pay the fare for that ride.

#### **E. Previous marketwide services payments**

62. The FSA of 1985 specifically allowed for the marketwide sharing of those costs and that is what is requested in Proposal 7. A set of proposals for marketwide service payments was denied to the seven southeast orders in 1987 because substantial volumes of milk moved between those relatively small orders and nearby orders. There was no way to assure that the producers in one order would not pay more than their share of balancing the costs incurred in other orders. Equitable sharing of costs was the problem and, the Secretary found, "so pervades this proceeding that it (was) concluded that further consideration of the proposals would serve no purpose" (52 Fed. Reg. at 15959(May 1, 1987))

63. Proposal 7 differs from the marketwide service proposals made for the seven Southeast Orders in many respects. A primary difference in the context, however, is with respect to the size and scope of the Northeast Order. The Northeast Order is one extremely large market that is far more regionally contained than the Southeast Orders were in 1986. In fact, the current Northeast Order is not only the largest Federal Order in terms of both producer receipts and Class I sales, it is larger than all of those seven southeast Orders combined.



64. From 1967 until January 2000, cooperative service payments existed in the New York-New Jersey Federal Order.<sup>15</sup> Those payments included reimbursement for balancing the market. Agri-Mark and other cooperatives, who operated in the Northeast, but not in the NY-NJ Order, regularly discussed seeking marketwide payments for adjoining orders, but cooperatives in the region could not agree on a way to proceed. The ADCNE cooperatives did make certain proposals for marketwide service payments as part of FAIR Act process that merged the Orders, effective on January 1, 2000. However, in the informal hearing process the proposals were denied.

64. Presently in Order 1 there no marketwide service payments which provide any compensation through the pool for the balancing services performed by the ADCNE cooperatives.

**F. The Cost of Balancing the Class I Market: the Ling Study and ADCNE Costs.**

65. There are multiple types of balancing necessary in a milk market such as Order 1, including balancing of the total market's milk supply, balancing Class II and III on-demand users, and balancing the Class I market seasonally and daily. Proposal 7 deals solely with two types of balancing (1) daily balancing of Class I needs and (2) seasonal balancing of Class I needs.

66. It is very difficult to identify and measure the costs of Class I balancing on a plant's operating statement because it is exceedingly difficult to isolate those costs and allocate them back to the Class I balancing function. Butter and powder manufacturing plants do many

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<sup>15</sup> In fact, cooperative service payments in Order 2 and its predecessor orders existed prior to 1967 and for most of the time of those orders' existence some form of marketwide service payment existed..

functions. They often reload milk for longer distance travel; they can separate milk and sell skim milk or cream; they can condense skim and sell that product directly; they can combine condensed skim milk and cream in many combinations and sell them as blends; they can manufacture butter and they can manufacture dry milk powder. The powder could be high heat powder, low heat powder or whole milk powder. Some operations such as O-AT-KA also produce and package various milk- based drinks.

67. Thus, one of the challenges with proposing marketwide service payments is to try to separate the costs of balancing the Class I market with the costs of balancing the entire supply of milk in the market. Plant operators can identify total plant costs but attributing those costs solely to Class I balancing is almost impossible. The study by Dr. Charles Ling, USDA, RBCS, addresses that challenge.

68. Dr. Ling's analysis uses real data and reasonable assumptions to exclusively focus on the Class I balancing costs. In reality, a butter/powder plant may run at an even lower capacity level in the fall than dictated by needed Class I balancing in order to accommodate the total seasonal fluctuations in all producer supplies. Neither Dr. Ling's study, nor Proposal 7, attempts to account for any of these costs nor should they.<sup>16</sup>

69. Dr. Ling's study isolates the costs of balancing at a plant from all the other activities occurring at the plant.

70. The Ling study is a least-cost proxy for the actual costs of balancing. It assumes a best-case, least-cost balancing scenario where several large, efficient butter-powder

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<sup>16</sup> Thus, if aggregate producer supply fluctuations result in the need for additional butter/powder plants to facilitate constant volumes of milk into Class III plants all year long, those costs are not be included in the Ling study.

plants handle the entire Northeast market's balancing needs. In the real world, the system is not so perfect. There are more than 4 balancing plants; they are not all of the size used by Dr. Ling, and they are by no means optimally located. There are also additional costs, such as extra hauling costs needed to move milk to existing plant facilities after a milkshed has shifted, which are not included. However, the Ling study provides a documented cost basis that has not been presented in any past proceeding on this issue.

71. Dr. Ling begins his report with a discussion of the seasonal nature of milk in the marketplace. Table 1 of his report (Exhibit 12) shows indices of seasonality of producer milk deliveries and fluid demand. Clearly this table reflects the patterns we have seen in the marketplace. Bob Wellington of Agri-Mark duplicated Ling's table using year 2000 and 2001 data from page 5 of the Market Administrator exhibit (Exhibit 5). In Table 3, Exhibit 14 (Appendix 1 to this brief), he used Class I volume per day as the measure of fluid demand. He also used producer milk deliveries per producer for the production index since the number of producers pooled in the Order shifted during the year. This table mirrors Dr. Ling's table to a very high degree.

72. Dr. Ling discusses three categories of milk reserves: operating reserves, seasonal reserves and excess reserves. Operating reserves and seasonal reserves are necessary to the functioning of a Class I market. Hence, Dr. Ling refers to them in a combined category of necessary reserves. Reserves in excess of necessary ones are referred to by Dr. Ling as excess reserves. This term was used because Dr. Ling's study focused on the Class I market exclusively. In reality, excess reserves are the milk supplies that, for the most part, are important to the manufacturing sector in the Northeast. Most of these "excess reserves" go to Class III

cheese uses. However, those excess reserves are not a factor in Dr. Ling's study nor in the ADCNE proposal.

73. The key volume factors in Class I balancing are the seasonal, operating, and necessary reserves. Figure 7 in Dr. Ling's report (Exh. 12) isolates those amounts. The operating reserve in Figure 7 is the area between the seasonal and necessary reserves. The Class I balancing challenge is providing for the large volumes of reserves needed and accommodating their volatility. To determine the cost of Class I balancing Dr. Ling applies those volumes to plant cost estimates. Both the volume estimates and the plant cost estimates are conservative.

**1. A 20% operating reserve is necessary to balance the Order 1 Class I market.**

74. The concept of operating reserves in dairy is much like the requirements of the electrical industry. The electrical industry must have sufficient power reserves for the highest day of usage. The consequences of inadequate reserves of electrical power are brownouts or blackouts. The consequence of an inadequate reserve milk supply is empty store shelves.

75. Dr. Ling's study calculates the market costs of balancing the Northeast market under two assumptions; first, that the required operating reserve is 10 percent; and another assumption that the required operating reserve is 20 percent. While Dr. Ling could calculate the reserve volumes needed from published monthly market data, no such data exist for day of the week milk deliveries in Federal Order 1. Data from the ADCNE cooperatives show that the Northeast market requires a 20 percent operating reserve.

76. Exhibit 5, Appendix 1 reveals that 80 percent of non-member milk associated with Order 1, is delivered to Class I plants every month of the year. Obviously the non-member milk supply of Order 1 provides little of the operating reserves of the market. If

receipts at distributing plants differ on a daily basis, then the extent of those fluctuations (operating reserves) are accommodated by the cooperatives.

77. Prior to the hearing, ADCNE provided the Department with a graph, “Average Daily Deliveries to Distributing Plants” (Exh. 17, Table 2; Appendix 7 to this brief)<sup>17</sup>. That chart was gleaned from information provided by six cooperatives, representing more than 72 percent of the market’s Class I milk supply, for the months of May and November 2000. Each cooperative provided its daily deliveries to Order 1 pool distributing plants. The percentages on the chart were derived by comparing each day’s 7(a) plant deliveries to the monthly average. Further, each of the days of the two months were averaged to provide the percentages listed on Exh. 17, Tables 1A and 1B; Appendices 7, 8, and 9 to this brief. For instance, the 4.7 percent listed on the graph for Monday is the average of May 1, 8, 15, 22 and 29, and November 6, 13, 20 and 27.

78. Exhibit 17, Tables 1A and 1B , provides the raw data for the bar graph of Table 3; Appendices 7, 8 and 9 to this brief. The raw data provides two comparisons: first, the relationship of each day to the monthly average and also the relationship of each day to the weekly average. The chart in Exh. 17, Table 3, smooths the daily fluctuations by averaging the two months. However, the real measure of a market’s operating reserves is the specific daily fluctuations. If the market requires that 18 percent more than the daily average be delivered to distributing plants on any day, then that 18 percent is the operating reserve. On May 25, distributing plants ordered from the cooperatives and received 24.5 million pounds of milk. That was 16 percent more than the weekly average and 16.2 percent more than the monthly average.

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<sup>17</sup> Appendix 7 to this brief.

On November 16, distributing plants received 26.3 million pounds of milk from the cooperatives, which was 18.8 percent greater than the weekly average.

79. The market's distributing plants required a nearly 20 percent swing in daily deliveries compared to average deliveries. Providing this operating reserve is a cost borne by the cooperatives.

80. Another way of analyzing the same data is to compare the ratio of each day to the monthly average as shown in the table. The range reaches 17%. If you consider this range as a ratio from the lowest day to the highest, that ratio is nearly 50%. In either case, these deliveries do not include shrinkage or returns of packaged products. This data clearly documents the need for a 20% operating reserve as discussed in Tables 4 and 5 of Dr. Ling's report, Exhibit. 12.

## **2. ADCNE costs demonstrate that Dr. Ling's calculations are conservative.**

81. Dr. Ling testified that, on the basis of prior studies which he and others had done, the manufacturing cost per pound of butter or powder increased \$.0010/pound for every percent decrease in plant capacity utilization. Agri-Mark reviewed its plant overhead costs at various levels of capacity. Its cost data showed that the costs per pound of product increased about \$.0011 cents per pound for each 1% drop in the plant capacity use. Land O'Lakes analyzed its plant operating costs per pound of solid and charted them to identify the relationship of cost per unit of product manufactured with changes in capacity utilization. (Exh. 17, Table 4)<sup>18</sup> These studies verified the factor used by Dr. Ling in his study.

82. Balancing plants, such as Agri-Mark's West Springfield operation and LOL's

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<sup>18</sup> Appendix 19 to this brief.

Carlisle plant, have functions beyond drying milk and churning butterfat. These activities include receiving and condensing milk. Condensed milk, cream and blends tend to generate more value than drying/churning. If you look at a plant running at full capacity and then remove milk volume from that plant, the removed volume will impact the dryer and churn first. Therefore, one can look at the stranded costs of reducing powder and butter production as a measure of the costs of balancing in the manner reflected in Ling's study.

83. Dr. Ling's total plant cost estimates are also very conservative. When he considers the balancing costs of handling the reserve supply, he assumes a cost of \$28 million for a butter-powder plant with a capacity of manufacturing 3 million pounds of milk per day. In 1999, Agri-Mark looked at relocating its West Springfield plant and estimated a cost of \$33 million if the equipment was moved to the new location. If new equipment was purchased, the cost estimate approached \$40 million. Dr. Ling also estimated total fixed and overhead costs at about \$3 million. Total fixed and overhead costs at Agri-mark's West Springfield plant are in excess of \$4.5 million per year.

84. Dr. Ling used an estimate that for every 1-percent decrease in the plant capacity use, product costs will increase one-tenth of a cent per pound. Agri-mark's costs at West Springfield increase slightly over that amount, approximately .11 cents per pound.

85. Land O'Lakes' experience also supports Dr. Ling's estimates for a balancing plant. Land O'Lakes operates a butter-powder plant in Carlisle, PA. The plant is pooled on Federal Order 1 as a supply plant. There are three operational dryers and three evaporators located in the plant. It has a design through-put of about 156 million pounds per month and a storage capacity of around 5 million pounds of milk. During the last two and a half years, the

period since the commissioning of the new dryers, milk receipts have ranged from a low of 62.5 million pounds during October 2000 to a high of 165.7 million pounds during May of 2002.

86. Dr. Ling estimates that the cost of a “greenfield” butter-powder plant with the capacity to dry 3 million pounds of milk per day to be \$28 million. Land O’Lakes’ engineering staff estimates that such a plant today would cost \$47 million (Exhibit 17, Table 3). Land O’Lakes’ estimate is confirmed by WestFarm Foods’ experience in Jerome, Idaho. As reported in the August 6, 2002, edition of The Cheese Reporter, a WestFarm representative stated that their 3.3 million-pound per day powder drying plant recently opened in Jerome cost \$50 million. The Land O’Lakes estimate includes the purchase of land, the evaporator and dryer for 3 million pounds of milk per day and the churn capacity for 15,000 of butter per hour. Additionally, the plant would have 3 loading bays, and adequate waste water treatment plant and silo capacity for 3 million pounds of milk.

87. Dr. Ling defines plant manufacturing costs as the costs directly associated with manufacturing milk to its end products, powder and butter. These costs include labor, electricity, fuel, water and sewage, plant and cleaning supplies, repair and maintenance, depreciation, taxes and insurance, and miscellaneous expenses. He notes that unit costs increase as plant volume decreases. From previous studies and assuming no shipments of intermediate products, Dr. Ling estimates that for every one-percent (1%) decrease in plant capacity, there is a corresponding increase to product cost of \$.001 per pound (Exhibit 12, p.6).

88. While the Ling study compares the relationship between plant capacity and product costs, Land O’Lakes tracks the same costs as Ling’s “semi-variable or semi-fixed” costs on a per pound of milk solids basis. Additionally, the USDA study assumes a butter/powder



plant with no intermediate product inputs or sales. The Land O'Lakes plant at Carlisle buys and sells cream, condensed and milk. During 2001, the Land O'Lakes plant in Carlisle sold about 20 percent of its total solids as condensed skim or cream.

89. Exhibit 17, Table 4 (Appendix 19 to this brief) is a graph that plots Land O'Lakes' experience at Carlisle for the period January 2001 through July 2002. The period was chosen because the depreciation of the 2000 expansion started to be fully charged against the plant beginning January 2001. A month's cost per pound of solids is plotted against the relationship of plant receipts over plant capacity. For instance, as already noted, Carlisle processed over 165 million pounds (100 percent of capacity) of milk during May 2002. During that month the cost per pound of solids was just over \$0.10 per pound; thus, the furthestmost right data point on the graph represents May 2002. Similarly, the other 18 months are so plotted. The best-fit line that minimizes the variation between the points is also plotted.

90. That line estimates that for every 1 percent change in Carlisle plant capacity, there is a 7.7 hundredth's (\$.0077) cent increase in the cost per pound of total solids. Again, the Land O'Lakes report substitutes the relationship of capacity utilization to cost per pound of product for the relationship of capacity to cost per pound of total solids. Also, the Carlisle plant buys and sells intermediate products, while the Ling study addressed the cost change for hard finished products only.

91. Dr. Ling has modeled the most efficient method to balance the seasonal and operating reserves of the Order 1 Class I market. He has calculated that it would require four butter/powder plants with the capacity of 3 million pounds per day to accomplish the balancing of the necessary reserves of the Northeast market. Dr. Ling's optimal balancing model does not

reflect the actual balancing operations of the Northeast. There are seven balancing plants on the Northeast of varying sizes and capacities. Dr. Ling assumes that each plant receives an equal volume of milk. Due to ownership and logistic reasons, that assumption does not reflect reality in the Northeast. Other testimony established that the balancing capacity of the Order is not equally utilized. The data regarding utilization of the Deitrich's plants shows this, for example. Land O'Lakes' relatively high capacity utilization does not reflect the operation of the other Northeastern balancing plants. Thus, costs at the Land O'Lakes' plant are probably lower than the other older, less utilized Northeastern balancing plants.

92. Land O'Lakes replicated Dr. Ling's methodology for finding the cost of unused capacity at Carlisle during the last 19 months and compared that cost to the amount Land O'Lakes would have received had Proposal 7 been in effect for the period. The cost of unused capacity was 2.3 times greater than the amount Land O'Lakes would have received. ADCNE believes that the experience at Land O'Lakes Carlisle plant provides a real world validation of Dr. Ling's observations relative to the effect of plant capacity on per unit costs.

93. The DMS cost data for balancing class I markets without plant ownership also validates Dr. Ling's cost estimates. DMS's costs are \$.08 to \$.20 per cwt of all milk for balancing costs, well in excess of the Ling cost estimates and the \$.06 per hundredweight requested in Proposal 7.

94. In the aggregate, ADCNE believes that Dr. Ling's estimated cost of balancing necessary reserves assuming 20 percent operating reserves (his Table 5) are low, and therefore a conservative fit to be used for regulatory minimum reimbursements. We are not suggesting adjusting his estimates upward, however, since each plant is different and the

Department has consistently leaned to conservative estimates in the past.

#### **F. Operation of Proposal 7**

95. Under proposal 7, qualifying organizations performing marketwide services of balancing the Class I market would receive \$.06 per hundredweight on qualified milk volumes which they pool. Each month the payments would be made by the Market Administrator from the producer settlement fund. Both cooperatives and proprietary handlers who performed these duties and met the performance criteria would be eligible for payments.

96. The \$.06 per hundredweight rate was determined using Dr. Ling's cost of balancing for the Northeast. At a 20% operating reserve rate, total balancing costs, on a conservative basis are estimated to be \$11,567,210.<sup>19</sup> Cooperatives have approximately 76% (Exh. 5, Appendix 17; Appendix 4 to this brief) of total producer receipts of about 24.5 billion pounds of milk annually (Exh. 5, page 5). This represents about 18.6 billion pounds of milk annually. When one divides Ling's costs by this milk volume, it results in a rate of \$.0622 per hundredweight.

97. In order to qualify for payments, a handler would be required to (1) pool 3% of the market's milk or pool 1 million pounds of milk per day AND operate a pool manufacturing plant (Class III or IV) located in the marketing area or a pool distributing plant.

These percentages and volumes of milk are supported as minimums because any handler, cooperative or otherwise, who balances milk on a daily and seasonal basis must have sufficient volumes and non-Class I destinations for milk in order to meet market needs. A 3% minimum of

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<sup>19</sup> The DMS balancing costs of \$9 million for January to July 2002 alone represent 78.5% of the cost of the most efficient method of balancing the **entire market for the year** as estimated by Dr. Ling.

the total volume pooled in the order for the month represents about 60 million pounds of milk per month. This handler must have significant marketing relations with at least one manufacturing plant plus a Class I plant since it must move at least 20% of that volume, or 12 million pounds, as Class I milk in the fall. Handlers who operate Class III or Class IV plants and pool milk can qualify at a lesser milk volume of one million pounds of milk per day, each month. This million pound per day minimum was used in the cooperative payment provisions of the former NY-NJ Order 2. It also represents about 20 loads of milk per day, which is a significant volume.

98. Under subsection (a)(2) of the provisions of Proposal 7, a qualifying handler could not deliver more than 65% of its pooled milk to distributing plants. A handler who delivers 65% or more of its milk to a Class I plant is not balancing to a great degree. That milk is likely coming from a dedicated source of nonmember producers. Adjustments (a) and (b) are included to limit the ability of a handler to merely move milk around to qualify for payments without balancing those supplies.

99. Under sub section (b), the qualifying handler could be required by the market administrator to ship extra volumes of milk to Class I plants if markets conditions warranted. Such extra shipments would not necessarily be required of other handlers pooled in the Northeast order. Qualifying handlers who receive a marketwide balancing payment should be willing to take on additional responsibilities and additional costs when needed by the market.

100. Under subsection (c), cooperatives can only receive payments on the milk of their members or the members of another qualifying cooperative association. Non-cooperative handlers can only receive payments on nonmember milk that they pool. This will assist with accounting from the market administrator perspective and assure that the milk on which

marketwide services payment is made is under the marketing control of the handler receiving payment.

101. A proviso at the end of subsection (c) should be added as follows:

“Provided further that no payment shall be made on the milk of any producer until such producers milk has been pooled for three consecutive months.” The intent of this provision is to assure that any milk receiving a marketwide service payment is committed to serving the Northeast market. Milk that is moved to another market on a seasonal basis would have a waiting period before qualifying for a marketwide service payment. This provision further addresses the issue faced in the former southeast orders proceeding.

#### **G. Summary and Discussion of Issues in Support of Proposal 7**

1. The necessity for, and the magnitude of, Class I balancing. The data are both graphic and overwhelming in depicting the necessity for and the magnitude of balancing the Class I market. Dr. Ling, of course, carefully identified the necessary reserves for Class I demand, using 6 years of pre-Order reform data. However, the record does not stop there. Several of the tabular and graphic depictions of later data are collected in the attachments to this Brief. Exhibit 11, Figures 4, 5, and 6 show the counter-cyclical nature of Class I versus Class III/IV receipts in Order 1 since January 2000. Table 3 of Exhibit 14<sup>20</sup>, prepared by Bob Wellington, compares the Ling data with Order 1 data for 2000 and 2001. Figures 1 – 7 of Exhibit 14 (Appendices 2 and 3 to this brief) further document the divergence of producer receipts and Class I usage in Order 1, through June 2002. Finally, the ADCNE day of the week delivery data (Exhibit 17, tables 1A, 1B and 2; Appendices 17, 18, and 19 to this brief)

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<sup>20</sup> Appendix 1 to this brief.

documents the daily and seasonal fluctuations in demand for milk by fluid distributing plants. As Dennis Schad testified, this data supports the need for a 20% operating reserve for Class I.

The need for balancing is generally not disputed in the trade;<sup>21</sup> however, the extent and magnitude of the balancing demands for Class I in a market the size of Order 1 is not documented elsewhere in the detail that this record has established. For instance, the “swing” in demand from fall peaks to spring valleys may be an accepted phenomenon in theory, but how many would have understood that for the Class I balancers in Order 1, the ADCNE cooperatives, this means accommodating a 10 million pound per day swing in deliveries to Class I plants. See Exhibit 17, Tables 1-A and 1-B (Appendices 8 and 9 to this brief). To handle that difference in Class I demand requires the capacity of the manufacturing plants which Dr. Ling identified as necessary for those functions. Absorbing that balancing is taken for granted – milk is rarely dumped for lack of a home and business-as-usual goes on in the marketplace. Dairy farmers shipping to proprietary Class I plants tend to be oblivious to the balancing function because they do not need to be concerned about it. But the parties performing the service bear the burden of the costs involved, and that is what Proposal 7 addresses.

2. The benefit of Class I balancing is marketwide. There are a number of ways in which it is clear that the benefits of balancing are shared marketwide. The stability which balancing brings to the marketplace does not have metes and bounds. The Class I utilization which is assured through balancing services is shared by all through the pool. The levels of prices, both minimum order prices, and market premiums are maximized through a well-serviced market, and all producers in the market benefit. If there were to be any debate about whether

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<sup>21</sup> But note the discussion below of the IDFA testimony which questioned the significance today.

there is a marketwide benefit to Class I balancing, we would submit that Congress resolved the issue when it enumerated the “services of marketwide benefit” under the AMAA to include:

Providing facilities to furnish additional supplies of milk needed by handlers and to handle and dispose of milk supplies in excess of quantities needed by handlers; (ii) Handling on specific days quantities of milk that exceed the quantities needed by handlers; and (iii) Transporting milk from one location to another for the purpose of fulfilling requirements for milk of a higher use classification or for providing a market outlet for milk of any use classification.

Certainly, it should not be seriously contested that the benefits of balancing services to the Class I market are experienced and shared by all producers in the Order 1 market.

3. Not all suppliers perform balancing services. The Order 1, Class I market is serviced by two groups of suppliers: (1) The year-round, dedicated, nonmember supply; and (2) the balancing, cooperative suppliers. The exhibits prepared by the Market Administrator document this rather clearly. (Exh.5, Appendix 15; Appendix 5 to this brief) The ADCNE day of week delivery data, and balancing plant receipt data also document this relationship. But the realities of the marketplace are sometimes most clearly communicated in the experience of individuals, such as Mr. Arie Scholte, a producer for Byrne Dairy, a Class I plant in the Syracuse area. Mr. Scholte traveled to the hearing to express his opposition to Proposal 7. He testified that the production of his 300 cow dairy is delivered twice daily to Byrne Dairy “three hundred sixty five days, snow, wind, storm, whatever.” (Tr. 588) Mr. Scholte is an independent producer and one of the many in Order 1 who deliver every day to Class I plants. See Exh. 5, App. Table 15; Appendix 5 to this brief. Mr. Scholte, and the several thousand other similarly situated producers do not make any effort to balance the market and do not share the cost of balancing that market. Nevertheless the balancers preserve the market and enable the non-balancing

suppliers to deliver twice daily, year round. The non-balancing producers reap a more than pro-rata benefit of the marketwide balancing services; although they contribute nothing. Proposal 7 merely provides for a limited sharing of the expense by all who receive the benefit.

4. Where there is benefit sharing, without cost sharing, there is inequity. A fundamental issue which Proposal 7 addresses is the matter of equity. ADCNE witnesses explained in detail the inequity that exists in Order 1 where benefits of balancing are shared while the burden, the expense of providing the service, is borne by the balancers, primarily the ADCNE cooperatives. The singular function of Proposal 7 is to achieve a degree of equity in addressing this situation. Equity for all producers is one of the cornerstones of marketwide pools under the AMAA. Marketwide pooling in part creates this limited inequity since all Class I values in the pool are shared, including the values which are retained, or preserved by virtue of balancing services. Thus, if a portion of the Class I differential is considered to provide for balancing of the Class I market, it is an extension of that pooling, not a contradiction of it, if the parties performing the balancing receive reimbursement from the pool before the blend price is calculated.<sup>22</sup> Proposal 7 is necessary for **equity** among producers in Order 1.

5. The Ling study isolates and quantifies the costs of Class I balancing. The Ling study, Exh. 12, is invaluable in providing guidance for Proposal 7 because it isolates and

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<sup>22</sup> If there is embedded within the Class I differential a value for balancing the Class I market (which is implied as Bob Wellington testified by the fact that differentials are higher in higher Class I utilization markets where proportionately more balancing is done), it is only logical that the persons performing that function be reimbursed from the funds which are “earmarked” for that function. Thus, what may seem a contradiction, that “handlers” are charging “producers” for services is in actuality contemplated within the differential values, as well as expressly authorized in the AMAA by Congress. Stated another way, sharing of the full differential requires performance of all services implied. Producers who do not perform balancing services “earn” the value, net of their pro-rata share of the balancing cost.



quantifies the costs of balancing the Class I market. Both elements – isolation and quantification – are important. Isolating Class I balancing is important because the proponents of Proposal 7 are not requesting, and do not want there to be any question that they are requesting, reimbursement for costs of balancing manufacturing uses or balancing what Dr. Ling calls the “excess” reserve (which is all uses beyond Class I and II). Dr. Ling’s methodology of calculating the volumes of seasonal and operating reserves required to service the Class I market effectively isolates the volumes of reserve milk which must be accommodated in some way by the market balancers. The elements of those reserve volume equations were properly determined by Dr. Ling, using six years of data for the predecessor orders 1, 2, and 4. One could recalculate using the seasonal numbers for Order 1 since its inception, as Bob Wellington did. That calculation will show an immaterial variance from Dr. Ling’s calculated volumes of necessary reserves. The 20% operating reserve is validated by ADCNE data as presented and discussed by Dennis Schad and Bob Wellington. In sum, the isolation of reserves necessary for Class I by the methodology of Dr. Ling is well supported on this hearing record. Balancing the Class I market in Order 1, in a perfect world, with plants dedicated solely to Class I balancing would require about 12 million pounds per day of plant capacity to meet the peak reserve need. (Exh. 12) It is not a coincidence that this calculated need comes quite close to the magnitude of the swing in ADCNE supplies to distributing plants per Exh. 17.

Dr. Ling’s quantification of the cost of balancing is reasonable and conservative. He uses butter/powder plant capacity not because that is the capacity used for all balancing in Order 1 but because that is known to be the **low cost** option, as Dr. Ling testified and Bob Wellington also explained. In addition, the use of plant capital costs which are several years old,

and well under current construction costs, keeps the costs on the conservative side. The actual plant cost data presented by Messrs. Wellington, Gallagher, and Schad validates the Ling numbers as conservative, and that is the intention of proposal 7.<sup>23</sup>

Dr. Ling's quantification of Class I balancing expenses in Order 1 is the best study of which we are aware of these types of costs. Proposal 7 is not intended to recover costs beyond Class I balancing; and it is not intended to cover actual costs of Class I balancers to the extent that those costs exceed the low-cost, ideal model which Dr. Ling has presented. Dr. Ling's study supports the \$.06 per hundredweight request of Proposal 7.

6. Operation of Proposal 7. Bob Wellington discussed succinctly the details and intended operation of Proposal 7. We will just note a few salient elements of its design in this discussion. First, the \$.06 payment is calculated on all milk of the qualifying handler. This is the only feasible manner to compensate for balancing in our view. Balancing costs cannot readily be calculated on a transaction by transaction basis. So the balancer must, in effect, have two "homes" for the milk, with the ability to move the milk back and forth as required by the market. At all times, one "home" is not being utilized; nevertheless, the balancer is in ready state to move the milk to that alternate destination. The costs of providing the balancing service are incurred all the time, whether the balancing milk is being manufactured or being delivered to fluid. The balancing handler has year round obligations; and responsibility on all milk volumes. **If, for any reason, payments were to be made on less than 100% of the balancing handlers' volumes, the rate would need to be increased accordingly to generate the necessary compensation for the balancing costs.**

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<sup>23</sup> Dr. Ling's cost estimate is also lower than that experienced by DMS in their balancing at plants owned by others.

ADCNE has attempted to build in safeguards from any possible abuse of the proposal. Thus, we believe that milk moved on and off the Order should not qualify for payments (as Bob Wellington testified, TR. 451–453). The proposal also does not allow cooperative and proprietary commingling of volumes for payment. However, it does provide for proprietary organizations to qualify for payments if they perform balancing services. Thus, if a Class I proprietary handler wishes to be responsible for the necessary reserves for its Class I usage, so that it delivers less than 65% of its milk to its distributing plant, it could qualify for the marketwide services payments. Few, if any, Class I handlers maintain their reserve in Order 1 today, for obvious reasons: It is an expensive, burdensome responsibility which they wish to have the benefit of, but not the burden of undertaking. Proposal 7 addresses that circumstance in a modest and equitable manner.

#### **H. Response to arguments in opposition to Proposal 7**

There are a number of arguments which were articulated by opponents of Proposal 7 which we will address.

1. **“The cost of balancing is already compensated in the Class IV price.”**

IDFA has argued that Proposal 7 should not be adopted because it would constitute a form of double-dipping as “the costs of balancing are already fully paid for through the make allowance on Class IV products.” (Exh. 21, p. 9) There are several fallacies in this argument. First, the argument assumes incorrectly that all balancing is done with Class IV utilization and that is not the case. As Mr. Gallagher testified in great detail (TR. 714–749) there is substantial balancing done in Order 1 through non-Class IV outlets. None of those expenses could be compensated in any manner by the Class IV make allowance.

Secondly, there is a fundamental disconnect between manufacturing make allowances and balancing services: When services are the greatest, the recovery is the least; and vice versa. That is, the “make allowance” is only “earned” on product which is processed, whereas Class I balancing services are rendered both when milk is released from processing for Class I uses, and when milk is backed out of Class I plants into surplus outlets. Thus, the make allowance on Class IV products does not in fact provide compensation for the balancing services to the Class I market. The make allowance is part of the price formula for Class IV products. It is set at a level which is reflective of usage of Class IV facilities. But it is neither intended nor designed to compensate those who render Class I balancing services for the benefit of all in the market. Another way of viewing the disconnect between make allowances and balancing services is to consider that the costs of servicing the Class I market are essentially constant from year to year, assuming a basic consistency in seasonal Class I demand, while the “returns” from make allowances on any given product vary with the larger “excess” reserve in the marketplace. So, in a year when milk is tight and manufacturing plants are utilized the least, the “return” on make allowances is low; but the Class I market is the same and the cost of servicing it is the same. The converse could also be true. When milk is long, the “return” from make allowances is great, but Class I balancing costs are the same as at any other time. Make allowances do not, and should not, compensate anyone for Class I balancing services.<sup>24</sup>

Finally, we must point out that IDFA inaccurately portrayed ADCNE’s position (in the Class III and IV hearing) on make allowances and marketwide balancing services. As Bob Wellington testified in this hearing (Tr. 1112–1114), Agri-Mark (and ADCNE) quite explicitly

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<sup>24</sup> We do think it is quite proper to reflect the cost of balancing “excess reserves” (as defined by Dr. Ling) in make allowances; but that is not the cost sought by Proposal 7.

preserved the point in the prior hearing that balancing services were not being compensated in the make allowances supported and adopted in the Class III/IV hearing.

2. Over-order premiums neither fully compensate for balancing services, nor achieve the equity which Proposal 7 addresses.

IDFA, and others, have argued that funds to cover the costs of balancing “have been more than amply provided through over order premiums” (Ex. 21, p. 19–21; Yonkers TR. 886, 911–914) and that Proposal 7 should therefore not be adopted. This argument has no merit; other than to highlight the heart of the equity issue which is involved with marketwide services payments. Class I handlers demand balancing services (and other services) from cooperatives in supplying their needs. That much is essentially undisputed. E.g., Fitchett Tr. 1048 (“there is a recognition of balancing the milk supply”). The independent suppliers to the Class I plants are paid premiums and do not bear any of the expenses of balancing their own supplies. The balancing suppliers – the cooperatives — charge the highest price that the market will bear in order to pay a competitive price to their members, and recover costs of operating and supplying the Class I market. In a market where there are more than 4000 independent producers, the overwhelming majority of which are dedicated suppliers to distributing plants, it is evident that the independent option is a favorable economic option. The producers have voted with their “feet”. If the prices paid to cooperatives were “more than ample” to defray the costs of balancing those markets, independent status would not be so attractive since cooperative producers would be experiencing a higher return. If the return on the cost of the balancing service was, in fact, “more than ample,” one would expect that there would be a “surplus” of suppliers to provide the balancing services for the “more than ample” return. But there is not because the return is not

there.

Handling charges are negotiated by Class I plants which have the inherent upper hand under the order. Suppliers must deliver to the Class I market to be part of the pool. This impacts the charges which can be negotiated. Thus, while the Class I utilization is shared through the pool, the cost of supplying the Class I market is not shared when not all are providing the service.

The fact of over order charges does not mean that the charges are payments for balancing services. Thus, the reported levels of over order premiums cited by Dr. Yonkers do not prove that balancing services are being paid for. They only prove that premiums are being paid. The market structure of Order 1 and the record of this hearing shows that premiums are charged by suppliers, and paid to producers, just to maintain a supply. When independent producers who have no balancing costs whatsoever are paid premiums, cooperatives need to charge and pay premiums just to stay competitive before recouping any balancing costs.<sup>25</sup>

If the balancing cooperatives were consistently out-paying everyone else in the marketplace consistently, one might be able to argue that they were being paid more than the cost of services for balancing. But that is not the case. As the ADCNE witnesses emphasized, the market simply does not allow recovery of those costs directly on a transaction basis. The costs need to be recovered through Proposal 7 to preserve a modicum of equity among all who benefit.

3. There is no longer sufficient seasonality of production to require extensive Class I balancing.

IDFA attempts to contend that “market trends [in production] have greatly weakened whatever justification ever existed for marketwide service payments.” (Ex. 21, p. 21–23; TR.

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<sup>25</sup> Mr. Gallagher addressed the competitive dynamics required of cooperatives in responding to nonmember supply pay price competition.

913–917 ) While it may be the case that seasonality of production has improved over time, which is what the IDFA data tends to show, this in no way demonstrates that there is no longer a contra-seasonal matching of milk production and Class I demand as Dr. Ling studied. Simply because a mis-match is arguably not of the same magnitude that it was years ago does not mean that it does not exist. Furthermore, this IDFA data does not even purport to address the daily fluctuations in demand at distributing plants which present such a challenge for fluid milk suppliers. Ex. 17, Tables 1A, 1B, and 2; Appendices 7, 8, and 9. Whether there will ever be a time when milk production and Class I demand are so matched that no balancing services of any magnitude are needed by the Class I marketplace is an academic issue because that is not the case today.

4. “Proposal No. 7 is hopelessly flawed.”

Opponents have challenged the particulars of Proposal 7 in multiple respects in an attempt to defeat it. We will attempt to respond to and address those various issues and concerns.

a. “Proposal 7 violates the requirement that any handler can qualify.”

This contention is just plain inaccurate. Any handler, proprietary or cooperative, can qualify for payments under Proposal 7. It is not limited to cooperatives, in spite of the fact that the record demonstrates quite clearly that cooperatives do the overwhelming share of balancing in Order 1. There is no certain way of knowing who would qualify once the Proposal is adopted; but it is open to all who perform in accordance with the criteria of the proposal.

b. The qualifying criteria for size are discriminatory and unfair. Several witnesses objected to the “critical mass” size qualification in Proposal 7. ADCNE continues to

believe that a critical mass is necessary for anyone, coop or proprietary, to perform balancing services of marketwide benefit such that compensation from the pool is appropriate. Balancing in a meaningful sense requires coordination of deliveries on a daily and seasonal basis. This involves more than the occasional diversion of a load of milk to a cheese plant; or the occasional release of a load of milk from a manufacturing plant. We believe that our basic areas of criteria for qualification are sound: First, to be engaged in balancing, a handler must be a mixed-use handler, not essentially handling a dedicated supply of Class I milk. Thus the < 65% deliveries to distributing plant test. Secondly, there must be a scale with marketwide significance, or critical mass. We propose 3% of the order; or the operation of a manufacturing plant and pooling more than 1 million pounds per day. That said, if there is a sound basis for establishing critical mass criteria which are different than those advanced by ADCNE, we would study them carefully.<sup>26</sup>

c. Proposal 7 does not require performance of services for payment.<sup>27</sup>

IDFA, and others [Buelow (Worcester Creamery)] argue that Proposal 7 does not require any actual service for receipt of payment. That is not the case. The mis-match of Class I demand, daily and seasonally, with farm level production is such that any handler who services Class I on a substantial basis while also having substantial Class II/III/IV uses is going to incur substantial

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<sup>26</sup> We did not hear any advanced at the hearing because the opponents were, for the most part, interested in defeating the proposal in full rather than perfecting it.

<sup>27</sup> The comment was also made by at least one witness, Mr. Arms, that there should be some auditing of the use of marketwide services payments (presumably similar to the audit review done of cooperative service payments in old Order 2). While ADCNE does not see the necessity for that burden on the Market Administrator, since Proposal 7 does not deal with line item expenses such as employment of economists and attorneys, and delivery of newsletters, as did Order 2, we are in no way opposed to any system of review which the Department might feel necessary and appropriate to assure the integrity of the program.



balancing expenses; and perform substantial balancing services. The arithmetic of the marketplace allows no other resolution. Dr. Yonkers contends that a handler who operates a cheese plant at 100% of capacity year round would qualify for the credit without providing any service. (Ex 21, p. 26) First, if that was the handler's entire operation, it would not be part of the pool. To be pooled, the handler must deliver 10% or 20% of its supply to a distributing plant, year round if Proposals 5 and 6 are adopted. Thus, unless that handler's herds are producing tailored volumes related to the Class I market needs --- on days related to the market's needs --- and all those volumes are over and above the amount needed to fill the cheese plant, the cheese plant will not be full (unless the handler purchases surplus from another source). The fact is that in Order 1 where nearly 20% of the producers' daily production is delivered to distributing plants every day of the year, the rest of the major marketers are going to be required to balance the remaining Class I demand, both daily and seasonally. While there will be a difference in magnitude of balancing services among handlers with differing degrees of affiliation with Class I plants (10% to 65%), all those handlers will necessarily be balancing the Class I facilities and, therefore, should receive some compensation from the market for that service of benefit to all.

d. Inter-order milk movements and poolings are not material to Proposal 7. Hoping to ride the legacy of the failed southeastern orders proposals from 15 years ago, the argument is made that the existence of movements of milk on and off Order 1, and the distribution beyond Order 1 of packaged milk by Order 1 handlers builds in such inequities that the proposal should fail. This argument is not supported by the record. We must first point out that the Order 1 market is far different from the 7 orders which were involved in the 1987 proceeding. Order 1 is a large, regional order which is very highly self-contained. This situation

could hardly differ more from the situation among the small southeastern orders in 1987 where the largest supply organization, which was the proponent of the services payments, had the ability to control the utilization of orders and, thereby, control the assessment of payments. That was an inequitable situation which has no parallel in the huge Order 1 market today.

Furthermore, while there are, of course, movements of milk on and off the order in the ordinary course of trade in a dynamic dairy business, the proposal has safeguards to prevent possible abuse. (TR. 451–452) The magnitude of any other intermingling of sales or supplies from other orders are just not material, in the context of this 2 billion pound per month order. Proposal 7 will not pay for the balancing of sales of other orders and should not be rejected on that basis.

### **III. CONCLUSION**

ADCNE again thanks the Department for the opportunity to present its position with respect to the issues in this hearing, and Proposal 7 in particular.

The most fundamental marketing disorder which the AMAA addresses, and marketwide pooling remedies, is inequity in returns among similarly situated dairy farmers. In Order 1 there is a pervasive inequity in the sharing of the **necessary, unavoidable** costs for balancing this huge Class I market. The restoration of equity, and the elimination of disorder, in Order 1 is the purpose of Proposal 7. We respectfully suggest that the data and evidence in the record

overwhelmingly support the adoption of Proposal 7 and that its adoption will bring greater stability and equity to the largest marketplace in the federal order system.

RESPECTFULLY SUBMITTED,

By 

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Dated: January 31, 2003

BEFORE THE UNITED STATES DEPARTMENT  
OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE

In re:	)	
Milk In the Northeast	)	Docket Nos.:
Marketing Area	)	AO-14-A70
	)	DA-02-01

**POST-HEARING BRIEF AND PROPOSED FINDINGS**  
**SUBMITTED ON BEHALF OF THE ASSOCIATION OF DAIRY COOPERATIVES**  
**IN THE NORTHEAST ("ADCNE")**  
**(PART II)**

**I. INTRODUCTION**

This portion of the Post-Hearing Brief for ADCNE will address all hearing issues other than Proposals 7 and 11<sup>1</sup>. These issues primarily concern the pooling provisions of the Order, as well as the reporting and payment provisions. Our discussion will be organized as follows: (1) Discussion of all proposals relating to pooling including: Pool plant (Section 1001.7) amendments; and producer milk (Section 1001.13) amendments, this discussion covers Proposals 2, 3, 5, 6, 8, 9, 10, and 14; (2) Proposals relating to the reporting and payment provisions of the Order: Proposals 1, 4, and 12; and (3) Finally, we will discuss the need for emergency action on the hearing issues.

**II. PROPOSED REVISIONS TO THE POOLING PROVISIONS OF THE ORDER**

This hearing, like those held before it in 2001 and 2002 for other orders, revealed that

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<sup>1</sup> Proposal 11 was withdrawn by Proponents. (TR. 1200, L.13) (TR. \_\_ L. \_\_ will be used to refer to pages and lines of the hearing transcript.)

some revision needs to be done to the Order's pooling provisions, Post-Federal Order Reform. There were eight proposals in the Hearing addressing pooling issues. Six of those eight proposals addressed pool plant definitions and requirements. Five of those six proposals concerned supply plants and one involved the definition of distributing plant units. Two proposals concerned the producer milk requirements. After discussing generally the principles which we believe should be applied to pooling requirements, we will discuss first the supply plant amendment proposals, then the producer milk proposals. ADCNE is not taking any position on Proposal 14 concerning the requirements for a distributing plant unit.

**A. Performance-based Pooling.**

Equity among producers in a milk order requires a minimum level of shared performance in meeting the market's Class I needs, thereby contributing to the revenue which is distributed through the market order pool in the form of the blend price. This record reveals that there are some provisions of the Order which do not require sufficient performance for pooling. These provisions should be eliminated and replaced with reasonable performance requirements. The proposals which would reduce existing performance requirements should not be adopted; nor should proposals which would increase existing minimum performance levels for the Fall months. The Order should continue to rely upon the discretion of the Market Administrator (hereinafter "MA") to require greater levels of mandatory shipments; and, by the same token, should allow the MA to reduce requirements when conditions warrant. (TR. 1372, L.4) The pool plant definition needs to be changed to eliminate the "split plant" authorization which could accommodate pooling without sufficient performance.

**B. The “Free Ride” for Supply Plants Should Be Eliminated.**

Proposal 5 should be adopted to eliminate the current January to July “free ride” period, during which no shipment performance is required for supply plants which have performed during the preceding August to December period. (TR. 1357, L.22) With the elimination of the “free ride” the 10% shipping level should be applicable for supply plants during these months (as it is at present during those months for a plant coming onto the Order or which has not been a supply plant during the preceding Fall).

There is no justification under present marketing conditions for this so-called “free ride” period. (TR. 1363, L.5; 1367, L.7) All milk, plants, and producers associated with Order 1 should be required to serve the market on a year round basis. Ed Gallagher described in detail (TR. 1355, L.63) how the combination of the “free ride” and the “split plant” provisions presently makes possible the pooling of nearly-unlimited volumes of milk which is not serving the Order in any respect.

There was some limited support expressed at the Hearing for maintenance of the “free ride” provision. Both the New York State Dairy Foods’ and the Friendship Dairies’ proposals retain the “free ride” period. However, there was no demonstration that the 10% shipping required under Proposal 5 could be a hardship for any supply plant which wishes to draw from the pool on a year round basis. (TR. 1367, L.9) After all, even in the Spring, more than 40% (taking into account Class II usage) of the total market’s needs are at distributing plants. The minimal level of connection with the market which a 10% performance requires is not too much to ask. In any event, the MA has the discretion to reduce the requirements if there is an unusual

circumstance which will require unnecessary and uneconomic shipments for pooling. (TR. 1372, L.7)

**C. The Split-plant Language of (H)(7) Should Be Excised from the Order.**

Proposals 2 and 5 both call for the elimination of the “split plant” authorization in Order 1. There was no opposition to these Proposals. As Mr. Gallagher described, (TR.1355, L.17-1368) the provision allows large volumes of milk to be pooled from distant facilities with minimal performance. There are no “split plants” historically in the region or associated with the Order. The language was inserted into the Order as part of the uniform order provisions during order reform and it should now be removed.

**D. The Shipping Percentages for Supply Plants Should Remain at 20% for September Through November and 10% in All Other Months.**

There were three proposals for establishing the levels of shipping required of supply plants. Proposal 2 would increase the required percentages during the August to September period to 15% and 25%, from 10% and 20%. (TR. 1367, L.15) Proposal 10, on the other hand, would reduce the levels to 5% and 10%. (TR. 1368, L.12) Proposal 5, put forth by ADCNE, while eliminating the “split plant” and “free ride” provisions, would retain the existing performance levels of 10% and 20%. (TR. 1355, L.17)

We remain of the view that the existing levels are the right levels for the market as a whole. (TR. 1368, L.16) It is extremely important to recognize that changes in these levels, either up or down, can be accomplished on a discretionary basis by the MA at any time that conditions so require. (TR. 1372, L.7) There was no showing at the Hearing that existing conditions are such that a permanent increase, or decrease, in the base level of performance is necessary. (TR.

1367, L.19) When there have been occasional shortages, the MA has been able to see that the market is served by temporarily increasing the percentage, without making permanent changes in the performance level which may not be required the next month, or the next year. The record supports the existing level as the right base level of supply plant performance.

Although shipping requirements were raised in certain months during 2000 and 2001, they were not adjusted during 2002. Maintaining the August-September shipping requirements at 20 percent, with the continued authorization allowing the Market Administrator to adjust the percentages, as the need arises, continues to be the best approach to facilitate orderly marketing under the Northeast Order.

**E. The Definition of Required Performance for a Supply Plant Should Be Retained.**

Friendship advanced two proposals, numbers 8 and 9, which would change the qualification equation for a supply plant by changing the numerator (Proposal 9) or the denominator (Proposal 8) for performance. ADCNE does not support either amendment.

Proposal 9 would recognize a form of hybrid supply/distributing plant by combining the Class I route distribution from a plant with the plant's bulk milk shipments in order to meet the performance required for pool plant status. As Dennis Schad testified for ADCNE (TR. 1396, L.1)

The Proposal would cause unnecessary confusion to handlers by merging the characteristics of the 7-A and 7-C provisions together. Additionally, the Proposal would have the possible unintended consequence of pooling on the Order partially regulated distributing plants with route distribution (1001.3) greater than the 7-C plant-shipping requirement of 10 or 20 percent. Moreover, while the 7-A definition only includes in-area route distribution, the Proposal 9 does not specify that the route distribution be within the marketing area. ADCNE opposes Proposal 9 which combines



the characteristics of two different order provisions for the benefit of the few supply plants that may have Class I sales. The Proposal confuses the provisions, such that a distributing plant could qualify as a supply plant. During the Reform Process, ADCNE advocated the expansion of Federal regulation into the unregulated portions of the Northeast and a lower in-area route disposition standard for 7-A plants. The Final Rule included neither. If the Proposal's intention is to accomplish the goal of extending regulation, ADCNE rejects the method and opposes Proposal 9.

Additionally, such a change as proposed by Friendship, could have the unintended consequence of allowing nonpool manufacturing plants, currently without their own producer supply, but desiring such a supply, a means of "gaming" the system, by transferring packaged product into and then back out of the plant, to meet pool plant status and attract its own pool producer supply. Such an occurrence would be destabilizing to the market and lead to less orderly marketing conditions. It would make procurement efforts by, and on behalf of, Class I processors, much more difficult and costly. Certainly, the purchase and transfer of Class I products, into and out of a manufacturing plant, in no way meets the spirit or intent of Federal order provisions requiring a pool supply plant to **supply** the Class I market in order to be pooled.<sup>2</sup>

On the denominator side of the equation, ADCNE also opposes Proposal 8 which would effectively reduce the performance required of a supply plant by removing from the performance equation all milk supplies at the supply plant. (TR. 1393, L.22) Again, as Mr. Schad testified (TR. 1394, L.15):

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<sup>2</sup> If Friendship's Class I route sales are to be addressed in some way under Order No. 1, consideration should be given to limiting such provisions to plants whose Class II, III, and IV utilization, combined, exceeds 85 percent, and that any Class I usage credited to the supply plant shipping provision must come from milk received, processed, and distributed from the manufacturing plant. ADCNE remains of the view that the best resolution for the order is denial of any aspect of Proposal 9.

The intent of the supply plant qualification procedure is to qualify both the plant and the handler-operator of the plant. It is meaningless to qualify a supply plant in which the operator does not control the milk of a group of dairy farmers. A cheese plant operator would never incur the costs to ship milk from the plant to a distributing plant unless the plant intended to pool a group of dairy farmers and draw from the Federal order pool. Thus, it is appropriate for the operator of plant, who also controls the milk of a group of dairy farmers, to qualify both the plant and the supply of milk he controls. Proposal 8 would effectively reduce the supply plant qualification standards from their existing modest levels in this 45% Class I utilization market. ADCNE does not believe that reduction in the performance requirements in Order 1 are appropriate.

The operator of a supply plant has an option in Order 1 with respect to his milk supply. The plant can be pooled, allowing the operator to acquire and maintain his own producer milk supply to his plant; in which case the plant must meet the standards of the Order. On the other hand, the plant can maintain nonpool status and purchase his milk supplies from other handlers, pool or nonpool. In that case, the plant can be oblivious to the requirements for pooling. It is a choice which the plant has to make.<sup>3</sup> The current limited requirements for shipping 10% or 20% of the plant milk supply to the Order so as to receive the 45% blend value for all milk should be retained and not watered-down as Friendship has proposed. Proposals 8 and 9 should not be adopted.

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<sup>3</sup> Friendship was a pool plant when Federal Order Reform was implemented. It became a nonpool plant when pricing inversions provided some advantage to de-pooling. Subsequently, it has retained the ability to find a handler to pool its milk. Friendship's choice of not meeting the pool supply plant provisions, as currently prescribed, has not prevented it from having its own producer supply, nor prevented the producers that ship to Friendship from receiving the producer price differential. At the same time, Friendship has avoided any responsibility of supplying the Class I market. It seems to us that Friendship has created business relationships that enable it to have the best of both worlds, regarding Federal Order Regulation; and is not a disorderly circumstance which requires order amendments.

**F. The Producer Milk Provisions Of The Order Should Be Amended In Several Respects.**

Proposals 3 and 6 advocated amendments to the producer milk section of the Order, Section 1000.13. Proposal 6 and portions of Proposal 3 should be adopted.

Proposal 6 should be adopted to accomplish the following:

- (1) Elimination of the possibility that milk on a state order with market-wide pooling could be pooled on Order 1 (TR. 1370, L.13-22);
- (2) Clarify that a producer who touches base any day during a month is eligible for pooling for the entire month (TR. 1369, L.1-10);
- (3) Eliminate the “free ride” of unlimited diversion requirements, by establishing year round diversion limitations as a reciprocal of the pooling performance percentage required for the month (TR. 1369, L.21);
- (4) Provide the Market Administrator discretion to reduce or increase the diversion limitations as market conditions may warrant; (TR. 1372, L.4) and
- (5) Clarify that milk de-pooled for over-diversion is not treated as dairy farmer for-other-market milk. (TR. 1371, L.23 - 1372, L.3)

We oppose the portions of Proposal 3 which would increase the touch-base requirements to two-days per month and establish mandatory months of touching base in August through December. (TR. 1374, L.12) The current Order No. 1 touch base requirements have served this market well. As outlined by Mr. Gallagher in his initial testimony, Order 1 is unique due to its large geographic area, huge milk supply that is dispersed throughout the entire geographic area, its large Class I demand and number of processors, and its large manufacturing base. Also setting

the Northeast Order apart from other orders with Class II, III, and IV supplies of similar size, is the paucity of pool supply plants, especially in New York state, most of New England, and Northern Pennsylvania. In fact, large numbers of Order No. 1 pool producers are not located within a close proximity to a Class I pool handler. This is one reason the old Order 2 and the present Order 1 incorporated nominal touch-base provisions. Although nominal, these provisions have served the market well in fashioning more orderly marketing and increasing the ability to assure an adequate supply of milk to meet the daily and seasonal fluctuations in Class I processors milk demands. The ADCNE cooperatives have not witnessed a disorderly marketing situation caused by the current touch-base provisions. On the contrary, the New York State Dairy Foods' proposal could force unnecessary movements of milk to maintain pool status of producers.(TR. 1374, L.22) In the end, no additional milk would be removed from the pool, dairy cooperatives would have increased costs, some of which would be associated with higher balancing costs, and Class I processors' availability of milk would be unchanged. (TR. 1374, L.16) Dairy farmers would ultimately have less money because of the additional hauling expense. The New York State Dairy Foods' proposal would reduce marketing efficiencies which farmers have worked hard to create, generate added costs to the marketing system and create a less orderly marketing environment.

We also oppose the higher levels of diversion limitations in Proposal 3. (TR. 1374, L.14) The most basic need to amend Section 13 of the Order is to establish appropriate diversion limitations for all months. This eliminates unlimited diversions by any handler, just as we propose that the "free ride" period be eliminated for supply plants for certain months. Every handler should have a performance required on the Order every month.

The level of performance for producers, and the diversion reciprocal, should follow the levels for supply plants. We do not believe that the record of operation of this Order supports the need for the increased levels of performance which would be mandated by Proposal 3. We continue to support the Market Administrator's discretionary authority to increase, or decrease, as applicable from the base levels of diversion allowed. (TR. 1374, L.10) The absence of diversion provisions was an ADCNE oversight during the Federal Order Reform process. Presently, Class I processors can have unlimited diversions. The potential harm to the orderly marketing of milk under the Northeast Order is as great, due to this oversight, as the "free-ride" and "split-plant" provisions are on the pool supply plant issue. This loophole needs to be immediately corrected to protect against the possible gaming of the system and the pool dumping abuse that could occur. As described by Mr. Gallagher in his testimony, the lack of diversion provisions could lead to drastically lower milk prices and disorderly marketing conditions.

There is unanimous support in the record for eliminating the possibility of "double dipping" on both a state order and Order 1. The language prohibiting this, however, must make absolutely clear that it does not interfere in any way with the state-based programs in this region which establish classified values in excess of Federal order minimums. For this reason, the language of Proposal 6 provides that the ban on double pooling does not apply to: "[state programs] pertaining to market-wide pooling of premiums." ADCNE's intention is that this language expressly exclude the existing state programs in the region (Virginia, Pennsylvania, and Maine) (and any others of the same type) from any interference by this amendment to Order 1. These state-based premium programs go hand-in-hand with the Federal order and do not interfere in any way with its operation or create market disorder.

**III PROPOSALS 4 AND 12, REQUESTED BY THE MARKET ADMINISTRATOR, SHOULD BE ADOPTED.**

The two proposals advanced by the Market Administrator, and others in the case of Proposal 4, should be adopted. (TR. 1355, L.13) Both of these proposals are necessary with respect to administration of the Order and the Producer-Settlement Fund. While ADCNE does not support the delay of producer payments (as discussed more elsewhere), we recognize that Proposal 12's clarification of the sequence of payment in and out of the pool on business days is unavoidable and required for due administration of the Settlement Fund.

**IV PROPOSAL 1, WHICH WOULD DELAY REPORTING DATES AND PAYMENT DATES, SHOULD NOT BE ADOPTED.**

Proposal 1 should not be adopted; the reporting and payment dates for Order 1 should be retained as they were adopted in the order reform process. The basis for rejecting the Proposal was stated by Mr. Gallagher (TR. 1376, L.1):

Dairy farming is an industry that's 24/7. Those that provide services to dairy farmers unfortunately sometimes have to work some pretty odd and pretty hard hours and sometimes that means working late to get the required things done so that dairy farmers can get paid. We are all challenged in our businesses to be able to meet deadlines. There is no single business in this room that isn't challenged in that manner, and regarding the -- the reporting issues, certainly any -- any handler in this room that has to rely on data coming in from another business entity is -- is challenged on getting the information in time so that they can file the reports timely, and certainly anybody that relies on information from another business does not necessarily have any ability to force another business to report to them earlier. So, we are all challenged with that. That said, I do not believe -- ADCNE does not believe that the current filing date is unreasonable, and we all, I think, as an industry need to work harder together to find ways for the industry to come together to resolve this problem as opposed to

making a regulatory change that in the end will result in delay of payment to those who we serve and that is dairy farmers.

**V THIS DECISION SHOULD BE RENDERED ON AN EMERGENCY (INTERIM FINAL) BASIS, AS HAS BEEN THE PRACTICE WITH OTHER RECENT HEARINGS INVOLVING POOLING AND RELATED ISSUES.**

ADCNE urgently requests that a decision be rendered in this matter on an interim final basis, as has been done in other recent hearings. All of the issues are important to the dairy farmers serving the Order; and the Proposal for Market-Wide Services Provisions is of critical importance to ADCNE and its dairy farmer members.


The urgency of expedited implementation of pooling amendments is almost self-evident. As the data showed, there has been substantial volumes of milk pooled on Order 1 while taking advantage of the availability of several of the “loopholes” in the current pooling language. (TR. 1379, L.18) As other orders are amended, the attractiveness of Order 1 for opportunistic pooling will increase. Time is of the essence and the amendments are needed at the earliest possible date because of the underlying marketing conditions. (TR. 1365, L.17)

The same is true for the market-wide services provisions. There is disorder inherent in the lack of a sharing mechanism for market balancing costs. This disorder costs the ADCNE cooperatives and their members millions of dollars annually. At a minimum, the Act of Congress which mandated prompt implementation of market-wide services provisions means that Congress

appreciated the importance of those provisions and the Secretary should honor that Congressional statement in the most expeditious manner, even if the one hundred and twenty day (120) letter of the law cannot be met.

RESPECTFULLY SUBMITTED,

By

  
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*Attorney for ADCNE*

Dated: January 31, 2003



## APPENDIX OF SELECTED HEARING EXHIBITS

### **Seasonal and Class I Need for Balancing**

1. "Indices of Seasonality of producer milk deliveries and fluid demand, Ling study and year 2000/2001 averages, Northeast Order" (Exh. 14, Table 3)
2. Exh. 14, Figures 1-3:
  - "Producer Receipts Per Day Classified as Class I" (Figure 1)
  - "Total Producer Receipts Per Day" (Figure 2)
  - "Producer Receipts Per Day Not Classified As Class I" (Figure 3)
3. Exh. 14, Figures 4 and 7:
  - "Producer Receipts Classified As Class IV, Jan 2002–June 2002" (Figure 4)
  - "Seasonal, Operating and Necessary Reserves, Northeast Orders" (Figure 7)

### **Cooperative and Nonmember Supplies**

4. "Cooperative and Non-Cooperative Member Share of Producer Receipts and Producers, January 2000-June 2002" (Exh. 5, Appendix 17)
5. "Producer Deliveries to Pool Distributing Plants, January 2001-June 2002" (Exh. 5, Appendix 15)
6. "Estimated Milk Receipts at Class I Distributing Plants by Members and Nonmembers for the Northeast Order, January 2001 to June 2002" (Exh 5, Table 1)

### **Daily Class I Balancing**

7. "ADCNE Deliveries to 7(a) Plants" (Exh. 17, Table 2)
8. "Day of the Week Delivery Data for Six Cooperatives, May 2001" (Exh. 17, Table 1-A)
9. "Day of the Week Delivery Data for Six Cooperatives, November 2001" (Exh. 17, Table 1-B)

## APPENDIX OF SELECTED HEARING EXHIBITS (Continued)

### Utilization of ADCNE Balancing Plants

10. "Milk Powder and Butter Production at Selected Plants, Associated with the Northeast Order, May and November, 1992-2002" (Exh. 5, Appendix 14)
11. "Reading's Estimated Plant Capacity Utilization, Jan 00–June 02" (Exh. 19, Figure 1)
12. "Middlebury Center's Estimated Plant Capacity Utilization, Jan 00–June 02" (Exh. 19, Figure 2)
13. "Reading Milk Intake vs Ling Study" (Exh. 19, Figure 3)
14. "Middlebury Center Intake vs Ling Study" (Exh. 19, Figure 4)
15. "Total Solids Capacity at Land O'Lakes, Carlisle" (Exh. 17, Table 5)
16. Exh. 14, Figures 5 and 6:
  - "Milk Receipts Used for Manufacturing at the Agri-Mark W. Springfield MA" Plant, Jan 2000–June 2002" (Figure 5)
  - "% of Manufacturing Capacity Used at the Agri-Mark W. Springfield Plant, Jan 2000–June 2002" (Figure 6)
17. "Producer Receipts Classified as Class IV Under the Northeast Federal Order and Milk Used for Manufacturing at the Agri-Mark West Springfield, MA Plant" (Exh. 14, Table 2)

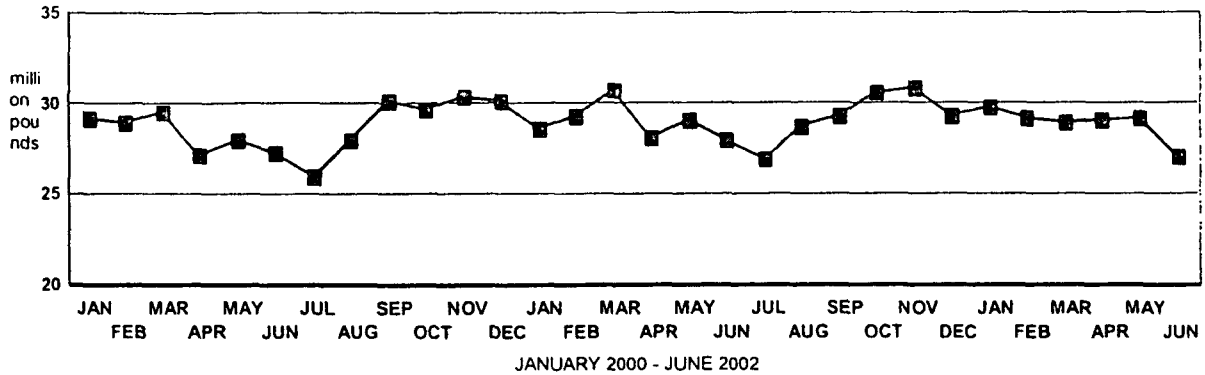
### ADCNE Cooperative Cost Data

18. "DMS Balancing Costs, 2001 and Jan–Jul 2002" (Exh. 19, Table 3)
19. "Land O'Lakes - Eastern Operations, % Capacity - Expense" (Exh. 17, Table 4)

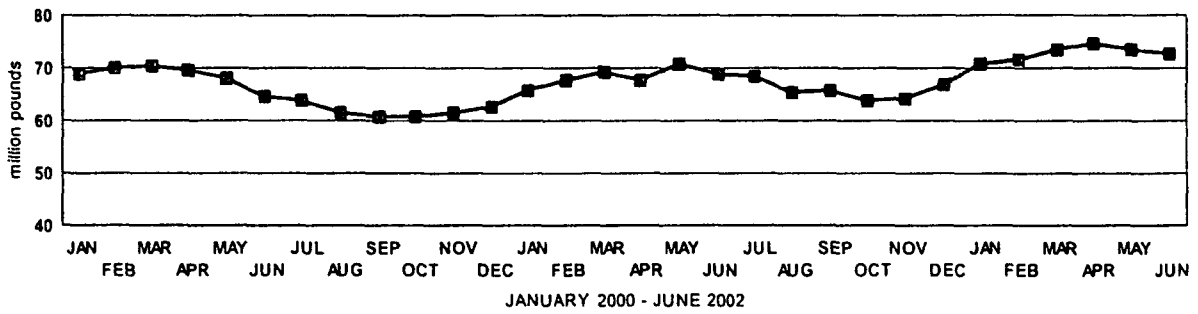
**TABLE 3: INDICIES OF SEASONALITY OF PRODUCER MILK DELIVERIES AND FLUID DEMAND, LING STUDY AND YEAR 2000/2001 AVERAGES, NORTHEAST ORDERS**

Month	Producer milk deliveries		Fluid demand	
	<u>Ling study</u>	<u>2000/2001</u>	<u>Ling study</u>	<u>2000/2001</u>
	Percent			
JAN	100.1	102.0	101.9	100.0
FEB	101.8	103.9	100.6	100.8
MAR	103.7	105.4	100.9	104.2
APR	105.4	103.7	98.2	95.6
MAY	106.0	104.8	98.1	98.8
JUN	103.4	100.8	94.0	95.6
JUL	97.8	100.0	94.2	91.4
AUG	97.0	96.1	98.1	97.9
SEP	96.3	95.6	105.2	102.8
OCT	95.4	94.4	104.6	104.1
NOV	95.0	95.3	102.8	105.9
DEC	98.1	97.9	101.4	102.9
Simple average	100.0	100.0	100.0	100.0

**FIGURE 1: PRODUCER RECEIPTS PER DAY CLASSIFIED AS CLASS I**



**FIGURE 2: TOTAL PRODUCER RECEIPTS PER DAY**



**FIGURE 3: PRODUCER RECEIPTS PER DAY NOT CLASSIFIED AS CLASS I**

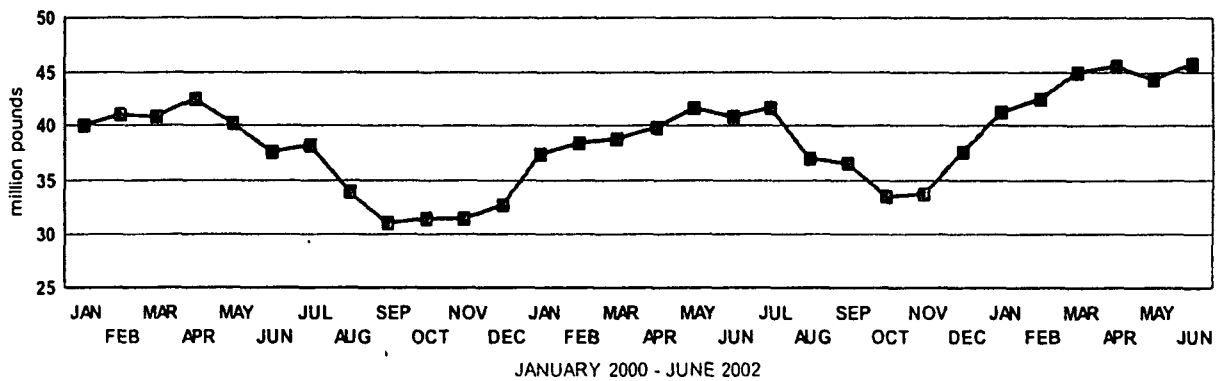


FIGURE 4. PRODUCER RECEIPTS CLASSIFIED AS CLASS IV, JAN 2000 - JUNE 2002

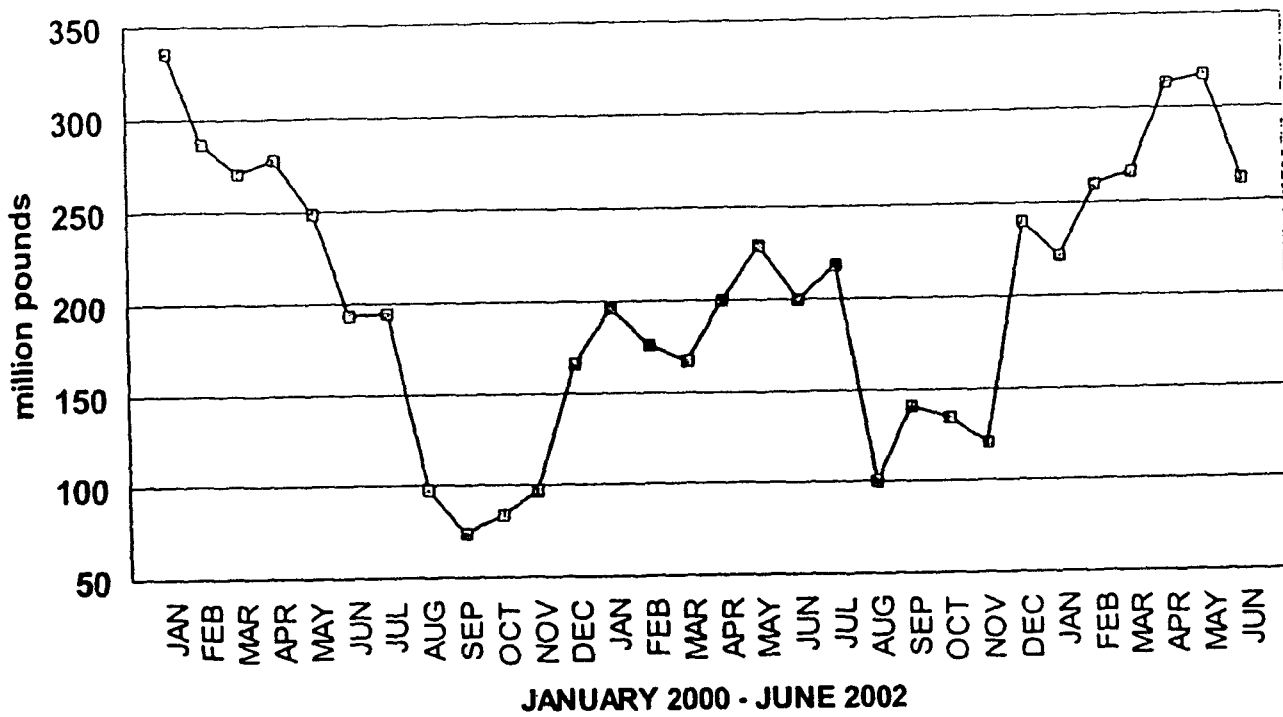
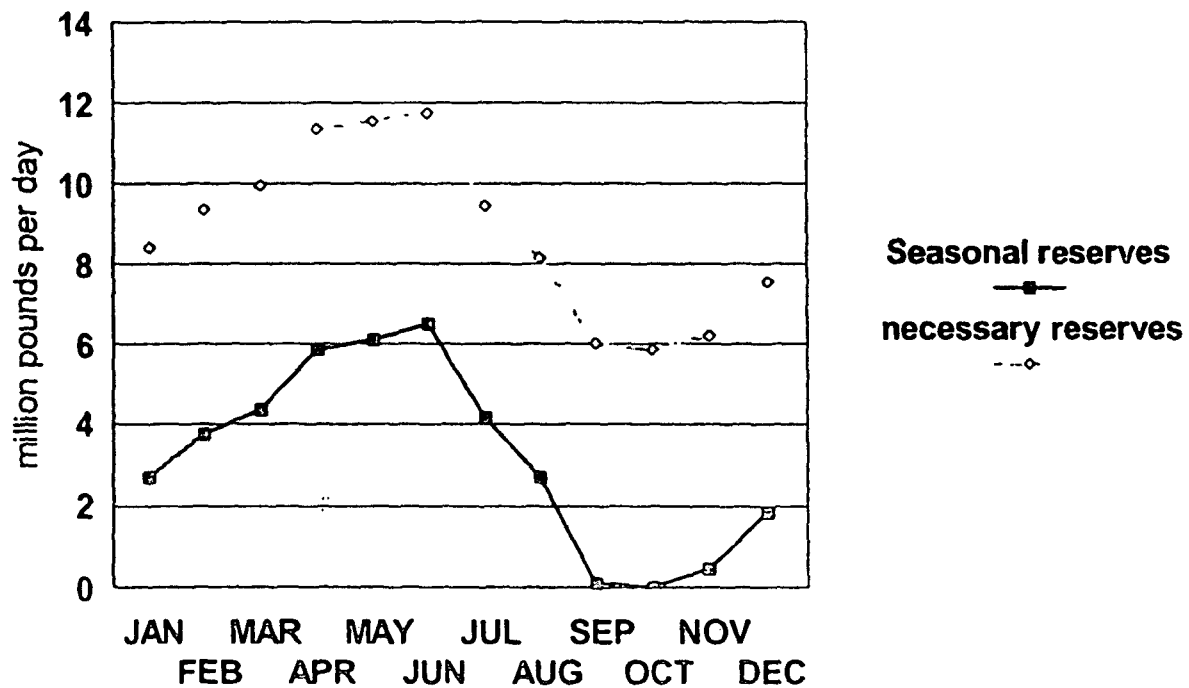


Figure 7. Seasonal, Operating and Necessary reserves, Northeast Orders



20%

**Cooperative and Non-Cooperative Member Share of Producer Receipts and Producers,  
January 2000–June 2002\***

	Producer Receipts			Percent of Receipts		Number of Producers			Percent of Producers	
	Market Total	Cooperative	Non-Cooperative	Cooperative	Non-Cooperative	Market Total	Cooperative	Non-Cooperative	Cooperative	Non-Cooperative
	pounds									
Jan 2000	2,145,585,867	1,584,259,200	561,326,667	73.8	26.2	18,009	14,029	3,980	77.9	22.1
Feb	2,033,955,948	1,544,704,115	489,251,833	75.9	24.1	17,923	13,967	3,956	77.9	22.1
Mar	2,181,973,341	1,692,357,139	489,616,202	77.6	22.4	17,485	13,227	4,258	75.6	24.4
Apr	2,090,183,118	1,586,945,439	503,237,679	75.9	24.1	17,433	12,931	4,502	74.2	25.8
May	2,116,654,246	1,605,061,324	511,592,922	75.8	24.2	17,187	12,794	4,393	74.4	25.6
Jun	1,948,129,893	1,471,894,973	476,234,920	75.6	24.4	17,054	12,713	4,341	74.5	25.5
Jul	1,987,814,577	1,539,725,147	448,089,430	77.5	22.5	17,196	13,165	4,031	76.6	23.4
Aug	1,916,876,690	1,424,892,197	491,984,493	74.3	25.7	17,000	12,504	4,496	73.6	26.4
Sep	1,832,591,012	1,379,578,511	453,012,501	75.3	24.7	16,977	12,677	4,300	74.7	25.3
Oct	1,894,879,890	1,448,708,990	446,170,900	76.5	23.5	16,895	12,842	4,053	76.0	24.0
Nov	1,857,356,593	1,428,358,344	428,998,249	76.9	23.1	17,080	13,018	4,062	76.2	23.8
Dec	1,950,868,822	1,504,827,625	446,041,197	77.1	22.9	17,113	13,076	4,037	76.4	23.6
			<b>Simple Average</b>	<b>76.0</b>	<b>24.0</b>			<b>Simple Average</b>	<b>75.7</b>	<b>24.3</b>
Jan 2001	2,049,231,646	1,590,596,936	458,634,710	77.6	22.4	17,098	13,070	4,028	76.4	23.6
Feb	1,897,841,624	1,464,875,005	432,966,619	77.2	22.8	17,154	13,044	4,110	76.0	24.0
Mar	2,154,275,780	1,666,689,829	487,585,951	77.4	22.6	17,379	13,153	4,226	75.7	24.3
Apr	2,048,337,887	1,572,372,624	475,965,263	76.8	23.2	17,292	13,134	4,158	76.0	24.0
May	2,195,663,646	1,693,507,184	502,156,462	77.1	22.9	17,279	13,127	4,152	76.0	24.0
Jun	2,066,456,892	1,589,195,874	477,261,018	76.9	23.1	17,115	12,985	4,130	75.9	24.1
Jul	2,125,305,676	1,608,119,752	517,185,924	75.7	24.3	17,620	13,185	4,435	74.8	25.2
Aug	2,035,833,898	1,532,448,523	503,385,375	75.3	24.7	17,143	12,712	4,431	74.2	25.8
Sep	1,975,436,831	1,486,267,295	489,169,536	75.2	24.8	16,996	12,577	4,419	74.0	26.0
Oct	1,986,831,804	1,482,098,092	504,733,712	74.6	25.4	17,008	12,594	4,414	74.0	26.0
Nov	1,937,539,619	1,442,177,647	495,361,972	74.4	25.6	16,960	12,544	4,416	74.0	26.0
Dec	2,077,074,294	1,547,883,126	529,191,168	74.5	25.5	16,941	12,489	4,452	73.7	26.3
			<b>Simple Average</b>	<b>76.1</b>	<b>23.9</b>			<b>Simple Average</b>	<b>75.1</b>	<b>24.9</b>
Jan 2002	2,205,241,349	1,667,471,145	537,770,204	75.6	24.4	17,239	12,789	4,450	74.2	25.8
Feb	2,008,493,717	1,512,744,973	495,748,744	75.3	24.7	17,172	12,789	4,383	74.5	25.5
Mar	2,288,924,931	1,734,597,217	554,327,714	75.8	24.2	17,093	12,617	4,476	73.8	26.2
Apr	2,240,997,850	1,696,999,377	543,998,473	75.7	24.3	17,092	12,594	4,498	73.7	26.3
May	2,281,648,633	1,741,614,362	540,034,271	76.3	23.7	16,894	12,551	4,343	74.3	25.7
Jun	2,134,854,098	1,631,498,181	503,355,917	76.4	23.6	17,028	12,718	4,310	74.7	25.3
			<b>Simple Average</b>	<b>75.5</b>	<b>24.5</b>			<b>Simple Average</b>	<b>74.2</b>	<b>25.8</b>

Page 88

\*As reported by handlers at time of calculation of monthly Statistical Uniform Price.

### Producer Deliveries to Pool Distributing Plants, January 2001—June 2002

Year/Month	*Percentage of Cooperative 9c Producer Milk Receipts Delivered to Distributing Plants		**Percentage of Proprietary Handler Producer Milk Receipts Delivered to Distributing Plants		
<b>2001</b>					
Jan	38.6		85.4		83.3 <i>w/o <del>9c</del> coop milk</i>
Feb	37.4		82.9		80.6
Mar	38.7		83.7		81.5
Apr	36.9		82.1		79.6
May	36.4		81.4		78.8
Jun	35.3		79.8		77.0
Jul	38.6		81.8		80.4
Aug	42.2		77.4		75.7
Sep	43.4		80.8		79.2
Oct	45.7		78.9		77.2
Nov	45.5		78.6		76.9
Dec	41.6		77.2		75.3
	Average	40.0	Average	80.8	<u>78.8</u>
<b>2002</b>					
Jan	40.5		79.4		77.8
Feb	38.5		78.5		76.7
Mar	37.8		78.9		77.2
Apr	36.3		77.3		75.5
May	36.3		77.6		75.9
Jun	36.7		76.9		75.5
	Six Month Average	39.9	Six Month Average	78.1	<u>76.4</u>

\* Weighted averages calculated by combining total producer milk deliveries to distributing plants by Section 1000.9 (c) cooperatives, divided by cooperatives' total producer milk receipts. Total producer milk receipts include non-cooperative member milk if any such producer milk was pooled by a Section 1000.9 (c) cooperative.

\*\* Weighted averages calculated by combining total proprietary handler producer milk deliveries to distributing plants less any producer milk diversions by same proprietary handlers, divided by the total proprietary handler producer milk receipts. Total proprietary handler producer milk receipts may include receipts of cooperative members, if cooperative producers were pooled by the proprietary handler.

**TABLE 1: ESTIMATED MILK RECEIPTS AT CLASS I DISTRIBUTING PLANTS BY MEMBERS  
AND NONMEMBERS FOR THE NORTHEAST ORDER, JANUARY 2001 TO JUNE 2002**

	CLASS I PRODUCE RECEIPTS	ESTIMATED TOTAL RECEIPTS AT DISTRIBUTING PLANTS		NON-COOPERATIVE PRODUCER RECEIPTS		% OF PROPRIETARY HANDLER PRODUCER MILK RECEIPTS DELIVERED TO DISTRIBUTING PLANTS	EST. VOLUME/DAY OF OF NON-CO-OP RECEIPTS DELIVERED TO DISTRIBUTING PLANTS		EST. VOLUME/DAY OF OF CO-OP RECEIPTS DELIVERED TO DISTRIBUTING PLANTS		
		TOTAL	AVG/DAY	TOTAL	AVG/DAY		mil lbs	% of low mon	mil lbs	% of low mon	
		-----million pounds-----									
JAN 2001	888.3	1045.0	33.7	458.6	14.8	85.4%	12.6	101%	21.1	117%	
FEB	822.3	967.4	34.5	433.0	15.5	82.9%	12.8	102%	21.7	121%	
MAR	953.2	1121.4	36.2	487.6	15.7	83.7%	13.2	105%	23.0	128%	
APR	843.4	992.2	33.1	476.0	15.9	82.1%	13.0	104%	20.0	111%	
MAY	904.0	1063.5	34.3	502.2	16.2	81.4%	13.2	105%	21.1	117%	
JUN	840.9	989.3	33.0	477.3	15.9	79.8%	12.7	101%	20.3	113%	
JUL	834.1	981.3	31.7	517.2	16.7	81.8%	13.6	109%	18.0	100%	
AUG	889.5	1046.5	33.8	503.4	16.2	77.4%	12.6	100%	21.2	118%	
SEP	881.0	1036.5	34.5	489.2	16.3	80.8%	13.2	105%	21.4	119%	
OCT	949.4	1116.9	36.0	504.7	16.3	78.9%	12.8	102%	23.2	129%	
NOV	925.6	1089.0	36.3	495.4	16.5	78.6%	13.0	103%	23.3	129%	
DEC	910.4	1071.1	34.6	529.2	17.1	77.2%	13.2	105%	21.4	119%	
JAN 2002	924.9	1088.1	35.1	537.8	17.3	79.4%	13.8	110%	21.3	118%	
FEB	819.6	964.2	34.4	495.7	17.7	78.5%	13.9	111%	20.5	114%	
MAR	897.2	1055.5	34.0	554.3	17.9	78.9%	14.1	112%	19.9	111%	
APR	872.3	1026.2	34.2	544.0	18.1	77.3%	14.0	112%	20.2	112%	
MAY	907.7	1067.8	34.4	540.0	17.4	77.6%	13.5	108%	20.9	116%	
JUN	813.2	956.7	31.9	503.4	16.8	78.1%	13.1	104%	18.8	104%	

\*Data from Market Administrator exhibit, p.5, appendices 15 and 17.



TABLE 2

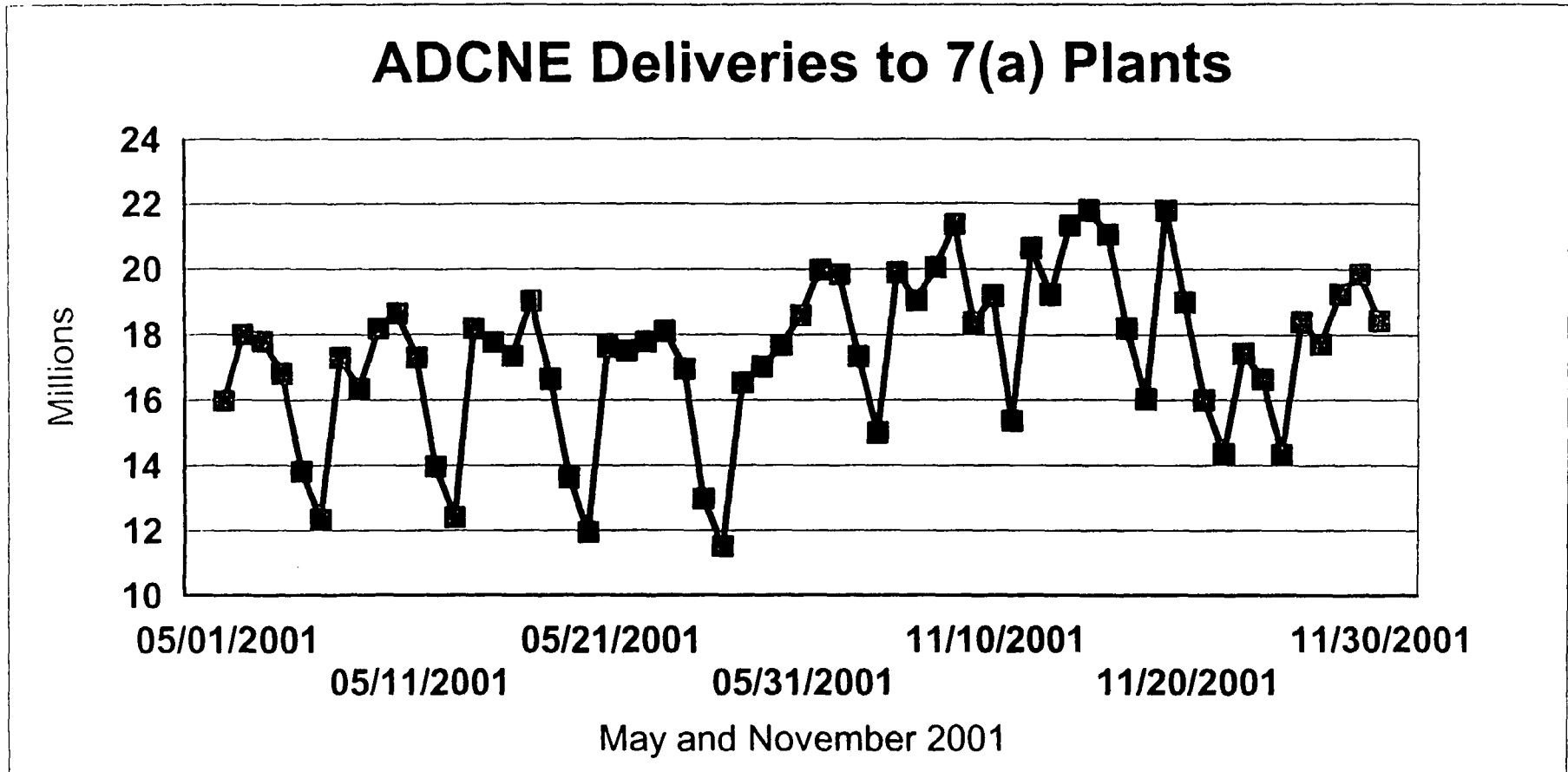


TABLE 2

## Day to the week Delivery Data for Six Cooperatives, May 2001

Date	Day	Deliveries to 7-A	Ratio of Day to Monthly Average
5/1/2001	Tuesday	15,978,470	98.0%
5/2/2001	Wednesday	18,005,831	110.4%
5/3/2001	Thursday	17,790,373	109.1%
5/4/2001	Friday	16,812,671	103.1%
5/5/2001	Saturday	13,816,501	84.7%
5/6/2001	Sunday	12,330,292	75.6%
5/7/2001	Monday	17,305,174	106.1%
5/8/2001	Tuesday	16,338,014	100.2%
5/9/2001	Wednesday	18,188,412	111.5%
5/10/2001	Thursday	18,652,102	114.3%
5/11/2001	Friday	17,305,675	106.1%
5/12/2001	Saturday	13,961,906	85.6%
5/13/2001	Sunday	12,398,141	76.0%
5/14/2001	Monday	18,188,765	111.5%
5/15/2001	Tuesday	17,768,495	108.9%
5/16/2001	Wednesday	17,344,005	106.3%
5/17/2001	Thursday	19,027,025	<b>116.6%</b>
5/18/2001	Friday	16,637,831	102.0%
5/19/2001	Saturday	13,623,102	83.5%
5/20/2001	Sunday	11,949,378	73.3%
5/21/2001	Monday	17,624,700	108.0%
5/22/2001	Tuesday	17,518,174	107.4%
5/23/2001	Wednesday	17,778,310	109.0%
5/24/2001	Thursday	18,111,644	111.0%
5/25/2001	Friday	16,944,636	103.9%
5/26/2001	Saturday	12,973,350	79.5%
5/27/2001	Sunday	11,508,165	<b>70.5%</b>
5/28/2001	Monday	16,526,936	101.3%
5/29/2001	Tuesday	17,013,939	104.3%
5/30/2001	Wednesday	17,669,521	108.3%
5/31/2001	Thursday	18,592,650	114.0%
		505,684,188	
		16,312,393	

TABLE 1-B

Day of the week Delivery Data for Six Cooperatives, November 2001

11/1/2001	Thursday	19,980,849	107.6%
11/2/2001	Friday	19,829,939	106.8%
11/3/2001	Saturday	17,325,375	93.3%
11/4/2001	Sunday	14,999,441	80.8%
11/5/2001	Monday	19,895,457	107.2%
11/6/2001	Tuesday	19,044,853	102.6%
11/7/2001	Wednesday	20,056,778	108.0%
11/8/2001	Thursday	21,374,142	115.1%
11/9/2001	Friday	18,370,554	99.0%
11/10/2001	Saturday	19,192,820	103.4%
11/11/2001	Sunday	15,354,716	82.7%
11/12/2001	Monday	20,646,907	111.2%
11/13/2001	Tuesday	19,228,772	103.6%
11/14/2001	Wednesday	21,332,758	114.9%
11/15/2001	Thursday	21,803,626	117.5%
11/16/2001	Friday	21,068,285	113.5%
11/17/2001	Saturday	18,192,515	98.0%
11/18/2001	Sunday	16,025,502	86.3%
11/19/2001	Monday	21,804,778	<b>117.5%</b>
11/20/2001	Tuesday	18,996,144	102.3%
11/21/2001	Wednesday	16,002,007	86.2%
11/22/2001	Thursday	14,341,388	<b>77.3%</b>
11/23/2001	Friday	17,440,375	93.9%
11/24/2001	Saturday	16,642,531	89.7%
11/25/2001	Sunday	14,325,251	77.2%
11/26/2001	Monday	18,398,682	99.1%
11/27/2001	Tuesday	17,712,807	95.4%
11/28/2001	Wednesday	19,248,809	103.7%
11/29/2001	Thursday	19,848,109	106.9%
11/30/2001	Friday	18,431,196	99.3%

556,915,366

18,563,846

**Milk Powder and Butter Production at Selected Plants Associated with the  
Northeast Order, May and November, 1992–2002**

	Total Milk Receipts	Total Cream Receipts	Combined Milk and Cream Receipts	Total Skim Milk Powder Manufactured	Total Whole Milk Powder and Other Powder#	Total Butter Manufactured
	pounds of product					
May-92*	323,910,899	4,748,060	328,658,959	128,425,719	64,518,136	8,141,988
Nov-92*	230,988,182	7,408,682	238,396,864	63,291,925	59,599,201	4,729,549
May-93*	365,930,371	2,469,704	368,400,075	176,034,155	46,013,132	9,000,924
Nov-93	240,614,003	9,700,746	250,314,749	59,724,627	75,880,210	7,085,801
May-94	412,007,786	5,457,393	417,465,179	206,413,633	78,711,647	12,400,436
Nov-94	279,316,061	7,242,325	286,558,386	115,999,039	47,674,635	8,765,615
May-95	429,619,806	5,863,813	435,483,619	229,822,782	61,484,647	13,762,279
Nov-95	279,448,982	11,465,150	290,914,132	100,285,594	50,606,443	9,527,847
May-96	360,783,337	6,516,009	367,299,346	232,122,989	21,450,800	12,942,437
Nov-96	263,443,101	8,157,790	271,600,891	107,137,865	21,969,765	8,186,301
May-97	469,119,740	4,838,539	473,958,279	258,111,241	46,933,476	12,727,461
Nov-97	319,757,555	7,104,510	326,862,065	101,056,732	39,867,500	7,867,325
May-98	459,394,854	5,504,762	464,899,616	216,211,792	61,631,031	10,933,743
Nov-98	283,626,101	9,926,454	293,552,555	88,643,949	35,419,623	12,475,633
May-99	499,142,735	7,752,010	506,894,745	249,269,351	45,320,899	11,059,887
Nov-99	361,629,523	10,037,413	371,666,936	160,679,994	46,941,846	8,634,590
May-00	<u>454,385,205</u>	10,932,965	465,318,170	233,271,908	24,720,090	15,937,061
Nov-00	253,987,160	12,861,951	266,849,111	79,124,239	23,603,184	5,401,563
May-01*	407,401,634	11,217,520	418,619,154	214,518,682	18,165,378	21,931,432
Nov-01*	306,762,045	9,323,350	316,085,395	97,239,621	20,839,703	10,231,100
May-02**	506,085,672	7,119,716	513,205,388	285,871,675	23,844,037	21,829,790

\* May 92, November 92, May 93, data for six plants only; data for O-AT-KA Milk Products Co-op. unavailable. May 01 and November 01, data for six plants only; Dietrich's Milk Products LLC, Middlebury Center, did not manufacture these products. Other months include data for seven plants.

\*\* May 02 data are unaudited as reported by handlers.

Represents data for the following plants: Agri-Mark, Inc.-West Springfield, MA; Dietrich's Milk Products LLC.-Reading, PA & Middlebury Center, PA; Land O' Lakes Cooperative, Inc.- Mt. Holly Springs, PA; Maryland and Virginia Milk Producers Cooperative, Inc.- Laurel, MD; O-AT-KA Milk Products Co-op-Batavia, NY; St. Albans Cooperative Creamery, Inc.- St. Albans, VT.

Figure 1

### Reading's Estimated Plant Capacity Utilization, Jan 00-Jun02

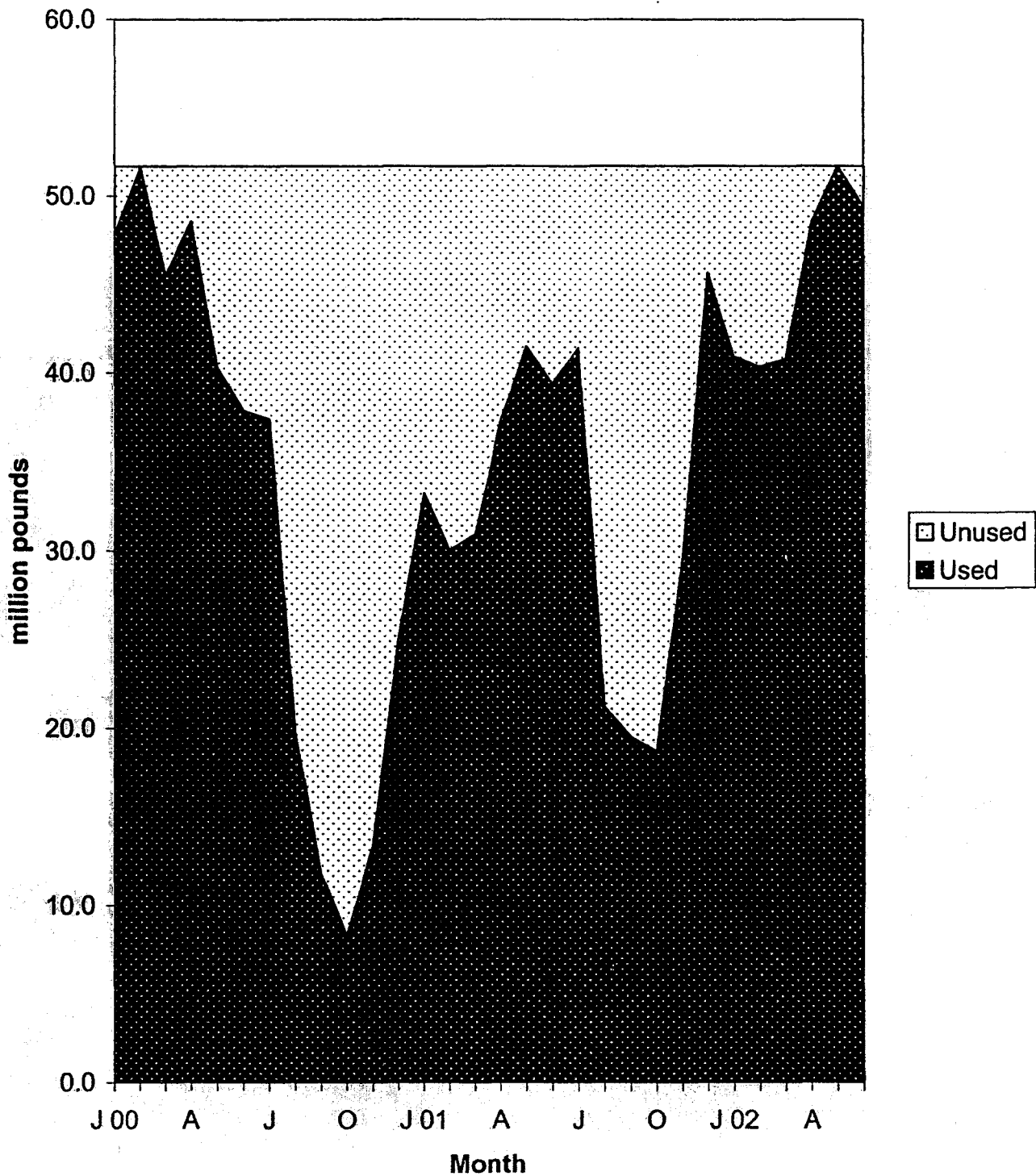


Figure 2

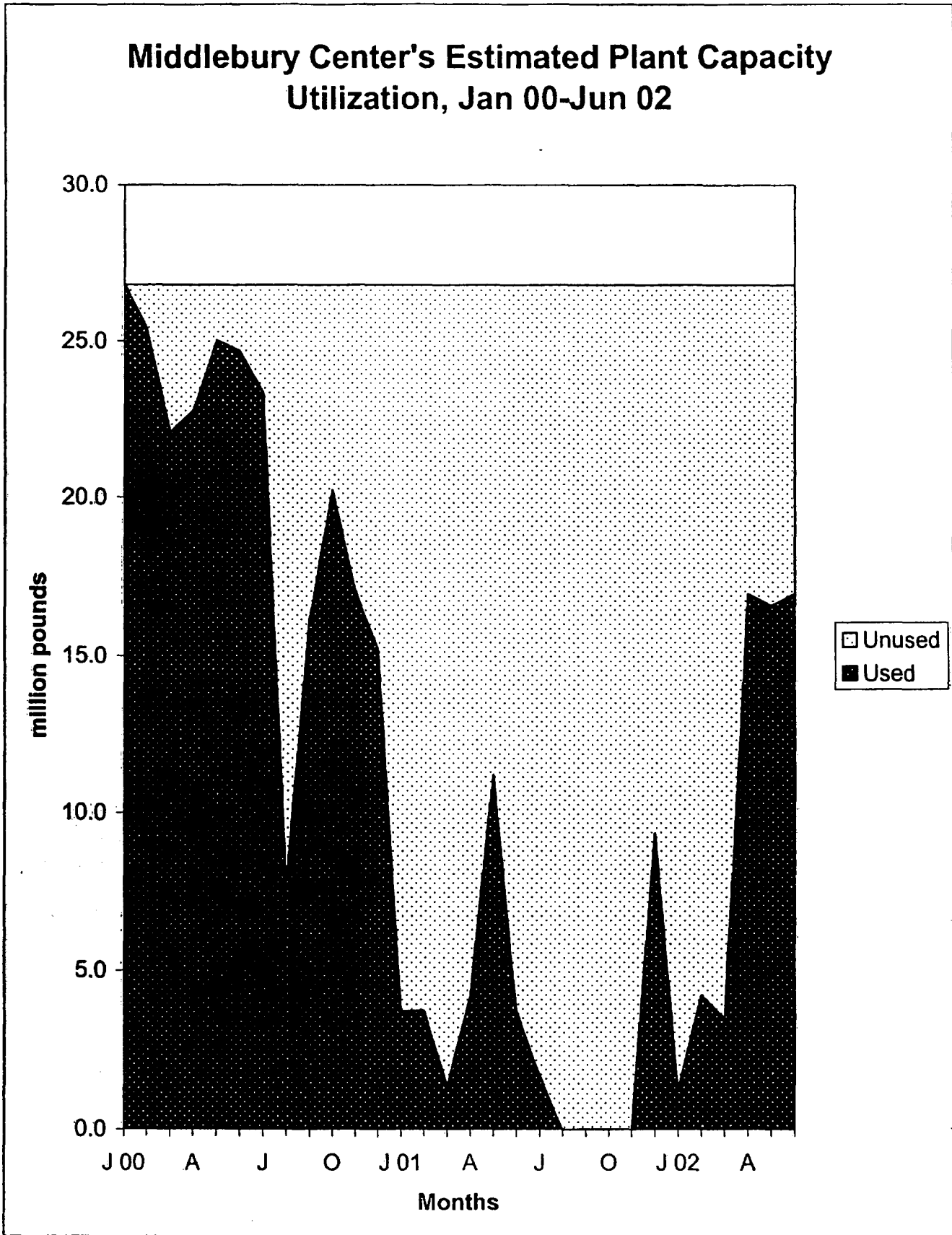
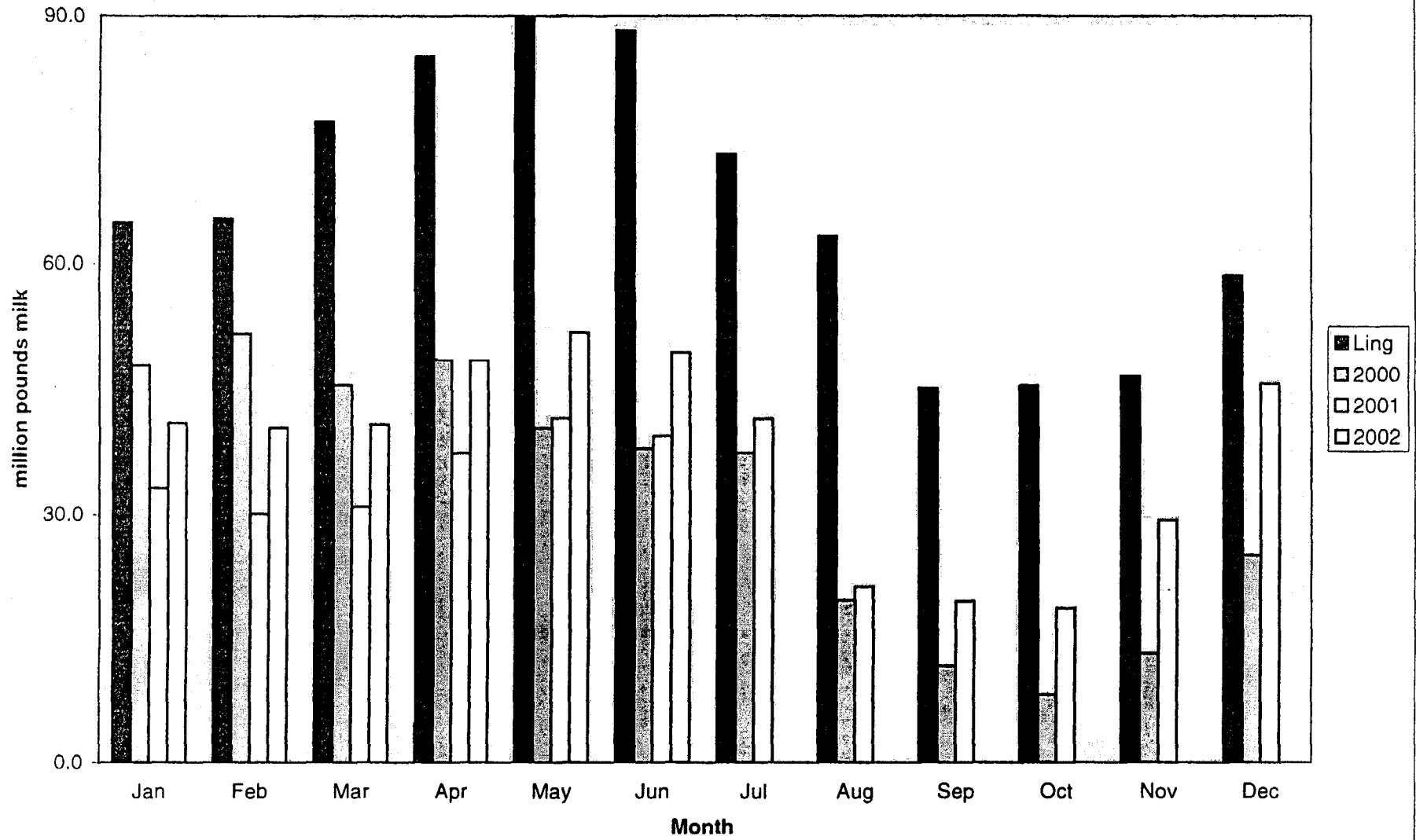


Figure 3. Reading Milk Intake vs Ling Study



**Figure 4. Middlebury Center Intake vs Ling Study**

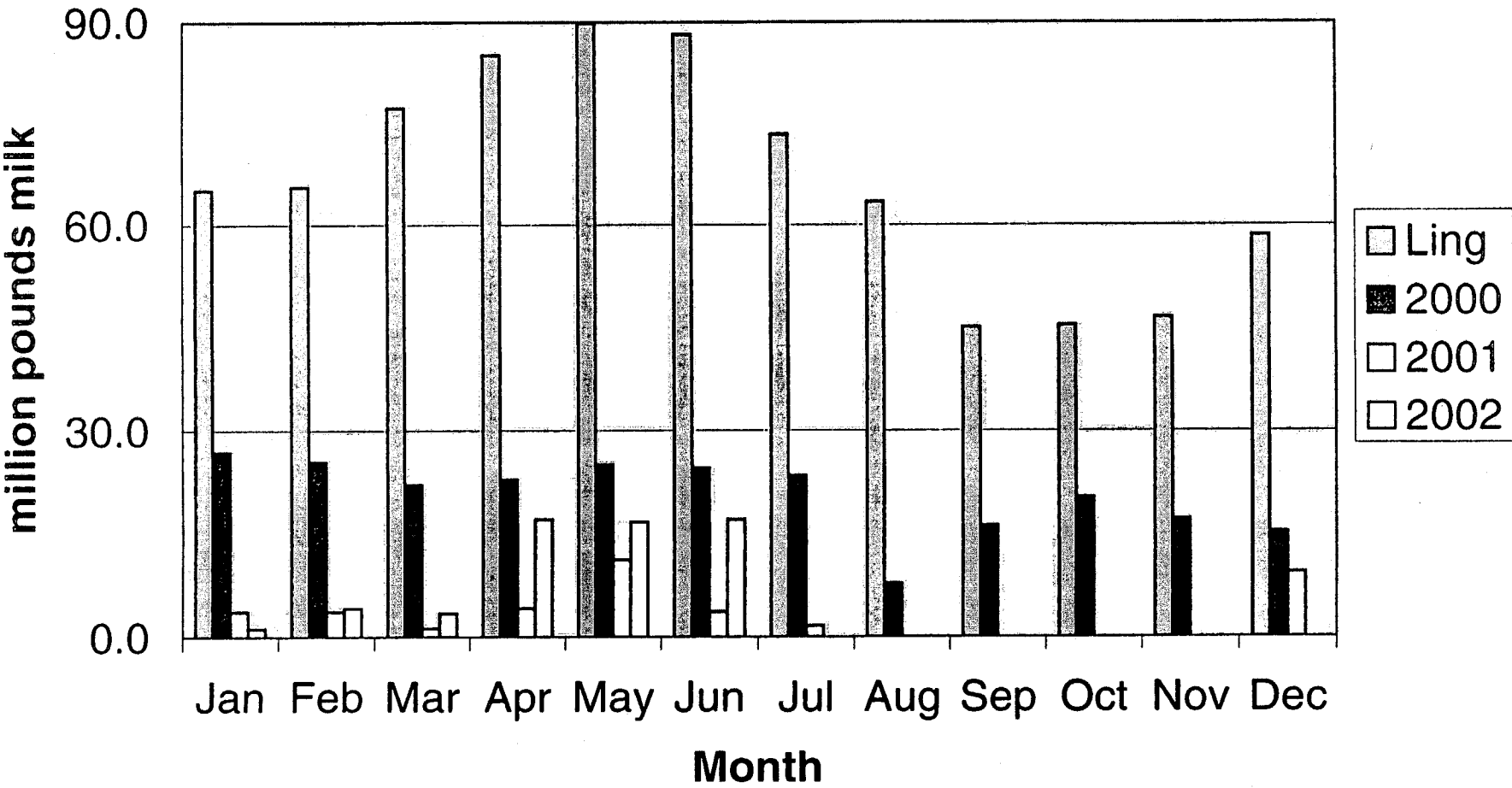




TABLE 5

Table 5  
TOTAL SOLIDS CAPACITY AT LAND O'LAKES, CARLISLE

2001	PERCENT OF CAPACITY
JANUARY	68%
FEBRUARY	64%
MARCH	64%
APRIL	68%
MAY	77%
JUNE	64%
JULY	64%
AUGUST	50%
SEPTEMBER	55%
OCTOBER	59%
NOVEMBER	59%
DECEMBER	77%

2002	
JANUARY	77%
FEBRUARY	81%
MARCH	81%
APRIL	91%
MAY	100%
JUNE	82%
JULY	59%

FIGURE 5. MILK RECEIPTS USED FOR MANUFACTURING AT THE AGRI-MARK WEST SPRINGFIELD, MA PLANT, JAN 2000 - JUNE 2002

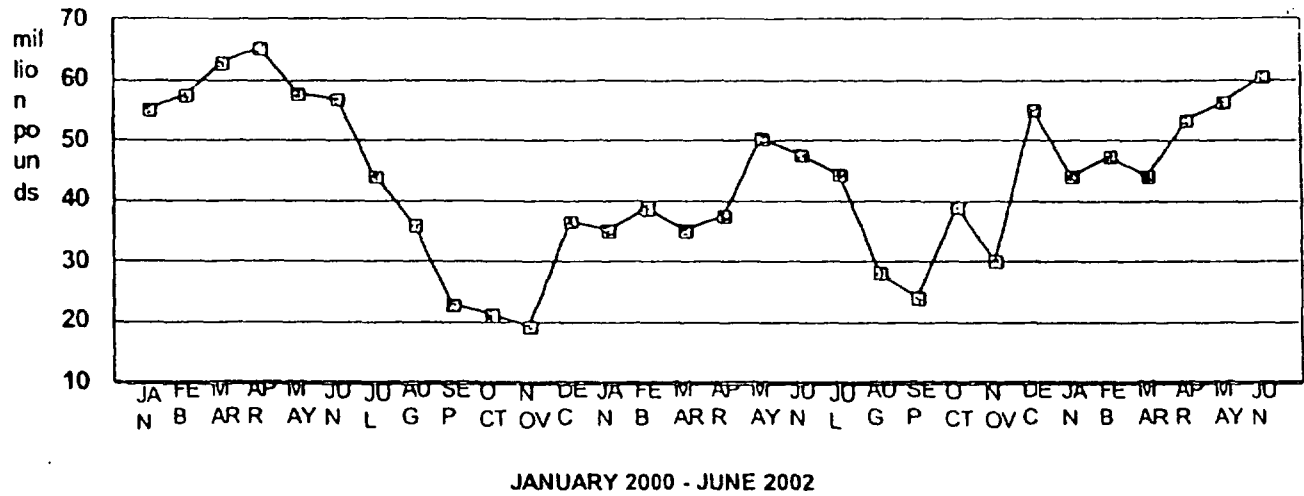


FIGURE 6. % OF MANUFACTURING CAPACITY USED AT THE AGRI-MARK W. SPRINGFIELD PLANT, JAN 2000 - JUNE 2002

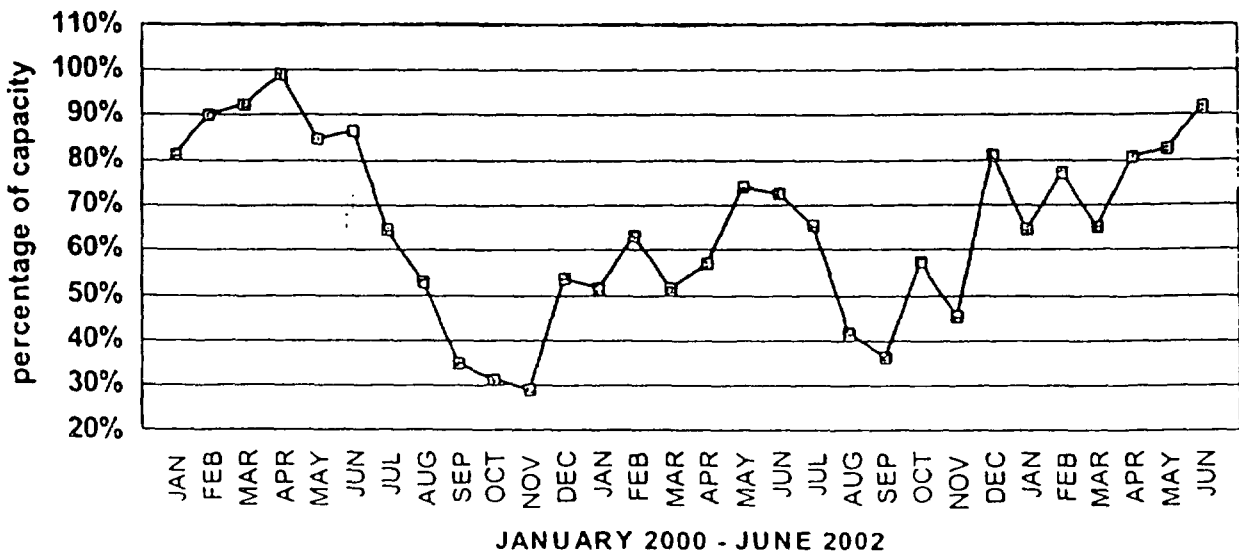


TABLE 2: PRODUCER RECEIPTS CLASSIFIED AS CLASS IV  
 UNDER THE NORTHEAST FEDERAL ORDER AND  
 MILK USED FOR MANUFACTURING AT THE AGRI-MARK  
 WEST SPRINGFIELD, MA PLANT

		<u>CLASS IV</u>	<u>W. SPRINGFIELD</u>	
		mil lbs.	mil lbs.	as a percentage of capacity
JAN	2000	336	55.3	81%
FEB		287	57.5	90%
MAR		272	63.1	93%
APR		279	65.4	99%
MAY		249	57.9	85%
JUN		194	57.1	87%
JUL		195	44.1	65%
AUG		99	36.1	53%
SEP		75	23.1	35%
OCT		84	21.4	31%
NOV		97	19.4	29%
DEC		167	36.6	54%
JAN	2001	197	35.3	52%
FEB		177	38.8	63%
MAR		168	35.1	51%
APR		201	37.6	57%
MAY		230	50.3	74%
JUN		201	47.8	72%
JUL		219	44.6	65%
AUG		100	28.4	42%
SEP		142	24.1	37%
OCT		135	39.2	57%
NOV		121	30	45%
DEC		241	55.2	81%
JAN	2002	222	44.1	65%
FEB		260	47.4	77%
MAR		267	44.2	65%
APR		314	53.3	81%
MAY		317	56.3	83%
JUN		262	60.5	92%

*(2.2 mil/day  
for butter powder)*

Table 3. DMS Balancing Costs, 2001 and Jan-Jul 2002

<u>Balancing Cost Category</u>	<u>Jan-Jul 2002</u> (\$1,000)	<u>2001</u>
Dietrich's Loss	\$ 4,942	\$ 6,647
Underclass Pricing	\$ 586	\$ 182
Unreimbursed Hauling	\$ 715	N.A.
Lost Handling	\$ 2,838	N.A.
Grand Total	\$ 9,081	\$ 6,829
DMS Member Milk	4,465,693,735	7,139,373,833
Cost/CWT of DMS Member Milk	\$ 0.203	\$ 0.096

N.A. Not Available

TABLE 4

Land O'Lakes - Eastern Operations  
% Capacity - Expense

