

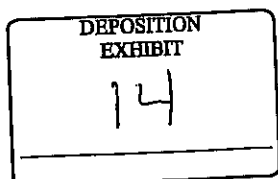
**BEFORE THE UNITED STATES DEPARTMENT  
OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE**

**In the Matter of** : **Docket Nos.**  
:   
**Milk In The Mideast** : **AO- 166-A77;**  
:   
**Marketing Area** : **DA-08-09**

**Statement of Elvin Hollon**

**August 18, 2008  
Cincinnati, Ohio**

**EXHIBIT** 14



## **Statement of Proponents**

**I am Elvin Hollon. I am employed by Dairy Farmers of America as the Director of Fluid Marketing and Economic Analysis. My office is located at 10220 Ambassador Drive, Kansas City Missouri, 64153. I am testifying today on behalf of Michigan Milk Producers, Inc., Foremost Farms USA Cooperative, Inc., Dairylea Cooperative Inc., NFO, Inc. and Dairy Farmers of America, Inc. or collectively, *The Cooperatives*.**

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

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

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

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

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

## **Summary of the Issue**

The proponents are supporters of Federal Milk Marketing Orders and we believe that without them dairy farmers' economic livelihood would be much worse. Federal Orders are economically proven marketing tools for dairy farmers. *The Cooperatives* - all of whom supply milk to processors and pool the milk of producer members on the Order are requesting this Hearing to consider changes in the Order 33 differential price surface. *The Cooperatives* collectively market the majority of the milk and service the majority of the class I sales in the Order. Failure to address these issues will be detrimental to all the members of our cooperatives both in their day-to-day dairy farm enterprises and the milk processing investments which they have made.

Recent urgently needed changes to Federal Orders 5, 6 and 7, which provided for temporary increases in both the Class I differential price surface, and in Order 5 and 7 only, enhancements to the Inter-Market Transportation Credit payments, have increased the difficulty in supplying the southern tier of fluid milk processing plants in Federal Order 33.

In a February 28, 2008 release the Agriculture Marketing Service announced changes in the differential price surface to Orders 5, 6 and 7 that increased differentials by as little as 10 cents per hundredweight in the northern and western portions of the combined marketing area to as much as \$1.80 per hundredweight in the southern counties of Order 6. These and other changes to those Orders will increase blend prices in the Southeastern Orders. For example, in testimony presented at the Hearing by the Federal Order 5 Market Administrator the change in location adjustments in Order 5 were projected to increase the Uniform Price at location (weighted average) by approximately 30 cents if applied to market conditions in 2004 – 2006. Similar testimony from the Order 7 Market Administrator indicated the changes could increase blend prices by 64 cents there. (73 Fed. Reg. 11198 (Feb. 29, 2008))

**In addition, the Decision modified the Inter-Market Transportation Credit system in Order 5 and 7 by increasing the transportation credit assessment charged to handlers. The effect of this increase means more total dollars are available to offset transportation costs and the fund will be less likely to prorate credit payments to shippers. Also, the credits are now applicable in more months of the year, further enhancing those markets' ability to pay for milk. The resulting scenario is that the Southeastern Orders are now better able to attract milk from further supply areas, such as Order 33, into their markets and away from the local Mideast Order plants. (73 Fed. Reg. 11209 – 11212 (Feb. 29, 2008))**

### **Issue with Partial Changes to the Differential Price Surface**

**The proponents realize that some may differ with the concept of making changes in the differential price surface on a temporary basis. There has been a concern raised that such changes should be made at a one time "national hearing". We would support such a hearing if one were called and if the data existed for a thorough review of the nationwide price grid and the changes in it that may be necessary. There may be issues that result from the single order approach and certainly some that could be avoided if a single national hearing were available to deal with the issues in a single setting. However, such data does not presently exist and no one has proposed a national hearing. The issues that we present are real, current and ongoing and deserve to be addressed now.**

**There is no prohibition in the regulations for changing the differential price surface in individual orders. Hearing history would indicate this has been done in prior instances. As a safeguard to discovering that additional changes may be necessary the proponents, like those in the Southeast, have offered changes that are to be considered temporary and may be changed in the future if and when a more comprehensive pricing surface is disclosed by USDA and reviewed by the industry or if marketing conditions warrant further change.**

**As the testimony will show, the changes being proposed are less than levels that could be justified using accepted methods of calculation. This means the proponents are choosing a less than optimal solution but nonetheless a more proper differential level than is currently in place.**

**While there is industry knowledge of research being undertaken by a partnership between USDA/AMS – Dairy Programs and Cornell University concerning differentials, there is no publication of that research current, nor reason to expect that the industry will be any more unified in its opinion of the proper level of differential when results are published than it is now.**

**As in the recently completed make allowance hearings dealing with manufacturing costs, it is indisputable that costs of attracting milk from production areas to markets where there is processing capacity has risen dramatically since the last time differentials were adjusted. Milk suppliers are justified in asking the Secretary to review these costs and their resultant impacts on the differential surface just as product manufacturers were justified in asking for a review of make allowance changes.**

### **Class I Differential**

**The Federal Order Reform Decision declared, "The purpose of the minimum Class I differential is to generate enough revenue to assure that the fluid market is adequately supplied." (63 Fed. Reg. 16102 (April 2, 1999)) Due to recent changes in both fuel costs inherent in supplying markets and in the increased returns from nearby markets our opinion is that the Class I differentials in portions of Order 33 need to be adjusted to compensate suppliers for adequately supplying the market.**

## **Supply Situation in the Mideast Order**

The Market Administrator provided tables and maps (Exhibit \_\_\_\_\_) titled Mideast Milk Marketing Area Milk Production in the Lake States by Pool Status May 2000, 2003 and 2007, (DFA et al. Request 2 – A (Table format) and DFA et al. Request 2 – B (Graphical Format) contain data on milk production by state and county, including FIPS code, current Class I differential, pounds of milk that is produced in the county that is either pooled on Order 33, associated with Order 33 but not pooled in that month or pooled on another Federal Order. The volume represented in this exhibit equals the total milk production and disposition of all milk produced in those counties. The states represented (except for New York) each have at counties located in the marketing area of Order 33. New York milk volumes regularly pool and deliver milk to handlers in Order 33 and have for a long time been considered a regular part of the Order's milk supply. This exhibit clearly details the milk produced within the Marketing Area boundaries and the associated volumes of milk pooled on the Order. Equally so, milk production that is produced in the Marketing Area but not pooled on Order 33 can be assumed to have been marketed elsewhere - likely due to a better return from another market.

On the maps, dark rust colored counties represent the most milk production; black - a lesser production volume; dark blue - lesser; tan – a smaller volume; light blue some volume and white - no milk production volume. The proponents selected 11 counties to represent reserve supply areas for Order 33. In nearly every case the counties selected represent a high milk production county (dark rust) in each month of the three year periods and/or were representative of a supply region in their segment of the state. Additionally from the market knowledge of *The Cooperatives* each county represents areas from which reserve milk supplies are drawn for servicing fluid use plants in Order 33.

In Michigan, Clinton, Huron, Lenawee, Missaukee and Ottawa counties were selected. In Indiana Jasper and Elkhart were selected; in Ohio – Mercer and Wayne counties were

chosen; in Pennsylvania – Crawford county and in New York – Chautauqua county. (each of these eleven counties are detailed on Exhibit \_\_\_\_\_ Page 51) Clinton and Missaukee Michigan are counties where milk supplies are rapidly growing – hence a rust colored county in 2007 but not necessarily in prior years. Elkhart County Indiana is a traditional reserve supply area in Indiana with all of the milk available for Order 33 deliveries; but in May 2007 a volume of those pounds were not pooled – likely due to price relationships. Jasper County Indiana is a high production county located within the marketing area of Order 33 with much of the growth occurring in recent since 2000 and with an increasing volume of the milk supply marketed and pooled on other Orders. However it does represent a potential milk supply for Order 33. Based on this data and the best professional judgment of *The Cooperatives* these eleven counties represent a reasonable basing point for the reserve supplies for Order 33 fluid use milk sales and to serve as a base reference for the accuracy of the current differential price surface.

MA Exhibit \_\_\_\_\_ DFA et al. 5 – C contains a wide variety of important market information on a single exhibit. It provided graphic detail of the more than ample competition for milk supplies inside of Order 33 from non pool plants, each denoted by a number. Simply reviewing the legend key indicates that there is a wide mix of Class II, III and IV plant operations all competing for the milk supplies in the Order. The black dots represent locations for milk supplies. Each dot represents 500,000 pounds of milk per month. More dots mean more milk. The milk supply is concentrated in the central to northern regions of the Order and many of the non pool plants are located close to the milk supply. This means that the differential structure in the southern regions of Order 33 must not only bid milk away from the manufacturing plants but must “up the ante” to overcome the lower transportation cost advantages of the nearby buyer.

### Demand Situation

**The Southern tier of fluid processing plants in Order 33, generally speaking the 10 plants south of Interstate 70 located in Indiana, Ohio, and West Virginia, lie in a deficit milk supply region. This region absorbs all of the local milk supply that does not get attracted away to Order 5 or 7 and, then, must rely on supplemental supplies delivered from milk produced primarily within the Order but from more northern zones. Furthermore, the reserve supply in the northern zones will be further attracted to the Southeast Orders as supplemental supplies through the now increased differentials and the enhanced transportation credit payments. For example, data regularly published by the Order 33 Market Administrator shows that Jasper and Newton Counties are the two counties with the most production in Indiana. In both counties, over 80% of the milk produced there is pooled in another Federal Order, clearly attracted there by the higher price.**

**The Order 33 marketing area can be subdivided for analysis into three reasonably distinct milk sheds characterized by groupings of demand points and supply regions. This aggregation was constructed based on current supply/demand relationships deemed most reasonable from the best professional judgments of the day to day milk marketing agents employed by *The Cooperatives*. Current experience with which regions of the market are deficit versus surplus in milk production relative to demand and those areas from which supplemental milk supplies are regularly taken in order to supply deficits in the other areas within the Order 33 marketing area guided the selection process.**

**Once *The Cooperatives* established the milk supply/demand regions we asked the Market Administrator to generate market statistics to describe the areas. (See DFA et al. Request 1-A, 1-B, 3-A and 3-B prepared by the Market Administrator's Office – Exhibit \_\_\_\_\_) The Regions and their current differentials are depicted in the map shown in Request 1-B. This map details the county makeup of each of the three supply Regions, the state boundaries and a numeric marker for each Pool Distributing Plant regulated by the Order for April 2008. The blue colored area on Request 1-B composes the Northwest Region and includes Michigan, Northern Indiana and Northwest Ohio. The purple colored area represents the Northeast Region which is primarily the northern half of Ohio and the western portion of**



Pennsylvania that is located in Order 33. The orange colored area represents the Southern Region as defined by *The Cooperatives* and includes the southern portions of Indiana and Ohio, the extreme northern and northeast portions of Kentucky that are located in the Order 33 marketing area and the western half of West Virginia. The Table shown in Request 1-A details the plant code as shown on the map, the city, state and county for each plant and the prevailing differential for each plant.

*The Cooperatives* requested that the Market Administrator calculate summary statistics for each of the three defined Regions. We asked for data to be developed for January, April, August and November of 2007 (one month out of each quarter) and for January and April 2008 – the most recent selected months available this year. (Exhibit \_\_\_\_\_) We asked for one month per quarter as a balance between showing what a year-round typical situation in the marketplace would be and the time demand for the Market Administrator staff's to produce the data.

We asked for milk that was produced on farms located in the defined supply area either pooled on the Mideast Order or pooled on another Order and delivered to a pool distributing plant in the defined supply area. This volume is noted in the column labeled Available Milk on the one page table - Request 3-B titled The Mideast Marketing Area Summary of Available Milk v. Milk Received at Distributing Plants by Months and Supply Region. We then asked for the pounds of bulk milk physically received at distributing plants located in the defined supply area – noted as Milk Received at Distributing Plants on Request 3-B. We also asked for a net of the two figures which would indicate the more deficit supply situation and the area for which some adjustment in differential would be justified. Request 3-A (18 pages of maps) pictorially describes the summary statistics.

Additionally, as a further descriptor of each Region, *The Cooperatives* requested that the Market Administrator summarize the distance milk had to be hauled within each Region to meet the demand in that Region. These data are located in DFA et al. Request 4-A (12 pages of tables) titled Mideast Marketing Area Hauling Distance of Producer Milk to Distributing

**Plants by Supply Region (4-A). (Exhibit \_\_\_\_\_) These mileages represent actual milk movements from data provided to the Market Administrator regularly each month by the Orders suppliers. This request details mileage breakdowns in twenty mile increments for each Region for the months of January, April, August and November 2007 and January and April 2008 showing the pounds transported to distributing plants by the 20 mile increments and secondly the percentage of milk distributed in each increment. Table 4-B is a summary of the mileage data only. (Exhibit \_\_\_\_\_)**

**The Mideast - Northwest Region (NWR) is composed of what are now the two lowest valued Class I differential zones in Order 33. This is the area with the largest milk production, the most counties exhibiting growth in milk production and the largest volume of Class I demand. This area by any possible definition is the reserve supply region for Order 33. Within this Region, milk production is surplus to Class I demand by an average of over 156% in the six time periods measured. Based on our knowledge of the market, milk is transported out of this Region to customers in each of the other two Regions many days and in every week of the year. For the milk that is delivered to Class I plants in the Region, the average haul distance for each load is 72 miles for the six monthly periods measured – the lowest transported miles of any Region.**

**The Mideast – Northeast Region (MNR) is composed of what is now the \$2.00 zone within Order 33 generally north of Interstate 70 in Ohio, and the \$2.10 and \$2.30 zone in Pennsylvania; but not including any of the \$2.00 zone in Indiana. This is also a surplus Region – but at a lesser rate. Here supply is a little less than double (89%) the Class I demand over the six monthly periods measured. The average distance that each load of milk is moved to meet the Class I demand in this Region averages 70 miles.**

**The Mideast – Southern Region (SR) is composed of the remaining marketing area in Indiana – the \$2.00 and \$2.20 zones; the remainder of Ohio – the \$2.00 zone south of Interstate 70; and any counties in Kentucky and West Virginia except the four counties north of Wetzel county that are wedged between the Ohio border and the Pennsylvania**

border. The counties in the Southern Region comprise the \$2.20 / \$2.30 and \$2.40 zones in the Order. The Southern Region (based on the April data published in the Market Administrator information) contains 10 plants currently with an eleventh plant in the startup phase. The Nestle Company's plant in Anderson Indiana will, according to industry estimates, process 1,000,000 pounds of milk per day. When this plant is operating at full capacity the deficit in the Southern Region will worsen. Recent news reports have indicated an expansion to the plant, which manufactures Nesquik flavored milk drinks, expanding plant capacity by 2011.

The milk supply for this Region, averages, for the six monthly periods measured, only 60% of the required Class I demand, making the Southern Region a severely deficit milkshed. In Order to supply the Southern Region milk transport averages 133 miles – clearly representing milk movements from outside the Region being delivered to plants within the Region. In order to meet the demands of the Southern Region milk must be transported over 60 miles further than in the other two Regions.

### **The Inadequacy of the Current Differential Surface**

One of the purposes of the Class I differentials, as noted earlier in this testimony, is to provide incentives for an adequate milk supply. The incentive must be adequate enough to attract milk to the demand points in the market. This conclusion was also reached in the recent Southeastern Orders Decision as noted in the following discussion from the February 28, 2008 Tentative Partial Decision.

Opponents to DCMA's Class I price adjustments noted that there is an adequate supply of milk to meet fluid demands. There is an adequate national supply of milk to meet the national demands for fluid milk. However, in the deficit areas of the southeastern marketing areas, there must be sufficient incentives provided by the Orders to encourage the movement of milk from reserve areas to these deficit markets. In this regard, the

location value of milk needs to consider local milk supplies, local demand, and transportation costs.

73 Fed. Reg. 11207-11208 (February 28, 2008)

**In the deficit Southern Region of the Mideast Order, the relationship of the Class I differential to cost of transport has been eroded sufficiently that it does not provide an adequate incentive to move milk.**

**Nationwide, the differential surface has been modified only two times in the past 23 years, as a result of the 1985 Farm Bill and as a result of the 2000 Federal Order Reform Decision. The Reform Decision was based on data from the mid 1990's. In this market there have been significant changes in the market since the mid 1990's. Farm counts have declined, farm sizes increased and the growth in milk production has moved primarily to the northern counties of the market. City populations in the Southern Region have grown. From 1990 to 2007 according to the US Census Bureau, Indianapolis has increased population by a compound annual growth rate of 1.6% per year; Columbus has increased 1.3% per year and Cincinnati 0.9%.**

**The Federal Order Reform price surface resulted in a very flat price surface across Order 33. For example from southern Michigan to Cincinnati the current differential spread is only 40 cents. A reasonable representation of today's transport rate is \$3.23 per hundredweight per loaded mile. To travel the 229 miles between Lenawee County, Michigan, a county that regularly supplies fluid handlers with milk, and Cincinnati would cost \$739.67; using a 48,000 pound payload would result in a \$1.54 per hundredweight cost – far more than the current differential spread. The forty cents differential only represents 26% of the \$1.54 cost. Or doing the calculation a different way and using the same constants, 40 cents would move the 48,000 pound load only 59 miles – far short of the intended destination.**

***The Cooperatives* will offer two methods to document the extent to which the current differential is inadequate. The first will use data from the every day marketplace**

transactions of the Mideast Milk Marketing Agency (MEMA) used to manage milk transport. The second method will parallel the methodology from the recent Southeastern Order's Decision used to adopt the temporary adjustments to the Class I differentials in Orders 5, 6 and 7.

### **Mideast Milk Marketing Agency Experience**

*The Cooperatives* collectively market milk in the Mideast Order through the Mideast Milk Marketing Agency (MEMA). This Common Marketing Agency works to achieve as much efficiency as possible in the day to day marketing process. We share customer order information, milk availability, balancing capacity and use many logistical tools in our attempt to market efficiently. This process generates much market information and enables us to better manage milk assembly and transport systems.

There are several data factors which require additional explanation before I can outline our summary conclusions. Exhibit \_\_\_\_\_ Page 32 - 34 titled US on-Highway Fuel Prices Midwest Number 2 Diesel Energy Information Administration CY 2000 – date lists weekly diesel fuel costs as published by the Energy Information Agency. This data is used extensively by the dairy industry to measure changes in fuel costs. This table outlines the US national average and the Midwest average prices for diesel fuel. The PADD – Midwest includes the states of Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, South Dakota, Ohio, Oklahoma, Tennessee and Wisconsin and includes the main milk production and consumption areas of the Mideast Order. The prices are published by 5:00 P.M. Monday, each week for the prior week. The MEMA Agency uses this information regularly. This data is plotted in Exhibit \_\_\_\_\_ Page 35 titled US On-Highway Fuel Prices Midwest Number 2 Diesel - EIA - 2000 – Date.

I'd like to detail several data points that I will refer to later in this statement. From the chart, it is clear that fuel prices have increased markedly in the last several months. This

increase affects the cost of milk delivery markedly. Since milk is harvested daily this cost must be borne daily. We have selected the period May 12 – July 28, 2003 as a base point from which to measure change. In those months the fuel price was stable for several weeks ranging between \$1.3980 - \$1.4340 and averaged 1.413. As shown in the chart even this much consistency in price is not the normal experience. The MEMA Agency's program for compensating milk transport uses the EIA – Midwest numbers in its rate payment schedule. So far this year the diesel rate has averaged \$4.516, peaking at \$4.698 on July 14 and hit the low point of \$3.218 on January 28, 2008.

Since we are not diesel fuel price forecasters, we have chosen to use the 2008 calendar year average diesel prices in our calculations in an attempt to provide a measure that is not based on the absolute peak price. The Agency also uses a base transport rate of \$2.20 per loaded mile in its compensation calculations. This base rate was in effect in 2003 as shown in Exhibit \_\_\_\_\_ Page 1 - 31. The data represents 10 different transport companies and the months of May – July 2003. The MEMA document (rate sheets) is the template used to determine the hundredweight rate compensation for delivery to a specific plant for a specific hauler and route. The rate is used with the transport route data on a monthly basis. Approximately 120 different transport businesses receive these statements each month representing over 290,000,000 pounds of milk hauled per month. In each case the base rate paid to all haulers for transport services was \$2.20 per loaded mile for all transport in excess of 36 miles.

In its calculations the Agency uses a six mile per gallon rate. The Southeast Order differential Decision utilized a 5.5 mile per gallon rate thru testimony and evidence into the provisions for Orders 5 and 7. The six mile figure is more typical for this market. The payload we will use is 48,000 pounds which is typical for our area and also used in the Southeast hearings.

In order to measure the erosion of the differential value, we selected eleven counties (as noted earlier in this statement) representing the largest milk production areas from which

reserve milk supplies potentially could be sourced to meet Class I demand in the deficit Southern Region. We obtained mileages from the county seat of each reserve supply county to each of the ten Class I processing plants in the Southern Region and computed the cost per hundredweight to transport milk from each reserve point to each plant.

Exhibit \_\_\_\_\_ Pages 36 outline the 11 counties and 10 plant locations. This page also calculates the net dollars available to offset the transport cost from the difference in the differential at the ship from and ship to locations. For example if a load were to move from Clinton County, Michigan to Eastside Dairy in Anderson Indiana, the Order differential would provide 20 cents to offset the transport cost. This difference is calculated for each pair of destination / supply points in our example. Exhibit \_\_\_\_\_ Page 37 lists the mileages between each pair of locations. There is a mileage point for each combination. So in the example above it is 235 miles from the county center in Clinton County Michigan to Eastside Dairy in Anderson.

Exhibit \_\_\_\_\_ Page 38 computes the transport cost from point to point. Each month the MEMA Agency computes a fuel surcharge to be applied to the base rate for transport payments. For July, the most recent month the surcharge was 58% - reflecting the sharp increase in diesel prices. Again in order to be conservative we have chosen to use the 2008 year to date average surcharge of 47% in order be more representative of fuel costs. Using \$2.20 and a 47% fuel surcharge yields a \$3.23 transport rate per mile. This rate multiplied by the mileages and divided by the 480 hundredweight payload yields the per hundredweight of \$1.59 for the 235 miles between Clinton County, Michigan and Eastside Dairy in Anderson, Indiana.

Exhibit \_\_\_\_\_ Page 39 nets the haul costs with the differences in differential to yield the remaining transport cost not covered by the differential and thus a measure of the erosion of the differential. Each individual combination is computed for review. In a perfect world this worksheet would be populated by zeros. For the entire group, the average differential

shortfall is \$1.76 per hundredweight. If one chooses the minimum shortfall for each supply /demand combination, that average is \$0.66 per hundredweight. For those plants in the \$2.00 zone the average of the minimum shortfall is 57 cents and in the \$2.20 zone 80 cents. Note that the Charleston plant is somewhat of an outlier within the current \$2.20 zone with a \$1.17 minimum shortfall. If the standard is, "there must be sufficient incentives provided by the Orders to encourage the movement of milk from reserve areas to these deficit markets." (73 Fed. Reg. 11207-11208 (February 29, 2008)) then the current differential structure in the Southern Region is inadequate.

### **Southeastern Model**

A methodology was developed and presented at the recent Southeast Order hearing in which all differentials for the Southeastern Orders were temporarily increased. That methodology was substantiated in the Decision which reads:

**"The basic foundation for deriving the temporary adjustments to Class I prices begins with DCMA's identification of *potential* supply areas and reliance on that *potential* supply area to yield the lowest Class I price adjustment based on the farthest point of milk demand."  
(73 Fed. Reg. 11205 (February 29, 2008))**

We will follow this method to again demonstrate that the current differential surface has eroded to the point where adjustment is needed and justified and to support the level of adjustment proposed. Exhibit \_\_\_\_\_ Page 41 outlines the components necessary to establish the methodology. The calculation process described next replicates that provided for in Federal Orders 5 and 7 now which was based on testimony presented in the Hearing that created those fuel adjusters. (The methodology is set out in 7 C.F.R. Sections 1005.83 (Order 5) and 1007.83(Order 7).) The end result of this procedure is to compute a current fuel adjusted transportation rate per hundredweight per mile in order to establish what the relationship should be between a supply point and a demand point based on transport cost.



The procedure utilizes a diesel fuel rate from the EIA data previously mentioned. For our purposes we will use the average rate for calendar 2008 - \$4.052 per gallon. As noted earlier we chose a May – July period for establishing a base period and during that period the base fuel was \$1.413 per gallon. Subtraction yields an increase of \$2.639 and dividing by 6 miles per gallon yields an adjustor of \$0.44 cents which adds to the base haul rate of \$2.20 per mile to result in a fuel adjusted rate of \$2.64. Using a 48,000 pound tank size and dividing the \$2.64 by 480 hundredweights results in a rate per hundredweight per mile of \$0.00550. For reference purposes the current (August 2008) rate in Order 5 and 7 is \$0.00521. This rate will be used in the comparison of alternative supplies for several of the Order 33 Southern Region markets.

Exhibit \_\_\_\_\_ Page 40 is the exact template used in the Southeastern Differential Hearing to determine what an adjustment to the differential in Miami, Florida might be and procedurally was used multiple times in that hearing record. (This table can be located at <http://www.ams.usda.gov/AMSV1.0/getfile?dDocName=STELPRDC5060147> PAGE F in the testimony of Jeffery Sims.) This process compares the transport cost of potential alternative supplies for a selected demand point and then bases a proposed differential from the least cost supply alternative. For example, that record identified five potential alternative supply points surrounding the Southeast that could possibly be used to supply the Miami market developed in the same manner as we have described for Order 33. The distances between the supply points and the demand point were multiplied by the mileage rate (computed in a procedure as described above) and reduced by 20% in keeping with the concept of Order prices as a minimum amount. The adjusted haul rate was then added with the current differential for the supply point to form what was termed an acquisition cost. The differences between the acquisition cost and the actual differential were used to suggest what the temporary adjustment to the existing differential might be.

We repeated this methodology for six plants in the Southern Region of Order 33. The six plant locations chosen Indianapolis, Marietta, Newark, Cincinnati and Springfield, Ohio and Charleston, West Virginia are representative of the geographic spread of plants within the

**Southern Region. We picked six potential supply points from our eleven previously identified counties that serve as the reserve supply for the Order. As with the demand points these six supply points represent a reasonable geographic spread for supply points in the Order.**

**For Indianapolis, Elkhart County, Indiana was the least cost alternative at \$2.55 per hundredweight. When compared to the current differential of \$2.00 a suggested temporary adjustment could be \$0.55 per hundredweight.**

**For Marietta, Ohio, Wayne County, Ohio was the least cost alternative at \$2.52 per hundredweight. When compared to the current differential of \$2.00 a suggested temporary adjustment could be \$0.52 per hundredweight.**

**For Newark, Ohio, Wayne County, Ohio was the least cost alternative at \$2.29 per hundredweight. When compared to the current differential of \$2.00 a suggested temporary adjustment could be \$0.29 per hundredweight.**

**For Springfield, Ohio, Mercer County, Ohio was the least cost alternative at \$2.40 per hundredweight. When compared to the current differential of \$2.00 a suggested temporary adjustment could be \$0.40 per hundredweight.**

**For Cincinnati, Ohio Mercer County, Ohio was the least cost alternative at \$2.54 per hundredweight. When compared to the current differential of \$2.20 a suggested temporary adjustment could be \$0.34 per hundredweight.**

**For Charleston, West Virginia, Wayne County, Ohio was the least cost alternative at \$2.89 per hundredweight. When compared to the current differential of \$2.20 a suggested temporary adjustment could be \$0.69 per hundredweight.**

**Exhibit \_\_\_\_\_ Page 48 lists a summary comparison of the two alternatives evaluated and the proposed differential structure. In the representative examples the proposed alternatives all are significantly less than either of the two alternative measures.**

**Exhibit \_\_\_\_\_ Page 49 and Page 50 are maps of the current differential surface and the proposed surface. In the case of the plants in the former \$2.00 zone, all will be in the newly proposed \$2.15 zone thus maintaining as much as possible the existing competitive relationship between the plants. Similarly, in the former \$2.20 zone all the plants except United Dairy in Charleston, West Virginia will be in the proposed \$2.40 zone. As noted in our calculations, the plant in Charleston showed justification for a greater adjustment than any other plant in the Southern Region, likely because it is more distant from the potential reserve supplies. The comparison of alternatives suggested an adjustment of between \$0.69 and \$1.17 per hundredweight could be made. So our proposal of an increase of 40 cents seems reasonable. Additionally, when price alignment is considered with Federal Order 5 to the south, the suggested temporary adjusted differential of \$2.60 aligns well with the effective differential of the nearest three competitors, Dean Foods at Louisville Kentucky with an effective differential of \$2.45; Winchester Farms Dairy, Winchester, Kentucky with an effective differential of \$2.75; and Flav-O-Rich Inc., London, Kentucky's effective differential of \$3.05. In this comparison, the term effective differential indicates the combination of the Order 5 announced Class I differential plus the 15 cents per hundredweight Transportation Credit Balancing Fund (TCBF) assessment. While the TCBF assessment may be waived if the fund balance is deemed overfunded, that has rarely happened. Thus, the use of an effective differential, as noted here, is a valid comparison.**

### **Impact of Proposal on Packaged Milk Distribution**

**We measured the impact the proposed changes would have on the competitive relationships between handlers in the Southern Region. Certainly with changes in the differential price surface there will inevitably be changes in competitive relationships between handlers. But**

we did not find any case where the changes in class price relationships resulting from the newly proposed differentials exceeded the cost of moving packaged milk between those same two plants.

In the Reform process, the Cornell models calculated costs for packaged distribution. The Cornell publication, *Pratt, James E., Phillip M Bishop, Eric M. Erba, Andrew M. Novakovic, and Mark W. Stephenson, "A Description of the Methods and Data Employed in the U.S. Dairy Sector Simulator, Version 97.3", Cornell Program on Dairy Markets and Policy, R.b. 97-09. Page 68.* referenced and used in the Reform Decision describes both the model and the process. The actual packaged goods distribution rate per hundredweight is calculated according to the following equation:

$$\text{Fluid Distribution Cost}(i,j) = \frac{80000}{(40000 + 0.5 * \text{GWV}(i,j))} * ((0.0311 * (\text{Distance}(i,j))^{0.73}) * (0.52 + 0.48 * \text{WageRate}(i)));$$

This equation uses gross vehicle weight, distance between the source plant and distribution point, and a wage rate unique to the source plant. In order to compute the fluid distribution cost, we need to provide the distance between the two plants and the prevailing wage rate. Distances were extracted from the internet program Mapquest. Cornell has updated the distance factor and also the wage rate and has made them available to the industry as represented in the above equation.

For example, using Marietta, OH as a source point and Charleston, West Virginia as a distribution point, the distance between the two locations is 90 miles and the wage rate constant is 0.86. Using these constants in the equation, the distribution cost between the two points is \$0.77 per hundredweight. The proposed Marietta differential is \$2.15. Adding \$2.15 to the \$0.77 results in a \$2.92 total cost of acquisition and packaged distribution. This cost should then be compared to the \$2.60 proposed differential at Charleston showing that the proposed differential would not result in an incentive for uneconomic movements of milk.

Using the equation and the corresponding mileage and wage rates for seven pairs of processing points and distributing locations resulted as follows:

From Processing Point	Proposed Differential	Distribution Cost	Total	Destination Point	Proposed Differential	Spread
Springfield OH	\$ 2.15	\$ 0.76	\$2.91	Cincinnati OH	\$ 2.40	\$ 0.51
Newark OH	\$ 2.15	\$ 1.17	\$3.32	Cincinnati OH	\$ 2.40	\$ 0.92
Marietta OH	\$ 2.15	\$ 0.77	\$2.92	Charleston WV	\$ 2.60	\$ 0.32
Huntington IN	\$ 1.80	\$ 0.97	\$2.77	Indianapolis IN	\$ 2.15	\$ 0.62
Rochester IN	\$ 1.80	\$ 0.90	\$2.70	Indianapolis IN	\$ 2.15	\$ 0.55
Canton OH	\$ 2.00	\$ 0.90	\$2.90	Newark OH	\$ 2.15	\$ 0.75
Canton OH	\$ 2.00	\$ 0.90	\$2.90	Springfield OH	\$ 2.15	\$ 0.75
Martins Ferry OH	\$ 2.10	\$ 0.90	\$3.00	Cincinnati OH	\$ 2.40	\$ 0.60

In each of these comparisons, the "spread" remaining after comparing the total acquisition and distribution costs are less than the resulting differential costs in the destination point.

### Language of Proposal

As noted in the Hearing Notice, *The Cooperatives* proposal would temporarily adjust the Class I price surface for the southern counties within the geographical marketing area of

the Mideast milk marketing order. The current Order language provides for an individual differential for each county in the marketing area of the Order as detailed in section 1000.52. The table as set out in the Notice would provide an adjustment to 111 of the counties in the Order. The adjustments would range from an increase of \$0.15 to \$0.40 per hundredweight.

## **Summary**

We have demonstrated that the Southern Region of Federal Order 33 operates in a deficit situation with respect to supply and demand for milk. One of the purposes of the differential structure is to attract milk to a market where needed. In this portion of Order 33 the effectiveness of the differential has been eroded by increases in the cost of transport. Since the differential surface has not been modified in eight years and the underlying data for those modifications were representative of market conditions in the mid to late 1990's it is reasonable for producer to ask the Secretary of Agriculture to examine them now.

Twice since the Reform decision the Secretary has adopted proposals that have tightened performance standards in this Order. Many of those proposals were offered and supported by some of the proponents (and some of the opponents) here today. Data presented in the record indicate that those proposals have been effective in improving performance in the Order. However, the issues as outlined by The Cooperatives here are a problem and it is now time to look at the price surface as a part of the solution.

The proposal is targeted to a specific area of the Order marketing area that has been shown to be deficit year round. We have documented using two approaches the magnitude of the problem and using those methods a reasonable alternative price solution. Our temporary adjustments could be modified with future hearings once more data is available.

Thank you for the opportunity to present our proposal. We will be glad to answer any questions you may have at this time.