BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE AGRICULTURAL MARKETING SERVICE

In the Matter of	:	
	:	**Docket Nos.:**
Milk In The Western	:	**AO-380-A18;**
	:	**DA-01-08**
Marketing Area	:	

Statement Regarding Proposal 8

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Salt Lake City, Utah

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Statement of Dairy Farmers of America

Proposal 8

In addition to our concerns about the level of the blend price we are also concerned about the costs associated with supplying the Class I market. The Class I market is where the additional revenues are generated that the Orders are designed to equalize between producers. Orders are structured with pricing surfaces and provisions designed to allow producers to share equitably in the returns from the market. Everyone gets the same blend price (adjusted for location) regardless of buyer. Our concern in this area is that it costs more to service the Class I market and while all producers share equally in the returns of the market, not all share in the service costs.

Areas of additional cost include transporting milk to the distributing plant locations from the production areas. The distributing plants are located in the population centers and away from the largest supplies of milk. The manufacturing plants are located in the production pockets. The location of the distributing plants and the location of the milksheds were discussed in earlier testimonies and do not need to be reviewed here.

Secondly there are costs associated with meeting the varying demand for milk from the fluid market. Fluid processors, reflecting consumer-buying habits, do not have a weekly order pattern that matches. Procuring extra milk and processing the milk that is not needed during certain parts of the week have costs. Also all market participants do not share the costs of maintaining a quality milk supply necessary to meet the demands of the Class I market equally.

We have a concern that while the costs of serving the market are not fully shared by all parties there is an equal concern that the proposals we are making be reasonable and reflective of the costs they are designed to offset. While we do not want DFA members to bear a disproportionate share of the costs of serving the Class I market, we do not want to set up a reimbursement structure that causes market participants to make decisions to get the credit that would be counter to sound economic principles.

Specifics of the Transport Cost Credit

Our proposal embodies the following principles:

1) The transport credit should apply to Class I pounds only.

2) The credit should only apply to milk produced within the marketing area and processed in the area. There is no need to bring supplemental

milk supplies into Order 135 so no need for the credit to apply to out of area sources.

3) In order to strive for the most economic efficiency, the credit should apply to milk picked up from the farm only. Most of the milk movements in Order 135 reflect this mode now. We do not see a need to apply the credit to supply plant milk as that mode has additional costs associated with it.

4) The credit calculation should recognize that a producer has a responsibility for a portion of the haul.

5) The credit calculation should recognize a typical transport volume for the market and typical cost per mile of transport operation. Because this rate is sensitive to gas prices and would have the propensity to be volatile we think the rate established should be on the low side of market experience.

6) The credit should recognize the location values already in the Order's price surface and thus reduce the total value of the calculation.

7) The credit should not apply if milk moves from a higher priced zone to a lower priced zone. This will require a modification to our original language as proposed and we will submit that language later in our testimony. However, we cannot find any rationale that would support moving milk out of the $1.90 "zone" into a distributing plant in the $1.60 "zone" so we would propose that that movement not receive a credit from the pool.

Components of and Calculation of the Credit

Our experience hauling milk in the marketing area is that a rate per milk of over $2.00 is not unrealistic. Long distances and terrain make transport costs high. We use a higher figure to price and cost our internal transport operation. In order to remain conservative, we propose a $1.90 rate per mile for use in the credit computation.

In this market a 63,000-pound payload for transportation milk intra Utah, intra Idaho and between the two states is typical. Because this represents efficiency we support using that volume in the credit computation.

We propose using an 80 mile distance to represent the portion of the haul to be borne by the producer. Exhibit _____ Table 1 **Analysis of Local Mileages - 2001** details how we arrived at this figure. The rate of $1.90 and the 63,000-pound tank volume were used as constants. The remaining data were taken from the Market Administrator study (Exhibit _____) on hauling rates in the market.

The formula for rate per hundredweight is outlined in the exhibit as: rate per hundredweight = (rate per mile * number of miles) / number of hundredweights. Our method involves rearranging the constants to solve for the number of miles. In order to derive aggregate data for northwest Utah and southwestern Idaho for further comparison a weighted average rate was computed using data provided by the MA study.

The weighted average rate was determined using the counties in the geographic area with the largest milk production volumes. By using the formulas and the constants a mileage figure for NW Utah was determined to be 123 miles, for SW Idaho 78 miles and for the weighted average of the area 90 miles. Because most of the reserve supply will be from Idaho, we chose 80 miles to represent the obligation of the producer haul to the credit computation.

Exhibit _____ Table 2 works thru the actual rate calculation. This calculation continues use of the 63,000 pound haul load and a per mile rate of $1.90. We also assume that a pool distributing plant has 90% Class I use. Using the example of Jerome to Salt Lake City, the miles (Rand Mc Nally Tripmaker) between the two are 224. Subtracting the 80 miles of producer responsibility leaves 144 miles available to submit for credit. The rate per hundredweight of $0.00302 X 144 miles yields a $0.434 rate per hundredweight. The load, delivering to a 90% Class I distributing plant would earn the credit on 567 hundredweights for a total credit of $246.24.

Since this transport moves from the $1.60 "zone" into the $1.90 zone the difference between the two is deducted from the credit total. This amounts to 30 cents per hundredweight or a total of $170.10. The net amount of the credit would be $76.14. The "zone" difference and the credit offset 58% of the total cost and the credit alone 18%.

The workings of the credit, for example purposes, are displayed for several likely delivery locations into Salt Lake City and for Jerome into Boise. As shown in the computation, delivery from the Smithfield (NE Utah) area would not qualify for the credit.

Exhibit _____ Table 3 outlines an estimate of the cost to the pool of the transportation credit under three possible scenarios. The data to compute the scenarios came from actual DFA experience per month for CY 2001. We recapped all transport haul by

month. The row labeled "eligible" recaps all of the combinations that originated from within the marketing area and delivered over 80 miles. The row labeled "all possible" recaps the total universe of loads that would include loads originating outside the marketing area or from 80 or fewer miles away.

The row "as proposed to actual destination" calculates the credit cost as it actually occurred based on our assumptions. For January the calculation would make a payment of $8,601. The row labeled "all eligible loads form Jerome to SLC" computes the costs as if all of the eligible loads originated from the Jerome milkshed and delivered to Salt Lake City. As this area is the likely reserve supply for the market place this computation is worth making. For January if all of the eligible transport loads had originated from Jerome the cost of the credit would total $10,460.

Finally, the row labeled "all possible loads to Salt Lake City" makes the computation if every load that was transported originated from the Jerome area. That cost totaled $13,219.

The remainder of the exhibit computes the cost to the pool as a whole for the transport credit under the three scenarios. The methodology while simplified is an accurate representation. It uses the statistical blend X the pounds in the pool to arrive at a total value for the pool. From that total the cost of the credit is deducted and the remaining dollars divided by the total pounds of producer milk pooled. In no month under any of the three scenarios does the credit result in a cost to the pool of a cent per hundredweight.

From a logistical standpoint the handler desiring to claim the credit must present documentation to the MA at pool time. That documentation should include the "last stop" on the route and the closest city to that stop, the volume of milk on the load, the miles from the city to the distributing plant, the date and the name of the plant delivered to. This data should allow for the credit to be computed, the pool calculated and the appropriate payments made within the time needed. If the route is composed of more than one farm stop the stop that results in the least cost to the pool must be used.

Our proposal specifies that payment may be made to the milk supplier if he is not the pooling handler.

The language to effect our proposal would be as follows:

Proposal No. 8

§ 1135.30 Reports of receipts and utilization.

* * * * *

(a) * * *

(5) Receipts of producer milk described in § 1135.55 (d), including the identity of the individual producers whose milk is eligible for the transportation credit pursuant to that paragraph and the date that such milk was received;

* * * * *

(c) * * *

(3) With respect to milk for which a cooperative association is requesting a transportation credit pursuant to § 1135.55, all of the information required in paragraph (a)(5) of this section.

Notes: The added sections are needed to make clear that the reporting handler has the obligation to make the information know to the Market Administrator.

§ 1135.32 Other Reports.

(a) In addition to the reports required pursuant to §§ 1135.30 and 1135.31, each handler shall report any information the market administrator deems necessary to verify or establish each handler's obligation under the order.

(b) On or before the 21st day after the end of each month, each handler described in § 1000.9(a) and (c) shall report to the market administrator any adjustments to transportation credit requests as reported pursuant to § 1135.30(a)(5).

Notes:

1) This language makes clear the Market Administrator's ability to collect the information necessary to administer the credit.

2) It also makes clear the dates before which the handler applying for a credit must make any requests for adjustments.

§ 1135.55 Transportation credits and assembly credits.

(a) Payments for the transportation of and assembly of milk supplies for pool distributing plants to cooperative associations and handlers that request them shall be made as follows:

(1) On or before the 14th day (except as provided in § 1000.90) after the end of each month, the market administrator shall pay to each handler that received and reported pursuant to § 1135.30(a)(5) milk directly from producers' farms, a preliminary amount determined pursuant to paragraph (b) and/or (c) of this section;

(2) The market administrator shall accept adjusted requests for transportation credits on or before the 21st day of the month following the month for which such credits were requested pursuant to § 1135.32(a). After such date, the market administrator will conduct a preliminary audit. Handlers will be promptly notified of an overpayment of credits based upon this final computation and remedial payments will be made on or before the next payment date for the following month;

(3) Transportation credits paid pursuant to paragraph (a)(1) and (2) of this section shall be subject to final verification by the market administrator pursuant to § 1000.77. Adjusted payments will remain subject to the final computation established pursuant to paragraph (a)(2) of this section; and

(4) In the event that a qualified cooperative association is the responsible party for whose account such milk is received and written documentation of this fact is provided to the market administrator pursuant to § 1135.30(c)(3) prior to the date payment is due, the transportation credits for such milk computed pursuant to this section shall be made to such cooperative association rather than to the operator of the pool plant at which the milk was received.

Notes:

1) Section (a) provides for the dates that payments should be made to handlers seeking the transportation credit and the final dates for which adjustments can be requested.

2) It also makes clear that a payment can be made directly to the supplying qualified cooperative with adequate documentation.

(b) Each handler operating a pool distributing plant described in § 1135.7(a) or (b) that receives bulk milk directly from farms of producers described in § 1135.12 that are located within the marketing area, shall receive a transportation credit for such milk computed as follows:

(1) Determine the hundredweight of milk eligible for the credit by completing the steps in paragraph (d) of this section;

(2) Multiply the hundredweight of milk eligible for the credit by **.302** cents times the number of miles between the receiving plant and the farm less 80 miles;

(3) Subtract from the effective Class I price at the receiving plant the effective Class I price of the county that the farm is located in;

(4) Multiply any positive amount resulting from the subtraction in paragraph (b)(3) of this section by the hundredweight of milk eligible for the credit; and

(5) Subtract the amount computed in paragraph (b)(4) of this section from the amount computed in paragraph (b)(2) of this section. If the amount computed in paragraph (b)(4) of this section exceeds the amount computed in paragraph (b)(2) of this section, the transportation credit shall be zero.

Note: Section (b) describes the calculation of the credit as follows:

1) The credit is only allowed on bulk milk received directly from farms that are located within the marketing area.

2) Paragraph (d) determines the allocation sequence that arrives at the pounds of Class I Usage that the credit is paid on.

3) The hundredweight credit rate is $0.302 cents (in Exhibit _____ Table 2 this is represented by the row credit rate per milk of 0.00302). This represents a modification of our original proposal.

4) The first 80 miles is deducted from the total miles.

5) An adjustment is made for the positive difference between the Class I differentials in the originating county and the receiving plant. In the Western Order under the current price surface this would always represent $1.90 less $1.60.

6) The credit is always either a positive number of zero.

(c)

[Section (c) describes the assembly credit. We will deal with it later in this statement.]

(d) The following procedure shall be used to determine the amount of milk eligible for transportation and assembly credits pursuant to paragraphs (b) and (c) of this section:

(1) At each pool distributing plant, determine the aggregate quantity of Class I milk, excluding beginning inventory of packaged fluid milk products;

(2) Subtract the quantity of packaged fluid milk products received at the pool distributing plant from other pool plants and from nonpool plants if such receipts are assigned to Class I;

(3) Subtract the quantity of bulk milk shipped from the pool distributing plant to other plants to the extent that such milk is classified as Class I milk;

(4) Subtract the quantity of bulk other source milk received at the pool distributing plant that is assigned to Class I pursuant to § 1000.43(d) and 1000.44; and

(5) Assign the remaining quantity pro rata to bulk physical receipts during the month from:

(i) Producers;

(ii) Handlers described in § 1000.9(c);

(iii) Handlers described in § 1135.11; and

(iv)Other pool plants.

Note: Section (d) details the allocation procedure used to determine the pounds of Class I milk that would be eligible for the credit at each plant.

(e) For purposes of this section, the distances to be computed shall be determined by the market administrator using the shortest available state and/or Federal highway mileage. Mileage determinations are subject to redetermination at all times. In the event a handler requests a redetermination of the mileage pertaining to any plant, the market administrator shall notify the handler of such redetermination within 30 days after the receipt of such request. Any financial obligations resulting from a change in mileage shall not be retroactive for any periods prior to the redetermination by the market administrator.

Note: Section (e) details what procedure the Market Administrator is to use to establish the mileages between two points in the credit computation. Furthermore the mileages may be redetermined from time to time as conditions warrant. Any change in mileages may not be retroactively to any period prior to when the redetermination was made.

(f) In the case of a direct ship farm load the distance shall be measured from the farm on the route that results in the fewest miles. It shall be the responsibility of the reporting handler to designate such farm and for the purpose of computing mileages, the city closest to that farm.

Note: Section (f) clarifies how to deal with deliveries from routes composed of multiple farms. The opportunity for abuse is minimized by the application of this section by making clear that no matter how the route was assembled or alleged to be assembled the credit computation must be based on the farm that results in the lowest possible mileage being applied for.

(g) No credit shall be given on any load in which the effective Class I price at the origination point is greater than the effective Class I price at the receiving location.

Note: Section (g) is designed to prevent any credit from being paid on loads of milk that originate in higher prices locations than the delivery point. In the case of the Western Order and the existing price surface, no credit would be paid if the load originated in the $1.90 zone and delivered to the $1.60 zone. We can find no rationale to support this type of delivery with a credit.

The Assembly Credit Proposal

Areas of additional cost that are separate from the transportation function include the cost of balancing the level of milk production with the demand of the

fluid use market, maintaining a quality milk supply that meets the demands of the fluid use market, costs associated with reloading tankers, washing them and dispatching them and the overhead associated with tracking these functions.

An additional cost of balancing the fluid market is the reduction in income caused by diverting milk away from fluid plants, which are mostly in higher order price locations to manufacturing plants in the lower priced zones. This cost is difficult to quantify. For the purposes of this hearing we have chosen to leave it out of any calculation.

Exhibit _____ Chart 1 details our experience in serving the Class I Salt Lake City market over the entire year. It shows that each month has a different level of demand. The computations are on a daily average basis to adjust for the different number of days in the month. This data represents the major Salt Lake City Class I bottlers but not the total market. The peak month of October had a 9% swing on a daily average basis over the low month of July. The fluctuation in volume between the two months amounted to a 7.4 million pound swing in demand. The market must have the capability to handle these fluctuations each month efficiently in order to best enhance producer income.

Exhibit _____ Chart 2 outlines a similar comparison for the month of February, the most recent month we had data available. It shows a similar variation inside each week with demand peaking on Thursday and falling noticeably on the weekend. Again capacity to handle these fluctuations must be available in the market.

DFA's balancing capacity is done primarily through its' plants in Smithfield Utah and Beaver Utah.

The DFA Smithfield plant is in northeast Utah in Cache County. It is a cheese plant with an average daily capacity of 1.2 – 1.8 million pounds of milk per day. The plant manufactures cheddar and swiss cheese. Whey is processed on site. It is also a primary reserve and balancing point for the market.

Chart 3 labeled **Smithfied – Average Daily Milk Volume and Processing Costs** shows the average daily volume by month for calendar 2001 plotted against the average processing costs per hundred pounds of milk for the DFA - Smithfield Utah plant. Volume thru-put is noticeably lower in the fall months. May is the peak month for volume averaging 1,269,379 pounds and December the low point at 795,951 or a 37% change from peak to base. The average daily thru-put is 1,041,875 pounds per day.

Costs peaked out in November at a little over $3.00 per hundredweight of milk and hit a low point in April or May at slightly over $2.00 per hundredweight. Costs are reflective of direct manufacturing costs only and reflect all cheese and whey product lines in the plant.

Chart 4 labeled Beaver – **Average Daily Milk Volumes and Processing Costs** depicts the same type of data for DFA's Beaver Utah plant. The plant is located in Southwest Utah. It manufactures several varieties of cheese, processes condensed milk products and sells cream. The plant was built in the 1950's. Its' processing capacity is about 500,000 pounds per day. Whey is sold and not further processed at the plant.

In CY 2001 average daily milk volume in the plant peaked in September at just under 300,000 pounds per day. Average thru-put was 231,048 pounds per day. The low point for plant thru put was January at just below 200,000 pounds per day. Direct manufacturing costs ranged from a low of about $1.75 per hundredweight of milk in July to a high of just under $3.00 in January. Again these costs reflect direct manufacturing costs only and for all product lines in the plant.

In order to assess a cost to the balancing function we have chosen to use the make allowance per hundred pounds of milk in the Class III formula rather than our own experience. It has been developed after an extensive hearing and is in use currently in the Federal Order system. Each of its components have been scrutinized by many of the parties in the room and all are somewhat familiar with its' workings. Use of this cost factor eliminates any discussion of what costs are in our proposal and how they were derived.

Exhibit _____ Table 4 describes how to convert the formula into a make cost per hundred pounds of milk. Since cheese making produces three revenue streams each of the individual equations are summed to produce a composite make allowance. In each case the concept is the same: (Market price less a make allowance) times a yield. If the market prices are set to zero, the resulting equations solve for a make allowance.

Performing this arithmetic yields a make allowance of $2.47 per hundred pounds of milk and each step is exhibited in the table.

Exhibit _____ Tables 5 and 6 utilize this make allowance and the actual through put in each plant to arrive at a cost on unused capacity. The capacity is unused due to the plant's function in balancing the market.

In Smithfield's case the difference between average daily throughput and the high month daily average is 227,504 pounds per day or a 22% swing in plant utilization. Put another way, in order to have enough capacity to balance when the most capacity is needed requires 22% more capacity than at the average. When unused, this 22% of capacity was not able to earn a return and yet still incurred cost. Pegging the cost at $2.47 per hundredweight of milk the 22% capacity that was available but unused cost $0.54 per hundredweight or $5,619.36 per day. Extended out to a year and apportioned across all milk in the pool would cost $0.044 per hundredweight or $0.199 on Class I volume alone.

The same type of calculation applied to the Beaver volume results in a $0.012 per hundredweight cost on all milk or $0.053 on Class I.

Because balancing milk supplies has a weekly and seasonal component the balancing plant operator cannot always scale his fixed and variable costs exactly to theory. For example, in a manufacturing plant, some portion of labor is a variable cost; but workers cannot be laid off on Thursday only to be hired back on Saturday. Also holidays, seasonal fluctuation in milk supply and changing retail promotions play a role in the need for balancing capacity.

The other component of Assembly costs that we can measure reasonably are the costs associated with procuring and maintaining a milk supply and tailoring that supply to the market needs. In order to accomplish this a laboratory, field service staff, facilities to operate tank fleets and the costs associated with the facilities themselves (not the transport function) and the overhead associated with these functions.

Exhibit _____ Table 7 outlines these costs for the DFA milk supply in the Western Order. Costs include the salaries and employee costs of a field force, their travel, training and day to day operating expenses. Laboratory costs include employees, equipment, buildings, supplies and communications. Milk receiving include the cost of employees, buildings, washing equipment, testing facilities in the facility and travel and day to day expenses. Accounting and G/A represent only those direct costs of supporting the above services, paying producers, the buildings and facilities needed to do so and the complying with Federal Order regulations. They do not include any expenses for membership meetings, governance or corporate costs. Furthermore all costs are directly associated to the Western Order are of DFA's Mountain Council only. Those costs totaled $2.5 million for CY 2001. Applied only against the 22% Class I market results in a pro rated cost of $555,795. Spread out on the entire pool this represents $0.012 per cwt and $0.054 per cwt on Class I pounds.

Taken as a whole these costs sum to 30.6 cents per hundredweight on all Class I milk in the pool or 6.76 cents on all milk.

The language to support our proposal would provide in §1135.55:

(c) Each handler operating a pool distributing plant described in § 1135.7(a) or (b) that receives milk from dairy farmers, each handler that transfers or diverts bulk milk from a pool plant to a pool distributing plant, and each handler described in § 1000.9(c) that delivers producer milk to a pool distributing plant shall receive an assembly credit on the portion of such milk eligible for the credit pursuant to paragraph (d) of this section. The credit shall be computed by multiplying the hundredweight of milk eligible for the credit by **10** cents.

Note:

1) The credit would only apply on deliveries to Class I use.

2) The credit would be paid to anyone making the delivery.

3) In order to make sure that the credit reflects only a portion of the costs we have reduced the credit from our calculation of 31.4 cents to 10 cents. This is a modification of the original proposal. At this rate the cost of the credit to all milk would be 2.2 cents per cwt.

4) The reduction represents approximately 1/3 of the estimated total costs that we have outlined in the assembly and balancing function. This reduction acknowledges that the distinction between fixed and variable costs in the balancing plant equation are difficult to disaggregate. The conservative nature of our proposal should not "over" compensate for costs.