UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

Re: Milk in the Mideast Marketing Area 76 Fed. Reg. 55608 (Sept. 8, 2011)	Docket No. AO–11–0333; AMS–DA–11–0067 DA–11–04

POST-HEARING BRIEF: PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW AND ARGUMENT SUBMITTED ON BEHALF OF SUPERIOR, DAIRY, INC.

By its Attorneys:

James D. Wilson
James D. Wilson LLC
29225 Chagrin Boulevard, Suite 350
Cleveland, Ohio 44122
(216) 342-4138
jwilson@wilsonlawyers.com

John H. Vetne
311 George Cole Rd.
P.O. Box 15
New Portland, Maine 04961
(207) 628-2005
johnvetne@gmail.com

Cowden & Humphrey Co., LPA
Terrence C. Steel
4600 Euclid Avenue, Suite 400
Cleveland, Ohio 44103
(216) 241-2880; Fax (216) 241-2881
tsteel@cowdenlaw.com

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Superior Dairy, an Ohio milk processor, developed unique and innovative production, packaging, and distribution technologies that permit a cost-effective means for the plant to market conventional pasteurized fluid milk products to customers at distant locations in seven federal milk marketing areas, from the Northeast to Florida, and from Appalachia to the Central Market. Expanded distribution from these production and marketing innovations caused Superior Dairy's Canton plant to lose pool plant status under the Mideast Order, and to become regulated by the Northeast Order in April 2010. In order to avoid the burdens and cost disadvantages of regulation under Order 1, Superior reduced sales from its Canton plant to the Northeast and thereby became partially regulated in March 2011. These events led Mideast cooperative associations to petition USDA for a hearing to cause Superior Dairy's plant to rejoin the fold of fully-regulated plants in the Mideast Market even though its distribution within the Mideast Marketing Area (and in all other markets) falls below the current 25% distribution standard for full regulation.

In this post-hearing brief, Superior Dairy joins with cooperative proponents in recommending a modified amendment to the Mideast Milk Marketing Order that would lock-in the Superior Dairy distributing plants as pool plants in Order 33 notwithstanding failure to meet the 25% distribution standard in the Mideast and notwithstanding the possibility that the plant(s) may qualify under pool plant standards in other milk marketing areas. In view of this remedial approach in harmony with cooperative proponents, it is unnecessary for Superior Dairy to

further explain (beyond the content of testimony and exhibits offered by Emil Soehnlen) why the cooperative proposal as published in the Notice of Hearing is unsupportable as a matter of fact, law and regulatory policy.[1]

A. The Appropriate Regulatory Remedy is a Lock-In for Superior Dairy.

The Mideast Milk Marketing Order should be amended, in Section 7(a), to provide a pool plant lock-in for Superior Dairy as follows (new language in italics):

> §1033.7 Pool plant
> * * * * *
> (a) A distributing plant other than a plant qualified as a pool plant pursuant to paragraph [b) of this section or § ___ .7[b) of any other Federal milk order from which during the month 30 percent or more of the total quantity of fluid milk products physically received at the plant (excluding concentrated milk received from another plant by agreement for other than Class I use) are disposed of as route disposition or are transferred in the form of packaged fluid milk products to other distributing plants. At least 25 percent of such route disposition and transfers must be to outlets in the marketing area. *Any plant located within the marketing area with combined route disposition and transfers of at least 50% into Federal Order marketing areas will be regulated as a distributing plant in this Order.*

The proposed amendment differs from the proposal in the Notice of Hearing in that it would lock-in the Superior plant as an Order 33 pool plant even if the plant otherwise qualifies as a pool plant in another order. The purpose of this amendment is to regulate Superior Dairy as a locked-in distributing plant in Order 33 regardless of whether it may also qualify as a distributing plant in any other Order, or in no Federal Milk Order. The only qualification standards will be (1)

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[1] Adoption of the proposed amendment offered by Superior Dairy in common with cooperative proponents would also render harmless, if not necessarily moot, serious questions of procedural integrity addressed in Superior Dairy's two pre-hearing motions, rulings thereon by the ALJ, and the responses thereto by AMS counsel. Those motions are incorporated by reference, for possible later review by the Secretary pursuant to 5 U.S.C. §557(c) and 7 C.F.R. §§900.12 – .13a , in the event that the Administrator or Secretary may recommend an amendment to Order 33 that is inconsistent with this modified proposal.

location in the Mideast Marketing Area, and (2) distribution and transfers of 50% or more of the plant's fluid milk products into Federal Order marketing areas. This modification is one alternative proposed by Mr. Soehnlen in his testimony, Oct. 5 Tr. pp. 139-40. [2] This simple amendment, designed to foster the continued integrity of market-wide revenue pooling for producers in the Mideast can, and should be, adopted expeditiously.[3] It is enough that this proposal tends to promote "overall market stability" and the "regulatory stability" of Superior Dairy's plant. [4]

Some questions were raised on examination of Mr. Soehnlen about possible conflict with pooling standards under other Orders if this were adopted. Oct. 5 Tr. pp. 198-99. There would be no conflict between Order 33 and other marketing orders if Order 33 is amended to unequivocally lock in Superior Dairy regardless of its distribution into any market, including the Mideast Marketing Area.[5]

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[2] This modification of the published proposal fits very comfortably within the subject matter and issues raised by the Notice of Hearing, as described in *Alto Dairy v. Veneman*, 336 F.3d 560, 569-70 (7th Cir. 2003).

[3] The agency may avoid issuance of a recommended decision if the record evidence "imperatively and unavoidably" supports omission of a recommended decision. 7 C.F.R. §900.12(c) and 5 U.S.C. §557(b)(2). However, as described in USDA's first lock-in decision responding to then-new ESL technology, a recommended decision with a short period for comments will allow prompt decision-making and still allow the general industry to have input on a new rule that will serve as precedent for other markets. 47 Fed. Reg. 14919, 14921 (April 7, 1982) ("Since this decision involves an issue that is unique, it is especially appropriate that parties have an opportunity to file exceptions to the Department's proposed changes.").

[4] The Secretary's 1982 decision to adopt a lock-in for the Savannah plant, described above, was not accompanied by any finding of "disorderly" conditions in the absence of an amendment. Rather, the Secretary simply "concluded that overall market stability will tend to be maintained and the regulatory stability of DI's new plant (or any other such plant) will tend to be assured if the order is modified along the lines proposed." 47 Fed. Reg. at 14921.

[5] Should AMS Dairy Programs perceive any conflict between the proposal and other provisions, or lack of clarity in the regulatory text, Superior Dairy would not object to other modifications created by agency experts that would achieve the same result without potential conflict and/or with greater clarity. The objective for Superior might also he achieved by reducing the in-area distribution requirement from 25% to 15%, as it was prior to 2000.

All of the Milk Marketing Orders contain a provision to exclude from their pool plant definition, plants that are locked into other Orders. This provision, in each case, is in the section that begins: "The term pool plant shall not apply to the following plants...." That is section 7(g) or 7(h) in the 10 Milk Orders. 7 C.F.R. Secs. 1001.7(h)(5), 1030.7(h)(5), 1032.7(h)(5), 1033.7(h)(5), 1124.7(h)(5), 1126.7(g)(5), and 1131.7(g)(5), all state that the term "pool plant" shall not include:

> (5) A plant qualified pursuant to paragraph (a) of this section that is located in another Federal order marketing area if the plant meets the pooling requirements of such other Federal order and does not have a majority of its route distribution in this marketing area for 3 consecutive months or if the plant is required to be regulated under such other Federal order without regard to its route disposition in any other Federal order marketing area; [emphasis supplied].

Similarly, 7 C.F.R. Secs. 1005.7(h)(4), 1006.7(g)(4), and 1007.7(g)(4) use slightly different words to the same end, and exclude from the pool plant definition:

> (4) A plant qualified pursuant to paragraph (a) of this section which is located in another Federal order marketing area, meets the pooling standards of the other Federal order, and has not had a majority of its route disposition in this marketing area for 3 consecutive months or is locked into pool status under such other Federal order without regard to its route disposition in any other Federal order marketing area; [emphasis supplied].

B. Proposed Findings and Conclusions in Support of the Amended Rule.

The amendment proposed above is based upon facts and conclusions, supported by substantial record evidence and regulatory precedent, as follows. Superior Dairy respectfully requests the Administrator or Secretary to make a ruling on its proposed findings, in accordance with 5 U.S.C. §557(c); 7 C.F.R. §§900.12(b)(2) and .13a(b).

1. Since Federal Order reform in 1999, distributing plants generally have continued to increase the distance and geography in which packaged fluid milk is distributed. Sales in Federal Milk Marketing Areas by "other order" handlers increased 40% from 2000 to 2010. Sales by partially regulated distributing plants (PRDPs) increased by 48% during the same period. Ex. 10 pp. 2 – 3.

2. Superior Dairy operates a milk distributing plant in Canton, Ohio, that was fully regulated under the Mideast Order and its predecessors for many decades prior to April 2010. The plant was regulated as a Northeast pool plant from April 2010 through February 2011, and has been a partially-regulated distributing plant since March 2011.

3. Superior Dairy currently receives about 40 million pounds of producer milk each month. A significant majority of such producer milk is supplied by DFA for which Superior pays, consistent with industry practice, at class prices plus premiums based on plant utilization. Soehnlen, Oct. 5 Tr. p. 111. Superior also procures milk from about 120 independent producer patrons. *Id.*, p. 186.

4. About 82 percent of Superior's milk receipts are used to produce Class I fluid milk products. *Id.*, p. 111.

5. In the mid 2010's, Superior Dairy started to significantly expand its distribution footprint by use of unique, newly patented filling and packaging technologies. This product line caught on with large warehouse stores such as Costco and Sam's Club. In early 2010, Superior's sales to stores in the Northeast were enough to qualify the Canton plant as a pool plant under 7 C.F.R. §1001.7(a).

At the same time, Superior lost accounts within Order 33 (Superior's second-largest distribution area) so that its Mideast in-area sales were only 20% -- not enough to qualify the plant as a Mideast pool plant under the 25% standard of §1033.7(a). In April 2010 the plant became fully regulated as a Northeast pool plant. Soehnlen, Oct. 5 Tr. pp. 112-13. [6]

6. The switch in regulation of the Canton plant from the Mideast to the Northeast resulted in unique burdens to Superior Dairy and its producer milk suppliers. Although its classified milk prices remained the same, Superior Dairy had to pay more into the Order 1 pool, and retained less of the milk value to pay producer blend prices. Significantly, the producer blend price at Canton under the Northeast Milk Order pool was about $0.13 less per cwt., on average, than the blend price at Canton under the Mideast Order. To maintain its milk supply, therefore, Superior had to pay higher premiums to producers simply to offset the lower Order 1 blend price because other producers in the procurement area were receiving higher blend price under Order 33 and Order 5. The Order 1 versus Order 33 blend price disadvantage for the volume of producer milk received by Superior Dairy from April 2010 through February 2011 totaled about $500,000. Soehnlen, Oct. 5 Tr. pp. 113-14; Carmen, Oct. 4 Tr. pp. 68 – 70, 333.

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[6] Superior Dairy's producer milk receipts in April 2010 were about the same as they are at the current time. After Superior Dairy became regulated in the Northeast, the Northeast Market Administrator's Annual Bulletin for 2010 (p. 11) disclosed that 36.6 million pounds of producer milk from "other states" had been added to the Order 1 pool in April 2010 because an additional plant was pooled on the order due to changes in the plant's route disposition. That plant was Superior Dairy in Canton.

7. The shift in regulation of a milk plant from a local marketing order, where competing handlers also procure milk, to regulation under a distant marketing order, presents numerous difficulties for the plant and its producer milk suppliers, as observed in several plant lock-in decisions of the Secretary. 47 Fed. Reg. 14919, 14923 (April 7, 1982) (lock-in for a Savannah E.S.L. plant under the Georgia Order); 53 Fed. Reg. 14804 (April 26, 1988) (lock-in for the Winchester, Ky., Kroger plant under the Louisville Order); 53 Fed. Reg. 38730 (October 3, 1988) (lock-in of three Nashville-area plants under the Nashville Order).

8. A shift in regulation of a plant located south of the Northeast into the Northeast Order provides particularly challenging problems of producer pooling and milk supply coordination, in addition to price disadvantages, as described in refreshing detail by Jeff Sims, testifying for the seven cooperative members of the Southern Marketing Agency. Sims, Oct. 5 Tr. pp. 80-81, 93-94, 97.

9. In order to avoid the disadvantages and burdens of regulation of its Canton plant under Order 1, Superior Dairy sought to reduce sales from Canton into the Northeast below the 25% pool plant distribution threshold. Superior accomplished this objective by purchasing a small plant in Wauseon, Ohio, and shifting distribution to the Northeast from this facility rather than Canton for enough sales to bring Canton's Northeast sales below 25%. As a result, the Canton plant became partially regulated in March 2011 because it did not have 25% distribution into any

federal milk marketing order.[7] The Wauseon plant, in turn, became a fully-regulated Order 1 distributing plant. Soehnlen, Oct. 5 Tr. pp. 114-15.

10. The Superior Dairy Canton plant has accounted for minimum classified milk prices under the Wichita option, 7 C.F.R. §1000.76(b), since the plant became partially regulated in March 2011. Under this option, the plant must pay at least the same uniform classified prices for milk as its fully-regulated competitors, so partial regulation does not result in a regulated price advantage over fully regulated plants. A Wichita option plant, in effect, operates as an individual handler pool. Soehnlen, Oct. 5 Tr. pp. 120, 157; Hollon, Oct. 4 Tr. p. 153; Carmen, Oct. 4 Tr. p. 91. For more than a half-century, the Secretary has held that Wichita option pricing for partially-regulated plants would "equalize the competitive positions of both fully regulated plants and those plants not regulated under an order...." 64 Fed. Reg. 16026, 16163 (April 2, 1999); 16 Fed. Reg. 1242, 1243 (Feb. 9, 1951).

11. However, the competitive position of fully regulated plants and Wichita option PRDPs is not equal or equitable when it comes to procurement competition, as reflected in blend prices. This is a principal claim of cooperative proponents underlying the hearing request (e.g., Oct. 4 Tr. pp. 153, 156), with which Superior Dairy has consistently agreed (Oct. 5 Tr. pp. 123-25). Because distributing plant Class I utilization is ordinarily greater than market-wide Class I use, Wichita

[7] Although transfers of packaged fluid milk products from Canton to Wauseon count the same as in-area route disposition for Section 7(a) pooling purposes, these transfers plus route sales from Canton to Mideast customers were still insufficient to bring the Canton plant back into regulation as an Order 33 pool distributing plant.

option distributing plants will almost always enjoy an individual handler pool blend prices for payment to producers that are greater than the market-wide blend prices received by producers supplying fully-regulated handlers. Where a cooperative sells milk to a Wichita option PRDP at class prices, the individual handler pool blend and benefit is in effect transferred to and enjoyed by the cooperative. Producers will therefore prefer Wichita option (individual handler pool) markets for their milk, if such markets are available, rather than sell to pool handlers and receive only the marketwide blend price.

12. The higher blend price received by producers supplying Wichita option PRDPs also reflects the fact that those producers, unlike producers participating in the marketwide pool, do not equally share in the burden of surplus, lower-valued Class III and IV milk used for manufacturing purposes in the market.

13. An effort was made by proponent cooperatives to quantify the extent of Wichita option PRDP's plant blend price procurement advantage over market-wide blend prices in hearing Exhibit 25. In that exhibit, proponents sought to calculate the plant blend for a "typical" distributing plant with "typical" Class I use (86%), for milk receipts from typical Ohio dairy farmers at test (i.e., farm butterfat and milk component tests). Hollon, Oct. 4 Tr. pp. 129, 241-56.

14. Column QQ on page 2 of Exhibit 25 purports to show an estimated $0.93/cwt procurement price advantage – the difference between estimated in-plant blend price and Mideast Order blend price for producer milk at test for each month of January 2010 through July 2011. This Column QQ value would be the amount

that a fully-regulated plant is required to pay to the Mideast producer settlement fund, but which a Wichita option PRDP would pay directly to its producer patrons or cooperative suppliers. Exhibit 25, however, applies an extraordinarily erroneous assumption that the "typical" plant's Class I milk contains the same butterfat content as producer milk at test. For January 2010, for example, the Ex. 25 "Class I Contribution" to in-plant blend assumes that Class I milk contained 3.86% butterfat. In fact, typical Class I milk for that month contained only 1.75% fat. A corrected calculation for the month of January 2010, for example, reveals that the Class I contribution to the in-plant blend price should be $12.40, *not $15.11* as represented in Exhibit 25 Column Y. The total in-plant blend price advantage over market-wide blend price at test for January 2010, reflected in Column QQ of Exhibit 25, should be $0.70 not $0.97. This and other errors in assumption or data entry contained in Exhibit 25, which produce significantly overstated estimates of the Wichita option PRDP blend price advantage, are discussed after the conclusion of this brief in a separate Addendum.

15. Apart from errors described in the Addendum, Exhibit 25 and the related testimony by its sponsoring witness, do not accurately represent the in-plant blend price procurement advantage enjoyed by Superior Dairy and its producer-suppliers, for several reasons, including: (a) Superior's Class I use is 82%, not 86% assumed by proponents for a typical plant, (b) Superior Dairy buys only a majority of its milk from DFA at class prices and plant utilization, so any blend price advantage on that share of the milk supply is transferred to the cooperative, and (c) it is necessary for

Superior Dairy to operate a plant at Wauseon for Superior to avoid Order 1 regulation, and thereby enjoy PRDP status for its Canton plant as a by-product. The cost of transportation and plant operation association with Wauseon offsets the procurement advantage Superior and its producers have from a PRDP in-plant blend price.

16. Nevertheless, it is acknowledged and obvious that Wichita option PRDP status, and its associated individual handler pool in-plant blend price payable to producers, provides a substantial procurement price advantage for PRDPs.[8] It is also acknowledged and obvious that if such PRDPs (including Superior Dairy in this instance) participate as pool distributing plants in a marketwide pool, the marketwide blend price will be modestly enhanced and producer price uniformity will be advanced.

17. Regulation under Order 33 by lock-in of Superior Dairy, as proposed, would add new Class I value and utilization to the Order 33 pool. Superior's Class I value, prior to its PRDP status, previously contributed to the Order 1 pool from April 2010 through February 2011.

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[8] Several other partially-regulated distributing plants are located in the Pennsylvania and Maryland portions of the Mideast milkshed, and in the milksheds for Order 1 and Order1, though outside of the defined marketing areas. These plants have the same type of individual handler pool blend price advantage when procuring milk in competition with handlers fully regulated by the Mideast Order or other eastern Orders that are also supplied from this common supply area. Compare location of PRDPs in Pennsylvania, Maryland and Virginia in Ex.6bwith milkshed (milk supply area) data for Order 1, 33, and 5 in Exs. 11a through 15, and 33a – 33c. In several cases, PRDP plant operators also operate one or more fully-regulated plants, and thereby have the opportunity to coordinate distribution from the plants in order to maintain PRDP status for one plant in much the same manner as Superior Dairy coordinated distribution from its Canton and Wauseon locations. We trust that the agency, as represented by a declaration of the Deputy Administrator (Oct. 4 Tr. pp. 264-65), will consider future action to protect the integrity of marketwide pooling in the Mideast and other milk orders where such individual handler (Wichita option) plants procure milk in competition with handlers and producers participating in marketwide pools.

CONCLUSION

While Superior Dairy's packaging and distribution technology represents a new innovation, the regulatory remedy advanced by Superior in concert with cooperative proponents applies time-tested and long-standing regulatory policy: the integrity of marketwide pooling and producer price uniformity is diminished where plants subject to individual handler pools such as Wichita option PRDPs procure milk in the same milkshed as fully regulated handlers.

The blue ribbon Milk Order Study Committee addressed these issues at length in its 1962 Report to the Secretary of Agriculture, sometimes referred to as the "Nourse Report" after the Committee Chairman.[9]

> Compensatory payments or some equivalent device are especially needed with respect to milk that moves from a market with individual handler pooling to a Federal order market with market-wide pooling, to protect the integrity of the pool.
> * * * *
> In the case of milk sold on routes within the marketing area by an unregulated handler, many of the orders provide that the compensatory payment may be calculated ... [by handler option] as follows:
> The difference between the total amount paid by the unregulated handler to his producers and the amount he would have been required to pay for his milk if fully regulated by the order.

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[9] The Nourse Report has served as a primary reference for milk order economic policy and regulatory analysis during the past five decades. The Secretary's adjudicatory decision in *In re Borden, Inc.,* 46 Agric. Dec. 1315, 1408, 1411-19 (1987), analyzed a milk order pricing amendment against Nourse Report conclusions, explaining: "One of the most authoritative reports on the Federal Milk Order Program was issued by an 18-member committee headed by Dr. Edwin G. Nourse (U.S. Dep't of Agric., *Report to the Secretary of Agric. by the Federal Milk Order Study Committee....*" The Nourse Report has been cited by the Supreme Court, *Zuber v. Allen,* 396 U.S. 168, 188 fn. 25, 191 fn. 26 (1969), by the D.C. Circuit, *Schepps Dairy, Inc., v. Bergland,* 628 F.2d 11 at fn 29 (D.C. Cir 1979), and by the district court in *Willow Farms Dairy, Inc. v. Freeman,* 206 F. Supp. 239 (D. Md. 1962). The complete Nourse Report is available on the web at http://books.google.com/books/about/Report_to_the_Secretary_of_Agriculture.html?id=BXmpGwAACAAJ

> This latter method of computation, commonly known as the "Wichita Plan", is objectionable because in effect it sets up an individual handler pool for the unregulated handler, while the fully regulated handlers with whom he is competing are required to equalize. If the unregulated handler has a higher Class I utilization than the average for the market his producers will fail to bear a proper share of the burden of maintaining the reserve supply.

Nourse Report, pp. II-4-26 to -27. There was apparently a regulatory policy in place at the time of the Nourse Report limiting or prohibiting use of the Wichita option where the procurement area of partially-regulated and fully-regulated handlers overlapped. Nourse Report, p. 11-4-27, fn. 7. This policy is no longer in place, and its absence is the source of potential farm milk price disparity described by proponent cooperatives, and with which Superior Dairy agrees.

For the foregoing reasons, and those stated in hearing testimony by Mr. Soehnlen, the modified proposal herein to amend 7 C.F.R. §1033.7(a), should be recommended by the Administrator and adopted by the Secretary in order to promote the integrity of marketwide pooling in the Mideast.

Respectfully submitted,

James D. Wilson
James D. Wilson LLC
29225 Chagrin Boulevard, Suite 350
Cleveland, Ohio 44122
(216) 342-4138
jwilson@wilsonlawyers.com

John H. Vetne
311 George Cole Rd.
P.O. Box 15
New Portland, Maine 04961

Cowden & Humphrey Co., LPA
Terrence C. Steel
4600 Euclid Avenue, Suite 400
Cleveland, Ohio 44103

ADDENDUM TO SUPERIOR DAIRY'S POST-HEARING BRIEF

Proponents' Exhibit 25 Contains Significant Errors and is of No Use in Estimating the Plant Blend Price Advantage of Partially Regulated Plants.

As explained in the foregoing brief, Superior Dairy supports a modified proposal to eliminate the blend price advantage it has as a partially-regulated (individual handler pool) plant operating in a marketwide pool procurement area. The amendment will help promote integrity of marketwide pooling, and enhance industry confidence in USDA's milk marketing order program. Regulatory integrity and industry confidence in program administrators also compels rejection of proponent's estimates of the degree of advantage enjoyed by partially-regulated plants.

Proponents have maintained since their June 17 request for hearing, and stated again in testimony, that the plant blend price advantage enjoyed by Superior over a fully-regulated competitors is at least 80 to 93 cents per hundredweight.[1] In Hearing Exhibits 25 and 25a, DFA's witness revealed for the first time the data sources, the assumptions used, and the calculations made to support these estimates. Column PP of Ex. 25 purports to show the estimated in-plant blend

[1] In their June 17, 2011, request for hearing, page 10, proponents stated: "Using... the average distributing plant estimated class utilizations, actual class prices, actual market test data for Ohio, and statistical uniform blend price data, we conservatively estimate the potential advantage that could have arisen from Superior being partially regulated for the 14 months ending in February 2011 to average 80 cents per hundredweight." In testimony on October 4, DFA's witness updated these estimates through July 2011, as follows: "Using... the average distributing plant estimated class utilizations, actual class prices, actual market test data for Ohio, and statistical uniform blend price data, we conservatively estimate the potential advantage that could have arisen from Superior being partially regulated for the 19 months ending in July 2011 to average 93 cents per hundredweight." Hollon, Oct. 4 Tr. pp. 155-56.

price for a typical Ohio distributing plant, with typical utilization and product mix, using milk from Ohio producers with average fat and nonfat component content, for each month of January 2010 through July 2011. The "typical" in-plant blend price is the sum total of contributions to the in-plant hundredweight price from Class I use (Ex. 25, Column Y), Class II use (Column DD), Class III use (Column JJ) and Class IV use (Column OO). This in-plant blend price (Ex. 25 Column PP) is then compared to the marketwide blend price for typical Ohio milk containing the same average components (Ex. 25 Column. T), and column QQ of the Exhibit shows a purported in-plant blend price minus the market-wide blend price averaging $0.93 for the 19 month period. Hollon, Oct. 4 Tr. pp. 241 - 43. Proponents assert that this is the amount that fully-regulated plants would have to pay to the pool, but partially-regulated plants are able to retain for payment to the plant's producers under 7 C.F.R. §1000.76(b), thereby gaining a procurement advantage. *Id.*

However, the proponent witness neglected to adjust the fat content in Class I milk (and in other uses) to reflect the typical use of fat in Class I (and other classes). The contribution of Class I use to the in-plant blend price in Exhibit 25 (columns U through Y) assumes that typical Class I milk for January 2010 had 3.86% butterfat, the same as in typical producer milk. As explained by Mr. Hollon on pp. 129 and 241-42 of the October 4 hearing transcript, describing the line entries for January 2010 for illustration:

> A. As I'll explain in my testimony, we assign plants in Order 33 a typical plant having an 86 percent Class I use value. So Column Y is the Class I contribution from that -- those prices and the 86 percent utilization value.

* * * *

Q. Okay. So we have over here Class I price at test. What's the test; is that the average?
A. If we go back to the average butterfat test on the prior page.
Q. Okay.
A. So you would take Columns U [Class I skim price] and V [Class I butterfat price] and multiply them times the appropriate skim pounds and butterfat pounds calculation to get that average [$]17.5669 [Class I price at test].
Q. Okay. And then you have this Class I contribution?
A. Correct. That's the typical plant. And our universe was 87 percent Class I. So 17.57 roughly times 86 percent would be [$]15.11.

The problem with the assumption in Exhibit 25 that Class I milk has the same fat content as producer milk is that Class I milk, in fact, has much less fat. For the month of January 2010 (Ex. 25, line one), the average butterfat content in Order 33 Class I milk was 1.75%, not 3.86%.[2] Packaged fluid whole milk contains about 3.25% fat (21 C.F.R. §131.110). Other fluid milk products, 2% (reduced fat), 1% (low fat), and skim (nonfat), lower the fat average in the Class I product mix of handlers. The lower fat in typical Class I milk, if accurately incorporated in columns U through X of Exhibit 25, produces a much lower "Class I Contribution" in Column Y. Accurately applying the Class I Skim Price (Column U) and the Class I Butterfat Price (Column V) to Class I milk at average Class I test (1.75% fat) would produce a January 2010 Class I contribution of $12.40 to the handler's in-plant blend, *not $15.11* as represented in Exhibit 25 Column Y.[3]

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[2] Ex. 8, p. 55 (attached) contains the Market Administrator's Feb. 2010 Bulletin, with milk utilization and price data for the month of January 2010. That exhibit reveals total Class I product pounds for the month of pounds, of which pounds, or 1.75%, were butterfat. 10,263,130/585,181,985 = 0.0175 . Exhibit 8 p. 55, also reveals the Mideast milk, fat and component values for January 2010.

[3] For a handler having Class I use of 86%, as reasonably represented by proponents to be typical, per hundredweight of producer milk, 86 product pounds would be used in Class I, of which 1.75% or

By similar process, the remaining utilization and class price contribution to the in-plant blend of a typical distributing plant can be accurately calculated. A distributing plant's Class II use, like Class I, is designed to meet customer needs for products of specific fat content. Proponents reasonably estimate that a "typical" distributing plant uses 9% of its milk receipts in Class II products. For milk received and used in January 2010, the Market Administrator's Bulletin reveals that average fat content in Class II products was 5.36%.[4] The handler's typical use of 9 product pounds per cwt. in Class II use, therefore, would include .482 pounds of fat and 8.518 skim milk pounds. The skim pounds, however, need to be converted to nonfat solids pounds for Class II pricing purposes. Since typical Ohio producer milk contained 8.81% NFS and 3.86% fat, NFS as a percent of skim milk alone would be 9.1637%. So the NFS content of 8.518 skim pounds would be .78 lbs. The Class II skim value would be $0.91 (.78 x 1.1689), and the Class II fat value would be $0.70 (.482 x $1.4475), for a total Class II contribution of $1.61.

At this point, of the 100 lbs. of producer milk originally containing 3.86 lbs. fat and 96.14 lbs. skim milk that the handler received, here is what is left for combined Class III and IV uses: 3.122 lbs. skim milk and 1.878 lbs. butterfat. Virtually all of the value of this remainder is in butterfat, for which the price per

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1.5 pounds would be Class I butterfat, and the remaining 84.5 pounds would be Class I skim (84.5 + 1.5 = 86). The skim part of the contribution for January 2010 would be $11.82 (Class I skim price/cwt) x .845 cwt = $9.9879. The fat part of the contribution would be $1.6074* (Class I fat price/lb.) x 1.5 = 2.4111. The total Class I contribution therefore, which should have been reflected in Column Y of Ex. 25, would be $12.40. (*note – the Class I fat price for January 2010 in Ex. 25, represented as $1.6070, is inaccurate in the fourth decimal.)

[4] Ex. 8, p. 55. January 2010 Class II product pounds in the Mideast totaled 253,129,698, of which 13,567,193 or 5.36% was butterfat.

pound was $1.4404 in both Class III and IV uses (Ex. 8 p. 55, Ex. 25 Columns EE and LL). Allocating these remaining skim (skim component) and fat pounds to Class III and IV based on Ex. 25's representation of typical Class III use of 3% and typical Class IV use of 2%, Class III contributes $1.81 to the plant blend and Class IV contributes $1.20. The total contributions to plant blend from each use by a typical distributing plant for the month of January 2010 is as follows:

Class I Contribution	$ 12.40
Class II Contribution	$ 1.61
Class III Contribution	$ 1.81
Class IV Contribution	$ 1.20
Total In-Plant Blend	$ 17.02

Exhibit 25, line one, Column PP, therefore overstates the January 2010 In-Plant Blend and overstates the difference between in-plant blend and market blend in Column QQ, by $0.27. The same error in assumptions and approach affect calculated class price contributions, and blend price comparisons, for each of the remaining 18 months shown on Exhibit 25. These errors are carried forward to all data on page 3, Columns PP to EEE of Ex. 25.

Additional analytical impropriety infects the data on page 3 of Exhibit 25, columns RR through EEE. In Column RR, USDA milkshed mailbox prices are entered, and imputed advantages drawn from reported mailbox prices are contained in the remainder of the Exhibit. We do not question (but have not checked) the accuracy of mailbox prices entered in the exhibit. The use of this price series, however, is inappropriate for hearing purposes and inconsistent with other testimony of Mr. Hollon.

Mr. Hollon testified repeatedly that he and proponent cooperatives were concerned about "Federal Order minimum values" and advantages or disadvantages created by Federal Order minimum pricing applied to pool plants compared to PRDPs. Hollon, Oct. 4 Tr. pp. 177-78, 180, 235. Mr. Hollon was asked questions about over-order and premium pricing, but consistently refused to answer these questions claiming his focus was only on minimum regulated prices. *Id.* In the colloquy on Tr. p. 235 (lines 3 – 14), Mr. Hollon reiterated:

> Q. Do handlers sometimes pay premiums to suppliers?
> A. In this provision -- in this proceeding we're concerned about Order minimum prices. So that's where my testimony is going to focus.
> Q. I understand. And I'm not asking you to refocus. I'm asking if sometimes handlers pay premiums to suppliers.
> A. And, again, I'm going to stay where I am.
> Q. You won't answer that?
> A. I don't think I want to get into that discussion.

Likewise, counsel for the proponent cooperatives expressed an apparent belief, albeit erroneous, that the analysis in Exhibit 25 was "strictly calculating order values." Oct. 5 Tr., p. 194.

Proponent's claimed focus on minimum regulated prices, and any consequent regulatory advantage or disadvantage, would be reasonable in view of USDA's express policy to limit its relevant inquiry to regulated pricing. In the producer-handler proceeding that concluded last year, witnesses argued that "the presence of effective prices—or actual prices paid and received—that differ from minimum prices set under the orders is indicative of disorder." 75 Fed. Reg. 10122, 10147 (March 4, 2010). The Secretary disagreed, stating: "The regulatory plan of the milk order program is not tasked with setting the effective prices." *Id.* Similarly, the

Secretary concluded that cost differences among handlers are not a "relevant factor for determining conditions in which handlers should or should not be subject to full regulation." *Id.,* 10147-48.

But Exhibit 25 page 3 includes analysis of average producer premiums or over-order prices by its inclusion of reported "mailbox" prices in column RR. This is a "weighted average" price reflecting producer income from "all sources" and "all costs associated with marketing the milk." USDA Dairy Market Statistics, Annual, Table 36 (mailbox milk prices) fn. 1 and 2. If there were any doubt that "all sources" of revenue include over-order premiums, the AMS Dairy Programs website describes the mailbox price series as one of three reports on over-order prices. Attachment "Agricultural Marketing Service – Over-Order Prices." It is difficult to conclude, in these circumstances, that the witness did not know that Exhibit 25 contained over-order price analysis while at the same time the witness disclaimed relying on such analysis and refused to answer questions on over-order pricing.

Further, since the reported mailbox price is a "weighted average" price, it is entirely improper for an economist or statistician to draw any conclusion – such as asserted in Columns TT through YY of Exhibit 25, that PRDP price advantage, measured by mailbox prices, is the amount of money a competitor would have to come up with to meet the competition and avoid loss of milk supplies. Neither Exhibit 25 nor reported mailbox prices reveal the range of pay prices and premiums that produce the weighted average, nor any information of standard deviations from the calculated average. More importantly, a suggestion that a competitor would

lose a milk supply to a PRDP with prices imputed by Exhibit 25 page 3 necessarily requires that the PRDP have room in its plant for the extra milk that may be offered. If there is no more room for producer milk, as is the case with Superior Dairy, the higher PRDP price will have no impact on the ability of pool handlers to retain milk supplies under existing price arrangements.

For these reasons, Exhibit 25 should be disregarded as a measure of PRDP blend price advantage. The theoretical approach on pp. 1 and 2 of that exhibit (adjusted to typical fat and skim milk use) supports the uncontested fact that Wichita option PRDPs do have a procurement price advantage, by their individual handler pool blend price, over regulated competitors that procure milk based on market-wide blend prices.

ANNOUNCEMENT OF PRODUCER PRICES

Federal Order No. 33

January 2010

COMPUTATION OF PRODUCER PRICE DIFFERENTIAL

	POUNDS	BUTTERFAT	SKIM / PROTEIN	NONFAT SOLIDS	OTHER SOLIDS	PRICE	VALUE
Class I Skim Value			574,918,855			$ 11.82 / cwt	$ 67,955,408.64
Class I Butterfat		10,263,130				1.6074 / lb	16,496,955.17
Class I Location Differential	585,181,985						(277,289.92)
Class II SNF Value				21,944,752		1.1689 / lb	25,651,220.62
Class II Butterfat		13,567,193				1.4475 / lb	19,638,511.93
Class III Protein Value			14,623,385			2.7916 / lb	40,822,641.58
Class III Other Solids Value					26,762,425	0.1946 / lb	5,207,967.89
Class III Butterfat		17,988,634				1.4405 / lb	25,912,627.29
Class IV SNF Value				8,850,225		1.0148 / lb	8,981,208.35
Class IV Butterfat		11,511,398				1.4405 / lb	16,582,168.83
Somatic Cell Value II / III / IV							854,604.19
TOTAL PRODUCER MILK VALUE	1,415,799,499	53,330,355	44,127,080		80,720,607		$227,826,024.57
Overages					$ 10,591.17		
Beginning Inventory and Other Source Charges					$ 6,573.06		
TOTAL ADJUSTMENTS							$ 17,164.23
TOTAL HANDLER OBLIGATIONS							$ 227,843,188.80
Total Protein Value			44,127,080 lbs	@	$2.7916		$(123,185,156.50)
Total Other Solids Value			80,720,607 lbs	@	0.1946		(15,708,230.13)
Butterfat Value			53,330,355 lbs	@	1.4405		(76,822,376.38)
Total Somatic Cell Values							(1,436,844.29)
TOTALS							$ 10,690,581.50
Net Producer Location Adjustments							$ 713,285.39
1/2 Unobligated Balance Producer Settlement Fund							621,000.00
Total - Divided by Total Pounds			1,415,799,499 lbs		0.8493340		$ 12,024,866.89
Rate of Cash Reserve					(0.0493340)		(698,470.52)
PRODUCER PRICE DIFFERENTIAL *at Cuyahoga County, OH**			1,415,799,499		$ 0.80 /cwt		$ 11,326,396.37

COMPONENT PRICES

	January 2010	January 2009
Butterfat Price	$1.4405 / lb	$1.1084 / lb
Protein Price	2.7916 / lb	2.3638 / lb
Other Solids Price	0.1946 / lb	(0.0304) / lb
Somatic Cell Adjustment Rate	0.00077 / cwt	0.00065 / cwt
Nonfat Solids Price	1.0148 / lb	0.6574 / lb

COMPUTATION OF UNIFORM PRICE

	January 2010	January 2009
Class III Price - 3.5% BF	$ 14.50	$10.78
Producer Price Differential*	0.80	2.44
Statistical Uniform Price	$15.30	$13.22

CLASS PRICES

	January 2010	January 2009
Class I*	$17.03	$17.74
Class II	15.22	10.41
Class III	14.50	10.78
Class IV	13.85	9.59

* Subject to Location Adjustment.

CLASSIFICATION OF PRODUCER MILK

	January 2010 *Product lbs.*	January 2009 *Product lbs.*
Class I	585,181,985	591,435,516
Class II	253,129,698	246,511,171
Class III	469,350,114	442,499,680
Class IV	108,137,702	111,617,041
Total	1,415,799,499	1,392,063,408

ORDER 33 MARKET SUMMARY

The Producer Price Differential for the Mideast Marketing Area for February 2010 was $.80 and the Statistical Uniform Price was $15.30 for the month. The Statistical Uniform Price is $0.18 higher than last month, and is $2.08 higher than January 2009.

The Producer Butterfat Price of $1.4405 per pound decreased 10.28 cents from December and is up 33.21 cents from a year ago. The Protein Price of $2.7916 is down $0.0835 from last month and is up $0.4278 from January 2009. The Other Solids Price in January was $0.1946 per pound, an increase from last month's price of $0.1727 and an increase of 22.50 cents from last January. The Somatic Cell Adjustment rate for January was $0.00077.

January producer receipts of 1.42 billion pounds were 1.8 percent higher than December and 1.7 percent higher than January 2009 production of 1.39 billion pounds. Producer milk allocated to Class I accounted for 41.3 percent of the total producer milk in January 2010, less than the 43.6 percent in December and less than the 42.5 percent in January 2009. A total of 7,171 producers were pooled on the Mideast Order compared to 7,422 producers pooled in January 2009.

The market average content of producer milk was as follows: Butterfat 3.77%; Protein 3.12%; Other Solids 5.70% and Nonfat Solids 8.82%.

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Marketing Orders

Over-Order Prices

Federal milk orders (FMO) establish minimum class prices that regulated handlers (milk processors) pay for raw milk. See Milk Prices. The sellers of raw milk, dairy farmers (producers) or their cooperative representatives, can bargain with regulated handlers to sell milk at prices higher than the FMO minimums. These higher than minimum prices are called over-order prices and the difference between the prices are called over-order charges or over-order payments. Sometimes the over-order price is referred to as the effective price.

Dairy Programs, via the administration of the FMO program, collects and publishes over-order price information data series – Announced Cooperative Class I Prices, the Over-Order Price Report, and Mailbox Prices. Each of these is described below.

More >>

- Announced Cooperative Class I Prices
- Over-Order Price Report
- Mailbox Prices

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- View other information on milk prices and price announcements
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Other Resources
- Dairy Market News
- NASS Publications
- Milk Market Administrator Web Sites
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- Annual Summaries of Federal Milk Order Statistics
- Milk Marketing Order Statistics Home

Last Modified Date: 06/18/2010

Marketing Orders

Mailbox Prices - Description

The Mailbox Prices Report is one of the data series of over-order price information collected by Dairy Programs via the administration of the Federal milk order (FMO) program. See Over-Order Prices.

This data series reports the net prices received by dairy farmers at their farm gates, in their mailboxes. It includes all payments received for milk sold and all deductions for costs associated with marketing the milk. All payments include, where applicable: over-order premiums; quality, component, breed, and volume premiums; payouts from State-run over-order pricing pools, including the Northeast Dairy Compact, when it was operating; payouts from superpool organizations or marketing agencies in common; payouts from programs offering seasonal production bonuses; and monthly distributions of cooperative earnings. Annual distributions of cooperatives earnings – 13th checks or equity distributions are not included. The mailbox price also does not include any Milk Income Loss Contract (MILC) payments.

Costs associated with marketing milk include, where applicable: hauling charges; cooperative dues, assessments, equity deductions/capital retains, and reblends; the FMO deductions for marketing services; Federally mandated assessments such as the National Promotion Program and budget deficit reduction, when they applied; and advertising/promotion assessments above the national program level. Other deductions, such as loan, insurance or feed mill assignments are not included.

The FMO market administrators (MA) collect the information for specific reporting areas in their order(s) using regularly submitted producer payrolls of both cooperatives and handlers with non-member supplies. A reporting area can vary from part of a State to several States combined. Reporting areas were selected to include the major supply areas of FMO and other supply areas for which there was an interest to report and for which at least 75 percent of FMO milk could be reported. Information for a particular reporting area may be reported by more than one MA. The MA submit reports to the Market Information Branch (MIB) in Dairy Programs headquarters office at the end of the following month; January price information submitted on February 28th. The MIB develops a summary report for all the reporting areas and calculates FMO system-wide information. The mailbox price for the reporting area and all FMO areas combined are weighted averages and are reported at the area-average milk component tests. This report, including similar information for California submitted by that State's Department of Food and Agriculture, is published on the Dairy Programs Milk Marketing Order Statistics web site.

The following Mailbox Prices Reports are carried on the web site: current month information, generally available around the 10th of the third following month (January data in April); monthly information for the current year, to date; and, historical monthly and annual information from January 1995 to date.

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