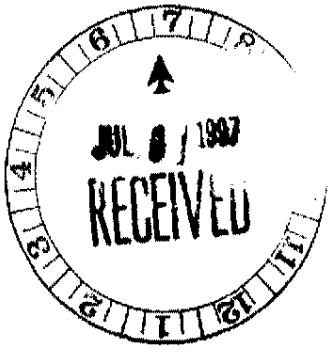
FOR-2903

Mid-America Dairymen

Mid-America Dairymen
3253 E. Chestnut Expressway
Springfield, MO
65802

Phone: (417) 865-7100
FAX: (417) 831-8145
email:



Memorandum

To: *Distribution*

From: *John Wilson*

Date: *Wednesday, July 2, 1997*

Subject: *Enclosed Letter to Mr. McKee*

Enclosed please find a corrected copy of my letter to Mr. Richard McKee that was faxed to you on July 1, 1997.

Enclosure

MID-AMERICA DAIRYMEN, INC.

3253 E. CHESTNUT EXPWY • SPRINGFIELD, MISSOURI 65802 • A.C. 417/865-7100

June 30, 1997

Mr. Richard McKee
USDA/AMS Dairy Division
Order Formulation Branch
Room 2968, South Building
P.O. Box 96456
Washington, DC 20090-6456

Dear Richard,

Mid-America Dairymen, Inc. respectfully submits these comments on Federal order reform as mandated by the 1996 Farm Bill.

Marketing Areas

The following comments supplement those stated in our letter of March 3, 1997. Below is a summary of our previously stated positions and comments on the map released during May 1997.

Southwest Missouri and Northwest Arkansas should be part of the Southeast Federal order marketing area. The Mid-Am supply plants at Monett, Lebanon and Cabool, Missouri help balance Southeast Class I sales, but cannot qualify as reserve supply plants on the Southeast order because they are not in the marketing area. Currently, producer milk from Southwest Missouri is attracted to plants pooled on the Southeast order at times when the Southeast market is surplus. For example, during the period December, 1996 through May, 1997, 38.2 million pounds of surplus milk originating in the Southeast marketing area was delivered to Southwest Missouri manufacturing plants. At the same time, Southwest Missouri producer milk procured by other cooperatives was being delivered to Southeast distributing plants because the high blend price of the Southeast order attracts Southwest Missouri milk. During January through May 1997, Cabool, Missouri producer milk was attracted to Memphis, Tennessee, Little Rock, Arkansas, Fulton, Kentucky and Tupelo, Mississippi (see Attachment 1). This inefficient movement of milk is clearly not within the intent of Federal orders and could be eliminated if Southwest Missouri is included in the Southeast Federal order marketing area.

One might argue that Southwest Missouri/Northwest Arkansas producers will be pooled on the Southeast order even if the local plants are not pooled. There are three distributing plants in Southwest Missouri and Northwest Arkansas that are also balanced by the Southwest Missouri manufacturing plants. There is considerable and increasing overlap in procurement in Southwest Missouri between Southeast and Southwest Plains Federal order pool plants. It is only logical that if the reserve producer milk is to be pooled on the Southeast Federal order, the local Class I sales should also be part of the Southeast pool. Otherwise, milk may be attracted away from the local distributing plants in favor of the higher blends to the Southeast. In addition, we understand including the Hiland Dairy plants at Springfield, Missouri, Fayetteville, Arkansas

and Ft. Smith, Arkansas in the Southeast Federal order will increase the Class I utilization and blend price which supports including them in the Southeast Federal order.

The disorderly marketing conditions reflected by the inefficient milk movements mentioned above and the potential loss of an adequate supply of milk for the Hiland Dairy plants can best be solved by including Southwest Missouri and Northwest Arkansas in the Southeast order as we have proposed.

The "Revised Preliminary Report on Order Consolidation" issued in May 1997 used January 1997 data to illustrate Southwest Missouri and Northwest Arkansas have more association with the Central marketing area than the Southeast. Since January 1997, significant changes have occurred including: 1) additional milk volumes from Southwest Missouri and Northwest Arkansas have been pooled on the Southeast order (78 million pounds in April compared to 56 million pounds in January); 2) Dairy Marketing Cooperative Inc., a cooperative procuring milk in Southwest Missouri, has commenced selling milk to Dairyfresh distributing plants pooled on the Southeast Federal order; and 3) Class I sales competition is intensifying between Hiland Dairy at Fort Smith, Arkansas and Coleman Dairy at Little Rock, Arkansas.

The most logical solution to correct both the inequity caused by Southwest Missouri manufacturing plants balancing the Southeast without being able to pool, and the inefficient milk movement caused by blend discrepancies, is to include Southwest Missouri and Northwest Arkansas in the Southeast marketing area. Our letter dated 3/3/97 (attachment 2) is included for more details.

The Appalachian and Southeast orders should be combined because of procurement overlap and Class I route disposition. An area of particular concern is South Central Kentucky. This area is the procurement area for both Southeast and Tennessee Valley distributing plants. The Tennessee Valley blend price has been higher ($.34 average for June 1996 through May 1997) than the Southeast Federal order blend zoned to Nashville, Tennessee. This is causing disorderly marketing conditions. (See Attachment 2 for more details.)

The map released in May, 1997 included Iowa (Federal Order 79), Eastern Nebraska (Federal Order 65) and some Northern Missouri counties in the Upper Midwest order instead of the Central Order as in the previous map. These areas should be part of the Central Order.

Mergers of Federal order marketing areas are predominantly based on common sales areas for distributing plants and common procurement areas for handlers and cooperatives supplying those plants. Chart 3 illustrates there are 5 plants currently regulated on Federal Orders 65 or 79 that have sales in Federal Orders 30 or 68. Chart 4 reflects these sales. Federal Order 65 and 76 handlers sold only 3.4 million pounds into Federal Order 30 and 68 combined. Federal Order 79 handlers sold 14.4 million pounds into the combined Federal Order 30 and 68 marketing area. This amounts to only 4.7% of the total Class I sales in the Upper Midwest and Chicago orders combined. While the market administrator, for confidentiality reasons, could not disclose the sources of the 14.4 million pounds, our belief is the vast majority is sold into the Chicago market from one plant (Swiss Valley at Dubuque, Iowa).

Considering Class I sales into Federal Orders 79 and 65 from Federal Orders 68 and 30, Chart 5 illustrates the following: only 2 plants (both owned by Marigold Foods) are pooled on Federal Order 68 with sales in Federal Orders 65 or 79; only 5 plants pooled on Federal Order 30 have sales into Federal Order 65 or 79. Chart 6 shows these sales. Federal Order 30 and 68 handlers sold only 31,580 pounds (.07%) of Federal Order 65 Class I sales. Federal Order 30 and 68 handlers sold 6.6 million pounds into the Federal Order 79 marketing area representing 11% of the total. This data clearly shows a minimal association based on Class I sales overlap between Federal Order 65 and 79 with Federal Order 68 and 30.

Producer overlap needs to be considered. Chart 7 illustrates milk pooled on Federal Order 65 by state. This information indicates 2 major points. First, since Class I sales in Federal Order 65 amounts to approximately 57 million pounds per month, Nebraska and Iowa alone produce sufficient milk to satisfy the market's Class I needs plus a reserve supply. Therefore, while Minnesota milk was pooled, it very likely was never needed to meet the fluid needs of Federal Order 65.

Secondly, the volume of Minnesota milk pooled on Federal Order 65 varied from a high of 16.2 million in March to a low of 3.5 million in June. Also, in August and September which are typically the months Class I demand is most difficult to satisfy, only 6.2 and 6.3 million pounds respectively were pooled on Federal Order 65. This indicates Minnesota milk is only associated with Federal Order 65 because of the favorable blend price relationship on diversions.

Likewise, Minnesota and Wisconsin milk pooled on Federal Order 79 (see chart 8) shows tremendous fluctuation in short periods of time. Minnesota milk went from 56 million pounds in December 1996 to 6 million pounds in February 1997. Wisconsin milk went from 68 million in December 1996 to 11 million in February 1997. Obviously, the determination of pooling this milk is based on blend price relationships, not Class I needs. Also, with 83 million pounds of Class I in Federal Order 79, Iowa alone has sufficient milk to satisfy the Class I needs of the market with a more than adequate reserve.

To summarize, the data shows there is an insignificant overlap of Class I sales activity between Federal Orders 65 and 79, and 68 and 30. While significant quantities of producer milk from Minnesota and Wisconsin have been pooled on Federal Orders 65 and 79, the milk is only associated with these orders because of favorable blend price relationships and is not needed to serve the Class I market.

The Des Moines market has previously experienced difficulty attracting milk for Class I sales at times when the utilization of Federal Order 79 has been very low. This indicates the pooling provisions are too liberal. If the Des Moines market is merged in with the Upper Midwest (which is expected to have very relaxed pooling provisions), we anticipate having tremendous difficulty attracting an adequate supply of milk to meet the fluid milk requirements of distributing plants located in Des Moines.

For these reasons, no part of Nebraska, Missouri or Iowa should be included in the Upper Midwest marketing area. However, if the department feels compelled to include part of Iowa with the Upper Midwest, it should only be the extreme Northeast Iowa area which includes Dubuque.

Class I Pricing

One of the roles of Federal orders is to provide integrity and equity in the prices charged to handlers for Class I milk. In absence of orders, short term Class I differentials would gravitate toward zero. This is because dairy farmers will undercut each others' price as long as the market has more total producer milk than Class I sales. It is difficult for cooperatives to charge significant premiums above Federal order minimum prices because of the same principle. Consequently, the order price will generally approximate the total price charged for Class I milk. Farmers cannot rely on premiums above Federal order prices to survive. Class I prices in Federal orders should be developed with this in mind. The "Agricultural Marketing Agreement Act of 1937", as amended, states "Whenever the Secretary finds . . . that the parity prices of such commodities are not reasonable in view of the price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk and its products ..., he shall fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk to meet current needs and further to assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs, and be in the public interest." We believe our proposal for establishing Class I prices meets the criteria of the Act.

Class I prices should be decoupled from cheese. There is no need for Class I prices to be reduced if consumers are willing to pay higher prices. During 1996, national consumption of fluid milk was 740 million pounds higher than 1995 although Class I prices under Federal orders were $2.01 higher in 1996. The inelasticity of fluid milk demand is confirmed in the attached May 1997 *Market Service Bulletin* issued by Donald R. Nicholson, Market Administrator, Tulsa, Oklahoma (Attachment 9). The report illustrates that using the 1988 average as a base, the monthly effective basic formula price varied from a +42% to a -8% during the following 10 year period. During the same period, Class I producer milk pooled on Federal orders varied from +11% to -8%. The summary states "it would seem that changes in the effective basic formula prices, which drive the Federal order Class I prices, have little visible effect on Class I sales."

Mid-Am supports a stable, yet responsive Class I pricing system. The average Class I price for 1996 should be used as a base price. This allows for the current price alignment between cities to continue. A supply-demand adjuster should be used to change prices in each of the orders to reflect long term trends in each order. Using a 12 month rolling average of the Class I utilization percentage, rounded to the nearest full percentage, each two percent change should cause a price adjustment of $.12 per cwt. For short term price adjustments, a cost of production index should be developed whereby Class I prices would be increased in a timely manner when input costs to dairy farmers are increasing. This is consistent with the intent of the 1937 Act as amended. Mid-Am will submit details of the cost of production index under separate cover.

Class I prices should be raised in fluid-deficit areas of the country, such as the Southeast. Consumers, not dairy farmers, should bear the burden of attracting an adequate supply of fluid milk.

Class II Pricing

The Class II price should be the Basic Formula Price plus $1.00. Class II products are value added, demand driven products that should carry more of the burden of assuring an adequate supply of fresh milk. Many pool distributing plants also produce Class II items and demand milk

for these uses. Suppliers of those pool distributing plants cannot choose to only supply the Class I portion of that plant. Likewise, the procurement manager of a distributing plant procures a total milk supply, not just a Class I supply. A Class II differential of $1.00 would price Class II products closer to, but below, Class I in all orders, and would help attract the milk supply to pool distributing plants for these Class II uses which are companion products to Class I products.

Basic Formula Price

Mid-Am supports Option 1 in the BFP report. This option is consistent with our desire for a four class system. It is derived by a product price formula and is conducive to decoupling cheese from Class I. Seasonal yields derived from previous year, same month national average producer milk component levels should be used. Multiple component pricing should be used for charging for milk used in manufacturing.

Pool Plant Definition

Mid-Am supports the principle that distributing plants should be pooled based on their location instead of their sales, unless greater than 50% of the plant's distribution is in another Federal order marketing area. The key is whether an adequate supply of milk is attracted to that plant location, which is driven by blend prices, not Class I differentials.

In higher utilization markets, the pooling standard for distributing plants should be 50% Class I rather than 25% as proposed in the Identical Provisions report.

Market Administrators should be given the authority to adjust shipping requirements in all orders. This is conducive to more timely decisions.

All orders should allow for split-plants where a non pool manufacturing plant can be attached to a pool balancing plant.

Reserve Supply plant qualification should be based on total cooperative performance and should not be required to be located in the marketing area. If a cooperative plant is performing a balancing function for the market, it should not be discriminated against just because it is not located in the marketing area. This is happening currently in the high utilization markets of the Southeast. As previously stated, Mid-Am plants in Missouri perform a balancing function for Class I sales in the Southeast, but are not eligible to be reserve supply plants on Federal order 1007 because they are not located in that marketing area.

Producer / Producer Milk Definitions

Diversion limits must be tailored for each market. Total cooperative performance should be the standard for limiting pooling instead of individual member performance. One intent of the order is to promote efficient movement of milk. There is no need for a distant producer's milk to be hauled to a pool plant only for the purpose of qualifying the producer, if milk closer to the pool plant is available as long as they are members of the same cooperative. To require individual producer touch base would cause inefficient milk movements that can be avoided by using the total cooperative performance as the determining factor on members' producer milk qualification.

Mid-Am does not support a "dairy farmer for other markets" provision. While, in principle, the provision makes sense, it causes problems in practice. For example, Class I accounts can switch to a supplier whose producers were not pooled on that order the prior fall, or new producers who come on the market during the spring of the year would not be eligible to pool. Both these circumstances potentially cause inefficient milk movements.

Market wide Service Payments

Mid-Am supports the use of market wide service payments to cooperatives performing fluid balancing functions instead of hauling credits, such as those used in the Texas Federal order.

Product Classification

There should be an up-allocation for nonfat dry milk used in a higher valued product. Currently, nonfat dry milk reconstituted as a fluid product is allocated to Class I. The same principle should apply to Class II and III products. Federal order pricing should not cause milk solids to be dried only to gain a price advantage over fresh milk used in Class II or III.

Sport Shake should remain in Class II. Sport Shake is a dairy product especially formulated and packaged in a steel can. The product is sterilized in the manufacturing process, does not require refrigeration and is distributed nationwide. The manufacturing process utilizes much of the same manufacturing technology, equipment and processes as that used to manufacture infant formulas and other shelf stable, hermetically sealed products such as Slim Fast, Sweet Success, Ensure, Sustacal, Boost and Nutrament. At the present time the product is offered for sale in 8 oz. and 12 oz. cans. The manufacturing process is more complex and more expensive than the processing required for chocolate milk or other fluid milk products. A schedule of the comparative costs is enclosed (attachment 10).

The issue is whether Sport Shake is intended to be used as a beverage or as a dietary product. Sport Shake is used as a dietary product. A beverage is something that is consumed for fluid replenishment or to quench thirst. Sport Shake is consumed as a snack or meal replacement.

Typically, Sport Shake is stocked in the dry grocery shelf near other meal supplements, replacements and energy drinks including Slim Fast, Ensure, Sustacal, Boost and Nutrament. Sport Shake is not stocked with soft drinks, fruit drinks or other beverages. Normally, Sport Shake is not stocked with fluid milk in the refrigerated dairy case.

Mid-Am has considerable evidence as to the use of Sport Shake. A study involving two focus groups was undertaken in 1991 by MedProbe, Inc. of Minneapolis. Quantitative research of 126 Sport Shake users was conducted in 1987 by Frazee Research Associated of Minneapolis. In addition, there have been store checks and interviews of brokers, wholesalers and retailers. New England Consulting Group of Westport, Connecticut assisted and lead this market research.

The quantitative market research of the 126 Sport Shake users revealed approximately 79% used Sport Shake as a snack (primarily before, during or after periods of physical activity), approximately 13% used Sport Shake as a replacement for a meal and 30% used Sport Shake as an energy source. These are all dietary uses. Only 8% used Sport Shake during a meal; the place one would anticipate a beverage being consumed.

Clearly, Sport Shake should be Class II because it is packaged in a hermetically sealed container, it is consumed for dietary use and it competes with many other similarly packaged products that are classified as Class II such as Slim Fast, Sweet Success, Ensure, Sustacal, Boost and Nutrament.

Location adjustments

Disallowed location adjustments for pool supply plants should be discontinued. Under current order provisions, milk transferred from a pool supply plant to a pool distributing plant is allocated Class I. However, the location adjustment is often disallowed because, according to the calculation in subsection 52(b) of the orders, there is enough producer milk to supply the Class I needs of the receiving plant. The inequity occurs because a distributing plant's demand is not equal for each day throughout the week. On average, enough producer milk may be available to supply the Class I needs of the market, but supply plant milk is required on days of high demand. Therefore, supply plant milk that is balancing the fluid needs of a distributing plant will get penalized as compared to distant direct ship milk because of disallowed location adjustment.

Shrinkage

Mid-Am supports prorating shrinkage as the Classification Committee suggested.

Mid-America Dairymen continues to support the Federal order program and thanks the United States Department of Agriculture for the opportunity to comment through the informal rule making process. Should you have any questions regarding our position, please call.

Sincerely,

MID-AMERICA DAIRYMEN, INC.

John J. Wilson
Vice President of Fluid Milk Marketing/
Economic Analysis

JJW/dr

Attachments

Federal Order Blend Analysis
January-May 1997

Origin	Destination	Blend	Additional Haul	Net	Gain
Cabool	Cabool	$12.83	$0.00	$12.83	
	Memphis	$13.92	($0.56)	$13.36	$0.53
	Little Rock	$13.92	($0.60)	$13.32	$0.49
	Tupelo	$13.98	($0.97)	$13.01	$0.18
	Fulton	$13.89	($0.67)	$13.22	$0.39
	Hattiesburg	$14.45	($1.69)	$12.76	($0.07)
	Huntsville	$13.98	($1.39)	$12.60	($0.23)
Fayetteville	Fayetteville	$13.19	$0.00	$13.19	
	Little Rock	$13.92	($0.41)	$13.51	$0.32
	Memphis	$13.92	($0.90)	$13.02	($0.17)