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AGRICULTURAL MARKETING SERVICE

In the Matter of :  
Milk in the Appalachian, Florida and : Docket Nos.:  
Southeast Marketing Areas : AO-338-A22; AO-356-A43;  
: AO- 366-A51  
: DA-07-03

Post-Hearing Brief for:

**Dairy Cooperative Marketing Association, Inc.**

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Attachment:

Comparison of DCMA Proposed Class I Price Differences to USDA Final Rule Adopted Class I Price Differences

## I. INTRODUCTION

A three day hearing upon proposed amendments to the three federal milk marketing orders regulating the marketing of milk in the southeastern United States was held May 21-23 in Tampa, Florida. This brief is filed on behalf of Dairy Cooperative Marketing Association, Inc. (DCMA), the common marketing agency of producer cooperatives which requested the hearing and sponsored the primary hearing proposals. DCMA wishes to note at the very outset its utmost appreciation to the Department for expediting this proceeding in the manner which it has. Addressing these urgent issues is very important to dairy farmers, and we believe the dairy industry, in the southeast and we are grateful for the Secretary's willingness to hear us.

DCMA through its expert witness, Jeffrey Sims, presented an exhaustive set of data chronicling the historic and increasing milk supply deficit in the southeast, documenting the extensive and expensive sourcing of supplemental supplies to serve the southeast markets, and elaborating the justification, rationale, and mechanics of the proposed changes to the Class I prices in all three orders and the changes to the pooling provisions and the transportation credit balancing fund provisions in Orders 5 and 7.

The vast proportion of Mr. Simms' data and testimony was unchallenged and so stands in the record. There was no data presented to challenge the facts of the supply deficit in the region. The uncontested and unchallenged data will not be reiterated in full in this brief; although some will be summarized. With respect to the DCMA proposals, there was essentially no opposition to the increased assessments for the transportation credit balancing funds<sup>1</sup>, even from handlers

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<sup>1</sup> Mr. Kinser for Dean Foods did note an objection to the proposed payment of transportation credits on the full load volumes, including non Class I volumes.

opposed to the Class I price increases. There was also no opposition to tightening of diversion requirements, although some queried whether even further tightening should be adopted. Most of the concerns in opposition to the DCMA package of proposals involved handler (buyer) opposition to Class I price increases – higher prices (which opposition one would expect) and the speed (emergency procedures) with which such higher prices might be adopted. This brief will primarily attempt to discuss and address these debated issues.

## **II. DCMA PROPOSALS 1, 2, AND 3 SHOULD BE ADOPTED**

Dairy Cooperative Marketing Association, Inc., (DCMA) a marketing agency in common of nine cooperative members operating in the southeastern United States, proposed a package of several improvements to the Appalachian, Florida and Southeast Federal Milk Marketing Orders (1005, 1006 and 1007 respectively) aimed at augmenting the Orders' ability to attract sufficient quantities of milk to the southeastern United States' marketing areas. All nine of the members of DCMA market milk on one or more of the three Orders, and together represent a majority of milk pooled on the three Orders (Tr. pgs.76-77).

### **A. The emergency conditions for milk supply to the southeast.**

The southeastern United States is an area of increasing population and decreasing milk supply. Despite opponents statements to the contrary, procuring milk for the regions is a major challenge, and a challenge met disproportionately by cooperative associations and their members (Tr. p.155). The statement that plants in the southeast are having no trouble getting milk (Tr. pgs. 457-473) is testament the those plants laying off the responsibility of procuring milk for the southeast onto cooperative associations. The record is clear regarding milk production and population trends in the region, and the trends are frightening (Tr. pgs. 28, 82-83, 85, 163-164, 251-253, 269, 289, 324-325, 349, 351, 458, and 530, Exhibit 21 pgs. A, R, S). DCMA would

argue that anyone who truly believes there is not a problem in supplying milk to and within the southeast simply has not been paying attention to the data.

Milk imported into the region to meet the Southeast's growing milk deficit increased yearly in distance moved and in volumes delivered (Tr. pgs. 79; 163-164, Exhibit 9 p.8, and Exhibit 18, p.3). This dynamic, coupled with increases in hauling costs, have left the southeast in dire straits in securing a sufficient quantity of milk for the region. The Secretary is well aware of the impacts of fuel costs and hauling rates on the cost of moving milk and supplying the southeast (Tr. pgs. 86 and 99, Exhibit I1 – I3).

**B. The DCMA package of proposed changes to Orders 5, 6, and 7**

In order to attack the problem of securing a sufficient quantity of milk for the southeast, several enhancements to the three southeastern Orders are proposed. First, Class I prices are proposed to be increased in the three Orders on a temporary basis; second, diversion limit provisions are proposed to be revised in the Appalachian and Southeast Orders, and third, the Transportation Credit provisions are proposed to be enhanced in the Appalachian and Southeast Orders. As a package, these proposals will send economic signals and provide marketing tools which will enhance the southeastern Orders' ability to attract a sufficient quantity of milk for the region (Tr. p. 150).

Increasing Class I prices in the Appalachian, Florida and Southeast Orders will offer dual benefits by virtue of the resulting enhanced producer blend prices. First, local producers may be encouraged to increase milk production for use in supplying the fluid milk needs of the three marketing areas, and second, producers outside the three marketing areas will experience increases price incentives to move milk out of manufacturing uses in the reserve supply areas, thus encouraging milk delivery to the predominately fluid milk marketing areas in the southeast

(Tr. pgs. 87-89, 97, and 110-111). In a parallel action to increasing Class I prices, decreasing diversion limits in the Appalachian and Southeast Orders will offer the same dual benefits by virtue of the resulting enhanced producer blend prices (Tr. pgs. 116-117). The producer "touch-base" provisions of the Appalachian and Southeast Orders is proposed to be changed, making the provisions more conducive to the efficient movement of milk (Tr. pgs. 125-126).

Enhancements to the Transportation Credit provisions of the Appalachian and Southeast Orders will offer those marketers supplying supplemental milk to the Orders greater assurance that costs of hauling milk to the southeast will be covered by expanding the payment of Transportation Credits to the months of January and February, and applying Transportation Credits to entire loads of milk (Tr. pgs. 129, 131, and 135). Additionally, the simplification of the method for determining which producers are supplemental will reflect the nature of the supply needs for the two marketing areas, and offer administrative and marketing efficiencies (Tr. pgs. 141-142). The proposed increase in the assessment for the Transportation Credit Balancing Fund in the Southeast Order will insure that funds required to be paid in Transportation Credits will be sufficient in the Order (Tr. pgs. 129-130, and 146-147).

The proposed provision changes put forward by DCMA are designed to function together in expanding the three Orders' ability to attract a sufficient quantity of milk to meet the fluid milk needs of the three marketing areas. Class I price adjustments and diversion limit changes work together to enhance producer blend prices in all three Orders. Diversion limit changes and Transportation Credit provision enhancements work together to reduce the pooled milk reserve on the Appalachian and Southeast Orders. Touch-base provisions and the definition of supplemental producers work together to enhance milk marketing efficiencies in the Appalachian and Southeast Orders. The Class I price adjustments and the Transportation Credit

provision enhancements work together to send economic signals and provide equitable regulated cost recovery in the delivery of supplemental milk to the region. The package of provisions is just that, an integrated, linked, comprehensive bundle of needed Order changes, and it is necessary to be considered as a package (Tr. pgs. 79-80, and 147-150).

### **C. Development of the Class I Price Increases**

The system of temporary Class I price increases proposed by DCMA is reasoned and reasonable. Handlers argued at the hearing that the proposed Class I price increases will change the relationship of plants' regulated Class I prices, price relationships which have been in many cases in existence for over 20 years (Tr. p. 436). DCMA agrees that the proposed Class I price adjustments will alter some plant to plant Federal Order Class I price relationships, and that some of those relationships are two decades old. We would just add, "It's about time".

The method employed by DCMA in establishing the proposed temporary Class I price surface is time-honored, contains all the elements of developing a Class I price surface used over and over by the Secretary, and generates Class I price relationships consistent with encouraging a sufficient quantity of milk to be available to the three marketing areas; not encouraging uneconomic movements of milk; and reflective of the economic conditions affecting the supply and demand for milk in the marketing areas. Testimony and data presented by DCMA provides proof positive that Class I price relationships are reasonable and reasoned (Exhibit 21 pgs. L1-L8). No probable competitive plants have price relationships altered such as to encourage uneconomic movements of milk.

In comparing the differences in plant Class I prices generated under the DCMA prices to the differences in plant Class I prices which were adopted by the Secretary in his 1999 Order Reform Final Rule, striking similarities are evident. Attached as an Exhibit to this brief is a

comparison of differences in Class I prices at numerous plant points within and outside the southeast as proposed by the Secretary in 1999 and as proposed by DCMA in 2007. The similarity in plant Class I price relationships as suggested by the Secretary and as proposed by DCMA is persuasive proof of the validity of the DCMA price development process, and further confirmation that the DCMA system of Class I price surface development meets the requirement of a regulated Class I price system.

### **III. THE PRODUCER CONCERNS THAT THE PROPOSED ACTIONS ARE INSUFFICIENT**

Producers and representatives of independent producer groups testified in qualified support of the DCMA proposals with an emphasis on the thought that the proposals do not go far enough in raising prices to producers in the southeast. We would suggest that these comments are important for two reasons: First, they should underscore to the Secretary that producer discontent and unrest in the southeast goes very, very deep. The structural supply deficit, the decline of profitable dairy farming in the southeast, and the accompanying decline in the dairy infrastructure in the southeast are very troublesome, difficult and painful parts of the southeast dairy experience for several decades now. In all candor, the Department has not seen fit, prior to this hearing, to indicate a willingness to consider substantial price relief on a regional basis.

Thus, the regional pain at the dairy farm level runs very deep as the testimony indicated. Furthermore, the comments of these dairy farmers and non-marketing organizations emphasize that DCMA has been aggressive, but reasonable, in the temporary price relief which it has presented in its proposals. This relief is important, it is significant, but it surely is not designed to, or able to, cure all ills in the southeast. The Secretary will be aware, however, in evaluating the full hearing record that, a few handler detractors notwithstanding, the DCMA proposals are

reasoned and reasonable ones.

#### **IV. OBJECTIONS AND ISSUES RAISED IN OPPOSITION TO THE DCMA PROPOSALS**

##### **A. Consideration of the Cost of Moving Packaged Milk.**

Opponents of the DCMA Class I price proposal challenged the use of the cost of packaged milk movements between plants as a decisional element in developing the proposed Class I price surface, arguing that the Secretary has found that packaged milk movement costs beyond 900 miles are non-linear, and that the DCMA process used linear cost relationships. The Secretary did state, in the 1999 Order Reform Final Rule that "While assembly costs and interplant bulk shipments were calculated using a linear cost function, the finished product functions were non-linear. In fact, finished product hauling costs (e.g. packaged milk) fell below raw milk assembly and hauling costs on an equivalent unit basis *in many cases* at distances more than 900 miles."<sup>2</sup> (emphasis added) As for this solitary reference to 900 miles and the non-linear cost of moving packaged milk products in that Decision, and its applicability to this proceeding, there is little if any relevance. First, distances across the southeast, except the most northern and western plants to the most southern plants, do not exceed 900 miles. Second, no new data is available which supports the maintenance of this cost equation theorem based on current hauling costs (opponents were unable or unwilling to provide for the record data on current packaged milk hauling costs (Tr. pgs. 571-573). Third, even if the costs of packaged milk movement beyond 900 miles do fall below the cost of moving bulk milk, the Secretary choose not to say by how much or in which or what "cases" such was true. Just because the cost of moving packaged milk may be less than moving bulk milk over some distance range, does not make moving

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<sup>2</sup> 64 Fed. Reg. at 16108 (April 2, 1999).

packaged milk free. DCMA cannot envision any non-linear hauling cost equation whose marginal cost at any point of moving milk another mile is zero. At the extreme case in the three Orders subject to this hearing, Springfield, Missouri to Miami, Florida, the DMCA proposal provides a price difference which is certainly not excessively reflective of the cost of moving packaged milk, even if the cost function is nonlinear. From Springfield, Missouri to Miami, Florida is 1,274 miles; with a proposed Class I price difference of \$3.20 per hundredweight (\$6.00 - \$2.40). This price relationship thus is \$0.0025 per hundredweight per mile, certainly less than the cost of moving packaged milk, whether linear or not.

#### **B. PLANT PRICE RELATIONSHIPS**

Two witnesses cited specific cases of changes in plant to plant Class I price relationships and the perceived impact on certain plants' competitive condition and position vis-à-vis other plants, whether within the three southeastern Orders or outside the three Orders. A principal consideration in developing the DCMA pricing proposal was the maintenance of Class I price relationships with other Orders not a part of this Proceeding (Tr. p. 91). Evidence of this concern by DCMA is seen by the vary nature of the proposed Class I price changes at the northern and western borders of the Appalachian and Southeast Orders. Most plant locations on the Appalachian and Southeast Orders borders are proposed to have regulated Class I price increases of \$0.10 per hundredweight. A few plant locations, locations more distant from competing other order plants or sources of supplemental supplies, are proposed to have greater Class I price increases, but in no case more than \$0.40 per hundredweight. The Class I prices as proposed are reasonable in light of milk movement distances, and costs of alternate supplies.

In Exhibit 36, page 3, Mr. Kinser of Dean Foods depicts what he describes as the "reduced competition miles" effected by the DCMA Class I price change proposals. The exhibit

depicts a myopic view of the proposal's effects. Moreover, when the full impact of changes in the cost of moving milk which has occurred since the benchmark years of 1985 and 1987 cited by handlers is evaluated, the DCMA proposal does more to restore traditional relationships among plants than it does to alter them adversely as alleged by not only Mr. Kinser but Messrs. Hitchell and Cottay, as well.

Mr. Kinser's exhibit is myopic because it only looks at impacts from the point of view of a plant whose price is raised relatively more than another plant. That is only one aspect of what occurs when Class I prices are changed. The other side of the coin is that plant "B" in the Kinser analysis has "gained" in relationship to plant "A". Furthermore, in the wider milkshed, Plant A is in the reverse relationship with Plant C, further south in the milkshed whose price has been increased \$.10 more than has the price of Plant B. Thus, Plant B is the beneficiary of "increased" competition miles, not just the victim of "decreased" competition miles. The bottom line is this: Of course Class I price changes change relationships among plants. Mr. Sims acknowledged this and described DCMA's attempts to "smooth" the proposed price surface and ameliorate all impacts to the greatest extent possible; and the proposal does an excellent job of doing just that.

In this entire context of evaluating competitive relationships among plants, what must not be overlooked is that over the years since 1985 or even 1999, which Mr. Hitchell of Kroger references and would like to retain, the increased cost of moving milk, while plant prices were not changed, has changed plant competitive relationships more than the DCMA proposals. We know, just from the changes in reimbursement rates in the transportation credit balancing funds in these orders, that the cost of moving bulk milk has increased dramatically in recent years. The current cost of moving bulk or packaged milk approaches \$.005 per mile, twice the rate (\$.0025)

at which the plant Class I price differences were established after the 1985 legislation. See Interim Final Decision, dated May 28, 1986, Docket Nos. AO-366-A27, et al.<sup>3</sup> Using Mr. Kinser's terminology, the "reduced competition miles" caused by increases in the cost of moving packaged milk are far, far greater than the same effect of the DCMA proposal. Take two plants which have a \$.20 price difference. When the cost of moving packaged milk has increased by 60 %, from \$.0025 to \$.004 per hundredweight per mile, the lower-priced plant "uses up" its \$.20 advantage in 50 miles, where it could move 80 miles previously in "using up" the \$.20 cost advantage. Across the region, every \$.10 price difference was "reduced" by 60% with the 60% increase in the cost of moving milk. In truth the cost increase since 1985 has been more like 100%, which means that every \$.10 difference, plus or minus, in the cost of moving packaged product between competing plants is more like \$.20 in actuality. In reality, the real cost of hauling suggests that the differences in plant Class I prices which currently exist are only half enough. If the DCMA proposal reflected the full changes in the costs of hauling, the prices would be even higher than they are. The actual proposal in its minimalist approach does not reflect the full changes in costs. The DCMA changes move toward conformity with the reality of the marketplace, and do not distort it.

#### **C. DIVERSION LIMITS IN THE APPALACHIAN AND SOUTHEAST ORDERS**

DCMA proposes lowering codified diversion limits in the Appalachian and Southeast Orders, thereby redefining the pooled milk reserve and increasing blend prices to producers, for

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<sup>3</sup> Official Notice of this Interim Final Decision is requested. The Hearing Notice for the proceeding is at 51 Fed. Reg. 5363 (February 13, 1986).

<sup>4</sup> The Energy Information Agency reports that for the cost of comparable fuels to Diesel fuel (Distillate No 2) for which data is published since 1985 has increased from less than \$.90 per gallon in 1985 to more than \$2.00 per gallon in 2006.

[http://tonto.eia.doe.gov/dnav/pet/pet\\_pri\\_top.asp](http://tonto.eia.doe.gov/dnav/pet/pet_pri_top.asp) (Official notice requested)

the reasons cited above. Considerable discussion at the Hearing dealt with the appropriate diversion provisions for the two Orders. Diversion limits should be reflective of the need for reserve supplies in an Order marketing area and milk shed (Tr. pgs.113-122). While alignment with neighboring Orders in diversion and pooling provisions is a consideration, the dominant question must be what level of pooled milk represents a marketwide pool and is that pool carrying a reasonable reserve, daily, weekly, monthly and annually. Data supplied by DCMA demonstrates absolutely the need for diversion limits as proposed. The daily fluctuation in pool distributing plant receipts and the need to accommodate seasonal swings in supply and demand necessitates diversion limits as proposed by DCMA.

Much focus from at least one party at the hearing was placed on the possibility of establishing for the Appalachian and Southeast Orders, the percentage diversion limits now in effect in the Florida Order<sup>5</sup> (those established after the promulgation of the Order by Market Administrator discretionary authority). No evidence exists to support this desire. While the application of the tighter diversion limits now in effect in the Florida Order would have the impact of further increasing producer blend prices in the Appalachian and Southeast Orders over the increases anticipated from the DCMA proposal, other considerations must be weighed.

First, diversions are limited beyond the amounts stated in the codified limits in the Appalachian and Southeast Orders by virtue of an effective zero diversion limit applicable on milk which receives a Transportation Credit, and DCMA has proposed more months be eligible for Transportation Credit, extending this diversion limit adjustment to even more months. If the Florida diversion limits were applied to the Appalachian and Southeast Orders, the resulting

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<sup>5</sup> This proposal seems to have been premised, at least in part on the erroneous conclusion that there was satisfaction among producers in Florida with the status quo. The producer testimony which followed (Peachey, Tr. 631-637) proved beyond purview that this was a handler illusion.

effective diversion limits would be in fact tighter than the Florida Order. Second, the purpose stated by the DFC witness for proposing tighter diversion limits in the Appalachian and Southeast Orders was to generate producer blend price increases commensurate with DCMA proposal which uses Class I increases and diversion limit decreases in tandem. DCMA appreciated DFC acknowledging the need for higher producer blend prices in the southeast Orders, but the DFC diversion limit modification leaves the Florida Order unaffected. DFC admitted their desire to raise producer blend prices, without raising Class I prices (Tr. p.625). Given the principal requirement that Class I price relationships be reflective of the cost of moving milk, and Order price alignment be weighted and recognized, the DFC modification would allow no appreciable increase in Order 1006 Class I prices, since Order 1005 and Order 1007 Class I prices would be unchanged under the DFC modification. Securing a sufficient quantity of milk for the Florida Order marketing area requires the same attention to economic signals as the Appalachian and Southeast Orders, therefore, Class I price increases, and the resulting producer blend price increases in the Florida Order are necessary.

No evidence was presented at the hearing which would allow the Secretary to evaluate the needs for reserve supplies in the Florida Order relative to needs for reserve supplies in the Appalachian and Southeast Orders. DCMA trusts that the Market Administrator for the Florida Order assessed these issues at the time of making the discretionary change in the Order 1006 diversion limits, however, no evidence on conditions in Florida and its particular need for pooled reserves is present in this record. The evidence pertaining to pooled reserve requirements in the Appalachian and Southeast Orders is complete and compelling, and thus the diversion limits adopted for those two Orders should be as proposed by DCMA.

#### **D. PLANT POOLING INCENTIVES**

The witness for DFC placed into evidence a calculation purporting to evaluate the economic incentives for distributing plants located outside the Order 5, 6 and 7 marketing areas to become pooled on those Orders (Tr. pgs. 536-548, Exhibit 36 pgs. 5 – 7). The Exhibit 36 suggests that there could be an advantage gained by plants now regulated on other Orders, e.g. 1030, 1032, or 1033, to shift Class I route dispositions into the Order 5, 6 and 7 marketing areas in sufficient quantities to become pooled on one of the southeastern Orders.

There are a number of defects in the DFC exhibit rendering the computation unusable for its stated purpose. First, the packaged milk hauling costs used by DFC are the substantially understated values utilized by DCMA in its Class I price development process. While it is appropriate for DCMA to use the understated packaged milk hauling costs in order to arrive at a minimalist Class I pricing structure, the hauling costs faced by a plant are the real hauling costs faced in real life. The higher actual hauling costs in truth experienced by real milk plants paying real haulers would remove the perceived advantages reported. Second, the analysis fails to analyze the impact of the out-of-area plant having to pay a Transportation Credit Balancing Fund assessment if pooled on either the Appalachian or Southeast Orders. Plants located outside the Order 5, 6 and 7 marketing areas with Class I route disposition inside these areas may compete with plants which pay the Transportation Credit Balancing Fund assessment. This is certainly true for Class I disposition in the Appalachian and Southeast Order marketing areas. As of today, no out-of-area plant has found it advantageous to become pooled on the Appalachian, Florida, or Southeast orders, probably because they don't want to pay a Transportation Credit balancing Fund assessment, or the cost of moving milk far exceeds any benefit received from pooling in a higher blended Order. Lastly, and certainly not least, the DFC exhibit calculates a presumed

financial "benefit" to out-of-area plants getting pooled on a southeastern Order. This calculation is the zoned out blend price difference between the producer blend price applicable at the distributing plant if pooled on the southern Order, versus the producer blend price applicable at the plant under the Order where the plant is located. In each calculation, the blend price to producers if the plant were pooled in one of the southern Orders exceeds the blend price effective on the "home" order. The calculation then presumes that this blend price enhancement is available to the plant to offset hauling costs of moving additional volumes of packaged Class I milk south necessary to get pooled in the south. This presumption is not correct. The distributing plant pays into whatever pool it is regulated in the Class I price applicable at that plant, and that Class I price does not change no matter what the Order it is pooled on. The blend price enhancement the plant experiences is not the plant's to keep, rather those greater blend values must be paid to the producers delivering to the plant. There are no additional dollars available to the plant, its regulated costs are unchanged no matter the Order on which the plant is pooled. Exhibit 36 pages 5 – 7 fails to provide any basis for the unease for which it was presented.

#### **E. THE SCHEPPS CASE LEGAL OBJECTION.**

Dean Foods and National Dairy Holdings moved to terminate this proceeding on the basis that the Class I prices proposed were in some way inconsistent with the legal teachings of the litigation culminating in the decision of the United States Circuit Court of Appeals for the District of Columbia Circuit in Schepps Dairy, Inc. v. Bergland, 628 F.2d 11 (D.C. Cir. 1979). A close reading of the Schepps case, however, provides no support to the Dean Foods and National Diary Holdings' objection; to the contrary, the DCMA proposals and their supporting data and rationale are fully supported and proper under the Schepps case. In Schepps, the

Schepps dairy in Dallas challenged the location differential structure under the Texas Milk Marketing Order, in particular the location differential in Houston, Texas. Schepps contended that the price difference between Dallas and Houston was insufficient and should be higher because of the cost of transportation between Dallas and Houston. The Court noted that "under Schepps plan, Houston handlers would face minimum prices \$.53 over the Dallas Class I minimum price. Schepps markets over half of its milk in Houston, so its proposal had the single objective of raising its competitors' costs." 628 F.2d at 16. The Court however affirmed the Secretary and rejected this rigid, cost-based constraint upon the Secretary's setting of location prices. The Court stated "we think the straightjacket that Schepps thus would place on the Secretary will not fit;" 628 F.2d at 19. Furthermore, the Court quoted with approval the Secretary's decision which stated "contrary to [Schepps] contentions, price uniformity for all handlers in a market does not contemplate a "precise" alignment of prices (or, in effect, raw milk costs) at different locations based on actual hauling costs. In fact, this is something that simply cannot be achieved. . . . It is not possible to establish a price structure under which each plant's Class I price is lower, and at the same transportation rate, than the price of every other plant in the market. . . . [A] handler may distribute milk in any area he chooses." 628 F.2d at 19n.51.

DCMA's use of the cost of delivering packaged milk in its proposal as detailed by Mr. Sims, was not as a primary determinate of Class I location values: it was as a secondary consideration for a "check" on price relationships. It is frankly very hard to understand how Dean Foods and National Dairy Holdings can criticize DCMA's consideration of this factor when both Mr. Cottay and Mr. Kinser's testimony emphasized the competitive relationship among distributing plants in sales of packaged milk. Mr. Kinser specifically analyzed how the relationship between plants would be impacted under the proposals given certain cost of moving

packaged milk (Exhibit 36, p.3). The Secretary, DCMA, and the handlers, including Mr. Hitchell for Kroger, all take note of the necessary importance of the competitive relationship between distributing plants. After all, these are DCMA's customers too. The Schepps case recognizes that the Secretary has discretion and is not constrained by a straightjacket in setting location prices. DCMA has made its proposals with these criteria in mind fully in conformance with prevailing law.

**F. GENERAL OBJECTIONS TO THE NEED FOR, AND APPROPRIATENESS OF, THE HEARING.**

The IDFA witness and the National Dairy Holdings witness each commented that there didn't seem to be any problem in obtaining adequate supplies of fluid milk in the southeast. Therefore, they contended that the premise of the hearing - the need to increase prices in the southeast in order to assure sufficient supplies - is flawed. Certainly, the overwhelming weight of the supply-demand data provided by Mr. Sims and not substantially questioned on a data basis by anyone at the hearing, should compel findings that there is indeed a supply-demand crisis in the southeast. Therefore, these general comments of the handler witnesses are not supported by the record. We would urge the Secretary to consider one other point in this context: if the only evidence of "inadequate" supplies is actual "shorting" of a fluid milk distributing plant, suppliers need to be aware of that. The fact is that the cooperative sector has always taken its responsibility to supply fluid milk plants seriously: these plants get all the milk they need, when they need it, even at extraordinary expense as routinely occurs in the southeast. Therefore, we urge the Secretary to let it be known that he does not require that plants be left short of milk in order to demonstrate difficult, if not emergency, supply-demand circumstances. The relationships of production and demand within a marketing area; distances which milk needs to

move; the expense required to bring milk long distances into a market; and all elements related to those dynamics should be taken into account in determining whether there are issues with the adequacy of supply in a market area. Detailed information regarding supply-demand offered by DCMA should speak much more loudly and profoundly in this record of the significant supply challenges in this region than the bland pronouncements of handlers or handler representatives that from their point of view they are having no difficulty getting a supply.

The additional contention of handler representatives that Class I prices should not be under any circumstances reviewed or changed on a regional basis should be rejected. The Federal order system today has many challenges, not the least of which is its ability to be responsive. This hearing notice and the hearing record itself demonstrate that there are important issues such as Class I prices which have been treated on a national basis in the past but which can be addressed on a local or regional basis as well. The DCMA proposals which are expressly indicated per the hearing notice to be temporary, have been designed to integrate with the national grid of Class I prices in the most acceptable manner possible. Because the southeast region is bordered on two sides by the Gulf of Mexico and the Atlantic Ocean, it is quite feasible to address the Class I prices in the region without impacting all prices in the country. The DCMA proposals do this and do this well. The more or less rote position that Class I prices should only be reviewed nationally does not fit the regional needs of the southeast or the urgent need of the dairy farmers in the southeast. These general objections should be overruled.

#### **V. NEED FOR EMERGENCY ACTION**

Abundant evidence of urgent, emergency marketing conditions in the southeast is present in the record. Milk production in the southeastern states during the first quarter of 2007 declined faster than the annual decline during 2006, which declined faster than the annual decline during

2005 (Tr. p. 163, Exhibit 21 pgs. R and S). This is the nonlinear relationship the Secretary should be most concerned about.

Fuel costs (Exhibit 21 pages I1 – I3) and the costs of moving milk to the southeast have increased precipitously, as have the volumes moved and the distance the milk travels (Tr. p.163, Exhibit 9, p.8 and Exhibit 18, p.3). As for the costs of supplying milk to a marketing area, more milk, moved farther, at higher haul rates is not a good thing. Further, national milk production growth is slowing, putting even more pressure on the ability of the southeast to obtain the sufficient quantities needed to supply the region's fluid milk needs.

The record recognizes that nationally milk prices are currently rising. While this helps dairy farmers nationally with incentives to supply milk to the marketplace, the rising price environment can actually make procuring milk for the southeast more difficult (Tr. p.161). Further, the disproportionate sharing of the costs of supplying supplemental milk to the region is exacerbated in an environment of milk scarcity and high hauling costs. Further still, relatively high Federal Order prices can put pressure on over order values, jeopardizing the revenues necessary to cover costs of supplying supplemental milk to the marketing areas if regulated cost recovery systems are inadequate to cover the realized costs.

DCMA demonstrated the losses incurred in procuring milk for the southeast at the current Class I price and producer blend price relationships (Exhibit 21, pgs. Q1 – Q4). Without adjustment in the Class I price surface, blend price surface, and Transportation Credit provisions, losses on procuring supplemental milk for the region can exceed \$4,000,000 per month (Tr. p. 154). These costs are not uniformly or equitably borne across the producer or handler populations (Tr. pgs.155-156).

The benefits of the package of proposals as submitted by DCMA are plain on their face.

Higher blend prices will encourage milk, whether produced inside or outside the southeast, to be available to supply the fluid milk needs of the marketing areas. Enhanced Transportation Credit provisions will continue to provide an equitable, certain, and transparent cost reimbursement system for hauling supplemental milk to the critically milk-deficit southeast.

**VI. THE MARKET ADMINISTRATORS' PROPOSALS 4 AND 5**

DCMA is well aware of the necessary costs of administration of the federal orders. We believe that the Market Administrators have made, and do make, an effort to control costs and operate efficiently. With those understandings, DCMA does not oppose the amendments to Orders 5, 6, and 7, as set forth in hearing proposals 4 and 5, to increase the maximum allowable rate of assessment for purposes of market administration.

**VII. CONCLUSION**

Proponents respectfully thank the Department for the opportunity to present their requests in this hearing process and appreciate the careful consideration which their testimony, evidence and arguments will be given.

Respectfully submitted,

By

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Dated: June 22, 2007

Comparison of DCMA Proposed Class I Price Differences to USDA Final Rule Adopted Class I Price Differences

Final Rule USDA Adopted Class I Price Structure	USDA Adopted System Difference	2007 DCMA Proposed Class I Price Surface	DCMA Difference	USDA Adopted to DCMA Proposed Difference		
<u>Charlotte</u> \$2.55	<u>Atlanta</u> \$2.90	\$0.35	<u>Charlotte</u> \$3.40	<u>Atlanta</u> \$3.80	\$0.40	\$0.05
<u>Nashville</u> \$2.05	<u>Atlanta</u> \$2.90	\$0.85	<u>Nashville</u> \$2.90	<u>Atlanta</u> \$3.80	\$0.90	\$0.05
<u>Atlanta</u> \$2.90	<u>Tampa</u> \$4.20	\$1.30	<u>Atlanta</u> \$3.80	<u>Tampa</u> \$5.40	\$1.60	\$0.30
<u>Dallas</u> \$2.10	<u>Atlanta</u> \$2.90	\$0.80	<u>Dallas</u> \$3.00	<u>Atlanta</u> \$3.80	\$0.80	\$0.00
<u>Dallas</u> \$2.10	<u>Tampa</u> \$4.20	\$2.10	<u>Dallas</u> \$3.00	<u>Tampa</u> \$5.40	\$2.40	\$0.30
<u>Springfield</u> \$1.70	<u>Atlanta</u> \$2.90	\$1.20	<u>Springfield</u> \$2.40	<u>Atlanta</u> \$3.80	\$1.40	\$0.20
<u>Mt. Crawford</u> \$2.15	<u>Charlotte</u> \$2.55	\$0.40	<u>Mt. Crawford</u> \$2.90	<u>Charlotte</u> \$3.40	\$0.50	\$0.10
<u>Spartanburg</u> \$2.55	<u>Charleston</u> \$3.10	\$0.55	<u>Spartanburg</u> \$3.60	<u>Charleston</u> \$4.30	\$0.70	\$0.15
<u>Birmingham</u> \$2.70	<u>Pritchard</u> \$3.30	\$0.60	<u>Birmingham</u> \$3.40	<u>Pritchard</u> \$4.00	\$0.60	\$0.00
<u>Springfield</u> \$1.70	<u>New Orleans</u> \$3.05	\$1.35	<u>Springfield</u> \$2.40	<u>New Orleans</u> \$3.80	\$1.40	\$0.05
<u>Tampa</u> \$4.20	<u>Miami</u> \$4.75	\$0.55	<u>Tampa</u> \$5.40	<u>Miami</u> \$6.00	\$0.60	\$0.05
<u>London</u> \$2.15	<u>Asheville</u> \$2.55	\$0.40	<u>London</u> \$2.90	<u>Asheville</u> \$3.40	\$0.50	\$0.10