

Arkansas Milk

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ARKANSAS DAIRY COOPERATIVE ASSN.

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March 13, 2006

Hearing Clerk, STOP 9200-Room 1031
United States Department of Agriculture
1400 Independence Avenue, SW
Washington, DC 20250 - 9200

Hearing Clerk:

Enclosed is the brief for Arkansas Dairy Cooperative Association (ADCA)
regarding the recent Federal Order Transportation Credit hearing.

Sincerely,



Floyd Wiedower,
General Manager

Arkansas Milk

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**APPALACHIAN and SOUTHEAST FEDERAL MILK MARKETING ORDERS
HEARING ON TRANSPORTATION CREDITS**

Docket Numbers AO-388-A17 and AO-366-A46; DA-05-06

Hearing Clerk, STOP 9200-Room 1031
United States Department of Agriculture
1400 Independence Avenue, SW
Washington, DC 20250 - 9200

Brief on Behalf of Arkansas Dairy Cooperative Association.

Arkansas Dairy Cooperative Association (ADCA) supports Proposals Number 1, Number 2 and Number 3 as included in the Notice of Hearing, Milk in the Appalachian and Southeast Marketing Areas, Docket Numbers AO-388-A17 and AO-366-A46; DA-05-06. ADCA opposes Proposals Number 4 and Number 5 as included in the Notice of Hearing.

Regarding Proposals 1, 2 and 3:

As a supplier of milk produced within the Order 1007 marketing area and milk produced outside the Order 7 marketing area, and as a member of marketing agencies in common which serve the southeastern United States, ADCA is deeply mindful of milk transporting costs increases and how those cost increases have affected our producer-members.

ADCA operates its own trucks and uses contract haulers as well. We have experienced cost increases in hauling which have come from increases in fuel costs just like was testified to at the hearing, and have seen fuel adjusters paid to contract haulers skyrocket with the cost of diesel. The system for allocating costs of serving the Class I needs of the southeast is most definitely in need of updating.

The milk which ADCA markets on Order 7 from outside the marketing area does not typically qualify for Transportation Credit payments because the milk is associated with Order 7 or Order 32 all of the time. Nevertheless, ADCA members are impacted by the cost of hauling milk to the southeast by virtue of our membership in a marketing agency in common.

ADCA has reviewed the cost factors which were used to develop the mileage rate used in the Orders for the Transportation Credit Balancing Fund (TC) payments and find it woefully inadequate. In very few instances, all costs of hauling milk have increased since the time when the TC provisions were put into the Orders, and fuel has become especially costly. ADCA would dearly love to be able to get milk hauled for a rate of \$0.00350 per hundredweight per mile, which is what the Order calls for in the TC provisions, but we must pay almost twice that much currently.

ADCA recalls the time when the TC were put into the southeastern Orders. At that time, the mileage rate and TC payments covered about 95 percent of the cost of hauling Class I milk, which was fair. ADCA recognizes that the reimbursement rate should remain less than 100 percent of the actual cost so as to encourage efficiency in hauling. However, what is paid out in TC now versus the real cost of hauling is markedly less than the original 95 percent. TC payments have been prorated by the market administrators because the money collected for the TC funds has been too little to cover the money claimed from the funds. When you combine this proration with the fact that the mileage rate is too low, you get real effective reimbursements from the TC funds which hover around 40 to 45 percent. USDA should return the TC payments to the 95 percent of Class I hauling cost by getting more money into the TC funds by raising the TC assessment, and modernizing the TC mileage rate.

Using the U.S. Department of Energy, Energy Information Administration weekly fuel prices for diesel is the right thing to do to update the monthly mileage rate. This fuel cost series is used widely in industry, and is well known and understood. Using an unbiased third party diesel price source will remove any question as to the appropriateness of reported changes in fuel costs over time.

For these reasons ADCA supports Proposals 1 and 3 as noticed or as modified by the proponents of proposals 1 and 3 at the hearing.

As we have said, something less than 100 percent of the cost of hauling Class I milk is a reasonable standard to apply to hauling cost reimbursement. The mileage rate computation which was included in the notice of hearing will generate a mileage rate which is less than 95 percent of the actual hauling cost, so no further modification or adjustment to the mileage factor is necessary. ADCA supports the Order language as proposed, it does not need any additional limits or prorations.

ADCA supports the use of the mileage rate computation as provided in Proposal 3. The fuel adjustment mechanism as proposed is fair, transparent, and mirrors fuel adjusters used in industry.

Proponents of Proposal 1 requested a different maximum rate of TC Class I assessment in Order 7 than in Order 5. ADCA supports this. As a member of the marketing agency in common which markets a substantial portion of the milk in the two Orders, we are aware of the distance supplemental milk moves to supply the two Orders. The Appalachian Order can get a portion of its supplemental supply from the northeast and middle-Atlantic states, while the Southeast Order gets a greater proportion of its supplemental supply from the southwest. The distances are substantially shorter moving milk from Pennsylvania and Maryland into Virginia and the Carolinas, than from Texas and New Mexico into Louisiana and Arkansas. As

a result, costs of transport on supplemental milk tend to be higher for delivery into Order 7 than into Order 5. These differences in costs hauling costs translate to greater draws on the Order 7 TC fund than the Order 5 TC fund, and thus the Order 7 TC fund needs to be funded at a greater assessment rate than the Order 5 assessment rate.

ADCA supports proposal 1 because there is equity and fairness in the allocation of the costs. When these assessments for transportation costs are included in the Orders, there is certainty by consumers, processors, and producers that the work paid for is actually done. Likewise, there is assurance to each of these groups that all handlers of Class I milk pay the same assessment and incur the same rate of regulated costs. These benefits are not necessarily true when these costs are left to over order pricing. ADCA has seen the benefit of the TC provisions in the southeastern Orders and unwaveringly supports the continuation of the TC process.

ADCA markets its milk in concert with the other members of a marketing agency in common. There are very few places in the southeast where milk production matches with plant demand. If the production and demand balance is reached in one month, it will be out of balance in the next month due to the counter-seasonality of supply and demand. As such, marketers of milk must move milk past many producers' closest plant. These extra movements of milk are not necessarily uniformly distributed amongst all marketers of milk and all producers, so the extra costs of supplying milk to Class I is not uniformly distributed either. This problem would be lessened if the differences in the location adjustments between plants were more reflective of the cost of moving milk. However, as proponents ably showed at the hearing, the Class I differential structure, which is the producer location adjustment structure, simply does not come close to moving the milk.

ADCA supports putting new provisions in Orders 5 and 7, the Intra-market Transportation Credit noticed in the hearing as Proposal 2.

It is true that the Class I differential surface in the southeast needs to be addressed. However, until this can be accomplished, something must be done to correct the inequity which exists in who bears these additional costs of supplying milk for Class I use. This is where the Intra-market Transportation Credit (IMTC) shines.

The IMTC as proposed is a relatively simple process for correcting these inequities in milk supply costs. The IMTC would reimburse handlers of milk if milk produced within the marketing areas moves for Class I use to a plant other than the pool distributing plant nearest to a producer. If the location adjustment structure covers those incremental costs, no IMTC is received. Whatever portion of the incremental costs is covered by the location adjustment differences reduces the IMTC. The IMTC is exactly the same concept as location adjustments, but is only applied to Class I movements, only on the defined extra movements, and when used in conjunction with the proposed variable mileage rate factor, self corrects for changes in milk movement costs much quicker than location adjustments can change. In addition, one of the beauties of the IMTC process as proposed is that it is self correcting if location adjustments change, or if plants open or close.

The Class I marketplace should bear the costs of these additional movements, because these are costs of supplying Class I. Therefore, ADCA supports the Secretary setting the

IMTC assessment rate high enough to cover all the anticipated IMTC claims. A fail safe process is necessary however, such that if the IMTC fund is not sufficient to cover all of the claimed IMTC's in a month, at least some of the difference can come from the producer revenue pool. These costs continue whether there is enough money in the kitty or not. The costs should be paid to preserve producer equity in the allocation of these costs whether the Fund has enough money or not. ADCA does support limiting any draw from the producer revenue pool to the amount of money in the IMTC fund. While equity must be preserved, we respect the need to put a maximum on the reduction in pool funds if the IMTC fund is underfunded in a month.

Regarding Proposals 4 and 5:

ADCA is opposed to proposals 4 and 5, as included in the notice of hearing, and modified at the hearing.

Proposal 4, as we understand it, would lower the payments from the TC fund if a handler has pooled deliveries to plants other than pool distributing plants which exceed 30 percent of its total pooled supply. The lessening of these payments would be progressively greater as the reserve milk pooled increased over the 30 percent standard.

Federal order marketing areas must be balanced, and that balancing requires a necessary reserve to cover daily, weekly, monthly and seasonal variations in supply and demand. Unfortunately, these variations in supply and demand do not coincide well, and in fact quite often move counter to each other.

Seasonality of production in the southeast is the worst in the country, which necessitates a greater annual reserve for the southeast than anywhere else. For example, a handler in the southeast projects it needs 30,000,000 pounds of supplemental milk in September. Of course the 30,000,000 pounds the handler needs in September won't be needed 1,000,000 pounds per day - it will more likely be needed at a rate of 1,500,000 pounds per weekday. So now instead of being able to just acquire the 30,000,000 pounds really needed in September, the handler will have to procure at least 42,000,000 pounds. However, the 1,500,000 pounds per weekday won't be needed the same across the month, maybe needed more like 1,600,000 pounds per weekday in the first week of the month, and less throughout the rest of the month. So now the volume necessary to cover the highest day's requirement means the handler will have to procure more like 45,000,000 pounds for the month - just in order to make sure that the highest day's processing is covered. So that handler's reserve requirement, intra-month, is now 50 percent of its supplemental volume. This same relationship would hold true on its regular source of supply too. In case we forget, in order to insure that 45,000,000 pounds is available in September, the handler would have to secure 58,500,000 pounds in April or May, given a 30 percent seasonality ratio between the flush and the tight season. This is all predicated on the handler having superb advance knowledge of its needs, several months in advance. Woe is the handler that experiences some unforeseen occurrence!

The example above shows how one handler's need for milk can necessitate a reserve requirement greater than 30 percent within a month. If that handler relies on a cooperative as the primary supplier, then that cooperative could theoretically be penalized for the handler's processing seasonality. Worse yet, if the handler had a regular source of its own producer milk, and relied on a cooperative to partially balancing its supply, the handler could cause the cooperative to experience reductions in the cooperative's TC payments, while arranging the handler's own supply such that it could receive 100 percent payments from the TC fund. This is blatantly unjust. The language in proposal 4 is silent as to how to make the process just and equitable. If for no other reason, proposal 4 should be rejected.

ADCA is opposed to proposal 5.

The southeast needs milk from outside the marketing areas, just to satisfy Class I demand. The out-of-area producers that fill this need are just as entitled to the Order blend as a producer located inside the marketing area if both producers have satisfied the Order's touch-base and pooling requirements. If the Order's provisions on pooling are improper, and we don't contend that they are, then let's have a hearing and re-set them. Setting up some discriminatory process which treats distant producers as second-class citizens is wrong, and we feel it is prohibited.

ADCA has reviewed the language contained in proposal 5 and agree that it would create opportunities for moving milk in uneconomic ways. This is not what Orders are supposed to do.

Conclusion

Arkansas Dairy Cooperative Association supports proposals 1, 2 and 3. These proposals would assign the costs of moving milk for Class I use which are not covered by the Orders' location adjustments where those costs ought to be, on the Class I marketplace. We are opposed to proposals 4 and 5 because they would create inequities between parties, and would encourage uneconomic movements of milk.