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**Via E-Mail Only - [dana.coale@usda.gov](mailto:dana.coale@usda.gov)**

Ms. Dana Coale, Deputy Administrator  
Dairy Programs, AMS, USDA  
USDA-AMS-Dairy Programs  
1400 Independence Avenue, SW  
Washington, D.C. 20250-0225

Re: Request for hearing upon amendments to  
Federal Milk Order 33, 7 C.F.R. 1033

Dear Ms. Coale:

Land O'Lakes, Inc., Michigan Milk Producers Association, Inc., Foremost Farms USA Cooperative, Inc., Dairylea Cooperative Inc., NFO Inc., and Dairy Farmers of America, Inc. (the "Cooperatives") each of which supply milk to processors and pool the milk of producer members on the Order are requesting a Hearing to consider changes in the Order 33 differential price surface. The Cooperatives, in aggregate, market a majority of the milk pooled on Order 33.

**Changes in Surrounding Markets**

Recent urgently needed changes to Federal Orders 5, 6 and 7, which provided for temporary increases in both the Class I differential price surface and, in Order 5 and 7 only, enhancements to the transportation credit balancing funds, have made it increasingly difficult to supply the southern tier of fluid milk processing plants in Federal Order 33. In a February 28, 2008 release the Agriculture Marketing Service announced changes in the differential price surface to Orders 5, 6 and 7 that increased differentials from as little as 10 cents per hundredweight in the northern and western portions of the combined marketing area to as much as \$1.80 per hundredweight in the southern counties of Order 6. These and other changes to those Orders will increase blend prices in the Southeastern Orders. For example, in testimony presented at the Hearing by the Federal Order 5 Market Administrator the change

in location adjustments in Order 5 were projected to increase the Uniform Price at location (weighted average) by approximately 30 cents if applied to market conditions in 2004 – 2006. Similar testimony from the Order 7 Market Administrator indicated the changes could increase blend prices by 64 cents under that Order. See Exhibit 9 - Federal Order 5 Market Administrator page 10 - Milk in the Southeast Marketing Areas, May 21 – 23, 2007; Exhibit 18 - Federal Order 7 Market Administrator page 1 - Milk in the Southeast Marketing Areas, May 21 – 23, 2007.

In addition, the Decision modified the inter market transportation credit system by increasing the transportation credit assessment charged to handlers in Order 7. The effect of this increase means more total dollars are available to offset transportation costs and the fund will be less likely to prorate credit payments to shippers. Also the credits are now applicable in more months of the year, further enhancing those markets' ability to pay for milk. The resulting scenario is that the Southeastern Orders are now better able to attract milk from reserve regions such as Order 33 into their markets and away from the local Mideast Order plants. (73 Fed. Reg. 11208-11212, (February 29, 2008)).

#### Issues in the Mideast Order

The Southern tier of fluid processing plants in Order 33 (generally speaking the 10 plants south of Interstate 70 located in Indiana, Ohio, and West Virginia) lie in a deficit milk supply region. This region absorbs all of the local milk supply that does not get attracted away to Order 5 or 7 and, then, must rely on supplemental supplies delivered from milk produced primarily within Order 33 but from more distant northern zones. Furthermore, the reserve supply in the northern zones will be further attracted as supplemental supplies to the Southeast through the increased differentials and the enhanced transportation credit payments. For example, data regularly published by the Order 33 Market Administrator shows that Jasper and Newton Counties are the two counties with the most production in Indiana. In both counties, over 80% of the milk produced there is pooled in another Federal Order, clearly attracted there by the higher price.

The rapid rise in diesel fuel prices is increasing the cost of supplying milk to all fluid processors, but is especially burdensome in supplying processors in deficit areas. The EIA published diesel fuel price for the Midwest Region, the most identifiable index for the Mideast Order, was \$4.463 per gallon for the week ending May 19, 2008. That is a 60% increase from the same week in 2007 when the price was \$2.773 per gallon. However when measured against the price in May of 2000 – when the current differentials (adopted in

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Federal Order Reform) became effective – the diesel price then \$1.42 is now 214% greater. Also, the Reform differential price surface was based on research performed by Cornell University and done in the mid 1990's. Milk assembly, transport, and finished product distribution costs (all of which reflect fuel costs) are essential to the "Cornell model". All price relationships derived from fuel cost data based in the mid-1990's are very much outdated.

The current price surface is also based on milk supply demand relationships as they existed in the mid 1990's. Conditions are noticeably different today. For the most part, demand centers have increased population, dairy farms have become fewer in number, larger in production per farm and the largest farms in the supply network are further away from the population centers. These structural changes in the Midwest market are not reflected in the current differential make-up as they have occurred since the last changes were made to the price surface. Thus, the supply/demand relationship is stressed both by rising supply costs and an outdated differential structure which is in need of review.

### **Order 33 Market Analysis**

The Order 33 Marketing Area was subdivided for analysis into three reasonably distinct milk sheds characterized by groupings of demand points and supply regions. This aggregation was constructed based on current supply/demand relationships deemed most reasonable from the best professional judgments of the day to day milk marketing agents employed by the Cooperatives. Current experience with surplus areas and those areas from which supplemental milk supplies are regularly taken from in order to supply deficits in the other areas within the Order 33 marketing area guided the selection process. The map attached to this request and the associated index describes that division. (Attachments 1–3) The accompanying tables provide data about the Regions.

Once the Cooperatives established the milk supply/demand regions, we asked the Market Administrator to compile market statistics for the areas. The Regions and their current differentials are noted in the attachment labeled "Midwest Regional Milk Supply Areas" and an accompanying two page table. (Attachments 1-3). For this purpose the term "Area" represents the three subdivisions we have created.

The "Summary of Available Supply v. Milk Received at Distributing Plants" (Attachment 4) was developed to yield a picture of the relative balance between milk production and sales in the Order 33 Marketing Area. The months we reviewed were November 2006 and January, April, and August 2007. The data we requested were milk produced in the area, milk volumes pooled on the Order, and Class I sales by plants located in the area. Additionally, we requested that the Market Administrator summarize the distance

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milk had to be hauled within each area to meet the demand in that area. Thus, data for each Area represents all market production, all milk pooled in Order 33, and all Class I sales in the Area. We have also included a map labeled “Current Federal Order 33 Class I Differentials” to indicate the current differential structure in Order 33. (Attachment 6)

The Mideast - Northwest Region is composed of what are now the two lower valued Class I differential zones in Order 33. This is the area with the largest milk production, the most counties exhibiting growth in milk production and the largest volume of Class I demand. This area by any definition possible is the reserve supply region for Order 33. Within this Region, milk production is surplus to Class I demand by an average of over 200% in the four time periods measured. Based on our knowledge of the market, milk is transported out of this Region to customers in each of the other two Regions many days and in every week of the year. For the milk that is delivered to Class I plants in the Region, the average haul distance is only 73 miles for the four periods measured – the lowest transported miles of any Region. (Attachment 5).

The Mideast – Northeast Region is composed of what is now the \$2.00 zone within Order 33 generally north of Interstate 70 in Ohio, and the \$2.10 and \$2.30 zone in Pennsylvania; but not including any of the \$2.00 zone in Indiana. This is also a surplus Region – but at a lesser rate. Here the supply is approximately double the Class I demand over the four months measured. The distance that milk is moved to meet the Class I demand in the Region averages 80 miles. (Attachment 5).

The Mideast – Southern Region is composed of the remaining marketing area in Indiana – the \$2.00 and \$2.20 zones; the remainder of Ohio – the \$2.00 zone south of Interstate 70; and any counties in Kentucky and West Virginia except the four counties north of Wetzel county that are wedged between the Ohio border and the Pennsylvania border. The counties in the Southern Region comprise the \$2.20 / \$2.30 and \$2.40 zones in the Order. The Southern Region contains 10 plants currently with an eleventh plant currently in the startup phase (owned by the Nestle Company) that is projected according to published reports, to process 1,000,000 pounds of milk per day. The milk supply for this Region is approximately half of the required Class I demand, making the Southern Region a severely deficit milkshed. In Order to supply the Southern Region milk transport averages 137 miles – clearly representing milk movements from outside the Region being delivered to plants within the Region. (Attachment 5).

One of the purposes of the Class I differential is to provide incentives for milk to move from supply points to demand points. In the Mideast Order, the relationship of differential to cost of transport has been eroded sufficiently that it does not provide an adequate incentive to move milk. In order to measure this erosion we selected eleven

counties representing large milk production areas from which reserve milk supplies might be sourced to meet Class I demand in the deficit Southern Region. These county selections were based on milk production data regularly generated by the Order 33 Market Administrator and the Cooperatives' expectations of growth and potential growth of future milk production. We obtained mileages from the county seat of each reserve supply county to each of the ten Class I processing plants in the Southern Region and computed the cost per hundredweight to transport milk from each reserve point to each plant. (Attachment 7).

In Order to compute the transport cost, we used current market-based cost factors from our own transportation experience of \$2.20 per loaded mile base rate and a 46% fuel surcharge or \$3.21 per loaded mile, with a 48,000 pound payload. After computing the transport, we reduced the cost per hundredweight by any gain provided by the Order's differential price surface. For example, using Mercer County, Ohio (\$2.00 zone) as a supply point and the Meyer Dairy Plant in Cincinnati (\$2.20 zone) as a delivery point, there are 122.4 miles between the two locations. At \$3.21 per mile and a payload of 48,000 pounds the transport cost would be \$0.82 per hundredweight. The Order provides \$0.20 to make the trip leaving a shortfall of \$0.62 per hundredweight. Using this method the differential needed to effectuate cost recovery would be \$2.82 per hundredweight. The table labeled "Hauling Cost minus Location Adjustment" which follows the procedure outlined above yield a shortfall at **every demand point** by an average of \$1.75 per hundredweight. The lowest "lost recovery" was \$0.45 per hundredweight, the largest \$3.22 per hundredweight and the median \$1.76 per hundredweight. Clearly, the existing price surface is not sufficient to offset even a reasonable portion of the cost. (Attachment 7).

We also tested the methodology followed in the recent Southeastern hearing to measure adequacy of the existing differential. This methodology requires a rate per hundredweight per mile computed using a diesel fuel cost from the EIA Mideast region, a base rate per mile of \$1.20 based on the experience of the Cooperatives, a 6-mile per gallon fuel use rate and the same 48,000 pound payload. This calculation is set out in the table labeled "Calculation of the Rate per Cwt. per Mile using the Southeastern Model for April 2008" and produced a \$0.00554 rate per cwt per mile. The Southeastern Model multiplied the miles times the rate factor, reduced the product of the multiplication by 20% (to meet the standard that Order reimbursements are at less than full cost levels and then reduced this product by the existing differential). The proponents in the Southeast then chose the lowest supply alternative from the group to base the potential new differential on. This computation for the same supply / destination points – Mercer County Ohio and Cincinnati Ohio – yields a possible differential of \$2.54 or 34 cents above the existing \$2.20 level. (Attachment 8).

The table labeled "Results from the Matrix and the Southeastern Model and Comparisons with Current Class I Differentials for the Mideast's Southern Region and the Northern Region of Federal Order 5" details the results from computations as described above for the Cincinnati; Charleston, West Virginia; Indianapolis, Indiana; and Marietta, Ohio demand points. The Southeastern Model computed shortfalls in the differential level of 34 cents for Cincinnati, 74 cents for Charleston, 56 cents for Indianapolis, and 52 cents for Marietta. The Cooperatives' matrix model generated shortfalls of Cincinnati – 62 cents; Charleston \$1.16; Indianapolis 55 cents and Marietta 79 cents. (Attachment 9).

Attachment 9 also highlights the urgent alignment problem between Order 33 Southern Area Plants and nearby Order 5 plants. Winchester, Kentucky, for example now has a Class I differential \$.40 greater than the Cincinnati plants which are its primary competitors. At a Class I price of \$.40 less than Winchester and the hauling expenses described above, there is little incentive for dairy farmers to supply Southern Area Order 33 Plants.

### **The Proposal**

The Cooperatives realize that the differential changes as announced in the Southeast are temporary and may be further adjusted by future hearings. Furthermore those changes, as proposed by the industry representatives there and adopted by the Secretary, were constrained by the price levels in surrounding markets and the overall price alignment issues with the nationwide price grid. The Cooperatives realize similar constraints exist in this request.

Our proposal for temporary change is made only for the marketing area covered by the Southern Region of Order 33 which the Cooperatives in their day to day business operations document to be a deficit market. For that area in the State of Ohio, we would propose that a new zone be created encompassing the counties which may generally be described as the counties in the existing \$2.00 zone south of Interstate 70 and that zone carry a \$2.20 differential. In the State of Indiana, the corresponding counties south of Interstate 70 should be part of a new zone with a \$2.10 differential. (Attachment 10 and 11). (Proposed Order language and map).

The former \$2.20 zone would be increased to \$2.40. The West Virginia counties of Kanawha, Fayette, Lincoln, Logan, Boone, Raleigh, Wyoming and Mingo and the Kentucky counties of Johnson, Floyd, Martin, and Magoffin be deleted from that zone. These counties would be added to Pike County KY (formerly the \$2.40 zone) to form a new zone priced at \$2.60. (Attachment 10 and 11).

The supply situation in the Southern Region of Order 33 will become even more difficult as the changes in the Southeastern Orders become more readily apparent and a part of

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the market's daily business patterns. The difficulty of attracting milk to remain available to serve Order 33 markets will only become more difficult. Whether milk prices are high or low, the relative price differences will not be sufficient to meet the objectives of the Federal Order program. We request that this request for a hearing be considered on an expedited basis so that the needed corrections to the price surface can be instituted as soon as possible.

Thank you for your consideration of this request

Very truly yours,

/s/Marvin Beshore

Marvin Beshore  
Attorney for the Cooperatives

MB/tlm  
Attachments

cc: Via E-Mail Only

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