

BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE

AGRICULTURAL MARKETING SERVICE

In the Matter of: : **Docket Nos:**
: :
Proposed Amendment to the : **AO-11-0333**
Mideast Federal Milk Order : **AMS-DA-11-0067**
(7 C.F.R. §1033) : **DA-11-04**

U.S. DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE
OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20250

POST HEARING BRIEF ON BEHALF OF:

Southern Marketing Agency, Inc.

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November 23, 2011

This Brief is filed on behalf of Southern Marketing Agency, Inc., a Capper Volstead marketing agency in common whose members market milk on seven Federal Milk Marketing Orders, including the Mideast Milk Marketing Order, Number 1033. The members of Southern Marketing Agency, Inc. are: Arkansas Dairy Cooperative Association; Dairy Farmers of America, Inc., Dairymen's Marketing Cooperative, Inc., LANCO-Pennland Quality Milk Producers, Inc., Lone Star Milk Producers, Inc., Maryland & Virginia Milk Producers Cooperative Association, Inc., and Premier Milk, Inc.

Southern Marketing Agency, Inc. supports proposal number 1, as included in the Notice of Hearing, Milk in the Mideast Marketing Area, AO-11-0333, AMS-DA-11-0067, and DA-11-04. Proposal 1 would fully regulate on the Mideast Order a distributing plant located inside the Mideast Order marketing area which distributes more than 50% of its route distribution in Federal Order marketing areas but, however, does not have sufficient route disposition in any one Federal Order marketing area to qualify as a pool distributing plant.

Disorderly marketing conditions are currently occurring in the Mideast Order Marketing Area. The elements of this disorder are manifesting themselves in a number of ways, including:

1. the disruption of uniform producer and uniform handler pricing
2. the irregular switching of plant regulation between Orders and fully regulated and partially regulated status
3. the improper pooling assignment of reserve supplies resulting from regulatory variation
4. the uneconomic movement of milk

Points to Consider

1. Repeatability

Substantial evidence was presented in hearing testimony of the transfer of packaged fluid milk products from a large-volume partially regulated distributing plant to a small-volume fully regulated distributing plant for the purpose of reducing the in-area route disposition percentage of the larger plant so that the larger plant attains and retains partially regulated status (TR. Volume I, October 4, 2011, pages 150 – 151; and Volume II, October 5, 2011, pages 114-115). In fact, the transferred packaged fluid milk product moves westward from the partially regulated distributing plant to the regulated plant, and then moves eastward, past the partially regulated plant for route disposition inside the Northeast Order marketing area. Such a movement of milk would only make sense if an

economic advantage accrues from the activity. That economic advantage is the inherent price advantage enjoyed by a partially regulated plant.

The most ominous aspect of this process is that it is repeatable, virtually by any current fully regulated plant. This process can be accomplished simply by installing a bottling line and packaging a few gallons of milk in an already established distribution center or warehouse, and convert what otherwise is a traditional fluid milk distributing point into a “plant” under the Order. This could be done with relative ease, and relatively modest expense. One can easily envision a series of fly-by-night satellite plants in stationary orbit around the central processing plant, all of the satellite plants processing just enough milk to qualify as a fully regulated (pool) plant. The center “star” plant in this galaxy of gamesmanship would transfer enough of its packaged fluid milk products to the satellite plants that its route disposition in any Order would fail the in-area percentage test for regulation, thereby becoming partially regulated.

By their own admission, Superior Dairy engages in “exploitation of the partial regulation status” (TR. Volume II, October 5, 2011, page 32). The Secretary should not stand idly by while the idea of what should constitute a fully regulated plant and a partially regulated plant is tainted.

2. The uneconomic movement of milk

The record is complete in its description of the uneconomic movements of milk which are currently occurring in the Mideast Order marketing area. Opponents of proposal I do not even attempt to deny the allegation. The obvious loophole must be closed.

The Secretary should send a signal to the industry that this type of regulatory avoidance will not be condoned or tolerated. If the milk processing and distributing universe were to devolve into the scenario painted in item I above, such a perverse picture of crisscrossing lines of distribution it would be. There would be a proliferation of tiny supposed fluid milk plants; shuttling milk in and out; shuttling milk between trucks; trucks crossing paths empty and full, all to avoid the regulation of a main center processing plant. Except for the obvious increase in demand for truck drivers and fork-lift operators, there is no place for these diseconomies to exist in the Federal Order regulatory framework.

3. The improper pooling of reserve supplies

The variable regulatory status of a plant can bring disorder to a marketing area due to the improper pooling of reserve supplies associated with the plant. Varying producer definitions between Orders and differing reserve requirement provisions make assigning proper reserves associated with the Class I use of a plant difficult when a plant

is constantly changing regulatory status between Orders, or between full and partial regulation status.

When a plant changes regulation, the reserve supplies associated with that plant, at least in theory, should also move to the new regulatory venue. By way of examples, if an Order 33 plant becomes regulated on Order 1, the reserve supplies associated with that plant should rightly switch to Order 1 too. Or if a fully regulated plant becomes partially regulated, then those reserves should exit the pool likewise. Unfortunately, the pooling of the reserves all-too-often does not move in lock-step with the plant. Plant regulatory mobility does not necessarily mean “reserve supply pooling portability”.

When a plant changes regulation from one order to another, some of the reserve supplies associated with the plant can become “stranded”, at least temporarily, on the original Order. Meaning of course, that until the reserves can be properly qualified on the Order the plant moves to, the Order the plant moved from gets to carry a reserve, without benefit of the Class I milk the reserve is set aside for. The same is true if a plant becomes unregulated or partially regulated.

The proper pooling of reserve supplies with the plants and Orders with which these reserves are associated is a hallmark of orderly marketing. In the current case in the Order 33 milkshed and marketing area, plants are obviously switching regulatory status, and the ensuing disorderly marketing conditions are present or threatening. Creating provisions in Order 33 which will ameliorate these disorderly conditions by cementing the full regulatory status of distributing plants located in the marketing area will definitely be a good thing.

4. Disruption of Uniform Pricing

While the Order provisions pertaining to the Producer Settlement Fund obligation of a partially regulated plant, the oft-referred-to §10xx.76(b), a.k.a. the “Wichita Option”, ostensibly equates the classified use value of milk at a partially regulated plant to that of a fully regulated plant, there still are subtle but nonetheless important differences which can impact the nature and flow of commerce.

A partially regulated plant, even if it pays producers the equivalent of its classified use value still can have a competitive advantage over a fully regulated plant. This is due to the Order’s differing application of the Administrative Assessment to the two types of plants.

Fully regulated plants pay the Administrative Fund (A.F.) assessment on 100 percent of their producer milk receipts, whether the fully regulated pool plant used the milk in Class I or any other Class. A partially regulated plant pays the A.F. assessment on 100 percent of their Class I route disposition in Federal Order marketing areas. The partially regulated plant has no obligation to the A.F. on its Class II, III or IV use, or on Class I route disposition outside Federal Order marketing areas.

In addition, if the partially regulated plant receives milk from dairy farmers who are not members of a cooperative association, those non-member producers are not subject to the Order's marketing service assessment.

All their testimony suggesting the contrary to the side, the Superior Dairy witness admitted that the partially regulated status created a financial benefit to the plant (TR. Volume II, October 5, 2011, pages 161-162).

5. Orderliness Value of Uniform Pricing

Much time was spent at the hearing discussing the Wichita Option, and how a plant may gain an advantage even when it seemingly has a theoretically equal cost of milk to that of a fully regulated plant. The impact of the Administrative Assessment Fund issue aside, there is value to a plant of being an individual handler pool with a higher-than-Order-average Class I use in competition with fully regulated plants. In short, producers who can deliver to the individual handler pool plant stand to receive a higher price than their neighbors, and plants are fond of that, apparently enough to send truckload after truckload of milk initially backwards away from their consumers in order to secure the partially regulated status. The plant must like it a whole lot to go to that much trouble.

One additional and perhaps overriding fact should not elude the Secretary in deciding this issue. Dairy Farmers of America, Inc., a member of the proponent cooperative group, is a raw milk supplier to Superior Dairy. While not stated specifically at the hearing, one can presume that the price paid to DFA for the milk they sell to Superior Dairy is at or near Superior's average classified use value, and thus, since the plant is admittedly 82 percent Class I, would be greater on a per hundredweight basis than the Order 33 Uniform price. Yet, DFA has joined a group of cooperatives in proposing that Superior Dairy be fully regulated, advocating putting that classified value in the Order 33 pool, rather than keeping the additional value for themselves. Upon the plant's full regulation, one can likewise presume that the basic price charged to Superior by DFA will no longer be a function of the plant's classified use value, but rather the base price will be the lesser Order 33 components and Producer Price Differential.

In plain terms, DFA is a giver in this scenario, their revenue for the sale to Superior Dairy is likely to go down, and the difference they give up will be shared with all Order 33 producers (TR. Volume II, October 5, 2011, pages 111, 125 and 182).

For DFA to support this change in the regulatory status of the plant, the worth of uniform pricing to producers and handlers must exceed the pecuniary gains DFA is currently receiving. The important value gained by DFA is the value of orderly marketing.

The potential loss if the current circumstances are allowed to persist is the impairment of Orderly marketing and thus the regular, systematic, organized flow of milk to consumers which the Federal Order program provides.

6. Offered Modifications to Proposal 1

Superior Dairy advocated modifications to Proposal 1 at the hearing which would lock the Canton, Ohio plant into full regulation on the Mideast Order, provided the plant otherwise qualified for pool plant status based on its Class I use, etc. Southern Marketing Agency, Inc. would have no opposition to the installation of such lock-in provisions in Order 33 as a method for alleviating the disorderly marketing conditions now occurring in the Mideast marketing area.

7. Need for Emergency Action

The Secretary should exercise the authority to treat this proceeding as an Emergency action and thus omit the issuance of a recommended decision. The record is replete with testimony on the detrimental nature of the marketing conditions and the resulting marketing disorder. Swift action by the Secretary to close the regulatory loophole is required, such that other handlers will not replicate the uneconomic conditions currently existing and the resultant degradation in confidence in the Order's uniform pricing provisions.

Conclusion

On the basis of the foregoing, and the testimony and evidence received at the hearing, Proposal 1 or an appropriate modification thereto which regulates plants inside the Order 33 marketing area with substantial volumes of route disposition in Federal Order marketing area(s), should be adopted.

Respectfully submitted,

November 23, 2011

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