

Federal Order Educational and Listening Sessions

United States Department of Agriculture
Agricultural Marketing Service
Dairy Programs
Federal Order No. 5 – Appalachian Marketing Area
Federal Order No. 7 – Southeast Marketing Area

What We Will Cover

- ▶ Federal Order Overview
- ▶ Pool Plants
- ▶ Milk Production
- ▶ Seasonality and Daily Variation of Supply and Demand
- ▶ Delivery Day Requirements & Diversions
- ▶ Transportation Credits
- ▶ Multiple Component Pricing
- ▶ Discussion/Q & A

Federal Order Overview

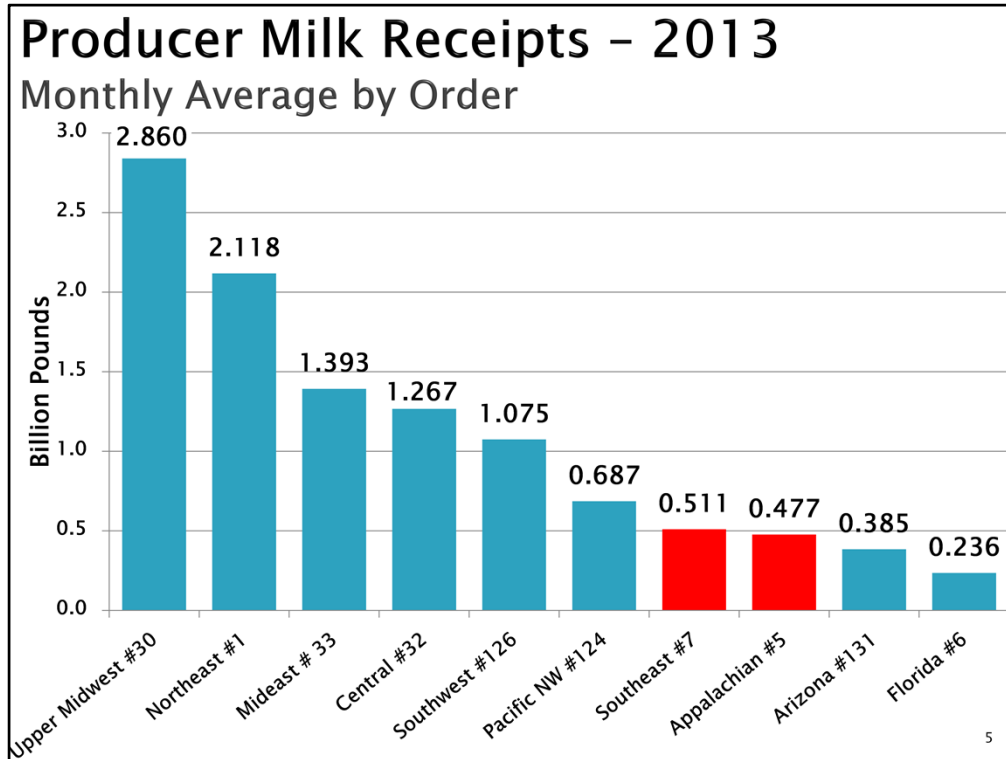
Federal Milk Marketing Orders

“On the one side, they promote economic orderliness and commercial equity through a system of classified prices, applied uniformly to all handlers in a given market. On the other side, they promote orderliness and equity among producers through a system of distribution of total returns to individual producers”

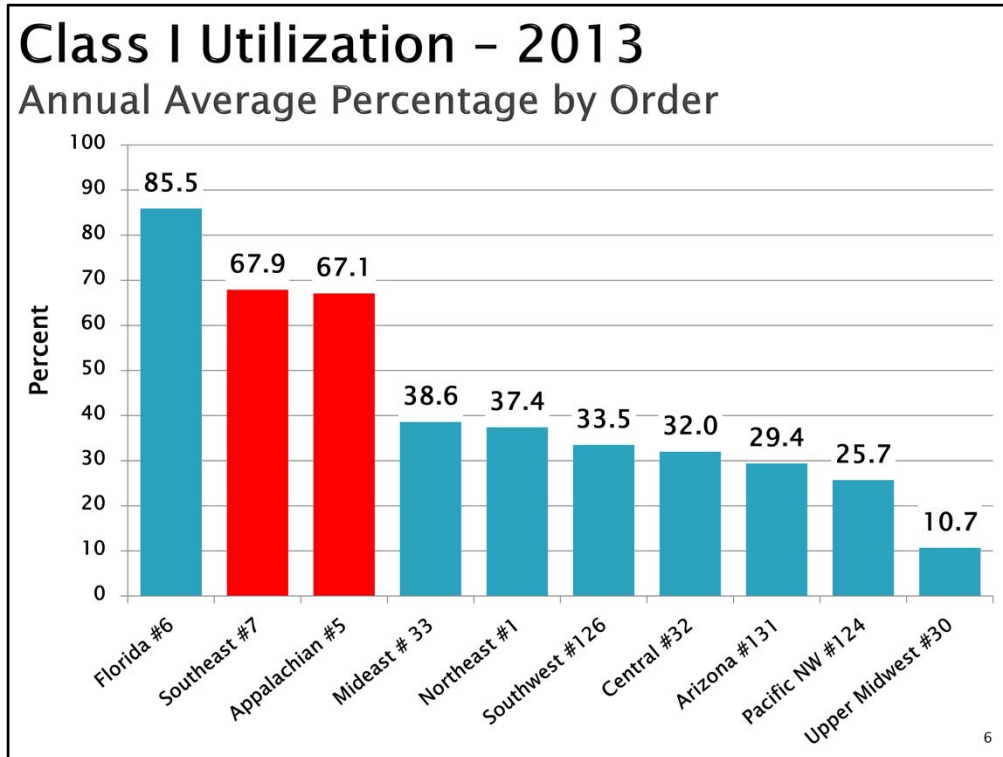
—Federal Milk Order Study Committee
“Nourse Report”, 1962

4

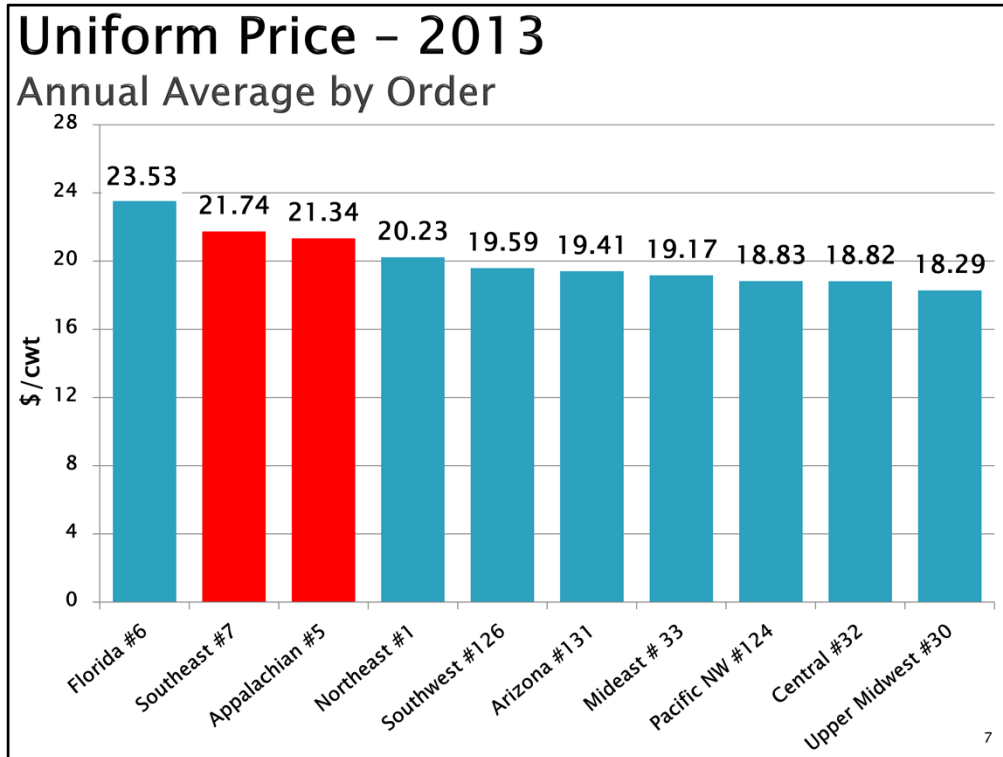
A quote explaining the economic impact of the Federal Order system from the 1962 Federal Milk Order Study Committee Report to the Secretary of Agriculture or commonly referred to as the Nourse Report.



The monthly average producer milk receipts by Federal Order in 2013.



The annual average Class I utilization percentage by Federal Order in 2013. The three Southeastern orders have significantly higher Class I utilization than the other seven orders.



The annual average announced Uniform price by Federal Order in 2013. Due to the higher Class I utilization and higher level of Class I differentials, the three markets also have the highest announced uniform prices.

Class I Differential Value – 2013

Order Name	Class I Pounds (Billion Lbs)	Class I Utilization	Class I Differential Value (Million \$)	Differential Value as Percent of Uniform Price
Northeast	9.51	37.4%	\$277.12	5.4%
Appalachian	3.84	67.1%	\$123.60	10.1%
Florida	2.42	85.5%	\$135.12	20.3%
Southeast	4.16	67.9%	\$137.15	10.3%
Upper Midwest	3.69	10.7%	\$64.05	1.0%
Central 2/	4.87	32.0%	\$103.65	3.6%
Mideast	6.45	38.6%	\$126.05	3.9%
Pacific Northwest	2.12	25.7%	\$40.26	2.6%
Southwest	4.32	33.5%	\$134.52	5.3%
Arizona	1.36	29.4%	\$30.99	3.5%
Total	42.74	32.4%	\$1,172.52	4.6%

8

Due to the high Class I utilization and differential levels in the Appalachian, Florida and Southeast orders, Class I differentials represent over 10 percent of the uniform price in the Appalachian (FO 5) and Southeast (FO 7) orders and over 20 percent of the uniform price in the Florida (FO 6) orders.

Class I differentials were increased based on a Department decision that was effective May 2008. The change in differential levels added an approximately \$18 million to the pool value of both Appalachian and Southeast orders and \$38 million to Florida.

Pool Plants

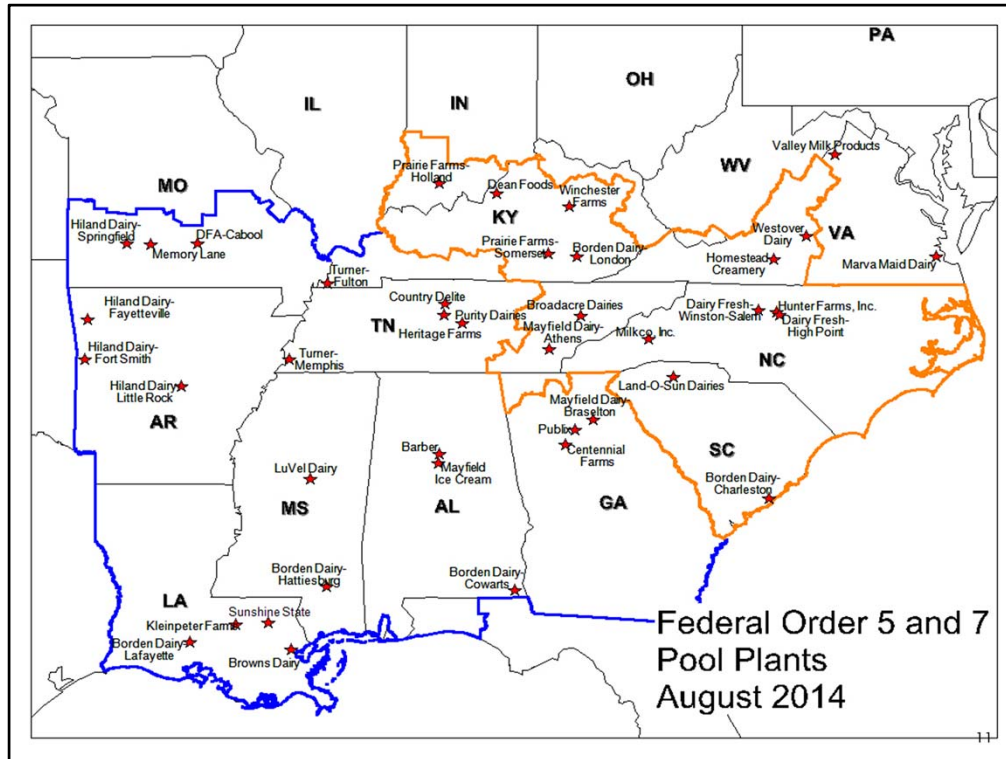
Pool Plants

Fully regulated plants subject to all the provisions of an order:

- Pool Distributing Plant – based on its distribution of Class I packaged milk sales in the marketing area
- Pool Supply Plant – based on its shipments of milk to pool distributing plants for Class I use
- Producer qualifies to participate in the pool by delivering milk to a pool plant

10

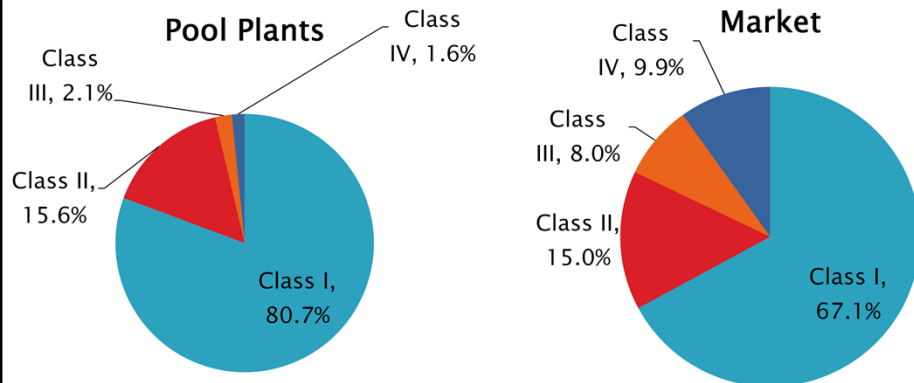
Federal milk orders specify the criteria that determine how producers, producer milk and milk handlers are able to participate in the marketwide pool. Marketwide pooling is how dairy farmers share in the benefits arising from classified pricing of milk. A pool plant is a plant qualified to participate in a Federal milk order marketwide pool. Standards for plants to be considered pool plants vary by order.



Pool plants regulated by Federal Order 5 and 7 in August 2014.

2013 Utilization Federal Order 5

20 Pool Distributing Plants (17 currently)
1 Pool Supply Plant



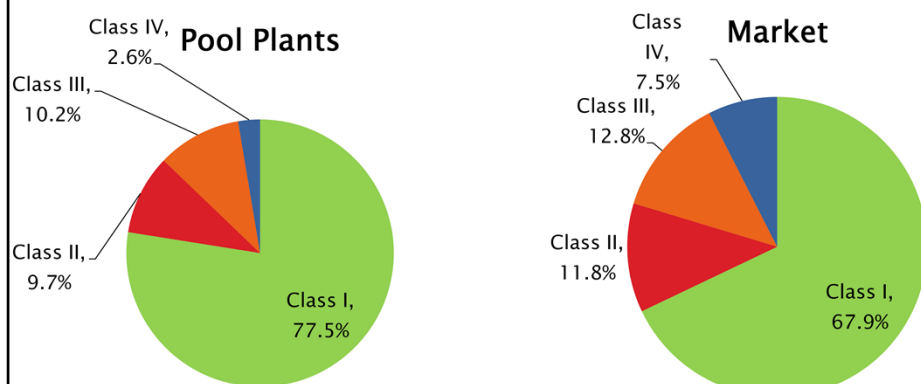
12

The pie graph on the left represents the utilization percentages of all pool plants regulated by Federal Order 5 in 2013. The pie graph on the right is the total market average utilization percentages for 2013.

2013 Utilization Federal Order 7

25 Pool Distributing Plants (22 currently)

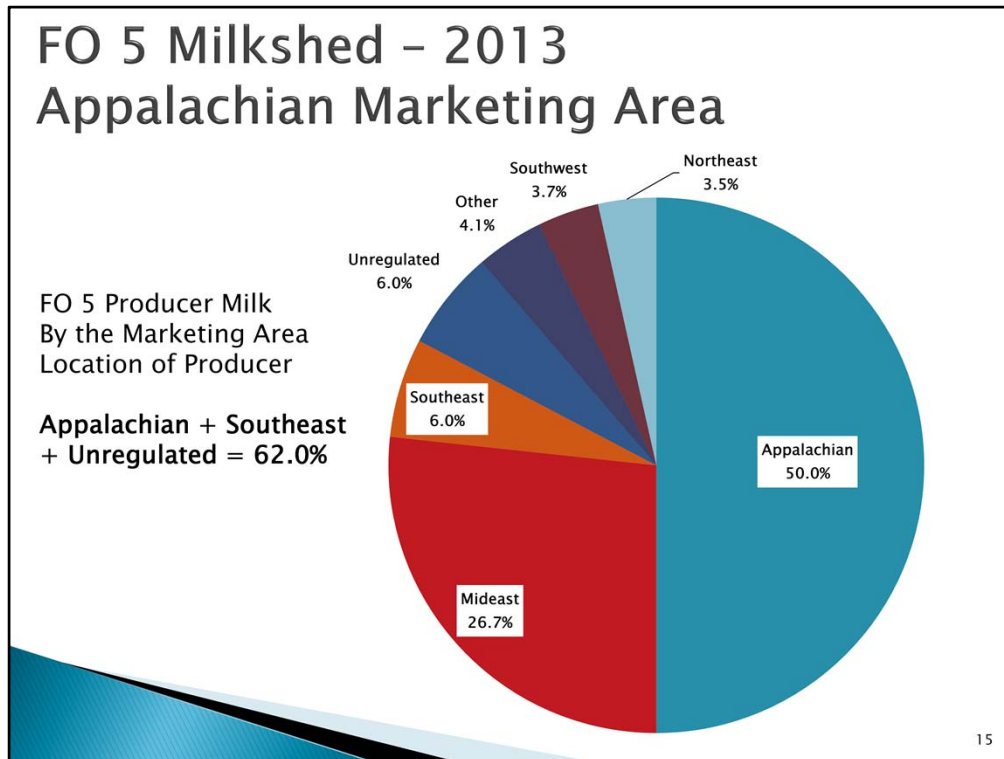
1–3 Pool Supply Plants (2 currently)



13

The pie graph on the left represents the utilization percentages of all pool plants regulated by Federal Order 7 in 2013. The pie graph on the right is the total market average utilization percentages for 2013.

Milk Production

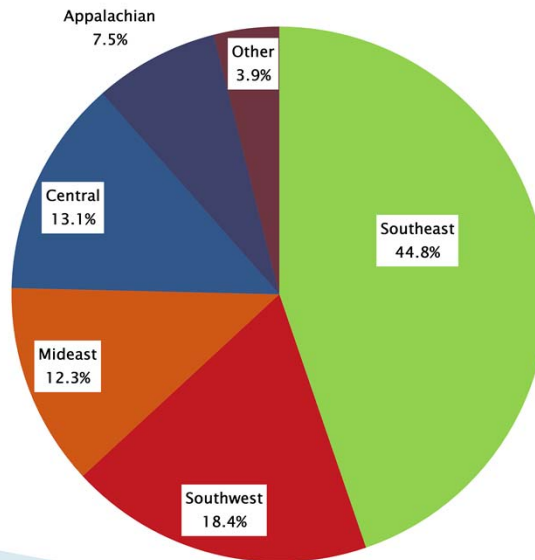


The graph represents the source of producer milk pooled on Federal Order 5 by the marketing area location of the producer. Approximately 62 percent of the Federal Order 5 producer milk in 2013 originated from producers located in the Southeast (Appalachian, Southeast, and Unregulated areas) region. The unregulated region is mainly the unregulated area of Virginia.

FO 7 Milkshed – 2013 Southeast Marketing Area

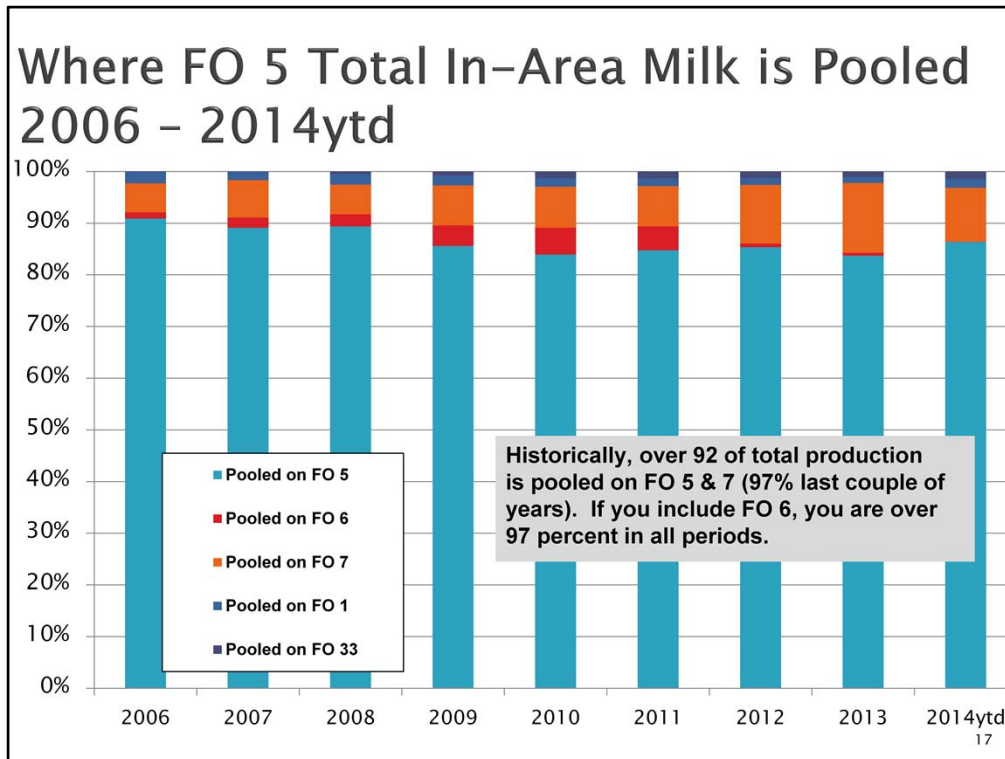
FO 7 Producer Milk
By the Marketing Area
Location of Producer

**Appalachian + Southeast
= 52.3%**

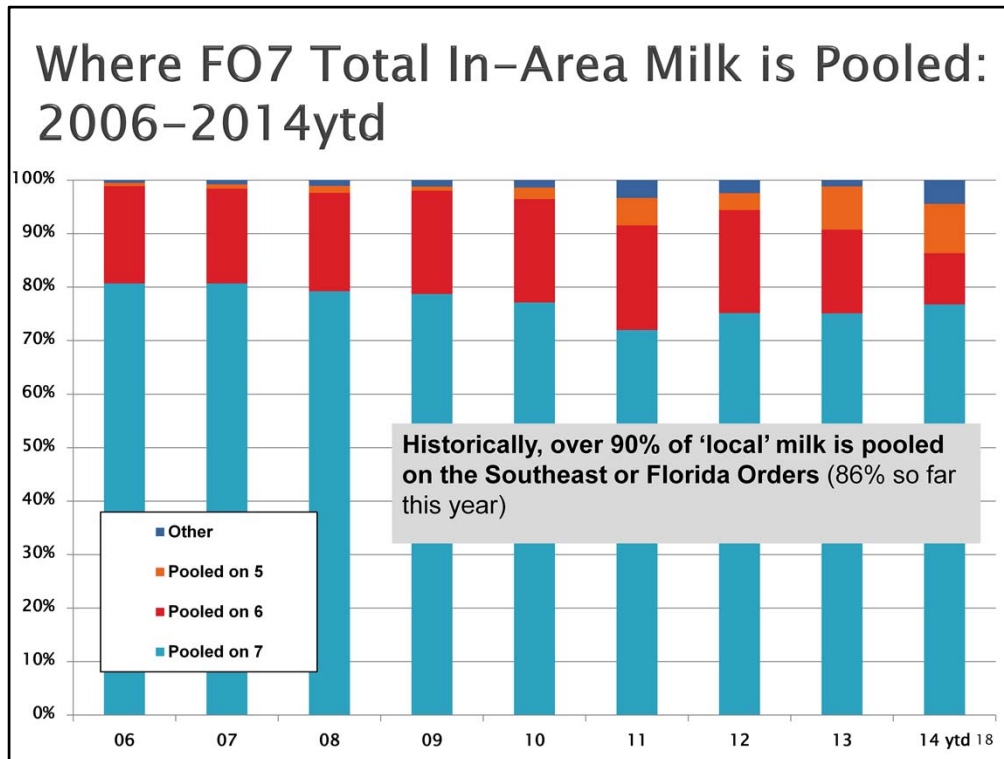


16

The graph represents the source of producer milk pooled on Federal Order 7 by the marketing area location of the producer. Approximately 52 percent of the Federal Order 7 producer milk in 2013 originated from producers located in the Appalachian and Southeast marketing areas.



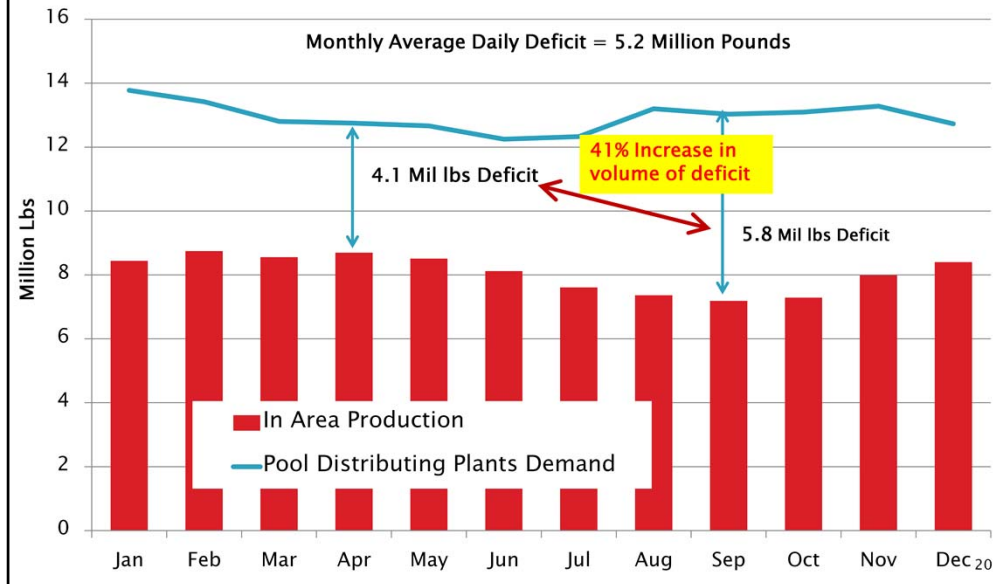
The graph represents the total production in counties that comprise the Appalachian marketing area. Over 97 percent of the milk produced in the marketing area is producer milk in Federal Order 5, 6, or 7.



The graph represents the total production in counties that comprise the Southeast marketing area. Historically, approximately 97 percent of the milk produced in the marketing is producer milk in Federal Order 5, 6, or 7.

Seasonality and Daily Variation of Supply and Demand

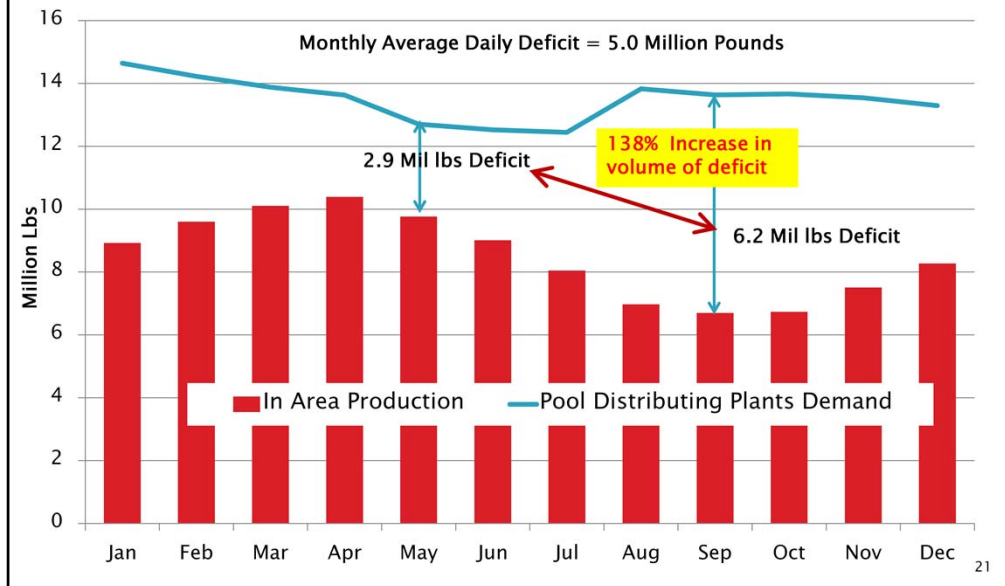
FO 5 Daily Average Production and Pool Distributing Plant Demand 2011–2013



The blue line represents the daily average producer receipts received at pool distributing plants by month during the years of 2011-2013. The red bars represent the daily average producer milk produced and pooled in the Federal Order 5 marketing area. The difference between the two represents the volume of milk that needs to be delivered from outside the Federal Order 5 marketing area to meet pool distributing plant demand, reference as “deficit” in the graph. The average daily “deficit” during the time period was 5.2 million pounds. The least “deficit” month was April at 4.1 million pounds per day, while the most “deficit” month was October at 5.8 million pounds.

Pool distributing plant demand increases in August due to the increase demand of fluid milk with the beginning of the school year. This occurs at the same time, the in-area production is declining. The need for additional milk from outside the marketing area is significantly greater from August through October.

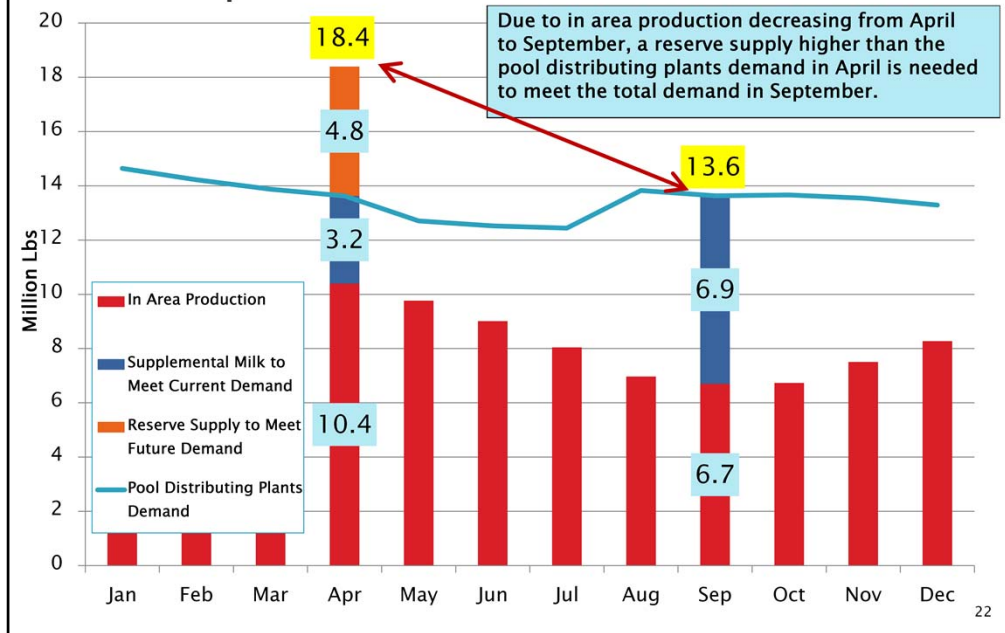
FO 7 Daily Average Production and Pool Distributing Plant Demand 2011–2013



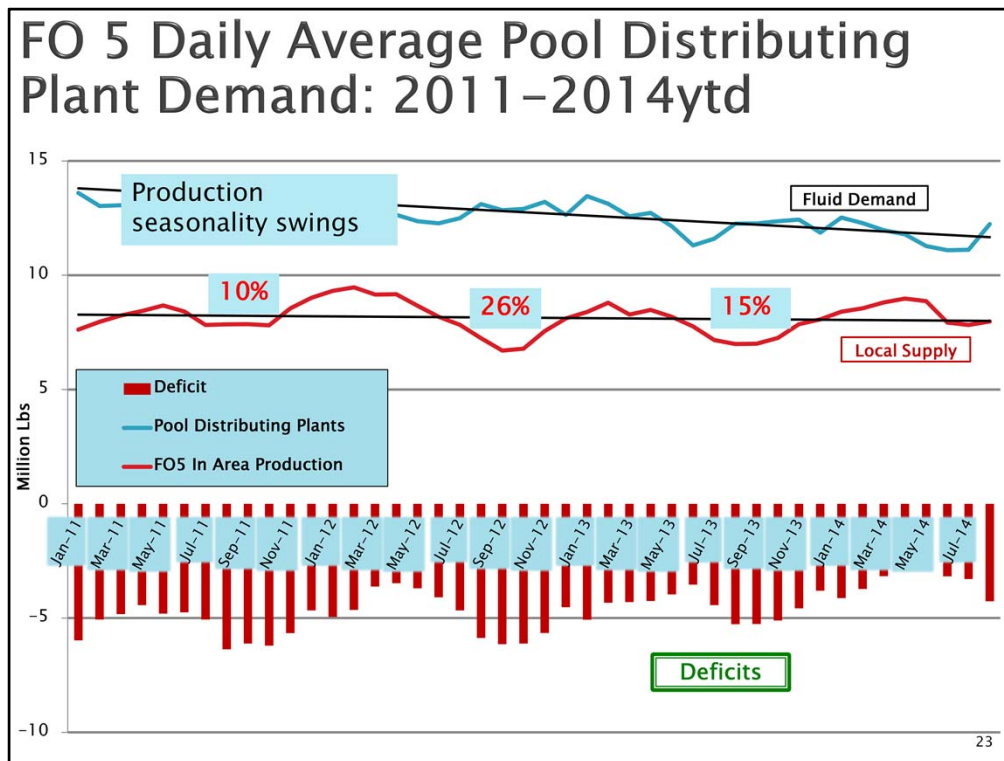
The blue line represents the daily average producer receipts received at pool distributing plants by month during the years of 2011-2013. The red bars represent the daily average producer milk produced and pooled in the Federal Order 7 marketing area. The difference between the two represents the volume of milk that needs to be delivered from outside the Federal Order 7 marketing area to meet pool distributing plant demand, referenced as “deficit” in the graph. The average daily “deficit” during the time period was 5.0 million pounds. The least “deficit” month was May at 2.9 million pounds per day, while the most “deficit” month was October at 6.2 million pounds.

Pool distributing plant demand increases in August due to the increase demand of fluid milk with the beginning of the school year. This occurs at the same time, the in-area production is declining. The need for additional milk from outside the marketing area is significantly greater from August through October.

Need for a Reserve Supply due to Seasonality: FO 7 Example

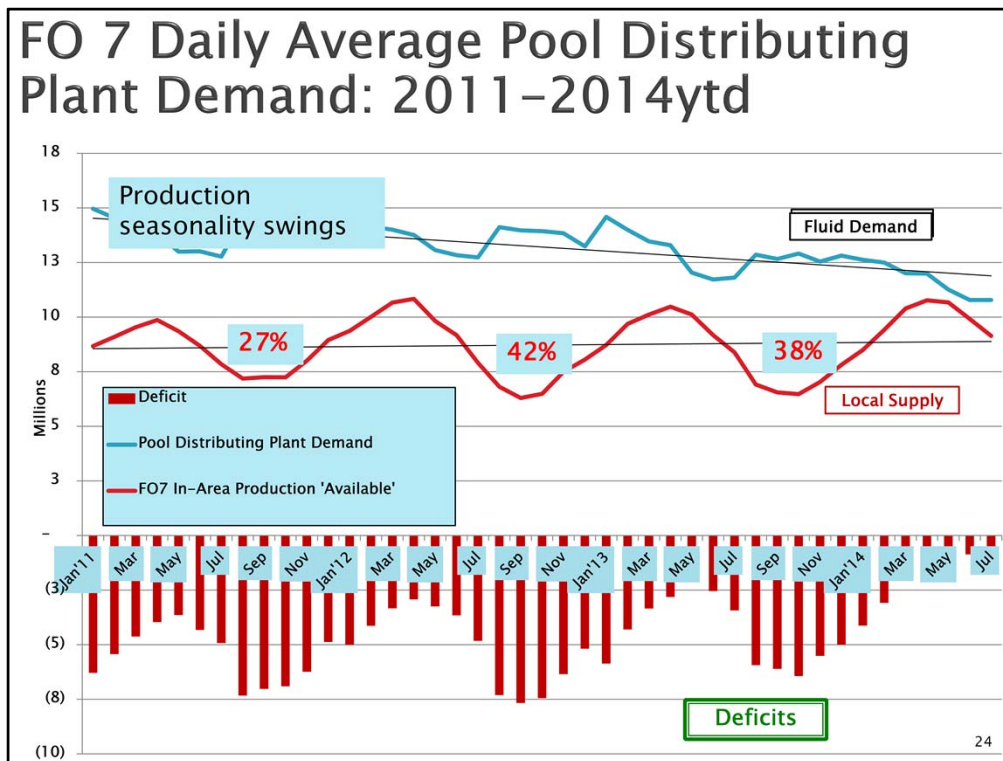


On average during this period, the pool distributing plants of Federal Order 7 demanded 13.6 million pounds of milk daily in both the months of April and September. Due to the seasonality of production in the marketing area, the producers that delivered 10.4 million pounds in April were only able to deliver 6.7 million pounds in September. If you apply the seasonality of the marketing area to the total 13.6 million pounds needed in September, the producers supplying the market would need to produce 18.4 million pounds per day in April, or 4.8 million pounds more per day than the demand of all pool distributing plants. This represents the need for a reserve supply due to seasonality of production to meet Class I demand.



The graph is the data from the previous graph on a monthly basis (including January – August 2014). The demand for milk at pool distributing plants is declining over the time period. (The black straight line represents a trend line.) The Federal Order in-area production over the period has remained relatively unchanged on average. (The black straight line again represents a trend line of production). The levels of “deficits” in Federal Order 5 has decreased slightly over this time period.

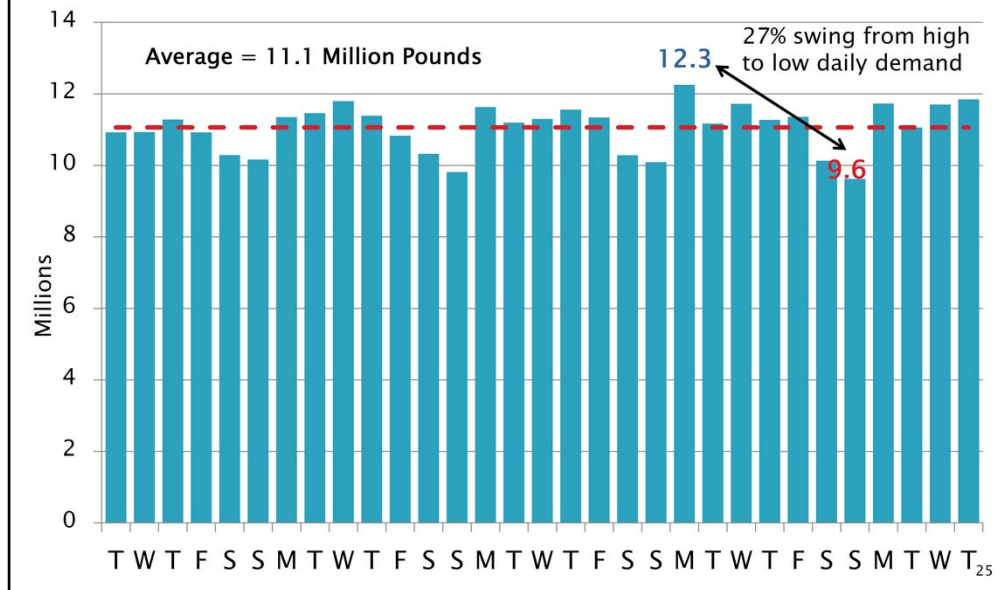
The in-area production line also shows the variation in the seasonality swings that occurred over the 3 year period. The change in the high production month to the low production month was 10 percent in 2011, while it increased to 26 percent in 2012 .



The graph is the data from the previous graph on a monthly basis (including January – August 2014). The demand for milk at pool distributing plants is declining over the time period. (The black straight line represents a trend line.) The Federal Order in-area production over the period has remained relatively unchanged on average. (The black straight line again represents a trend line of production). The levels of “deficits” in Federal Order 7 has decreased significantly over this time period, especially in 2014.

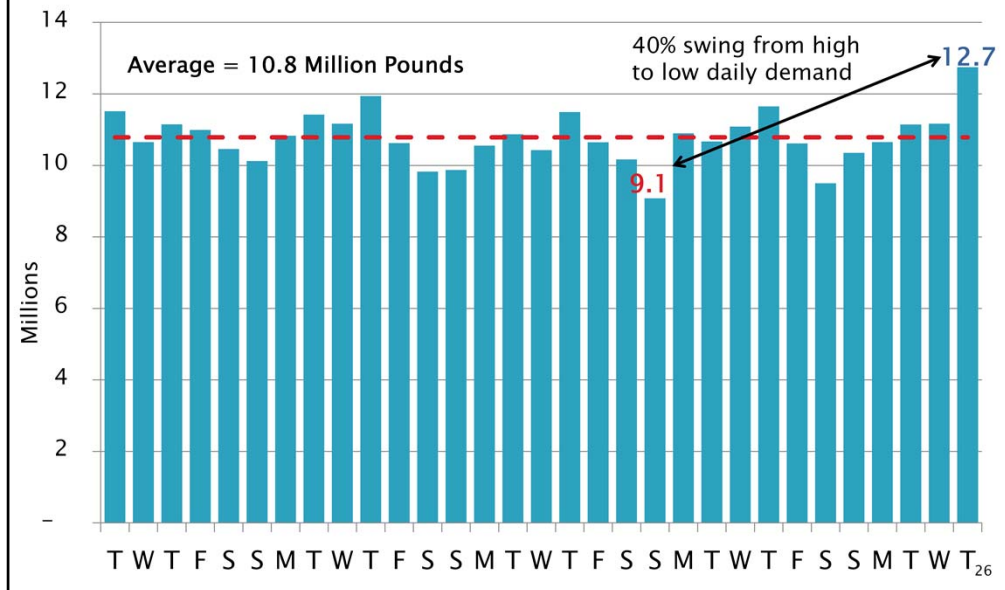
The in-area production line also shows the variation in the seasonality swings that occurred over the 3 year period. The change in the high production month to the low production month was 27 percent in 2011, while it increased to 42 percent in 2012 and 38 percent in 2013 .

Daily Producer Milk Receipts FO 5 Pool Distributing Plants – July 2014



The data is based on the producer milk receipts at Federal Order 5 pool distributing plants in July 2014. Pool distributing plant demand varies based on the day of the week. The lowest demand days at the plants are over the weekend. The difference in the high demand day (12.3 million pounds) to the low demand day (9.6 million pounds) represented a 27 percent swing.

Daily Producer Milk Receipts FO 7 Pool Distributing Plants – July 2014



The data is based on the producer milk receipts at Federal Order 7 pool distributing plants in July 2014. Pool distributing plant demand varies based on the day of the week. The lowest demand days at the plants are over the weekend, while Thursday represented the highest demand day in Federal Order 7. The difference in the high demand day (12.7 million pounds) to the low demand day (9.1 million pounds) represented a 40 percent swing.

Class I Demand

Primary function of a fluid milkshed is to meet the Class I milk requirements of the market.

Orders include provisions to attract an adequate milk supply to meet Class I needs:

- **Class I Differentials**

- Increase Uniform prices at pool distributing plant locations

- **Diversions**

- Need a greater supply than the market's fluid demand due to the daily and seasonal variations in supply/demand and balancing needs of the market
- Facilitate the orderly and efficient disposition of milk when not needed for Class I use

- **Transportation Credit Balancing Fund**

- Increase need for supplemental milk for Class I during July – February
- Reflect transportation costs above those in current differential level – payment nets out the differential gain
- Prohibit diversions on milk requesting a transportation credit payment

Producer Delivery Requirements and Diversion Limits

Producer Delivery Requirements and Diversion Limits

Diversion Limit Percentages

- ✓ Specify the maximum volume of milk that may be delivered to a non-pool plant and still be pooled and priced under the qualifying order (i.e. what milk shares in the pool)

Producer Delivery Requirements

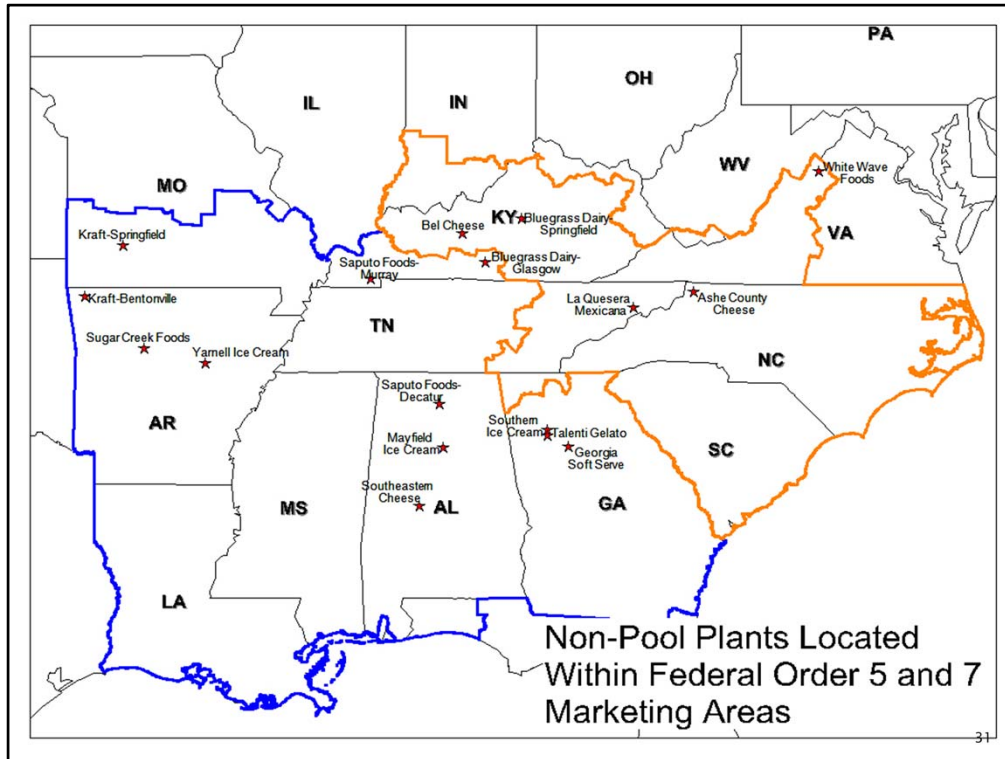
- ✓ Establish individual producer delivery requirements to pool plants for allowing the pooling of diverted milk (i.e. which producers share in the pool)

Diversions

What is a diversion?

Direct delivery of milk from a farm to a non-pool manufacturing plant that can still remain pooled and priced under the qualifying order

- Used by pool plant operators and cooperatives acting as handlers to attract an adequate milk supply to meet Class I needs
- Limit standards must take into account reserve supplies needed for Class I use, the balancing needs of the market, and the seasonality of production.

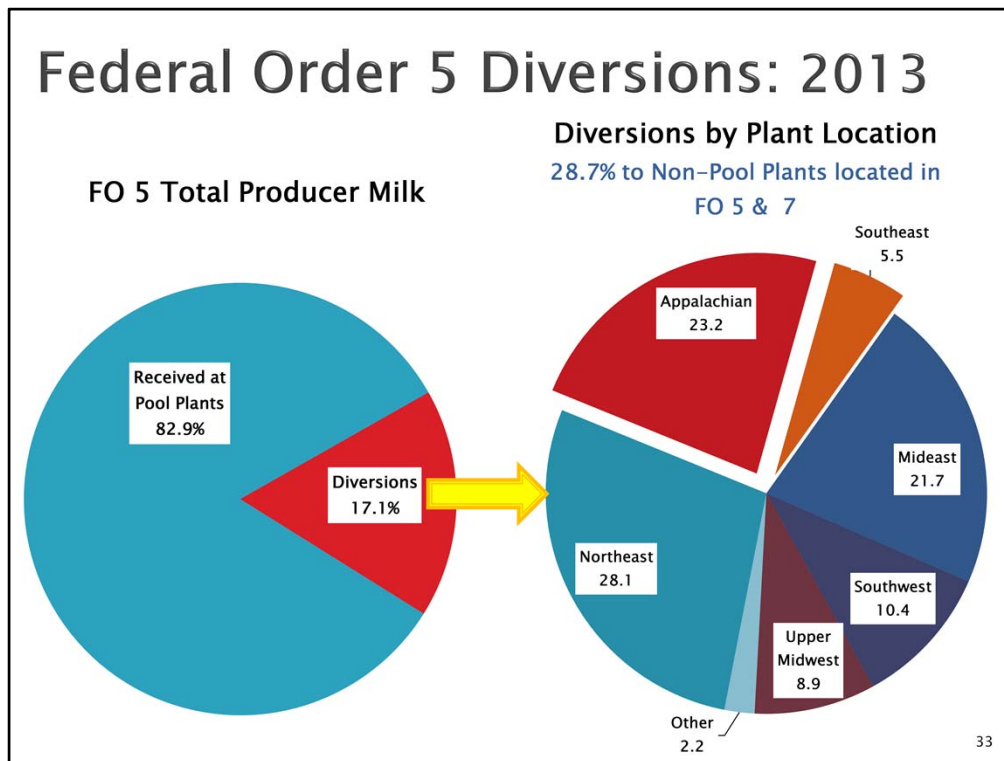


The map shows the location of non-pool plants located in the Federal Order 5 and 7 marketing areas. Approximately 30 percent of the total diversions in both orders are delivered to plants located in the two marketing areas.

Diversion Limits & Performance Requirements

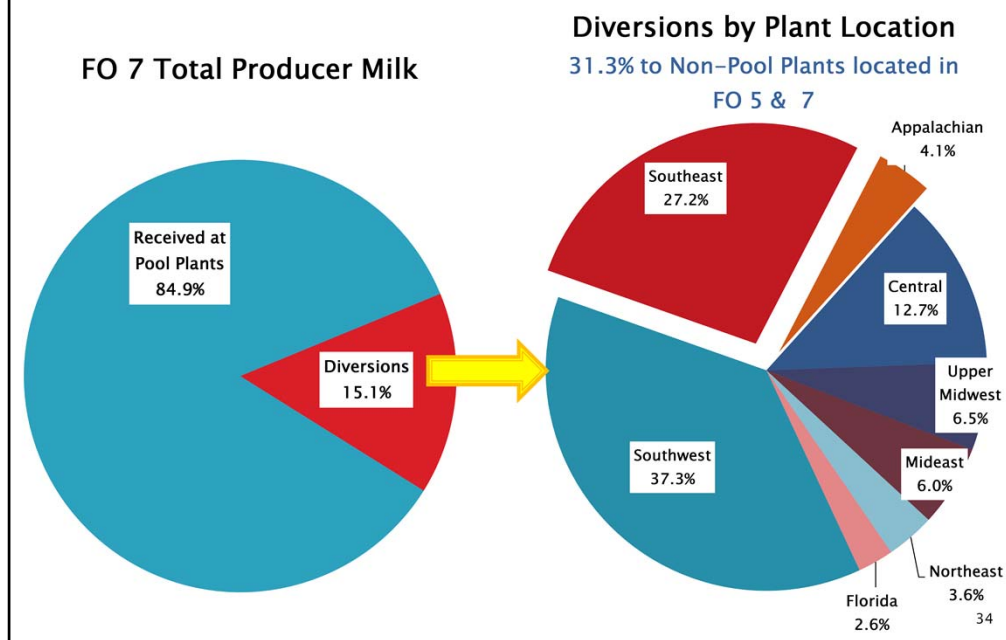
FO No.	FO Name	Diversion Limits	Delivery Day Requirements
5	Appalachian	25-35%	1 /month
6	Florida	10-20%	10/month
7	Southeast	25-35%	1 /month
1	Northeast	80-90%	1 /month
30	Upper Midwest	90%	1 -(until association lost)
32	Central	75-80%	1 -(until association lost)
33	Mideast	50-60%	2 -(until association lost)
124	Pacific Northwest	80%	3 /month
126	Southwest	50%	1 -(at least 40,000 lbs)
131	Arizona	50%	1 /month

Diversion limits and producer delivery day requirements help to define how much milk is associated with a Federal order market. The three southeastern orders have the most stringent diversion limits in the Federal order system.

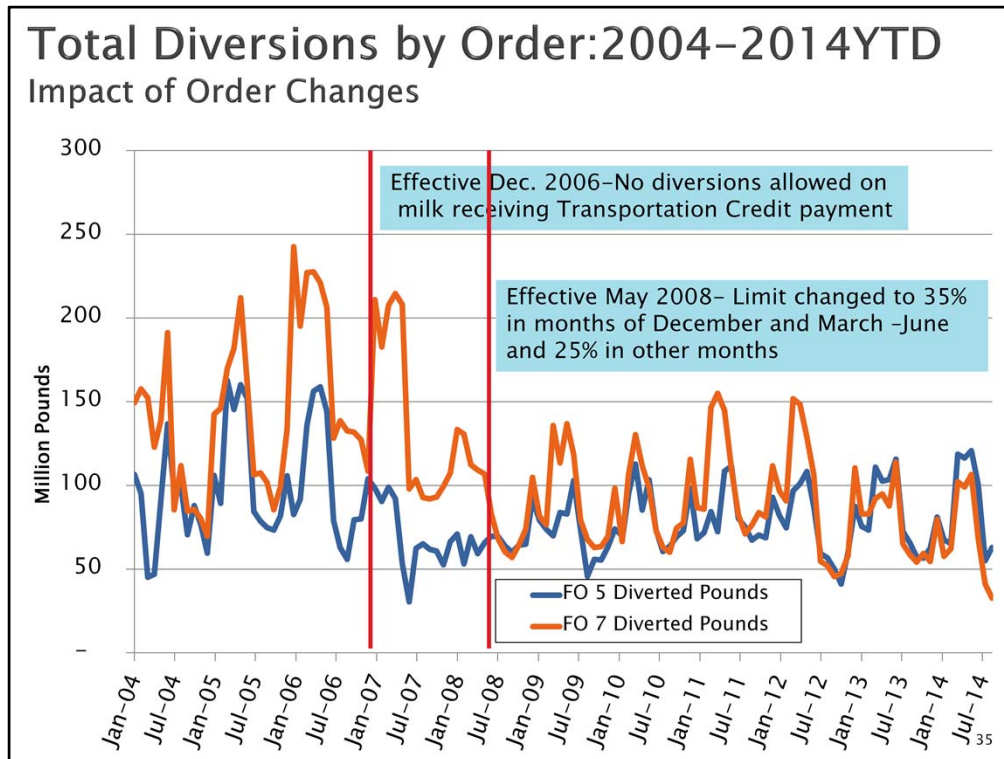


The pie graph on the left shows the percentage of total Federal Order 5 producer milk that was received at pool plants (82.9 percent) and non-pool plants (17.1 percent). The pie graph on the right illustrates the location of the non-pool plant by marketing area. Almost 29 percent of Federal Order 5 total diversions are delivered to non-pool plants located in the Federal Order 5 or 7 marketing areas.

Federal Order 7 Diversions: 2013



The pie graph on the left shows the percentage of total Federal Order 7 producer milk that was received at pool plants (84.9 percent) and non-pool plants (15.1 percent). The pie graph on the right illustrates the location of the non-pool plant by marketing area. Over 31 percent of Federal Order 7 total diversions are delivered to non-pool plants located in the Federal Order 5 or 7 marketing areas.



The graph includes the total volume of diverted milk (delivered to non-pool plants) by month for January 2004 to August 2014. The Secretary of Agriculture has issued two separate decisions that have reduced the maximum allowable diversions on Federal Orders 5 and 7. Effective December 2006, diversions could no longer be applied to milk requesting a transportation credit payment. Effective May 2008, diversion limits were reduced to the current levels in both orders to 35 percent in March – June and December and 25 percent in the other months.

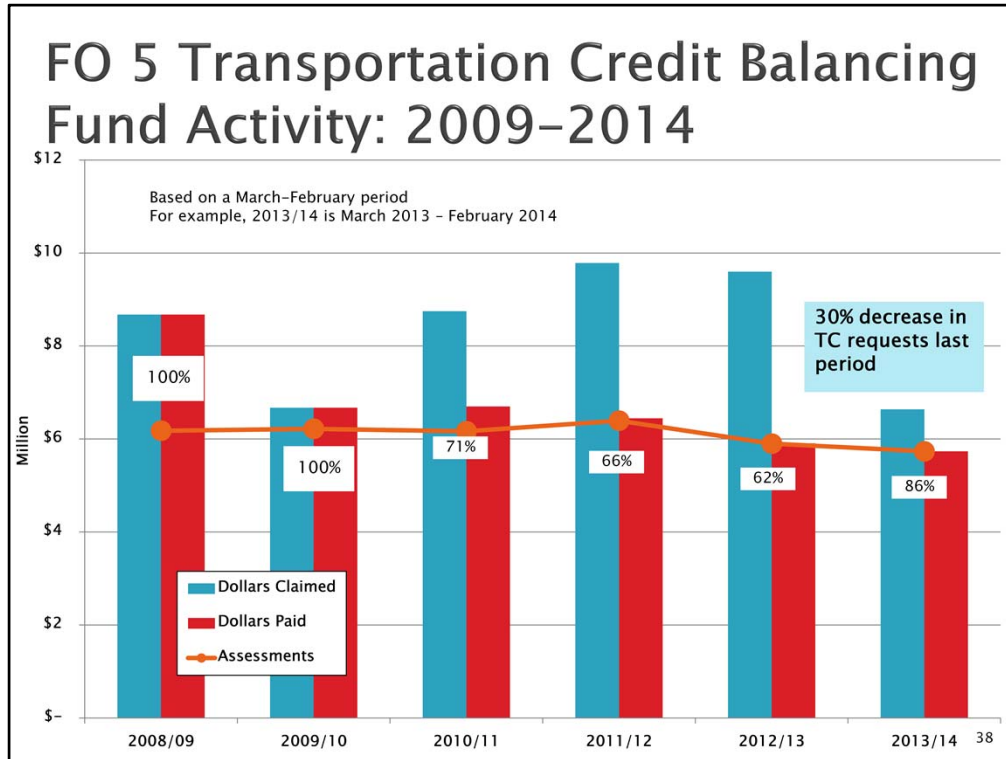
Transportation Credit Balancing Fund

Transportation Credit Balancing Fund

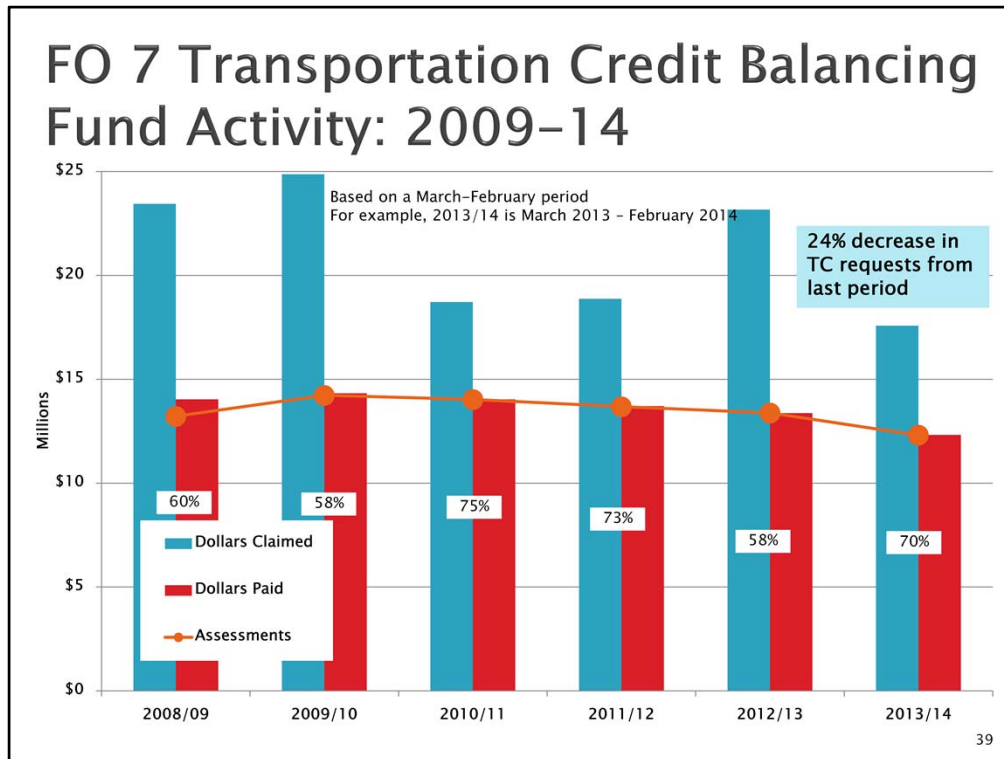
- ▶ Funded by assessment on Class I handlers of \$0.15 per cwt in FO 5 and \$0.30 per cwt in FO 7
- ▶ Eligibility based on pooled production in March – May (Producer cannot be located in FO 5 or 7 marketing areas)
- ▶ Pay out of fund in July – February
 - Payment based on distance from last pickup to plant less 85 miles multiplied by the Mileage Rate Factor (adjusts with diesel fuel prices)
 - Subtract any positive difference in differentials from plant to last pickup locations
- ▶ Prorate monthly payment when balance fund is insufficient to pay all requests

37

The Transportation Credit Balancing Fund is a separate fund from the Producer Settlement Fund. It is funded by an assessment paid by handlers on Class I milk.



The graph illustrates the activity of the Federal Order 5 Transportation Credit Balancing Fund over the last six periods. The orange line represents the total value of assessments during the transportation credit period (March – February). Payments out of the fund are made during the months of July – February (June can be requested). During the 2008/2009 and 2009/2010, the Federal Order 5 fund had beginning balances from prior period to pay out values greater than the assessments. When claims are greater than the balance funds, payments are prorated based on total available funds. In the March 2013 – February 2014 period, the Federal Order 5 Transportation Credit Balancing Fund was able to pay 86 percent of the total dollars claimed. During the last period, total transportation credit dollars claimed decreased by 30 percent.



The graph illustrates the activity of the Federal Order 7 Transportation Credit Balancing Fund over the last six periods. The orange line represents the total value of assessments during the transportation credit period (March – February). Payments out of the fund are made during the months of July – February (June can be requested). When claims are greater than the balance funds, payments are prorated based on total available funds. In the March 2013 – February 2014 period, the Federal Order 7 Transportation Credit Balancing Fund was able to pay 70 percent of the total dollars claimed. During the last period, total transportation credit dollars claimed decreased by 24 percent.

Multiple Component Pricing

Skim/Butterfat vs. Component Pricing

Handler's Value

- ▶ **Class I Value – No Difference**

Based on Class I Skim/Butterfat Prices

- ▶ **Class II Value**

In MCP, based on Nonfat Solids Price (including \$0.007 per pound differential)

- ▶ **Class III Value**

In MCP, based on Protein and Other Solids Prices

- ▶ **Class IV Value**

In MCP, based on Nonfat Solids Price

Somatic Cell Adjustment value is only applied to Class II, III, and IV

41

The computation of uniform prices in Federal Orders 5, 6, and 7 are currently based on skim and butterfat prices. There has been discussion about the possibility of implementing multiple component pricing in the three orders. Of the 10 orders, the only other order under skim and butterfat pricing is the Arizona (FO 131) order. All other orders have a multiple component pricing system. The slide highlights the difference in the handler's value between the two pricing systems. Class I value does not change based on the current multiple component pricing system. It would continue to be based on skim and butterfat values. The values of Class II, III, and IV would be based on component pounds and prices instead of skim pounds and prices.

Skim/Butterfat vs. Component Pricing

Skim/Butterfat

- ▶ Uniform Butterfat/Skim Prices are roughly the weighted average of the Class Prices
- ▶ Component levels in skim prices are fixed
 - Class III Skim Price = 3.1 x Protein Price + 5.9 x OS Price
 - Class II/IV Skim Prices = 9 x Nonfat Solids Price

42

The component levels in the current skim prices are fixed. For example, an hundredweight of Class III skim milk is currently valued based on the above formula. The value does not change if it contains two pounds of protein or four pounds of protein. Under multiple component pricing, the value would be based on the actual pounds of protein in the milk.

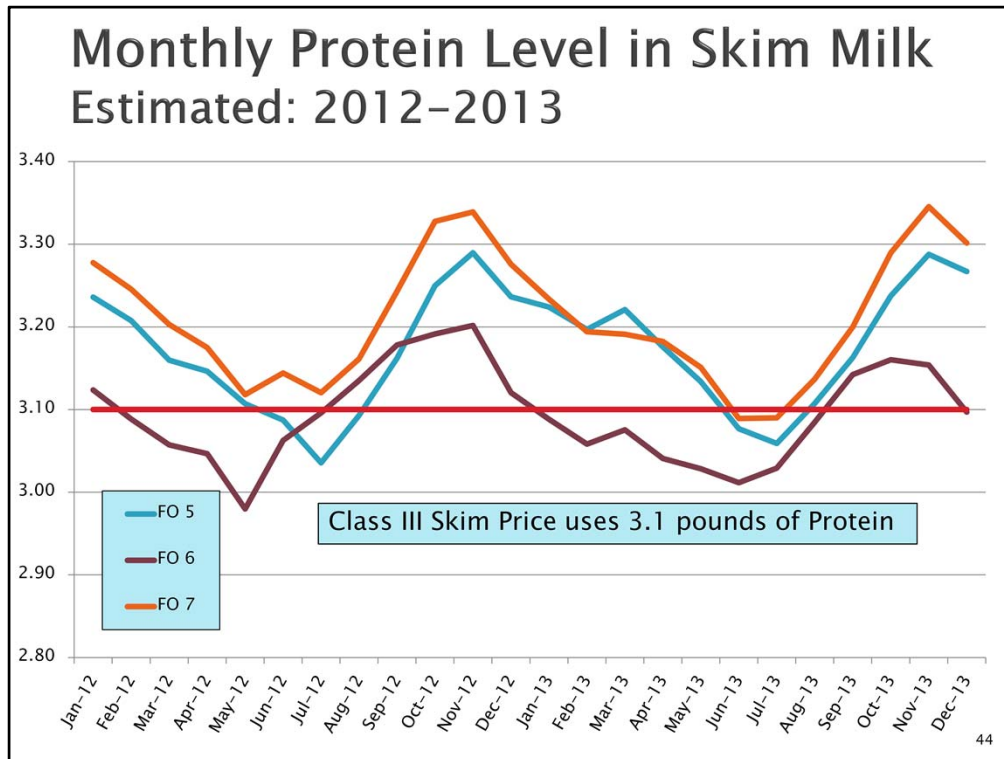
Skim/Butterfat vs. Component Pricing

Multiple Component Pricing

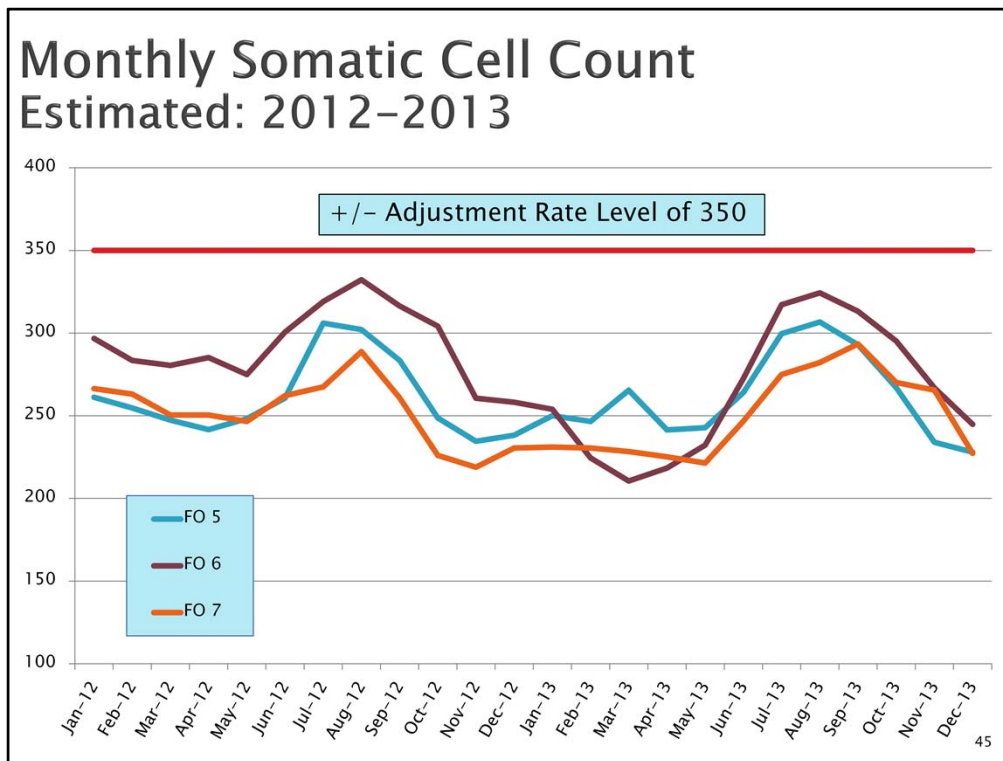
- ▶ Prices paid out of pool are at the Class III prices for butterfat, protein and other solids
- ▶ Somatic Cell adjustment rate
 - Cheese price x 0.0005
 - Value -/+ based on count difference from 350,000
 - Not used in all current orders with MCP
- ▶ Producer Price Differential (PPD) = Residual value of the pool after deducting component values at producer levels

43

The Northeast (FO1) and Pacific Northwest (FO 124) orders do not include the somatic cell adjustment rate in their multiple component pricing system.



The Class III skim milk price formula uses a factor of 3.1 pounds of protein to determine the per hundredweight value of skim milk. Not all handlers currently report component level data for producer milk to the Market Administrator offices for Federal Order 5, 6, and 7. However, the data is available for a majority of the producer milk on the three markets. The actual data for each order was used as an estimate for the entire market. The above graph reports the monthly protein level in a hundredweight of skim milk for January 2012 – December 2013 in the 3 orders in relation to the fixed factor of 3.1. If the average line is above the 3.1 line, there could be additional value in the pool with a multiple component pricing system.



Not all handlers currently report component level data for producer milk to the Market Administrator offices for Federal Order 5, 6, and 7. However, the data is available for a majority of the producer milk on the three markets. The actual data for each order was used as an estimate for the entire market. The above graph reports the monthly Somatic Cell Count level for January 2012 – December 2013 in the 3 orders in relation to the adjustment rate level of 350 thousand.

Contact Info



Federal Order 5

Website: <http://www.malouisville.com/>

Email: friedly@malouisville.com

Federal Order 7

Website: <http://www.fmmatlanta.com/>

Email: FMMA6&7@fmmatlanta.com