

Dated: February 15, 2006.

Lloyd C. Day,

Administrator, Agricultural Marketing Service.

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DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

7 CFR Part 1030

[Docket No. AO-361-A39; DA-04-03B]

Milk in the Upper Midwest Marketing Area; Recommended Decision and Opportunity To File Written Exceptions on Proposed Amendments to Tentative Marketing Agreement and Order

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Proposed rule; Recommended Decision.

SUMMARY: This decision recommends adoption of proposals that would amend certain features of the Upper Midwest (UMW) Federal milk marketing order. Specifically, this decision recommends adoption of proposals that would deter the de-pooling of milk and increase the order's maximum administrative assessment rate.

DATES: Comments must be submitted on or before April 24, 2006.

ADDRESSES: Comments (six copies) should be filed with the Hearing Clerk, United States Department of Agriculture, STOP 9200—Room 1031, 1400 Independence Avenue, SW., Washington, DC 20250-9200. Comments may also be submitted at the Federal e-Rulemaking portal: <http://www.regulations.gov> or by e-mail: amsdairycomments@usda.gov. Reference should be made to the title of action and docket number.

FOR FURTHER INFORMATION CONTACT:

Gino Tosi, Associate Deputy Administrator, Order Formulation and Enforcement Branch, USDA/AMS/Dairy Programs, STOP 0231—Room 2968, 1400 Independence Avenue, SW., Washington, DC 20250-0231, (202) 690-1366, e-mail gino.tosi@usda.gov.

SUPPLEMENTARY INFORMATION: This decision recommends adoption of amendments that would: (1) Establish a limit on the volume of milk a handler may pool during the months of April through February to 125 percent of the volume of milk pooled in the prior month; (2) Establish a limit on the volume of milk a handler may pool during the month of March to 135 percent of the volume of milk pooled in

the prior month; and (3) Allow the market administrator to increase the maximum administrative assessment rate up to 8 cents per hundredweight on all pooled milk if necessary to maintain the required fund reserves.

This administrative action is governed by the provisions of sections 556 and 557 of Title 5 of the United States Code and, therefore, is excluded from the requirements of Executive Order 12866.

The amendments to the rules proposed herein have been reviewed under Executive Order 12988, Civil Justice Reform. They are not intended to have a retroactive effect. If adopted, the proposed amendments would not preempt any state or local laws, regulations, or policies, unless they present an irreconcilable conflict with this rule.

The Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601-674), provides that administrative proceedings must be exhausted before parties may file suit in court. Under section 608c(15)(A) of the Act, any handler subject to an order may request modification or exemption from such order by filing with the Department a petition stating that the order, any provision of the order, or any obligation imposed in connection with the order is not in accordance with the law. A handler is afforded the opportunity for a hearing on the petition. After a hearing, the Department would rule on the petition. The Act provides that the district court of the United States in any district in which the handler is an inhabitant, or has its principal place of business, has jurisdiction in equity to review the Department ruling on the petition, provided a bill in equity is filed not later than 20 days after the date of the entry of the ruling.

Regulatory Flexibility Act and Paperwork Reduction Act

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Agricultural Marketing Service has considered the economic impact of this action on small entities and has certified that this proposed rule will not have a significant economic impact on a substantial number of small entities.

For the purpose of the Regulatory Flexibility Act, a dairy farm is considered a "small business" if it has an annual gross revenue of less than \$750,000, and a dairy products manufacturer is a "small business" if it has fewer than 500 employees. For the purposes of determining which dairy farms are "small businesses," the \$750,000 per year criterion was used to establish a production guideline of

500,000 pounds per month. Although this guideline does not factor in additional monies that may be received by dairy producers, it should be an inclusive standard for most "small" dairy farmers. For purposes of determining a handler's size, if the plant is part of a larger company operating multiple plants that collectively exceed the 500-employee limit, the plant will be considered a large business even if the local plant has fewer than 500 employees.

During August 2004, the month during which the hearing occurred, there were 15,802 dairy producers pooled on and 60 handlers regulated by the UMW order. Approximately 15,608 producers, or 97 percent, were considered small businesses based on the above criteria. Of the 60 handlers regulated by the UMW during August 2004, 49 handlers, or 82 percent, were considered small businesses.

The recommended amendments for adoption of the pooling standards serve to revise established criteria that determine those producers, producer milk, and plants that have a reasonable association with and consistently serve the fluid needs of the UMW marketing area. Criteria for pooling milk are established on the basis of performance standards that are considered adequate to meet the Class I fluid needs of the market and, by doing so, determine those producers who are eligible to share in the revenue that arises from the classified pricing of milk.

Criteria for pooling are established without regard to the size of any dairy industry organization or entity. Administrative assessments are similarly charged without regard to the size of any dairy industry organization or entity. Therefore, the proposed amendments will not have a significant economic impact on a substantial number of small entities.

A review of reporting requirements was completed under the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). It was determined that these proposed amendments would have no impact on reporting, recordkeeping, or other compliance requirements because they would remain identical to the current requirements. No new forms are proposed and no additional reporting requirements would be necessary.

This recommended decision does not require additional information collection that requires clearance by the Office of Management and Budget (OMB) beyond currently approved information collection. The primary sources of data used to complete the approved forms are routinely used in

most business transactions. The forms require only a minimal amount of information which can be supplied without data processing equipment or a trained statistical staff. Thus, the information collection and reporting burden is relatively small. Requiring the same reports for all handlers does not significantly disadvantage any handler that is smaller than the industry average.

No other burdens are expected to fall on the dairy industry as a result of overlapping Federal rules. This rulemaking proceeding does not duplicate, overlap, or conflict with any existing Federal rules.

Interested parties are invited to submit comments on the probable regulatory and informational impact of this proposed rule on small entities. Also, parties may suggest modifications of this proposal for the purpose of tailoring their applicability to small businesses.

Prior Documents in This Proceeding

Notice of Hearing: Issued June 15, 2004; published June 23, 2004 (69 FR 34963).

Notice of Hearing Delay: Issued July 14, 2004; published July 21, 2004 (69 FR 43538).

Tentative Partial Decision: Issued April 8, 2005; published April 14, 2005 (70 FR 19709).

Interim Final Rule: Issued May 26, 2005; published June 1, 2005 (70 FR 31321).

Final Partial Decision: Issued September 29, 2005; published October 5, 2005 (70 FR 58086).

Preliminary Statement

Notice is hereby given of the filing with the Hearing Clerk of this recommended decision with respect to proposed amendments to the tentative marketing agreement and the order regulating the handling of milk in the UMW marketing area. This notice is issued pursuant to the provisions of the Agricultural Marketing Agreement Act and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900).

Interested parties may file written exceptions to this decision with the Hearing Clerk, U.S. Department of Agriculture, STOP 9200—Room 1031, 1400 Independence Avenue, SW., Washington DC 20250–9200, by April 24, 2006. Six copies of the exceptions should be filed. All written submissions made pursuant to this notice will be made available for public inspection at the Office of the Hearing Clerk during regular business hours (7 CFR 1.27(b)).

The hearing notice specifically invited interested persons to present evidence concerning the probable regulatory and informational impact of the proposals on small businesses. Some evidence was received that specifically addressed these issues and some of the evidence encompassed entities of various sizes.

A public hearing was held upon proposed amendments to the marketing agreement and the order regulating the handling of milk in the UMW marketing area. The hearing was held pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937 (AMAA), as amended (7 U.S.C. 601–674), and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900).

The proposed amendments set forth below are based on the record of a public hearing held at Bloomington, Minnesota, on August 16–19, 2004, pursuant to a notice of hearing issued June 16, 2004, published June 23, 2004, and a notice of hearing delay issued July 14, 2004, and published July 21, 2004.

The material issues on the record of hearing relate to:

1. Pooling Standards
 - A. Establishing Pooling Limits
 - B. Producer definition.
2. Administrative assessment rate.

Findings and Conclusions

This recommended decision specifically addresses proposals published in the hearing notice as Proposals 3, 4, 5 and features of Proposal 2 that seek to establish a limit on the volume of milk that can be pooled on the order, features of Proposal 6 intending to clarify the *Producer* definition by providing a definition of “temporary loss of Grade A approval,” and Proposal 7 which seeks to increase the order’s maximum administrative assessment rate. As published in the hearing notice, Proposals 1, 6, and a portion of Proposal 2 concerning diversion limit standards and transportation credits were addressed in a tentative partial decision published on April 14, 2005 (70 FR 19709). For the purpose of this recommended decision, references to Proposal 2 will only pertain to the first portion regarding de-pooling and references to Proposal 6 will only pertain to establishing a definition of “temporary loss of Grade A approval.”

The following findings and conclusions on the material issues are based on evidence presented at the hearing and the record thereof:

1. Pooling Standards

A. Establishing Pooling Limits

Preliminary Statement

Federal milk marketing orders rely on the tools of classified pricing and marketwide pooling to assure an adequate supply of milk for fluid (Class I) use and to provide for the equitable sharing of the revenues arising from the classified pricing of milk. Classified pricing assigns a value to milk according to how the milk is used. Regulated handlers who buy milk from dairy farmers are charged class prices according to how they use the farmer’s milk. Dairy farmers are then paid a weighted average or “blend” price. The blend price that dairy farmers are paid for their milk is derived through the marketwide pooling of all class uses of milk in a marketing area. Thus each producer receives an equal share of each use class of milk and is indifferent as to the actual Class for which the milk was used. The Class I price is usually the highest class price for milk. Historically the Class I use of milk provides the additional revenue to a marketing area’s total classified use value of milk.

The series of Class prices that are applicable for any given month are not announced simultaneously. The Class I price and the Class II skim milk price are announced prior to the beginning of the month for which they will be effective. Class prices for milk in all other uses are not determined until on or before the 5th day of the following month. The Class I price is determined by adding a differential value to the higher of either an advanced Class III or Class IV value. These values are calculated based on a formula using National Agricultural Statistics Service (NASS) survey prices of cheese, butter, and nonfat dried milk powder for the first two weeks of the preceding month. For example, the Class I price for August is announced in late July and is based on the higher of the Class III or IV value computed using NASS commodity price surveys for the first two weeks of July.

The Class III and IV prices for the month are determined and announced after the end of the month based on the NASS survey prices for the selected dairy commodities during the month. For example, the Class III and IV prices for August are based on NASS survey commodity prices during August. A large increase in the NASS survey price for the selected dairy commodities from one month to the next can result in the Class III or IV price exceeding the Class I price. This occurrence is commonly referred to by the dairy industry as a

“Class price inversion.” A producer price inversion generally refers to when the Class III or IV price exceeds the classified use value, or blend price, of milk for the month. Price inversions have occurred with increasing frequency in Federal milk orders since the current pricing plan was implemented on January 1, 2000, despite efforts made during Federal Order Reform to reduce such occurrences. Price inversions can create an incentive for dairy farmers and manufacturing handlers who voluntarily participate in the marketwide pooling of milk to elect not pool their milk on the order. Class I handlers do not have this option; their participation in the marketwide pool is mandatory.

The producer price differential, or PPD, is the difference between the Class III price and the weighted average value of all Classes. In essence, the PPD is the dairy farmer's share of the additional/reduced revenues associated with the Class I, II and IV milk pooled in the market. If the value of the Class I, II and IV milk in the pool is greater than the Class III value, dairy farmers receive a positive PPD. However a negative PPD can occur if the value of the Class III milk in the pool exceeds the value of the remaining classes of milk in the pool. This can occur as a result of the price inversions discussed above.

The UMW Federal order operates a marketwide pool. The Order contains pooling provisions which specify criteria that, if met, allow dairy farmers to share in the benefits that arise from classified pricing through pooling. The equalization of all class prices among handlers regulated by an order is accomplished through a mechanism known as the producer settlement fund (PSF). Typically, Class I handlers pay the difference between the blend price and their use-value of milk into the PSF. Manufacturing handlers typically receive a draw from the PSF, usually the difference between the Class II, III or IV price and the blend price. In this way, all handlers pay the Class value for milk and all dairy farmer supplies receive at least the order's blend price.

When manufacturing class prices of milk are high enough to result in a use-value of milk for a handler that is higher than the blend price, manufacturing handlers may choose to not pool their milk receipts. Opting to not pool their milk receipts allows these handlers to avoid the obligation of paying into the PSF. The choice by a manufacturing handler to not pool their milk receipts is commonly referred to as “de-pooling”. When the blend price rises above the manufacturing class use-values of milk these same handlers

again opt to pool their milk receipts. This is often referred to as “re-pooling”. The ability of manufacturing handlers to de-pool and re-pool manufacturing milk is viewed by some market participants as being inequitable to both producers and handlers.

The “De-Pooling” Proposals

Proponents are in agreement that milk marketing orders should contain provisions that will tend to deter the practice of de-pooling. Four proposals intending to deter the de-pooling of milk were considered in this proceeding. The proposals offered different degrees of deterrence against de-pooling by establishing limits on the amount of milk that can be re-pooled. The proponents of these four proposals are generally of the opinion that de-pooling erodes equity among producers and handlers, undermines the orderly marketing of milk and is detrimental to the Federal order system.

Two different approaches on how to best limit de-pooling are represented by these four proposals. The first approach, published in the hearing notice as Proposals 2 and 5, addresses de-pooling by limiting the volume of milk a handler can pool in a month to a specified percentage of what the handler pooled in the prior month. The second approach, published in the hearing notice as Proposals 3 and 4, addresses de-pooling by establishing what is commonly referred to as a “dairy farmer for other markets” provision. These proposals would require milk of a producer that was de-pooled to not be able to be re-pooled by that producer for a defined time period. All proponents agreed that while none of the proposals would completely eliminate de-pooling, they would likely deter the practice.

Of the four proposals received that would limit de-pooling, this decision recommends adoption of Proposal 2, offered by Mid-West Dairymen's Company (Mid-West) on behalf of Cass-Clay Creamery Inc. (Cass-Clay), Dairy Farmers of America, Inc. (DFA), Foremost Farms USA Cooperative (Foremost Farms), Land O'Lakes Inc. (LOL), Milwaukee Cooperative Milk Producers (MCMP), Manitowoc Milk Producers Cooperative (MMPC), Swiss Valley Farms Company (Swiss Valley), and Woodstock Progressive Milk Producers Association (Woodstock). Hereinafter, this decision will refer to these proponents as “Mid-West, et al.” Although Foremost Farms was a proponent of Proposal 2, no testimony was offered on their behalf. At the hearing, Plainview Milk Products Cooperative and Westby Cooperative Creamery also supported the testimony

given on behalf of Mid-West, et al. The proponents of Proposal 2 are all cooperatives representing producers whose milk supplies the milk needs of the marketing area and is pooled on the UMW order.

Specifically, adoption of Proposal 2 will limit the volume of milk a handler could pool in a month to no more than 125 percent of the volume of milk pooled in the prior month during the months of April through February, and to no more than 135 percent of the prior month's pooled volume in the month of March. Milk diverted to nonpool plants in excess of this limit will not be pooled, and milk shipped to pool distributing plants will not be subject to the 125 or 135 percent limitation.

As published in the hearing notice, Proposal 5, offered by Dean Foods Company (Dean), addresses de-pooling in a similar manner as Proposal 2, but would establish a limit on the total volume of milk a handler could pool in a given month to 115 percent of the volume that was pooled in the prior month. Dean is a handler who operates manufacturing plants and distributing plants in the UMW marketing area. Producer milk shipped to and physically received at a pool distributing plant, and producer milk that was pooled continuously on another Federal Order during the previous six months, would not be subject to this pooling standard. Proposal 5 is not recommended for adoption.

As published in the hearing notice, Proposals 3 and 4, also offered by Dean, address de-pooling by establishing defined time periods during which de-pooled milk could not be pooled. Proposal 3 would require an annual pooling commitment by a handler to the UMW market. As advanced in Proposal 3, if the milk of a producer is de-pooled in a month, the milk of a producer could not re-establish eligibility for pooling on the order during the following 11 months unless 10 days' milk production of a producer was delivered to a pool distributing plant during the month. Under Proposal 3, handlers that de-pool milk have limited options to return milk to the pool, either shipping 10 days' milk production of a producer to a pool distributing plant during the month or waiting 11 months to regain pooling eligibility.

Proposal 4 is similar to Proposal 3 but is less restrictive. Under Proposal 4, as modified at the hearing, if a producer's milk is de-pooled in any of the months of February through June, or during any of the preceding three months, or during any of the preceding months of July through January, the equivalent of at

least 10 days' milk production would need to be physically received at a pool distributing plant in order to pool all of the dairy farmer's production for the month. Additionally, if the milk of a dairy farmer is de-pooled in any of the months of July through January, or in a preceding month, at least 10 days' milk production of the dairy farmer would need to be delivered to a pool distributing plant to have all the milk of the dairy farmer pooled for the month.

The current *Producer milk* provision of the UMW order considers the milk of a dairy farmer to be producer milk when it is delivered directly from farms to pool plant or diverted by a pool plant or cooperative handler to a nonpool plant. Milk is not eligible for diversion to nonpool plants unless at least one days' production of such dairy farmer is received at a pool plant anytime during the initial qualifying month, often referred to as "touching-base". To be eligible to pool all of its milk receipts, the pooling handler must ship at least 10 percent of its milk receipts to a pool distributing plant, producer-handler, a partially regulated distributing plant, or a pool distributing plant regulated by another Federal order. A handler's diversion of milk to nonpool plants can only be made to nonpool plants located in the States of Illinois, Iowa, Minnesota, Wisconsin, North Dakota, South Dakota, and the Upper Peninsula of Michigan, or to a distributing plant regulated under another Federal order. Milk that is subject to inclusion in another marketwide equalization program operated by a state government is not considered producer milk. The order currently does not limit a handler's ability to de-pool milk.

The proponents of Proposals 2, 3, 4 and 5 are all of the opinion that the current pooling standards are inadequate because they enable manufacturing handlers to de-pool milk when advantageous to do so and immediately re-pool milk in a following month if advantageous to do so. According to the proponents, the UMW blend price is lowered when large volumes of sometimes higher valued milk used for manufacturing is de-pooled and when the large volumes of de-pooled milk returns to the pool. Furthermore, the witnesses argued that de-pooling handlers do not account to the UMW pool at the order's classified prices and therefore face different costs than their similarly situated pooling competitors. The proponents insisted that the pooling standards of the order need to be amended to ensure producer and handler equity, even though the proposals differed on how best to meet this end.

A witness appearing on behalf of Mid-West, et al., testified in support of Proposal 2. The witness was of the opinion that the underlying principles of the Federal order program are to supply milk to the fluid market, equitably share pool proceeds among all participating producers, and promote orderly marketing. The witness explained that the Federal order program achieves these objectives through classified pricing, through which Class I milk generates revenue for the pool; and marketwide pooling, which equalizes payments to all participating producers who serve the market regardless of how the milk of any single producer is utilized.

The Mid-West, et al., witness said that currently milk utilized at manufacturing plants can be de-pooled and again pooled in a subsequent month when it is economically beneficial to the handler. When choosing to pool or not to pool, the witness explained, handlers assess whether participating in the marketwide pool would require them to make a payment into or receive a payment from the PSF. According to the witness, milk utilized as Class I must always be pooled regardless of whether the pooling handler would make a payment into, or receives a payment from, the PSF.

The Mid-West, et al., witness testified that because manufacturing milk can freely exit and return to the pool, producers who regularly and consistently service the UMW fluid market are not being treated equitably under the terms of the order. According to the witness, these producers receive a lower blend price because the value of the milk that was de-pooled was not shared equitably among all the market's producers.

The Mid-West, et al., witness maintained that the ability of manufacturing handlers to de-pool milk creates inequities among handlers and producers. The witness said that when the PPD is negative, dairy farmers receive different payments for their milk depending on if their milk was pooled, and handlers are not required to account to the pool at classified prices depending on their pooling decisions. Class I handlers who must pool their milk receipts always have a disadvantage when the PPD is negative, explained the witness, because a manufacturing handler can opt to de-pool and avoid paying into the PSF. According to the witness this results in higher prices that can be paid to the producers supplying the manufacturing handler. The witness contrasted that when the PPD is positive, milk that had been de-pooled seeks to return to the

pool. According to the witness, this also dilutes the blend price paid to producers who had been supplying the Class I handler.

The Mid-West, et al., witness, relying on Market Administrator statistics, noted that in May 2004, all producer milk pooled on the order was subject to a negative \$1.97 per hundredweight (cwt) PPD. However, the witness emphasized that a manufacturing handler who chose to de-pool their milk supply and did not have to account to the pool at classified prices had an imputed PPD of zero. In other words, the witness explained, milk used in manufactured products was worth more than milk used in fluid products. Relying on additional Market Administrator statistics, the witness demonstrated that if 100 percent of eligible Class III milk had pooled in July 2003 through May 2004, the estimated PPD would have averaged a negative \$0.098 per cwt rather than the actual average PPD of negative \$0.773 per cwt.

The Midwest, et al., witness explained how adoption of Proposal 2 would improve both producer and handler equity. The witness said that Proposal 2 would only limit the amount of milk a handler could pool up to 125 or 135 percent of the previous month's pooled volume and clarified that any milk delivered to a distributing plant would not be subject to the 125 or 135 percent pooling calculation. If Proposal 2 were adopted, the witness claimed, no current handler would have to change the physical operations of their plant. While adoption of this proposal would not end the practice of de-pooling, speculated the witness, it would establish financial consequences for handlers who might not otherwise consistently pool their milk receipts.

In explaining why adoption of Proposal 2 would be reasonable and appropriate for the UMW order, the Mid-West, et al., witness said that a 125 percent standard should accommodate any change in the potential growth of a handler's pooled milk volume resulting from seasonal fluctuations in milk supply or the addition of new producers, assuming that the handler did not de-pool. Additionally, the witness added that to ensure no handler would need to change its physical operations, Proposal 2 allows a 135 percent re-pooling standard in March because of the fewer calendar days in February. The witness stressed that the 125 and 135 percent standards allow a handler to de-pool a portion of its milk supply and over a period of months, regain the ability to again pool its entire supply. The witness added that the proposal does not restrict the volume of

milk able to be pooled in August since this is generally considered the start of the new marketing year

The Mid-West, et al., witness also emphasized that establishing a standard on the basis of the prior month's pooled volume has been done in other orders. The Northeast order has a "producer for other markets" provision that restricts the ability to pool the milk of a producer if the milk of that producer had been previously de-pooled, noted the witness. Furthermore, the witness said, milk orders in the south and southeastern part of the country had provisions which limited the sharing of marketwide returns in the spring months to only those producers whose milk served the fluid market during the fall months.

The Mid-West, et al., witness predicted that price volatility would continue in the future and result in negative PPD's and the further de-pooling of milk. The witness was of the opinion that price volatility and de-pooling have created emergency marketing conditions that would warrant the Department to omit issuing a recommended decision.

A witness from DFA, appearing on behalf of Mid-West, et al., testified in support of Proposal 2. The witness testified that DFA engages in the practice of de-pooling when warranted to earn sufficient revenue to pay their producer members a competitive milk price. The DFA witness emphasized that de-pooling creates disorderly marketing conditions and supported Proposal 2 as the best option to deter the practice of de-pooling. The witness offered scenarios that demonstrated the financial incentives available to handlers who de-pool milk. The witness asserted that the current pooling standards of the UMW order where producers qualify for pooling by meeting a one-day touch base standard allow handlers the opportunity to reap financial rewards from the market by de-pooling and re-pooling their milk receipts.

The DFA witness explained that Proposal 2 was a compromise position among all the entities of Mid-West, et al., noting that its adoption would improve the current disorderly market conditions arising from the practice of de-pooling. The witness noted that many alternatives were considered but the proponents were of the opinion that Proposal 2 is a significant improvement to the order's pooling provisions while still allowing handlers to make their own pooling decisions.

Witnesses from LOL, Swiss Valley, Cass-Clay, MMPC, and DFA Central Council, all appearing on behalf of Mid-

West, et al., testified in support of Proposal 2. Many of the witnesses testified that their respective organizations engage in the practice of de-pooling when it is to their advantage but that they recognize that the practice has a negative impact on the PPD and creates disorderly marketing conditions. Consequently, they are of the opinion that while a moderate level of de-pooling should be tolerated, a set of standards should be established to deter de-pooling in order to maintain orderly marketing conditions.

The Mid-West, et al., witnesses identified above expressed support for Proposal 2 as an acceptable and moderate approach to limiting the practice of de-pooling. The proposal would allow flexibility in making pooling decisions, explained the witnesses, but would also establish significant consequences for those who opt to de-pool large volumes of their producer milk supply. In this regard, the witnesses said that Proposal 2 would result in ensuring more equity among handlers and producers during times of price inversions.

A DFA dairy farmer member, whose milk is pooled on the UMW order, testified in support of Proposal 2. The witness was of the opinion that if a dairy farmer wants to participate in the UMW marketwide pool and share in the revenue generated from the market, they should be prepared to service the market every month. When handlers engage in the practice of de-pooling their milk receipts, the witness said, the results are severe price fluctuations and larger negative PPDs that negatively impact the price paid to pooled producers. The witness was of the opinion that the adoption of Proposal 2 would result in more stable pooled milk volumes and consequently would lessen the severe and volatile price changes that producers have experienced.

A dairy farmer appearing on behalf of MCMP, whose milk is pooled on the UMW order, testified in support of Proposal 2. The witness said that their farm income was negatively impacted during May 2004 as a result of the negative \$1.97 per cwt PPD. The witness added that neighboring farms that shipped milk to other handlers reported receiving a higher price for their milk. The opinion of the witness was that the practice of de-pooling has led to non-uniform prices received by farmers and that adoption of Proposal 2 would restore price equity among producers.

A witness appearing on behalf of Dean testified in opposition to Proposal 2. The witness said that the pooling standards of Proposal 2 are too liberal and that unlimited pooling in the month

of August could allow handlers to again take advantage of the pooling system.

A witness appearing on behalf of Northwest Dairy Association (NDA) testified in opposition to Proposal 2. NDA is a dairy cooperative that markets 7 billion pounds of milk annually with members in the States of Washington, Oregon, Idaho, and Northern California. The witness explained that NDA engages in the practice of de-pooling in other Federal orders as a way to recover costs in their manufacturing of butter and cheese because the Class III and IV make allowances that do not adequately reflect such costs. The NDA witness was of the opinion that the practice of de-pooling should be addressed at a national hearing that would also consider other issues such as the make allowances used in the Class III and IV price formulas.

A witness appearing on behalf of Dean testified in support of Proposals 3, 4, and 5. The witness asserted that the intent of the Federal order system is to ensure a sufficient supply of milk for fluid use and provide for uniform payments to producers who stand ready, willing, and able to serve the fluid market. While some entities are of the opinion that the Federal order system should ensure a sufficient milk supply to all plants, the Dean witness was of the opinion that the Federal order system addresses only the need for ensuring a milk supply to distributing plants. The witness elaborated on this opinion by citing examples of order provisions that stress providing for a regular supply of milk to distributing plants as a priority of the Federal milk order program.

The Dean witness was of the opinion that for the Federal milk order system to ensure orderly marketing, orders need to provide adequate economic incentives that will attract milk to fluid plants and also need to properly define regulations to determine the milk of those producers who can participate in the marketwide pool. The witness argued that a major flaw in the current regulations is that they allow handlers to choose when to participate in the pool. In this regard, the witness said, the order lacks the economic incentive for pool participation by its lack of an economic disincentive to the practice of de-pooling.

The Dean witness testified that Proposals 3, 4, and 5 are designed to establish proper economic incentives for supplying the fluid market and maintain equity among handlers and producers. While each proposal offered a slightly different solution to the problem, the witness said Dean Foods supports their adoption in the following order or

preference: Proposal 3, Proposal 4, and then Proposal 5.

A second witness appearing on behalf of Dean testified in support of Proposals 3, 4, and 5. The witness argued that when handlers engage in the practice of de-pooling it creates a burden on the producers who consistently serve the Class I needs of the market. According to the witness, when the PPD is negative, there is an incentive for handlers to de-pool Class III and Class IV milk. When a handler opts to de-pool, it decreases the amount of pooled milk and makes the PPD more negative than it would have been had all milk been pooled, the witness said. When the PPD is positive, milk previously de-pooled seeks to be re-pooled which increases the volume of pooled milk valued at lower classified prices and lowers the blend price paid to all producers, the witness asserted. The major "losers" in this process, concluded the witness, are the producers whose milk is continuously pooled regardless of the PPD.

The second Dean witness said that Proposal 3 was designed to increase the availability of milk for fluid use and ensure that pool proceeds are only shared among producers who consistently service the fluid market. The witness said that if Proposal 3 is adopted, de-pooled milk could again become pooled as long as the producer delivered ten-day's milk production to a pool distributing plant for twelve consecutive months. Once that standard was met, the witness added, the producer's milk could then be pooled under the more flexible provisions of the UMW order.

The Dean witness asserted that there are three benefits to adoption of Proposal 3: (1) When the PPD is negative, more Class III milk would stay in the pool resulting in a less negative PPD; (2) Some Class III de-pooled milk would never be re-pooled which would result in a more positive PPD; and (3) Class III de-pooled milk would have to demonstrate regular and significant deliveries to distributing plants in order to be re-pooled.

In explaining Proposal 4 as an alternative to Proposal 3, the second Dean witness indicated that the difference in the two proposals is the number of months that the ten-day touch base provision would be applicable before de-pooled milk could again be pooled under normal circumstances. The witness was of the opinion that Proposal 4 would discourage some de-pooling, however, the harm caused by the practice of de-pooling would be better prevented by the adoption of Proposal 3.

The Dean witness also discussed Proposal 5 as a less desirable alternative to Proposals 3 and 4. According to the witness, Proposal 5 would limit the amount of milk that can be pooled to 115 percent of the handler's previous month's pooled milk volume. The witness explained that the greater the volume of de-pooled milk, the more time needed under Proposal 5 for a handler to re-pool all its milk receipts. This, the witness said, ensures that the entities that benefit the most from the practice of de-pooling would not receive an immediate benefit that would otherwise occur when re-pooling.

A third witness appearing on behalf of Dean testified in support of Proposal 3. The witness said that the current liberal pooling standards of the UMW order are one source of disorderly marketing and are preventing all producers from sharing equally in pool proceeds. The witness asserted that the Federal milk order system was designed so that through marketwide pooling all producers would share equally in pool proceeds, and that through classified pricing milk would move to the market's highest-valued use.

Relying on Market Administrator statistics for January 2000 through June 2004, the witness asserted that the volume of pooled Class III milk varied from 1.5 billion pounds in January 2004 to 11 million pounds in April 2004. Furthermore, the witness said, the blend price in April 2004 would have been \$2.97 higher if all Class III milk had been pooled. The witness was of the opinion that these large swings in the volume of pooled milk results in the disorderly marketing condition of inequitable sharing of pool proceeds among producers.

A witness appearing on behalf of Oberweis Dairy testified in support of Proposals 2 and 3. Oberweis Dairy operates a distributing plant with approximately 40 dairy farmer suppliers and 32 ice cream stores in the Chicago and St. Louis area markets. The witness was of the opinion that it is inequitable to producers and Class I handlers when manufacturing handlers engage in the practice of de-pooling. The witness was of the opinion that either all handlers should be able to engage in the practice of de-pooling or de-pooling should be prohibited. While no proposal at the hearing proposed such a restriction, the witness was of the opinion that Proposal 3 would be the best option to restore equity among producers. Nevertheless, the witness said that Oberweis would support the adoption of Proposal 2 if the Department finds it to be more appropriate.

A witness appearing on behalf of the Wisconsin Farmers Union, Minnesota Farmers Union, and the North Dakota Farmers Union testified about the negative effects of de-pooling on dairy producers. These organizations represent farmers of various agricultural products in their respective States. The witness asserted that when a cooperative engages in the practice of de-pooling, dairy farmers are negatively impacted because the revenue a cooperative gains from de-pooling is not paid to producers by the cooperatives. The witness insisted that the practice of de-pooling should be curbed so that producers are adequately paid for the total value of their milk.

A witness appearing on behalf of Galloway Company (Galloway) testified in support of all proposals that would limit the practice of de-pooling. Galloway owns and operates a dairy manufacturing plant in the UMW marketing area. The witness was of the opinion that large negative PPD's are due, in part, to de-pooling and that has a negative impact on the income of Galloway. The witness was of the opinion that changes to order provisions to limit the ability to re-pool are necessary but had no opinion as to which proposal would be the best option.

A post-hearing brief submitted by Dean reiterated their opinion that the pooling standards of the order need to be amended to correct the disorderly marketing conditions arising from the practice of de-pooling. The brief argued that the practice of de-pooling is disorderly because a handler who de-pools milk avoids accounting to the pool at classified prices and is not required to pay its suppliers the minimum blend price. However, asserted Dean, a pooled handler not only accounts to the pool at classified prices and pays its suppliers the minimum blend price, the handler also finds it necessary to pay large premiums to keep its suppliers.

According to the Dean brief, negative PPD's and the resulting practice of de-pooling are not a national issue, noting that de-pooling typically occurs in markets with low Class I utilization such as the UMW. The Dean brief predicted that the practice of de-pooling would occur in the future and therefore concluded that the disorderly marketing conditions arising from the practice of de-pooling warrant emergency action from the Department by omitting a recommended decision.

A post hearing brief submitted on behalf of Lamers Dairy, Inc. (Lamers) asserted that the ability of some handlers to engage in the practice of de-

pooling when it is economically advantageous is a disorderly marketing condition. Furthermore, the brief expressed the opinion that de-pooling causes inequitable treatment among handlers because pooling handlers must account to the PSF at minimum classified prices while handlers who de-pool their milk receipts do not. The Lamers brief supported adoption of Proposal 3 as the most appropriate solution to limit the practice of de-pooling.

A witness appearing on behalf of Mid-West, et al., testified in opposition to Proposal 3. According to the witness, requiring a producer whose milk was de-pooled to deliver 10-day's milk production to a pool distributing plant is a standard that would be extremely difficult to meet. The witness stressed that finding access to a pool distributing plant for 10-day's production would not only be extremely difficult, it would also be costly. The Mid-West, et al., brief also contended that the proposals offered by Dean would require physical changes in plant operations that are not necessary to address the practice of de-pooling in the UMW market.

The Mid-West, et al., brief disagreed with others who were of the opinion that the de-pooling issue should be addressed at a national hearing. The brief explained that historical Federal milk order policy is that the pooling provisions of orders be reflective of each order's individual marketing conditions. Therefore, the brief concluded, it is appropriate to address the practice of de-pooling on an individual order basis.

A witness appearing on behalf of Associated Milk Producers, Inc. (AMPI) testified in opposition to all proposals intended to limit the practice of de-pooling as specified in Proposals 2, 3, 4, and 5. The witness' testimony was given on behalf of Alto Dairy Cooperative, Bongards' Creameries, Ellsworth Cooperative Creamery, Family Dairies USA, First District Association, Davisco Foods, Valley Queen Cheese Company and Wisconsin Cheesemakers Association (WCA). The members consist of cooperative associations and handlers who market or purchase milk in the UMW marketing area. Hereinafter, this coalition of members will be referred to collectively as "AMPI, et al."

The AMPI, et al., witness testified that the option to engage in the practice of de-pooling in response to price inversions has been a longstanding part of the Federal milk order system. The witness testified that as a result of timing differences in announcing classified prices, a lag between changes in the market value of milk used in

manufacturing and corresponding changes in the Federal order Class I price sometimes results in price inversions. The witness explained that the occasional price inversion is caused by the announcement of the Class I price approximately two weeks prior to the month and the announcement of the price for milk used in Class II, III, and IV products occurring after the close of the month—a difference of six weeks. The witness drew attention to April 2004 where the value of Class III milk increased \$6.02 per cwt during the six-week lag. This resulted in a blend price that was substantially less than the estimated Class III price, resulting in a large amount of de-pooled Class III milk because, the witness said, there was no incentive for manufacturing handlers to pool all of their milk receipts.

The AMPI, et al., witness asserted that the argument that de-pooled milk does not serve, nor is available to serve, the fluid market is false. According to the witness, milk that is de-pooled is available to the Class I market during the month it is marketed and a decision to de-pool the milk is made after the end of the month when the Class II, III and IV prices are known. Additionally, the witness asserted that fluid milk plants always receive a continuous supply of fluid milk because of their contractual supply agreements.

The AMPI, et al., witness characterized the proposals under consideration to address the practice of de-pooling as designed to penalize handlers who engage in de-pooling their Class III milk. AMPI, et al., the witness stated, is strongly opposed to this change in pooling philosophy. The witness was of the opinion that the Federal order system should continue to provide for the marketwide sharing of money derived from sales of Class I milk since it is Class I sales that historically generate additional revenue to producers. However, the witness said, the order should not force handlers to share money generated from manufactured milk products to offset a low Class I price.

The AMPI, et al., witness was of the opinion that the practice of de-pooling is a national issue that should be addressed in a national hearing. The witness believed that a better solution to the practice of de-pooling would be to eliminate the advanced pricing of Class I milk and instead announce all Class prices after the end of the month.

The AMPI, et al., witness also testified that emergency marketing conditions do not exist to warrant the omission of a recommended decision by the Department. The witness stressed that price inversions and the practice of de-

pooling have occurred in the Federal order system for decades and any major change in Department policy regarding this practice should be addressed in a recommended decision where interested parties can file comments and exceptions.

A post-hearing brief submitted on behalf of AMPI, et al., reiterated their opposition to all of the proposals that seek to deter de-pooling. The brief argued that the AMAA intended for the government to only require the sharing of the revenues generated from fluid sales. According to the brief, requiring manufactured milk to remain pooled oversteps the authority of the AMAA. The brief also expressed the opinion that Proposals 3, 4, and 5 are designed to limit a producer's access to the market and should therefore be denied. Furthermore, the brief stressed that Proposals 3 through 5 would unfairly increase costs of some UMW handlers because of the increased transportation and capital investment that would be needed to comply with the proposed amendments.

A witness appearing on behalf of WCA, testified in opposition to all proposals intended to limit the practice of de-pooling as specified in Proposals 2, 3, 4, and 5. The witness testified that WCA represents dairy manufacturers and marketers with 32 of its members operating 42 pooled dairy facilities on the UMW order. According to the witness, 30 of the 42 pooled dairy facilities are small businesses and if the proposals to limit the practice of de-pooling were adopted, these small businesses would face new and significant costs to comply with the proposed new standards without benefit to their dairy farmer suppliers.

The WCA witness expressed concern that Proposal 2 addressed the practice of de-pooling without regard to the cause of negative PPD's, specifically the inversion of classified prices. The witness also said that Proposals 2, 3, 4 and 5 would put an additional administrative burden on handlers by requiring them to designate which producers would remain pooled or de-pooled. The witness asserted that access to distributing plants in the UMW market is very limited and it would be hard for a de-pooled producer to re-associate with a distributing plant in order to be eligible to again pool their milk on the order.

The WCA witness was of the opinion that Proposals 3 and 4 also would add additional transportation costs, administrative costs, and the potential need for additional silo capacity to accommodate the increased volume of milk that would be needed to meet the

10-day production delivery standard at a pool distributing plant. The witness explained that many WCA members do not have the capacity to accommodate meeting a 10-day production delivery standard for each month. The witness was also of the opinion that existing supply contracts provide ample milk supplies for the Class I market and concluded that additional deliveries to pool plants are not needed to assure an adequate supply to Class I facilities.

A witness appearing on behalf of the National Family Farm Coalition, an organization representing family farms located in 32 states including those states comprising the UMW marketing area, testified in opposition to all proposals at the hearing. The witness was of the opinion that the entire Federal order system was in need of a complete reform. The witness asserted that the proponents of the proposals being heard were entities whose past actions have lowered prices received by family farmers.

A post-hearing brief submitted on behalf of Alto Dairy (Alto), a cooperative with 580 dairy farmer members in Wisconsin and Michigan, reiterated their opposition to all proposals seeking to limit the practice of de-pooling. The brief stressed that a decision to de-pool is made separately from the decision to adequately supply the Class I needs of the market.

An Extension Dairy Marketing Specialist at the University of Wisconsin testified on the issues surrounding the practice of de-pooling but did not support or oppose any specific proposal. The witness referred to and explained a research paper which identified and explained problems arising in the UMW marketing area by pooling distant milk, the practice of de-pooling, and the resulting economic impacts to producers. The witness said that if manufacturing prices for milk rapidly increase during the month there will be a negative PPD but as prices begin to decline, the PPD will again become positive over time. The witness also explained that a negative PPD does not mean that producers lost money. Rather, the witness clarified, the PPD is a calculation of the difference between the Class III price and the blend price that producers receive. However, concluded the witness, the ability to engage in the practice of de-pooling does result in volatile PPD's and gives rise to inequities among producers and handlers.

All Federal milk marketing orders require the pooling of milk received at pool distributing plants—which is predominantly Class I milk—and all pooled producers and handlers on an

order share in the additional revenue arising from higher valued Class I sales. Manufacturing handlers and cooperatives of Class II, III and IV uses of milk who meet the pooling and performance standards make all of their milk receipts eligible to be pooled and usually find it advantageous. Manufacturing handlers and cooperatives who supply a portion of their total milk receipts to Class I distributing plants receive the difference between their use-value of milk and the order's blend price. Federal milk orders, including the UMW order, establish limits on the volume of milk eligible to be pooled that is not used for fluid uses primarily through diversion limit standards. However, manufacturing handlers and cooperatives are not required, as are Class I handlers, to pool all their eligible milk receipts.

According to the record, manufacturing handlers and cooperatives have opted to not pool their milk receipts when the manufacturing class prices of milk are higher than the order's blend price—commonly referred to as being “inverted.” During such months, manufacturing handlers and cooperatives have elected to not pool all of their eligible milk receipts because doing so would require them to pay into the PSF of the order, the mechanism through which handler and producer prices are equalized. When prices are not inverted, handlers would pool all of their eligible receipts and receive a payment or draw from the PSF. In receiving a draw from the PSF, such handlers will have sufficient money to pay at least the order's blend price to their supplying dairy farmers.

When manufacturing handlers and cooperatives opt to not pool all of their eligible milk receipts in a month, they are essentially avoiding a payment to the PSF. This, in turn, enables them to avoid the marketwide sharing of the additional value of milk that accrues in the higher-valued uses of milk other than Class I. When the Class I price again becomes the highest valued use of milk, or when other class-price relationships become favorable, the record reveals that these same handlers opt to again pool their eligible milk receipts and draw money from the PSF. It is the ability of manufacturing handlers and cooperatives opting to not pool milk and thereby avoid the marketwide sharing of the revenue accruing from non-Class I milk sales that is viewed by proponents as giving rise to disorderly marketing conditions. According to proponents, producers and handlers who cannot escape being

pooled and priced under the order are not assured of equitable prices.

The record reveals that since the implementation of Federal milk marketing order reform in January 2000, and especially in more recent years, large and rapid increases in manufactured product prices during certain months have provided the economic incentives for manufacturing handlers to opt not to pool eligible milk on the UMW order. For example, during the three-month period of February to April 2004, the Class III price increased over 65 percent from \$11.89 per cwt to \$19.66 per cwt. During the same time period, total producer milk pooled on the UMW order decreased by over 60 percent from 1.94 billion pounds to 608 million pounds. When milk volumes of this magnitude are not pooled the impacts on producer blend prices are significant. Producers who incur the additional costs of consistently servicing the Class I needs of the market receive a lower return than would otherwise have been received if they did not continue to service the Class I market. Prices received by dairy farmers who supplied the other milk needs of the market are not known. However, it is reasonable to conclude that prices received by dairy farmers were not equitable or uniform.

The record reveals that “inverted” prices of milk are generally the result of the timing of Class price announcements. Despite changes made as part of Federal milk order reform to shorten the time period of setting and announcing Class I milk prices and basing the Class I price on the higher of the Class III or Class IV price to avoid price inversions, large month-to-month price increases in Class III and Class IV product prices sometimes trumped the intent of better assuring that the Class I price for the month would be the highest-valued use of milk. In all orders, the Class I price (and the Class II skim price) is announced prior to or in advance of the month for which it will apply. The Class I price is calculated by using the National Agricultural Statistics Service (NASS) surveyed cheese, butter, nonfat dry milk and dry whey prices for the two most current weeks prior to the 24th day of the preceding month and then adding a differential value to the higher of either the advanced Class III or Class IV price.

Historically, the advance pricing of Class I milk has been used in all Federal orders because Class I handlers cannot avoid regulation and are required to pool all of their Class I milk receipts, they should know their product costs in advance of notifying their customers of price changes. However, milk receipts

for Class III and IV uses are not required to be pooled thus, Class III and IV product prices (and the Class II butterfat value) are not announced in advance. These prices are announced on or before the 5th of the following month. Of importance here is that manufacturing plant operators and cooperatives have the benefit of knowing all the classified prices of milk before making a decision to pool or not pool eligible receipts.

The record reveals that the decision of manufacturing handlers or cooperatives to pool or not pool milk is made on a month-to-month basis and is generally independent of past pooling decisions. Manufacturing handlers and cooperatives that elected to not pool their milk receipts did so to avoid making payments to the PSF and they anticipated that all other manufacturing handlers and cooperatives would do the same. However, the record indicates that normally pooled manufacturing handlers and cooperatives met the pooling standards of the order to ensure that the Class I market was adequately supplied and that they established eligibility to pool their physical receipts, including diversions to nonpool plants. Opponents to proposals to deter de-pooling are of the view that meeting the pooling standards of the order and deciding how much milk to pool are unrelated events. Proponents took the view that participation in the marketwide pool should be based on a long-term commitment to supply the market because in the long-term it is the sales of higher priced Class I milk that adds additional revenue to the pool.

The producer price differential, or PPD, is the difference between the Class III price and the weighted average value of all Class I, II and IV milk pooled. In essence, the PPD is the residual revenue remaining after all butterfat, protein and other solids values are paid to producers. If the pooled value of Class I, II and IV milk is greater than the Class III value, dairy farmers receive a positive PPD. While the PPD is usually positive, a negative PPD can occur when class prices rise rapidly during the six-week period between the time the Class I price is announced and the time the Class II butterfat and III and IV milk prices are announced. When manufacturing prices fall, this same lag in the announcement of class prices yields a positive PPD.

As revealed by the record, when manufacturing plants and cooperatives opted to not pool milk because of inverted price relationships, PPD's were much more negative. When this milk is not pooled, a larger percentage of the milk remaining pooled will be "lower" priced Class I milk. When

manufacturing milk is not pooled the weighted average value of milk decreases relative to the Class II, III or IV value making the PPD more negative. For example, record evidence demonstrated that in April 2004, a month when a sizeable volume of milk was not pooled, the PPD was a negative \$4.11 per cwt. If all eligible milk had been pooled, the PPD would have been \$2.97 per cwt higher or a negative \$1.14 per cwt.

The record reveals that when manufacturing handlers and cooperatives opt to not pool milk, unequal pay prices may result to similarly located dairy farmers. For example, Dean noted that when a cooperative delivers a high percentage of their milk receipts to a distributing plant, it lessens their ability to not pool milk, making them less competitive in a marketplace relative to other producers and handlers. Other evidence in the record supports conclusions identical to Dean that when a dairy farmer or cooperative is able to receive increased returns from shipping milk to a manufacturing handler during times of price inversions, other dairy farmers or cooperatives who may have shipped more milk to a pool distributing plant are competitively disadvantaged.

The record of this proceeding reveals that the ability of manufacturing handlers and cooperatives to not pool all of their eligible milk receipts gives rise to disorderly marketing conditions and warrants the establishment of additional pooling standards to safeguard marketwide pooling. Current pooling provisions do not require or prohibit handlers and cooperatives from pooling all eligible milk receipts. However, the record reveals that when handlers and cooperatives opt to not pool milk inequities arise among producers and handlers that are contrary to the intent of the Federal milk marketing order program—maintaining orderly marketing conditions.

The record contains extensive testimony regarding the effects on the milk order program resulting from advance pricing and the priority the milk order program has placed on the Class I price being the highest valued use of milk. It remains true that the Class I use of milk is still the highest valued use of milk notwithstanding those occasional months when milk used in usually lower-valued classes may be higher. This has been demonstrated by an analysis of the effective Class I differential values—the difference in the Class I price at the base zone of Cook County, Illinois, and the higher of the Class III or Class IV price—

for the 65 month period of January 2000 through May 2005 performed by USDA.¹ These computations reveal that the effective monthly Class I differential averaged \$1.76 per cwt. Accordingly, it can only be concluded that in the longer-term Class I sales continue to be the source of additional revenue accruing to the pool even when, in some months, the effective differential is negative.

Price inversions occur when the wholesale price for manufactured products rises rapidly indicating a tightening of milk supplies to produce those products. It is for this reason that the Department chose the higher of the Class III or Class IV prices as the mover of the Class I price. Distributing plants must have a price high enough to attract milk away from manufacturing uses to meet Class I demands. As revealed by the record, this method has not been sufficient to provide the appropriate price signals to assure an adequate supply of milk for the Class I market. Accordingly, additional measures are needed as a means of assuring that milk remains pooled and thus available to the Class I market. Adoption of Proposal 2 is a reasonable measure to meet the objectives of orderly marketing.

This decision does find that disorderly marketing conditions are present when producers do not receive uniform prices. Handlers and cooperatives opting to not pool milk do not account to the pool at the classified use-value of those milk receipts. They do not share the higher classified use-value of their milk receipts with all other producers who are pooled on the order, primarily the producers who are pooled on the order are incurring the additional costs of servicing the Class I needs of the market. This is not a desired or reasonable outcome especially when the same handlers and cooperatives will again pool all of their eligible receipts when class-price relationships change in a subsequent month. These inequities borne by the market's producers are contrary to the intent of the Federal order program's reliance on marketwide pooling—ensuring that all producers supplying the market are paid uniform prices for their milk regardless of how the milk of any single producer is used.

It is reasonable that the order contain pooling provisions intended to deter the disorderly conditions that arise when de-pooling occurs. Such provisions maintain and enhance orderly

¹ Official notice is taken of data and information published in Market Administrator Bulletins as posted on individual Market Administrator web sites.

marketing. Accordingly, this decision finds it reasonable to recommend adoption of provisions that would limit the volume of milk a handler or cooperative may pool during the months of April through February to 125 percent of the total volume pooled by the handler or cooperative in the prior month and to 135 percent of the prior month's pooled volume during the month of March. Adoption of this standard will not prevent manufacturing handlers or cooperatives from electing to not pool milk. However, it should serve to maintain and enhance orderly marketing by encouraging participation in the marketwide pooling of all classified uses of milk.

Consideration was given on whether de-pooling should be considered at a national hearing with other, broader national issues of milk marketing. However, each marketing area has unique marketing conditions and characteristics which have area-specific pooling provisions to address those specific conditions. Because of this, pooling issues are considered unique to each order. This decision finds that it would be unreasonable to address pooling issues, including de-pooling on a national basis.

Some manufacturing handlers and cooperatives argue that their milk did perform in meeting the Class I needs during the month and this occurred before making their pooling decisions. They argue that the Class I market is therefore not harmed and that the intents and goals of the order program are satisfied. With respect to this proceeding and in response to these arguments, this decision finds that the practice of de-pooling undermines the intent of the Federal order program to assure producers uniform prices across all uses of milk normally associated with the market as a critical indicator of orderly marketing conditions. Similarly, handlers and cooperatives that de-pool purposefully do so to gain a momentary financial benefit (by avoiding making payments to the PSF) which would otherwise be equitably shared among all market participants. While the order's performance standards tend to assure that distributing plants are adequately supplied with fresh, fluid milk, the goals of marketwide pooling are undermined by the practice of de-pooling. Producers and handlers who regularly and consistently serve the Class I needs of the market will not equitably share in the additional value arising momentarily from non-fluid uses of milk. These same producers and handlers will, in turn, be required to share the additional revenue arising from higher-valued Class I sales in a

subsequent month when class-price relationships change.

The four proposals considered in this proceeding to deter the practice of de-pooling in the UMW order have differences. They all seek to address the market disorder arising from the practice of de-pooling. However, this decision does not find adoption of the two "dairy farmer for other market" proposals—Proposals 3 and 4—reasonable because they would make it needlessly difficult for milk to be re-pooled and because their adoption may disrupt prevailing marketing channels or cause the inefficient movement of milk. Likewise, Proposal 5, to restrict pooling in a month to 115 percent of the prior month's volume pooled by the handler, is not recommended for adoption. Adoption of this proposal would disrupt current marketing conditions beyond what the record justifies. Therefore, this decision recommends adoption of Proposal 2 to limit the pooling of milk by a handler during the months of April through February to 125 percent of the total milk receipts the handler pooled in the prior month and to 135 percent of the prior month's pooled volume during the month of March because it provides the most reasonable measure to deter the practice of de-pooling.

Consideration was given to omitting a recommended decision on the issue to de-pooling. The record does not support a conclusion that adoption of measures to deter de-pooling warrant emergency action. The recommended adoption of provisions to limit the volume of milk that can be pooled during the month on the basis of what was pooled in the preceding month warrant public comments before a final decision is issued.

B. Producer Definition

A proposal published in the hearing notice as Proposal 6, seeking to specify the length of time a dairy farmer may lose Grade A status before losing producer status on the order, is not recommended for adoption. Proposal 6, offered by Dean, would amend the *Producer* definition by explicitly stating that a dairy farmer may lose Grade A status for up to 21 calendar days per year before needing to requalify as a producer on the order. The UMW order currently does not specify the specific length of time a dairy farmer may lose Grade A status before needing to requalify as a producer on the order. Currently, a dairy farmer must deliver one day's milk production to a pool plant during the first month a producer is to be pooled in order to have their

milk pooled and priced under the terms of the order.

A witness appearing on behalf of Dean testified in support of Proposal 6. The witness said the UMW order currently does not specify how long a dairy farmer who temporarily loses their Grade A status can retain producer status before they must requalify as a producer on the order. Proposal 6, the witness stated, sets a reasonable limit to the number of days a producer can lose Grade A status within a calendar year.

A witness appearing on behalf of Mid-West, et al., testified in opposition to Proposal 6. The witness said that many situations could arise where a producer is unable to regain Grade A status in less than 21 days due to damages resulting from situations beyond their control. The current order language provides for waivers in pooling standards for pool plants due to such "acts of God" and, in the witness' opinion, is adequately provided for in the *Producer* definition of the current order language.

The *Producer* definition of the UMW order does not define the length of time a producer may lose Grade A status before needing to requalify for producer status on the order. The issue of qualifying for producer status is important since it determines which producers and which producer milk is entitled to share in the revenues arising from the marketwide pooling of milk on the UMW order.

The definition of "temporary" used by the Market Administrator has accommodated the Upper Midwest market by giving producers a reasonable amount of time to regain Grade A status without burdening the market with excessive touch-base shipments or recordkeeping requirements. Limiting the time period a producer can lose Grade A status would require handlers and the Market Administrator to track the producer's loss of Grade A status throughout the year to determine when the 21 day limit is reached.

This decision finds that the additional touch-base shipments that would be required for a dairy farmer to requalify for producer status on the order would cause uneconomic shipments of milk. Additionally, the increased recordkeeping requirements would burden handlers without contributing to the goals and application of the proposed amendments to the pooling standards contained in this decision. Accordingly, Proposal 6 is not recommended for adoption.

2. Administrative Assessment Rate

A proposal, published in the hearing notice as Proposal 7, seeking to increase the maximum assessment rate of the

UMW order, should be adopted. Specifically, the maximum administrative assessment rate should be increased from the current rate of 5 cents per cwt to 8 cents per cwt. At the time of the hearing, the administrative assessment rate of 5 cents per cwt applied to all milk pooled on the order and was the maximum assessment rate that could be charged. Adoption of this proposal will not increase the administrative assessment above the current rate but it will give the market administrator the ability to increase the assessment up to a maximum 8 cents per cwt, if necessary.²

According to the Market Administrator, Proposal 7 was offered because there is not sufficient milk volume being consistently pooled on the UMW order to generate adequate funding for the proper administration of the order. Administration of the UMW order generates substantial costs for the many services provided to UMW marketing area participants including pooling, auditing, gathering market information, and providing market services such as laboratory testing, explained the witness. The witness noted that there are also fixed expenses such as salaries and office leases and that the order must maintain a specified minimum level of operating reserves.

The Market Administrator stated that from 2000 to 2002, the amount of producer milk on the UMW order ranged from 1.7 to 1.95 billion pounds per month. According to the witness, this volume of pooled milk generated sufficient funds for the administration of the order for the 4-cent per cwt assessment rate being assessed on pooled milk during that time. However, the witness said, from July through November 2003 almost 6.2 billion pounds of producer milk was de-pooled which resulted in the loss of nearly \$2.5 million in potential revenue for the administration of the order. According to the Market Administrator, this loss of revenue caused the assessment rate to be increased from 4 cents to 5 cents per cwt. The Market Administrator stressed that substantial de-pooling occurred again from March through May 2004 when nearly 4.7 billion pounds of producer milk was de-pooled.

The Market Administrator emphasized that the UMW order still services the de-pooled milk because handlers make decisions to de-pool

their milk receipts after the end of the month after already utilizing many of the UMW order services. According to the Market Administrator, the UMW order must sometimes service an approximately 2 billion pound market per month while only collecting an assessment on 600 to 700 million pounds of milk. At the current assessment rate of 5 cents per cwt, noted the Market Administrator, the order needs approximately 1.5 billion pounds of pooled producer milk per month to operate and provide the services expected by market participants.

The Market Administrator said that actions to reduce operating costs have taken place but an increase in the maximum assessment rate is needed to ensure the proper administration of the order and to maintain necessary operating reserves. The Market Administrator explained that increasing the maximum administrative assessment rate to 8 cents per cwt would not necessarily be the actual rate that would be charged to pooling handlers. The Market Administrator stressed that the proposed 8-cent assessment rate is a maximum level, and the actual assessment rate charged would only be as high as needed to operate the order.

The Mid-West, et al., brief expressed support of the Proposal 7 but emphasized that the assessment rate should be viewed as a maximum. The brief speculated that if Proposal 2 is adopted, the volume of milk pooled consistently will stabilize making it unnecessary to raise the assessment rate. The brief also discussed the option of having the assessment rate vary to ensure that milk which is consistently pooled does not pay for services on milk that is de-pooled and does not pay an assessment.

A witness appearing on behalf of Dean viewed Proposal 7 as an extra tax on those producers who already pay for the administration of the order every month, unlike those producers whose milk is de-pooled. The witness contended that if Proposal 3, 4, or 5 were adopted, the amount of milk being de-pooled on the UMW order would decrease significantly, thus giving the Market Administrator a more consistent income stream. However, asserted the witness, if the Department decided to increase the administrative assessment, Dean would encourage an amended provision that would charge a higher assessment on milk not pooled in the previous month.

Dean's post-hearing brief reiterated support for increasing the maximum administrative rate while maintaining that adoption of Proposal 3 would

prevent the need to actually increase the administrative assessment rate. The brief proposed that if the administrative assessment rate is increased, the Market Administrator should be granted the authority to insulate continuously pooled producers from paying the increased assessment.

A witness appearing on behalf of WCA testified in opposition to Proposal 7. The witness asserted that the Market Administrator should use other means to address what the witness characterized as short-term funding declines.

A witness representing Oberweis Dairy also opposed adoption of Proposal 7 because it would increase costs to producers.

The hearing record reveals that fluctuations in the volume of milk pooled on the UMW order attributed to de-pooling can reduce the Market Administrator revenues to a level too low for proper administration of the order. At the current assessment rate of 5 cents per cwt, 1.5 billion pounds of pooled milk is needed to generate sufficient funds for the administration of the order. However, de-pooling has resulted in pooled volumes far below that needed to generate an adequate revenue stream.

The recommended adoption of a proposal to deter the de-pooling of milk should result in a more stable revenue stream for the administration of the UMW order. Nevertheless, it is reasonable to increase the maximum administrative assessment rate to ensure that the Market Administrator has the proper funds to carry out all of the services provided by the UMW order. While the maximum administrative rate should be increased to 8 cents per cwt, the actual rate charged will only be as high as necessary to properly administer the order and provide the necessary services to market participants.

Rulings on Proposed Findings and Conclusions

Briefs and proposed findings and conclusions were filed on behalf of certain interested parties. These briefs, proposed findings and conclusions, and the evidence in the record were considered in making the findings and conclusions set forth above. To the extent that the suggested findings and conclusions filed by interested parties are inconsistent with the findings and conclusions set forth herein, the requests to make such findings or reach such conclusions are denied for the reasons previously stated in this decision.

² Official notice is taken of a letter from the UMW Market Administrator to UMW handlers, cooperatives and interested persons, dated September 28, 2005, that decreases the administrative assessment from 5 cents to 4 cents per cwt, effective with milk produced on or after September 1, 2005.

General Findings

The findings and determinations hereinafter set forth supplement those that were made when the UMW order was first issued and when it was amended. The previous findings and determinations are hereby ratified and confirmed, except where they may conflict with those set forth herein.

(a) The tentative marketing agreement and the order, as hereby proposed to be amended, and all of the terms and conditions thereof, will tend to effectuate the declared policy of the Act;

(b) The parity prices of milk as determined pursuant to section 2 of the Act are not reasonable in view of the price of feeds, available supplies of feeds, and other economic conditions which affect market supply and demand for milk in the marketing area, and the minimum prices specified in the tentative marketing agreement and the order, as hereby proposed to be amended, are such prices as will reflect the aforesaid factors, insure a sufficient quantity of pure and wholesome milk, and be in the public interest; and

(c) The tentative marketing agreement and the order, as hereby proposed to be amended, will regulate the handling of milk in the same manner as, and will be applicable only to persons in the respective classes of industrial and commercial activity specified in, the marketing agreement upon which a hearing has been held.

Recommended Marketing Agreement and Order Amending the Order

The recommended marketing agreement is not included in this decision because the regulatory provisions thereof would be the same as those contained in the order, as hereby proposed to be amended. The following order amending the order, as amended, regulating the handling of milk in the UMW marketing area is recommended as the detailed and appropriate means by which the foregoing conclusions may be carried out.

List of Subjects in 7 CFR Part 1030

Milk marketing orders.

For the reasons set forth in the preamble, 7 CFR part 1030, is proposed to be amended as follows:

PART 1030—MILK IN THE UPPER MIDWEST MARKETING AREA

1. The authority citation for 7 CFR part 1030 continues to read as follows:

Authority: 7 U.S.C. 601–674.

2. Section 1030.13 is amended by adding a new paragraph (f), to read as follows:

§ 1030.13 Producer milk.

* * * * *

(f) The quantity of milk reported by a handler pursuant to § 1030.30(a)(1) and/or § 1030.30(c)(1) for April through February may not exceed 125 percent, and March may not exceed 135 percent of the producer milk receipts pooled by the handler during the prior month. Milk diverted to nonpool plants reported in excess of this limit shall be removed from the pool. Milk in excess of this limit received at pool plants, other than pool distributing plants, shall be classified pursuant to § 1000.44(a)(3)(v) and § 1000.44(b)(3)(v) of this title. The handler must designate, by producer pick-up, which milk is to be removed from the pool. If the handler fails to provide this information, the market administrator will make the determination. The following provisions apply:

(1) Milk shipped to and physically received at pool distributing plants shall not be subject to the 125 or 135 percent limitation;

(2) Producer milk qualified pursuant to ____ .13 of any other Federal Order and continuously pooled in any Federal Order for the previous six months shall not be included in the computation of the 125 or 135 percent limitation;

(3) The market administrator may waive the 125 or 135 percent limitation:

(i) For a new handler on the order, subject to the provisions of § 1030.13(f)(3), or

(ii) For an existing handler with significantly changed milk supply conditions due to unusual circumstances;

(4) A bloc of milk may be considered ineligible for pooling if the market administrator determines that handlers altered the reporting of such milk for the purpose of evading the provisions of this paragraph (f).

3. Section 1030.85 is revised, to read as follows:

§ 1030.85 Assessment for order administration.

On or before the payment receipt date specified under § 1030.71, each handler shall pay to the market administrator its pro rata share of the expense of administration of the order at a rate specified by the market administrator that is no more than 8 cents per hundredweight with respect to:

(a) Receipts of producer milk (including the handler's own production) other than such receipts by a handler described in § 1000.9(c) that were delivered to pool plants of other handlers;

(b) Receipts from a handler described in § 1000.9(c) of this title;

(c) Receipts of concentrated fluid milk products from unregulated supply plants and receipts of nonfluid milk products assigned to Class I use pursuant to § 1000.43(d) of this title and other source milk allocated to Class I pursuant to § 1000.44(a)(3) and (8) of this title and the corresponding steps of § 1000.44(b) of this title, except other source milk that is excluded from the computations pursuant to § 1030.60(h) and (i); and

(d) Route disposition in the marketing area from a partially regulated distributing plant that exceeds the skim milk and butterfat subtracted pursuant to § 1000.76(a)(1)(i) and (ii) of this title.

Dated: February 15, 2006.

Lloyd C. Day,

Administrator, Agricultural Marketing Service.

[FR Doc. 06–1585 Filed 2–21–06; 8:45 am]

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DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

7 CFR Part 1032

[Docket No. AO–313–A48; DA–04–06]

Milk in the Central Marketing Area; Recommended Decision and Opportunity To File Written Exceptions on Proposed Amendments to Tentative Marketing Agreement and to Order

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Proposed rule; recommended decision.

SUMMARY: This decision recommends adoption of proposals that would amend certain features of the Central Federal milk marketing order. Specifically, this decision recommends adoption of proposals that would increase supply plant performance standards, amend features of the “touch-base” provision, amend certain features of the “split plant” provision and decrease the diversion limit standards of the order. This decision also recommends adoption of a proposal that would limit the volume of milk a handler can pool in a month to 125 percent of the total volume of milk pooled in the previous month.

DATES: Comments should be submitted on or before April 24, 2006.

ADDRESSES: Comments (6 copies) should be filed with the Hearing Clerk, STOP 9200-Room 1031, United States Department of Agriculture, 1400 Independence Avenue, SW., Washington, DC 20250–9200.