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Agricultural Marketing Service

7 CFR Parts 1005 and 1007

**Milk in the Appalachian and Southeast
Marketing Areas; Partial Recommended
Decision and Opportunity To File Written
Exceptions on Proposed Amendments to
Tentative Marketing Agreements and to
Orders; Proposed Rule**

DEPARTMENT OF AGRICULTURE**Agricultural Marketing Service****7 CFR Parts 1005 and 1007**

[Docket No. AO-388-A15 and AO-366-A44; DA-03-11]

Milk in the Appalachian and Southeast Marketing Areas; Partial Recommended Decision and Opportunity To File Written Exceptions on Proposed Amendments to Tentative Marketing Agreements and to Orders

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Proposed rule; partial recommended decision.

SUMMARY: This document recommends adoption of provisions that would expand the Appalachian milk marketing area, eliminate the ability to simultaneously pool the same milk on the Appalachian or Southeast order and a State-operated milk order that has marketwide pooling, and amend the transportation credit provisions of the Southeast and Appalachian orders. This decision does not recommend adopting a proposal that would merge the Appalachian and Southeast milk marketing areas and a proposal that would create a "Mississippi Valley" marketing order. Proposals regarding the producer-handler provisions of the Appalachian and Southeast orders will be addressed in a separate decision.

DATES: Comments must be submitted on or before July 19, 2005.

Comments (6 copies) should be filed with the Hearing Clerk, United States Department of Agriculture, STOP 9200-Room 1083, 1400 Independence Avenue, SW., Washington, DC 20250-9200. You may send your comments by the electronic process available at the Federal eRulemaking portal: <http://www.regulations.gov> or by submitting comments to amsdairycomments@usda.gov. Reference should be made to the title of action and docket number.

FOR FURTHER INFORMATION CONTACT:

Antoinette M. Carter or Jack Rower or Gino M. Tosi, Marketing Specialist, USDA/AMS/Dairy Programs, Order Formulation and Enforcement Branch, STOP 0231-Room 2971, 1400 Independence Avenue, SW., Washington, DC 20250-0231, (202) 690-3465 or (202) 720-3257 or (202) 690-1366, e-mail address: antoinette.carter@usda.gov, or jack.rower@usda.gov or gino.tosi@usda.gov.

SUPPLEMENTARY INFORMATION: 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's 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 marketing 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 February 2004, the milk of 7,311 dairy farmers was pooled on the Appalachian (Order 5) and Southeast (Order 7) milk orders (3,395 Order 5 dairy farmers and 3,916 Order 7 dairy farmers). Of the total, 3,252 dairy farmers (or 96 percent) and 3,764 dairy farmers (or 96 percent) were considered small businesses on the Appalachian and Southeast orders, respectively.

During February 2004, there were a total of 36 plants regulated by the Appalachian order (25 fully regulated plants, 7 partially regulated plants, 1 producer-handler, and 3 exempt plants) and a total of 51 plants regulated by the Southeast order (32 fully regulated plants, 6 partially regulated plants, and 13 exempt plants). The number of plants meeting the small business criteria under the Appalachian and Southeast orders were 13 (or 36 percent) and 13 (or 25 percent), respectively.

The proposed amendments adopted in this proposed rule would expand the Appalachian milk marketing area to include 25 counties and 14 cities in the State of Virginia that currently are not in any Federal milk marketing area. This decision recommends the adoption of a proposal that would amend the producer milk provisions of the Appalachian and Southeast milk orders to prevent producers who share in the proceeds of a state marketwide pool from simultaneously sharing in the proceeds of a Federal marketwide pool on the same milk. In addition, this decision recommends adopting proposed amendments to the transportation credit provisions of the Appalachian and Southeast orders.

The proposed amendments to expand the Appalachian marketing area would likely continue to regulate under the Appalachian order two fluid milk distributing plants located in Roanoke, Virginia, and Lynchburg, Virginia, and shift the regulation of a distributing plant located in Mount Crawford, Virginia, from the Northeast order to the Appalachian order.

The proposed amendments would allow the Kroger Company's (Kroger) Westover Dairy plant, located in Lynchburg, Virginia, that competes for a milk supply with other Appalachian order plants to continue to be regulated under the order if it meets the order's minimum performance standards. The plant has been regulated by the Appalachian order since January 2000. In addition, the proposed amendments

would remove the disruption that occurs as a result of the Dean Foods Company's (Dean Foods) Morningstar Foods plant, located in Mount Crawford, Virginia, shifting its regulatory status under the Northeast order.

The Appalachian order currently contains a "lock-in" provision that provides that a plant located within the marketing area that meets the order's minimum performance standard will be regulated by the Appalachian order even if the majority of the plant's Class I route sales are in another marketing area. The proposed expansion along with the lock-in provision would regulate fluid milk distributing plants physically located in the marketing area that meet the order's minimum performance standard even if the majority of their sales are in another Federal order marketing area. Accordingly, the proposed amendments would regulate under the Appalachian order Kroger's Westover Dairy, located in Lynchburg, Virginia; Dean Foods' Morningstar Foods plant, located in Mount Crawford, Virginia; and National Dairy Holdings' Valley Rich Dairy, located in Roanoke, Virginia. Based on Small Business Administration criteria these are all large businesses.

This decision recommends proposed amendments to the transportation credit provisions of the Appalachian and Southeast orders. The Appalachian and Southeast orders contain provisions for a transportation credit balancing fund from which payments are made to handlers to partially offset the cost of moving bulk milk into each marketing area to meet fluid milk demands.

The proposed amendments would increase the maximum rate of the transportation credit assessment of the Appalachian and Southeast orders by 3 cents per hundredweight. Specifically, the proposed amendments would increase the maximum rate of assessment for the Appalachian order from 6.5 cents per hundredweight to 9.5 cents per hundredweight while increasing the maximum rate of assessment for the Southeast order from 7 cents per hundredweight to 10 cents per hundredweight. Increasing the transportation assessment rates will tend to minimize the exhaustion of the transportation credit balancing fund when there is a need to import supplemental milk from outside the marketing areas to meet Class I needs.

Currently, the Appalachian and Southeast orders provide that transportation credits shall apply to the milk of a dairy farmer who was not a "producer" under the order during more than two of the immediately preceding

months of February through May but not more than 50 percent of the milk production of the dairy farmer, in aggregate, was received as producer milk under the order during those two months. The proposed amendments recommended for adoption in this decision would provide the Market Administrator of the Appalachian order and the Market Administrator of the Southeast order the discretionary authority to adjust the 50 percent milk production standard.

This decision recommends adoption of proposals seeking to prohibit the simultaneous pooling of the same milk on the Appalachian or Southeast milk marketing orders and on a State-operated order that provides for the marketwide pooling of milk. Since the 1960's, the Federal milk order program has recognized the harm and disorder that result to both producers and handlers when the same milk of a producer is simultaneously pooled on more than one Federal order. When this occurs, producers do not receive uniform minimum prices, and handlers receive unfair competitive advantages.

The need to prevent "double pooling" became critically important as distribution areas expanded, orders merged, and a national pricing surface was adopted. Milk already pooled under a State-operated program and able to simultaneously be pooled under a Federal order has essentially the same undesirable outcomes that Federal orders once experienced and subsequently corrected. Accordingly, proposed amendments to eliminate the "double pooling" of the same milk on the Appalachian or Southeast order and a State-operated milk order that has marketwide pooling is recommended for adoption.

The proposed amendments would be applied to all Appalachian and Southeast order participants (producers and handlers), which consist of both large and small business. Since the proposed amendments recommended for adoption would be subject to all the orders' producers and handlers regardless of their size, the provisions are not expected to provide a competitive advantage to any participant. Accordingly, the proposed amendments should 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 notice 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 forms are routinely used in most business transactions. 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.

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 January 16, 2004; published January 23, 2004 (69 FR 3278).

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 agreements and the orders regulating the handling of milk in the Appalachian and Southeast marketing areas. 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, Washington, DC 20250-9200, by the 60th day after publication of this decision in the **Federal Register**. 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 proposed amendments set forth below are based on the record of a public hearing held at Atlanta, Georgia, on February 23-26, 2004, pursuant to a notice of hearing issued January 16, 2004 (69 FR 3278).

The material issues on the hearing record relate to:

1. Merger of the Appalachian and Southeast Marketing Areas.
 - a. Merging the Appalachian and Southeast milk marketing areas and remaining fund balances.
 - b. Expansion of the Appalachian marketing area.
 - c. Transportation credits provisions.
2. Promulgation of a new "Mississippi Valley" milk order.
3. Eliminating the simultaneous pooling of the same milk on a Federal milk order and a State-operated milk order that provides for marketwide pooling.
4. Producer-handler provisions.

This partial recommended decision deals only with Issues 1 through 3. Issue No. 4 will be addressed separately in a forthcoming decision.

Findings and Conclusions

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

1. Merger of the Appalachian and Southeast Marketing Areas

1a. Merging the Appalachian and Southeast Milk Marketing Areas and Remaining Fund Balances

This decision recommends denial of a proposal that would merge the current Appalachian marketing area and Southeast milk marketing area into a single marketing area under a proposed order. Accordingly, a proposal that would combine the fund balances of the current Appalachian and Southeast orders is rendered moot and is not recommended for adoption.

The Appalachian marketing area consists of the States of North Carolina and South Carolina, parts of eastern Tennessee, Kentucky excluding southwest counties, 7 counties in northwest/central Georgia, 20 counties in southern Indiana, 8 counties and 2 cities in Virginia, and 2 counties in West Virginia. The Southeast order marketing area consists of the entire States of Alabama, Arkansas, Louisiana, Mississippi, Georgia (excluding 4 northern counties), southern Missouri, western/central Tennessee, and southern Kentucky.

A witness testifying on behalf of Southern Marketing Agency, Inc. (SMA), presented testimony in support of Proposals 1 and 2 as contained in the hearing notice published in the **Federal Register** (69 FR 3278). Proposal 1 would merge the current Appalachian and Southeast marketing areas into a single marketing area (hereafter referred to as

the proposed merged milk order) and Proposal 2 would combine the remaining balances of funds of the current Appalachian and Southeast orders if the proposed merged order was adopted. According to the witness, SMA is a marketing agency whose cooperative members include Arkansas Dairy Cooperative Association, Inc., Dairy Farmers of America, Inc. (DFA), Dairymen's Marketing Cooperative, Inc., Lone Star Milk Producers, Inc., Maryland & Virginia Milk Producers Cooperative Association, Inc. (MD&VA), and Southeast Milk, Inc. (SMI) (proponent cooperatives).

The witness for the proponent cooperatives said SMA was created in response to a changing market structure and is an extension of the cooperatives' initiative to consolidate and seek enhanced marketing efficiencies. The witness indicated that SMA pools certain costs and returns for its cooperative member producers supplying distributing plants fully regulated under the Appalachian and Southeast milk orders. SMA considers the Appalachian and Southeast orders one market in terms of the distribution of revenues, the allocation and pooling of marketing costs, milk supply and demand, and the development of its annual budget, the witness explained.

The proponent cooperatives' witness stated that the proposed order merger would create a milk market which would be commonly supplied and deserving of a common blend price. The witness testified that the continued existence of the separate Appalachian and Southeast Federal milk orders across a functionally single fluid milk marketing area inhibits market efficiency in supplying and balancing the market, creates unjustified blend price differences, encourages uneconomic movements of milk, and results in the inequitable sharing of the Class I proceeds of what should be a single market.

The proponent cooperatives' witness stated that different blend prices and different and separate pool qualification requirements constitute disruptive conditions that would be removed by a merger of the orders. The witness asserted that the proposed merger would allow producer milk to flow more freely between pool plants and provide for the equal sharing of balancing costs across all producers in the proposed merged order.

The proponent cooperatives' witness stressed that the adoption of the proposed merged order would assure producers that milk would be sold at reasonable minimum prices and producers would share pro rata in the

returns from sales of milk including milk not needed for fluid use. The witness further stated that handlers would be assured that competitors would pay a single set of minimum prices for milk set by the established order. The witness stated that a merged order is in the public interest because it assures that an adequate supply of high quality milk will be available for consumers.

The proponent cooperatives' witness noted that the adoption of a new Federal order is contingent upon being able to show that interstate commerce occurs in the proposed marketing area. It is the opinion of the witness that "interstate commerce" does exist due to the movement of bulk and packaged milk products within, into, and out of the Appalachian and the Southeast marketing areas—the proposed marketing area.

The proponent cooperatives' witness noted a trend of larger geographical areas being served by fewer Federal milk marketing orders. Specifically, the witness said between 1996 and 2003 the number of dairy farmers in the southeastern states of Alabama, Arkansas, Georgia, Kentucky, Louisiana, Mississippi, Missouri, North Carolina, South Carolina, Tennessee, and Virginia declined from 11,712 to 7,180. This decrease, the witness explained, parallels the trend of a drop in the number of dairy farmers pooled on the current Appalachian and Southeast orders. The witness stated that based on the final decision for Federal Order Reform (issued March 12, 1999, and published April 2, 1999 (64 FR 16025)) 8,180 dairy farmers were expected to pool their milk on the consolidated Appalachian and Southeast orders. However, the witness noted only 7,243 dairy producers supplied milk to the two orders during December 2003.

The proponent cooperatives' witness stressed that there is an acute milk deficit in the Appalachian and Southeast Federal orders. Referencing data obtained from the USDA National Agricultural Statistics Service (NASS) for the states of Alabama, Arkansas, Georgia, Kentucky, Louisiana, Mississippi, Missouri, North Carolina, South Carolina, Tennessee, and Virginia (southeast region), the witness testified that a decline in dairy farmers led to a decline in milk production in the southeast region. The witness noted milk production decreased from 13,518 million pounds in 1996 to 10,671 million pounds in 2003 a decline of 21 percent. The witness asserted that this decline coupled with an increase in population has resulted in a major

expansion of the milkshed for the southeastern region of the United States.

According to the proponent cooperatives' witness, 9,071.9 million pounds of Class I producer milk was pooled on the combined Appalachian and Southeast orders during 2003. The witness said marketings of milk produced in the southeastern region was 10,671 million pounds in 2003, which means 85 percent of Grade A milk production was needed for Class I use on an annual basis.

In 1996, the proponent witness testified, it was anticipated that 72 fluid milk processing plants were or would become fully regulated distributing plants on the consolidated Appalachian and Southeast orders. However, the witness noted, only 52 remained regulated by the orders during December 2003. The witness indicated that of the fully regulated pool plants existing in both January 1996 and December 2003, more than two-thirds have experienced at least one ownership change and some have experienced several ownership changes.

The proponent cooperatives' witness cited a set of criteria used for consolidation of orders during the reform process. The witness said this list included overlapping route sales and areas of milk supply, the number of handlers within a market, the natural boundaries, the cooperative associations operating in the service area, provisions common to the existing orders, milk utilization in common dairy products, disruptive marketing conditions, and transportation differences.

The proponent cooperatives' witness testified that significant competition for sales between plants exists between the Appalachian and Southeast orders. The witness noted that the "corridor of competition" is the shared border of the Appalachian and Southeast. The witness testified that Federal milk order data for 2003 shows Class I disposition on routes inside the Southeast order by Appalachian order pool plants was 11.25 percent of the total Class I route disposition by all plants in the Southeast order. According to the witness, Class I route disposition in the Southeast order by Appalachian order pool plants has increased in total by 11.1 percentage points since January 2000 (*i.e.*, 5.9 percentage points from 2000 to 2001, 2.1 percentage points from 2001 to 2002, and 1.9 percentage points from 2002 to 2003). In addition, the stated record data reveals that Class I route disposition by Appalachian order pool plants into the Southeast order was 63.9 percent of the total Class I disposition by all nonpool plants for the Southeast order during 2003.

According to the proponent cooperatives' witness, all of the distributing plants currently regulated under the Appalachian and Southeast orders are expected to be fully regulated by the proposed merged order. Using December 2003 data, the witness stated that the proposed merged order would have had a Class I route distribution of 773.4 million pounds. The witness added that 86.58 percent of Class I sales would have been from milk produced in the proposed marketing area. The witness stated that the proposed Southeast order would rank third in the total number of pool plants regulated by a Federal milk order.

The proponent cooperatives' witness stated that there is substantial and significant overlap of the supply of producer milk for the Appalachian and Southeast orders. The witness noted Federal order data for 2000 through 2003 shows that dairy farmers located in southern Indiana, central Kentucky, central Tennessee, central North Carolina, western South Carolina, and central and southern Georgia have supplied milk to plants regulated under Appalachian or Southeast orders. The witness said milk of dairy farmers located in the Central marketing area and Southwest marketing area, and dairy farmers located in northwestern Indiana and south central Pennsylvania, have supplied fluid milk plants regulated by the Appalachian and Southeast orders.

In December 2003, the witness stated, dairy farmers located in 28 states supplied milk to handlers under the Appalachian or Southeast orders. Sixteen of the 28 states supplied milk to both orders and 13 states were located wholly or partially within the proposed merged order marketing area, the witness noted.

The witness for the proponent cooperatives testified that the proposed order would rank second in Class I utilization representing 19.5 percent of total Class I sales in all Federal milk orders. Using annual Federal milk order data, the witness noted that for 2003, Class I utilization for the Appalachian and Southeast orders was 70.36 percent and 65.47 percent, respectively. The witness said the combined Class I utilization for the proposed merged order would have been 67.77 percent for 2003 or 9,071.9 million pounds of 13,385.7 million pounds of producer milk pooled.

The proponent cooperatives' witness noted that milk not needed for fluid uses in the Appalachian order is primarily used in Class II and Class IV while milk not needed for fluid uses in the Southeast order is primarily used in

Class III. For 2003, the witness noted that non-fluid milk utilization for the Appalachian order was 14.41 percent Class II, 7.11 percent Class III, and 8.12 percent Class IV, while the non-fluid milk utilization for the Southeast order was 9.97 percent Class II, 17.79 percent Class III, and 6.78 percent Class IV. The witness stressed that these differing uses of milk result in different blend prices between the Appalachian and Southeast orders which leads to disorderly marketing conditions. The witness emphasized that differences in blend prices between the two orders is largely due to significant differences in uses and prices in the manufacturing classes and is not necessarily due to significant differences in Class I milk utilization.

The witness explained that SMA in April 2002 began the common pooling of the costs and returns to supply the customers of member cooperatives in the separate orders in an effort to alleviate disruptive blend price differences. The witness testified that while this procedure has resolved some blend price differences, their procedure does not result in removing inequitable blend prices for all producer milk pooled on the separate orders.

Regarding the commonality of cooperative associations in the two marketing areas, the proponent cooperatives' witness stated that cooperative membership is an indication of market association and provides support for the consolidation of marketing areas. The witness noted that the six SMA member cooperatives accounted for approximately 734 million pounds of producer milk during November 2003, which represents about 67 percent of the total producer milk that would be pooled on the proposed Southeast order. Also, the witness stated these cooperatives market milk of other cooperatives whose member producers' milk would be pooled on the proposed Southeast order. Using November 2003, the witness stated approximately 871 million pounds or 79 percent of the producer milk pooled under the proposed Southeast order would be represented by these proponent cooperatives.

The witness for the proponent cooperatives pointed out that the regulatory provisions of the Appalachian and Southeast orders are similar in most respects except for the qualification standards for producer milk and a producer. While not a Federal milk order regulatory provision, the proponent witness stated that the common handling of cost and returns for milk that would be pooled on the proposed merged order recognized

similar marketing conditions within the proposed order marketing area.

The proponent cooperative witness testified that the proposed merged order should retain the Appalachian order pool plant provisions. The witness recommended adopting provisions that would allow the pooling of a supply plant operated by a cooperative association that is located outside the marketing area but within the State of Virginia. The witness stated that the proposed merged order should include the Appalachian order "split" pool plant provision which would continue to provide for defining that portion of a pool plant designated as a "nonpool plant" that is physically separate and operates separately from the pool portion of such plant.

The proponent cooperatives' witness stated that lock-in provisions be included in the proposed merged order. According to the witness, distributing plants in the Southeastern markets have been "locked in" or fully regulated as pool plants under the order in which they are physically located since the mid-1980s. The witness testified that unit pooling distributing plants on the basis of their physical location should be retained in the merged order. The witness noted that the Appalachian and Southeast orders currently provide that two or more plants operated by the same handler that are located within the marketing area may qualify for pool status as a unit by meeting the in-area Class I route disposition standards specified for pool distributing plants.

The witness for the proponent cooperatives explained that lock-in provisions help to preserve the viability of capital investments in pool distributing plants. The witness indicated that lock-in provisions in the Southeast and Appalachian orders adequately provide for regulatory stability for pool plants on the edge of a market area that may shift regulatory status between two orders due to changes in route disposition patterns.

The proponent cooperatives' witness recommended changing the "touch base" requirement of the producer milk provision from a "days" production standard to a "percentage" production standard. This change, the witness stated, will accommodate pooling the milk of large producers who ship multiple loads of milk per day. The witness proposed that individual producers deliver 15 percent of their monthly milk production (equivalent to approximately 4.5 days of milk production) to a pool plant during January through June and 33 percent (equivalent to about 10 days of milk production) of their monthly milk

production during the months of July through December. The witness stated that the 33 percent production standard is a reasonable minimum requirement for establishing a producer's association with the market during the short production months of July through December. Under their proposal, the milk of a dairy farmer would be eligible for diversion to a nonpool plant the first day of the month during which the milk of such dairy farmer meets the order's touch base requirements.

The proponent cooperatives' witness indicated that their proposal contains current Southeast order language that limits the total amount of producer milk that may be diverted by a pool plant operator or cooperative association to 33 percent during the months of July through December and 50 percent during January through June.

The proponent cooperatives' witness proposed that the reserve balances of the marketing services, administrative expense, producer-settlement funds, and the transportation credit balancing funds that have accrued in the individual Appalachian and Southeast orders, be merged or combined in their entirety if the proposed merged order is adopted. The witness explained that the handlers and producers servicing the milk needs of the individual orders would continue to furnish the milk needs of the proposed marketing area.

According to the proponent cooperatives' witness, it would be appropriate to combine the reserve balances of the orders' marketing service funds since marketing service programs for producers would continue under the proposed order. In regards to the administrative expense funds, the witness stated that it would be equitable and more efficient to combine the remaining administrative funds accumulated under the individual orders. In addition, the witness indicated that this would enable the producer-settlement funds and the transportation credit funds of the proposed merged order to continue without interruption.

Witnesses for Maryland & Virginia Milk Producers Cooperative, Inc. (MD&VA), Arkansas Dairy Cooperative, Inc. (ADC), Lone Star Milk Producers, Inc. (Lone Star), and Dairymen's Marketing Cooperative, Inc. (DMC), testified in support of consolidating the current Appalachian and Southeast milk orders into a single milk order. According to witnesses, MD&VA is comprised of 1,450 to 1,500 dairy farmers, ADC has 160 member dairy farmers, Lone Star is comprised of about 160 member dairy farmers, and DMC is comprised of 168 member dairy farmers.

The witnesses indicated that all of the cooperatives are members of SMA and that the milk of their dairy farmer members is shipped to plants regulated by the Appalachian or Southeast orders.

The MD&VA witness asserted that the consolidation of the current Appalachian and Southeast orders is necessary due to changes in the marketing structure (*i.e.*, milk production and processing sectors) in the southeastern United States. The witness was of the opinion that the area covered by the two current orders is essentially a single market and that all of the producers delivering milk to the market should share a common Federal order blend price.

The witnesses for MD&VA, ADC, Lone Star, and DMC stated the producer milk requirements under the current Appalachian and Southeast Orders make it difficult to ensure the pooling of milk on the orders. The witnesses contended a merger of the Appalachian and Southeast orders would enhance market equity, allow for increased efficiencies in supplying a deficit milk region, and eliminate the disruptive and disorderly marketing conditions that currently exist in the Appalachian and Southeast orders by eliminating blend price differences.

Witnesses representing Georgia Milk Producers, Inc. (GMP), testified in opposition to the merger as proposed in Proposals 1 and 2. The witness was of the opinion that USDA had made a mistake in 2000 when the western part of the current Southeast order, which had a lower Class I utilization, was added to the Southeast order which had a higher Class I utilization.

Other testimony presented on behalf of GMP, and relying on 1997 data, indicated that milk production in Georgia fell short of Georgia's fluid milk demand by about 122 million pounds as compared to only 4 to 11 million pound supply shortfalls in the other states included in the proposed merged order area. The witness stated that the widening supply-demand gap will accelerate as population increases and milk production declines in Georgia. The GMP witness stated that: "Based on the decline in production in the region compared to the growth in demand, USDA has not sufficiently considered the needs of the dairy farmers in the states covered by the Order." According to the witness, GMP dairy farmers have lost income each time the Southeast Federal Order has been expanded.

The GMP witness testified that a rejection of the proposed merged order together with the creation of a new Mississippi Valley Order, as offered by Proposal 5, would be the first step to

help rectify the mistake made in Federal milk order reform. The witness supported raising the utilization in the most deficit areas of the Southeastern States by creating a Mississippi Valley order and combining the high utilization areas of the remainder of Order 7 into a new smaller Southeast Order.

The GMP witness asserted that historically, the larger the marketing area, the higher the balancing costs in a deficit market. The witness further asserted that transportation credits shift part of that cost to the entire market rather than to the dairy farmers in the order who are members of cooperatives. The witness testified that transportation credits unintentionally encourage the importation of milk rather than encourage increased production of local milk.

A witness representing the Kroger Company (Kroger) testified in support of the proposed merger of the Appalachian and Southeast orders. According to the witness, Kroger owns and operates Winchester Farms Dairy, in Winchester, Kentucky, and Westover Dairy, in Lynchburg, Virginia. The witness stated that both plants are pool distributing plants regulated on the Appalachian Federal milk order. The witness stated that Kroger owns and operates Heritage Farms Dairy in Murfreesboro, Tennessee, and Centennial Farms Dairy in Atlanta, Georgia, both fully regulated distributing plants under the Southeast milk order.

According to the Kroger witness, their Winchester, Kentucky, plant was associated with the Ohio Valley order (now part of the Mideast order) from 1982 to 1988, with the Louisville-Lexington-Evansville order from 1988 through 1999, and with the Appalachian order since 2000. The witness indicated that previous decisions by USDA adopted pool plant provisions that allowed their Winchester, Kentucky, plant to be regulated under the Appalachian order. According to the witness, being regulated by the Appalachian order retains that plants ability to procure milk with a higher blend price when compared with the Mideast order.

The Kroger witness indicated that with the exception of the Murfreesboro, Tennessee, plant, which has a minority supply of milk from independent producers, all of the Kroger pool distributing plants are supplied by Dairy Farmers of America. The witness indicated that if their Winchester plant were to again be associated with the Mideast order, the returns to the milk supplying cooperative would be reduced due to the lower Mideast order

blend price. The witness requested that the current Appalachian order pool plant definition be included in the proposed merged order. This request, according to the witness, would permit their plant located in Winchester, Kentucky, to continue its association with the proposed merged order rather than with the Mideast order.

A witness representing Dairy Farmers of America (DFA) testified that the proponents do not anticipate any difficulties from merging of the two orders or expanding the proposed merged area to include additional Virginia counties. According to the witness, the Virginia State Milk Commission has been able to simultaneously operate a producer base milk pricing program for producers supplying milk to plants with Class I sales within the State. The witness indicated that DFA opposes any change to the proposed merged order provisions that may cause conflicts between the operations of the Virginia State Milk Commission and the Federal milk marketing order program.

A witness representing Prairie Farms testified in opposition to Proposals 1 and 2. The witness indicated that the fluid milk industry would be better served by more Federal milk marketing orders covering smaller areas rather than fewer Federal milk marketing orders covering large areas. The witness indicated that Federal milk order reform left "dead zones" in the State of Illinois and Missouri, near St Louis. According to the witness, this area is not able to attract a fluid milk supply and experiences weekly fluid milk deficits.

The Prairie Farms witness indicated that the low per capita milk production in Illinois, in combination with economic incentives to move the milk produced in Illinois and eastern Missouri into the Appalachian and Southeast orders, has caused disorderly marketing conditions. The witness indicated that the blend price differences between the Upper Midwest order and the Central order are not sufficient to cover the transportation cost of moving milk to the "dead zones". The witness testified that at an October 31, 2001, meeting, DFA—Prairie Farms' major supplier—indicated that they would no longer be able to provide supplemental milk supplies to Prairie Farms due to the lack of incentives and expenses.

The Prairie Farms witness stated that today's dairy environment shows that the current order system needs to be reconfigured and inequities fixed system-wide. The witness asserted that the consequences for nearby marketing areas and adjacent orders must be

considered when revising or merging orders. The witness indicated that market efficiency suffers and difficulties occur in supplying and balancing the market at all Federal milk order borders. The witness indicated that the lines drawn between marketing areas create unjustified blend price differences, encourage uneconomic movements of milk, and result in the inequitable sharing of Class I proceeds.

A witness representing Dean Foods testified in opposition to the proposed merger of the Appalachian and the Southeast market areas. According to the witness, more and smaller order areas create more flexible incentives to deliver milk to Federal order pool plants. According to the witness, relative blend prices determine where milk is shipped and pooled. According to the witness the disincentives associated with increased transportation costs increase faster than the incentives from the higher location value of the merged order blend price. The witness cited the St. Louis/southern Illinois area and its chronic milk deficit as a prime example of these phenomena.

Post-hearing briefs addressing Proposals 1 and 2 were submitted by SMA, Dean Foods, and Prairie Farms. The proponent cooperatives for the proposed order merger, submitted a post-hearing brief reiterating their support for the merger of the Appalachian and Southeast orders. The brief described conditions existing in the Appalachian and Southeast orders as disruptive and disorderly, and asserted that these conditions are symptoms of a market that has changed significantly since the orders were promulgated by Federal order reform, effective January 1, 2000.

According to the proponent cooperatives' brief, a merger of the existing orders would bring blend price uniformity, recognize inter-order competition and integrate Class I sales within the proposed merged order, recognize common supply areas within the proposed merged order, and allow producer milk to move more freely between pool plants within the proposed marketing areas. In addition, proponents contended it would equalize the costs of balancing within the proposed marketing area, erase the artificial line that separates a common milk market, and recognize the common pooling of costs and returns for producer milk within the proposed merged order. The brief asserts that no additional parties would become regulated as a result of the proposed merged order. According to the proponent cooperatives' brief, other options that forestall a complete merger

are inadequate to correct the present disruptive and disorderly conditions in the separate orders.

Opposition to proposal 1 was reiterated by Dean Foods and Prairie Farms in a joint post-hearing brief. The brief suggested that blend price differences between orders cause milk to move to where it is most needed. The Dean Foods and Prairie Farms stated that without blend price differences milk movements between and within marketing areas are impaired. The opponents brief suggested a national hearing in order to consider simultaneously all marketing regions because the results of one proceeding directly affects other regions. The brief stated that combining the Appalachian and Southeast marketing areas was considered but was not adopted under Federal milk order reform.

The Dean Foods and Prairie Farms joint brief stated that market administrator data demonstrates that moving milk to where it is needed through blend price differences effectively moves milk from the west to the east for the Southeast marketing area and from north to south for the Appalachian marketing area. The brief offered the St. Louis area as an example of blend price differences that are sometimes too small to cover additional costs of transporting milk to major metropolitan area for fluid use. The brief indicated that similar problems could result elsewhere if the two orders are merged.

In their joint brief, Dean Foods and Prairie Farms suggested that although a majority of dairy market participants may favor a merger, it is important to consider the minority opinion. The brief also requested the inclusion of the Kentucky counties of Ballard, Calloway, Carlisle, Fulton, Graves, Hickman, Marshall, and McCracken in the Southeast marketing area if Proposal 1 is denied and Proposal 5 is adopted.

Dean Foods and Prairie Farms' joint brief contended that the proposal to merger the Appalachian and Southeast orders brings forth a significant policy and legal question the Department must address prior to issuing a decision on the merits of the proposal. The proposed merger, if adopted, would cause the number of Federal orders to fall to below the minimum number of 10 required by Congress in the 1996 Farm Bill, they stated.

A written statement submitted on behalf of LuVel Dairy Products, Inc., requested that the administrative requirements of the producer-settlement fund be modified to extend the time period in which payments to the fund are due by one full business day and to

allow payments due to the fund to be submitted overnight instead of through the electronic wiring of funds. However, this was not a noticed proposal and no evidence or witness was available to testify regarding this written request.

The 1996 Farm Bill mandated that Federal milk orders be consolidated to not less than 10 or more than 14. The Federal order reform final decision issued March 12, 1999 and published in the **Federal Register** April 2, 1999, (64 FR 16026) meet the requirements set forth in the 1996 Farm Bill through the consolidation of the 31 Federal milk orders into 11 orders. The Agricultural Marketing Agreement Act of 1937 (AMAA), as amended, provides the Department the authority to issue and amend orders. Accordingly, the merger proposal may be considered by the Department.

This decision does not recommend merging the Southeast and Appalachian marketing areas. Record evidence of this proceeding does not substantiate the need for merging these two separate marketing order areas. Overlap of Class I route disposition between the two orders is relatively unchanged since the separate orders were created in 2000. The overlap in milk supply areas for plants in the Appalachian and Southeast orders remains minimal and unchanged since 2000. Blend price differences and other marketing conditions of the two orders raised by the proponents are not significantly different from conditions existing in 2000. The proponents have not demonstrated that the current marketing conditions are disorderly. The proponents have not made a convincing case that the current marketing conditions are disorderly.

The AMAA provides that milk orders may be issued where the marketing of milk is in the current of interstate or foreign commerce or where it directly burdens, obstructs, or affects interstate or foreign commerce. Federal milk orders define the terms under which handlers in a specified market purchase milk from dairy farmers. The orders are designed to promote the orderly exchange of milk between dairy farmers (producers) and the first buyers (handlers) of milk. Record evidence of this proceeding does not support a finding that the current Appalachian and Southeast milk orders are not achieving the goal of orderly marketing.

In determining whether Federal milk order marketing areas should be merged, the Department generally has considered the extent to which Federal order markets share common characteristics such as overlapping sales and procurement areas, and other

commonly shared structural relationships. The most important of these factors are evidence of overlapping sales patterns among handlers of Class I milk and overlapping milk procurement area. The measures of association between the Appalachian and Southeast milk order marketing areas in terms of overlapping route sales and milk procurement have not change significantly since the consolidated orders became effective in January 2000.

Several criteria were used by the Department in determining which of the 31 milk order marketing areas exhibited a sufficient measure of association in terms of sales, procurement area, and other structural relationships to warrant consolidation or mandated by the 1996 Farm Bill into the current 10 milk marketing areas. These criteria included overlapping route disposition, overlapping areas of milk supply, number of handlers within a market, natural boundaries, cooperative associations, common regulatory provisions, and milk utilization in common dairy products.

The primary factors during reform that supported the creation of the consolidated Appalachian milk order and the consolidated Southeast milk order were overlapping route sales and milk procurement areas between the marketing areas. The determinations were based on an analysis of milk sales and procurement area overlap between the pre-reform orders using 1997 data. Specifically, the Federal order reform final decision issued March 1999, stated that the primary factors for the consolidation of the (1) Tennessee Valley, (2) Louisville-Lexington-Evansville, and the (3) Carolina marketing areas into the current Appalachian milk order were commonality of overlapping route disposition and milk procurement between the two marketing areas. The decision found that there was "a stronger relationship between the three marketing areas involved than between any one of them and any other marketing area on the basis of both criteria." (64 FR 16059)

For the Southeast order, the Federal order reform final decision stated that the basis for the adopted Southeast marketing area which consolidated the former Southeast marketing area with additional counties in Arkansas, Kentucky, and Missouri was "overlapping route dispositions within the marketing area to a greater extent than with other marketing areas. Procurement of producer milk also overlaps between the states within the market." (64 FR 16064)

Proposals to merge the Appalachian and Southeast order marketing areas into a single marketing area were considered during the Federal order reform process. Dairy Farmers of America, Inc., and Carolina-Virginia Milk Producers Association submitted comments requesting that the proposed consolidated Appalachian order marketing area and the proposed consolidated Southeast order marketing area be combined into a single consolidated Southeast marketing area. Also, the Kentucky Farm Bureau Federation requested a single Federal order consisting of the proposed consolidated Appalachian and Southeast marketing areas including all of the State of Kentucky.

The proponents for merging the two consolidated marketing areas contended that common procurement areas between the orders would result in different blend prices paid to producers if the orders were not consolidated. The Federal order reform final decision rejected this assertion stating that "As discussed in the proposed rule, consolidating the Carolina and Tennessee Valley markets with the Southeast does not represent the most appropriate consolidation option because of the minor degree of overlapping route disposition and

producer milk between these areas." Accordingly, the merger proposals were not adopted during Federal order reform.

Record evidence indicates that the Appalachian and Southeast order marketing areas share minor and unchanged commonality in sources of milk supply, fluid milk route sales, and market participants (cooperative associations and handlers). However, as discussed later in this decision, such measures of association between the Appalachian and Southeast orders can only support a finding to maintain two separate Federal orders with some minor modifications.

Overlapping Route Sales and Milk Supply. Current proponents of merging the Appalachian and Southeast marketing areas contend that there is substantial overlap in route sales and milk supply areas between the orders. The movements of packaged fluid milk between Federal milk order marketing areas provide evidence that plants from more than one Federal milk order are in competition with each other for fluid milk sales. Overlapping sales patterns can result in the regulatory shifting of handlers between orders and tends to cause disorderly marketing conditions by the changed price relationships between competing handlers and

neighboring dairy farmers. As discussed later in this decision, there is no evidence of disorder occurring within the Appalachian and Southeast order marketing areas as a result of plants shifting regulation to other orders.

Overlapping milk supply principally applies when the major proportions of a market's milk is supplied by the same area. The cost of a handler's milk is influenced by the location of the milk supply which affects other competitive factors. The common pooling of milk produced within the same procurement area facilitates the uniform pricing of producer milk among dairy farmers. However, all marketing areas having overlapping procurement areas do not warrant consolidation. An area that supplies a minor proportion of an adjoining area's milk needs from minor proportions of its own total milk supply and has minimal competition among handlers in the adjacent marketing area for fluid sales, supports concluding that the two marketing areas are clearly separate and distinct.

Based on record evidence of Federal milk order data, Table 1 illustrates that the Appalachian and Southeast milk orders have experienced no significant change in overlapping route disposition or milk procurement since the orders were consolidated.

**TABLE 1: Overlapping Route Sales and Milk Supply
Appalachian (Order 5) and Southeast (Order 7) Milk Orders**

Route Disposition (Share of Class I Sales)		
Date	From Order 5 to Order 7 (Percent)	From Order 7 to Order 5 (Percent)
Annual Average - 2000	11.4	1.9
Annual Average - 2001	12.2	2.4
Annual Average - 2002	12.2	1.9
Annual Average - 2003	12.4	2.0
Overlapping Milk Supply (Share of Total Producer Milk)		
Date	From Order 5 to Order 7 (Percent)	From Order 7 to Order 5 (Percent)
Annual Average - 2000	3.1	8.5
Annual Average - 2001	3.2	6.9
Annual Average - 2002	3.2	6.8
Annual Average - 2003	3.2	4.3

Source: Appalachia and Southeast Market Administrator Data

For the 2000 through 2003 period, route sales by distributing plants regulated by the Appalachian order into the Southeast marketing area averaged about 12 percent, while the route sales from plants regulated by the Southeast order into the Appalachian marketing area averaged about 2 percent. Record data also indicates that the majority of the Class I sales by distributing plants regulated by the Appalachian and Southeast orders are within each of the respective orders. For the 4-year period, Appalachian order handlers accounted for about 75 percent of the total Class I sales within the order's marketing area and plants regulated by the Southeast

order accounted for about 85 percent of the order's total Class I sales.

Of the total producer milk pooled on the Appalachian order, the amount of producer milk produced in the Southeast marketing area decreased from 8.5 percent in 2000 to 4.3 percent in 2003. The milk produced in the Appalachian marketing area that was pooled on the Southeast order accounted for about 3.2 percent of the total producer milk pooled on the Appalachian order for the same 4-year period.

In summary, the Table 1 data illustrates that route sales from Appalachian order handlers into the Southeast marketing area increased slightly (1 percentage point) from 2000

to 2003, while route sales from the Southeast order regulated plants into the Appalachian marketing area remained relatively unchanged for the 4-year period. Likewise, the data in Table 1 shows that producer milk pooled on the Appalachian order that originated from the Southeast marketing area declined each year since 2000, while the producer milk pooled on the Southeast order that originated from the Appalachian marketing area has remained unchanged since the orders were consolidated in January 2000.

Table 2, which is based on Federal milk order record data, further details the source of producer milk pooled on the Appalachian and Southeast orders.

Table 2: Source of Producer Milk for the Appalachian and Southeast Orders by Order and Unregulated Areas

Appalachian Order Producer Milk:					
Year	Percent From Inside Order Area	Percent From Northeast Order Area	Percent From Mideast Order Area	Percent From Southeast Order Area	Percent From All Other Orders & Unregulated Areas
2000	51.9	6.7	9.1	8.5	23.9
2001	47.9	6.9	11.4	6.9	26.8
2002	46.7	7.3	14.6	6.8	24.6
2003	45.1	5.8	19.2	4.3	25.6
Southeast Order Producer Milk:					
Year	Percent From Inside Order Area	Percent From Central Order Area	Percent From Southwest Order Area	Percent From Appalachian Order Area	Percent From All Other Orders & Unregulated Areas
2000	66.5	8.9	17.1	3.1	4.4
2001	59.8	9.8	20.1	3.2	7.1
2002	57	10.5	21.8	3.2	7.5
2003	58.1	14.2	17.5	3.2	7.1

Source: Appalachia and Southeast Market Administrator Data

The Table 2 data illustrates that the share of total producer milk pooled on the Appalachian order produced within the marketing area during 2000 through 2003 has declined from about 51 percent to about 45 percent. The amount of producer milk produced in the Southeast marketing area as a share of the total amount of producer milk pooled on the Appalachian order also has declined from 8.5 percent in 2000 to 4.3 percent in 2003. At the same time, the amount of producer milk produced in the Mideast marketing area that was pooled on the Appalachian order increased from 9.1 percent in 2000 to 19.2 percent in 2003.

During 2000 through 2003, the Northeast, Southeast, and Mideast marketing areas accounted for about 27 percent of the total producer milk pooled on the Appalachian order. Of the total producer milk pooled on the

Appalachian order that was produced outside the Appalachian marketing area during this period, 12.7 percent was produced in the Southeast marketing area and 12.8 percent in the Northeast marketing area, and 26 percent in the Mideast marketing area. In addition, record data indicates that approximately half of the pooled milk on the Appalachian order is produced in counties within the marketing area and 20 percent to 25 percent of the total pooled milk is supplied by Federally unregulated areas, mainly from counties in the State of Virginia, Pennsylvania and New York.

For the 4-year period of 2000 through 2003, record data reveals the share of the total Southeast order producer milk produced within the marketing area declined from about 67 percent in 2000 to about 58 percent in 2003. However, this decline was not supplied by

producer milk that was produced in the Appalachian marketing area which remained relatively unchanged at about 3 percent from 2000 through 2003. Record data reveals that the supplemental milk for the Southeast order is produced primarily in the Central and Southwest marketing areas. Specifically, the share of producer milk produced in the Central marketing area that was pooled on the Southeast order increased from 8.9 percent in 2000 to 14.2 percent in 2003. In addition, producer milk produced in the Southwest marketing area that was pooled on the Southeast order was about 17 percent in 2000, increased to about 22 percent in 2002, and declined to about 17 percent in 2003.

The record data clearly reveals the degree of overlap in milk supply between the Appalachian and Southeast milk order marketing areas has

decreased over the 4-year period since Federal order reform while the degree of overlap between the Appalachian and Mideast orders has increased each year. The data further reveals that the primary out-of-area sources of supplemental milk for the Appalachian order marketing area are the Northeast and Mideast regions. In contrast, the primary out-of-area sources of milk supply for the Southeast order marketing area are the Southwest and Central marketing areas.

Record data reveals that the minimal overlap in milk supply areas that exists between the Appalachian and Southeast milk order marketing areas is primarily concentrated along the Tennessee and Kentucky borders. Such overlap is typical for adjoining marketing areas. The Federal order reform final decision addressed the issue of overlapping milk supply areas among adjacent orders by stating that "an area that supplies a minor proportion of an adjoining area's milk supply with a minor proportion of its own total milk production while handlers located in the area are engaged in minimal competition with handlers located in the adjoining area likely does not have a strong enough association with the adjoining area to require consolidation. For a number of the consolidated areas it would be very difficult, if not impossible, to find a boundary across which significant quantities of milk are not procured for other marketing areas." (64 FR 16045) Accordingly, the overlap existing between the Appalachian and Southeast milk order marketing areas does not warrant an order merger.

Based on the record data, this decision finds that the overlap in route sales and milk procurement areas between the Appalachian and Southeast milk order marketing areas does not support merging the two orders.

Milk Utilization. During 2000 through 2003, the 4-year weighted average Class I utilizations for the Appalachian and Southeast orders were 66.9 percent and 63.1 percent, respectively. The level of Class I utilization is a factor considered in determining whether orders should be merged but does not form the basis for adopting a merger because it is a function of how much milk is pooled on an order.

From 2000 through 2004, the non-Class I use of milk (Class II, Class III, and Class IV) of the Appalachian and Southeast marketing areas have been different. During this 5-year period, Appalachian order Class II, Class III and Class IV utilization rates averaged 14.5 percent, 7.30 percent, and 10.1 percent, respectively. For the same period, the Class II, Class III, and Class IV

utilization rates for the Southeast order averaged 10.8 percent, 17.3 percent, and 8.5 percent, respectively. This data illustrates that the Appalachian marketing area is balanced primarily by Class II and Class IV while in the Southeast marketing area is balanced by Class II and Class III.

Blend Prices. Proponent cooperatives contend that the differences in blend prices between the Appalachian and Southeast milk orders result in disruptive marketing conditions. The blend price of an order is a function of the utilization of milk in the respective classes (Class I, Class II, Class III, and Class IV) at the corresponding class prices. The blend prices for the Appalachian and Southeast order have differed due to the Orders' different class utilization of milk. The magnitude of the blend price differences is primarily attributed to the differences between the class prices since the Appalachian marketing area is mainly balanced by Class II and Class IV and the Southeast marketing area by Class II and Class III. The blend price difference further illustrates that the Appalachian and Southeast milk orders have separate and distinct market characteristics.

For the 5-year period of 2000 to 2004, the annual average blend price of the Appalachian order has been higher than that of the Southeast order blend price. This is in part due to the Appalachian order having a greater percentage of milk utilized in Class I compared to the Southeast order over the past five years. The range of the blend price differences for the Appalachian and Southeast orders is mainly due to differences in the Class III and Class IV prices (*i.e.*, the "balancing" class of milk). When the Class III price goes up relative to the Class IV price, the blend price difference between the two orders narrows due to the predominance of milk utilized in Class III among the non-Class I uses in the Southeast marketing area.

Blend price differences between the Appalachian and Southeast orders have narrowed since the orders were consolidated in 2000. The differences in the weighted average blend prices for the two orders was \$0.36 per cwt in 2000, \$0.24 per cwt in 2001, \$0.21 per cwt in 2002, \$0.09 per cwt in 2003, and \$0.08 per cwt in 2004. Over the 2000 to 2004 period, the Appalachian order blend price exceeded the Southeast order blend price by an average of \$0.20 per cwt.

A 1995 final decision that consolidated five former Southeastern orders (Georgia, Alabama-West Florida, New Orleans-Mississippi, Greater Louisiana, and Central Arkansas) with

unregulated counties of four states to form the Southeast order addressed the issue of blend price differences among orders (60 FR 25014). The decision stated that blend price differences between orders may be caused by a number of factors including order provisions, institutional factors, the location of surplus milk and differences in class prices. The decision concluded that the five separate orders were encouraging plants to shift regulation among the orders which resulted in disorderly marketing conditions as producers and handler inequity greatly increased.

The current Southeast and Appalachian orders do not experience disorderly marketing conditions as a result of plants shifting regulation between orders. This may be attributed to the current lock-in and unit pooling provisions contained in the Appalachian and Southeast orders' pooling provisions. The lock-in provisions provide that a plant located within a marketing area that meets the minimum performance standards of the order will be regulated by that order even if the majority of its sales occur in another marketing area. Also, the unit pooling provisions allow two or more plants located in the marketing area and operated by the same handler to qualify for pool status as a unit by meeting the order's total and in-area route disposition standards as if they were a single distributing plant.

A plant shifting regulation to an order with a lower blend price could jeopardize the plant's ability to maintain a milk supply. Current Appalachian and Southeast order provisions allow a plant that meets the performance standards of the order and is physically located within the order marketing area to be regulated by the order even if the majority of its sales are in another marketing area. The provisions were adopted into the southeastern orders and retained in the consolidated Appalachian and Southeast orders to allow plants that are associated with the market and are servicing the market's fluid needs to be regulated under the order in which they are physically located.

If these provisions were not present in the Appalachian and Southeast orders, then plants could shift regulation between orders because of blend price differences which could cause disorderly marketing conditions to occur. Since record data indicates that the Appalachian and Southeast orders' blend price differences are continuing to decrease and there are provisions that prevent plants from shifting regulation among orders, this decision finds that

the blend price differences between the two orders do not form a contributing basis for merging the two marketing areas.

An analysis of the record data reveals that the proposed order merger would likely lower the blend price paid to dairy farmers of the Appalachian milk order and increase the blend price paid to dairy farmers of the Southeast order. The gains to Southeast order dairy farmers would be offset by losses to Appalachian order dairy farmers by a similar magnitude.

If the two orders are merged and assuming no significant depooling in the Federal order system, it is projected that for the period of 2005 through 2009 the blend price paid to dairy farmers of the current Appalachian order would be reduced by about \$0.07 per cwt on average, while the blend price paid to dairy farmers of the current Southeast order would be increased by \$0.07 per cwt on average. The \$0.07 per cwt decline in the current Appalachian order blend price would cause average order pool receipts to decline by about 11 million pounds and average order pool revenues to fall by \$6.6 million. For the current Southeast order, the \$0.07 per cwt blend price increase would increase average order pool receipts by an average of 11 million pounds, resulting in an average gross pool revenue increase of \$6.5 million per year.

Record testimony by proponent cooperatives indicates that SMA has, through its pooling of costs and returns, reduced their pay price differences to their member producers. Thus, a merger of the Appalachian and Southeast orders would merely increase the blend price for Southeast order nonmember producers while reducing the blend price received by Appalachian order nonmember producers. In effect, while benefiting certain producers, the proposed merged order would negatively affect certain other dairy farmers.

Based on this analysis, the absence of disorderly marketing conditions, together with the minimal and unchanged overlap between the Appalachian and Southeast orders in Class I sales and milk procurement area, the two orders should not be merged.

Cooperative Associations. Record evidence clearly demonstrates that there is a strong cooperative association commonality between the Appalachian and Southeast order marketing areas. During December 2003, there were a total of 14 cooperatives marketing the milk of members on the Appalachian and Southeast orders and 9 of these cooperatives marketed milk on both

orders. A number of these cooperatives are members of SMA and others cooperatives have the milk of their members that is pooled on the Appalachian and Southeast orders marketed by SMA.

The evidence indicates that proponent cooperatives market the majority of the milk pooled on the Appalachian and Southeast orders. For example, for December 2003, proponent cooperatives marketed 62.23 percent of the total producer milk pooled on the Appalachian order and 69.68 percent of the total producer milk pooled on the Southeast order. While commonality of cooperative associations can be significant it is not a primary criteria used to determine whether orders should be merged.

The record indicates that the proposed merger could likely provide some administrative relief to SMA in marketing the milk of their cooperative members. However, this outcome is at the expense of independent dairy farmers who are currently associated with the Appalachian order.

Market and Structural Changes. Record evidence indicates that there have been several market and structural changes in the Southeast and Appalachian markets since the Federal Order Reform process began in 1996 and the implementation of the consolidated orders in January 2000. These changes include fewer and larger producers and producer organizations, handler consolidations, and other plant ownership changes.

From January 2000 through December 2003, the number of dairy farmers pooled on the Appalachian and Southeast milk orders decreased. For the Southeast, the decline was 13.6 percent from 4,213 to 3,658, and the number of dairy farmers pooled on the Appalachian order decrease by 15.6 percent from 4,974 to 4,200. Milk production in the Appalachian and Southeast marketing areas has decreased since the Federal orders were consolidated. This decrease in milk production has caused additional supplemental milk to be imported into these deficit milk production markets.

The record reveals that producer organizations associated with the Appalachian and Southeast order marketing areas changed since the Federal order reform process. In 1996, there were 14 cooperative associations marketing the milk of their members on what is now the Appalachian order and nine Southeast order cooperatives. During December 2003, the number of cooperative associations marketing members' milk on the Appalachian and Southeast orders was 12 and 11,

respectively. In 2002, five cooperative associations formed SMA, which markets the majority of the raw milk supplied to plants regulated by the Appalachian and Southeast orders.

The number of pool distributing plants on the Appalachian and Southeast orders for 1996 was 29 and 36, respectively. For December 2003 the number of pool distributing plants for the orders was 24 and 27, respectively. The plant changes that have occurred include ownership changes, new plant openings, as well as plant closings.

Taken singularly or as a whole, the structural changes that have occurred from 1996 to present have had no significant impact on overlapping route disposition and overlapping procurement patterns of the Appalachian and Southeast orders.

Other order provisions. Proponent cooperatives' proposal to combine the balances of the Producer Settlement Funds, the Transportation Credit Balancing Funds, the Administrative Assessment Funds, and the Marketing Service Funds of the Appalachian and Southeast milk orders for the proposed merged order is not adopted in this decision. The proposal is moot since this decision does not recommend merging the two orders.

Proponent cooperatives offered order provisions for inclusion in the proposed merged order. These recommendations included adopting for the proposed merged order provisions that currently are included in the Appalachian order and/or the Southeast order. The proponent cooperatives recommended that the proposed merged order include pool plant provisions currently in the Appalachian order, and proposed the "touch-base" requirement of the producer milk provisions include a "percentage" production standard instead of a "days" production standard. Since this decision does not recommend adopting the proposal to merge the Appalachian and Southeast marketing areas, the recommendations concerning order provisions for the proposed merged order are moot.

The proponent cooperatives requested that the proposed merged order contain transportation credit provisions currently applicable to the Appalachian and Southeast milk orders, with certain modifications. The proponent cooperatives requested the transportation credit provisions be modified to increase the maximum rate of assessment to \$0.10 per cwt, change the months a producer's milk is not allowed to be associated with the market for such producer to be eligible for transportation credits, and provide the Market Administrator the authority

to adjust the 50-percent production eligibility standard. They also supported the proposed changes for the individual orders if their order merger proposal was not adopted.

Proponent cooperatives contended that by adopting transportation credits provisions in the Appalachian and Southeast orders the Secretary established the inextricable and common supply relationship between the orders. The proponents state that the proposed merger simply extends that recognition to provide common uniform prices and terms of trade for all dairy farmers delivering milk to the market, and a common set of producer qualification requirements.

This decision finds that the inclusion of transportation credit provisions in the Appalachian and Southeast orders is not a basis for merging the two orders. Such provisions were incorporated and established in the orders based on the prevailing marketing conditions of each individual order. Also, record indicates that the orders' transportation credit balancing funds have functioned differently since 2000 with respect to the assessment rates at which handlers made payments and the payments from the orders' transportation credit balancing fund for each year since 2001. The Appalachian order waived the collection of assessments at least two months of each year from 2001 through 2003. The Southeast order, while collecting assessments at the maximum rate of \$0.07 per cwt, has prorated payments from the fund each year since 2001.

As discussed later in this decision, proposed amendments to the transportation credit provision of the Appalachian and Southeast orders are recommended for adoption. The proposed amendments are warranted due to the declining milk production within the Appalachian and Southeast marketing areas and the anticipated growing need of importing milk produced outside the marketing areas to supply the fluid needs of the markets.

1b. Expansion of the Appalachian Marketing Area

While the proposal for merging the Appalachian and Southeast milk marketing area is not recommended for adoption, this decision recommends expanding the current boundaries of the Appalachian milk marketing area to include certain unregulated counties and cities in the State of Virginia.

Expansion of the marketing area adjoining the Appalachian marketing area was contained in the proposal published in the hearing notice as Proposal 3. The proposal would have

expanded the proposed merged order to include 25 currently unregulated counties and 14 currently unregulated cities in the State of Virginia. Similarly, a proposal published in the notice of hearing as Proposal 4 sought the expansion of the marketing area by adding an area adjoining the Appalachian marketing area that includes two unregulated cities and two unregulated counties in State of Virginia. Proposal 3, which also was supported by proponents of Proposal 4, is adopted.

Proponent cooperatives of Proposal 3 offered that the merger of the Appalachian and Southeast marketing area be expanded to include the Virginia counties of Allegheny, Amherst, Augusta, Bathe, Bedford, Bland, Botetourt, Campbell, Carroll, Craig, Floyd, Franklin, Giles, Grayson, Henry, Highland, Montgomery, Patrick, Pittsylvania, Pulaski, Roanoke, Rockbridge, Rockingham, Smyth, and Wythe) and Virginia cities of Bedford, Buena Vista, Clinton Forge, Covington, Danville, Galax, Harrisonburg, Lexington, Lynchburg, Martinsville, Radford, Roanoke, Salem and Staunton.

The proponent cooperatives' witness testified that the addition of the 25 counties and the 14 cities would properly change the regulatory status of a Dean Foods' Morningstar Foods plant located at Mount Crawford, Virginia, from the Northeast order to the Appalachian order. Also, the witness stated the proposed expansion would have the effect of fully and continuously regulating under the Appalachian order two fluid milk distributing plants (the Kroger Company's Westover Dairy plant, located in Lynchburg, Virginia, and the National Dairy Holdings' Valley Rich Dairy plant, located in Roanoke, Virginia) under the proposed merged order.

The witness said the Dean Foods Company's Mount Crawford plant alternates between partially regulated and fully regulated status under the Northeast milk order. According to the witness, in order for the plant to procure an adequate supply of milk, producers delivering to it must receive a blend price comparable with the blend price generated under the proposed merged order, if adopted.

The proponent cooperatives' witness stated that the milk supply located near Dean Foods' Mount Crawford, Virginia, plant is an attractive source of supply for plants that are fully regulated by the Appalachian order that are located in southern Virginia, North Carolina, South Carolina, and eastern Tennessee. The witness indicated that the impact of this proposal on the Virginia State Milk

Commission and Virginia base-holder producers would be insignificant. The witness was of the opinion that, if there were any impact on Virginia base-holders producers, it would be positive—reflecting the higher blend price at Mount Crawford, Virginia, for the plants under the proposed merged order versus the Northeast order.

The proponent cooperatives submitted a post-hearing brief supporting the expansion of the proposed merged order area to include the additional 25 counties and 14 cities in Virginia.

A witness representing the Kroger Company (Kroger) testified in support of Proposal 4 to expand the proposed merged order to include two currently unregulated counties (Campbell and Pittsylvania), and two currently unregulated cities (Lynchburg and Danville) in the State of Virginia. The witness stated that Kroger owns and operates four pool distributing plants associated with the Southeast and Appalachian milk orders, including Westover Dairy located in Lynchburg, Virginia. The witness also testified in support of adopting the current Appalachian order pool plant definition.

According to the Kroger witness, the Appalachian order pool distributing plant provisions require that at least 25 percent of a plant's total route disposition must be to outlets within the marketing area. This requirement, explained the witness, has restricted Kroger's ability to expand its Class I sales into areas outside the Appalachian marketing area, including the area directly associated with the plant's physical location (Lynchburg, Virginia).

The Kroger witness noted that Westover Dairy has been a fully regulated plant on the Appalachian order since January 2000, and prior to reform, the plant was regulated on the Carolina order—one of the former orders combined to form the Appalachian order. According to the Kroger witness, the total in-area route disposition standard increased from 15 percent to 25 percent when the consolidated and reformed Appalachian order became effective in January 2000. This change, the witness contended, has created an undue hardship on Westover Dairy and has force it to relinquish sales in areas outside of the Appalachian market to maintain its pool status under the order.

The witness concluded by stating that Kroger prefers Proposal 3—the larger expansion—which would not only expand the order area to include their plant located at Lynchburg, Virginia, but would allow a further expansion of

Class I sales into other surrounding areas.

The witnesses for MD&VA, ADC, Lone Star, and DMC testified in support of Proposal 3 to expand the proposed Southeast milk order area to include certain unregulated counties and cities in the State of Virginia as proposed by the proponent cooperatives. The witnesses stated that the cooperatives were not opposed to the expansion of the proposed Southeast milk marketing area into the smaller territory in the State of Virginia as proposed by Kroger but stated the larger expanded area in Proposal 3 was preferable.

The MD&VA witness explained that some of the its member producers are located in the proposed expanded area and that the cooperative delivers the milk of producers holding Virginia Milk Commission base to plants fully regulated under the Appalachian milk order. According to the witness, the milk of MD&VA member producers is marketed to Dean Foods' Morningstar Foods plant located in Mount Crawford, Virginia, which would become a pool distributing plant if the proposed merged order and the expansion to Virginia counties and cities are adopted.

Witness appearing on behalf of Dean Foods and Prairie Farms stated they were not opposed to Proposals 3 and 4. Thus, there was no opposition to the adoption of these proposals.

This decision recommends adopting proposed amendments to the Appalachian order that would expand the marketing area to include 25 currently unregulated counties and 14 cities in the State of Virginia. The proposed amendments would cause the full and continuous regulation under the Appalachian order of three fluid milk distributing plants, one of which has been shifting regulatory status under the Northeast order. The plants are located in Lynchburg, Virginia, Roanoke, Virginia, and Mount, Crawford, Virginia. Because of Appalachian order's lock-in provision, these plants, which would be physically located within the Appalachian marketing area, would continue to be regulated under the Appalachian order even if the majority of their sales are in another Federal order marketing area.

The proposed expansion would continue the regulation of two fluid milk distributing plants (Kroger's Westover Dairy plant, Lynchburg, Virginia, and National Dairy Holdings' Valley Rich Dairy plant, Roanoke, Virginia) under the Appalachian order. The proposed expansion also would shift the regulation of the Dean Foods' Morningstar Foods plant, Mount

Crawford, Virginia, from the Northeast order to the Appalachian order.

The Kroger's Westover Dairy plant has been regulated by the Appalachian order since the order was consolidated in January 2000. Current Appalachian order pool plant provisions require that at least 25 percent of a distributing plant's total Class I sales be to outlets within the marketing area. Prior to the reform of Federal milk orders, the former orders that were combined into the Appalachian order contained a 15 percent in-area route disposition standard for pool distributing plants.

Record evidence indicates that the current in-area Class I route sales standard likely is limiting the growth potential of Kroger's Westover Dairy plant, located in Lynchburg, Virginia. It is not the intent of Federal milk orders to inhibit the growth of handlers. Federal orders are designed to provide for the orderly exchange of milk from the dairy farmer to the first buyer (handler). The orders also provide minimum performance standards to ensure that the fluid needs of the market are satisfied. Accordingly, the adoption of the expansion proposal should ensure that Kroger's Westover Dairy plant is able to maintain a milk supply in competition with nearby Appalachian order plants.

In the case of Dean Foods' Morningstar Foods plant in Mount Crawford, Virginia, the proposed amendments would eliminate the current disruption and disorder caused by the plant shifting its regulatory status from fully to partially regulated under the Northeast order. Such shifting from fully to partially regulated status under an order may cause financial harm to producers supplying that plant.

The record indicates that the Kroger's Westover Dairy plant and Dean Foods' Morningstar plant are supplied by producers located near the plants and that the plants compete with other Appalachian order plants in milk procurement. This decision finds that orderly market conditions would be preserved by the adoption of the proposed expansion amendments. The regulation of no other plants should be affected by the adoption of these proposed amendments. In addition, the proposed expansion of the Appalachian marketing area is not expected to have a negative impact on the blend price paid to producers.

1c. Transportation Credits Provisions

The maximum rates of the transportation credit assessment for the Appalachian and Southeast orders should each be increased by 3-cents per hundredweight. Increasing the

transportation assessment rates will tend to minimize the exhaustion of the *transportation credit balancing fund* when the need for importing supplemental bulk milk from outside of the marketing areas to meet Class I needs occurs. Additionally, the Market Administrators of the orders should be given the discretionary authority to increase or decrease the 50 percent production standard for determining the milk of a dairy farmer that is eligible for transportation credits. Such dairy farmer should not have been a producer under the order during more than two of the immediately preceding months of February through May for the milk of the dairy farmer to be eligible for receipt of a transportation credit.

The Appalachian and Southeast orders each contain a transportation credit balancing fund from which a payment is made to partially offset the cost of moving milk into each marketing area to meet fluid milk demands. The fund is the mechanism through which handlers deposit on a monthly basis payment at specified rates for eventual payout as defined by a specified formula. The orders' transportation credit provisions provide payments typically during the short production months of July through December to handlers who incur hauling costs importing supplemental milk to meet the fluid demands of the market.

Transportation credit payments are restricted to bulk milk received from plants regulated by other Federal orders or shipped directly from farms of dairy farmers located outside the marketing areas and who are not regularly associated with the market. The handler payments into the funds are applicable to the Class I milk of producers who supply the market throughout the year. The Market Administrators of the orders are authorized to adjust payments to and from the relevant *transportation credit balancing fund*.

The transportation credit provisions of the Appalachian and Southeast orders differ by the assessment rate at which handlers make payments to the *transportation credit balancing fund*. The maximum rate of assessment for the Appalachian order is \$0.06 per cwt while the maximum rate of assessment for the Southeast order is \$0.07 per cwt.

A feature of the proposal for merging the Appalachian and Southeast orders was providing for a maximum transportation assessment rate of 10-cents for the proposed Southeast order. This would essentially represent a 3-cent per cwt increase from the current Southeast order, and a 3.5-cent increase from the Appalachian order. While there was no separate proposal for

increasing the assessment rate for the transportation credit fund, it was made clear by the proponents that in the absence of adopting the proposed merger an increase in the transportation credit assessment rate was warranted and supported for the current orders.

With regard to the transportation credit issue, the proponent cooperatives' witness testified that the maximum transportation credit assessment rate should be increased to \$0.10 per cwt. According to the witness, the increase is necessary to eliminate insufficient funding for transportation credit claims that would likely have been paid had sufficient funds been available.

According to the witness, that the transportation credit rate of \$0.07 per cwt for the current Southeast order has been at the maximum rate since the inception of the order, but that payments from the transportation credit balancing fund were exhausted in 2001, 2002, and 2003 resulting in a prorating of dollars from the transportation credit balancing fund to the amount of transportation claims submitted for receipt of the credit. In contrast, the witness noted, the transportation credit fund for the Appalachian order has been sufficiently funded since 2000 thus enabling the payment of all claims.

The proponent cooperatives' witness was of the opinion that the exhaustion of transportation credit funding in the Southeast order resulted in inequitable supplemental milk costs to handlers between the two orders. The witness testified that handlers procuring supplemental milk supplies for the Appalachian order were reimbursed at 100 percent of their claimed credits while handlers procuring supplemental milk supplies for the Southeast order were reimbursed at approximately 50 percent of their claimed credits. According to the witness, the unequal payout between the two orders results in disorderly marketing conditions exhibited by inequitable costs for producer milk among handlers.

Dean Foods and Prairie Farms voiced opposition to the proponents' proposed amendments to increase the maximum rate of assessments and increase the amount of milk that would be eligible for transportation credits. Dean Foods and Prairie Farms pointed out that the proposals to incorporate transportation credit provisions into the Southeastern orders were strongly opposed by some fluid milk processors and some dairy farmers. They noted that the intent and purpose of transportation credit provisions was to only pay a portion of the cost associated with hauling supplemental milk to the markets to meet fluid needs.

In their brief, Dean Foods and Prairie Farms stated there is no reason to increase the rate of assessment. Changing the rate of assessment, they contended, would effectively change the system of pricing without considering the impact on other marketing orders.

In opposition to any change in the rate of transportation credits, a witness for Georgia Milk Producers, Inc. (GMP), testified that increasing the assessment rate would generate more revenue to be paid to truck drivers instead of paying higher prices to local dairy farmers. According to the witness, the price of milk paid to local dairy farmers should be increased rather than subsidizing additional outlays for transportation costs.

The GMP witness suggested that instead of increasing the transportation credit assessment rate, a financial incentive should be initiated for dairy farmers to encourage milk production during the fall months when fluid milk demands are highest. According to the witness, if the incentive plan still does not cover the local milk production deficits, only then should the assessment rate for transportation credits be increased. The witness was of the opinion that an incentive plan encouraging local milk production would reduce hauling costs because less milk would be imported into the Southeast market. The witness also was of the opinion that a financial incentive plan would lower balancing costs by encouraging the movement of milk supplies located near processing plants.

Current Appalachian and Southeast order transportation credit provisions have been a feature of the orders, or predecessor orders, since 1996. The need for transportation credits arose from the consistent need to import milk from many areas outside of these marketing areas during certain months of the year when milk production in the areas is not sufficient to meet Class I demands. The transportation credit provisions provide payments to handlers to cover some of the costs of importing supplemental milk supplies into the Appalachian and Southeast marketing areas need during the short production months of July through December. The provisions also are designed to limit the ability of producers who are not normally pooled on these orders from pooling their milk on the Appalachian and Southeast orders during the flush production months when such milk is not needed to supply fluid needs.

While Federal milk order reform made modifications to certain features of the transportation credit fund provisions of the Appalachian and

Southeast orders, the maximum assessment rate at which payments are collected was not modified. The current maximum rate of \$0.065 cents per cwt for the Appalachian order has been sufficient to meet most of the claims made by handlers applying for transportation credit. The record reveals that since implementation of milk order reform in January 2000, the market administrator for the Appalachian order waived assessing handlers in at least two months of each year from 2001 through 2003.

For the current Southeast order, the current maximum transportation credit rate of \$0.07 per cwt has not been sufficient to cover hauling cost claims by handlers. As a result, the market administrator of the Southeast order has prorated payments from the transportation credit balancing fund since 2001.

Even though this decision does not recommend the merging of the current Southeast and Appalachian marketing area, the fundamental purposed of the transportation credit fund provisions of the orders are strongly supported by the proponent cooperatives. This support is independent of providing for a new and larger Southeast milk marketing order.

An increase in the maximum transportation credit assessment rate for the Appalachian and Southeast orders is warranted on the basis of declining milk production within the Appalachian and Southeast marketing areas. For example, the final decision of Federal milk order reform anticipated that the about two-thirds of the milk supply for the Appalachian order would be produced within the marketing areas, with supplemental milk supplies from unregulated area to the north in Virginia and Pennsylvania (based on 1997 data). Since implementation of order reform in January 2000, record evidence reveals that only 50 percent of the Appalachian milk supply is produced within the marketing area. The trend of lower in-area milk production strongly suggests that the anticipated future needs of relying on milk supplies from outside the marketing area will only grow and that such growth necessarily warrants an increase in the Appalachian transportation credit assessment rate. The Southeast marketing area exhibits the same trend.

To the extent that assessments are not needed to meet expected transportation credit claims, provisions that provide authority to the market administrator to set the assessment rate at a level deemed sufficient or to waive assessments should be allowed. Additionally, the transportation credit provisions of the Appalachian and Southeast orders

prevent the accumulation of funds beyond actual handler claims. In this regard, increasing the transportation credit rate will not result in an unwarranted accumulation of funds beyond what is needed to pay handler claims.

As part of the proposed merged marketing areas and orders, the proponent cooperatives' witness proposed that any producer that is located outside of the marketing area, would be eligible for transportation credits if that producer did not pool more than 50 percent of the producers farm milk production during the months of March and April. The witness testified that the market administrator should also be given the discretionary authority to adjust the 50 percent limit based on the prevailing supply and demand conditions for milk in the area.

The current transportation credit provisions of the Appalachian and Southeast orders specify that transportation credits will apply to the milk of a dairy farmer who was not a "producer" under the order during more than 2 of the immediately preceding months of February through May, and not more than 50 percent of the production of the dairy farmer during those two months, in aggregate, was received as producer milk under the orders during those two months. These provisions provide the basis for determining the milk of a dairy farmer that is truly supplemental to the market's fluid needs. The provision specifies the months of February through May—the period when milk production is greatest—as the months used to determine the eligibility of a producer whose milk is needed on the market.

The market administrators of the orders should be given discretionary authority to adjust the 50 percent eligibility standard for producer milk receiving transportation credits based on the prevailing marketing conditions within the marketing area. The market administrator should have the authority to increase or decrease this requirement because it is consistent with authorities already provided for supply plant performance standards and diversion limit standards. Accordingly, the proposed change to the transportation credit provisions of the Appalachian and Southeast orders is recommended for adoption.

This decision does not recommend changing the period the milk of a dairy farmer is not allowed to be associated with the market for such dairy farmer's milk to be eligible for transportation credits. If the months were modified from February through May to March

and April, the definition of supplemental milk under the transportation credit provisions would effectively change. Supplemental milk for purposes of determining the eligibility of transportation credits is that milk that is not regularly associated with the market. The proposed change would allow supplemental milk to be delivered to a pool plant all twelve months, potentially lowering the uniform price during those high production months by pooling additional milk when is not needed for fluid use.

By retaining the months of February through May and allowing the Market Administrators of the Appalachian and Southeast orders to adjust the 50 percent production standard, the current definition of supplemental milk remains intact. The orders' market administrator would be allowed to increase or decrease the 50 percent production standard, if warranted, based on current marketing conditions.

2. *Promulgation of a New "Mississippi Valley" Milk Order*

A proposal, published in the hearing notice as Proposal 5, seeking to split from the current Southeast marketing area and forming a new Mississippi Valley milk marketing area and order is not recommended for adoption.

A witness appearing on behalf of Dean Foods and Prairie Farms testified in support of Proposal 5. In splitting the current Southeast marketing area, a new marketing area, to be named the Mississippi Valley order, would include the area of the existing Southeast marketing area west of the Alabama-Mississippi borderline including the States of Mississippi, Louisiana, Arkansas. According to the witness, this new marketing area would extend northward through the relevant portions of Tennessee and Kentucky, and would include southern Missouri. The second order, according to the witness, would consist of the remainder of the current Southeast marketing area, *i.e.*, Georgia, a portion of the western panhandle of Florida, and Alabama.

The Dean Foods-Prairie Farms witness, and others supporting the adoption of Proposal 5, asserted that increasing the number of Federal milk marketing areas and orders would provide the economic incentives for more efficient movement of milk and increase the blend price received by producers who supply the needs of the Class I market. According to the witnesses, splitting the Southeast order into two orders would reduce transportation costs and improve the efficient operation of the transportation

credit balancing fund in each proposed new marketing area by more efficiently attracting milk to the Class I market and decreasing the need for hauling milk from longer distances.

The Dean Foods-Prairie Farms witness testified that there are two major incentives to ship milk to distributing plants—the blend price paid by pool distributing plants and the blend price paid for diverted milk. According to the witness, there are two disincentives to ship milk to a pool distributing plant under any order—the net transportation cost of shipping milk and the alternative blend prices in other markets that may attract milk to plants in those other markets. The witnesses cited milk deficit areas in southern Illinois and St. Louis, Missouri, as examples of areas where, in the opinion of the witnesses, blend price differences result in a failure to attract enough milk to adequately serve the Class I market. The witness asserted that the establishment of a Mississippi Valley order would likely result in blend price differences between the new areas which would provide producers the economic incentives of receiving higher blend prices while incurring lower transportation costs.

The Dean Foods-Prairie Farms witness testified that a national hearing may be justified to more fully consider the border, pricing, and milk deficit issues and alternatives to proposals (like Proposals 1 and 5) advanced to merge or to split the Southeast marketing area. According to the witness, when marketing area borders are changed, such change affects all marketing areas in the Federal order milk order system. The witness was of the opinion that considering border issues would necessarily require a broad rethinking of the marketing areas of the entire Federal order program and that a national hearing may be the most appropriate venue to consider these affects.

A witness for GMP testified that the expansions of the Southeast marketing area prior to Federal milk order reform, and as a result of Federal order reform, have successively reduced income to Georgia producers. The witness explained that the expansions of the marketing area have discouraged local milk production and encouraged movements of milk from outside the marketing area. According to the witness, the declining ability of local production to meet the Class I needs of the market, and the increased balancing requirements of an expanded marketing area, have increased costs while reducing revenues to Georgia dairy farmers.

In the opinion of the GMP witness, the establishment of a separate Mississippi Valley marketing area and order and a smaller Southeast marketing area would have positive benefits for Georgia milk producers. The witness explained that as a smaller Southeast marketing area, the Georgia market would likely experience lower balancing costs and expanded local production to meet the growing Class I needs of the market.

A witness for proponents of Proposal 1 testified in opposition to adopting a new Mississippi Valley marketing area by splitting it from the current Southeast marketing area. According to the witness, the proposed new marketing area would not lead to lower transportation costs but instead may lead to increased administrative difficulties with transportation credit balancing funds. The witness was of the opinion that blend price enhancement for the proposed smaller Southeast marketing area would be achieved at the expense of producers pooled on the proposed new Mississippi Valley order.

The opposition witness was of the opinion that blend prices for the proposed smaller Southeast marketing area may increase to levels that would exacerbate differences between the blend prices of the new smaller Southeast and the Appalachian order and may give rise to unintended market disruptions. The witness was of the opinion that a smaller Southeast marketing area and order also may result in administrative difficulties in the operation of transportation credit balancing funds among the three orders and may lead to the inefficient movements of milk. The witness expressed the opinion that splitting the Southeast marketing area would not address the concerns that proponents of Proposal 1 have raised regarding overlapping sales and inefficient milk movement issues between the Appalachian and Southeast marketing areas. The witness indicated that these issues would remain unresolved if the Southeast marketing area was split and if the Southeast and Appalachian marketing areas were not merged.

A post hearing brief by the proponents of Proposal 5 reiterated their position that creating more, rather than fewer, blend price differences will provide incentives to ship milk to markets where the milk is demanded. In addition, the brief reiterated that splitting the Southeast marketing area will reduce transportation costs and result in more efficient movement of milk in a smaller Southeast marketing area and a Mississippi Valley marketing area. The brief also called for the

including the Kentucky counties of Ballard, Calloway, Carlisle, Fulton, Graves, Hickman, Marshall, and McCracken into the smaller Southeast order if Proposal 5 is adopted.

The proposal to split the current Southeast marketing area hinges on the assertions that geographically smaller marketing areas tend to reduce transportation and balancing costs and increase blend prices for pooled producers in each of the newly defined marketing areas. The record does not contain specific evidence to support these conclusions. The record lacks evidence to support concluding that the adoption of Proposal 5 would lower transportation costs, increase local milk production, and reduce balancing costs. The same is true for concluding that local milk production would be encouraged and increased to the extent that transportation expenses, and the need for continued transportation credit fund payments, would be significantly reduced while bringing forth a sufficient supply of milk to meet the Class I needs of the proposed marketing areas.

Opponents of Proposal 5 argued that blend price increases from splitting the Southeast marketing area may not occur and that lower transportation cost may not be realized. However, the record does not contain information necessary for determining if either the positions of the proponents or opponents of Proposal 5 are valid.

This decision does not recommend the adoption of Proposal 5. The record is insufficiently persuasive in demonstrating the efficiencies in milk movements for handlers as advanced by its proponents.

3. Eliminating the Simultaneous Pooling of the Same Milk on a Federal Milk Order and a State-operated Milk Order that Provides for Marketwide Pooling

A proposal, published in the hearing notice as Proposal 6, seeking to prohibit the simultaneous pooling of the same milk on the Appalachian or Southeast milk marketing orders and on a State-operated order that provides for the marketwide pooling of milk is recommended for adoption. Currently, neither the Appalachian or Southeast orders have a provision that would prevent the simultaneous pooling of the same milk on the order and on a State-operated order that provides for marketwide pooling.

The proponents of Proposal 6, Deans Foods and Prairie Farms testified that the simultaneous pooling of milk on more than one marketing order was prohibited between all Federal milk orders. According to the Dean Food-Prairie Farms' witnesses, a loophole was

inadvertently created during the consolidation of Federal orders permitting double pooling of the same milk on a Federal milk marketing order and on a State-operated order that, like a Federal order, provides for the marketwide pooling of producer milk. (The double pooling of milk has become known as "double dipping")

According to the Dean Food-Prairie Farms' witnesses, this loophole has been exploited for financial gain by some parties at the expense of pooled producers in other Federal orders until prohibited by subsequent milk order amendments. The proponents testified that proposals similar to Proposal 6 have been adopted in the Upper Midwest, Pacific Northwest, and Central Federal milk orders.

Proponents testified that prohibition of double dipping in the Southeast and Appalachian orders would close a potential loophole in these orders or in a successor order if these orders were merged. The witnesses testified that the pooling of milk regulated by Virginia and Pennsylvania milk programs would not be affected by the prohibition of double pooling. According to the witnesses, milk that is pooled on these State milk programs does not receive extraordinary benefits that would have an impact on Federal milk order pools. No opposition testimony was presented.

Since the 1960's the Federal milk order program has recognized the harm and disorder that resulted to both producers and handlers when the same milk of a producer was simultaneously pooled on more than one Federal order. When this occurs, producers do not receive uniform minimum prices, and some handlers receive unfair competitive advantages. The need to prevent "double pooling" became critically important as distribution areas expanded, orders merged, and a national pricing system was adopted. Milk already pooled under a State-operated program and able to simultaneously be pooled under a Federal order creates the same undesirable outcomes that allowing milk to be pooled on two Federal orders used to cause and subsequently corrected.

There are other State-operated milk order programs that provide for marketwide pooling. For example, New York operates a milk order program for the western region of that State. A key feature explaining why this State-operated program has operated for years alongside the Federal milk order program is the provision in the State pool that excludes milk from the State pool when the same milk is already pooled under a Federal order. Other

States with marketwide pooling similarly do not allow double-pooling of Federal order milk.

The record supports that the Appalachian, Southeast, and possible successor orders should be amended to preclude the ability to simultaneously pool the same milk on the order if the milk is already pooled on a State-operated order that provides for marketwide pooling. Proposal 6 offers a reasonable solution for prohibiting the same milk to draw pool funds from Federal and State marketwide pools simultaneously. It is consistent with the current prohibition against allowing the same milk to participate simultaneously in more than one Federal order pool. Adoption of Proposal 6 will not establish any barrier to the pooling of milk from any source that actually demonstrates performance in supplying the Appalachian and Southeast markets' Class I needs.

Evidence presented at the hearing establishes that milk that can be pooled simultaneously on a State-operated order and a Federal order, would render the Appalachian and Southeast milk orders unable to establish prices that are uniform to producers and to handlers. This shortcoming of the pooling provisions allows milk which was pooled on a state order to be pooled milk on a Federal order. Such milk therefore could not provide a reasonable or consistent service to meet the needs of the Class I market because it was committed to the State order.

No record evidence was presented illustrating or documenting current double pooling of milk in the Appalachian and Southeast orders. Consequently, it is determined that emergency marketing conditions do not exist and the adoption of Proposal 6 should be included as part of the issuance of a recommended decision.

4. Producer-Handler Provisions

A decision considered at the hearing regarding the regulatory status of producer-handlers will be addressed in a separate decision.

Conforming Change

This decision recommends amending the Appalachian and Southeast orders to appropriately reference the Deputy Administrator of Dairy Programs.

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.

General Findings

The findings and determinations hereinafter set forth supplement those that were made when the Appalachian and Southeast orders were first issued and when they were 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 agreements and the orders, 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 areas, and the minimum prices specified in the tentative marketing agreements and the orders, 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 agreements and the orders, 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, marketing agreements upon which a hearing has been held.

Recommended Marketing Agreements and Order Amending the Orders

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

List of Subjects in 7 CFR Part 1005 and 1007

Milk marketing orders.

For the reasons set forth in the preamble 7 CFR Parts 1005 and 1007 are amended as follows:

PART 1005—MILK IN THE APPALACHIAN MARKETING AREA

1. The authority citation for 7 CFR part 1005 continues to read as follows:

Authority: 7 U.S.C. 601–674.

2. Section 1005.2 is amended by revising the Virginia counties and cities to read as follows:

§ 1005.2 Appalachian marketing area.

* * * * *

Virginia Counties and Cities

Alleghany, Amherst, Augusta, Bath, Bedford, Bland, Botetourt, Buchanan, Campbell, Carroll, Craig, Dickenson, Floyd, Franklin, Giles, Grayson, Henry, Highland, Lee, Montgomery, Patrick, Pittsylvania, Pulaski, Roanoke, Rockbridge, Rockingham, Russell, Scott, Smyth, Tazewell, Washington, Wise, and Wythe; and the cities of Bedford, Bristol, Buena Vista, Clifton Forge, Covington, Danville, Galax, Harrisonburg, Lexington, Lynchburg, Martinsville, Norton, Radford, Roanoke, Salem, Staunton, and Waynesboro.

* * * * *

3. Section 1005.13 is amended by revising the introductory text and adding a new paragraph (e), to read as follows:

§ 1005.13 Producer milk.

Except as provided for in paragraph (e) of this section, *Producer milk* means the skim milk (of the skim equivalent of components of skim milk) and butterfat contained in milk of a producer that is:

* * * * *

(e) Producer milk shall not include milk of a producer that is subject to inclusion and participation in a marketwide equalization pool under a milk classification and pricing program imposed under the authority of a State government maintaining marketwide pooling of returns.

* * * * *

§ 1005.81 [Amended]

4. In § 1005.81(a), remove “\$0.065” and add, in its place, “\$0.095”.

§ 1005.82 [Amended]

5. In § 1005.82, paragraph (b) is revised by removing the words “Director of the Dairy Division” and adding, in their place, the words “Deputy Administrator of Dairy Programs” and adding a new paragraph (c)(2)(iv) to read as follows:

§ 1005.82 Payments from the transportation credit balancing fund.

* * * * *

- (c) * * *
- (2) * * *

(iv) The market administrator may increase or decrease the milk production standard specified in paragraph (c)(2)(ii) of this section if the market administrator finds that such revision is necessary to assure orderly marketing and efficient handling of milk in the marketing area. Before making such a finding, the market administrator shall investigate the need for the revision either on the market administrator's own initiative or at the request of interested persons. If the investigation shows that a revision might be appropriate, the market administrator shall issue a notice stating that the revision is being considered and inviting written data, views, and arguments. Any decision to revise an applicable percentage must be issued in writing at least one day before the effective date.

* * * * *

PART 1007—MILK IN THE SOUTHEAST MARKETING AREA

6. Section 1007.13 is amended by revising the introductory text and

adding a new paragraph (e), to read as follows:

§ 1007.13 Producer milk.

Except as provided for in paragraph (e) of this section, *Producer milk* means the skim milk (of the skim equivalent of components of skim milk) and butterfat contained in milk of a producer that is:

* * * * *

(e) Producer milk shall not include milk of a producer that is subject to inclusion and participation in a marketwide equalization pool under a milk classification and pricing program imposed under the authority of a State government maintaining marketwide pooling of returns.

* * * * *

§ 1007.81 [Amended]

7. In § 1007.81(a), remove "\$0.07" and add, in its place, "\$0.10".

§ 1007.82 [Amended]

8. In § 1007.82, paragraph (b) is revised by removing the words "Director of the Dairy Division" and adding, in their place, the words "Deputy Administrator of Dairy Programs" and adding a new paragraph (c)(2)(iv) to read as follows:

§ 1007.82 Payments from the transportation credit balancing fund.

* * * * *

(c) * * *

(2) * * *

(iv) The market administrator may increase or decrease the milk production standard specified in paragraph (c)(2)(ii) of this section if the market administrator finds that such revision is necessary to assure orderly marketing and efficient handling of milk in the marketing area. Before making such a finding, the market administrator shall investigate the need for the revision either on the market administrator's own initiative or at the request of interested persons. If the investigation shows that a revision might be appropriate, the market administrator shall issue a notice stating that the revision is being considered and inviting written data, views, and arguments. Any decision to revise an applicable percentage must be issued in writing at least one day before the effective date.

* * * * *

Dated: May 13, 2005.

Kenneth C. Clayton,
Acting Administrator, Agricultural Marketing Service.

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