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7 CFR Parts 1005 and 1007

Milk Marketing Orders—Tentative Partial Decision in the Appalachian and Southeast Marketing Areas; Proposed Rule

DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

7 CFR Parts 1005 and 1007

[Docket No. AO–388–A17 and AO–366–A46; DA–05–06]

Milk in the Appalachian and Southeast Marketing Areas; Tentative Partial 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; tentative partial decision.

SUMMARY: This document is the tentative partial decision proposing to adopt on an interim final and emergency basis amendments to the transportation credit balancing fund provisions of the Appalachian and Southeast milk marketing orders. Specifically, this document would establish a variable mileage rate factor using a fuel cost adjustor to determine the transportation credit payments of both orders, increase the maximum transportation credit assessment rate for both orders and establish a zero diversion limit standard on all milk receiving transportation credits in both orders. Other proposals concerning producer milk provisions and establishing transportation credit provisions on intra-market order movements of milk within the Appalachian and Southeast marketing areas will be addressed in a separate decision to be issued soon. This decision requires determining if producers approve the issuance of the amended orders on an interim basis.

DATES: Comments must be submitted on or before November 13, 2006.

ADDRESSES: Comments (six copies) should be filed with the Hearing Clerk, United States Department of Agriculture, STOP 9200—Room 1031, 1400 Independence Avenue, SW., Washington, DC 20250–1031. 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: Gino Tosi, Associate Deputy Administrator, USDA/AMS/Dairy Programs, Order Formulation and Enforcement Branch, STOP 0231—Room 2971, 1400 Independence Avenue, SW., Washington, DC 20250–0231, (202) 690–1366, e-mail address: *gino.tosi@usda.gov.*

SUPPLEMENTARY INFORMATION: This tentative partial decision proposes to adopt amendments that would: (1) Establish a variable transportation credit mileage rate factor which uses a fuel cost adjustor in both orders, (2) increase the Appalachian order's maximum transportation credit assessment rate to $0.15 per hundredweight (cwt) and the Southeast order's maximum transportation credit assessment rate to $0.20 per cwt and (3) establish a zero diversion limit standard on eligible Class I milk receiving transportation credits in both orders.

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) (the Act), 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 of Agriculture (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 would 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 January 2006, the time of the hearing, there were 3,055 dairy farmers pooled on the Appalachian order (Order 5). For the Southeast order (Order 7), 3,367 dairy farmers were pooled on the order. Of these, 2,889 dairy farmers in Order 5 (or 95 percent) and 3,218 dairy farmers in Order 7 (or 96 percent) were considered small businesses.

During January 2006, there were a total of 37 plants associated with the Appalachian order (22 fully regulated plants, 11 partially regulated plants, 2 producer-handler and 2 exempt plants). A total of 51 plants were associated with the Southeast order (31 fully regulated plants, 9 partially regulated plants and 12 exempt plants). The number of plants meeting the small business criteria under the Appalachian and Southeast orders were 9 (or 24 percent) and 18 (or 35 percent), respectively.

The proposed amendments adopted in this tentative final decision would amend the transportation credit provisions of the Appalachian and Southeast orders. The Appalachian and Southeast orders contain provisions for a transportation credit balancing fund. To partially offset the costs of transporting supplemental milk into each marketing area to meet fluid milk demand at distributing plants during the months of July through December, handlers are charged an assessment year-round to generate revenue used to make payments to qualified handlers.

The proposed amendments would establish a variable mileage rate factor that would be adjusted monthly by changes in the price of diesel fuel (a fuel cost adjustor) as reported by the

Department of Energy for paying claims from the transportation credit balancing funds of the Appalachian and Southeast orders. Currently, the mileage rate of both orders is fixed at 0.35 cents per cwt per mile.

The proposed amendments would increase the maximum rates of the assessments for the Appalachian and Southeast orders. Specifically, the maximum assessment rate for the Appalachian order would be increased by 5.5 cents per cwt from the current 9.5 cents per cwt to 15 cents per cwt. The maximum assessment rate for the Southeast order would be increased by 10 cents per cwt to 20 cents per cwt. The increase in each order's maximum transportation credit assessment rate is intended to minimize the proration and depletion of each order's transportation credit balancing fund during those months when supplemental milk is needed to service the fluid needs of both marketing areas. The increases in the maximum assessment rates for the Appalachian and Southeast orders adopted in this decision are necessary due to, primarily, expected higher mileage reimbursement rates arising from escalating fuel costs and the transporting of milk over longer distances and, secondarily, the expected continuing need to rely on supplemental milk supplies arising from declining local milk production in the marketing areas.

The proposed amendments also would amend the producer milk provisions of the Appalachian and Southeast orders by eliminating the current ability to pool diverted milk associated with supplemental milk receiving a transportation credit payment. While this tentative partial decision does not specifically adopt the Dean Foods Company proposal (published in the hearing notice as Proposal 4), the Department agrees with the need to limit diverted milk pooled on the order made possible by supplemental milk eligible to receive transportation credits.

Currently, the Appalachian and Southeast orders provide transportation credits on supplemental shipments of milk for Class I use provided the milk was from a dairy farmer who was not defined as a ''producer'' under the orders during more than 2 of the immediately preceding months of February through May and 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 2 months and whose milk is produced on a farm not located within the specified marketing areas of either order. The provisions of each order provide the Market Administrator the discretionary authority to adjust the 50 percent milk production standard to assure orderly marketing and efficient handling of milk in the marketing areas.

The proposed amendments would be applied to all Appalachian and Southeast order handlers and producers—both consist of large and small businesses. The proposed amendments will affect all supplemental producers and handlers equally regardless of their size. Accordingly the proposed amendments should not have a significant economic impact on a substantial number of small entities.

The Agricultural Marketing Service is committed to complying with the E-Government Act, to promote the use of the Internet and other information technologies to provide increased opportunities for citizen access to Government information and services, and for other purposes.

This notice does not require additional information collection that needs 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 that 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 December 22, 2005; published December 28, 2005 (70 FR 76718).

Preliminary Statement

Notice is hereby given of the filing with the Hearing Clerk of this tentative partial 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 (AMAA) and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR Part 900).

Interested parties may file written exceptions to this decision with the Hearing Clerk, U.S. Department of Agriculture, STOP 9200—Room 1031, 1400 Independence Avenue, SW., Washington, DC 20250–9200, by November 13, 2006. Six (6) copies of these exceptions should be filed. All written submissions made pursuant to this tentative partial decision will be made available for public inspection at the Office of the Hearing Clerk during regular business hours (7 CFR 1.27(b)).

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

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

The proposed amendments set forth below are based on the record of a public hearing held in Louisville, Kentucky, on January 10–12, 2006, pursuant to a notice of hearing issued December 22, 2005, published December 28, 2005 (70 FR 76718).

The material issues on the record of hearing relate to:

1. Transportation Credits
   A. Establishing a variable mileage rate factor.
   B. Increasing the maximum assessment rates.
   C. Establishing diversion limit standards.
2. Determination of emergency marketing conditions.

Findings and Conclusions

This tentative partial decision specifically adopts on an interim basis, proposals published in the hearing notice as Proposals 3, 1 and certain objectives of Proposal 4. Proposal 3 seeks to establish a variable mileage rate factor using a fuel cost adjustor. Proposal 1 seeks to increase the maximum transportation credit assessment rates for both orders. The intent of Proposal 4 is to discourage the volume of milk pooled by diversions by

reducing the amount of transportation credits a handler could receive. A complete discussion and findings on these three proposals appears after the summaries of testimony.

Proposal 2, seeking to establish an intra-market transportation credit provision for both the Appalachian and Southeast orders and Proposal 5, seeking to reduce the volume of milk diverted to an out-of-area plant, will be addressed in a separate decision to be issued soon. Therefore, no further references to Proposals 2 and 5 will be made in this decision.

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

1. Transportation Credits

A. Establishing a Variable Mileage Rate Factor

A proposal, published in the hearing notice as Proposal 3, which seeks to establish a variable mileage reimbursement rate factor (MRF) that uses a fuel cost adjustor in the transportation credit payment provisions in both the Appalachian and Southeast orders should be adopted immediately. The orders currently provide for a fixed mileage rate of 0.35 cents per cwt per mile. The proposal was offered by Dairy Farmers of America, Inc., (DFA). DFA is a dairy farmer member-owned Capper-Volstead cooperative with 12,800 member farmers whose milk is pooled throughout the Federal order system, including the Appalachian and Southeast orders.

A witness appearing on behalf of Southern Marketing Agency, Inc. (SMA) and Dairy Cooperative Marketing Association, Inc. (DCMA) testified in support of Proposal 3. SMA and DCMA are marketing agencies-in-common operating in the southeast region of the country. Members of SMA include Arkansas Dairy Cooperative Association; Dairy Farmers of America, Inc.; Dairymen's Marketing Cooperative, Inc.; Lone Star Milk Producers, Inc.; and Maryland & Virginia Milk Cooperative Association, Inc. Members of DCMA include Zia Milk Producers Association; Select Milk Producers Association; Cooperative Milk Producers Association, Inc.; and Southeast Milk, Inc. Dairylea Cooperative, Inc. also requested that the witness testify on their behalf and in support of Proposal 3.

The SMA witness testified that the southeastern region of the United States is experiencing declining milk production while the population and demand for fluid milk are increasing. As a result, the witness stated that the Appalachian and Southeast marketing areas must continually seek supplemental supplies of milk from outside their normal milksheds. The witness added that the volume of supplemental milk needed to meet demands that cannot be met by local production, and the distances from where the supplemental milk is obtained continues to increase. The witness explained that these marketing conditions result in payments to handlers from the transportation credit balancing funds being depleted at a rate faster than the rate they are assessed.

The SMA witness presented monthly fuel cost data for the United States and nine U.S. sub-regions from the Energy Information Administration of the United States Department of Energy (EIA). Relying on EIA data, the witness asserted that the cost of diesel fuel has escalated sharply in recent years. According to the witness, the national average diesel fuel price in mid-1997 was reported to be approximately $1.15 to $1.17 per gallon while the national average diesel fuel price in mid-2005 was reported to be $2.20 to $2.50 per gallon. The witness emphasized that these current diesel fuel prices are much higher than the prices that existed when the transportation credit provisions were first implemented in 1996 and amended in 1997.

The SMA witness noted that the cost of hauling has also increased in recent years. Relying on EIA data, the SMA witness estimated the cost of hauling to be in the range of $1.75 to $1.80 per loaded mile in 1997, whereas the cost in 2005 was about $2.35 per loaded mile. As diesel fuel costs have increased, the witness explained, so have other costs such as equipment, insurance and labor.

The SMA witness emphasized that there have been no adjustments made to the MRF of the transportation credit provisions since they were last amended in 1997. The witness recounted that the original mileage rate was reduced by five percent, from 0.37 cents per cwt per mile to 0.35 cents per cwt per mile in 1997.

The SMA witness explained that in 1997, approximately 94 to 95 percent of the transportation costs on supplemental milk were covered by transportation credit balancing fund payments. The witness reiterated that since no adjustments have been made to the orders' transportation credit reimbursement rate since 1997, the percentage of hauling costs covered by the transportation credits today are substantially less than those in 1997.

According to the SMA witness, the current use of a fixed mileage rate is not responsive to changes in hauling costs. The witness explained that Proposal 3 would compute a variable transportation credit mileage rate per cwt per mile that would adjust with changes in the cost of diesel fuel. The witness stressed the importance and need to keep information on hauling costs current by using independent fuel cost data. The witness stated that hauling cost rates, adjusted for changes in fuel costs, are common in industry.

The SMA witness illustrated components used to calculate the proposed variable MRF. According to the witness, a monthly average diesel fuel price, a reference diesel fuel price, an average mile-per-gallon truck fuel use, a reference hauling cost per loaded mile and a reference load size are the components needed to calculate the proposed variable MRF.

Using EIA data for the United States and nine U.S. sub-regions, the SMA witness explained that using the Lower Atlantic and Gulf Coast EIA regions in computing the monthly mileage rates would be reflective of the Appalachian and Southeast marketing areas. Relying on EIA data, the witness explained that the Lower Atlantic region is comprised of the states of Virginia, West Virginia, North Carolina, South Carolina, Georgia and Florida. Similarly, the witness added, the Gulf Coast region is comprised of Alabama, Mississippi, Arkansas, Louisiana, Texas and New Mexico. According to the witness, of the nine sub-regions described by the EIA, the Lower Atlantic and Gulf Coast regions best reflect the Appalachian and Southeast marketing areas geographically. The witness also noted that according to EIA data, the diesel fuel costs for these two regions are among the lowest reported nationally.

In establishing a reference diesel fuel price for the proposed transportation credit mileage rate calculation, the SMA witness relied on EIA retail diesel fuel prices for the time period of October to November 2003. During that period, the witness said, diesel fuel prices averaged $1.48 per gallon nationally and ranged from $1.42 per gallon in the Lower Atlantic to $1.43 per gallon in the Gulf Coast EIA regions. Due to the relatively little fluctuation of diesel fuel prices during October to November 2003, the witness was of the opinion that this period is a fair and conservative timeframe on which to establish a reference diesel fuel price. The witness concluded by suggesting $1.42 per cwt per mile should be used as the reference diesel price.

The SMA witness submitted a random selection of actual milk hauler bills as the basis for computing a reference hauling cost component of the proposed MRF. According to the witness, actual origination and destination points, miles moved, and rates and fuel surcharges per loaded mile were depicted on each hauling bill. For the month of October 2005, the witness stated that hauling costs ranged from $1.89 to $2.70 per loaded mile, with the average being $2.48 per loaded mile. In order to be consistent with the timeframe used for the reference diesel price, the witness submitted selected milk hauling bills from October to November 2003 as the basis for determining the reference hauling cost. The witness testified that for this time period the simple average hauling rate charged per loaded mile in the Southeast was $1.9332 and $1.8913, respectively, and averaged $1.9122. Accordingly, the witness offered that the average hauling rate of $1.91 per loaded mile become the reference hauling cost used in calculating the MRF.

The SMA witness provided data compiled by the United States Department of Transportation (USDOT) on combination truck fuel economy. According to the witness, the USDOT data show that the average miles traveled per gallon for a combination truck in 2002 was 5.2 miles per gallon. The witness was of the opinion that the dairy industry fuel economy is similar as it ranges between 5.0 to 6.0 miles per gallon. Accordingly, the witness advocated using a 5.5 miles per gallon fuel consumption rate in computing the proposed MRF. The witness also testified that a 5,600 gallon tanker at its fullest can carry 48,160 pounds of milk. Therefore, the witness explained, 48,000 should be the reference load size used in calculating the MRF.

The SMA witness summarized that Proposal 3 calculates a variable monthly MRF by using: (1) EIA data from a base period defined as October and November 2003, (2) hauling cost of $1.91 per loaded mile, (3) a reference diesel fuel rate of $1.42 per gallon, (4) a fuel economy of 5.5 miles per gallon and (5) a load size of 48,000 pounds.

The SMA witness explained that the proposed mileage rate would be calculated by averaging the four most recent weeks of retail on-highway diesel prices for both the Lower Atlantic and Gulf Coast, as reported by the EIA that are available prior to each order's announcement of the Advance Class milk prices. According to the witness, the proposed mileage rate would then be computed and included in each orders' announcement of Advanced Class milk prices that are announced publicly on the Friday on or before the 23rd of the current month.

The SMA witness stressed that the proposed mileage rate computation reflects less than the actual cost of hauling for various reasons. The witness asserted that the proposed mileage rate is based on costs of hauling from 2003, rather than a more current timeframe, and therefore would only reflect changes in the cost of diesel fuel since that time. The witness also reiterated that the proposed mileage rates would only apply to milk used in Class I shipped directly from farms to plants that exceeds 85 miles. The SMA witness was of the opinion that transportation costs will continue to increase and that adopting the proposed changes to the transportation credit provisions will avoid exhausting the transportation credit balancing fund before costs are reimbursed.

The SMA witness asserted that they were incurring substantial losses in supplying supplemental milk for Class I use to the Appalachian and Southeast marketing areas. The witness indicated that hauling costs in supplying supplemental milk reach over $15 million annually.

Six DFA farmer-members testified in support of Proposal 3. According to these witnesses, it is the cooperative members of SMA who are acting as handlers to supply the supplemental fluid milk needs of both marketing areas. According to the witnesses, this results in additional costs that are absorbed by the dairy farmer members of the cooperatives that comprise SMA. The witnesses argued that hauling costs and the distance supplemental milk must be hauled continues to increase.

The six DFA dairy farmer witnesses were of the opinion that Proposal 3 is a reasonable solution to deal with the continued production decline and population driven demand increase in the southeastern region of the United States. The witnesses were of the opinion that using a fuel adjustor that moves up and down with changes in the cost of diesel fuel would more adequately cover the costs of transporting supplemental milk in the marketing areas.

A post-hearing brief submitted by DFA, and supported by SMA, reiterated support for adopting a fuel cost adjustor.

A post-hearing brief was submitted on behalf of Arkansas Dairy Cooperative Association (ADCA) in support of Proposal 3. According to ADCA, their members' milk does not usually qualify for transportation credit payments because their milk is typically pooled on the Southeast and Central orders year-round. However, ADCA noted that their members are impacted by the cost of hauling supplemental milk into the southeast because of their membership in a marketing agency-in-common.

A post-hearing brief was submitted on behalf of Dairymen's Marketing Cooperative, Inc. (DMCI) in support of Proposal 3. The brief emphasized that as fuel costs continue to increase, the Class I differential surface becomes more outdated and unable to reflect the costs of moving milk.

A post-hearing brief was submitted on behalf of Lone Star Milk Producers (Lone Star) in support of Proposal 3 because it would establish updated mileage rates for making payments from the transportation credit balancing funds. The brief stated that the hauling cost factor used to develop the mileage rate for the transportation credit balancing fund has not been updated since the mid 1990's and is inadequate.

A post-hearing brief submitted by Maryland & Virginia Milk Producers Cooperative Association, Inc. (Maryland & Virginia) reiterated support for the adoption of Proposal 3.

A post-hearing brief was submitted on behalf of South East Dairy Farmers Association (SEDFA). The brief expressed support for a variable mileage rate based on the changes in the cost of diesel fuel. The brief stated that the industry uses a consistent fuel economy estimate of 5.0 to 6.0 miles per gallon when calculating expected milk transportation costs. The brief stressed that the extreme rise in diesel fuel prices in recent months has made the adoption of Proposal 3 critical for producers who incur the cost of hauling milk to the market.

A dairy farmer who supplies milk to Dean Foods Company (Dean) testified in support of the intent of Proposal 3. The witness stated that a dynamic mileage rate that adjusts to the energy markets is better than a static factor that is unable to change with changes in energy costs.

A dairy farmer who markets milk to Dean through Dairy Marketing Service (DMS) testified in favor of Proposal 3. The witness stated that using a variable MRF derived from a source outside of the dairy industry such as the USDOT would help decrease the chances of industry manipulating what information should be used in calculating a MRF.

A witness appearing on behalf of Southeast Milk, Inc. (SMI) testified in support of Proposal 3. SMI is a dairy marketing cooperative with approximately 300 dairy farmer members in Florida, Georgia, Alabama and Tennessee. The SMI witness stated

that relying on cost indexes of other government agencies determined on a national scale makes the data less subject to manipulation by any given industry.

A witness testified on behalf of Dean in support of Proposal 3. According to the witness Dean owns and operates 8 plants regulated by the Appalachian marketing area and 10 plants regulated by the Southeast marketing area. The Dean witness agreed with the benefit of using an adjustor in determining the MRF to reflect changes in fuel prices over time. However, the witness also was of the opinion that the MRF should be reduced by 95 percent in order to be consistent with the Secretary's past decisions that transportation credits do not encourage the uneconomic movement of milk or inefficiencies.

The Dean witness testified that there is a need for supplemental supplies of milk for the marketing areas and that supplying such milk presents challenges. Nevertheless, the witness was of the opinion and expressed concern for the continuing and potential abuse of transportation credits. The witness asserted that current order provisions allow supplemental milk to receive transportation credits when such milk is not demanded. Moreover, the witness stressed that there is no assurance that transportation credit balancing fund payments would flow to the dairy farmer members of the cooperatives acting as handlers located in the two marketing areas regardless of their status as independent or cooperative members.

A post-hearing brief submitted on behalf of Dean reiterated support for Proposal 3, indicating that disorderly marketing conditions exist because the milk supply in the Southeastern United States is deficit and the cost of supplying the market is not borne equally.

A witness appearing on behalf of Land O'Lakes, Inc. (LOL) testified in support of Proposal 3. LOL is a dairy cooperative with over 4,000 dairy farmer member-owners who are pooled on six Federal Orders. The witness stated that their member's milk located in the Northeast and Midwest have provided supplemental supplies to both the Appalachian and Southeast marketing orders for the past 10 years.

According to the witness, LOL is a continuous supplemental milk supplier to the Appalachian and Southeast orders and has higher costs hauling milk. The witness asserted that basing the MRF on changes in diesel fuel prices would be responsive to costs actually experienced by the handlers who move milk into these two deficit markets.

A post-hearing brief submitted by LOL reiterated support for the adoption of Proposal 3. The brief said that in order to fulfill the supplemental milk needs of the two marketing areas, milk is sourced from 28 states, which demonstrates the distance milk must travel has further increased adding to the justification of why Proposal 3 should be adopted.

An independent dairy farmer from New Market, Tennessee, testified in opposition to any changes to the Appalachian or Southeast marketing orders. The witness testified that additional government intervention in moving milk was not necessary and that supply and demand should be relied upon to dictate what services are needed. The witness asserted that amending the orders as proposed would change the way milk is moved and that would hinder efficient milk hauling. The witness also was of the opinion that there is no assurance transportation credits received for supplying supplemental milk would truly reach the market's producers. The witness expressed concerns that the proposed increases in the transportation credit rate could affect producer decisions and producer blend prices.

A witness testified on behalf of the Kentucky Dairy Development Council (KDDC). KDDC is a member-based organization that represents approximately 1,360 dairy farmers in Kentucky. KDDC did not state support or opposition for the proposals presented at the hearing. The witness was of the opinion that noncompetitive pricing is discouraging milk production in the southeastern United States. The witness stated the opinion that farm milk prices in Kentucky and in the Southeastern states have eroded and that KDDC was opposed to any Federal Order changes which would further erode farm prices. The witness did testify in support of changes to the orders that would strengthen the position of dairy farmers in Kentucky and in other Southeastern states.

A post-hearing brief was submitted by KDDC in support of Proposal 3 even though no specific position was taken on proposals considered during the hearing. The brief said that Proposal 3 would benefit Kentucky dairy farmers by providing assistance in recovering market service costs.

B. Increasing the Maximum Assessment Rate

A proposal, published in the hearing notice as Proposal 1, offered by DFA, that seeks to increase the maximum transportation credit balancing fund assessment rates for the Appalachian and Southeast orders should be adopted immediately. Specifically, this proposal would increase the maximum transportation credit balancing fund assessment rate in the Appalachian order by $0.055 per cwt on Class I milk so that the maximum rate of assessment would be $0.15 per cwt. The Southeast order maximum assessment rate would be increased by $0.10 per cwt so that the maximum rate of assessment would be $0.20 per cwt.

A witness appearing on behalf of DCMA and SMA testified in support of Proposal 1. As previously described in testimony regarding Proposal 3, the SMA witness said that the current transportation credit provisions provide for collecting a maximum transportation credit assessment to handlers on all Class I milk for the Appalachian and Southeast marketing areas year-round. While the Market Administrator has the discretion to waive the maximum transportation credit assessments if deemed necessary, the SMA witness explained that the Market Administrator of each order collected the maximum assessments in 2004 and 2005. However, the witness said that the collected assessments in both orders had been insufficient to pay the requested credits necessitating the proration of payments from the transportation credit balancing fund.

The SMA witness stated that even with the November 1, 2005, implementation of the most recent transportation credit assessment increase of 3 cents per cwt for both orders, the assessment rate will likely not be able to ensure payments from the transportation credit balancing funds on all milk eligible to receive payment.

The SMA witness estimated that the transportation credit assessment rate for the Appalachian order for 2004 would have needed to be $0.0889 per cwt and $0.0953 per cwt for all of 2005 in order to cover all of the transportation credits requested. The witness also estimated that the Southeast area transportation credit assessment rate would needed to have been $0.1318 per cwt and $0.1246 per cwt in 2004 and 2005, respectively, to cover all requested credits. The witness also noted that the transportation credits requested for both the Appalachian and Southeast marketing orders for the months of July, September and October of 2005 exceeded the transportation credits requested in all of 2004. The witness said that this also demonstrates that increased volumes of supplemental milk were transported from locations located farther from the marketing areas.

The witness said that the reason the Market Administrators' prorated

payments from the transportation credit balancing funds was because the rate of assessments exceeded collections. The witness was of the opinion that this occurred because more supplemental milk was sourced from more distant locations.

Relying on Market Administrator data, the witness concluded that only 55 percent of the actual cost of transporting supplemental milk was covered by the transportation credit payments in the Appalachian Order and only 39 percent of the actual cost was covered for the Southeast Order in 2004. The witness estimated that for 2005, only 53 percent and 43 percent of the actual hauling costs for supplemental milk would be covered for the Appalachian and Southeast orders respectively.

In explaining the need for the adoption of Proposal 3, the SMA witness reiterated that the combined effect of higher mileage hauling rates and supplemental milk being hauled from more distant locations resulted in a smaller portion of actual transportation costs being funded with transportation credits than in 1997. The witness was of the opinion that transportation costs will continue to increase thus making it necessary to again increase the assessment rate.

Further illustrating the need to increase the maximum transportation credit assessment rate, the SMA witness related that if a transportation credit reimbursement rate of 0.46 cents per cwt per mile had been in place rather than the current rate of 0.35 cents per cwt per mile, the Appalachian order would have required an assessment of $0.133 per cwt in 2004 in order to prevent the proration of transportation credit claims, and 2005 would have required an assessment of $0.1415 per cwt. Similarly, the witness stated for the Southeast order, the assessment rate would have needed to have been $0.1927 per cwt for 2004 and $0.1869 per cwt for 2005.

The SMA witness testified that the differing rates of transportation credit balancing fund assessments proposed for the Appalachian and Southeast orders reflect the differing costs of supplying supplemental milk into each marketing area. The witness stated that while the transportation credit assessment was waived for 2 months during 2002 and 2003, assessments were not waived for the Southeast order. The witness asserted that while both orders rely on some of the same sources for supplemental milk, the Appalachian marketing area receives most of its milk from the more northern Mid-Atlantic States while the Southeast marketing area receives most of its supplemental milk from States located to the west and southwest of the marketing area. Further, the witness added that different assessment rates are warranted for the two orders because supplemental milk moves greater distances to service the Southeast market than it does to service the Appalachian market.

The six DFA dairy farmer witnesses that testified in support of Proposal 3 also testified in support for increasing the transportation credit assessments for both orders. The witnesses were of the opinion that the assessment increases would generate funds needed to maintain a sufficient transportation credit fund balance to pay eligible claims. In addition, the witnesses were of the opinion that the orders' current location adjustments are not able to reflect the rapidly increasing costs of transporting milk from where it is located to where it is needed. Similarly, the witnesses stated that over-order premiums cannot be commanded from the market to offset rapidly increasing transportation costs.

The six DFA dairy farmer witnesses were also of the opinion that the intent of increasing the transportation credit assessment rates was a reasonable solution to mitigate continued production declines and the increasing demand for milk in the southeastern United States by a growing population. The witnesses added that higher fuel costs and longer hauling distances from which to obtain supplemental milk supplies are costing the markets' producers. When producers go out of business, the witnesses related, the gap between supply and demand widens thereby increasing the cost of supplying the market with supplemental milk.

Post-hearing briefs submitted by DFA reiterated the position and testimony by SMA in support of increasing the transportation credit assessment rates immediately.

A post-hearing brief was submitted on behalf of Select Milk Producers, Inc. (Select) and Continental Dairy Products, Inc. (Continental) in support of Proposal 1. Select's members are located in New Mexico, Texas, Kansas and Oklahoma, and Continental's members are located in Indiana, Michigan and Ohio. The brief stated that both cooperatives supply the Appalachian and Southeast marketing areas with supplemental milk. The brief stated support for testimony given at the hearing by proponents for increasing the transportation credit assessment rates of the two orders. The brief also stated that while the proposals under consideration will not fix long-term marketing and transportation problems, Proposal 1 should be adopted in conjunction with the Department considering alternative approaches in an effort to correct the milk deficit problems in the southeast region of the United States.

The Select/Continental brief expressed the opinion that blend prices, not Class I prices, provide the economic incentive to supply milk to a marketing area. The brief stated that when producers in a large marketing area share the same blend price the incentive to move milk within the large marketing area is greatly diminished. In addition, the brief indicated that the pricing of diverted milk ignores the true relative value of milk to the market where pooled which results in milk being pooled that is not available to meet the Class I needs of the market.

A post-hearing brief was submitted on behalf of South East Dairy Farmers Association (SEDFA). The brief expressed support for Proposal 1 as published in the hearing notice. SEDFA represents cooperative and independent producers who are normal and supplemental milk suppliers and are located in and outside of the Appalachian and Southeast marketing areas.

The SEDFA brief asserted that whether milk is produced within or outside of the two marketing areas, the cost of moving Class I supplemental milk should be borne by the marketplace. The brief stated that while the percent reimbursement of actual hauling costs is much lower than in 1997, the amount of supplemental milk being brought into the marketing areas is increasing. The brief concluded that because reimbursement of actual hauling cost is smaller, the higher costs not reimbursed has fallen disproportionately to producers. The brief agreed with Lone Star and Maryland & Virginia that the 3-cent increase in the transportation credit assessments implemented in November 2005 would be insufficient to cover expected transportation credit claims during 2006.

A witness appearing on behalf of DFA testified in support of Proposal 1. The witness testified that the pay prices for cooperative producers in the southeast region of the country (Tennessee, Louisiana, Missouri, Virginia, North Carolina, South Carolina and Alabama) between January through June 2005 for DFA cooperative members ranged from $0.25 per cwt below the blend price to $0.30 per cwt above the blend price with the majority being at about $0.20 per cwt above the blend price. The witness indicated that over-order premiums paid to producers ranged from $0.10 to $0.90 per cwt above the blend price and were similar to the pay

price of their competitors in these areas who are not DFA members.

A witness appearing on behalf of LOL testified in support of Proposal 1. The LOL witness agreed with other proponents that the transportation credit balancing fund for both orders has been insufficient to support transportation credit payments. While the witness supported the transportation credit assessment increases effective in November 2005, the witness did not think that this would be sufficient to reimburse future claims.

A post-hearing brief submitted by LOL reiterated their support for the adoption of Proposal 1. The brief indicated that the southeast region of the country is not able to fulfill Class I demands during any season of the year and must rely on supplemental supply from about 28 States outside the Appalachian and Southeast marketing areas. The brief noted that transportation credits installed in the southeastern region in 1996 were based on recognition that the region's Class I needs could only be met by supplemental milk from dairy farms located outside of the region.

A witness testifying on behalf of Dean expressed cautious support for increasing the transportation credit assessment rates of the two orders because the availability of additional credits needs to be balanced with a consideration for abuses and undesired results. The witness was of the opinion that handlers who receive such credits also are pooling milk on the orders through the diversion process that does not actually serve the market's Class I needs.

A post-hearing brief submitted on behalf of Dean agreed with proponents of Proposal 1 that disorderly marketing conditions exist. The brief stated that the southeast area's milk supply is deficit and the cost of supplying the market is not borne equally.

A witness testified on behalf of SMI in opposition to Proposal 1. The witness characterized transportation credits as a subsidy and was of the opinion that subsidizing the transportation of milk produced outside of the marketing areas results in economic disincentives for local milk production and incentives for milk from outside the two marketing areas to replace local supplies. The witness noted that when transportation credits were first adopted in 1996, the average Class I utilization of the southeast region was in the mid-80 percent range. Since the implementation of transportation credits, the witness contrasted the Class I utilization noting that it had fallen to the 60 percent range. It was the opinion of the witness that transportation credit provisions are contributing to the declining milk production in the two marketing areas.

The SMI witness testified that transportation credits should be eliminated. As an alternative, the witness suggested (1) establishing a method by which Class I prices could be adjusted based on more regional marketing conditions, (2) adopting a base-excess plan, (3) increasing the current Class I differential level and (4) any other provisions that would encourage local milk production.

A Kentucky dairy farmer testified in opposition to Proposal 1. The witness argued that providing transportation credits devalues local milk, results in lower prices to local producers, and is a cause of the declining milk production in the two marketing areas. The witness expressed concern that Proposal 1 will provide for more milk located outside the marketing areas the opportunity to be pooled on the orders even though that milk is not delivered to either marketing area on a daily basis as is the locally produced milk. According to the witness, local producers are not able to receive the full value for local production because transportation credits give producers located far from the marketing areas price advantages. The witness concluded by stating that pooling milk located outside of both marketing areas does not represent Class I use and this milk should not be pooled on the Appalachian or Southeast orders.

A dairy farmer witness who supplies milk to Dean testified in opposition to Proposal 1. The witness viewed increasing assessment rates on transportation credits as detrimental to dairy farmers located in the Appalachian and Southeast marketing areas who regularly supply the Class I needs of the market. The witness was of the opinion that Proposal 1 lacks safeguards on the amount of additional milk that could be pooled on the orders by diversions. The witness said this additional pooled milk would unnecessarily lower the blend price received by producers and essentially result in out-of-area milk supplies becoming less expensive relative to milk produced in-area. As a consequence, the witness said local in-area producers will be forced out of business because of lower prices thereby further increasing the need for additional out-of-area supplemental milk supplies to meet the Class I needs of the marketing areas.

The witness suggested that instead of providing additional transportation credits, a review of the level of Class I differentials and a review of diversions and touch-base provisions should be considered in another hearing.

An independent dairy farmer from New Market, Tennessee, testified against making any changes to the Appalachian and Southeast marketing orders including the adoption of Proposal 1. In addition to the witness' testimony regarding Proposal 3 already described, the witness was of the opinion that additional government intervention to provide for the increasing transportation credit assessment rate was not necessary and that supply and demand forces should dictate what services are needed. The witness asserted that amending the orders as proposed would change the way milk is transported and would hinder efficient handling of milk. The witness was of the opinion that there would be no assurance that the transportation credits would benefit the producers who were pooled on the two orders and incurred the additional costs of servicing the Class I market.

A dairy farmer who also markets milk to Dean through DMS testified in opposition to Proposal 1. The witness said that local producers of the Appalachian and Southeast marketing areas are unable to supply all the fluid milk needs of the two marketing areas because local milk production in these areas is declining. The witness suggested that if Proposal 1 were adopted, the accounting of the total transportation costs of all milk movements should be supplied to the Market Administrators and be made available for public inspection. The witness also suggested making changes to the level of adjustments of milk prices by location (location adjustments) as an alternative to increasing the transportation credit assessment rate. The witness said if location adjustments were changed, the pooling standards for both orders would also need to be adjusted. Specifically, the witness suggested increasing the number of days' production needed to touch base or increasing the performance standards of the orders.

A post-hearing brief submitted by the Kentucky Dairy Development Council (KDDC) supported Proposal 1 even though they did not state their position at the hearing. The brief noted that increasing the transportation credit assessment rate would benefit Kentucky dairy farmers by providing assistance in recovering costs associated with serving the market.

C. Establishing Diversion Limit Standards

A proposal submitted by Dean Foods, published in the hearing notice as Proposal 4, seeks to reduce a handler's ability to utilize transportation credits to

help broaden the number of producers who touch base. The intent of the proposal is to limit the pooling of additional surplus milk on the orders through the diversion process. Currently, large volumes of milk are being pooled through diversions on the Appalachian and Southeast orders from locations distant from the marketing areas. While Proposal 4 would provide incentives to limit the pooling of milk through the diversion process, it would do so indirectly by limiting the payment of transportation credits. This decision chooses to directly limit diversions by establishing a zero diversion limit on milk that receives transportation credits.

A witness appearing on behalf of Dean testified in support of Proposal 4 while also expressing cautious support for the proposed transportation credit assessment increase (Proposal 1). The witness was of the opinion that handlers supplying supplemental milk to the two marketing areas receive a financial benefit from pooling diverted milk on the orders but maintained that such milk does not serve the fluid market. The witness explained that while the diverted milk typically does not serve the two markets, it is nevertheless pooled on the two orders because the blend prices are higher than what this milk could receive if pooled on other Federal orders.

The Dean witness testified that the establishment of large marketing orders has created new marketing problems. According to the witness, when the Federal order system had a larger number of smaller markets, each order's marketwide pools were small. Markets with large populations relative to associated milk, the witness explained, had higher Class I utilizations and higher blend prices to attract supplemental milk supplies. Markets with significant supplies of milk and smaller populations, the witness related, had lower Class I utilizations and producers pooled in those markets were provided with the economic incentive to look for higher returns in markets with higher blend prices. The witness further explained that smaller marketing areas limited the size of the Class I market and in turn limited how much milk could be pooled by diversion. The witness said that not only were smaller orders effective in limiting a handler's ability to pool milk through diversions, but smaller orders also had disincentives to pooling diverted milk. According to the witness, the relative value of diverted milk was tied to its distance from the market.

The Dean witness also testified that the Class I price surface adopted during Federal milk order reform changed the relative relationship of milk value to its distance from the market. According to the witness, the location value of diverted milk prior to reform was based on adjusting milk value based on the distance to an order's pricing point. The witness said this resulted in each plant having a different location adjustment value to its milk receipts depending on the order on which its receipts were pooled. The witness explained that the further milk was located from the order's pricing point, the less likely that such milk would be pooled as diversions.

The Dean witness expressed concern that no longer valuing milk relative to the order on which it is pooled had a material effect on the value of pooling milk located far from the market by diversion. The witness was of the opinion that the flatter Class I price surface, with fixed differential levels by county, places a value on milk that is not reflective of its value to the marketing order where pooled and has made it economically desirable to pool milk located far from the market by the diversion process. The witness was also of the opinion that this served to provide the incentive for pooling distant milk by diversions.

The Dean witness testified that even though there are closer milk supplies, distant milk is being pooled on both orders and asserted that transportation credits amplify the pooling of milk on the orders which does not service the Class I needs of the markets. The witness was of the opinion that pooling distant milk by diversions are clearly disorderly marketing conditions for the two markets. According to the witness, when such milk is pooled, local farmers who are consistently serving the Class I needs of the markets receive a needlessly lower blend price.

According to the Dean witness, the objective of Proposal 4 is to modify the receipt of transportation credits depending on a handler's specific service to the Class I need of the markets and to lower the payment of transportation credits to those handlers who have higher levels of diversions. The witness stated that the current reimbursement rate of transportation credits is the same for each handler regardless of the level of its relative service to the fluid market. The witness explained that when a handler delivers 100 percent of its receipts to a pool distributing plant, it receives transportation credits at the same rate as a handler delivering only the minimum volume needed to meet the pooling qualifications. The witness related that the handlers only meeting the minimum pooling standards are then able to divert milk which is not available to the market. Additionally, the witness indicated that adjusting a handler's receipt of transportation credits in this way will maintain and help extend the transportation credit balancing funds.

The Dean witness acknowledged the need for balancing because distributing plants do not typically need to receive milk every day of the week. However, the witness asserted that not limiting diversions undermines the purpose of the Federal order system. The witness explained that their proposed 30 percent diversion limit on supplemental milk seeking transportation credits was reasonable because a distributing plant typically receives milk for five days per week. The need to divert milk for two days per week, the witness explained, justifies the 30 percent diversion limit. The Dean witness explained that based on data provided by the Market Administrator, there are handlers in both orders who receive transportation credits and who divert significantly more pounds of milk than the orders need to balance the Class I demands of pool distributing plants.

A post-hearing brief submitted on behalf of Dean reiterated support for the adoption of Proposal 4 provided that Proposals 1 and 3 are adopted. The brief stated that Proposal 4, when adopted with Proposals 1 and 3, would tend to limit the abuse of transportation credits on supplemental milk for Class I use because Proposal 4 sets a cap on the receipt of transportation credits by handlers. The brief also stressed that the adoption of Proposal 4 would exercise some control over how much milk would be pooled on the orders through the diversion process.

A dairy farmer who supplies milk to Dean testified in support of Proposal 4. The witness agreed with Dean and other opponents that orders should only pool the milk of producers who truly serve the Class I needs of the market; otherwise revenue essentially leaves the two marketing areas. According to the witness, this loss of revenue leads to the area's dairy farmers exiting the industry and further reduces the availability of local milk supplies. The witness said that the result is the need for acquiring more milk produced from far outside the marketing areas. The witness was of the opinion that it is the shipments of supplemental milk into the marketing areas that provide the ability to pool milk by diversion when it is not available to the market.

A witness from SMI testified in support of Proposal 4 provided Proposals 1 and 3 are adopted.

A Kentucky dairy producer testified in support of Proposal 4 and said that

supplemental milk receiving transportation credits should have some limits on the amount of additional milk that can be pooled by diversions. The witness was of the opinion that transportation credits give producers located outside the marketing areas a price advantage because their diverted milk receives the blend price of the orders.

A witness appearing on behalf of LOL testified in opposition to Proposal 4. The witness noted that transportation credits were established to attract supplemental milk and to partially offset the cost of hauling supplemental milk into the deficit markets. The witness explained that the orders' specify conditions that must be met for being eligible to receive transportation credit payments. The current transportation credit provisions, the witness said, already limit payments for supplemental milk from outside the marketing areas to the milk of dairy farmers who are not defined as ''producers'' under the orders. The witness also said that payments are limited to Class I pounds and are not made on the first 85 miles of hauling milk from farms to the plant that receives supplemental milk.

The LOL witness stressed that additional limitations would do nothing to encourage the delivery of needed supplemental milk into the marketing areas during the short production months. The witness was of the opinion that if the intent is to change the diversion limits of the orders, those changes should be addressed in a separate hearing.

A post-hearing brief submitted by LOL reiterated opposition to Proposal 4. The brief reiterated the positions given at the hearing. The brief also stated that Proposal 4 improperly assumes that all handlers supplying supplemental milk have equal access to distributing plants and that distributing plants Class I use of milk is the same as the Class I utilization of the two markets.

A witness appearing on behalf of SMA also testified in opposition to Proposal 4. The SMA witness stated that there is some rational basis for the intent limiting transportation credits to a handler who diverts more milk to nonpool plants above reasonable levels. However, the witness was of the opinion that it is the touch-base and diversion limit standards of the orders that already provide sufficient safeguards to pooling milk not needed for Class I use. According to the witness, adoption of the proposal would disproportionately place burdens on market participants.

The SMA witness explained that it is difficult to establish specific diversion limits on supplemental milk as contained in Proposal 4 because of individual differences in the balancing needs of each distributing plant, noting that these needs continually change. The witness emphasized that there are difficulties in balancing pool distributing plants of the orders year-round and suppliers sometimes have no control over factors that may alter balancing needs. The witness noted that some of SMA's purchase agreements for supplemental milk included arrangements where transportation credit payments are paid directly to the cooperative acting as the supplier. In this regard, the witness expressed concern that providing a separate diversion limit on milk receiving transportation credit payments would unfairly penalize them when a distributing plant overestimates its need for supplemental milk. The witness stated that extreme variations in daily, weekly and monthly deliveries to pool distributing plants occur. Relying on Market Administrator data for January 2004 through October 2005 that showed the ratio of the highest delivery day to the lowest delivery, the witness concluded that a 30 percent reserve factor would not have been sufficient to cover distributing plant balancing needs.

The SMA witness also was of the opinion that Proposal 4 would give an advantage to pool distributing plant operators to the detriment of cooperatives who in their capacity as handlers are supplying supplemental milk. The witness said that while cooperatives handle the majority of supplemental milk for the orders, they may receive little or no transportation credit payments under Proposal 4. According to the witness, a diversion limit could only benefit handlers located nearer to the marketing areas.

A post-hearing brief was submitted on behalf of ADCA in opposition to Proposal 4. The brief stressed that the seasonality of production in the southeastern region is the highest in the country and means that a greater reserve of milk must be assured. The brief concluded that Proposal 4 would create inequities between handlers supplying supplemental milk and encourage uneconomic movements of milk.

A post-hearing brief was submitted on behalf of DMCI in opposition to Proposal 4. The brief asserted that there are too many unanswered questions about how Proposal 4 would be applied. The brief stated that a distributing plant's reserve milk needs are an individual business decision and should only be limited by the order's pooling provisions.

A post-hearing brief submitted by DFA and other SMA members reiterated their opposition to Proposal 4. The brief noted that there are many months when a 30 percent diversion limit is insufficient to cover balancing needs. Therefore, if Proposal 4 were implemented, the brief said, it could disproportionately affect different supplemental supplies and distributing plants in the marketing areas.

A post-hearing brief was submitted on behalf of Lone Star in opposition to Proposal 4. The brief opposed the adoption of Proposal 4 because it would establish a ''one-size-fits-all'' or single diversion limit for all Class I handlers. The brief noted that a distributing plant's reserve milk needs are individual decisions of the plant in response to its customer base and seasonal changes in demand. The brief was of the opinion that the orders already provide diversion limit standards and touch-base requirements that are some of the strictest in the Federal order system.

Findings/Discussion

The issue before the Department in this decision is to consider changes to the transportation credit provisions of the Appalachian and Southeast milk marketing orders. Transportation credit provisions have been a feature of the current orders (and their predecessor orders) since 1996. The need for transportation credit provisions arose from a consistent need to import milk from considerable distances to the marketing areas during certain months of the year when milk local production in the areas was not sufficient to meet Class I demands. Transportation credit provisions provide payments to handlers to cover a portion of the costs of hauling supplemental milk supplies into the Appalachian and Southeast marketing areas during the months of July through December—a time period during which supplemental milk is needed to meet the demand for Class I milk at distributing plants.

The transportation credit provisions are designed to distinguish between producers who are supplying the markets on these orders from producers who are *not* supplying the markets on these orders. The milk of producers who are located outside of the marketing areas and who are not considered ''producers'' of the order are eligible to receive transportation credits.

The record reveals that the Appalachian and especially the Southeast marketing areas are chronically unable to meet Class I

demands. Local milk production relative to demand has declined and is expected to continue declining. Consequently, local milk production is not always able to fulfill the Class I needs of the markets which necessitates the need for supplemental milk from distant locations. As local milk production has eroded, the volume of supplemental milk needed for fluid use and the distance from the marketing areas that supplemental supplies are obtained has been increasing, especially for the Southeast marketing area. These combined factors have caused the transportation credit balancing fund (TCBF) to be insufficient in covering requested transportation credit payments in the past. The TCBF will likely not be able to cover future requested payments unless the amendments contained in the decision also are adopted.

While both marketing areas are able to supply the Class I needs of their respective markets during the spring ''flush'' months without the need for transportation credits, the record clearly indicates that both orders are not able to fully supply their fluid needs with local production during the last 6 months of the year. The chronic shortage of milk for fluid uses during this time period has worsened over time, especially in the Southeast marketing area. Evidence shows that the trend of declining production relative to demand will increase the need for supplemental milk supplies and is likely to continue into the foreseeable future.

Variable Mileage Rate Factor—a Fuel Cost Adjustor

Based on record evidence, this tentative partial decision finds that the MRF used to determine the payment of transportation credits should include a fuel cost adjustor as proposed in DFA's Proposal 3.

The original fixed mileage rate for both orders was 0.37 cents per cwt per mile when the transportation credit provisions were first established in 1996. The computation of the transportation credit payments was based on the total miles supplemental milk was shipped from its point of origination to its destination—the receiving pool distributing plant. In 1997, several amendments were made to the transportation credit provisions of the orders that included a reduction of the mileage rate from 0.37 cents per cwt per mile to the current 0.35 cents per cwt per mile.

Additional amendments made in 1997 to the transportation credit provisions included excluding the first 85 miles supplemental milk was hauled from farms in determining the total miles shipped. Additionally, the amendments eliminated the use of the producer settlement fund of the orders as a source of revenue for the payment of transportation credits on supplemental milk when the TCBF was unable to pay net transportation credit claims. No other amendments have been made to the MRF used in the transportation credit provisions since 1997.

Proposal 3 adjusts the MRF by changes in the cost of diesel fuel. Specifically, a monthly average diesel fuel price, a reference diesel fuel price, an average mile-per-gallon truck fuel use, a reference hauling cost per loaded mile and a reference load size are all component factors needed to determine the variable MRF to be used in the calculation of payments from the TCBF.

The EIA data for the United States and nine U.S. sub-regions are a reliable and reasonable data source to establish certain components needed for determining a variable MRF. The data are representative of diesel fuel prices in the Appalachian and Southeast marketing orders and can be relied upon as a basis to make adjustments to the MRF. Reliance on EIA data that is independent and unbiased will make determination of the MRF objective and uniformly applicable to all handlers.

Proposal 3 suggested the use of the Lower Atlantic and Gulf Coast EIA regions in the computation of monthly mileage rates for the Appalachian and Southeast orders is reasonable. The record reveals that not only do the Lower Atlantic and Gulf Coast regions best reflect the Appalachian and Southeast marketing areas geographically, but also that the diesel fuel prices for these two regions are among the lowest in the country. Hence, it is appropriate to utilize these geographic defined data sets in the mileage rate calculations.

The record reveals that fuel prices and other factors impacting hauling prices have increased greatly since the establishment of transportation credits. Specifically, the record indicates that current diesel fuel prices exceed those prices that prevailed when transportation credit provisions were first implemented in 1996 and amended in 1997. The national average diesel fuel prices in mid-1997 were reported to be approximately $1.15 to $1.17 per gallon, while the national average diesel fuel price in mid-2005 was reported to be $2.20 to $2.50 per gallon. Additionally, while diesel fuel prices have increased, all other costs impacting hauling costs also have increased. According to the record, EIA data indicates that the hauling costs ranged from $1.75 to $1.80 per loaded mile in 1997 to about $2.35 per loaded mile in January 2006. Establishing a reference diesel fuel price for the MRF calculation using the EIA retail diesel fuel prices from the time period of October to November 2003 is reasonable. According to the EIA data, national average diesel fuel costs during this period demonstrated price stability relative to any other time between 1997 and 2005.

From October to November 2003, national diesel fuel prices fluctuated by only 0.1 cents. Specifically, diesel fuel prices averaged $1.48125 per gallon in October 2003 and $1.48225 per gallon in November 2003. Similarly, the record shows that for both the Lower Atlantic and Gulf Coasts, diesel fuel prices ranged from $1.4210 to $1.43075 per gallon between October and November 2003. The stability of diesel fuel prices during October to November 2003 supports this time period as a reasonable point to use in determining a reference diesel fuel price. Therefore, the record supports using $1.42 per gallon as the reference diesel price in the MRF calculation.

Evidence submitted by SMA provides a basis for determining a reference average hauling cost per loaded mile as a component for determining the MRF. The evidence consisted of data randomly selected from actual hauler bills paid to cooperatives during October and November 2003 and for October and November 2005. The record supports utilizing hauling cost data from October and November 2003 as a basis for computing the reference hauling cost in the MRF consistent with the time frame used for the reference diesel price.

The randomly selected hauling bills depict actual origination and destination points of the milk hauled, miles traveled, and the rates and fuel surcharges per loaded mile for each bill. For the month of October 2005, the data indicate that hauling costs ranged from $1.89 to $2.70 per loaded mile, with an average cost of $2.48 per loaded mile. Data also show that the simple average hauling rate charged per loaded mile in the Southeast marketing area was $1.9332 and $1.8913 in October and November 2003, respectively, with a two-month simple average cost of $1.9122 per loaded mile. Therefore, it is reasonable to conclude that a reference hauling rate of $1.91 per loaded mile be used as a component in the MRF calculations.[1]

[1] It should be noted that as a result of the Emergency Hurricane hearing held for the Appalachian, Florida and Southeast marketing

Continued

Another component needed in the calculation of the MRF is the average number of miles traveled per gallon of fuel used in transporting milk. Data regularly maintained by the United States Department of Transportation on combination truck fuel economy indicates the average miles per gallon for a combination truck in 2002 was 5.2 miles per gallon and in 2003 was 5.1 miles per gallon. The record also reveals testimony that the dairy industry typically estimates fuel economy at between 5.0–6.0 miles per gallon. Therefore, because 5.5 miles per gallon is the median point and to promote efficiencies, the record finds that a 5.5-mile per gallon fuel consumption rate is reasonable and should be used to compute the MRF.

The record also supports using 48,000 pounds as a reasonable reference load size for determining the MRF. Data reveal that a 5,600 gallon tanker truck at its fullest capacity can carry 48,160 pounds of milk. Therefore, using 48,000 pounds as the reference load size component is appropriate for calculating the MRF.

Proposal 3 would calculate the MRF by averaging the four most recent weeks of weekly retail on-highway diesel prices for both the Lower Atlantic and Gulf Coast, as reported by the EIA. Record evidence supports announcing the monthly MRF at the same time as Advanced Class Prices on or before the 23rd of the current month. This way, handlers will know in advance the rate at which transportation credits will be paid.

Table 1 shows an example of the calculation of the MRF to be used in the transportation credit provisions:

TABLE 1.—EXAMPLE OF THE CALCULATION OF THE TRANSPORTATION CREDIT MILEAGE RATE FACTOR (MRF) FOR JULY 2006 [1]

EIA weekly retail on-highway diesel fuel prices [2]	Lower Atlantic	Gulf Coast
5/29/2006	2.815	2.798
6/5/2006	2.825	2.805
6/12/2006	2.866	2.848
6/19/2006	2.867	2.859
Monthly average diesel fuel price [3]	$2.835	per gallon
Reference diesel fuel price	− $1.420	per gallon
Fuel price difference [4]	$1.415	per gallon
Reference truck fuel use	÷ 5.5	miles per gallon
Fuel cost adjustment factor [5]	$0.257	per loaded mile
Reference haul cost	+ $1.910	per loaded mile
Fuel-adjustment haul cost [6]	$2.167	per loaded mile
Reference load size	÷ 48,000	pounds
July 2006 Mileage Rate Factor [7]	$0.00451	dollars per cwt per mile

[1] To have been announced on June 23, 2006, with the Announcement of Advanced Class Prices.
[2] Dollars per gallon. Reported every Monday by the Energy Information Administration of the U.S. Department of Energy.
[3] Calculated by rounding down to three decimal places the average of the four most recent weeks of retail on-highway diesel fuel prices for the Lower Atlantic and Gulf Coast EIA regions combined prior to the Advanced Class Price announcement.
[4] Calculated by subtracting the reference diesel fuel price of $1.42 per gallon from the calculated average diesel fuel price for the month.
[5] Calculated by dividing the fuel price difference by 5.5 miles per gallon fuel use and rounding down to three decimal places.
[6] Calculated by adding fuel cost adjustment factor for the month to the reference haul cost of $1.91 per loaded mile.
[7] Calculated by dividing the fuel-adjusted haul cost by the number of hundredweights (cwt's) on the reference load size (48,000 pounds = 480 cwt's) and rounding down to five decimal places.

Concern exists that relying on a variable MRF may result in reimbursing the total, rather than a portion, of the hauling costs on supplemental milk. In this regard, a variable MRF that is consistent and reflective of the original intent of the transportation credit provisions of the Appalachian and Southeast orders is necessary. As already discussed, approximately 94 to 95 percent of the total transportation costs on supplemental milk were covered by the TCBF payments for both orders in 1997. However, the record reveals that for 2005, 53 percent and 42 percent of the total transportation costs for the Appalachian and Southeast orders, respectively, were covered by TCBF payments.

It is not possible to predetermine the percent of the total transportation costs that will be reimbursed by TCBF payments due to a number of unknown variables. However, the transportation credit provisions already contain precautionary measures for how the MRF is calculated. The record indicates that reference diesel fuel prices and reference hauling costs per loaded mile are components of the mileage rate calculation and are based on 2003 data that are much more current than the data considered and adopted in 1997 establishing a fixed mileage rate. It should also be noted that the current and proposed mileage rate are used to reimburse only the pounds of Class I milk shipped, and not total producer milk shipped. This provides an important safeguard against paying excessive transportation credit payments. Finally, current transportation credit provisions do not include the first 85 miles that supplemental milk is shipped from farms in determining the total miles shipped. This feature also plays a part against safeguard to excessive transportation credit payments.

As discussed earlier in this decision, transportation credit provisions of the

orders during the fall of 2004, a reasonable haul rate used to determine how handlers would be compensated for the transportation costs of extraordinary movements of milk was established for a temporary time period. Specifically, a maximum of $2.25 per loaded mile hauling rate was established.

Appalachian and Southeast orders were originally established to partially offset the cost of transporting supplemental milk supplies into each marketing area to meet fluid milk demands. The transportation credit assessment rates have been increased twice in an effort to ensure that the TCBF would be sufficient to meet the expected claims. When first established for the Appalachian, Southeast and predecessor orders (Orders 5, 7, 11 and 46), the maximum transportation credit assessment charged to Class I handlers was $0.06 per cwt for each order. The first increase was adopted in 1997 by raising the maximum assessment by $0.005 per cwt for the Appalachian order and by $0.01 per cwt for the Southeast order. The second increase in the maximum assessment rates for both orders became effective in November 2005. The maximum assessment rates for both orders were increased by 3 cents per cwt from $0.065 to the current rate of $0.095 per cwt for the Appalachian order and from $0.070 to $0.10 per cwt for the Southeast order.

The hearing record reveals that the Appalachian order was able to pay all transportation credit claims for every month since implementation through September 2004. For the remainder of 2004, the Appalachian Market Administrator began prorating the transportation credit payments. As discussed earlier in this decision, the Southeast order has prorated the transportation credit payments since 2001.

Specifically, the record shows that for the Appalachian order 41, 39 and 43 percent of the transportation credit claims were paid in October, November and December of 2004, respectively. Likewise for the Southeast order, only 86, 21, 26, 28 and 47 percent of the claims were paid for the months of August through December of 2004, respectively. 90 percent and 31 percent of the claims were paid from the Appalachian order in September and October of 2005, respectively. Similarly, the record reveals that for the Southeast order, only 41 percent and 23 percent of the claims were paid for the same time periods in 2005. Despite the assessment rate increase that became effective November 2005, evidence indicates that only 58 percent of the transportation credit claims for the Appalachian order were paid and only 40 percent of the claims for the Southeast order were paid during November of 2005. Table 2 below illustrates the percent paid from the TCBF for the Appalachian and Southeast orders:

TABLE 2.—PERCENT OF TRANSPORTATION CREDITS PAID

	Percent of transportation credits paid	
	Appalachian marketing area FO 5	Southeast marketing area FO 7
Jul 04	100.0	100.0
Aug 04	100.0	85.5
Sep 04	100.0	21.4
Oct 04	40.6	26.3
Nov 04	39.0	28.4
Dec 04	42.8	47.0
Jul 05	100.0	100.0
Aug 05	100.0	100.0
Sep 05	89.6	41.3
Oct 05	30.6	23.1
Nov 05 *	58.0	40.3

*Effective November 1, 2005, the transportation credit assessment rates were increased by 3 cents for the Appalachian and Southeast orders.
Source: Appalachian and Southeast Market Administrator data.

Maximum Assessment Rates

The record demonstrates that at the current transportation credit mileage rate of 0.35 cents per cwt per mile, the TCBF assessments for Appalachian and Southeast marketing areas have been insufficient to pay all transportation credit claims, especially during the time when payment of credits are most needed. Preventing the proration of the transportation credit reimbursement payments would have required that the assessment rates be higher than they are currently. Evidence submitted by the SMA witness showed that the maximum transportation credit assessment rate for the Appalachian order would have needed to be $0.0889 and $0.0953 per cwt for 2004 and 2005, respectively. Similarly, evidence by the SMA witness suggested that the assessment rate for the Southeast order would have needed to be $0.1318 and $0.1246 per cwt for 2004 and 2005, respectively. Such evidence further supports the need to increase the transportation credit assessment rates.

The adoption of the variable MRF that would be calculated and adjusted with changes in diesel fuel prices (as presented in Proposal 3) will most likely increase the current mileage rate of 0.35 cents per cwt per mile. Relying on EIA data, the record reveals that applying the calculated mileage rates to the months of July through December 2005 would have resulted in transportation credit mileage rates ranging from 0.432 to 0.461 cents per cwt per mile for both orders. If a transportation credit mileage reimbursement rate of 0.46 cents per cwt per mile had been in place rather than the current rate of 0.35 cents per cwt, the maximum transportation credit assessments needed for the Appalachian order to assure that the TCBF covered all claims would had to have been $0.133 and $0.1415 per cwt for 2004 and 2005, respectively. The Southeast order would have needed a maximum transportation credit assessment rate of $0.1927 and $0.1869 per cwt for 2004 and 2005, respectively. This analysis supports concluding that increasing the current Appalachian order maximum transportation credit assessment rate by 5.5 cents per cwt and the Southeast order maximum assessment rate by 10 cents per cwt is warranted.

The proposed increase in the maximum transportation credit assessment rate for the Southeast order is greater than the amount for the Appalachian marketing area. The record reveals that the Appalachian and Southeast marketing areas experience differing costs in supplying supplemental milk to meet Class I needs. As previously noted,

transportation credit assessments have, in the past, been waived in the Appalachian order. This has not been the case for the Southeast order. The transportation credit reimbursement on claims for the Southeast order have been prorated at greater rates than those of the Appalachian order in 2004 and is reflective of higher costs in supplying supplemental milk to the Southeast marketing area. The Appalachian marketing area receives the majority of its supplemental milk supplies from the northern, Mid-Atlantic States. The Southeast marketing area receives the majority of its supply from the Midwest and southwestern states. The location of supplemental milk supplies for the Southeast marketing area tends to be at a farther distance from the marketing area than for the Appalachian marketing area. Accordingly, the record supports increasing the maximum transportation credit assessments for both marketing areas by different amounts.

Precautionary measures are currently provided in the transportation credit provisions such that the rate of assessments beyond actual handler claims is unlikely. The transportation credit provisions provide the Market Administrators the authority to reduce or waive assessments as necessary to maintain sufficient fund balances to pay the transportation credits requested. Therefore, increasing the maximum transportation credit assessment rates will not result in an accumulation of funds beyond what is needed to pay transportation credit claims and no additional precautionary measures are necessary beyond those currently provided.

The record supports concluding that local milk production is expected to continue declining within both marketing areas and will result in an even greater reliance on supplemental milk to meet the fluid milk needs of the markets. Record evidence shows a constant increase in both the volume and distance that supplemental milk supplies are obtained, especially for the Southeast marketing area. As such, it is reasonable that future transportation credit claims will increase. In this regard, it is important to prevent exhausting the TCBF before the payment of claims on supplemental milk. Doing so is consistent with the fundamental purposes of the transportation credit provisions. Therefore, the adoption of Proposal 1, as proposed by DFA, will tend to better assure that the rate of assessments will keep pace with the payments from the TCBF.

Diversion Limit Standard for Supplemental Milk

The intent of a proposal offered by Dean, published in the hearing notice as Proposal 4, seeks to provide a method to limit the amount of additional milk being pooled by diversion on the Appalachian and Southeast orders. As proposed, Dean's proposal would change the amount of transportation credits paid on eligible supplemental milk depending on the amount of milk delivered to plants other than pool distributing plants—this includes diversions to plants located outside of the marketing areas and deliveries to pool supply plants. Simply put, the greater the volume of diversions, the lower the amount of transportation credits paid. In this regard, Dean's proposal attempts to provide an incentive to limit diversions *indirectly* by reducing transportation credits paid on supplemental milk. This decision agrees with the need to limit pooling diverted milk on the orders that is linked to supplemental milk deliveries to distributing plants. Rather than attempt to create disincentives to pooling diverted milk indirectly, this decision addresses the issue *directly* by adopting a zero diversion limit standard on supplemental milk deliveries to distributing plants that receives transportation credits.

The record reveals that the volume of supplemental milk needed to serve the Class I needs of the marketing areas has grown over time and is expected to continue growing. Supplemental milk is representing a greater percentage of the Southeast market's total Class I utilization. The record reveals that for the months of July through December, supplemental milk accounted for 16 percent of total Class I utilization in 2004. For 2005, such supplemental milk as a percent of total Class I utilization increased to 19 percent.

In addition, the record indicates that, for the Southeast marketing area, the monthly weighted average distance supplemental milk eligible to receive transportation credits traveled ranged from 578 to 627 miles during July through December 2000. During July through November 2005, the weighted average distance increased and ranged from 682 to 755 miles. The amount of supplemental milk receiving transportation credits during 2005 was nearly 686 million pounds, 541 million pounds during 2004, and 363 million pounds during 2000. This represents an 89 percent increase in the amount of supplemental milk receiving transportation credits in 2005 since 2000, and a 27 percent increase since 2004.

For the Southeast order, the record reveals that total diversions at locations outside of the Appalachian and Southeast marketing areas totaled 883.4 million pounds in 2004. Total diversions outside of the marketing areas for 2005, not including the months of November and December, was 965.6 million pounds, an increase of 9.3 percent from 2004. Such data for November and December 2005 was not contained in the record. For the months of January through June, when transportation credits *are not* available, total diversions outside the marketing areas increased almost 18 percent from 2004 to 2005. During the time period of July through October, when transportation credits *are* available, such diversions increased over 27 percent from 2004 to 2005. It is reasonable, given the trend of the data, that the percentage increase from 2004 would have been greater than 27 percent if data had been available for the months of November and December 2005.

It is reasonable to conclude that diversions outside the Appalachian and Southeast marketing areas are most likely be attributed to supplemental milk eligible to receive transportation credits. The record reveals that for the Southeast marketing area, the 27 percent increase in the amount of milk receiving transportation credits from 2004 through 2005 corresponds with the 27 percent increase of diversions outside the marketing areas between 2004 and 2005. It is also reasonable to conclude from the record that it is in the interests of the handler supplying supplemental milk, and in this case, cooperatives in their capacity as handlers, to maximize the value of diversions. Doing so would require pooling the maximum amount of diverted milk to the closest location from where supplemental milk was sourced. Therefore, relying on data provided by the Market Administrator for the Southeast marketing area, for the months when transportation credits are available, the calculated total maximum diverted pounds associated with supplemental milk would have totaled over 178 million pounds in 2004 and over 226 million pounds in 2005. On the basis of these calculations, an estimate of diversions attributed to supplemental milk is 64 percent of total diversions for both 2004 and 2005, ranging from 56 percent to 77 percent of the total known diversions outside the marketing areas.

The contribution from diversions associated with supplemental milk to total outside diversions is nearly three

times greater than the contribution of the supplemental milk to Class I utilization. As previously discussed, for 2004 and 2005, supplemental milk represented about 15.9 and 19 percent, respectively, of total Class I utilization. However, estimated diversions attributable to supplemental milk represent approximately 64 percent of total diversions. Clearly, not only do transportation credits offset the costs of hauling supplemental milk to the markets, they also contribute to pooling much more milk on the orders through the diversion process.

For the Appalachian order, data contained in the record is much more limited on determining the diversions arising from supplemental milk that is eligible to receive transportation credits. What can be reasonably concluded is that the pooling of diverted milk that is linked to supplemental milk is not nearly the magnitude of such pooled diversions as on the Southeast order. For the Appalachian order, evidence indicates that total diversions at locations outside of the Appalachian and Southeast marketing areas, for the time period of January through June, increased by 64.4 percent from 2004 to 2005. Total diversions from the time period of July through November, when transportation credits are available, decreased over 20 percent from 2004 to 2005.

For the Appalachian order, only two month data—October and November 2005—is available to estimate the maximum diversions that could be associated with to supplemental milk. Relying on Appalachian Market Administrator data, it is estimated that the maximum diversions from milk eligible to receive transportation credits during October and November 2005 to be approximately 34 percent and 28 percent, respectively, of the total diversions at locations outside the Appalachian and Southeast marketing areas. Supplemental milk on the Appalachian order for October and November 2005 is estimated to be approximately 19 percent and 16 percent, respectively, of the total Class I milk pooled.

Pooling diversions of this milk differs from pooling diverted milk that is part of regular supply of milk of the marketing area. Pooling diverted milk, made possible by supplemental milk eligible to receive transportation credits, allows more milk to be pooled on the order than normal. Pooling of this milk is different than pooling milk that is part of the regular supply for the marketing area. The difference is that producers of milk eligible to receive transportation credits *are not* a part of the regular and consistent supply of milk that serves the Class I needs of the markets. These producers are, therefore, supplemental suppliers of milk to the Appalachian and Southeast marketing areas. Transportation credit qualifying criteria *excludes* the milk of producers who are regularly pooled on the orders.

Pooling diverted milk arising from supplemental milk receiving transportation credits not only offsets the intended benefit of increasing the supply of milk for fluid uses, it also lowers blend prices. Higher blend prices provide important economic signals: The incentive (1) to continue supplying the markets, (2) to increase local production and (3) to attract the milk of producers to become regular and consistent suppliers.

The lower blend prices received by producers who regularly supply the markets relative to producers who supply supplemental milk send contradictory pricing signals. Lower blend prices do not send the proper price signals to local producers to increase local production or to continue supplying the Class I needs of the markets, and the signal to attract a regular and consistent milk supply from other producers is negated.

The availability of transportation credits on supplemental milk provides a platform to pool additional diverted milk at locations distant to the marketing areas. Milk diverted from supplemental producers is more likely to be diverted at locations far from the marketing areas. The record reveals that suppliers of the supplemental milk to the Appalachian and Southeast marketing areas pool diverted milk at locations as far away as California and Utah. Supplemental milk suppliers benefit in three ways: (1) Receiving reimbursement for costs of transporting milk to the deficit markets, (2) receiving cost savings from the diverted milk not transported to the marketing areas and (3) receiving higher blend prices on the diverted milk that would have otherwise been pooled on a different order with a typically lower blend price.

The pooling of milk that is not part of the regular and consistent supply of milk which serves the Class I needs of the market is contradictory to the intent of an order's pooling standards and provisions. The pooling standards of the orders serve to identify the milk of producers who regularly and consistently serve the Class I needs of the marketing areas. Pooling milk that is available but not immediately needed for Class I use is provided through diversion limit standards. Diversion limit standards provide the criteria in determining how much additional milk can be pooled on the orders. Diverted milk in this context reflects the legitimate reserve supply of milk available to serve the Class I needs of the marketing areas and, therefore, receives the blend of the orders.

Since implementation of Federal milk order reform, there have been many formal rulemakings that amended orders to more properly identify the milk of producers which should and should not be pooled on the orders. The milk of producers who are the consistent and reliable suppliers in serving the Class I needs of the market should have their milk pooled. This foundation principle of orderly marketing in milk marketing orders is essentially disregarded for 6 months every year because the orders allow the pooling of diverted milk from producers who are specifically identified as not being ''producers'' under either of the orders.

The lowering of blend prices by pooling such diverted milk is an unintended outcome not foreseen when the transportation credit provisions of the Appalachian and Southeast orders were implemented and amended. As the blend prices are reduced so is the incentive for local milk production. The markets become less capable of supplying their own Class I needs and supplemental milk supplies needed to meet Class I needs are not likely to be supplied without reliance on additional transportation credits.

The pooling of diverted milk associated to supplemental milk would seem to offer substantial benefits to cooperative suppliers. The record reveals that when transportation credits were first implemented, well over 90 percent of hauling costs were offset while today about 45 percent is reimbursed. This clearly represents a burden that is borne by the cooperatives who are supplying supplemental milk.

Pooling diverted milk at locations far from the marketing areas based on supplemental milk eligible to receive transportation credits would provide additional revenue to help offset hauling costs not covered by the current assessment rate. This diverted milk receives the blend price of the order on which it is pooled. The benefit is that the blend price received on such diverted milk on either the Appalachian or Southeast order, as the case may be, is historically higher than the price the milk would otherwise receive.

As presented above, this decision adopts a variable mileage rate factor, which will reimburse hauling costs at a level more reflective of actual costs, in addition to a significantly higher transportation credit assessment. To the extent that it is necessary to offset the

higher costs of transporting supplemental milk, the adoption of a variable MRF and the increase in the assessment rates should significantly reduce or eliminate the need to seek generating revenue to offset hauling costs at the expense of producers of the two marketing areas who are regularly and consistently supplying milk for the Class I needs.

Accordingly, this decision finds that the pooling of diverted milk arising from supplemental milk supplies receiving transportation credits needlessly results in the unwarranted lowering of the blend price to producers whose milk regularly and consistently supplies the Class I needs of the Appalachian and Southeast marketing area. Such milk is not part of the reliable and consistent supply of milk serving the Class I needs of the two markets and is not available for such service. Pooling this milk on the orders is indicative of disorderly marketing. Consequently, such milk should not be pooled on the orders. Accomplishing this intent necessitates adoption of a zero diversion limit standard on supplemental milk supplies receiving transportation credits.

2. Determination of Emergency Marketing Conditions

Evidence presented at the hearing and in post-hearing briefs establishes that current transportation credits of the Appalachian and Southeast orders are inadequate to meet current and expected future needs into the foreseeable future. Adopting a variable MRF by which to reimburse the suppliers of supplemental milk is needed due to the escalating fuel costs, coupled with the declining milk production in the southeastern United States that makes supplemental milk needs necessary to meet the fluid needs of the markets. The increases in the maximum rates of assessment for the Appalachian and Southeast orders adopted in this decision are necessary to sufficiently cover the transportation credit balancing fund payments. Conversely, the blend price received by producers who are regularly and consistently serving the Class I needs of the Appalachian and Southeast marketing areas is being unnecessarily eroded by pooling diverted milk that is associated with supplemental milk supplies eligible to receive transportation credits.

Additionally, the need for immediate action per dairy producer approval is warranted because the current transportation credit provisions will be inadequate to meet the fluid needs of the marketing areas and the need of supplies to recover a higher percentage of costs associated with providing supplemental milk during the months of July through December of 2006. Consequently, it is determined that emergency marketing conditions exist to omit the issuance of a recommended decision. The record clearly establishes a basis as noted above for amending the orders on an interim basis. The opportunity to file written exceptions to the proposed amended orders remains.

In view of these findings, an interim final rule amending the order will be issued as soon as the procedures are completed to determine the approval of producers.

Rulings on Proposed Findings and Conclusions

Briefs, 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 claims 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 was 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.

The following findings are hereby made with respect to the aforesaid marketing agreement and order:

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

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

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

Interim Marketing Agreement and Interim Order Amending the Order

Annexed hereto and made a part hereof are two documents—an Interim Marketing Agreement regulating the handling of milk and an Interim Order amending the order regulating the handling of milk in the Appalachian and Southeast marketing areas, which have been decided upon as the detailed and appropriate means of effectuating the foregoing conclusions.

It is hereby ordered, that this entire tentative partial decision and the interim orders and the interim marketing agreements annexed hereto be published in the **Federal Register**.

Determination of Producer Approval and Representative Period

The month of June 2006 is hereby determined to be the representative period for the purpose of ascertaining whether the issuance of the order, as amended and as hereby proposed to be amended, regulating the handling of milk in the Appalachian and Southeast marketing areas is approved or favored by producers, as defined under the terms of the order as hereby proposed to be amended, who during such representative period were engaged in the production of milk for sale within the aforesaid marketing area.

List of Subjects in 7 CFR Parts 1005 and 1007

Milk marketing order.

Dated: September 1, 2006.

Lloyd C. Day,

Administrator, Agricultural Marketing Service.

Interim Order Amending the Order Regulating the Handling of Milk in the Appalachian and Southeast Marketing Areas

This interim order shall not become effective until the requirements of § 900.14 of the rules of practice and procedure governing proceedings to formulate marketing agreements and marketing orders have been met.

Findings and Determinations

The findings and determinations hereinafter set forth supplement those that were made when the order was first issued and when it was amended. The previous findings and determinations are hereby ratified and confirmed,

except where they may conflict with those set forth herein.

(a) *Findings.* A public hearing was held upon certain proposed amendments to the tentative marketing agreement and to the order regulating the handling of milk in the Appalachian and Southeast marketing areas. The hearing was held pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601–674), and the applicable rules of practice and procedure (7 CFR Part 900).

Upon the basis of the evidence introduced at such hearing and the record thereof, it is found that:

(1) The said order as hereby amended, and all of the terms and conditions thereof, will tend to effectuate the declared policy of the Act;

(2) 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 aforesaid marketing area. The minimum prices specified in the order as hereby 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

(3) The said order as hereby amended regulates the handling of milk in the same manner as, and is applicable only to persons in the respective classes of industrial or commercial activity specified in, a marketing agreement upon which a hearing has been held.

Order Relative to Handling

It is therefore ordered, that on and after the effective date hereof, the handling of milk in the Appalachian and Southeast marketing areas shall be in conformity to and in compliance with the terms and conditions of the order, as amended, and as hereby amended, as follows:

The authority citation for 7 CFR parts 1005 and 1007 continues to read as follows:

Authority: 7 U.S.C. 601–674, and 7253.

PART 1005—MILK IN THE APPALACHIAN MARKETING AREA

1. Section 1005.13 is amended by revising paragraphs (d)(3) and (d)(4) to read as follows:

§ 1005.13 Producer milk.

* * * * *

(d) * * *

(3) The total quantity of milk diverted during the month by a cooperative association shall not exceed 25 percent during the months of July through November, January, and February, and 40 percent during the months of December and March through June, of the producer milk that the cooperative association caused to be delivered to, and physically received at, pool plants during the month, excluding the total pounds of bulk milk received directly from producers meeting the conditions as described in § 1005.82(c)(2)(ii) and (iii), and for which a transportation credit is requested;

(4) The operator of a pool plant that is not a cooperative association may divert any milk that is not under the control of a cooperative association that diverts milk during the month pursuant to paragraph (d) of this section. The total quantity of milk so diverted during the month shall not exceed 25 percent during the months of July through November, January, and February, and 40 percent during the months of December and March through June, of the producer milk physically received at such plant(or such unit of plants in the case of plants that pool as a unit pursuant to § 1005.7(d)) during the month, excluding the quantity of producer milk received from a handler described in § 1000.9(c) and excluding the total pounds of bulk milk received directly from producers meeting the conditions as described in § 1005.82(c)(2)(ii) and (iii), and for which a transportation credit is requested;

* * * * *

2. Section 1005.81 is revised to read as follows:

§ 1005.81 Payments to the transportation credit balancing fund.

(a) On or before the 12th day after the end of the month (except as provided in § 1000.90), each handler operating a pool plant and each handler specified in § 1000.9(c) shall pay to the market administrator a transportation credit balancing fund assessment determined by multiplying the pounds of Class I producer milk assigned pursuant to § 1005.44 by $0.15 per hundredweight or such lesser amount as the market administrator deems necessary to maintain a balance in the fund equal to the total transportation credits disbursed during the prior June January period, after adjusting the transportation credits disbursed during the prior Juney–January period to reflect any changes in the current mileage rate versus the mileage rate(s) in effect during the prior June January period. In the event that during any month of the June–January period the fund balance is insufficient to cover the amount of credits that are due, the assessment should be based upon the amount of credits that would had been disbursed had the fund balance been sufficient.

(b) The market administrator shall announce publicly on or before the 23rd day of the month (except as provided in § 1000.90) the assessment pursuant to paragraph (a) of this section for the following month.

3. Section 1005.82 is amended by revising paragraphs (d)(2)(ii) and (d)(3)(iv) to read as follows:

§ 1005.82 Payments from the transportation credit balancing fund.

* * * * *

(d) * * *

(2) * * *

(ii) Multiply the number of miles so determined by the mileage rate for the month computed pursuant to § 1005.83(a)(6);

* * * * *

(3) * * *

(iv) Multiply the remaining miles so computed by the mileage rate for the month computed pursuant to § 1005.83(a)(6);

* * * * *

4. Add a new § 1005.83 to read as follows:

§ 1005.83 Mileage rate for the transportation credit balancing fund.

(a) The market administrator shall compute a mileage rate each month as follows:

(1) Compute the simple average rounded down to three decimal places for the most recent 4 four weeks of the Diesel Price per Gallon as reported by the Energy Information Administration of the United States Department of Energy for the Lower Atlantic and Gulf Coast Districts combined.

(2) From the result in paragraph (a)(1) in this section subtract $1.42 per gallon;

(3) Divide the result in paragraph (a)(2) of this section by 5.5, and round down to three decimal places to compute the fuel cost adjustment factor;

(4) Add the result in paragraph (a)(3) of this section to $1.91;

(5) Divide the result in paragraph (a)(4) of this section by 480;

(6) Round the result in paragraph (a)(5) of this section down to five decimal places to compute the mileage rate.

(b) The market administrator shall announce publicly on or before the 23rd day of the month (except as provided in § 1000.90) the mileage rate pursuant to paragraph (a) of this section for the following month.

PART 1007—MILK IN THE SOUTHEAST MARKETING AREA

5. Section 1007.13 is amended by revising paragraphs (d)(3) and (d)(4) to read as follows:

§ 1007.13 Producer milk.

* * * * *

(d) * * *

(3) The total quantity of milk diverted during the month by a cooperative association shall not exceed 33 percent during the months of July through December, and 50 percent during the months of January through June, of the producer milk that the cooperative association caused to be delivered to, and physically received at, pool plants during the month; excluding the total pounds of bulk milk received directly from producers meeting the conditions as described in § 1007.82(c)(2)(ii) and (iii), and for which a transportation credit is requested;

(4) The operator of a pool plant that is not a cooperative association may divert any milk that is not under the control of a cooperative association that diverts milk during the month pursuant to paragraph (d) of this section. The total quantity of milk so diverted during the month shall not exceed 33 percent during the months of July through December, or 50 percent during the months of January through June, of the producer milk physically received at such plant (or such unit of plants in the case of plants that pool as a unit pursuant to § 1007.7(e)) during the month, excluding the quantity of producer milk received from a handler described in § 1000.9(c) and excluding the total pounds of bulk milk received directly from producers meeting the conditions as described in § 1007.82(c)(2)(ii) and (iii), and for which a transportation credit is requested;

* * * * *

6. Section 1007.81 is revised to read as follows:

§ 1007.81 Payments to the transportation credit balancing fund.

(a) On or before the 12th day after the end of the month (except as provided in § 1000.90), each handler operating a pool plant and each handler specified in § 1000.9(c) shall pay to the market administrator a transportation credit balancing fund assessment determined by multiplying the pounds of Class I producer milk assigned pursuant to § 1007.44 by $0.20 per hundredweight or such lesser amount as the market administrator deems necessary to maintain a balance in the fund equal to the total transportation credits disbursed during the prior June-January period, after adjusting the transportation credits disbursed during the prior June-January period to reflect any changes in the current mileage rate versus the mileage rate(s) in effect during the prior June-January period. In the event that during any month of the June-January period the fund balance is insufficient to cover the amount of credits that are due, the assessment should be based upon the amount of credits that would had been disbursed had the fund balance been sufficient.

(b) The market administrator shall announce publicly on or before the 23rd day of the month (except as provided in § 1000.90) the assessment pursuant to paragraph (a) of this section for the following month.

7. Section 1007.82 is amended by revising paragraphs (d)(2)(ii) and (d)(3)(iv) to read as follows:

§ 1007.82 Payments from the transportation credit balancing fund.

* * * * *

(d) * * *

(2) * * *

(ii) Multiply the number of miles so determined by the mileage rate for the month computed pursuant to § 1007.83(a)(6);

* * * * *

(3) * * *

(iv) Multiply the remaining miles so computed by the mileage rate for the month computed pursuant to § 1007.83(a)(6);

* * * * *

8. Add a new § 1007.83 to read as follows:

§ 1007.83 Mileage rate for the transportation credit balancing fund.

(a) The market administrator shall compute mileage rate each month as follows:

(1) Compute the simple average rounded down to three decimal places for the most recent 4 weeks of the Diesel Price per Gallon as reported by the Energy Information Administration of the United States Department of Energy for the Lower Atlantic and Gulf Coast Districts combined.

(2) From the result in paragraph (a)(1) in this section subtract $1.42 per gallon;

(3) Divide the result in paragraph (a)(2) of this section by 5.5, and round down to three decimal places to compute the fuel cost adjustment factor;

(4) Add the result in paragraph (a)(3) of this section to $1.91;

(5) Divide the result in paragraph (a)(4) of this section by 480;

(6) Round the result in paragraph (a)(5) of this section down to five decimal places to compute the MRF.

(b) The market administrator shall announce publicly on or before the 23rd day of the month (except as provided in § 1000.90) the mileage rate pursuant to paragraph (a) of this section for the following month.

Marketing Agreement Regulating the Handling of Milk in the Appalachian and Southeast Marketing Areas

The parties hereto, in order to effectuate the declared policy of the Act, and in accordance with the rules of practice and procedure effective thereunder (7 CFR part 900), desire to enter into this marketing agreement and do hereby agree that the provisions referred to in paragraph I hereof, as augmented by the provisions specified in paragraph II hereof, shall be and are the provisions of this marketing agreement as if set out in full herein.

I. The findings and determinations, order relative to handling, and the provisions of §§ 1005.1 to 1005.86 and 1007.1 to 1007.86 all inclusive, of the order regulating the handling of milk in the Upper Midwest marketing area (7 CFR Part 1030) which is annexed hereto; and

II. The following provisions: Record of milk handled and authorization to correct typographical errors.

(a) Record of milk handled. The undersigned certifies that he/she handled during the month of ________ 2006, ________ hundredweight of milk covered by this marketing agreement.

(b) Authorization to correct typographical errors. The undersigned hereby authorizes the Deputy Administrator, or Acting Deputy Administrator, Dairy Programs, Agricultural Marketing Service, to correct any typographical errors which may have been made in this marketing agreement.

Effective date. This marketing agreement shall become effective upon the execution of a counterpart hereof by the Department in accordance with § 900.14(a) of the aforesaid rules of practice and procedure.

In Witness Whereof, The contracting handlers, acting under the provisions of the Act, for the purposes and subject to the limitations herein contained and not otherwise, have hereunto set their respective hands and seals.

Signature

By (Name) ________________

(Title) ________________

(Address) ________________

(Seal)

Attest ________________

[FR Doc. 06–7497 Filed 9–6–06; 8:45 am]

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