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Before the United States Department of Agriculture

In the Matter of:	)	
	)	
Milk in the Appalachian	)	Docket No: AO-388-A22 et al
Florida and Southeast	)	DA-07-03
Marketing Areas	)	

Brief in Support of:

- Proposed Temporary Increase to the Class I Pricing Surface for the Three Marketing Areas
- Reduction of Diversion Percentage Limits (and Changes to Producer Delivery Day Requirements) For the Appalachian and Southeast orders, as Determined by the Secretary
- Changes to the Transportation Credit Provisions of the Appalachian and Southeast Orders, as Determined by the Secretary

On Behalf of
North Carolina Dairy Producers Association
Georgia Milk Producers, Inc.
Kentucky Dairy Development Council
Upper South Milk Producers Association

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Legal Argument

I. Procedural Posture, Standing of the Parties and Summary of Argument

Notice and Substance of the Hearing[1]

This hearing was noticed primarily to consider a four-part proposal submitted by Dairy Cooperative Marketing Association, Inc. (DCMA). DCMA's proposal would: 1) Increase minimum Class I prices in Federal Orders 5, 6 and 7, by amounts ranging from $0.10 per hundredweight to $1.00 per hundredweight in Order 5 (Appalachian) $1.30 per hundredweight to $1.70 for Order 6 (Florida) and $0.10 to $1.15 for Order 7 (Southeast); 2) Reduce diversion limits, and make them uniform, for Orders 5 and 7, with resulting percentage limits of 25 percent for January, February and July-November and 35 percent for March – June and December[2],[3]; 3) Lower the number of required producer delivery days, or "touch base" provisions, defining eligibility for milk diversion, to one day per month for Orders 5 and 7[4]; and 4) Change the transportation credit provisions for

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[1] "A public hearing is being held to consider proposals seeking to amend certain pooling and related provisions of the Appalachian, Florida and Southeast orders. Proposals include temporarily adjusting the Class I pricing surface for each county within each of the three milk marketing orders until such time that the Department is able to comprehensively address the Class I pricing surface on a national scale. Proposals also include changing the diversion percentage limits, the producer delivery days and the transportation credit provisions of the Appalachian and Southeast orders. Other proposals would change the maximum rates for each of the three orders the market administrator may charge for the expense of administration of the order from 5 cents per hundredweight (cwt) up to 8 cents per cwt. Testimony will be taken to determine if any of the proposals should be handled on an emergency basis." Exhibit 2, page 1.

[2] Federal Order 5 diversion limits would be changed as follows: (See Exhibit 2, page 2)

	January	February	March	April	May	June	July	August	September	October	November	December
Current	25	25	40	40	40	40	25	25	25	25	25	40
DCMA	25	25	35	35	35	35	25	25	25	25	25	35

Federal Order 7 diversion limits would be changed as follows:

	January	February	March	April	May	June	July	August	September	October	November	December
Current	50	50	50	50	50	50	33	33	33	33	33	33
DCMA	25	25	35	35	35	35	25	25	25	25	25	35

[3] In its proposal, DCMA indicated its specific diversion and touch base proposal represented a "reasonable compromise" with regard to the "difference of opinion as to the appropriate level of allowable diversion limits," and further, that "airing this issue at a hearing is the proper venue for receiving evidence on the appropriate level of allowable diversions under the two Orders." DCMA also expressed its support for "the continuation of market administrator discretion in changing diversion limit percentages and producer marketing areas association requirement, in case of changed marketing circumstances within the marketing areas or their milk-sheds." See Transcript Pages 332-33.

[4] Exhibit 2, page 2.

Orders 5 and 7 by a) extending their availability to January and February, in addition to July – December as current, b) providing for payment on the full load of milk rather than only the calculated Class I portion, c) simplifying the determination of which producers are supplemental and therefore have milk eligible for transportation credits, and d) raising the maximum Class I assessment for transportation credits in Order 7 from $0.20 to $0.30.[5]

In addition, the hearing was called to consider proposals by the three market administrators for Orders 5, 6, and 7 to increase the maximum administrative charge that may be imposed in each Order from $0.05 per hundredweight (cwt) to $0.08 per cwt. Exhibit 2 at page 2.

The hearing was noticed as an emergency hearing in accordance with 7 C.F.R. § 900.4(a), and testimony was taken "to determine if any of the proposals should be handled on an emergency basis."
Id.

Parties' Interests and Standing

This brief is filed collectively by four producer organizations that together comprise the Southeast Producers Steering Committee (SPSC). These four organizations, which have each entered notices of appearance as parties to the proceeding, are the North Carolina Dairy Producers Association, Georgia Milk Producers, Inc., the Kentucky Dairy Development Council and the Upper South Milk Producers Association.

The North Carolina Dairy Producers Association is a membership funded association of producers and associate members that pay annual dues. The association's mission is to ensure the future presence of profitable and viable dairy farms in North Carolina through education programs, communication with and formal representation before county, state and federal agencies. The association is an "interested" party within the meaning of 7 C.F.R. § 900.9(b).

The Georgia Milk Producers, Inc. is a producer-funded organization representing all Georgia dairy farm families that operates programs of communication,

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[5] Summary above drawn from Direct Testimony of Jeffrey Simms, Transcript pages 73-189; Exhibit 2 at page 2.

promotion and education for administrative, legislative and judicial matters relating to all issues, such as environmental regulations, animal health and milk pricing and Federal Orders function, affecting Georgia's dairy industry. Georgia Milk Producers, Inc. is an "interested" party within the meaning of 7 C.F.R. § 900.9(b).

The Kentucky Dairy Development Council is a trade organization representing over 400 Kentucky dairy farm families and numerous allied industry participants. The Council advocates for its members' interests in legislative, judicial and administrative proceedings. The Council's is an "interested" party within the meaning of 7 C.F.R. § 900.9(b).

Upper South Milk Producers Association (U.S. Milk) is an organization representing dairy farmers located throughout the southeast. U.S. Milk has a membership of over 100 dairies located in the southeast with production of just over 38,000,000 pounds per month. Mailings are made regularly to a mailing list of over 3,700 individuals. U.S. Milk has conducted training seminars on understanding Federal Orders. From these educational meetings, a Steering Committee was formed with representatives from Virginia, North Carolina, South Carolina, Georgia, and Kentucky and the decision made to participate in federal order hearings. U.S. Milk's dairy farmer members market milk in Orders 5, 6 and 7 and it is an "interested" party within the meaning of 7 C.F.R. § 900.9(b).

For purposes of this brief, these four party organizations will be referred to as the SPSC.

II. Proposed Findings of Fact and Conclusions

7 CFR §900.9(b) provides for the filing of "proposed findings and conclusions, and written arguments or briefs, based upon the evidence received at the hearing..." Consistent with 7 CFR §900.9(b), SPSC submits the following findings and conclusions, with argument on brief to follow in the next section.

1. Since 1990, the southeast region, encompassing federal orders 5, 6, and 7 has experienced a greater population increase than any other region of the country

except the Mountain states. In most cases, the population increase has been more than double that of the other regions.

2. At the same time, rather than expand to meet the corresponding, burgeoning demand for fluid milk products, milk production in the region has declined precipitously. In the Appalachian part of the region, milk production has declined by 35 percent, from just over 8 billion pounds to just over 5 billion pounds. In the actual southeast, milk production has declined by 16 percent, from 4.8 billion pounds to 4 billion pounds. In the Delta, milk production has declined a stunning 60 percent, from 2.5 billion pounds to 1 billion pounds.[6]
3. All three of the southeast federal orders are now milk deficit even in the flush period.
4. Confronting this increased demand and reduced supply within their marketing areas, Pool Distributing Plants in each of the Orders are dependent on ever-increasing supplies from producers located in the reserve areas for these Orders.
5. The current Class I pricing surface for the three Orders, and resulting producer blend prices, does not provide sufficient incentive to ensure stable current production within the primary supply areas for the marketing areas of the three Orders, much less encourage new production to meet the ever-increasing demand. Nor does it establish a sufficient incentive to move milk into the region from the reserve supply areas.[7]
6. The proposed increases to Class I differentials for federal Orders 5,6 and 7, for 2006, could have been expected to increase pooled Class I annual revenue by \$18.3 million,[8] \$39.2[9] million and \$17.7[10] million, respectively.
7. For 2006, these increases in pool revenues could have been expected to increase the base zone uniform prices by \$0.26, (Charlotte,N.C.); \$1.20 (Orlando,FL.);and \$0.64, (Atlanta,GA), respectively.[11]

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[6] Information presented by Norman Jordan, Transcript at pages 288-89; Exhibit 25, Figure 2.
[7] Testimony of Jeffrey Simms; Transcript, pages 76-89.
[8] Exhibit 9 at page 10.
[9] Exhibit 17 at page 1.
[10] Testimony of Jeffrey Simms, Transcript at page 96
[11] Id.

8. For Orders 5 and 7, these increases in uniform prices can be expected to result in a corresponding increase in producer pay prices. These increased pay prices may be expected to ameliorate but not reverse the trend of reduced production. Production within the marketing areas of the two Orders is expected to increase by up to 3 percent and 1.2 percent, respectively.[12] Again this represents a decline in production, albeit at a slower rate.
9. This level of increased production will not be sufficient to reverse the overall trend of production within the region being insufficient to keep up with increased demand in the marketing areas.
10. Increasing the Class I surface for some Market Orders without reconfiguration of the entire Class I pricing surface for all Market Orders may cause some instances of localized market dislocations on the border of the Orders where the pricing surface has been adjusted.
11. Minimization of these potential market dislocations requires dampening the amount that the Class I pricing surface might otherwise be raised so as to ensure proper performance of its intended purposes of encouraging additional production within the region and the importation of additional reserve supply.
12. Minimization of the potential market dislocations requires further, particular smoothing of the pricing surface in the border region, resulting in the additional market dislocation of relative reduction in the return to producers located within and near the border of the marketing area as compared with pool producers located deeper within the marketing area.
13. This reduction is particularly pronounced in the areas in closest proximity to the borders, where the Class I price would be only a $0.10 per hundredweight increase.[13]
14. The combination of increased demand and declining production in the marketing areas of Federal Orders 5 and 7 has lead to substantial increases in the sourcing of milk from the reserve supply areas of these Orders.

[12] Testimony of Tom Thompson, Exhibit 27 at page 6.
[13] Testiomony of Jeffrey Simms, Transcript at pages 95-96

15. Because of their enhanced, critical importance in the southeast region, diversion limits must be finely crafted to properly account for the pool's supply and reserve requirements so as to ensure adequacy and stability of supply. Diversion limits must also properly provide for the additional balancing functions of accounting for weekly, monthly and seasonal variations in supply requirements, and for the pronounced seasonality of milk production in the southeast.[14]
16. Properly devised, diversion limits ensure that pooled producer milk is not diluted by the unnecessary importation and pooling of supplemental milk from the reserve areas, and thereby should prevent irrational reduction of pooled producer blend prices.
17. Producer delivery day requirements, or "touch base" provisions, by definition, act as a limitation on the pooling of surplus supplies of milk.
18. With pressure to pool milk from increasingly remote regions of the reserve supply areas to ensure the availability of such milk in particular times of shortest supply, the current combination of producer delivery date requirements and diversion limits in Orders 5 and 7 may be creating the incentive to divert milk from near-in producers to accommodate the pooling of the more remote milk, causing inefficiencies in hauling costs for supplying the market and increasing the total volume of milk considered to be part of the pool.
19. DCMA's proposed reduction in producer delivery date requirements may be expected to eliminate this inefficiency in hauling costs, while its combination of this reduction with the reduction in diversion limits may be further expected to ensure that the pool volume is not increased irrationally in response to the reduction in producer delivery day requirements.
20. Testimony regarding the larger, essential issue of required supply and reserve for Orders 5 and 7 is uncertain, at best. There is consensus only that the production within the two marketing areas is diminishing at the same time that demand is increasing, as noted, requiring that substantial volumes of the current pools of milk be imported from the reserve areas outside the marketing areas. There is little consensus as to whether the resulting, total, current pool volumes, from all

[14] Id. At 113-14.

sources, may be more than sufficient to meet the demands of Class I pool distributing plants in the two marketing areas and if so, to what degree.

21. Despite this lack of consensus in the record with regard to the required pool volumes and reserves, there is consensus that diversion limits may be tightened at least in some measure so as to reduce pool volumes in both Orders 5 and 7.
22. According to analysis by the two Market Administrators' offices, the DCMA proposed reduction in producer delivery day requirements and diversion limits are expected to provide for only a marginal annual reduction in the volume of producer milk for Orders 5 and 7.
23. According to the analysis by the Market Administrator Order 5 office, the reduction in the amounts of diverted milk for 2004 could have been expected to be 70 million pounds in 2004 and 55 million pounds in 2005.[15]
24. According to the analysis by the Market Administrator Order 7 office, the reduction in the amounts of diverted milk for 2004 could have been expected to be 160 million pounds in 2004 and 200 million pounds in 2005 and 525 million pounds in 2006.[16]
25. Most of the amounts removed in Federal Order 7 are attributable to substantial changes for the months of January and February.[17]
26. By contrast, the proposal by Dean Foods for substantially tighter diversion limits would sharply reduce the volumes of pooled milk in the two Orders.
27. For the years 2004 – 2006, the Dean Foods proposal would be expected to reduce the volume of pooled milk in Federal Order 5 by 351 million pounds, 633 million pounds, and 525 million pounds, respectively.[18]
28. For Federal Order 7, for the years 2004-2006, the Dean Foods proposal would be expected to reduce the volume of pooled milk by 660 million pounds, 870 million pounds and 1.2 billion pounds, in 2004 – 2006, respectively.[19]
29. The relative impact of different diversion limits on producer pay prices is substantial.

[15] Exhibit 9 at page 13.
[16] Exhibit 18 at page 1.
[17] Id.
[18] Exhibit 10 at page 1.
[19] Exhibit 19 at page 1.

30. The expected reduction in the volumes of pool milk resulting from the DCMA proposal is further expected to increase producer blend prices only marginally, by \$0.02 and \$0.07 in Orders 5[20] and 7[21], respectively.
31. The Dean Foods proposal could have been expected to increase the blend price in Federal Order 5 by \$0.21 per hundredweight in 2004, \$0.31 per hundredweight in 2005 and \$0.24/cwt in 2006.[22]
32. For Federal Order 7, the Dean Foods proposal would have increased blend prices by \$0.23/cwt in 2004, \$0.27/cwt in 2005 and \$0.29/cwt in 2006.[23]

III. Legal Argument

Summary

SPSC Supports the DCMA Proposal to Increase Class I Differentials Across Federal Orders 5, 6 and 7, as Specified, to Enhance the Income of Southeast Dairy Producers and to Help Ensure That They May Continue to Provide the Primary Supply for the Southeast Market.

SPSC Further Supports in Principle the Additional DCMA Proposals that Diversion Limits Must be Tightened and Transportation Credits Adjusted in Federal Orders 5 and 7 to Further Enhance the Income of Southeast Dairy Producers and to Provide for More Orderly Marketing of Milk from the Region's Reserve Supply Areas.

By Way of Modification, SPSC Proposes that the Secretary Independently Review the Record and Establish the Tightest Diversion Limit Amounts Possible for Orders 5 and 7, Which Would Enhance In-Area Producer Income and Still Provide the Minimum Necessary Reserve Supply to Meet the Balancing Demands of the Two Marketing Areas. Appropriate Changes to Provisions Relating to Producer Delivery Day Requirements and Transportation Credits Will Necessarily Follow This Determination.

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[20] Exhibit 9 at page 13.
[21] Exhibit 18 at page 1.
[22] Exhibit 10 at page 1.
[23] Exhibit 19 at page 1.

Presented on behalf of the four state-wide producer groups of SPSC, this brief represents the interests of a broad number of exclusively southeast dairy producers. Being located solely within the marketing areas of the three southeast federal orders, these SPSC producers represent exclusively the interests of producers who serve to provide the basic milk supply for the region.

The vast majority of SPSC producers market their milk through DCMA, the primary proponent of the proposal before the Secretary in this hearing. SPSC members have so associated with DCMA with the understanding that DCMA works on their behalf to provide the best return possible for the sale of their product. SPSC members further understand that DCMA has submitted its proposal in furtherance of this basic objective, so that there is essential unity of interest between DCMA and SPCA for purposes of this hearing.

Arising from this association and unity of interest, SPSC agrees with the thrust of the DCMA proposal that substantial changes must be made to federal milk market orders 5, 6 and 7. As represented by DCMA, these changes are needed to promote greater milk production in the southeast in response to the continued decline of milk production within the region, and to ensure more orderliness in the marketing of milk from the surplus areas to further address the region's deficit circumstance.

More specifically, SPSC supports without qualification the DCMA proposal to raise Class I differentials in the three federal orders. This change is critical and will serve its intended purposes, as demonstrated convincingly by the supporting testimony presented at the hearing.

It is important to note that the other major party to this hearing, Dean Foods, also supports in principle the basic proposition that producer income for southeast dairy farmers must be increased. Dean Foods opposes using the vehicle of increased Class I prices to achieve this purpose, proposing instead to resort to substantially tighter diversion limits. Nonetheless, Dean Foods is on the record as supporting in principle the need to increase the income of southeast dairy farmers.

SPSC also supports in concept the additional, complementary changes proposed for diversion limits, producer delivery day requirements and transportation credits in orders 5 and 7. SPSC supports the thrust of these additional proposals, as represented by

DCMA, to protect the integrity of the pools and thereby to promote more orderly marketing in the two marketing areas covered by Orders 5 and 7, as well, of course, their further purpose of enhancing southeast producer income.

SPSC's support of these additional proposals is presented in such qualified form, as compared with its unqualified support for the Class I proposal, largely because the hearing record is less certain with regard to the actual impacts and benefits of the additional changes for SPSC's members. As DCMA has forthrightly recognized, while there has long been widespread understanding of the need to make diversion and transportation credit changes and resulting agreement on the need for a hearing, the actual calibration required in each instance was the subject of much disagreement in the period leading up to the hearing.

It is readily apparent from the on-going disagreement in the testimony that the evidentiary portion of the hearing has not served to resolve this disagreement between the two principle parties to the hearing. The actual volume of pool milk and reserve supply needed to provide the Class I needs for Orders 5 and 7 and the associated balancing concerns, including which party should properly bear the cost, remain open-ended issues.

Based on the still-evident consensus in principle on the need for change yet remaining disagreement as to specifics, SPSC proposes to modify the DCMA proposal by requesting that the Secretary independently determine from the record the proper producer delivery day requirements and diversion limits to be imposed.

SPSC further proposes that, in conducting its independent assessment, the Secretary should apply a different cast to its calculations than presented by DCMA (and Dean Foods). The Secretary should apply basic principles of milk market law to squarely confront the deficit circumstance in the southeast and thereby reaffirm by this decision that southeast dairy farmers, being located within and thereby most associated with the marketing areas of the southeast, must be understood as the primary suppliers for the region's milk supply.

Assurance of the continued viability of this essential supply must thereby be the Secretary's primary consideration in calculating producer delivery day requirements and setting diversion limits, to the utmost degree possible.

Beyond being established under principles of milk market law, such a decision to reaffirm the primary supply base for the market in this manner is also supported by the perhaps unique consensus among the leading parties to the hearing about the need to enhance producer income for southeast dairy farmers, in response to the region's deficit production condition.

Introduction

Finding Rare Consensus Between Processor and Producer on the Vital Need to Ensure the Primary Production Base for the Southeast, Through Emergency Action to Enhance the Income of Southeast Producers

This federal milk market order hearing has presented the rare circumstance of having producers and processors in a marketing area in basic agreement about the emergency need to enhance the income of producers located in that marketing area and thereby provide the primary supply. Quite remarkably, all parties to this hearing – producers, cooperative milk marketing organizations and processors – have uniformly testified that the Secretary needs to take corrective, emergency action to enhance dairy farm income for southeast producers, in response to the deficit milk supply circumstance of the three southeast orders for which these producers provide the primary supply.

Unquestionably, there is disagreement between the two principle parties – DCMA and Dean Foods - about the best means to achieve this common end. DCMA has proposed a package of changes that includes substantial increase to Class I differentials for the three southeast orders as the chief means to enhance producer income. Dean Foods, while opposing the use of Class I differentials to achieve this result, proposes instead the imposition of restrictive diversion limits. Yet while proposing a different means, it is still clear from the Dean Foods supporting testimony that the purpose of its proposal, at least in some substantial measure, is to enhance the producer income of southeast dairy farmers.

Such enhancement of producer income is certainly not the sole subject of this hearing. As indicated, DCMA has presented a package of proposals, and the additional proposals for producer delivery day requirements and diversion limits and transportation credits are squarely intended to address the deficit supply and balancing needs of the market, with only the apparent indirect purpose of enhancing producer income. Similarly, the Dean Foods' proposal to tighten diversion limits is also intended on some level to address its market balancing concerns as well as to positively affect southeast producer income.

Nonetheless, it is important for the Secretary, in reviewing this record, to keep in mind that, perhaps uniquely, the region's leading processor has joined with the leading producer representative in advocating at a fundamental level for the need to enhance the income of the producers located in and supplying the marketing area at issue in this hearing.

Again, according to the lead witness for Dean Foods,

"I think the emergency action that the secretary needs to take to improve farm income for Southeast dairy farmers today, and immediately, is to tighten diversion limits."

Evan Kinser, Transcript at 595.

This consensus is particularly significant given the critical timing of this hearing. By all accounts, this hearing occurs at a pivotal moment for addressing the region's supply deficit. The record is indeed replete with evidence of the pronounced deficit that has developed in the southeast, including the most unusual supply and demand dynamic for this region.

Restatement of proposed finding 1 -3, set forth above, with the simple, essentially responsive comment by the lead witness for Dean Foods, establishes the consensus on just how critical is the timing for this hearing, and the basic fact finding direction on this issue that the Secretary may take:

> Since 1990, the southeast region, encompassing these three federal orders, has experienced a greater population increase than any other region of the country except the Mountain states. In most cases, the population increase has been more than double that of the other regions. At the same time, rather than expand to meet the corresponding, burgeoning demand for fluid milk products, milk production in the region has declined precipitously in the region. In the Appalachian part of the region, milk production has declined by 35 percent, from just over 8 billion pounds to just over 5 billion pounds. In the actual southeast, milk production has declined by 16 percent, from 4.8 billion pounds to 4 billion pounds. In the Delta, milk production has declined a stunning 60 percent, from 2.5 billion pounds to 1 billion pounds.

"I won't rehash the numbers that have been presented; the department is quite competent of looking through that and seeing the deficit. Even the proponents have a great argument of the deficit market."

Evan Kinser, Transcript 3, page 530.

Mr. Kinser's statement is most decidedly far from the traditional response to such a market supply circumstance from the processor side. One need only consider the testimony of John Rutherford, Senior Economic Analyst for the International Dairy Foods Association to prove the point:

> There is no question that milk production has been declining over many years in the states which are part of the Appalachian, Southeast and Florida marketing areas. But we have a national market, meaning milk is available to move across states and regions. A reduction in local production does not necessarily mean a short supply if milk from a more distant location is readily available to replace it.

Transcript at pages 458-59.

Understandably, perhaps, the divergent competitive positions of processors and producers normally do not lend themselves to agreement about the need for enhanced producer income. The Secretary is traditionally called upon in these hearings to arbitrate between producer claims that prices within a marketing area are too low and should be raised against processor claims, such as Mr. Rutherford's, that there is sufficient supply and so prices must be at the proper level or may even be reduced.

Yet in this hearing, the key processing concern in the region, Dean Foods, has joined the call of the leading producer marketing agency, DCMA, for the Secretary to recognize the deficit circumstance and to take emergency action to enhance farm income for southeast producers.

This core agreement is not obscured by the disagreement among the parties about how best to achieve this desired objective of enhanced producer income. Inevitably, based on the divergent competitive positions of producers and processors, there is disagreement about the propriety of raising Class I differentials and the proper level for resetting producer delivery day requirements and diversion limits, as well as about the proper role of transportation credits.

Yet this is a disagreement about proper means, only, and does not distract from the basic agreement about the common purpose of enhancing the income of southeast producers.

The Need for This Hearing to Affirm that a Fundamental Principle of Milk Market Regulation Is the Assurance of Stability of the Primary Supply for a Class I Market Area, being Milk Produced Within The Marketing Area. Such Stability Is Dependent on Proper Delineation and Balancing of this Primary Supply and the Surplus Supply, or Milk Produced Outside the Marketing Area.

As part of the decision in this case, the Secretary will need to reaffirm fundamentally that the construct of a marketing area made subject to a federal Order depends on the primary supply being provided by producers within that marketing area. Only the theoretical, if not sophomoric, economics of IDFA allows for an inference that fluid markets somehow make no distinction between local and national supplies for a marketing area. The Secretary must sharpen, not further blur, this vital distinction between primary and reserve supply for a marketing area, when acting to resolve the competing concerns raised by the producer delivery day requirements, diversion limit and transportation credit issues.

From the perspective of SPSC, the Secretary's decision on this point will be pivotal in determining whether the southeast will be able to provide for its basic fluid needs into the future. The market simply cannot be sustained if the decline of the southeast milkshed is not reversed. The Secretary must act fundamentally to restore the primary supply capability of the region's marketplace, even as steps continue to be taken to resolve the competing balancing concerns raised by the need to import ever greater amounts of milk from the region's reserve areas.

A. SPSC Supports the DCMA Proposal to Increase Class I Differentials Across Federal Orders 5, 6 and 7, as Specified, to Enhance the Income of Southeast Dairy Producers and to Help Ensure That They May Continue to Provide the Primary Supply for the Southeast Market.

Most importantly, the Class I pricing surface for the region must be increased as proposed. Producer income in the southeast region is directly tied to return from the

Class I market. Here is where the Secretary can and must begin to squarely address the need to measurably enhance the income of southeast producers

The utilization rates for the three southern Orders should ensure that increasing the Class I pricing surface will directly result in substantial increases in producer blend prices and thereby producer income. Raising Class I prices will thus serve most immediately to provide the required signal to promote greater production within the marketing areas of the three Federal Orders.

The record on this issue is most complete. DCMA submitted voluminous testimony and exhibits describing its pricing surface proposal. Both its design and likely effect are explained in great detail in Mr. Sims' testimony on direct. Because of the quality and depth of the proposal, the benefits of its potential impact were even further illuminated by the detailed cross-examination.

From its distinct perspective of representing solely the interests of producers within the region, SPSC would assert that any contrary testimony at most raised the prospect of minimal market dislocation resulting from implementation of this new pricing surface. These potential market dislocations may be expected to occur, if at all, only in a localized manner at or near the borders of the marketing areas.[24]

Perhaps the most distinct market dislocation is the relative reduction in the return to producers located within and near the border of the marketing area as compared with pool producers located deeper within the marketing area. This reduction is particularly pronounced in the areas in closest proximity to the borders, where the change to the Class I surface is only $0.10.

Many SPSC members are those located within this part of the marketing region and are those who will most immediately experience this minimal impact on their pay prices. Yet, as represented by the unified SPSC support for this proposal, these members understand both that this impact is necessary to smooth the transition at the borders, and that the positive benefit for producers throughout the region is what must be considered of primary concern.

[24] Testimony regarding the additional market dislocation of the pooling of supply plants from outside the current marketing areas of Orders 5, 6 and 7 was not credible and should simply be discounted.

In sum, the pronounced positive impact to be derived for the region more than overcomes any potential minimum adverse consequences, supporting establishment of the proposed increase to the Class I pricing surface.

B. SPSC Further Supports in Principle the Additional DCMA Proposal To Tighten Diversion Limits and To Adjust Transportation Credits in Federal Orders 5 and 7, to Further Enhance the Income of Southeast Dairy Producers and to Provide for More Orderly Marketing of Milk from the Region's Reserve Supply Areas.

The DCMA proposal is presented as an integrated whole of three parts, including the Class I price increase, producer delivery day requirements and diversion limits, and adjustments to the Transportation Credit system. The Class I pricing increases are intended to work together with the diversion limits to ensure the adequacy of supply for the three marketing areas, without allowing the pool volume to swell beyond what is needed. Reflecting the current reality that the pools for the three marketing areas include substantial base as well as reserve supply drawn from the reserve areas, the transportation credit provisions and the diversion limits are intended to ensure the proper distinction between true pool reserve and truly supplemental milk.

SPSC supports this comprehensive approach in principle. Recognizing that producer welfare is promoted by both direct enhancement of producer income as well as the assurance of more orderly marketing in their region, all witnesses for SPSC in this hearing expressed their clear support for the integrated approach being promoted by DCMA.

As noted at the outset, from the strict perspective of producers located within the marketing area, as represented by SPSC, the gist of the proposal's compromise is the ability of the amended producer delivery day requirements and diversion limits in fact to reduce the volume of producer milk eligible for diversions. Given that there is consensus that the pool may in fact be reduced and still provide for the supply needs of the region's pool distributing plants, it is absolutely necessary to ensure that the pool is reduced to the greatest extent possible. This will ensure that pool revenues are properly distributed among true pool producers. Most particularly, such a design holds the best promise for the greatest enhancement of income of those producers located in the marketing areas and who provide its primary supply.

As might be expected, from this perspective, SPSC's support for the DCMA proposal hinges on the Department being able to prove out that the proposed amended limits will in fact act to reduce the volumes of the two pools. The analysis conducted by the Market Administrator's office, however, at least creates uncertainty about this conclusion.

The analysis indicates that, at least until recently, the bulk of the producer milk removed under the DCMA proposal would occur in the two months of January and February for Order 7, and only in the few months of the flush period for Order 5.[25] For the other, greater number of months, with the proposed, accompanying reduction in producer delivery days, it is unclear whether more milk actually could be added to the pools than is now occurring, rather than less. Combined annually, then, it is at least possible that more, rather than less, milk could be added to one or both of the two pools by the DCMA proposal. This would result in a pool greater than needed and only continue to depress the income of Southeast producers, contrary to the stated objective.

SPSC's assessment of the DCMA proposal must also account for Dean Foods' vigorous advocacy for the proposition that pool volumes may be reduced by substantially greater amounts without sacrificing the two pools' supply needs, and thereby provide for a much greater net impact on in-region producer income. The qualification here is Dean Foods' resolute refusal to recognize any balancing function for diversion limits, in its pursuit of a competitive advantage by operation of its proposal. Yet even accounting for this competitive disagreement between the parties over the balancing function to be served by diversion limits, there remains a marked disparity in the two proposed amounts for reduction of the pools, and parallel enhancement of producer income.

Again, notwithstanding its primary concern with the enhancement of income for southeast producers, SPSC supports the additional thrust of the DCMA proposal that changes must be made to ensure more orderly marketing of milk in the region. The issue here raised is not one of purpose as it is a concern for actual impact, given the record developed at this hearing.

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[25]Exhibit 9 page 13; Exhibit 10 at page 1.

C. By Way of Modification, SPSC Proposes that the Secretary Independently Review the Record and Establish the Tightest Diversion Limit Amounts Possible for Orders 5 and 7,Which Would Enhance In-Area Producer Income and Still Provide the Minimum Necessary Reserve Supply to Meet the Balancing Demands of the Two Marketing Areas. Appropriate Changes to Provisions Relating to Producer Delivery Day Requirements and Transportation Credits Will Necessarily Follow This Determination.

In combination, the uncertainty of the effect of the DCMA proposal and the potential for much more aggressive restrictions and accompanying enhancement of producer income made evident in the record lead SPSC to conclude that the Department must utilize its independent judgment to resolve these issues. Accordingly, by way of modification of the proposal at issue in this hearing, SPSC proposes that the Secretary independently determine the appropriate levels of producer delivery day requirements, diversion limits and transportation credit provisions that will best achieve the stated purposes of the DCMA proposal.

It is first important to reiterate that, in addition to proposing specific changes, DCMA's original submission to the Department also expressed its belief that this proceeding provides the appropriate forum for the best determination of the most proper amounts of diversion limits. DCMA itself was thus also leaving open the potential for the Secretary to resolve these issues, independently, as now proposed formally by SPSC.[26]

In any event, it is readily apparent from the record that the Department is in the best position to identify objectively the critical figures of required base and reserve supply. In large part, the uncertainty over this controlling calculation apparent in the testimony reflects the understandable disagreement between the competing concerns of the processor interests and their suppliers of milk. This disagreement, also quite understandably, plays itself out throughout the extensive testimony about the associated issues of just how much milk is necessary to ensure a proper balancing of supply and, thereby, which entity will or should bear these balancing costs.

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[26] Transcript pages 332-33.

On the one hand, DCMA accentuates the deficit circumstance of the region but still proposes reductions in diversion limits that may be expected to further reduce the pool volumes of milk for the two orders. Largely because of its basic supply and balancing concerns, these impacts on pool volume are expected to be marginal, and so would raise producer pay prices by equivalent minimal amounts. On the other hand, Dean Foods, while also acknowledging the market's deficit problem, nonetheless discounts essentially all balancing concerns and yet proposes much more aggressive diversion limits, which may be expected to reduce the volumes of the two pools quite substantially and to raise producer pay prices also by significant amounts.[27]

In essence, SPSC's proposal of modification recognizes that this is an understandable competitive disagreement about critical components of orderly marketing, properly resolved by the Department within its regulatory function to oversee operation of the federal Milk Market Order System. From this disinterested perspective, the Secretary is best situated to sort out the regulatory issues from the competitive issues, and determine the appropriate levels of producer delivery day requirements and diversion limits, accordingly. Particularly, from this perspective, the Secretary is best situated to sort out the balancing function of diversion limits as they relate to the function of milk market regulation rather than to promote the respective competitive advantage of market participants.

SPSC's proposal of modification is distinct in one particular regard. As noted at the outset, SPSC proposes that the Department's assessment of the proper producer delivery day requirements, diversion limits and transportation credit adjustment should be anchored in the regulatory principle that the primary supply needs of a marketing area must be drawn from within that marketing area.

Implicit, if not explicit, in the DCMA proposal is the assumption that calculation of the interplay between a pool's supply and balancing requirements and its correct producer delivery day requirements and diversion limits may essentially be made without regard to the location of producers supplying the pool; that the balancing

[27]In large part because of this uncertainty about the proper level of diversion levels, the record also is not clear about the proper, on-going function that transportation credits should serve to provide for the supplemental, or non-pool, milk supply for the two marketing areas of Orders 5 and 7.

considerations are in effect the primary concern. Similarly, DCMA's proposal relegates the impact on the producer income of producers located in the marketing area to be of secondary concern when devising diversion limits.

Viewing this perspective of pool supply from its vantage point of representing purely southeast producers, SPSC asserts that the deficit circumstance of the southeast has thus progressed to the point where the fundamental definition of a marketing area is in effect being called into question. In response, the Secretary must now resort to basic principles, in addition to resolving the competitive dispute about balancing among the market participants.

The Secretary must reaffirm by tangible action in this decision the regulatory principle that producers located within and thereby most associated with the marketing areas of the southeast are understood to be the primary suppliers for the region's milk supply. Derived from this principle, assurance of the continued viability of this essential supply will thus be the Secretary's primary consideration in calculating producer delivery day requirements and setting diversion limits, to the utmost degree possible.

Perhaps echoing in the background, again, is IDFA's assertion that the market's supply is national and recognizes no regional boundaries. Yet the issue is not simplistically geographic, it is the construct of marketing areas, which depends on demarcation of primary and reserve supply, clearly defined and enforced.

D. Changes to the Transportation Credit Provisions Must Necessarily Follow the Department's Determinations With Regard to Producer Delivery Day Requirements and Diversion Limits

The Department's determination of pool supply necessarily will determine what changes are necessary to the transportation credit provisions. Accordingly, SPSC would defer again to the Department's independent judgment on this part of the proposal.

E. Conclusion

SPSC again expresses its basic support for the DCMA package of proposals. SPSC agrees that the proposal is largely successful in providing for enhanced producer income and for providing the concept of what is needed to promote more orderly marketing in the region. SPSC's proposal of modification, however, is intended to emphasize the critical nature of detail with regard to the precise level of producer delivery day requirements, diversion limits and transportation credits that must be devised to ensure accomplishment of DCMA's properly articulated goals.

Beyond detail alone, however, SPSC's proposal is also intended to reestablish the essential definition of the marketing areas of the southeast, consistent with basic principles of milk market regulation. Grounded in this principle, the Secretary will be prompted to establish the tightest diversion limits possible, which yet account for the assurance of necessary reserve and supplemental supply. With discretion retained by the Market Administrators, such limits tightened in the first instance may yet be loosened without resort to hearing, if necessary to assure proper balancing of the market's supply and demand requirements.

Respectfully Submitted,

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