Testimony of Proponent Cooperatives

Southern Marketing Agency, Inc.

Milk Marketing Order Hearing

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

Atlanta, Georgia

February 23, 2004

My name is Elvin Hollon. I am the Director - Fluid Marketing / Economic Analysis for Dairy Farmers of America, Inc. My business address is P.O. Box 909700 Kansas City, Missouri 64190.

This testimony is being presented by Southern Marketing Agency, Inc. in support of proposals number 1, number 2, and number 3 as contained in the Notice of Hearing. With regard to the producer milk definition proposal dealing with "dual pooling" (proposal 6) and the proposal refining the definition of a producer handler (proposal 7) we support their intent and language but only as they would be included in our own

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proposal 1 through 3. We oppose proposals 5 and 8. It is being presented on behalf of the member producers of the six proponent cooperatives who are currently supplying plants that would be fully regulated distributing plants under the proposed Southeast Federal Milk Marketing Order.

Southern Marketing Agency, Inc. is a common marketing agency for cooperative member producers who supply pool distributing plants regulated under the Appalachian Federal Order 1005 and the Southeast Federal Order 1007. Southern Marketing Agency, Inc. performs a common pooling of certain costs and returns for member producers supplying Appalachian Federal Order 1005 and Southeast Federal Order 1007 pool plants.

The producers that I am representing in these proceedings are members of the following cooperative organizations listed in **Exhibit 48 Item 1 - SMA010 Proponent Cooperatives:**

Arkansas Dairy Cooperative Association, Inc.

Dairy Farmers of America, Inc.

Dairymen's Marketing Cooperative, Inc.

Lone Star Milk Producers, Inc.

Maryland & Virginia Milk Producers Cooperative association, Inc.

Southeast Milk, Inc.

As shown in **Exhibit** 48 **Item 2 - SMA020 Producer Milk Deliveries Proponent Cooperatives and Others**, the membership of these six proponent cooperatives, for November 2003, account for approximately 734 million pounds of producer milk, which likely will be pooled, on the proposed Southeast Federal Order. This represents approximately 66.62 percent of the total producer milk that will be pooled on the proposed Southeast order.

As shown in **Exhibit** 48 **Item 2 - SMA020**, these proponent cooperatives also market the milk of other cooperatives whose member milk will be pooled on the proposed Southeast order. Thus, in total for the month of November 2003, the proponent cooperatives market approximately 871 million pounds of producer milk that will likely be pooled on the proposed Southeast Federal Order. This would represent approximately 79.07 percent of the total producer milk that will be pooled on the proposed Southeast Federal Order.

As **Exhibit** 48 **Item 3 - SMA030 Proponents Cooperatives Supplying**

Pool Distributing Plants Proposed Southeast Federal Order - November 2003 indicates, one or more of these proponent cooperatives supply each of the fifty-two (52) plants that will be fully regulated pool distributing plants under the proposed Southeast order. The last column of this Exhibit indicates the thirty (30) plants to which the proponent cooperatives market milk of other cooperatives.

Regulatory Flexibility Act:

The notice of this hearing invites parties to present evidence of the probable regulatory and informational impact of the hearing proposals on small businesses, which are defined in the hearing notice, as a dairy farm with less than $750,000 in gross revenue. Per this definition the majority of farms represented by the proponents are small businesses. In this regard, the cooperatives that I represent certainly agree with the Agricultural Marketing Service (AMS) that the Regulatory Flexibility Act (RFA) applies to these proposals.

A major object of the RFA is to seek greater participation by individuals and small businesses when rules affecting them are proposed. To achieve this objective, the RFA encourages Federal agencies to utilize innovative administrative procedure in dealing with individuals and small businesses that may be unnecessarily and adversely affected by Federal regulations.

The cooperative associations that I represent are the marketing agent for their member-owners. Any factors, including the provisions of Federal Milk Marketing Orders, that affect these cooperatives, whether favorably or adversely, translate directly into a similar affect on the numerous small businesses of its member-owners. Hence, we are here representing basic small businesses-the family owned and operated dairy farmers. These member-owners depend upon their cooperative not only to represent their marketing interest, but also to advocate their concerns about laws and regulations that apply to them. Without this representation, many of the individuals and small businesses that comprise the membership would be unable to participate effectively in the Federal rule-making process.

The proponent cooperatives' member owners appreciate the expressed interest of Congress when it enacted the RFA. The legislative history of the RFA stresses that the benefits of the RFA are to be applied liberally to organizations such as these cooperatives whose membership is composed of individuals and small businesses. The history emphasizes that the size, dominance, or even nationwide activities of an organization are not to exclude that organization from being defined as "small" under the provisions of the RFA. For example, in specifying that nationwide organizations such as YMCAs fall under the RFA, Congress stated that the primary concern is the "structure and operating characteristics of the organization at the local as well as the national level." Certainly the individual member-owner structure and operating characteristics of cooperatives clearly entitles us to present testimony and evidence on behalf of members about the effects of the proposed regulations.

Proposal No. 1 - Merger of Orders:

Proponent cooperatives strongly support the adoption of proposal number 1 as contained in the notice of this hearing. That proposal will result in the merger into a single Southeast Federal Milk Marketing Order of all the territory now contained within the Appalachian Federal Order 1005 and the current Southeast Federal Order 1007.

Our purpose at this proceeding is to prove that what are now defined as the separate Appalachian Order 1005 and the Southeast Order 1007 together form a common milk market, commonly supplied, and thus deserving of a common blend price. Measures of commonality like how much milk has moved between Orders, both bulk and packaged, presume that Orders never impact how milk moves, nor place any limits on the free flow of milk. Orders do impact milk movements and do place some limits on the free flow of milk. This is an unavoidable consequence of regulation.

The drawing of a line always means something is on the other side of the line. Lines mean differences and differences change the way markets are structured, how they are supplied, and most importantly who shares in the proceeds from Order operations. There is thus generated a fallacy: "common milk markets share milk, and since we don't see the milk being shared as much as we think it should, there must be no common market". The fallacy in this particular marketing situation is generated in the milk-movement limiting impact of the Orders themselves. "If it should it would, since it doesn't it shouldn't", discounts the possibility of, "It doesn't because it can't, but it would if it could".

Interstate Commerce:

Adoption of a Federal milk marketing order in the area is contingent upon the showing that there is "interstate commerce" involved in the marketing of milk in the proposed marketing areas. In this regard, we believe that the record will clearly show the substantial degree of "interstate commerce" involved in the area.

Briefly, such commerce is demonstrated clearly in Exhibits 38-41. These exhibits show in-area packaged milk sale and sources of producer milk supply by state and county. Such evidence clearly shows the interstate movement of both bulk and packaged milk products being made within, into, and out of the proposed marketing area.

Changes in Market Structure:

As reflective of the consolidation of Federal Milk Marketing Orders effective January 1, 2000, there has been a trend toward fewer Federal Milk Marketing Orders as fluid milk processors increasingly serve larger geographic areas. With respect to the proposed Southeast Marketing area this is certainly the case. Processors have significantly increased their sales areas over the past years, thus increasing the need for, and this proposal for the merger of the Appalachian Federal Order 1005 and the Southeast Federal Order 1007.

Significant changes in market structure have occurred since the implementation of the final rule on January 1, 2000 which supports the conclusion that maintaining separate Appalachian Federal Order 1005 and Southeast Federal Order 1007 is no longer appropriate.

Proponent cooperatives will submit a number of documents that provide an overview of some of the structural and market changes that have occurred in this area over the last several years. In-as-much as a portion of the marketing and market-structure data used in the Order reform process to determine the consolidation of Orders were from as early as 1996, the comparisons that we submit here are largely between January 1996 and December 2003. Some data are annual comparisons between 1996 and 2003. The current market has functioned since January 1, 2000. But its' provisions and supporting rationale is rooted in the 1996 database. Today, eight years later, our evidence shows that marketing conditions have changed significantly and warrant a new hearing to modernize and change the terms of the Order to reflect the dynamics of the new market.

Pointing to a number of the statistics, as shown in **Exhibit 68 Item 4 - SMA040 Pool Distributing Plants Appalachian Order, No. 1005** and **Exhibit 68 Item 5 - SMA050 Pool Distributing Plants Southeast Order, No. 1007,** in

January 1996 there were 72 physical plant facilities which were, or would become fully regulated distributing plants on the Appalachian and Southeast Orders. In December 2003 there were just 52 physical plant facilities remaining that were fully regulated distributing plants on the Orders, a decline of 27.8 percent.

Of the plants existing in both periods, more than two-thirds have experienced at least one ownership change during that time, and some of those plants have experienced several ownership changes. In reviewing the plant operation and ownership histories it is interesting to note that of all the fully regulated distributing plants pooled on the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 in December 2003, only seven plants not owned by a grocery store company have experienced no ownership change in the last eight years.

~~As an additional measure of market concentration, **Exhibit ___ Item 6 - SMA060 Southern Marketing Agency, Inc. Sales to Pool Distributing Plants, Federal Orders 5 & 7., November 2003** shows, for the month of November 2003, that over eighty-five percent of the dollar sales to Appalachian Federal Order 1005 and Southeast Federal Order 1007 distributing plants by Southern Marketing Agency, Inc. are represented by sales to seven customer companies with over one-third to the largest company.~~

Exhibit 48 **Item 7 SMA070 Pool Supply Plants, Regulation and Operation Changes, January 1996 to December 2003, Appalachian and**

Southeast Orders lists the regulation and operational changes in supply plants pooled on the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 for the January 1996 to December 2003 period. As shown in the exhibit, there were one-fourth fewer supply plants pooled on the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 in December 2003. Two of these plants, Louisville, Kentucky and Greenville, Tennessee, are operated only seasonally. Since December of 2003 the Greenville plant has been sold to a private concern.

Exhibit 48 **Item 8 - SMA080 Cooperative Associations as Handlers Regulation Changes, 1996 to 2003 Appalachian and Southeast Orders** lists the cooperative associations who have pooled milk on the Appalachian Federal Order 1005 and the Southeast Federal Order 1007. This Exhibit highlights the considerable changes that have occurred between 1996 and 2003. Sixteen cooperative associations delivered milk to plants pooled on what would have been predecessor Federal Orders to the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 during 1996, and fourteen cooperative associations delivered milk to these Orders during 2003. However, only six cooperatives delivered milk in both 1996 and 2003. Eight of the cooperative handlers pooling milk in 1996 no longer exist, and four cooperatives have been newly formed, either as "start-ups" or were formed via the merger of one or more predecessor cooperatives. The other "new" cooperatives delivering milk in 2003 versus 1996 demonstrate the extent to which the milk shed for the southeast has expanded.

As shown in **Exhibit** 48 **Item 9 - SMA090 Grade A Milk Producers by States Southeast Region June 1996 and June 2003**, producer numbers in the region continue their long term trend of decline. Grade A milk producers in the eleven southeastern states outside of Florida declined from 11,712 to 7,180 between 1996 and 2003, a reduction in excess of one third. The drop in the number of producers in the region is also highlighted by the drop in the number of producers pooled on the current Appalachian and Southeast Orders. According to the March 12, 1999 decision of the Secretary, over 8,180 producers were expected to be pooled on the consolidated Appalachian and Southeast Federal Orders in December 1996 and January 1997. Today, as shown in **Exhibit** 48 **Item 16 – SMA150 Location of Producers Pooled Appalachian Order 1005 and Southeast Order 1007 December 2003,** even after the addition of a number of producers, many of which are farms located physically outside of the marketing area, only 7,243 producers served the two Orders during December 2003.

As shown in **Exhibit** 48 **Item 10 – SMA100 Milk Production by States, Southeast Region Annual 1996 and 2003, Million Pounds,** milk production in the region has also continued its long-term trend of decline. Milk production in the eleven southeastern states outside of Florida declined from 13,518 million pounds in 1996 to 10,671 million pounds in 2003, a decline of 21.06 percent. This significant decline in the number of Grade A milk producers, and the declining volume of milk production in the region coupled with an increase in population within the marketing area has led to the major expansion in the milk shed for the southeast. There were 9,071,901,486 pounds of Class I producer milk pooled on the combined Orders 5 & 7 during 2003. With milk production totaling 10,671 million pounds in 2003 for the eleven states referenced, this means that 85 percent of the Grade A milk production on an annual basis is needed in Class I. This acute milk deficit, with milk production insufficient to even provide a sufficient reserve above the Class I needs, is a condition unique to the southeast. Any regulatory structure that causes one load of milk to go underutilized in the region must be evaluated critically and changed to allow the most efficient use of the limited local supplies.

As the record will demonstrate, the southeast has experienced substantial and substantive changes in the market and its structure. The number of distributing plants has declined dramatically. A substantial reduction in the number of pool supply plants is also evident. Producer numbers within the area have declined even more rapidly, and the milk shed has increased in geographic size accordingly. Cooperatives have experienced substantial consolidation, and have together formed Southern Marketing Agency, Inc., as an extension of the cooperatives' moves to consolidate and seek out enhanced marketing and logistics efficiencies.

Any analysis using the traditional structure, conduct and performance models would point to a southeastern market very much unlike that which existed just seven or eight years ago. As the southeast market structure has changed by consolidation of operations at the producer, handler and cooperative levels, so should the Federal Order Program consolidate the two southeast region Orders to reflect these new structural realities.

In December 2001 two new national fluid milk distributing companies were formed which represent a substantial increase in the market concentration of fluid milk processing in the southeastern United States. The market concentration of these two companies represents in the area of 40 percent of the milk purchases by pool distributing plant in the proposed Southeast Order. Market concentration of this magnitude is unprecedented in the fluid milk business. The consolidation of control and decision making on the operation of such a large proportion of the Class I processing and distribution across the region only expands and magnifies the need to dissolve the current boundary between the two Orders.

Exhibit 48 Item 11 – SMA110 Top Seven Handlers SMA November 2003 shows the location of the top seven (in terms of dollar sales) Appalachian Federal Order 1005 or Southeast Federal Order 1007 pool distributing plants owned by the top seven fluid milk companies which are supplied by Southern Marketing Agency, Inc. member cooperatives. This map graphically displays the market concentration resulting with the formation of two national fluid milk-distributing companies in December 2001.

In April 2002, five cooperative associations formed a new marketing agency in common whose principle purpose is to cooperate fully in supplying, and increasing the efficiencies in supplying the fluid milk needs of the southeastern United States outside of Florida. Since that time, a sixth cooperative has joined the Southern Marketing Agency, Inc.

Southern Marketing Agency, Inc., as we have mentioned, pools and redistributes the costs and returns from serving the single fluid milk market currently defined by much of the Appalachian Federal Order 1005 and the current Southeast Federal Order 1007. Southern Marketing Agency, Inc., considers the entirety of this area to be one market in terms of distribution or revenues, allocation and pooling of marketing costs, and measurement of milk supply and demand. The annual milk budgets developed by Southern Marketing Agency, Inc. considers the combined Appalachian Federal Order 1005 and the Southeast Federal Order1007, for purposes of assessing needs for supplemental supplies, disposal of seasonal surplus supplies, and the direction and assignment of agency-producer-member supplies.

Exhibit 28 Item 6 - SMA060 Southern Marketing Agency, Inc. Sales to Pool Distributing Plants, Federal Orders 5 & 7., November 2003 shows the proportion of Southern Marketing Agency, Inc.'s total sales to pool distributing plants that were made to each of its seven largest fluid milk distributing company customers. As indicated, 85.7 percent of its total sales in November 2003 were made to its seven largest company customers with 48.4 percent of its total sales to its two largest company customers.

Since the implementation of the final rule January 2000, structural changes have also occurred outside the marketing areas of the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 which impact the supply and demand for milk in the area, and the manner in which the single market is serviced. The establishment of large farms in areas outside the southeast, and which are or can be associated with the southeast, cannot be overlooked. Milk from these large farms can be delivered to locations in either of the current two Orders every week of every month, and represent a regular out-of-area supplemental supply for both Orders.

The continued existence of the two Federal Milk Marketing Orders across a single fluid milk market inhibits market efficiency in supplying and balancing the market, creates unjustified blend price differences, encourages uneconomic movements of milk, and results in the inequitable sharing of the Class I proceeds of the single market.

The Proposed Southeast Order:

The proposed merged Southeast Federal milk marketing order, which establishes a classified milk pricing system at reasonable levels and a marketwide pool for distributing the returns from milk sold at such prices uniformly among all producers, will continue to provide the needed market stability in the proposed Southeast marketing area. The proposed Southeast Order will enhance the achievement of market stability that was provided for by the two individual orders that are to be merged.

An environment of stable and orderly marketing conditions throughout the proposed Southeast marketing area depends on the continuation of a classified pricing plan based on audited utilization of all Grade A milk purchased by handlers from producers and on an equitable division among all producers of the proceeds obtained from the sale of their milk under the classified pricing plan.

Under the proposed Southeast Federal order, all producers who supply the market will be assured that their milk will be sold at reasonable minimum prices applicable to the classified uses of milk provided for by the order. Producers will share pro rata in the returns from such sales in the respective classes, including the lower priced uses of reserve milk supplies not needed for fluid use. Handlers will be assured that their competitors will pay for milk at not less than the minimum prices set by the order and that such prices will apply whether the milk comes from farms in the Southeast area, or other states, and without regard to whether the milk is disposed of inside or outside the marketing area.

Detailed information provided on a continuing basis under the order will contribute to the maintenance of stable and orderly marketing conditions in the area. The availability of complete and accurate market information will continue to be of substantial benefit to producers, cooperatives, and handlers alike.

A regional Federal order for the proposed Southeast marketing area will further stabilize and help improve milk marketing conditions in the area. The proposed order is in the public interest in that it will continue to establish orderly marketing conditions for producers and handlers relative to milk distributed in the proposed marketing area and will help assure a continuing and adequate supply of high quality milk for consumers. Moreover, the proposed order will continue to effectuate the declared policy of the Agricultural Marketing Agreement Act of 1937, as amended, by providing for:

1. The establishment of uniform minimum prices to handlers for milk received from producers according to a classified plan based upon the utilization made of the milk;

2. A regular and dependable procedure that affords all interested parties the opportunity to participate, through public hearing, in the determination of changes that may be required in the marketing plan in order to insure an orderly market;

3. An impartial audit of handlers' records to verify the payment of required prices;

4. A system for verifying the accuracy of the weight and butterfat content of milk purchased;

5. Uniform returns to producers supplying the market based upon an equal sharing among all such producers of the returns from the order prices for both the higher-valued Class I milk and the lower returns from the sale of reserve milk that cannot be marketed for fluid use; and

6. Marketwide information on receipts, sales, prices, and other related data concerning milk marketing.

General Provisions:

The proposed Southeast order should incorporate, by reference, as do each of the two current orders, certain terms, definitions, administrative provisions, and other provisions that are included in Part 1000 of the Code of Federal Regulations. These are provisions that are common to all Federal milk marketing orders. Proponent cooperatives will make no proposals in these proceedings to modify these common provisions of the proposed Southeast Order.

A detailed discussion of the need and basis for incorporating these general provisions in each of the current orders is contained in the final decision issued by the Under Secretary on March 12, 1999 and published April 2, 1999 (64 FR 16026). The conclusions reached in that decision with respect to these general provisions are equally applicable under current marketing conditions in the proposed Southeast marketing area.

Provisions effected by Other Pending Proceedings:

Proponent cooperatives recognize that there currently are other proceedings underway that may result in changes to the current Appalachian Order No. 1005 and the Southeast Order No. 1007. Such proceedings would include the Class III & Class IV Classifications (Northeast et, al.) DA-03-08, and the proposals for a public hearing to amend the Fluid Milk Product definition in all Federal Milk Orders. Proponent cooperatives believe that any such changes proposed by the Secretary as a result of those proceedings, if approved by producers, should apply also in the proposed Southeast Order No. 1007.

Proposed Southeast Marketing Area:

The proposed Southeast Federal Order No. 1007 marketing area, as shown in **Exhibit 48 Item 12 – SMA115 Federal Milk Order Marketing Areas**, would include all of the current marketing areas of the Appalachian Federal Order No. 1005 and the Southeast Federal Order No. 1007. There would be 869 counties and 2 cities located within this proposed marketing area.

Geography:

The proposed Southeast marketing area is described geographically as follows: all counties or parishes in Alabama, Arkansas, Georgia, Louisiana, Mississippi, North Carolina, South Carolina, and Tennessee, 4 Florida counties, 20 Indiana counties, 103 Kentucky counties, 44 Missouri counties, 8 counties and 2 cities in Virginia, and 2 West Virginia counties.

As shown in **Exhibit 48 Item 12 – SMA115 Federal Milk Order Marketing Areas**, the proposed Southeast marketing area spans the southeastern area of the United States from the Gulf of Mexico and the Alabama/Georgia-Florida border to central Missouri, Illinois, Indiana, northeastern Kentucky, West Virginia and Virginia to the north, and from the Atlantic Ocean west to Texas, Oklahoma, and Kansas. Measuring the extreme dimensions, this marketing area extends about 575 miles north to south from central Missouri to southern Louisiana and 750 miles west to east from Louisiana's border with Texas to the Atlantic Ocean coast in southern Georgia.

The proposed Southeast marketing area would be contiguous to 4 other marketing areas: the Florida Order to the southeast, the Southwest Order to the west, the Central Order to the northwest and the Mideast Order area to the north.

Natural boundaries and barriers around the proposed Southeast marketing area would by formed by the unregulated counties in Missouri, West Virginia and the unregulated area in Virginia to the north; the almost 600 mile coastline of Georgia, North Carolina, and South Carolina on the Atlantic Ocean; and, the western Florida, Alabama, Mississippi and Louisiana almost 600 mile coastline along the Gulf of Mexico.

Moving from the south to the north of the proposed Southeast marketing area, climates range from humid subtropical in coastal areas to warm and humid or humid continental to temperate. Warm, humid summers and mild winters are typical in this area. These types of climates can severely limit the production level of dairy herds in the summer.

As shown in **Exhibit** 48 **Item 13 – SMA130 Comparative Statistics Federal Order Marketing Areas,** the proposed Southeast marketing area, at 451,198 square miles, would rank it first in marketing area coverage, but its length and breadth would be no greater than other nearby and adjacent Federal Orders. In terms of square miles the proposed Southeast Federal Order 1007 would be only approximately 10 percent larger than the current Central Federal Order 1032.

Population:

As shown in **Exhibit** 48 **Item 13 – SMA130 Comparative Statistics Federal Order Marketing Areas,** the total population estimates for the proposed Southeast marketing area would be 47.5 million. A population of 47.5 million people within the proposed Southeast marketing area would represent approximately 20.5 percent of the total population within all Federal Order marketing areas. The proposed Southeast Order would rank second, after the Northeast Federal Order No. 1001, among all Federal Orders. The population density of the proposed Southeast Order at 105.3 people per square mile is very much at the average of 106.2 people per square mile for all Federal Orders.

As shown in **Exhibit** 48 **Item 14 (A) & (B) – SMA140 MSA's located within the proposed Southeast Federal Marketing Area,** there are 66

Metropolitan Statistical Areas (MSA's) within the proposed marketing area, containing almost two-thirds of the area's population. There are sixteen (16) within the proposed marketing area that have populations of 500,000 or more. They are: Atlanta MSA, located about 60 miles south of the current Southeast-Appalachian marketing area boundary with a population of 4.11 million. Charlotte, North Carolina MSA located near the South Carolina border about 250 miles west of the Atlantic coast with a population of 1.50 million. New Orleans, Louisiana MSA is the third largest with 1.34 million people. Greensboro-Winston Salem-High Point, North Carolina is the fourth largest MSA with a population of 1.25 million. Nashville, Tennessee MSA is the fifth largest MSA in the area with a population of 1.23 million. The Raleigh-Durham-Chapel Hill, with 1.19 million people is the sixth largest MSA in the proposed area. The Memphis, Tennessee MSA with 1.14 million people is the seventh largest MSA in the proposed area. The Louisville, Kentucky MSA, with 1.03 million people is the eight largest MSA in the proposed area. Greeneville, South Carolina at 0.962 million, Birmingham, Alabama at 0.921 million, Knoxville, Tennessee at 0.687 million, Baton Rouge, Louisiana at 0.603 million, Little Rock, Arkansas at 0.584 million, Charleston, South Carolina at 0.549 million, Mobile, Alabama at 0.540 million, and Columbia, South Carolina at 0.537 million make up the remaining ninth (9) through sixteenth (16) largest MSA's in the marketing area. These sixteen MSA's represented about 62.5 percent of the total population within the proposed marketing area.

Exhibit 48 Item 15 – SMA141 Order 5 & 7 Marketing Areas 15 Largest MSA's shows the location of the 15 largest MSA's located within the current Appalachian Federal Order 1005 and the Southeast Federal Order 1007 marketing areas.

Producer Milk:

As shown in **Exhibit 48 Item 16 – SMA150 Location of Producers Pooled Appalachian Order 1005 and Southeast Order 1007** and **Exhibit 48 Item 17 – SMA151 Location of Producer Milk Pooled Appalachian Order 1005 and Southeast Order 1007**, for the month of December 2003, some 7,243 producers from 28 states pooled 1.172 billion pounds of producer milk on the Appalachian Federal Order No. 1005 and the Southeast Federal Order No. 1007. Producers located in 15 of the 28 states pooled milk on both the Appalachian Order No. 1005 and the Southeast Order No. 1007. These states include Alabama, Georgia, Illinois, Indiana, Kentucky, Maryland, Missouri, Ohio, Pennsylvania, South Carolina, Tennessee, Florida, Kansas, and Texas.

Exhibit 10 + 45 shows the location, by county, of producer milk pooled on the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 for the month December 2003. This map displays the many areas of concentration of producer milk pooled on the Orders. These charts also clearly show how the milk shed has expanded over the four years.

As shown in **Exhibit 48 Item 17 – SMA151 Location of Producer Milk Pooled Appalachian Order 1005 and Southeast Order 1007,** 42.92 percent of the volume of producer milk pooled on the Appalachian Order was from producers who are located within the marketing area. As presented in the final decision of March 12, 1999, this compares to the 71 percent from within the then proposed Appalachian Order in December 1996. Similarly, as shown in the exhibit, 56.01 percent of the volume of producer milk pooled on the Southeast Order was from producers who are located within the marketing area. Again, as presented in the final decision of March 12, 1999, this compares to the 85 percent from within the then proposed Southeast Order in January 1997. The producer milk supply from within the two Orders at that time was in excess of 78 percent. The expansion of the milk shed for the Appalachian and Southeast Orders as well as the substantial increase in the percentage of milk pooled on the two Orders originating from producers located outside the marketing area, both greatly exceed what was contemplated in the Secretary's final decision on Order reform. This growth in supply area and proportion of milk pooled on the Orders from producers located outside the marketing represents a major change in the structure of milk procurement for the Orders versus the structure which existed when the Secretary formulated the final decision establishing separate Appalachian and Southeast Orders.

As shown in **Exhibit 48 Item 17 – SMA151 Location of Producer Milk**

Pooled Appalachian Order 1005 and Southeast Order 1007, approximately 53.14 percent of the volume of the producer milk pooled on the Appalachian and Southeast Orders was from producers who are located within the proposed consolidated marketing area. This is at least 25 percentage points lower than the 78 percent for the combined two Orders in December 1996. The geographic source of supply for the proposed Southeast Order has expanded greatly over the past eight years.

Exhibit X8 **Item 18 – SMA152 Delivery Location of Other Producer Milk Located in Other Marketing Areas Calendar Year 2003** and **Exhibit ___ Item 19 – SMA153 Southern Marketing Agency, Inc. Primary Sources of Supplemental Milk Supplies** provides tabular and graphical data regarding the four major source groups of outside the marketing areas supplies which provide a significant and necessary supplement the producer supplies located within the marketing area. Although each supplemental milk location may represent one or more states, and from multiple handlers, they have been grouped into supply sources representing milk originating in the Northeast Order area (Order No. 1) noted as "N" on the table, milk originating in the Mideast Order area (Order No. 33) noted as "M" on the table, milk originating in the Central Order area (Order No. 32) noted as "C" on the table, and milk originating in the Southwest Order area (Order No. 126) noted as "S" on the table. Following the tabular record is a map pictorial which displays the approximate area within the proposed Southeast Order area to which the milk was delivered during 2003.

As can be seen from the table and map depiction, much of the outside supplemental supplies can and does service plants located in and pooled in both the current Southeast and Appalachian Orders.

Milk originating in the Northeast Order area served plants in Virginia, the Carolinas, Georgia, and Tennessee. Milk originating in the Mideast Order area served plants in Kentucky, Indiana, Tennessee, Virginia, the Carolinas, Georgia, Alabama and Missouri. It is interesting to note, and more than a little telling, that milk originating in the Mideast Order area, from farms located in one of two adjacent counties in northwestern Indiana, served pool distributing plants located in Springfield, Missouri and Florence, South Carolina in the same month (August 2003). Springfield, Missouri and Florence, South Carolina represent the near full east-west breadth of the proposed Southeast Order area. Milk originating in the Central Order area served plants in Kentucky, Tennessee, Missouri and Arkansas. Milk originating in the Southwest Order area served plants in Kentucky, Tennessee, Arkansas, South Carolina, Louisiana Georgia, Alabama and Missouri.

Milk from the Southwest Order marketing area served plants located in Alabama, Arkansas, Georgia, Kentucky, Louisiana, Mississippi, Missouri and Tennessee. Milk from this area served plants located in both in Louisville, Kentucky and New Orleans, Louisiana in two months of the year 2003, those being September and October. This represents market coverage from milk from the Southwest Order area at virtually the full north-south span of the proposed Order.

Exhibit 48 **Item 20 – SMA154 States and Producer Milk Deliveries to Orders 5 & 7** and **Exhibit** 48 **Item 21 (A) thru (E) – SMA155 States Delivering Producer Milk to Orders 5 &/or 7 May & December 2000, 2001, 2002, 2003, and May and/or December All Years** shows the source of producer milk by state for each of the current Southeast and Appalachian Orders, utilizing published milk source data from the market Administrators for the months of May and December 2000, 2001, 2002 and 2003. Producer milk originated in 30 states for the two Orders in one or more of the eight months cited, with only seven of those thirty states serving only one of the two Orders over that time. Some states served both Orders all eight months; some states served one of the Orders at one time and the other Order during a different period. Substantially, the milk shed for the Southeast and Appalachian Orders extends eastward from a north-south line extending from the upper Midwest through the Great Plains to the Southern Plains to the Desert Southwest, and south of a line from the Upper Midwest through the Great Lakes states to New York. Virtually every state in that area serves as a supply region for the southeast, and further, virtually every state that area can, and has, provided supplies which can serve any part of the two current Orders.

There have been some changes in the states that supply various parts of the proposed Southeast marketing area, as shown in the state source map for 2003 versus previous years. Notably, milk in the Plains states has not moved as often to what is now the Appalachian Order area. The cooperatives supplying the Orders, working through their marketing agency in common have restructured the logical, economic and rational delivery points for these distant supplies, thus minimizing, to the extent possible the miles milk moves to serve the market.

Undoubtedly, there is substantial and significant overlap in the pool plants that can be and are serviced from outside the proposed marketing area producer milk supplies, as well as significant and substantial overlap in the delivery of producer milk produced within the proposed marketing area.

As shown in **Exhibit 48 Item 16 – SMA150 Location of Producers Pooled Appalachian Order 1005 and Southeast Order 1007,** the volume of producer milk received from producers located within the marketing area was supplied by 72.54 percent of the total number of producers whose milk was pooled on either of the two orders.

Using data for the month of October 2003 as shown in **Exhibit 48 Item 13 – SMA130 Comparative Statistics Federal Order Marketing Areas,** producer milk that would have been pooled on the proposed Southeast Order, at 1,122.0 million pounds, would rank the proposed Southeast Order second in size among all Federal Orders. Similar data on number of producers would however rank the proposed Southeast Order at fourth in size among all Federal Orders.

The volume of producer milk in October 2003 that would have been pooled on the proposed Southeast Order would represent approximately 15.8 percent of the total producer milk pooled on all Federal Orders that month.

Utilization:

According to the Market Administrators' published December 2003 pool statistics for handlers who would be fully regulated under the proposed Southeast Order, the Class I utilization percentages for the current Appalachian and Southeast orders were 69.19 and 64.66 percent, respectively. The combined Class I utilization for the proposed Southeast Order for December 2003 would have been 66.79 percent based on 783.1 million pounds of producer milk used in Class I out of 1,172.4 million total producer milk pounds pooled.

As shown in **Exhibit** 48 **Item 22 – SMA170 Utilization of Producer milk 2003 Appalachian Order 1005, Southeast Order 1007, and Combined F.O.1007**, for the year 2003, the Class I utilization percentages for the current Appalachian and Southeast Orders were 70.36 and 65.47 percent, respectively. The combined Class I utilization for the proposed Southeast Order for the year 2003 would have been 67.77 percent based on 9,071.9 million pounds of producer milk used in Class I out of 13,385.7 million pounds of total producer milk pounds pooled.

As shown in **Exhibit** 48 **Item 13 – SMA130 Comparative Statistics**

Federal Order Marketing Areas the combined Class I utilization for the proposed Southeast Order for the month of October 2003 would rank it as the second highest Class I utilization of all Federal Orders. The proposed Southeast Order would also rank second in the volume of Class I producer milk among all Federal Orders and that volume would represent approximately 19.5 percent of the total Class I producer milk on all Federal Orders.

As shown in **Exhibit 48 Item 22 – SMA170 Utilization of Producer milk 2003 Appalachian Order 1005, Southeast Order 1007, and Combined F.O.1007,** the combined Class II utilization for the proposed Southeast Order for the year 2003 would have been 12.07 percent based on 1,615.2 million pounds of producer milk used in Class II. The Appalachian and current Southeast Orders were 14.41 and 9.97 percent respectively.

The Exhibit shows that the combined Class III utilization for the proposed Southeast Order for the year 2003 would have been 12.75 percent based on 1,706.6 million pounds of producer milk used in Class III. The Appalachian and current Southeast Orders were 7.11 and 17.79 percent respectively.

Lastly, the Exhibit shows that the combined Class IV utilization for the proposed Southeast Order for the year 2003 would have been 7.41 percent based on 991.9 million pounds of producer milk used in Class IV. The Appalachian and current southeast Orders were 8.12 and 6.78 percent respectively.

Pool Plants:

Using distributing plant lists as published by the Market Administrators for December 2003 for the Appalachian Order No. 1005, Exhibit ___, fifty-two (52) distributing plants would be expected to be associated with the proposed Southeast marketing area. This compares to the 79 distributing plants that were expected, at the time of the final decision in 1999, to be associated with the consolidated Appalachian and Southeast Orders January 2000.

This list of distributing plants that would be associated with the proposed Southeast Order is also presented in **Exhibit** 48 **Item 3 - SMA030 Proponents Cooperatives Supplying Pool Distributing Plants Proposed Southeast Federal Order - November 2003**. As indicated in this Exhibit, all expected pool distributing plants are supplied by the proponent cooperative associations.

As shown in **Exhibit** 48 **Item 22 – SMA175 Map Pool Distributing Plants Federal Order 1005 & 1007 November 2003**, all but two (2) of the distributing plants are located within the proposed marketing area. The two (2) distributing plants located outside the area are located in the unregulated area in the state of Virginia.

As shown in **Exhibit** 48 **Item 4 - SMA040 Pool Distributing Plants Appalachian Order, No. 1005** and **Exhibit** 48 **Item 5 - SMA050 Pool Distributing Plants Southeast Order, No. 1007**, since January 1996, twenty (20) fewer distributing plants would be pooled on the proposed Southeast Federal Order, a 27.7 percent reduction during the last eight years. Since January 2000, seven (7) distributing plants in the proposed marketing area have gone out of business, a 11.9 percent reduction in just the last 48 months.

As shown in **Exhibit** 48 **Item 24 - SMA180 (A) & (B) Class I Packaged Milk Disposition by Pool Plants Southeast Federal Order No. 1007 and Appalachian Federal Order No. 1005**, the 52 plants expected to be fully regulated under the proposed Southeast Federal Order had Class I route distribution totaling 773.4 million pounds for the month of December 2003, with 86.58 percent made within the proposed marketing area.

As shown in **Exhibit** 48 **Item 25 - SMA190 (A) & (B) Class I Packaged Milk Disposition In the Marketing Areas - Southeast Federal Order No. 1007 and Appalachian Federal Order No. 1005,** total in-area Class I route disposition in December 2003 by all plants was 711.5 million pounds with 94.11 percent made by the 52 plants expected to be fully regulated under the proposed Southeast order.

As shown in **Exhibit** 48 **Item 7 - SMA070 Pool Supply Plants, Regulation and Operation Changes, January 1996 to December 2003 Appalachian and Southeast Orders**, only six (6) pool supply plants are expected to be associated with the proposed Southeast marketing area. All but one (1) of the supply plants are located within the proposed Southeast Order marketing area. As the Appalachian annual

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statistics show, Exhibit 10, two of these supply plants, Greenville, Tennessee and Louisville, Kentucky, are seasonal operations only. As of December 2003 the Greenville operation was sold to a private concern and will no longer be a seasonal balancing facility.

The one (1) pool supply plant that is located outside the proposed Southeast Order marketing area is one that is located in the unregulated area within the state of Virginia. As proposed, this is the only area outside the proposed Southeast Order marketing area in which a pool supply plant operated by a cooperative may be located.

As shown in **Exhibit 48 Item 13 – SMA130 Comparative Statistics Federal Order Marketing Areas,** the total number of plants expected to be pool plants under the proposed Southeast Order would represent approximately 14.6 percent of the total number of plants that are currently pool plants under Federal Order regulation. The proposed Southeast Order would rank third in the total number of pool plants regulated under the order.

The current language in Order 7 regarding the pooling of distributing plants based on the plants being located within the marketing area should be maintained. Since the middle 1980's distributing plants in the southeast have been "locked-in" as a pool plant in the order in which they are physically located in a number of the predecessor Orders to the current Orders 5 and 7. The current Orders 5 and 7 provide in Section .7(e) that two or more plants operated by the same handler may qualify as pool plants, as long as together they meet the in-area and Class I utilization requirements specified in Section .7(a). There is substantial evidence to continue this procedure and for pooling distributing plants in general based on their physical location.

As we have shown and will show, there is substantial competition between and amongst distributing plants located and pooled in the two current Order areas. An important element of total Class I milk cost to a plant is the competitive price which must be paid to producers who supply a plant or plants. Differences in milk-check prices to producers, either as a result of differences in Over Order prices or as a result of differences in the underlying Federal Order uniform prices, can result in unequal Class I milk costs to competing handlers. As we have shown and will show, differences in over order prices can in fact be a result of differences in the underlying Federal Order uniform prices. Handler Class I cost equity is most easily preserved when Federal Order uniform prices to producers are equitable and rational in light of the various plants which may be drawing from a group of producers similarly situated.

Plants located within the marketing area of the proposed Southeast Order supply approximately 95 percent of the fluid milk products distributed on routes in the proposed combined marketing area, signifying a significant and substantial amount of competition between the plants that are expected to be regulated under the proposed Southeast Order. The 5 percent of the fluid milk distributed on routes in the marketing area from other nonpool plants suggests that the competition for sales in the marketing area is predominately between the pool plants currently regulated under the two Orders. A portion of the remaining 5 percent of route disposition comes from nonpool plants located within the marketing area, leaving a very tiny slice of competition between handlers regulated under the proposed Southeast Order and handlers pooled on other Orders or partially regulated plants located outside the proposed marketing area. Since all but two of the pool plants currently regulated under the two Orders are located within the proposed Southeast Order marketing area, and the two plants located outside the marketing area are proposed to be included within the marketing area as described in Proposal Number 3, it is reasonable to conclude that those plants located within the marketing area constitute the vast majority of fluid milk sales competition, and since they are virtually all located within the marketing area, should thus be subject to the same Federal Order uniform price, subject to the same producer qualification criteria, and subject to the same pool plant qualification criteria. This would be accomplished by consolidating the two Orders and preserving the current regulatory status of plants that are located within the marketing area, but may distribute a plurality of their fluid milk outside the proposed marketing area. This problem is most typically limited to plants on the fringe of the marketing area.

Distributing plants represent a significant capital investment generally made in a large single time period and then in smaller but continuous increments over the life of the facility. From time to time market considerations such a population shifts, changes in milk shed location, consolidation in ownership of processing capacity and retail ownership can have negative and positive effects on the return potential of those capital investments. Lock-in provisions help to preserve the viability of those investments for the benefit of both the distributing plant and to dairy farmers.

The plants that are most frequently subject to lock in provisions are those on the edge of the market that may shift regulation due to product mix or to the distribution pattern out of the plant. Occasionally a "border plant" may serve a larger population center located out of the marketing area and if the calculations are "on the fence" a series of retail promotions in that location may cause a regulatory change in the plants status. Most times these changes are discovered on audit after the fact. When this occurs, the after the fact billing adjustments can be very expensive, result in difficult negotiating postures for both buyer and seller and generally lead to a deterioration in the business relationship.

Lock-in language provides for corrective action from a regulatory standpoint that cannot be easily accommodated by the market. We feel that the current language has proved beneficial to our membership, marketing efforts and customer relationships and is not opposed by any party in the hearing that we are aware of and therefore should be continued.

Plants located geographically near one another typically seek supplies from a common group or groups of producers. As previously stated, disorderly conditions can occur if plants procuring milk from these common groups of producers cannot offer a commensurate Federal Order blend price. In order to insure that these plants, all of which are in competition with other plants similarly situated and which are in competition for producer supplies continue to have a common blend price, with differences based only on plant location adjustment, plants located within the proposed geographical area of the Southeast Order should be pooled together, and should remain pooled together even if they have a plurality of route disposition outside the marketing area.

In summary, it is our testimony that all plants that are currently pool plants (both distributing plants and supply plants) under the separate Orders 5 and 7 should be afforded pool plant status under the proposed Southeast order. The only plant for which a change in regulatory status is contemplated would be the plant impacted in Proposal Number 3..

Fluid Per Capita Consumption:

Total packaged Class I fluid milk disposition within the proposed Southeast marketing area, by all plants (pool and non-pool), as shown in **Exhibit** 48 **Item 25 - SMA190 (A) & (B) Class I Packaged Milk Disposition In the Marketing Areas - Southeast Federal Order No. 1007 and Appalachian Federal Order No. 1005,** would have averaged 690.0 million pounds per month for the year 2003. Based on a population estimate of 47.5 million people within the proposed marketing area, per capita consumption of packaged Class I fluid milk disposed within the marketing area would have averaged 14.5 pounds per month.

Other Plants:

Located within the proposed Southeast marketing area, as shown in **Exhibit 48 Item 26 – SMA200 Nonpool Plants Located Within the Appalachian Federal Order No. 1005 – September 2003** and **Exhibit 48 Item 27 – SMA205 Nonpool Plants Located Within the Southeast Federal Order No. 1007 – September 2003** are 50 nonpool dairy plants. Included within this number of plants are 14 exempt distributing plants; three partially regulated distributing plants; and, one producer-handler plant.

Of the proposed Southeast marketing area's remaining 32 nonpool plants, 13 manufacture cheese, 12 manufacture ice cream, two are commercial food processors, two manufacture butter, one manufactures culture products, and one each manufactures powder and packaged condensed products.

Cooperative Associations:

As shown in the Market Administrator's Annual Statistical Summary for 2003, Exhibit 10 41, during the month of December 2003, thirteen (13) cooperative associations represented producer members who marketed producer milk that would have been pooled on the proposed Southeast Federal Order. **Exhibit _48_ Item 27 - SMA210 Southern Marketing Agency Inc. Number of Producers and Producer Milk Deliveries, Appalachian 1005 and Southeast 1007, December 2003** is a listing of those cooperative associations.

Exhibit _48_ Item ~~27~~ 98 - SMA210 Southern Marketing Agency Inc. Number of Producers and Producer Milk Deliveries, Appalachian 1005 and Southeast 1007, December 2003 also shows that Dairy Farmers of America, Inc. represented 48.9 percent of the total producer milk supply that was pooled on the Appalachian and Southeast Orders during December 2003. For the same month, Maryland & Virginia Milk Producers Association, Inc. represented 9.3 percent of the total producer milk pooled on the Appalachian and Southeast Orders. Of the eight other cooperative associations with member milk that would have been pooled on the proposed Southeast Order, five such cooperatives market their member milk either to, or on the behalf of, Dairy Farmers of America, Inc. or Maryland & Virginia Milk Producers Association, Inc.

As shown in **Exhibit _48_ Item ~~27~~ 98 - SMA210 Southern Marketing Agency Inc. Number of Producers and Producer Milk Deliveries, Appalachian 1005 and Southeast 1007, December 2003**, the five member cooperatives of Southern Marketing Agency, Inc. represented 5,242 members who marketed 66.22 percent of the total producer milk that would have been pooled on the proposed Southeast Order during the month of November 2003. Further, as shown in **Exhibit 68 Item 2 - SMA020 Producer Milk Deliveries Proponent Cooperatives and Others**, SMA marketed 79.07 percent of the total producer milk that would have been pooled on the proposed Southeast Order during the month of November 2003.

Criteria for Consolidation:

The criteria for consolidation of Federal Milk Marketing Orders that were used in the final rule are considered here in determining whether a sufficient degree of association in terms of sales, procurement, and structural relationships exists that will warrant the consolidation of the Appalachian Federal Order No. 1005 and the Southeast Federal Order No. 1007. Those criteria are discussed as follows:

Overlapping route disposition:

The movement of Class I packaged milk between Federal Milk Marketing Orders indicates that plants from more than one Federal Order are in competition with each other for Class I sales within the areas. In addition, a degree of overlap that results in the regulatory status of plants shifting between orders creates disorderly conditions in changing price relationships between competing handlers and neighboring producers.

Distances of major population centers of the Appalachian Federal Order and the Southeast Federal Order are generally within the reasonable distribution areas of pool distributing plants regulated under the other Order. As shown in **Exhibit** 48 **Item 29 – SMA220 Distance of Major Population Centers, Federal Orders 5 & 7 to Nearby Plants Located in the Adjacent Marketing Area,** the Appalachian Federal Order No. 1005 largest six MSA's are located from 95 miles to 311 miles from the nearest city with a Southeast Federal Order No. 1007 distributing plant. These MSA's are located from 140 miles to 356 miles from the second nearest city with a Southeast Federal Order No. 1007 distributing plant.

The Southeast Federal Order No. 1007 largest six MSA's are located from 112 miles to 477 miles from the nearest city with an Appalachian Federal Order No. 1005 distributing plant. These MSA's are located from 140 miles to 581 miles from the second nearest city with an Appalachian Federal Order No. 1005 distributing plant.

Eight of the twelve largest MSA's in the proposed Southeast Order marketing area are within the normal distribution distance of the nearest pool distributing plant located within the marketing area of the other Order, signifying significant and substantial overlap in the sales area of the proposed Southeast Order.

As illustrated in **Exhibit** 48 **Item 30 – SMA230 Orders 5 & 7 Marketing Area, 12 Largest Population Centers,** two-thirds of the largest population centers in the combined marketing area fall along the corridor of competition which currently is the border of the two Orders. That corridor is graphically shown in **Exhibit** 48 **Item 31 – SMA235 Corridor of Greatest Fluid Milk Sales.**

Section II-1. Consolidation of Marketing Areas, - 1. Overlapping Route Disposition of the Final Decision in Federal Milk Marketing Order Reform states that overlapping route disposition is the, "criterion ... considered to be the most important." As demonstrated from the evidence, the area of greatest competition for fluid milk sales in the entire southeast is the corridor along the border between Orders 5 and 7. The evidence demonstrates substantial and ever-increasing competition between Order 5 and Order 7 handlers, and substantial increases in this competition for fluid milk sales since the Secretary's final decision establishing separate Appalachian and Southeast Orders. The existence of such a significant area of fluid milk sales competition suggests **the removal of the border between the Orders, not the preservation of such a border.**

Within the marketing areas of the Southeast Federal Order No. 1007 and the Appalachian Federal Order No. 1005 there is substantial and significant competition for sales between plants regulated under the two Orders. **Exhibit** 48 **Item 22 – SMA175 Map Pool Distributing Plants Federal Order 1005 & 1007 November 2003** shows the location of those distributing plants located within the two Orders. Currently there are some sixteen (16) Federal Order No. 1005 pool distributing plants, of a total of 24, with Class I route disposition into the Southeast Federal Order No. 1007 marketing area while some seven (7) Federal Order No. 1007 pool distributing plants have Class I route disposition into the Appalachian Federal Order No. 1005 marketing area.

As shown in **Exhibit** <u>48</u> **Item 25 - SMA190 (A) & (B) Class I Packaged Milk Disposition In the Marketing Areas - Southeast Federal Order No. 1007 and Appalachian Federal Order No. 1005**, Class I disposition on routes inside the Southeast Federal Order No. 1007 area by Appalachian Federal Order No. 1005 Pool plants for the year 2003 was 11.25 percent of the total Class I route disposition by all plants in the Southeast Federal Order No. 1007 marketing area. From data contained in the exhibit, Class I route disposition by Appalachian Federal Order No. 1005 Pool plants was 63.9 percent of the total Class I route disposition in the Southeast Federal Order No. 1007 marketing area by all non-pool plants. When considering Class I route disposition into the nearby and adjacent area, that is western Kentucky, Nashville, TN., Northern Alabama, Atlanta, GA., and Savannah, GA., of the Southeast Federal Order No. 1007, Class I route disposition by Appalachian Federal Order No. 1005 pool plants could equal as much as one-fourth of the total route disposition in that nearby and adjacent portion of the Southeast Federal Order No. 1007 marketing area.

Class I route disposition in the Southeast Federal Order No. 1007 marketing area by Appalachian Federal Order No. 1005 pool plants has increased in total by 11.1 percent since January 2000. Each year-to-year comparison also shows an increase in this relationship. The increase was 5.9 percent in 2001 from 2000; 2.1 percent in 2002 from 2001; and 1.9 percent in 2003 from 2002.

As shown in **Exhibit** 48 **Item 25 - SMA190 (A) & (B) Class I Packaged Milk Disposition In the Marketing Areas - Southeast Federal Order No. 1007 and Appalachian Federal Order No. 1005**, for the month of December 2003, the 52 pool distributing plants that are expected to be fully regulated under the proposed Southeast Order supplied 94.11 percent of the total Class I route disposition by all plants within the proposed Southeast marketing area.

As shown in the exhibit, Class I route disposition by pool plants averaged over 94 percent for each of the years 2000, 2001, 2002, and 2003. This high a percentage supplied by pool plants indicates that the proposed Southeast marketing area is an extremely self-reliant marketing area in terms of Class I processing and distribution; with only slightly more that five percent of total route disposition within the marketing area would being delivered from nonpool plants.

As previously stated, 11.25 percent of the route disposition in the current Southeast order marketing area came from Appalachian order pool plants during 2003, representing almost two-thirds of the route disposition in the current Southeast order marketing area from all nonpool plants. The route disposition association, overlap if you will, from Order 5 pool plants into the Order 7 area exceeds the portion of route disposition into other nearby or and adjacent Orders from all nonpool sources. **Exhibit** 48 **Item 32 – SMA236 Class I Distribution on Routes in the Marketing Area Pool and Nonpool Plants, Selected Orders Million Lbs., November 2003** shows the portion of all route dispositions in the marketing areas from all nonpool sources for the Florida, Northeast, Central, Mideast and Southwest Federal Orders for the month of November 2003. The route disposition portion of Order 5 plants into the Order 7 marketing area exceeded the portion of route disposition from all nonpool sources into the Northeast Order area at 3.4 percent from all nonpool sources, the Mideast Order area at 6.8 percent from all nonpool sources, the Southwest Order area at 7.1 percent from all nonpool sources, and approached the amount distributed in the Florida which had 12.7 percent of its total route disposition from all nonpool sources. Only the Central Order had significantly greater route disposition from all nonpool plants than did Order 5 plants have into the Order 7 area.

Located within the current Appalachian Federal Order No. 1005 is a distributing plant which has a greater proportion of its total Class I route distribution into the Southeast Federal Order No. 1007 marketing area than into the Appalachian Federal Order No. 1005 area. The plant remains "locked in" as a pool plant under the Appalachian Federal Order No. 1005 so long as it maintains at least 25 percent of its total Class I route disposition into the Appalachian Federal Order No. 1005 marketing area.

Overlapping areas of milk supply:

This criterion applies principally to areas in which major proportions of the milk supply are shared between more than one Order. The competitive factors affecting the cost of a handler's milk supply are influenced by the location of the supply. The pooling of milk produced within the same procurement area under the same order facilitates the uniform pricing of producer milk.

There is a substantial and significant overlap of the supply of producer milk for the current Appalachian Federal Order No. 1005 and the Southeast Federal Orders No. 1007. As shown in Exhibits 38-41, 47-50, over the past four years, producers located within the marketing areas of the two Orders in southern Indiana, central Kentucky, central Tennessee, central North Carolina, western South Carolina, and central and southern Georgia have supplied milk to plants regulated under each of the two Orders. Likewise, milk from producers located in the Central Order area serve fluid milk plants located and pooled under both the Appalachian and Southeast Orders, as do producers located in the Southwest Order. Outside the marketing areas of the two Orders, producers located in northwestern Indiana and south central Pennsylvania have also supplied milk to plants regulated under each of the orders. Our knowledge of the market tells us that nearly all of the milk produced within the Marketing area stays within the boundaries of the proposed Southeast Order – not that remarkable since the area is a deficit market.

As shown in **Exhibit 45 Item 16 – SMA150 Location of Producers Pooled Appalachian Order 1005 and Southeast Order 1007**, for the month of December

2003, producers located in 28 states supplied milk to either the Appalachian Order No. 1005 or the Southeast Order No. 1007 pool handlers. Producers from 16 of these states supplied milk to both Appalachian and Southeast Order handlers with 13 of these states located wholly or partially within the proposed Southeast marketing area. For December 2003, 72.54 percent of the producers were located within the proposed Southeast marketing area.

As shown in **Exhibit** 48 **Item 17 – SMA151 Location of Producer Milk Pooled Appalachian Order 1005 and Southeast Order 1007,** for the month of December 2003, producer milk located in 28 states was supplied to either the Appalachian Order No. 1005 or the Southeast Order No. 1007 pool handlers. Producer milk from 16 of these states supplied milk to both Appalachian and Southeast Order handlers. For December 2003, producers who are located within the proposed Southeast marketing area supplied 53.14 percent of the producer milk, but these producers represented 72.54 percent of the number of producers supplying the Order. Obviously the producer milk pooled on the Orders from outside the marketing area originates on farms of larger than the average size for all producers on the Orders. Of the milk supplied from outside the marketing area much of it came from a few pockets of milk supply – populated by large farms. Much of this "out of area reserve supply" delivered regularly to handlers in both Orders. Adoption of our proposal would make this supply function operate more efficiently and less costly.

Number of handlers within a market:

Formation of larger-size marketing areas is a stabilizing factor. Shifts of milk and/or plants between Order markets become less of a disruptive factor in larger markets. Also, the existence of Federal Order markets with handlers too few in number to allow meaningful statistics to be published without disclosing proprietary information should be avoided.

As previously shown, during the month of December 2003 there were 52 distributing plants that were regulated under the Appalachian Federal Order No. 1005 or the Southeast Federal Order No. 1007. These are the same distributing plants that are expected to be pool distributing plants under our proposed Southeast Federal Order No. 1007. Fifty of these plants are located within the proposed Southeast marketing area with the remaining two located in the unregulated area of the state of Virginia.

The combination of the two Orders into the proposed Southeast Order will provide stability within the area, will minimize the shifting of milk and/or plants between markets and will foster the release of meaningful statistics without disclosing proprietary information.

Natural boundaries:

Natural boundaries and barriers such as mountains and deserts often inhibit the movement of milk between areas, and generally reflect a lack of population (limiting the range of the consumption area) and lack of milk production. Therefore, they have an effect on the placement of marketing area boundaries. In addition, for the purposes of market consolidation, large unregulated areas and political boundaries also should be considered a type of natural barrier.

In reviewing the marketing area of the proposed Southeast Federal Order No. 1007, as depicted in **Exhibit** 48 **Item 12 – SMA115 Federal Milk Order Marketing Areas**, it is clear that a substantial portion of the boundary of the proposed marketing area is formed by natural boundaries or barriers. To the south is almost 600 miles of coastline along the Gulf of Mexico; to the East is almost 600 miles of the coastline of the Atlantic Ocean; and, to the north are the unregulated areas of central Missouri, West Virginia, and Virginia.

Cooperative association service areas:

Cooperative membership is an indication of market association and provides support for the consolidation of marketing areas. The proposed Southeast Federal Order marketing area represents the service area of the Southeast Council of Dairy Farmers of America, Inc. As shown in **Exhibit** 48 **Item 27 - SMA210 Southern Marketing Agency Inc. Number of Producers and Producer Milk Deliveries,**

Appalachian 1005 and Southeast 1007, December 2003, for the month of December 2003, DFA member producer milk represented 48.9 percent of the total producer milk and 58.0 percent of the producers that were pooled on the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 and therefore would have been pooled on the proposed Southeast Order.

As previously discussed, the proposed Southeast Federal Order marketing area represents the service area of the Southern Marketing Agency, Inc. As shown in **Exhibit 48 Item ~~27~~ 28 - SMA210 Southern Marketing Agency Inc. Number of Producers and Producer Milk Deliveries, Appalachian 1005 and Southeast 1007, December 2003,** for the month of December 2003, SMA's cooperative member milk represented 66.22 percent of the total producer milk and 72.31 percent of the producers that would have been pooled on the proposed Southeast Order.

Also, as shown in **Exhibit 48 Item ~~27~~ 28 - SMA210 Southern Marketing Agency Inc. Number of Producers and Producer Milk Deliveries, Appalachian 1005 and Southeast 1007, December 2003,** during the month of December 2003 there were 8 other cooperatives, other than SMA cooperatives, that would have had member milk pooled on the proposed Southeast Order. Of these eight, 5 were delivering milk to, or for the account of, an SMA member cooperative.

The cooperatives represented by the Southern Marketing Agency, Inc. for the month of December 2003, marketed 62.32 percent of the total producer milk pooled on the Appalachian Federal Order No. 1005 and 69.68 percent of the total producer milk pooled on the Southeast Federal Order No. 1007. On a combined order basis, including the other cooperative milk marketed by a Southern Marketing Agency, Inc. cooperative, the Southern Marketing Agency, Inc. cooperatives would have marketed approximately 78 percent of the total producer milk that would have been pooled on the proposed Southeast Order.

Provisions common to existing Orders:

The regulatory provisions of the Appalachian Federal Order No. ~~1007~~ 1005 and the Southeast Federal Order No. 1007 are similar in most all respects except for the qualification provisions for producer milk and a producer. Here, they differ only slightly.

While not a Federal Milk Marketing Order regulatory provision, the common pooling of costs and returns for member milk that would be pooled on the proposed Southeast Order by the Southern Marketing Agency, Inc. cooperatives does recognize similar marketing conditions within the proposed Southeast Order area and provides further justification for the consolidation of the Appalachian and Southeast Orders.

Milk utilization in common dairy products:

Utilization of milk in similar manufactured products has been considered to be an important criterion in determining the consolidation of existing Federal Milk Marketing Orders. As shown in **Exhibit 48 Item 33 - SMA250 Utilization of Producer Milk, Appalachian and Southeast Federal Orders, 2000, 2001, 2002 and 2003,** the difference in the Class I utilization under the Appalachian and Southeast Orders, except for some seasonal variations, has remained relatively unchanged in 2001, 2002, and 2003. As shown in the exhibit, they were 5.08 points different for the year 2001; 4.49 points different for the year 2002; and 4.89 points different for the year 2003.

For the year 2003, the Class II, III, and IV utilization under the Appalachian Federal Order No. 1005 was 14.41, 7.11, and 8.12 percent respectfully while utilization under the Southeast Federal Order No. 1007 was 9.97, 17.79, and 6.78 percent respectfully. Class II and Class IV usage predominates under the Appalachian Federal Order while Class III usage is predominate under the Southeast Order.

A significant portion of the Class II usage difference between the Appalachian Federal Order and the Southeast Federal Order can be accounted for by the fact that there are at least three Appalachian Order distributing plants that are significant producers of Class II products that are distributed in the Southeast Federal Order marketing area.

The higher usage of producer milk in Class III under the Southeast Federal Order is related to the usage of reserve milk in the major production areas of southern Missouri and northern Arkansas. Reserve milk disposition in these areas is primarily in cheese. However, during the peak surplus disposal periods all of the seasonal balancing capacity of these plants is fully utilized regardless of product classification. So it seems reasonable that since all of the market uses and needs this capacity at the peak balancing period it should also share the returns equally during the remainder of the year.

Disruptive Marketing Conditions:

Blend Price Differences:

The differences in the Class I, Class II, Class III, and Class IV utilization of producer milk pooled under the Southeast Federal Order No 1007 and the Appalachian Federal Order No. 1005, leads to significant blend price differences which contributes to disruptive marketing conditions in those areas of common producer milk supply.

Exhibit 48 Item 34 - SMA255 Computation of Weighted Average Blend Price, Combined Appalachian and Southeast Federal Order shows the differences in blend prices between the Appalachian Order 1005 and the Southeast Order 1007 by months for the period January 2000 to date. This Exhibit also shows a Combined F.O. 5&7 weighted average Blend Price for the period, and the variation of that Combined blend price from the actual Appalachian Order 1005 and Southeast Order 1007 blend prices. The significant price differences as shown in the Exhibit contribute to the disruptive marketing conditions in the proposed Southeast marketing area.

The difference in the Class I utilization of producer milk pooled on the two orders is due primarily to a disproportionate burdening of the balancing of the supply of milk necessary to meet the two order's needs by the Southeast Federal Order No. 1007 pool. Producer milk pooled on the Southeast Federal Order No. 1007 is shifted to the Appalachian Federal Order No. 1005 to meet its needs during the fall.

The difference in the Class II utilization of producer milk pooled on the two orders is due primarily to the existence of at least three Appalachian Order pool distributing plants who have significant Class II operations and who supply a portion of the Class II needs of their operations, or stores, in the Southeast Order marketing area.

The difference in the Class III and IV utilizations of producer milk pooled on the two orders is primarily a result of the usage of reserve milk at Class III cheese operations in the northwestern Arkansas and Southern Missouri supply area of the Southeast Order. In the common producer milk supply areas of the two Orders, the disposition of reserve producer milk to Class III and IV usage is similar. However, due to the difference in prices for the two use Classes, significant blend price differences do occur.

Since the differences in blend prices between the current Orders 1005 and 1007 are borne largely from differences in uses and prices in the manufacturing classes, and not primarily from differences in Class I milk utilization, pooling additional milk on the higher blend price Order to lower its blend price is ill-advised. Under the current market structure, the blend price advantage enjoyed by Order 1005 producers over Order 1007 producers would be erased with modest increases in the Class III price. Such was the case in August and September 2003 when Order 7 had a higher uniform price than Order 5, despite a Class I utilization percentage that was greater in Order 5 than in Order 7. As such, the blend price inequities and disruptions that now exist would simply be flip-flopped and would continue. If additional milk had been pooled on Order 1005 to blend down the uniform price so that it equals the Order 1007 blend price, and such a change in the Class III/Class IV price relationship were to occur, the blend price in-equity issue would be magnified, with Order 1007 having a higher Class I utilization, and additional pool revenues from the higher Class III price. This concern is always present – that is there is always a group of producer who feel disadvantaged by the blend price relationship. When class price relationships change the emotion simply shifts to the other Order – even though there is little change in the supply demand patterns in the every day functioning of the market.

The existence of the separate Orders, which divide a single fluid milk market, oftentimes encourages this perpetual attempt to equalize the Order blend prices by shifting supplies back and forth between Orders. Inherent in this attempt to equalize the Orders' blend prices by shifting pooled milk is the hopeful predicting of the relationships of the Class II, Class III, and Class IV prices; market uses of Class I; and the determination of which supplies to shift onto or off of one of the Orders; and the costs associated with doing so. Such a system is disorderly on its face. Others have suggested that the disruptive blend price differences have resulted from an Order 5 uniform price that has most often exceeded the Order 7 uniform price. The disruptive blend price differences would be just as acute if the Order 7 uniform price was regularly greater than the Order 5 uniform price. The inherent problem is that the uniform prices are not equal across this single fluid milk market.

To help minimize the disruptive marketing condition resulting from the blend price differences which have occurred, beginning April 2002 the members cooperatives of the Southern Marketing Agency, Inc. began the common pooling of the costs and returns to supply member customers regulated under the Appalachian Federal Order No. 1005 and the Southeast Federal Order No. 1007. While this procedure has helped resolve the disruptive pricing difference between the members of the cooperatives involved, it will not equally share the burden for all the producer milk pooled on the two Federal Orders. Only a merger of the Southeast Federal Order No. 1007 and the Appalachian Federal Order No. 1005 will resolve the inequities that exist.

Transportation Pool Differences:

The current system of two Transportation Credit Balancing funds, with differing levels of payout has resulted in disorderly marketing conditions, manifested in two ways.

As shown in Exhibit 92 the Transportation Credit Balancing funds have not been adequately funded nor are funds drawn paid to suppliers in an equal manner. The Transportation Credit Balancing fund in Order 7 has been exhausted in each year 2001, 2002 and 2003, while the Order 5 Transportation Credit Balancing fund has been sufficiently funded to pay virtually all claims requested since 2000. The market administrator for Order 7 has had to prorate payments from the fund while the market administrator for Order 5 has not.

The first instance of disorderly marketing is in unequal costs of milk. The inequity in payout between the two Transportation Credit Balancing funds has resulted in unequal supplemental milk costs to handlers regulated by the two Orders. Handlers procuring supplemental milk for Order 5 have been reimbursed at 100% of their claimed credits, while handlers procuring supplemental milk for Order 7 have been reimbursed at approximately 50% of their claimed credits. This inequity results in an unequal regulated cost of milk, and equal costs of milk for handlers similarly situated is a hallmark of the Federal Order regulation. The two current Orders share a common milk shed, with producers, especially producers outside the marketing areas, regularly serving both current Orders. **Exhibit 48 Item 18 – SMA152 Delivery Location of Other Producer Milk Located in Other Marketing Areas Calendar Year 2003** (map) and **Exhibit 48 Item 19 – SMA153 Southern Marketing Agency, Inc.**

Primary Sources of Supplemental Milk Supplies (table) depicts the four major sources of outside the marketing areas supplemental supply for the current Orders 5 and 7, and the area those supplemental supplies service. As can be seen, each of the four major sources of outside the marketing areas supplemental supplies services plants located in and regulated under both Orders 5 and 7. This milk suffers the loss when the two current Orders' Transportation Credit Balancing fund payments are not sufficient, or suffers inequities in returns when the payouts of the two Orders' funds are not equal. Much of the milk that is currently procured outside the marketing areas can serve both current Orders, and as such, this milk should be treated equitably with regard to the Transportation Credit Balancing fund payments such milk is entitled to under the Order program.

The second instance of disorderly marketing is in encouraging uneconomic movements of milk, and in limiting economic movements of milk. The inequity in payout between the two Transportation Credit Balancing funds has resulted in milk moving further distances than would be required if a single Transportation Credit Balancing fund were instituted. **Exhibit** 48 **Item 40 – SMA281 Comparison of Transportation Credit Fund Payments FO 1005 vs. FO 1007 When Order 7 Prorates and Order 5 Does Not** describes how milk moves to the current Order 5 in deference to Order 7 purely for the purpose of garnering the higher transportation credit payout available in Order 5. Since the same milk from outside the marketing area can serve both Atlanta and Greenville, the economic and rational way to route the milk would be to serve nearest plant, domino-ing local and distant milk to fill the demand. Rather, as a result of the inequity in payout between the two Transportation Credit Balancing funds, milk will move farther than necessary.

Milk from the middle-Atlantic region can economically move well into the current Order 7 area to service plants there. However, during the time when Order 7 is prorating transportation credits the milk does not move beyond the borders of Order 5, since the return to this milk would be reduced precipitously when earning only a partial transportation credit on Order 7.

Achievements of Order Consolidation:

The proposed consolidation of the Appalachian Federal Order No. 1005 and the Southeast Federal Order No. 1007, creating a new Southeast Federal Order No. 1007, would result in the following:

1. Consolidation of the Appalachian and Southeast Orders would resolve a disruptive producer blend pricing issue which currently occurs in the common supply areas of the Appalachian and Southeast Orders. With similar Class I utilizations under the two orders, such a divergence of producer blend prices is primarily the result of the differences in Class II, Class III, and Class IV usage under the two Orders. Class II and Class IV usage predominate under the Appalachian Order while Class III usage is

predominate under the Southeast Order. Because of different prices for each Class, the contribution to the order Blend price varies substantially between the two Orders.

Measuring blend price disparities with percentage differences in blend prices trivializes the actual per-hundredweight differences, and those per-hundredweight differences' impact in the numerous areas of overlapping producer milk procurement.

As shown in **Exhibit** 68 **Item 35 – SMA260 Class I Utilization and Producer Blend Price Comparisons Appalachian F.O. No.5 and Southeast F.O. No. 7,** the simple average of the Southeast Federal Order 1007 blend price for the 48 months since Order consolidation is $14.057, and is $14.274 for the Appalachian Federal Order 1005. The average per hundredweight difference is $0.217, but that is less than two percent of either the Southeast Federal Order 1007 blend price or the Appalachian Federal Order 1005 blend price. While a two-percent difference in uniform price may seem nominal, a long-standing blend price difference of this magnitude would generally be considered sufficient to convince dairy farmers to seek to switch markets.

In those areas where producer milk is procured for both Orders, over-Order prices paid by plants procuring from nonmembers will likely be unequal, resulting in unequal Class I costs. Why would an Appalachian Federal Order No. 1005 handler pay the same premium as a Southeast Federal Order 1007 handler competing in the same area, when the Appalachian Federal Order 1005 handler starts at a $0.217 higher blend price? Conversely, the Southeast Federal Order No. 1007 handler must make up the difference between the Order 5/7 blend in the form of an over-order premium if the handler desires to retain its producers. Unequal Class I costs can be, and typically are, an element of disorderly marketing.

Blend price differences are a product of Class I utilization differences and many other factors. Those other factors can be: Class I price differences; utilizations in the other classes; prices of the other classes; inventories; overages; the effect of handler and producer location adjustments on the base zone blend price; skim/butterfat utilization differences; rounding in the pool; and other factors. It seems to us that the differences in blends which exist between the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 are greater that one would expect using a Class I utilization percentage difference times Class I differential only method.

As shown in **Exhibit 48 Item 35 – SMA260 Class I Utilization and Producer Blend Price Comparisons Appalachian F.O. No.5 and Southeast F.O. No. 7,** the simple average of the monthly Class I utilizations of the Appalachian Federal Order No. 1005 for the 48 months since consolidation is 67.96 percent, and is 63.43 percent for the Southeast Federal Order No. 1007, a simple difference of 4.53 percent. Our simple Class I utilization difference method would yield an expected blend difference of $0.140 per hundredweight (derived by multiplying $0.0453 per hundredweight time the base zone differential of $3.10) vs. the $0.217 we have seen.

This exhibit shows that the blend price differences have indeed been greater than the percent Class I utilization differences would suggest. Something else is going on, and that something is largely producer milk use differences in the lower priced classes of utilization.

All Federal Milk Marketing Orders have similar Class III and IV classifications and pricing so that the market returns can be shared equitably between producers delivering to powder plants and to cheese plants, when market returns on those sales can be vastly different. Because Order 5 and 7 are a single common market the returns from Class III and Class 4 should also be shared equally.

A distinction can be drawn, or rather should be drawn, on the difference between market balancing and market driven demand. The majority of the Class III production in the Southeast Order 1007 is not particularly determined by available milk supplies, which defines market balancing, but rather is processed to supply demand sales. The volume of milk going to Class III does not vary as much seasonally as does the supply of milk vary seasonally, which is the appropriate statistic in measuring what product(s) are used for market balancing.

The variation in processing into hard products in the Southeast Order 1007, as in the Appalachian Order 1005, is in milk used to produce Class IV. Both the Appalachian and the Southeast Orders use butter-powder as their balancing products. It is the existence of the Class III demand component in the Southeast Order 1007 as a contributor to the blend price differences between the Orders which is significant.

2. Consolidation of the Appalachian and Southeast Orders would recognize the inter-order competition for Class I sales within the Appalachian Federal Order No. 1005 and the Southeast Federal Order No. 1007 marketing areas - primarily within the eastern portion of the current Southeast Federal Order No. 1007 area. There is more competition for Class I sales in this area between Southeast Order 1007 plants and Appalachian Order 1005 plants than there is between Southeast Order 1007 plants in that area and Southeast Order 1007 plants located in the western portion of the Southeast Order 1007 marketing area.

Exhibit 48 Item 41 – SMA290 Overlapping Distribution Patterns FO 5 & FO 7 Bottling Plants graphically demonstrates the concentration of Class I processing and Class I sales distribution competition that exists along the current border separating Order 5 and Order 7. Each circle around a Class I processing plant location represents the normal distribution distance of a fluid milk plant, which we estimate to be approximately 250 miles. As can be seen from the Exhibit, the greatest concentration of processing plants lies along the border of Orders 5 & 7, and thus the greatest amount of sales competition lies along this border. The large magnitude of Class I route disposition from Order 5 plants into the Order 7 area previously testified to is not surprising given the location of the plants and not-coincidentally the location of population centers along the marketing Order border.

Post-Reform Federal Milk Marketing Orders don't look like, act like, or even feel like pre-Reform Orders. They are bigger and much different operational entities than they used to be. Using pre-Reform tests of market commonality are no longer rational comparisons. The 15,000,000 pounds of packaged Class I sales from outside, in a market, which has 90,000,000 pounds of total in-area sales, may have in the past suggested Order consolidation. But what caused the problem was not the fact that it was 16.67 percent from another Order area, it's that there were 15,000,000 pounds of sales in an area and the local producers were not getting to share in the proceeds of those Class I sales. In addition, the producers supplying the milk which went into those 15,000,000 pounds weren't getting to share in the Class I proceeds in the rest of the market where those 15,000,000 pounds were being distributed.

It's the 15,000,000 pounds that's important, not the 16.67 percent. Those same 15,000,000 pounds may still be problematic, but now they are divided by 400,000,000 pounds. It's the same problem, just a substantially different statistic. The same argument goes for producer milk procurement overlap. The problem gets lost in the enormity of the fraction's denominator.

The sheer size of current Federal Order marketing areas makes percentage comparisons of in-area sales volume a difficult statistic to quantify as a determining factor in the need to merge Order areas. From data contained in **Exhibit 68 Item 25 - SMA190 (A) & (B) Class I Packaged Milk Disposition In the Marketing**

Areas - Southeast Federal Order No. 1007 and Appalachian Federal Order No. 1005, total in-area route disposition in the Southeast Order 1007 area approximately 400 million pounds per month. Requiring twenty percent of that total to signal consolidation with another Order would require 80,000,000 pounds of in-area route disposition from that other Order.

From data contained in **Exhibit 48 Item 22 – SMA170 Utilization of Producer milk 2003 Appalachian Order 1005, Southeast Order 1007, and Combined F.O.1007** the average monthly producer milk pooled on the Appalachian Order 1005 is approx. 526 million pounds. Requiring 80,000,000 pounds of Class I route disposition into the Southeast Order 1007 area from the Appalachian Order 1005 pool plants would require 13.9 percent of the producer milk pooled on the Appalachian Order 1005 to be sold on routes in the Southeast Order 1007area. This simply would be too high a standard to meet, virtually anywhere in the country.

Additionally, using a simple computation of Class I disposition on routes from one Order, divided by the total Class I route sales in another Order, implies that route sales are evenly distributed across the entire Order area. Such is certainly not the case in either the Appalachian Order 1005 or the Southeast Order 1007. The concentration of population along the Appalachian Order 1005 and the Southeast Order 1007 border is greater than the concentration anywhere else in the Appalachian Order 1005 area or the Southeast Order 1007 area.

3. Consolidation of the Appalachian and Southeast Orders would recognize the extent of the common supply area for the current Appalachian Order 1005 and the Southeast Order 1007. As shown in **Exhibit 18 Item 16 – SMA150 Location of Producers Pooled Appalachian Order 1005 and Southeast Order 1007 December 2003**, for the month of December 2003, this common supply area covered 16 states including Alabama, Florida, Georgia, Indiana, Kentucky, Louisiana, Mississippi, Missouri, North Carolina, South Carolina, Tennessee, and Virginia within the proposed Southeast marketing area.

The Southern Marketing Agency milk budget showed a member milk deficit each and every month of 2003. This was true even while including in the Southern Marketing Agency member milk supplies geographically located outside the Appalachian Order 1005 and the Southeast Order 1007 marketing areas. The monthly milk deficits ranged from approximately 43 million pounds in April to 270 million pounds in August. The monthly demand figures did not include any monthly balancing reserve. It must be noted again that only the Orders in the southeast have insufficient in area milk production to meet Class I needs and a reasonable reserve. As such the overlap of producer milk procurement is significantly greater for milk located outside the marketing area than for milk located within the marketing area. This is true for two reasons:

1. Virtually all of the milk produced within the marketing area is serving demand customers, predominantly Class I.

2. Producer qualification requirements of the Orders, that is touch base requirements, limit the movement of milk with the proposed Southeast Order area.

4. Consolidation of the Appalachian and Southeast Orders would allow producer milk to move more freely between pool plants within the proposed Southeast marketing area. Due to producer and producer milk qualification provisions of the individual Orders, milk may not shift from one Order to the other when needed.

A substantial portion of the milk supply situated within the proposed Southeast Order would become more available for use by pool plants located in either of the two current marketing areas. However, while there is producer milk which moves between and amongst the two Orders, the producer qualification criteria of the two Orders as they currently exits forms a regulatory barrier to the free and efficient movement of this milk. In effect, the "producer touch-base" requirement for market association and diversion qualification is additive as the two Orders exist today. That is, in order to insure producer qualification on a producer which may be efficiently and effectively pooled on either of the two current Orders, the producer touch-base" requirement in the short-supply months is, in actuality, 16 days per month. That is the six days required in the Appalachian Order plus the 10 days required in the current Southeast Order.

Additionally, the requirement that a producer re-associate with a Federal Order market by being physically delivered to a pool plant limits flexibility and efficiency in milk movements. A producer whose milk can be easily shifted between distributing plants in the current Order 1005 area and the current Order 1007 area is treated in this re-association matter as if the producer was off one of the markets for some reason other than the supply of milk to a nearby Class I plant. For example, a producer located in central Tennessee can equally reach the distributing plants located in either the Nashville area or the Knoxville-Athens-Chattanooga corridor. As the Orders exist today, these producers must be assigned to one of the two Orders on a monthly or seasonal basis, and if the producer is shifted between the Orders, must re-associate with the producer's "home" Order by delivery to a pool plant prior to diversion, even though the producer was supplying a distributing plant only a short distance away and which likely is supplying Class I packaged fluid milk in the area in which the producer is located. This amounts to a regulatory limit on the efficient delivery of producer milk to a common Class I market.

5. Consolidation of the Appalachian and Southeast Orders would resolve a disruptive practice whereby the Southeast Order 1007 carries some of the balancing cost of supply for the Appalachian Order 1005. Producer milk may shift from the

Southeast Order pool to the Appalachian Order pool in the fall months to partially supply the needs of Appalachian pool plants.

Some milk does shift, but why does more milk not shift between the Appalachian Order 1005 and the Southeast Order 1007 to cover seasonal demand shifts? The answer is, there just isn't any milk left to move. It's all serving a local demand market.

In order to cover the monthly milk production deficits and provide even a modest reserve, milk must be procured from outside the market. If you're looking for milk supplies you just don't look to a place that is also looking for milk. You look to the places that have some extra. This is another reason why you don't see major milk movements between the Appalachian Order 1005 and the Southeast Order 1007.

6. Consolidation of the Appalachian and Southeast Orders would reflect the membership area of the Southeast Council of Dairy Farmers of America, Inc. in that its area of coverage corresponds to the proposed Southeast marketing area. As shown in **Exhibit 48 Item ~~27~~ 28 - SMA210 Southern Marketing Agency Inc. Number of Producers and Producer Milk Deliveries, Appalachian 1005 and Southeast 1007, December 2003,** Dairy Farmers of America, Inc. represents 58.0 percent of the producers and 48.9 percent of the producer milk that would be pooled on the proposed Southeast Federal Order 1007.

We need to erase the line that artificially separates a common milk market.

While we realize that the "cooperative service area" may be a small or secondary point in the consolidation-decisional process the Secretary has used in the past, the way a market is supplied and the industry's view of what constitutes a common milk market must be considered. Perhaps the salient question is "where else in the Order system is there a single marketing agency in common, like Southern Marketing Agency, Inc., which serves what constitutes the vast majority of two Orders as if they are one?"

Southern Marketing Agency, Inc. includes as part of its operational area portions of the Central and Southwest Orders, and the unregulated portion of Virginia in addition to the majority of the Appalachian Order 1005 and the Southeast Order 1007. The Greater Southwest Agency encompasses part of the Central Order with the Southwest Order in their operational territory, but in no way takes in even the majority of Order 32. We know of no other circumstance like exists in the southeast with regard to a single marketing agency in common and its supply of milk to a market that is split down the middle by a Federal Order boundary. Rather, the converse seems to be more often true. That is, multiple agencies supplying or pricing milk in a part of what is now a single Order.

7. Consolidation of the Appalachian and Southeast Orders would recognize the Southern Marketing Agency, Inc. common pooling of costs and returns across the proposed Southeast marketing area.

As shown in **Exhibit 48 Item ~~27~~ 28 - SMA210 Southern Marketing Agency**

Inc. Number of Producers and Producer Milk Deliveries, Appalachian 1005 and Southeast 1007, December 2003 Southern Marketing Agency, Inc. cooperative membership represents 72.31 percent of the number of producers and 66.22 percent of the producer milk that would be pooled on the proposed Southeast Federal Order 1007. Also, as shown in **Exhibit 48 Item 36 - SMA265 Southern Marketing Agency Milk Pooled**, the volume of producer milk included in its pool illustrates the scope of the Southern Marketing Agency. For the year 2003 that volume averaged 951.8 million pounds per month.

Comparison of the Southern Marketing Agency, Inc. pool with the volume of producer milk expected to be pooled on the proposed Southeast Order 1007, as shown in **Exhibit 48 Item 22 – SMA170 Utilization of Producer milk 2003 Appalachian Order 1005, Southeast Order 1007, and Combined F.O.1007,** indicates that the SMA pool for 2003 represents a volume equal to 85.3 percent of the proposed Southeast Order pool; and finally,

8. Consolidation of the Appalachian and Southeast Orders as defined in Proposal 1, will as best we can determine, not result in the regulation of any additional parties under the proposed Southeast Federal Milk Marketing Order 1007.

Revised Producer Milk Provisions

Our proposal to modify certain paragraphs of section 1007.13 Producer Milk only converts the 'touch base" requirements of the provision from a number of "days" production basis to an equivalent "percentage" of production basis. In addition, the proposal changes the day of the month on which milk of a dairy farmer shall be eligible for diversion. The latter provision would provide that a dairy farmer shall be eligible for diversion the first day of the month during which the milk of the dairy farmer meets the touch base requirements of the Order. These provisions are deemed necessary in order to accommodate the advent of large dairy farms that ship multiple loads of milk per day. Previous testimony has demonstrated that the distant milk supplies, which provide a significant portion of the markets reserve, originate from farms that on average produce more milk per month than do the producers located within the proposed marketing area.

Under a Federal Milk Marketing Order it is necessary to designate clearly which milk will be subject to the various provisions of the proposed order. This principle was clearly articulated and applied in the decisions dealing with performance standards held over the past two years in Orders 30 / 32 / 33 / 124 and 135. The order accomplishes this by defining specific terms that describe the persons, that is producers, whose milk will be subject to the uniform prices.

The term 'producer' defines those dairy farmers who constitute the regular source of supply for the order. Producer status under the proposed order is provided for any dairy farmer who produces milk approved by a duly constituted regulatory agency for fluid consumption as Grade A milk and whose milk is received at a pool plant directly from the producer's farm or is picked up at the farm by a cooperative as a bulk tank milk handler for delivery to a pool plant. Producer status is also accorded to a dairy farmer who has an established association with the market and whose milk is diverted from a pool plant to a nonpool plant by a cooperative association or a pool plant operator.

To establish a producer's association with the market, our proposal requires that a dairy farmer's milk must be delivered to a pool plant each month to qualify such dairy farmer's milk for diversion to a nonpool plant.

The 'producer milk' definition, Section 13 of the proposed Southeast Federal order, defines the milk that will be priced and pooled under the order. Specifically, the provision deals with the minimum receipt requirements of individual producers and with allowable diversions of producer milk pooled on the order.

As previously stated, a Federal order must contain minimum performance standards in order to determine what milk should be pooled and share in the marketwide equalization associated with the Class I sales. Our proposed 'producer milk' definition is intended to both assure that milk pooled on the proposed Southeast Federal order is closely associated with fluid use in order to qualify for pooling and to assure that each producer who shares in the blend price performs for the market.

The minimum requirements included in our proposal are virtually the same as now contained in the current Southeast Federal Order 1007. However, the 'touch base' requirements have been converted from a "days" production to a "percentage" of production basis.

Our proposal would require that each individual producer deliver 15 percent of his production to a pool plant in each of the months of January through June and 33 percent of his production to a pool plant in each of the other months of July through December. A 15 percent requirement is equivalent to about 4.5 days production while a 33 percent requirement is equivalent to about 10 days production.

This requirement of a dairy farmers' milk being physically delivered to a pool plant is included so as to have some direct association between the producer each month and a pool plant of the proposed Southeast order. Without a provision of this kind, milk of a producer could be pooled without ever having to come to a pool plant. The provision indicates that the milk of that producer is associated with a pool plant of the order at least part of the month while still providing for the efficient handling of the milk. Milk can be diverted direct from the farm to a nonpool plant for all other times of the month if not needed at the pool plant.

If a producer's milk is not needed and not associated with the market for at least 33 percent of the producers production during the fall months of July through December, then that producer should not be considered as part of the regular supply of milk for the fluid needs of the order. A 33 percent of production standard is a reasonable minimum requirement for associating an individual producer's milk with the marketwide pool during the short production months.

First of all, milk is at peak demand on Wednesdays, Thursdays, and Fridays of each week. Since every month has at least four Wednesdays, Thursdays, and Fridays, a producer's milk would have to be brought in for only the days on which the Class I needs of the order pool plants are at a peak in order to meet the minimum delivery requirements.

Without delivery requirements for individual producers, it would be far to easy for the operator of a pool plant to associate enough milk with the order pool so that their utilization would always be at the minimum permitted under the order. Marketing conditions in the proposed Southeast area, as reflected by the Class I utilization percentage of the Orders, as shown in **Exhibit 48 Item 33 - SMA250 Utilization of Producer Milk, Appalachian and Southeast Federal Orders, 2000, 2001, 2002 and 2003** and **Exhibit 48 Item 35 – SMA260 Class I Utilization and Producer Blend Price Comparisons Appalachian F.O. No.5 and Southeast F.O. No. 7,** support the 33 percent of production delivery requirement for the short production season. If producers are to be considered as part of the necessary and reserve supply of milk for the order, then 33 percent of their production should brought in during the fall months. Our experience in the day-to-day operations of the market would support the proposal that at least 33 percent of a producer's monthly production during the fall months is a reasonable standard in order to be able to share fully in the Class I utilization of the marketwide pool.

Our proposal does not change the total amount of producer milk that may be diverted by the operator of a pool plant, or a cooperative association, to nonpool plants during the month. Our proposal would continue the current provisions of the Southeast Order that limit diversions to nonpool plants to a volume equal to thirty three percent of the producer milk that is physically received at pool plants as producer milk of such handler during the months of July through December, and 50 percent in the other months.

Marketing conditions based on historical trends and previously discussed and shown in **Exhibit 48 Item 35 – SMA260 Class I Utilization and Producer Blend Price Comparisons Appalachian F.O. No.5 and Southeast F.O. No. 7,** indicate that the average Class I utilization of the proposed Southeast Order during most of these months will probably exceed 67 percent. A high utilization necessitates that the milk pooled on the order during these months be made available for fluid use. These proposed limits in line with historical requirements, will permit the efficient disposition of milk that is not required at pool plants for fluid use.

Finally, we have proposed to include in the combined Southeast Order a new provision, 1007.13(d)(6), that provides that milk of a dairy farmer shall be eligible for diversion the first day of the month during which the milk of such dairy farmer is physically received as producer milk at a pool plant and the dairy farmer meets the delivery requirements of the proposed Southeast Order.

This proposed provision is new to the current Southeast Order. The current Southeast Federal Order 1007 follows a procedure that does not make the dairy farmer eligible for diversion until the first day after the milk of the dairy farmer is received as producer milk at a pool plant unless the milk of the producer was associated with the Order 7 pool at the end of the previous month.

Application of this our proposal across the proposed Southeast Federal Order 1007 will promote efficiency in the delivery of a dairy farmers milk to the market.

Transportation Credit:

As a result of the need to import milk to the Southeast from many areas outside the southeast during certain months of the year, transportation credit provisions were incorporated in the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 as they were in the previous 4 orders reformed January 1, 2000 into the current Appalachian and Southeast orders.

These provisions provide credits to handlers who incur additional costs to import supplemental milk for fluid use for markets during the short production months of July through December. The provisions restrict the use of credits by handlers to milk received from producers and plants located outside of the marketing areas. The credits are also restricted to milk received from producers who supply the markets only during the short season and are not applicable to milk of producers who supply the market throughout the year. **In addition, producers currently located within either of the Order 5 and Order 7 marketing areas are ineligible for transportation credits on either Order, that is each Order 5 and 7 recognizes producers located within the marketing area of the other Order to be a part of the regular supply for the southeast region.** In this provision, the Secretary has already established the inextricable supply relationship between Orders 5 and 7, and the commonality of supply for the orders. This concept is not new. Its underlying rationale is discussed in the decision that instituted transportation credits in 1996. Proposed Rule 7 CFR Parts 1005, 1007, 1011 and 1046 [Docket Number AO-388-A9, et al.; DA-96-08] The Secretary has, through this recognition of the southeast as a common market with regard to supply, signaled the need for the consolidation of the two orders. Proposal No. 1 simply extends that recognition to provide a common uniform price and terms of trade for all producers delivering to the market and a common set of producer qualification requirements for the market.

Proponent cooperatives propose that the transportation credit provisions be retained in the proposed Southeast Federal Order but modified to reflect the consolidation of the two individual orders. Those modifications, as outlined in our proposed revisions of Section 1007.82 are as follows:

First, revise paragraph (c)(1) to remove the exception "except Federal Order 1005". This is necessary since all of the Federal Order 1005 area would be merged into the new Southeast Federal Order 1007 marketing area. This is a conforming change and the exception is no longer necessary or appropriate.

Second, revise paragraph (c)(2)(ii) to incorporate a temporary proviso which would provide for the equitable implementation of the transportation credits under the proposed Southeast Federal Order 1007 should the effective date of the merger be after the month of January. The temporary provision would provide that any dairy farmer who qualified for payments under the provisions of the former Appalachian Federal Order 1005 or the former Southeast Federal Order 1007 shall continue to qualify under these provisions of the consolidated Southeast order through the following January.

Absent this provision, some producers who qualify for transportation credits under the current Appalachian Federal Order 1005, and who had the previous year qualified for such payments under the current Southeast Federal Order 1007, would not be eligible, pursuant to this section, to receive transportation credit payments under the proposed consolidated Southeast Federal Order 1007.

Adoption of this provision would not be necessary should the consolidated order become effective on January 1 of any year. In that regard, January 1, 2005 or sooner would be an acceptable date to the proponent cooperatives for the implementation of the consolidated Southeast Federal Order 1007.

Third, revise paragraph (c)(2)(iii) to remove the words "or the marketing area of Federal Order 1005". This again is necessary since all of the Federal Order 1005 area would be merged into the new Southeast Federal Order 1007 marketing area. This is a conforming change and the exclusion is no longer appropriate.

Southern Marketing Agency, Inc. offers the following modification to Proposal No. 1. In section 1007.81 amend the current maximum rate of assessment for the Transportation Credit Balancing fund from the current maximum of $0.070 per hundredweight to $0.100 per hundredweight. There is substantial evidence in support of this modification and amendment.

The current maximum rate of $0.070 per hundredweight, which has been the rate assessed by the Market Administrator since the current Southeast Federal Order 1007 was formed, has been insufficient in the current Southeast Federal Order 1007 to generate funds necessary to cover the claimed Transportation credits. Since the current Southeast Federal Order 1007 was formed under Order Reform in 2000, only in that year were the collections by the Market Administrator sufficient to cover the claimed Transportation Credits. In 2001, 2002 and 2003, the assessments generated were substantially short of the amount of transportation credits claimed. According to information published by the Market Administrator in the monthly Southeast Order Bulletin, claims were made for transportation credits in the current Southeast Federal

Order 1007, which exceeded the available fund balance, by the amounts of $1,096,064 in 2001; $1,078,292 in 2002; and $3,078,667 in 2003. The anticipated continued decline of milk production in the southeastern region, coupled with expected continued increases in demand in the region suggests the amount of supplemental milk, that is milk for which a transportation credit can be claimed, will continue to increase. As such, the deficit in the Southeast Order's Transportation Credit Balancing fund will likely continue, and will likely worsen.

The maximum Transportation Credit Balancing fund assessment rate of $0.065 per hundredweight in the current Appalachian Federal Order 1005 has been sufficient to cover all claims for Transportation Credits ~~to date~~ until Dec. 2003 ---. In fact, the Market Administrator waived the Transportation Credit Balancing fund assessment two months in each year of 2001, 2002 and 2003. However, in 2003 the balance in the Transportation Credit Balancing fund for the Appalachian Federal Order 1005 declined such that it neared the amount of claimed Transportation Credits in the latter months of the year. It is anticipated that the Market Administrator will not waive the assessment in 2004 due to the substantially lowered Transportation Credit Balancing fund balance. According to Market Administrator statistics, the Appalachian Federal Order 1005 Transportation Credit Balancing fund balance at the end of 2003 was virtually zero.

Exhibit 48 Item 37 – SMA280 Transportation Credit Analysis shows, hypothetically, based on information published by the Market Administrators for the

Southeast Federal Order 1007 and Appalachian Federal Order 1005, how the balances in a merged Transportation Credit Balancing fund for the period of 2000-2003 would have appeared. The hypothetical calculation also presumes that a merged Transportation Credit Balancing fund would have carried an assessment rate of $0.070 per hundredweight, the current maximum in the Southeast Federal Order 1007, and would not have waived the assessment any month in the four year period.

As can be seen from the exhibit, balances in a merged Transportation Credit Balancing fund would have been sufficient to pay all claims in 2000, 2001, and 2002. However, even a merged Fund, with assessments set at the current maximum of $0.070 per hundredweight for four years, would have been insufficient to pay all Transportation Credits claimed in 2003. As can be seen, neither the current assessment rate of $0.07 per hundredweight in Order 7 nor the current assessment rate of $0.065 per hundredweight in Order 5 is sufficient to cover the claimed credits.

The calculated hypothetical unpaid Transportation Credit claims in the merged Fund would have been $2,889,942 in 2003. The total Class I producer milk of the combined Southeast and Appalachian Orders during 2003 was 9,070,871,486 pounds, meaning in order to cover the shortage in the Fund balance, the assessment rate would have had to be increased by $0.032 per hundredweight in 2003, for a necessary effective assessment rate of $0.1032 per hundredweight.

The $3,078,667 in unpaid Transportation Credits during 2003 in the current

Southeast Federal Order 1007 would have necessitated an assessment rate of $0.13665 per hundredweight in that Order alone, which is derived by dividing the unpaid credits amount by the 4,628,998,057 pounds of Class I producer milk pooled during 2003 in the Southeast Federal Order1007, and adding the assessed rate of $0.070. In actuality, the assessments in the current Southeast Federal Order 1007 were barely sufficient to cover one-half the claimed Transportation Credits. Inasmuch as the balance in the Order 5 Transportation Credit Balancing fund at the end of 2003 was in practical terms zero, the effective annual Transportation Credit Balancing fund assessment rate in the Appalachian Federal Order 1005 of $0.054 was inadequate. A balance of $1.7 million was carried over into the Order 5 Transportation Credit Balancing Fund from December 2002, accumulated from previous years. According to Market Administrator statistics, $4.1 million was paid in 2003 in Transportation Credits, which represents $0.0926 per hundredweight when divided by the 4.44 billion pounds of Class I producer milk pooled on Order 5 during 2003.

It is indisputable that the southeast region needs milk from outside the region to supply its Class I needs. The Transportation Credit assessment helps shift the cost of securing those needed supplies onto the proper market segment, the consumers of Class I products. In order to maintain equity among market participants, an appropriate Transportation Credit Balancing fund system must be maintained. There are several options for correcting the current inadequacies of the Transportation Credit Balancing fund system, but only one option will correct all of the current inequities.

The assessment rate for the Transportation Credit Balancing fund in the current Southeast Federal Order 1007 must be increased in order to cover the claimed but unpaid Transportation Credits. In order to fully fund the Transportation Credit Balancing fund the assessment rate must be doubled from its current $0.070 per hundredweight maximum. While this increase in assessments would theoretically generate enough funds to cover the claimed Transportation Credits, it would create a Class I price alignment issue with the current Appalachian Federal Order 1005. In effect Class I processors located in the same Class I price zone as described in Section 1000.51 would in actuality have unequal Class I pricing. Such is currently the case at the difference between the current Appalachian Federal Order 1005 assessment rate of $0.065 hundredweight and the current Southeast Federal Order 1007 assessment rate of $0.070 per hundredweight, not counting the difference in months when the Appalachian federal Order 1005 assessment has been waived. The current nominal difference of $0.005 per hundredweight does not represent a material difference, but nonetheless any difference is not truly defensible. Doubling the assessment rate in the current Southeast Federal Order 1007 would create an effective Class I price difference between the Orders on the magnitude of $0.050 to $0.060 per hundredweight, or nearly a half cent per gallon. A difference of this size would certainly create competitive advantages and disadvantages between handlers when their stated Class I price is supposed to be the same.

Alternately, the current maximum rates in the two Orders can be maintained, which would preserve existing level of Class I price alignment between the Orders, but would perpetuate the inequitable differences to market suppliers in procurement costs on distant milk. Since the current Southeast Federal Order 1007 Transportation Credit Balancing fund can only fund approximately half of the claimed credits, the cost of hauling distant supplies for the Southeast Federal Order 1007 is substantially greater than for the Appalachian Federal Order 1005.

The only method available to rid the market of all of these inequities is to merge the two Transportation Credit Balancing funds. A common rate of assessment will preserve Class I price alignment, and a common pay-out rate will preserve equity in the costs of procuring supplemental supplies. Merging the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 and combining the Transportation Credit Balancing funds of the two Orders will accomplish all of these goals.

Except for the application of a uniform transportation rate of up to 10 cents per hundredweight, which is an increase of three cents per hundredweight for the current Southeast Federal Order1007 handlers and three and one-half of one cents per hundredweight for the current Appalachian Federal Order 1005 handlers, the Southern Marketing Agency, Inc. proposed transportation credit provisions are identical to those contained in the current Appalachian Federal Order 1005 and Southeast Federal Order

1007 Orders.

Additionally, Southern Marketing Agency offers the following modification to the Transportation Credit Balancing Fund provisions.

> 1007.82 (c)(B)(ii) ~~The dairy farmer was not a producer under this order during more than 2 of the immediately preceding months of February through May and not more than 50 percent of the production of the dairy farmer during those 2 months, in aggregate, was received as producer milk under this order during those 2 months; and~~
>
> 1007.82 (c)(B) (ii) The milk of a dairy farmer was not received as producer milk for more than 50 percent of the production of the dairy farmer during the immediately preceding months of March and April. The percentage amount specified in this section may be increased or decreased by the market administrator if the market administrator finds that such revision is necessary to assure orderly marketing and efficient handling of milk in the marketing area. Before making such a finding, the market administrator shall investigate the need for the revision either on the market administrator's own initiative or at the request of interested persons. If the investigation shows that a revision might be appropriate, the market administrator shall issue a notice stating that the revision is being considered and inviting written data, views, and arguments. Any decision to revise an applicable percentage must be issued in writing at least one day before the effective date.

Due to the location and distance of the supplemental milk supplies associated with the southeast and the coordination of those supplies into and out the market, a change is necessary to the definitions of which producers are eligible to receive transportation credits. Specifically, we propose that any producer that is located outside the marketing area of the proposed Southeast Order would be eligible for

Transportation Credits if that producer was not a producer for more than 50 percent of the producer's farm milk production during the months of March and April of each year.

More and more milk from outside the marketing area is needed to supply Class I needs of the market more and more months each year. The months in which surplus milk is available in the southeast from production within the marketing area has declined, and milk must be imported into the southeast to meet Class I demand most all months each year.

Milk imports into the southeast from distant sources have become commonplace in January, February, May and June. As such, deliveries of milk by dairy farmers located outside the marketing area as producer milk on the Order should not disqualify a dairy farmer from receiving Transportation Credit Balancing Fund payments in the following July through December period. The Order should continue to limit Transportation Credit Balancing Fund payments to milk from producers who do not constitute a year around supply of milk for the Order. Accordingly, a producer's milk would be eligible to receive Transportation Credit Balancing Fund payments if 50 percent or more of the dairy farmer's milk was not producer milk in the months of April and May.

Further, we believe that the market administrator should be given discretionary authority to adjust the 50 percent limit based on the supply and demand for milk in the area. The Market Administrator should have the authority, if warranted to adjust the requirement to zero percent.

The various exhibits entered at this hearing clearly demonstrate the expansion of the milk shed for the southeast, the decrease in production within the southeast, and the increasing need for milk produced outside the marketing area to meet Class I demand. This proposed modification of the Transportation Credit Balancing Fund payment provisions are necessary and should be adopted.

Section 1007.7 Pool Plant:

Proponent cooperatives recommend that the proposed Southeast Federal Order retain those provisions of the current Appalachian Order 1005 which provide for the pooling of a supply plant operated by a cooperative association where such plant is located outside the marketing area but within the state of Virginia.

Several of the dairy product manufacturing plants in the Southeast are operated by cooperative associations as "balancing plants". These "balancing plants" qualify for pooling based upon the performance of the cooperative association, not upon shipments from the plant alone.

A balancing plant may qualify for pool plant status based upon shipments directly from producers' farms as well as shipments from the plant. To qualify as a balancing plant, the plant generally must be located within the order's marketing area. This requirement ensures that milk pooled through the balancing plant is economically available to processors of fluid milk if needed. However, in the case of the current

Appalachian order, a cooperative balancing plant also may be located in the State of Virginia. This provision was contained in the previous Carolina Federal order and was continued in the reformed Appalachian order.

A primary mission of Southern Marketing Agency, Inc., is to efficiently provide milk to handlers for fluid use and to efficiently dispose of milk when not needed for fluid use. The proposed Southeast Order provision should accommodate and encourage efficient milk handling practices. Therefore, the proposed provisions of Section 1007.7(d) should be included in the proposed Southeast Federal Order.

Proponent cooperatives also recommend that the proposed Southeast Federal Order retain those provisions of the current Appalachian Order 1005 which provide for the "nonpool" status of a portion of a pool plant designated as a "nonpool plant" that is physically separate and operating separately from the pool portion of such plant.

In the current Appalachian Federal Order 1005, a pool supply plant does not include any portion of a plant that is not approved for handling Grade A milk and that is physically separated from a portion of a plant that has such approval. While some inspection agencies render only one type of approval for an operation, to accommodate those areas where split operations are permitted, the current Appalachian Federal Order 1005 provide for a physically separated portion of the plant as a "nonpool plant."

Proponent cooperatives believe that the inclusion of this provision in the proposed Southeast Federal Order would be appropriate.

Proposal No. 2: Consolidation of Funds:

To complete the consolidation of the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 effectively and equitably, the reserve balances in the marketing service, administrative expense, producer-settlement funds, and the Transportation Credit Balancing funds that have resulted under the individual orders should be combined.

The marketing area of the proposed Southeast Order, as described in proposal No. 1, is the same territory now covered by the two individual orders. Because of this, the handlers and producers servicing the milk needs of the individual Appalachian Federal Order market and the Southeast Federal Order market will continue to furnish the milk needs of the proposed Southeast Federal Order market.

In this regard, the reserve balances in the funds that have accumulated under the two individual orders should be combined into the appropriate fund established for the proposed Southeast Federal Order. Any liabilities of such funds under the individual orders would be paid from the appropriate newly established fund of the proposed Southeast Federal Order. Similarly, obligations that are due the separate funds under the individual orders would be paid to the appropriate combined fund of the proposed Southeast Federal Order.

The money accumulated in the marketing service funds of the individual orders is that which producers for whom the market administrators are performing such services have paid. Since the marketing area of the proposed Southeast Federal Order encompasses the territory covered by the two individual orders, the producers who have contributed to the marketing service funds of the individual orders are expected to continue supplying milk for the proposed Southeast Federal Order. Since marketing service programs will be continued for these producers under the proposed Southeast Federal Order, it would be appropriate to combine the reserve balances in the marketing service fund of the proposed Southeast Federal Order.

The money paid to the administrative expense fund is each handler's proportionate share of the cost of administrating the order. Handlers regulated under the two individual orders will continue to be regulated under the proposed Southeast Federal Order. In view of this, it would be an unnecessary administrative and financial burden to allocate the reserve funds of the two individual orders back to handlers and then accumulate an adequate reserve for the proposed Southeast Federal Order. It would be equitable and more efficient to combine the remaining administrative monies accumulated under the two individual orders in the same manner as the marketing areas are combined.

Likewise, the producer-settlement fund balances of the two individual orders should be combined. They should be combined on the same basis as the two individual marketing areas are proposed to be consolidated. This will enable the producer-settlement funds of the proposed Southeast consolidated order to continue without interruption.

The producers currently supplying the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 are expected to supply milk for the proposed Southeast consolidated Order. Thus, monetary balances in the producer-settlement funds of the two individual orders now would be reflected in the pay prices of the producers who will benefit from the proposed Southeast Federal Order. The combined fund for the proposed Southeast Federal Order also would serve as a contingency fund from which money would be available to meet obligations (resulting from audit adjustments and otherwise) occurring under the two individual orders.

To complete the consolidation process, the reserve balances in the Transportation Credit Balancing funds that are in effect now under the two individual orders also should be consolidated. The reserve balances in the Transportation Credit Balancing funds of the Appalachian Federal Order 1005 and the Southeast Federal Order 1007 should be consolidated into a newly established Transportation Credit Balancing fund for the proposed consolidated Southeast Federal Order.

This procedure will enable the transportation credits to continue without interruption under the proposed consolidated Southeast Federal Order.

Summary: Proposals No. 1 and 2:

In summary, based on the record we have established, the proponent cooperatives strongly urge the Secretary to merge the Appalachian Federal Order No. 1005 and the Southeast Federal Order No. 1007 as proposed in proposals number 1 and 2. We believe that the record we have provided clearly demonstrates the need for this action.

Proposal No. 3: Expand the proposed "Southeast" marketing area in the State of Virginia.

Southern Marketing Agency, Inc. submitted the additional proposal No. 3 for consideration at this hearing to consolidate the current Appalachian and Southeast Federal Milk Marketing Orders. In §1007.2 Southeast marketing area add the following counties and cities to those already listed in Proposal No. 1 under the subheading "Virginia Counties and Cities":

In "Counties" add Alleghany, Amherst, Augusta, Bath, Bedford, Bland, Botetourt, Campbell, Carroll, Craig, Floyd, Franklin, Giles, Grayson, Henry, Highland, Montgomery, Patrick, Pittsylvania, Pulaski, Roanoke, Rockbridge, Rockingham, Smyth, and Wythe, and

In "Cities" add Bedford, Buena Vista, Clifton Forge, Covington, Danville, Galax, Harrisonburg, Lexington, Lynchburg, Martinsville, Radford, Roanoke, Salem, Staunton.

Exhibit 48 **Item 38 - SMA300 Proposal Number 3 Area** and **Exhibit** 48

Item 39 - SMA310 Proposal Number 2 Plants are maps depicting the proposed additional marketing area and the location of plants within the proposed additional area.

This proposal will have the effect of "locking in", as fully regulated plants under the proposed Southeast Federal Milk Marketing Order, the fluid milk distributing plants which are current Appalachian Order plants located at Lynchburg, Virginia, the Westover Dairy - Kroger Company plant, and the Roanoke, Virginia Valley Rich Dairy - National Dairy Holdings plant. Both the Lynchburg and Roanoke plants have been pool distributing plants under the Appalachian Order since the order's inception in January 2000. Lynchburg and Roanoke are in the southern portion of the State of Virginia, very close in proximity to the current Appalachian marketing area.

The inclusion of the southern Virginia counties contiguous to the Appalachian Order would solidify and perpetuate the regulation of the Lynchburg and Roanoke plants in the proposed Southeast Order. Further. The inclusion of additional marketing area northward up the Shenandoah Valley is expected to regulate, as a pool distributing plant in the proposed Southeast Order, the plant located at Mt. Crawford, Virginia. This plant is owned and operated by Dean Foods Co. - Mt. Crawford Division - Morningstar Foods.

The Mt. Crawford plant is currently a fully regulated distributing plant under the Northeast Federal Milk Marketing Order, but since the Northeast Order's inception in January 2000 has alternated between partially regulated and fully regulated status.

During the month of October 2003, 79 producer-members of Dairy Farmers of America, Inc.; 14 producer-members of Land-O-Lakes, Inc.; and 6 producer-members of Maryland & Virginia Milk Producers Cooperative Association, Inc. delivered milk to the Mt. Crawford plant.

To the best of our knowledge and belief, the regulatory status of no other plant would be impacted by the inclusion of the proposed additional Virginia counties and cities.

In support of this additional proposal regarding expansion of the proposed "Southeast" marketing area, proponent cooperatives make the following points:

1. The regulation of the Lynchburg and Roanoke plants should be continued in the proposed Southeast Order without regard to the location of Class I route disposition from those plants. The addition of marketing area in the southern Virginia counties nearby and adjacent to the current Appalachian Order marketing area will perpetuate the regulation of these two plants as current, i.e. regulated in the "southern" order(s), as opposed to possible regulation in some other Federal Order. The Lynchburg and Roanoke plants compete for a milk supply with plants located further south, that is North and South Carolina plants, and to insure an adequate supply for the Lynchburg and Roanoke plants the producers delivering to those plants must receive a blend price not less than that generated by the proposed Southeast Order.

It is our understanding from the operator of the plant that some possibility exists for the Lynchburg plant to distribute a plurality of its Class I route distribution in the Order 1 area, thus becoming a fully regulated distributing plant under that Order. Significant economic harm could come to the producers delivering to the Lynchburg plant if such were to occur. Additionally, the Lynchburg plant would be significantly disadvantaged in its procurement of milk if the blend price returned to producers delivering to that plant were an Order 1 blend price, when that plant is in direct competition for producer milk supplies with plants regulated in the proposed Southeast Order. In order to maintain its raw milk supply the Lynchburg plant would be forced to pay additional over-order prices not less than the difference between the Order 1 blend price and proposed Southeast Order 7 blend prices, resulting in unequal and uncompetitive Class I pricing to the Lynchburg plant. The Southern Marketing Agency, Inc. additional proposal seeks to preserve the regulatory status of the Lynchburg and Roanoke plants and avoid a disruptive and disorderly condition of blend price and regulatory differences.

2. In order for the Mt. Crawford, Virginia plant to procure an adequate supply of milk, producers delivering to that plant must receive a blend price equivalent to the blend price generated under a "southern" order. The milk supply located near the Mt. Crawford, Virginia plant is an attractive source of supply for plants located in southern Virginia which are currently fully regulated on the Appalachian Order, as well as plants located in North and South Carolina, and eastern Tennessee. In order to maintain its

raw supply the Mt. Crawford plant must pay additional over-order prices not less than the difference between the Order 1 blend price and current Order 5 blend prices, resulting in unequal Class I prices to the plant versus plants nearby, without regard to whether those plants are regulated under the Appalachian or Northeast Orders.

3. The Mt. Crawford, Virginia plant has alternated between fully regulated and partially regulated status under the Northeast Order since the Order began in January 2000. In the 48 months since the Northeast Order was promulgated, the Mt. Crawford plant has been fully regulated 30 months and partially regulated 18 months. During 2002 the Mt. Crawford plant was fully regulated during the months of January, February, June, July, November and December, and partially regulated the other months. The seemingly random change in regulatory status of the plant causes blend price disruptions to the producers delivering to the plant, as well as Class I pricing issues on the plant's route disposition outside of Federally regulated areas when the plant does not qualify as a fully regulated plant. A plant constantly switching into and out of fully regulated status is disorderly on its face, and in the case of the Northeast Order, this condition is exacerbated by that Order's Dairy Farmers for Other Markets provision.

Significant and substantial financial harm can come to producers supplying a plant that alternates between fully regulated and partially regulated status under the Northeast Order because producers may fail to qualify for pooling depending on the month or months during which the plant is regulated or partially regulated. Producers delivering to the plant would be harmed through no fault of their own. The location of the Mt. Crawford plant outside the Northeast Order marketing area makes the possibility of continued regulatory changes very real. Regulating the Mt. Crawford plant permanently under the proposed Southeast Order by including the plant in the proposed Order's marketing area would eliminate this market disruption and insure the fair and equitable treatment of the producers delivering to the plant regardless of changes in the location of Class I route disposition from the plant.

4. Regulating the Mt. Crawford plant in the proposed Southeast Order would offer cooperative suppliers to the plant the opportunity to maximize logistical efficiencies in supplying the plant, as well as the broader southeast market. Mt. Crawford, Virginia is located on Interstate 81, a major north-south artery to the southeast for out-of-area supplies from the middle Atlantic area. In the short supply months, milk from the middle Atlantic area is drawn south to supply the critically milk deficit fluid milk market currently covered by the Appalachian and Southeast Orders. Conversely, as milk is seasonally surplus in the southeast, milk is sent back north to the surplus manufacturing plants in the middle Atlantic area. Local milk and out-of-market milk are "domino-ed", rolling in and out as seasonal shortages and surpluses come and go. The Mt. Crawford plant is strategically located to serve as the first "domino-able" plant in the chain of milk supply for the southeast. Domino-ing milk as seasonal supply

and demand changes is the most efficient and cost effective system for balancing a fluid milk market. The regulation of the Mt. Crawford plant as a part-time Order 1 plant, coupled with the Order 1 Dairy Farmers for Other Markets provision makes such logistical efficiencies unattainable. Regulation of the Mt. Crawford plant permanently by the proposed Southeast Order would allow the cooperative suppliers of the plant to take advantage of logistical and operational efficiencies in supplying both the Mt. Crawford plant, as well as the larger market.

5. The Lynchburg, Mt. Crawford, and Roanoke, Virginia plants are all currently fully regulated under a Federal Milk Marketing Order. The Southern Marketing Agency, Inc. additional proposal would perpetuate the regulation of the two Appalachian Order plants in the proposed Southeast Order, and fix the regulation of the Mt. Crawford plant as a fully regulated plant under the proposed Southeast Order. As such, the impact of the Southern Marketing Agency, Inc. additional proposal on the Virginia State Milk Commission and Virginia base-holder producers would be insignificant. If there were any impact on Virginia base-holder producers the impact should be positive, reflecting the likely higher regulated average blend price at the Mt. Crawford plant under the proposed Southeast Order versus the Northeast Order; and,

6. The current Appalachian Order, and the new Southeast Order as proposed by Southern Marketing Agency, Inc., regulates a cooperative-operated supply plant located in the State of Virginia as if the plant were located in the marketing area. The typical

Federal Order provision regarding cooperative supply plants requires location within the marketing area. Since the promulgation of the Carolina Federal Order, a predecessor Order to the current Appalachian Order, the Secretary has recognized Virginia, and the milk supply located therein to be integral to the supply of milk and marketing of milk in the southeast. The Southern Marketing Agency, Inc. additional proposal regarding the pooling of three fluid milk distributing plants located in the State of Virginia simply extends the Secretary's previous recognition of Virginia and its milk marketing association with the south from cooperative-operated supply plants to fluid milk distributing plants.

Summary: Proposal No. 3:

In summary, based on the record clearly established, the proponent cooperatives urge the Secretary to expand the proposed Southeast Federal Order No. 1007 as proposed in Southern Marketing Agency, Inc. proposal number 3. We believe that the record clearly demonstrates the need for this further action.

Proposal No. 4: Expand Proposals No. 1 and 2 to include two additional counties and two additional cities in the state of Virginia.

Proponent cooperatives are not opposed to the adoption of Proposal No. 4. However, we believe that the purpose for the adoption of proposal no. 4 would be achieved by the adoption of the Southern Marketing Agency, Inc. Proposal No. 3 and therefore the adoption of proposal No. 4 would be redundant and unnecessary.

With respect to Proposals No. 1 through 3, we urge the Secretary to adopt our proposals as soon as possible.

Thank you