



# Federal Register

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**Wednesday,  
August 27, 2003**

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## **Part II**

### **Department of Agriculture**

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**Agricultural Marketing Service**

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**7 CFR Part 1032**

**Milk in the Central Marketing Area;  
Decision on Proposed Amendments to  
Marketing Agreement and to Order;  
Proposed Rule**

**DEPARTMENT OF AGRICULTURE****Agricultural Marketing Service****7 CFR Part 1032**

[Docket No. AO-313-A44; DA-01-07]

**Milk in the Central Marketing Area; Decision on Proposed Amendments to Marketing Agreement and to Order****AGENCY:** Agricultural Marketing Service, USDA.**ACTION:** Proposed rule.

**SUMMARY:** This document proposes to adopt as a final rule, order language contained in the interim final rule published in the **Federal Register** on February 12, 2003, concerning pooling provisions of the Central Federal milk order. It sets forth the decision of the Secretary and is subject to approval by producers. Specifically, this final decision would continue to amend the *Pool plant* provisions which: establish lower but year-round supply plant performance standards; would not consider the volume of milk shipments to distributing plants regulated by another Federal milk order as a qualifying shipment on the Central order; exclude from receipts diverted milk made by a pool plant to another pool plant in determining pool plant diversion limits; and establish a "net shipments" provision for milk deliveries to distributing plants. For *Producer milk*, this final decision would continue to adopt amendments which: establish higher year-round diversion limits; would base diversion limits for supply plants on deliveries to Central order distributing plants; and eliminate the ability to simultaneously pool milk on the Central order and a State-operated milk order that has marketwide pooling.

**FOR FURTHER INFORMATION CONTACT:** Jack Rower or Carol S. Warlick, Marketing Specialists, USDA/AMS/Dairy Programs, Order Formulation and Enforcement Branch, Stop—0231—Room 2971, 1400 Independence Avenue, SW., Washington, DC 20250—0231, (202) 720-2357, e-mail address: [jack.rower@usda.gov](mailto:jack.rower@usda.gov), or (202) 720-9363, e-mail address: [carol.warlick@usda.gov](mailto:carol.warlick@usda.gov).

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

These proposed amendments have been reviewed under Executive Order 12988, Civil Justice Reform. This rule is

not intended to have a retroactive effect. If adopted, this proposed rule will not preempt any state or local laws, regulations, or policies, unless they present an irreconcilable conflict with this rule.

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

**Regulatory Flexibility Act and Paperwork Reduction Act**

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Agricultural Marketing Service has considered the economic impact of this action on small entities and has certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. For the purpose of the Regulatory Flexibility Act, a dairy farm is considered a "small business" if it has an annual gross revenue of less than \$750,000, and a dairy products manufacturer is a "small business" if it has fewer than 500 employees.

For the purposes of determining which dairy farms are "small businesses," the \$750,000 per year criterion was used to establish a production guideline of 500,000 pounds per month. Although this guideline does not factor in additional monies that may be received by dairy producers, it should be an inclusive standard for most "small" dairy farmers. For purposes of determining a handler's size, if the plant is part of a larger company operating multiple plants that collectively exceed the 500-employee limit, the plant will be considered a large business even if the local plant has fewer than 500 employees.

Approximately 9,695 of the 10,108 dairy producers (farmers), or 95.9

percent, whose milk was pooled under the Central order at the time of the hearing (November 2001) would meet the definition of small businesses. On the processing side, approximately 10 of the 56 milk plants associated with the Central order during November 2001 would qualify as "small businesses," constituting about 17.9 percent of the total.

Based on these criteria, more than 95 percent of the producers would be considered as small businesses. The adoption of the proposed pooling standards serves to revise established criteria that determine those producers, producer milk, and plants that have a reasonable association with, and are consistently serving the fluid needs of, the Central milk marketing area and are not associated with other marketwide pools concerning the same milk. Criteria for pooling are established on the basis of performance levels that are considered adequate to meet the Class I fluid needs and, by doing so, determine those that are eligible to share in the revenue that arises from the classified pricing of milk. Criteria for pooling are established without regard to the size of any dairy industry organization or entity. The criteria established are applied in an identical fashion to both large and small businesses and do not have any different economic impact on small entities as opposed to large entities. Therefore, the proposed amendments will not have a significant economic impact on a substantial number of small entities.

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

This action does not require additional information collection that requires clearance by the Office of Management and Budget beyond currently approved information collection. The primary sources of data used to complete the forms are routinely used in most business transactions. Forms require only a minimal amount of information which can be supplied without data processing equipment or a trained statistical staff. Thus, the information collection and reporting burden is relatively small. Requiring the same reports for all handlers does not significantly disadvantage any handler that is smaller than the industry average.

*Prior Documents in This Proceeding*

*Notice of Hearing:* Issued October 17, 2001; published October 23, 2001 (66 FR 53551).

*Tentative Final Decision:* Issued November 8, 2002; published November 19, 2002 (67 FR 69910).

*Interim Final Rule:* Issued February 6, 2003; published February 12, 2003 (68 FR 7070).

**Preliminary Statement**

A public hearing was held upon proposed amendments to the marketing agreement and the order regulating the handling of milk in the Central marketing area. The hearing was held, pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601–674), and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900), at Kansas City, Missouri, on November 14–15, 2001, pursuant to a notice of hearing issued October 17, 2001, and published October 23, 2001 (66 FR 53551).

Upon the basis of the evidence introduced at the hearing and the record thereof, the Administrator, on November 8, 2002, issued a Tentative Final Decision containing notice of the opportunity to file written exceptions thereto.

The material issues, findings, and conclusions, rulings, and general findings of the tentative final decision are hereby approved and adopted and are set forth in full herein. The material issues on the record of the hearing relate to:

**1. Pooling Standards**

- a. Supply plant pooling standards.
- b. Cooperative supply plant performance standards.
- c. Supply plant system standards.
- d. Standards applicable for Producer milk.
- e. Establishing pooling standards for “State units.”
2. Simultaneous pooling of milk on the order and on a State-operated milk order providing for marketwide pooling.
3. Rate of partial payments to producers.
4. Determining whether emergency marketing conditions existed warranting the omission of a recommended decision and the opportunity to file written exceptions.

**Findings and Conclusions**

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

**1. Pooling Standards****a. Supply Plant Pooling Standards**

Several amendments to the pooling provisions of the Central order, previously adopted on an interim basis, are proposed to be adopted on a permanent basis by this final decision. According to the tentative decision, certain inadequacies of the supply plant pooling provisions were resulting in disorderly marketing conditions and the unwarranted erosion of the blend price received by those producers who consistently provide milk to meet the fluid demands of the Central marketing area. Specifically, the following amendments to the Central order (Order 32) for pool supply plants, previously adopted on an interim basis, are proposed to be adopted on a permanent basis by this final decision: (1) Lower the performance standards to 20 percent in each of the months of August through February and 15 percent in each of the months of March through July. Accordingly, automatic pool plant status during the 3-month period of May through July is thereby eliminated from the order; (2) Eliminate the volume of milk shipments made by supply plants to distributing plants regulated by another Federal milk marketing order as qualifying shipments in meeting the Central order supply plant shipping standard; (3) Exclude from receipts the diversions made by a pool plant to a second pool plant from the calculation of the diversion limits established for pool plants; and (4) Provide a “net shipments” standard for supply plant deliveries to the order’s distributing plants for the purpose of meeting the Central order’s supply plant shipping standard. Expanding pool supply plant qualification to include milk shipments to any plant that is part of a distributing plant unit was not adopted in the interim rule and is not adopted in this final rule.

Prior to the adoption of the interim rule, the Central order provided a supply plant performance standard whereby 35 percent of the milk received directly from dairy farms and cooperative handlers had to be transferred or diverted to distributing plants, including milk diverted by the plant operator, during each of the months of September through November and January. For all other months a 25 percent standard applied.

In addition, the Central marketing order provided automatic pool plant status during the 3-month period of May through July for supply plants provided they were pool plants during each of the immediately preceding months of August through April. The order did not

include a performance standard which considered shipments to any plant that was part of a distributing plant unit as a qualifying shipment. The order did not limit supply plant shipments to distributing plants on a “net shipments” basis.

Prior to adoption of the interim rule, handlers could qualify supply plants as pool plants located inside or outside the market area by diverting milk to a pool distributing plant regulated by the Central order. Supply plant transfers to distributing plants regulated by another Federal order were considered as qualifying shipments for the purpose of determining if the Central supply plant shipping standard had been met.

The following amendments to the supply plant pooling standards were presented in testimony related to a proposal published in the hearing notice as Proposal 1. This proposal was offered by Dairy Farmers of America (DFA), Prairie Farms Cooperative (Prairie Farms), and Swiss Valley Farms (Swiss Valley). These organizations are cooperative associations that historically have pooled milk on the Central milk order or one of the nine orders consolidated to form the Central milk order. Hereinafter, this decision will refer to these proponents as “DFA, *et al.*” All three cooperative associations have ownership interests in fluid milk processing plants. Prairie Farms and Swiss Valley operate fluid plants.

Amendments to the supply plant pooling standards were offered, the proponents assert, because the pooling provisions of the order are not appropriately linking the ability to pool milk on the order with demonstrating consistent service in supplying the fluid needs of the market. DFA, *et al.*, proposed changing the seasonally adjusted performance standard for supply plants to 25 percent during each of the months of August through November and to 20 percent for each of the months of December through July. Adopting these standards would also eliminate automatic pool plant status for the 3-month period of May through July provided by the order. DFA, *et al.*, expressed continued support for these performance levels during the same periods in their comments on the tentative final decision.

Proposal 1 as offered would no longer consider milk deliveries to distributing plants regulated by another Federal milk marketing order as qualifying shipments for determining if the supply plant performance standard for the Central Order had been met. Similarly, the proposal would not consider milk deliveries to distributing plants that are part of a distributing plant unit as

qualifying shipments for determining if the supply plant performance standard had been met.

Proposal 1 also would limit a handler's ability to qualify supply plants located outside the Central Order marketing area as pool plants through direct deliveries of milk to pool distributing plants. The proposal also calls for establishing a "net shipments" provision. A net shipments standard would exclude from a supply plant's qualifying shipments any transfer or diversion of bulk fluid milk products made by a distributing plant receiving a qualifying shipment.

In support for Proposal 1, the DFA, *et al.*, witness testified that the orderly marketing of milk requires appropriate performance standards for supply plants to ensure that distributing plants are adequately supplied with milk as a condition for receiving the Central order's blend price. The witness explained that performance standards should require a level of association to a market by demonstrating the ability to supply the Class I needs of that market. The witness testified that milk located far from the market also should have performance standards that are workable and consistent with Federal order policy. According to the witness, the current practice of using direct deliveries from farms to distributing plants located inside the marketing area as a method to qualify plants located outside of the Central order marketing area as pool supply plants is inappropriate because milk pooled in this manner does not provide any reasonable service to the Class I needs of the market.

According to the DFA, *et al.*, witness, the reform of Federal milk orders provided unique pooling standards that apply to each market on an individual basis. The witness testified that during the reform process, the more lenient performance standard was often selected for the new consolidated orders. According to the witness, such standards are proving to be inappropriate for the larger consolidated Central milk marketing order.

As evidence that milk is being inappropriately pooled on the order, the DFA, *et al.*, witness noted that at the time of implementing Federal milk order reform, the consolidated Central order was expected to have Class I use of nearly 50 percent. Instead, Class I use is averaging below 30 percent, the witness noted. The witness was of the opinion that this shortfall in projected Class I use was due to pooling much more milk from sources outside the marketing area than could be explained by consolidating the nine pre-reform

orders into the current Central order. The DFA, *et al.*, witness asserted that milk order reform did not intend to provide for pooling milk supplies on the Central order that would not also provide a consistent and reliable service to the Class I needs of the market. Stressing that such milk does not provide a consistent and reliable service to the Class I needs of the market, the witness maintained that such milk should not be pooled on the Central order and receive the order's blend price.

The DFA, *et al.*, witness testified that the ability of handlers to pool large volumes of milk from distant sources without having to actually deliver the milk to the market has resulted in a significant reduction of the blend price received by producers who are serving the market's Class I needs. The witness also asserted that some Central order fluid handlers are having difficulties in obtaining sufficient milk supplies and find themselves competing for a supply of milk with other fluid handlers regulated under adjacent orders where blend prices are higher.

The DFA, *et al.*, witness also explained that a portion of the pre-reform Southwest Plains order area had contributed a significant share of the milk supply needed for fluid use in the southeastern portion of the current Central marketing area. Much of the milk produced in Arkansas and southern Missouri became part of the milk supply for the Southeast order area, added the DFA, *et al.*, witness. The witness was of the opinion that adoption of Proposal 1 would result in a higher blend price for the Central order dairy farmers and enhance the ability of local Class I handlers to procure local milk supplies.

A DFA, *et al.*, witness from Prairie Farms testified that the significantly higher blend prices paid to producers under the neighboring Southeast and Appalachian orders are attracting milk supplies located in the southern and southeastern areas of the Central marketing area. The witness observed that these producers receive a higher price for their milk without incurring a significant change in hauling costs. The witness indicated that this situation is resulting in distributing plants needing to pay substantial over-order premiums to obtain a supply of milk for distribution in the Central marketing area.

Witnesses representing several distributing plant operators confirmed that they are experiencing problems obtaining an adequate supply of milk for fluid use, especially during the fall months. These fluid handlers supported

the adoption of Proposal 1 because the link between milk pooled on the Central order needs to be tied to actual deliveries of milk to the order's pool distributing plants.

A witness from Anderson-Erickson (A-E), a distributing plant operator regulated by the Central order, testified that the order's pooling provisions need to be revised to better condition the receiving of the order's blend price to actual performance in supplying the market's Class I needs. Similarly, a witness representing Suiza Foods (Suiza), a company which owns and operates distributing plants regulated by the Central order, testified that the pooling of milk on the Central order needs to be directly tied to actual performance in serving the fluid market. The Suiza witness stressed that actual performance in serving the fluid market should be necessary because it is the fluid market that generates the additional dollars to the marketwide pool.

The Suiza witness testified that their costs and ability to obtain raw milk for Class I use are tied directly to the pooling provisions of Federal milk orders, including the Central milk order. The witness stressed that blend prices, especially relative blend prices, provide the incentives for producers to move milk to where it is needed. However, explained the witness, Suiza faces new challenges in the Central marketing area since its formation under milk order reform. Specifically, the witness noted difficulty in procuring milk at one of their plants because local dairy farmers are delivering their milk to plants regulated on the Southeast and Appalachian orders. According to the witness, the blend prices in those orders are higher than in the Central milk order and therefore attract milk to those markets.

The Suiza witness was of the opinion that milk order reform placed other Central order distributing plants at a similar competitive disadvantage in competing for a supply of milk. While noting that the purpose of this proceeding is to address pooling problems resulting in lower blend prices to Central order dairy farmers, the witness stressed that in their opinion, the real issue that needs to be addressed is whether the Central order is too large. The witness cited the geographic diversity of the order and vastly differing marketing conditions within the marketing area's boundaries to question whether the Central order is truly a viable, single milk marketing area.

A witness from Mid States Dairy, an organization that operates a distributing

plant regulated by the Central order, testified that they were no longer able to source milk from their usual milksheds in southern Missouri and central Illinois. This witness stated that until recently, they had to rely on contracts with southern milk sources at premium prices to obtain a supply of milk because milk supplies were not available locally.

The DFA, *et al.*, witness testified that the order's supply plant performance standards should continue to be adjusted seasonally but at slightly different times. According to the witness, a higher standard of performance is needed for the months of August through November because increased customer demand occurs in those months. More importantly, the witness indicated that performance should be specified for every month of the year. In this regard, the witness from Prairie Farms added that specifying August through November for increased performance would help to ease their need to obtain additional milk supplies from other marketing areas.

Using milk located within the marketing area to qualify milk for pooling at plants located far from the marketing area was described by the DFA, *et al.*, witness as "pyramiding." The witness also attributed pyramiding to inadequate performance standards. As an illustration, the witness provided evidence to show how pooling provisions permit the pooling of milk volumes that cannot reasonably demonstrate performance in serving the Class I needs of the Central marketing area. As an example, the witness explained how a single tanker load of milk delivered to a pool plant within the Central order marketing area can qualify as many as 15 additional tanker loads of milk for pooling on the order through diversions. The witness contended that the ability to pyramid milk for pooling in this way reveals the inadequacy of the current pooling standards. Eliminating the ability to pyramid milk for pooling, the witness stressed, provides a basis for lowering the order's supply plant performance standard.

The DFA, *et al.*, witness testified that supply plants delivering milk to distributing plants not regulated by the Central milk order should not be counted in determining if the Central order's performance standards have been met. The witness indicated that such milk does not serve the Class I needs of the Central order. The witness offered that standards allowing for pool qualification to be earned from shipments to another order's distributing plants stem from pre-reform

pooling provisions that were generally associated with "reserve supply" orders where Class I use was relatively small. The witness contended that the consolidated Central order is not such an order. While deliveries of milk to another order could still occur, noted the witness, the deliveries should not count toward pool qualification.

The witness from DFA, *et al.*, also offered a modification to Proposal 1 for incorporating a "net shipments" feature for pool supply plants as a way to ensure that fluid milk was actually received and retained at a distributing plant for Class I use. According to the witness, this feature would prevent a supply plant from physically shipping milk into the facilities of a distributing plant only to have the milk reloaded and moved to another plant for uses other than Class I. The witness also noted that without a "net shipments" provision, suppliers could qualify milk for pooling on the Central order without that milk ever being available to service the Class I needs of the market.

The witnesses from A-E concurred with the need for a "net shipments" provision, as did a witness from Foremost Farms, USA, a cooperative whose plants were regulated under the Central and Upper Midwest milk marketing orders. A witness from Suiza, testified that while they did not oppose a "net shipments" provision, they were of the view that milk actually delivered to a distributing plant was performing a service to the Class I needs of the market. To the extent that the same milk is subsequently pumped back out of the plant, indicated the witness, that decision is made by the receiving handler. Therefore, concluded the Suiza witness, such milk should be counted in determining if the supply plant performance standard is being met.

Briefs from both A-E and Dean Foods<sup>1</sup> reaffirmed their opposition to the inclusion of supply plant shipments to distributing plant unit plants as counting towards meeting pool qualifying performance standards noting that a relatively large non-Class I volume of milk is often associated with distributing plant units. The briefs contended that pooling stand-alone Class II operations could result in placing pooling priority for milk used in Class II dairy products on a par with milk used for Class I. They viewed that adoption of expanding supply plant qualifying deliveries to distributing plant units would create inequities and

<sup>1</sup> Suiza Foods Corporation merged with Dean Foods Company on December 21, 2001, at which time the name of the merged company became Dean Foods Company.

perhaps even result in creating new disorderly marketing conditions.

Exceptions to the tentative final decision from A-E and Dean Foods agreed that the decision adequately and appropriately addressed the disorderly conditions raised by them and others in the record.

A group of cooperative associations with members located primarily in the Upper Midwest milk marketing area opposed amendments included in Proposal 1 because it was their view that the amendments would limit their ability to pool milk on the Central order. The cooperative associations included: Associated Milk Producers, Inc. (AMPI); Foremost Farms, USA (Foremost); Land O'Lakes (LOL); First District Association (FDA); Family Dairies USA (Family Dairies); and Lakeshore Federated Dairy Cooperative (Lakeshore), comprised of Midwest Dairymen's (Midwest Dairymen) Company, Manitowoc Milk Producers Cooperative, and Milwaukee Cooperative Milk Producers. Hereinafter this decision will collectively refer to this group of cooperative associations as the "Upper Midwest Cooperatives."

Testimony by the Upper Midwest Cooperatives' witnesses argued that the adoption of more restrictive pooling standards would force milk that currently is pooled on the Central order to be pooled instead with the Upper Midwest pool. According to the witnesses, this would result in lower blend prices to Upper Midwest producers because of the lower Class I use in that area. The witnesses also argued that adopting the amendments contained in Proposal 1 would establish the more stringent pooling provisions that were in effect prior to milk order reform. According to the witnesses, this would establish a barrier to pooling the milk of producers who had long been associated with the markets merged to form the Central order.

To illustrate their point that the amendments of Proposal 1 would limit their ability to pool milk on the Central order, an Upper Midwest Cooperatives' witness testified that under current pooling provisions, every pound of milk delivered to Central order pool distributing plants provides the ability to pool 15 additional pounds of milk. If the pooling provisions proposed are adopted, the witnesses indicated that only 3 additional pounds of milk could be pooled for each pound of milk delivered on the Central order.

The Foremost witness, testifying on behalf of AMPI, LOL, Family Dairies, Midwest Dairymen, and FDA, testified that if Proposals 1 and 5 (Proposal 5 is discussed in more detail later in this decision) were adopted, and if they

were pooling the maximum amount of milk allowed in the pre-reform orders, approximately 400 million pounds of milk per month would no longer be pooled on the Central order. Instead, the witness testified, this milk would be pooled on the Upper Midwest order. The witness maintained that this would increase the blend price differences between the two orders.

According to the Foremost witness, the blend price differences would have ranged between 32 cents per hundredweight (cwt) to as much as 91 cents per cwt for the one-year period of September 2000 through August 2001 if the pooling standards proposed had been in effect during that time. The witness emphasized this would have had an enormous adverse effect on the net income of Upper Midwest producers.

An Upper Midwest Cooperatives' witness from Family Dairies testified in opposition to pooling provision amendments that would limit the ability to pool milk on the Central Order and result in lower blend prices to producers located in the Upper Midwest. The witness stated that adoption of such proposals would result in creating more regional pricing problems and give selected handlers the ability to use the blend price as a procurement tool in areas outside the Central Order.

A witness for Lakeshore joined other Upper Midwest Cooperatives' witnesses by also stating their concern that the proposed pooling changes specifically in Proposals 1, 3, 5, and 7 (Proposals 3, 5, and 7 are discussed later in this decision) could force milk currently pooled on the Central order to instead be pooled on the Upper Midwest order. According to the witness, this would result in decreasing producer returns for those dairy farmers located in Northern Illinois and the surrounding area. Specifically, the Lakeshore witness explained that while a fluid milk plant at Rockford, Illinois, and a Dubuque, Iowa, distributing plant have the same federal order-dictated Class I price, the Rockford plant is disadvantaged because it has to pay a higher competitive value to attract Class I milk, adversely impacting their northern Illinois businesses.

A witness from LOL emphasized the necessity of basing pooling provisions on performance in serving the Class I needs of the market rather than the location of where milk originates. The witness was also of the opinion that the current order provisions provide adequate incentives to service Central order distributing plants. Stating that producers who share in the pool must

be willing to serve the market, the LOL witness nevertheless stressed that the ability to pool milk on the Central order pool should not be restricted for the benefit of a select few. The LOL witness testified that milk no longer pooled on the Central order would instead be pooled on adjoining milk orders such as the Upper Midwest or Western marketing areas and characterized these areas as already carrying a disproportionate volume of reserve milk.

In response to concerns that Central order Class I handlers are having difficulty in obtaining a supply of milk, the LOL witness provided an analysis which suggested that tightening pooling provisions would not achieve what the proponents of Proposal 1 assert. The witness estimated that adopting the proposed pooling provisions would result in an increase of 35 cents per cwt in the Central Order blend price.

According to the witness, such an increase would still leave the Central order blend price \$1.48 per cwt below the blend price of the Southeast order thus weakening the argument that the higher blend price would mitigate the problem of Central order distributing plants securing a supply of milk.

The LOL witness asserted that the combination of Proposals 1, 3, 5, and 7 would place unreasonable restrictions on milk produced outside the marketing area relative to milk produced inside the marketing area. The witness indicated that supply plants located outside the marketing area would be required to receive milk and transfer it to distributing plants, thereby causing uneconomic movements of milk, adding costs and degrading milk quality due to additional handling. Furthermore, barriers to trade would be created by adopting these proposals, indicated the witness.

Two of the Upper Midwest Cooperatives' witnesses introduced cost-of-production studies conducted by universities indicating that dairy farmers in northern Illinois and Wisconsin enjoy little financial return from their dairy operations. The Foremost witness cited the Wisconsin study to indicate that in Wisconsin the marginal return of producing milk can be less than zero. According to the witnesses, the financial impact by limiting participation in the Central order pool through increased performance standards would be detrimental to Upper Midwest dairy farmers. In this regard, all of the Upper Midwest Cooperatives' witnesses stressed that their member producers are considered small businesses pursuant to the Regulatory Flexibility

Act and that such status should be considered in determining appropriate performance standards for the Central order.

The witnesses for A-E and Suiza testified in opposition to considering supply plant shipments to distributing plant "units" as counted in determining pool-qualifying deliveries unless each plant of the "unit" could independently be a distributing plant under the terms of the order. The witness noted that relatively large non-Class I volumes of milk associated with a distributing plant unit could result in reducing the actual need for qualifying shipments made to distributing plants. In post-hearing briefs, Dean Foods indicated opposition to expanding qualifying shipments to any plant that is part of a distributing plant unit, noting that such performance standards would be inequitable and result in the creation of new disorderly marketing conditions.

The record of this proceeding strongly supports the conclusion in the tentative decision that the various features of the Central milk marketing order's supply plant pooling standards were either inadequate or unnecessary. These deficiencies contained in the pooling standards for supply plants were causing much more milk to be pooled on the Central milk order than could reasonably be considered as properly associated with the Central marketing area. Such milk does not demonstrate reasonable levels of performance necessary to conclude that it provides a regular and reliable service in satisfying the Class I milk demands of the Central marketing area.

The pooling standards of all milk marketing orders, including the Central order, are intended to ensure that an adequate supply of milk is supplied to meet the Class I needs of the market and to provide the criteria for identifying those who are reasonably associated with the market as a condition for receiving the order's blend price. The pooling standards of the Central order are represented in the *Pool Plant*, *Producer*, and *Producer milk* provisions of the order. Taken as a whole, these provisions are intended to ensure that an adequate supply of milk is supplied to meet the Class I needs of the market. In addition, it provides the criteria for identifying those whose milk is reasonably associated with the market by meeting the Class I needs and thereby sharing in the marketwide distribution of proceeds arising primarily from Class I sales. Pooling standards of the Central order are based on performance, specifying standards that, if met, qualify a producer, the milk of a producer, or a plant to share in the

benefits arising from the classified pricing of milk.

Pooling standards that are performance-based provide the only viable method for determining those eligible to share in the marketwide pool. This is because it is the additional revenue from the Class I use of milk that adds additional income, and it is reasonable to expect that only those producers who consistently bear the costs of supplying the market's fluid needs should be the ones to share in the distribution of pool proceeds. Pool plant standards—specifically standards that provide for the pooling of milk through supply plants—also need to reflect the supply and demand conditions of the marketing area. This is important because producers whose milk is pooled receive the market's blend price.

Similarly, supply plant pooling standards should provide for those features and accommodations that reflect the needs of proprietary handlers and cooperatives in providing the market with milk and dairy products. When a pooling feature's use deviates from its intended purpose, and its use results in pooling milk that cannot reasonably be determined as serving the fluid needs of the market, it is appropriate to re-examine the need for continuing to provide that feature as a necessary component of the pooling standards of the order. Because one of the objectives of pooling standards is ensuring an adequate supply of fluid milk for the market, a feature which results in pooling milk on the order that does not provide such service should be considered as unnecessary for that marketing area.

Pooling standards are needed to identify the milk of those producers who are providing service in meeting the Class I needs of the market. If a pooling provision does not reasonably accomplish this end, the proceeds that accrue to the marketwide pool from fluid milk sales are not properly shared with the appropriate producers. The result is the unwarranted lowering of returns of those producers who actually incur the costs of servicing and supplying the fluid needs of the market.

The post-hearing brief received from the Upper Midwest Cooperatives continued to stress opposition to the amendments offered by Proposals 1 (and Proposals) 3, 5, and 7. They view that such changes to the Central milk marketing order are discriminatory and that the proposed amendments would foster inefficiencies in milk marketing. The brief re-iterated their view that the Department's policy has been to design plant and producer pooling provisions that provide a regulatory balance

between the fluid needs of the market and transportation efficiency to meet those needs. In this regard, the brief stressed the opinion that orderly marketing is promoted by not requiring shipments to distributing plants when such shipments are not needed for fluid uses. Additionally, the brief asserts that the Department has long recognized that excluding milk from the pool under rigid performance rules is a greater threat to orderly marketing in surplus marketing areas than is the pooling of surplus milk supplies.

The Upper Midwest Cooperatives' brief added that marketwide pooling has been determined as a constitutional means for surplus Grade A milk to share in the additional revenue resulting from fluid sales. Additionally, the brief noted that the 43-day national hearing review and reform proceeding of 1990—and the Second Amplified Decision of 1996 of that proceeding—articulate the policy of the Department to allow milk to shift to different markets in response to blend price changes. The brief also cited case law to maintain that the statutory scheme for promoting orderly marketing is the sharing of proceeds among producers in the form of uniform, or blend, prices. The opinion expressed in the Upper Midwest brief cites that case law has concluded that producer blend prices cannot be thwarted by a discriminatory transportation burden imposed on distant producers by government mandate.

The Upper Midwest Cooperatives objected to the tentative final decision, as restricting the amount of pooled milk on the Central Marketing order by mechanisms such as committed and controlled supplies from established producer organizations. The Upper Midwest Cooperatives continued by stating that the decision would eliminate much "out-of-area" milk from the pool and would also exclude Grade A milk produced inside the Central order.

The record of this proceeding clearly supports a finding that certain features of pooling standards of the Central Order established under the Federal order reform process, especially as they relate to supply plants, were either inadequate or unnecessary and that the Department was justified in adopting the interim rule. The Final Decision of milk order reform examined and discussed the various pooling standards and features of the pre-reform orders for their applicability in a new, larger consolidated milk order. The pooling standards and features adopted for the consolidated Central Order were designed to reflect and retain those standards and features of the pre-reform

orders so as not to cause a significant change and indeed to provide for the continued pooling of milk that had been pooled by those market participants.

As noted in the tentative decision, the record provides strong evidence to conclude that several features of the *Pool plant* definition, specifically the provisions and features for supply plants, were not being used for the reasons they were intended. Other shortcomings of the Central order, specifically as they relate to producer milk (discussed later in this decision) also have contributed to the inappropriate pooling of the milk of producers who are not a legitimate part of the Central milk marketing area. Here too the impact has been an unwarranted pooling of milk classed at lower prices resulting in a lower blend price to those producers who actually and consistently supply the Class I needs of the market.

The tentative decision and this final decision find that the milk of some producers was benefitting from the blend price of the Central order while not demonstrating actual and consistent service in satisfying the Class I needs of the Central milk marketing area. This finding was attributed to improper and inadequate features of the pooling standards. The pooling provisions provided in the Final Decision of milk order reform established pooling standards and pooling features that envisioned the needs of the market participants resulting from the consolidation of nine pre-reform milk marketing areas consolidated to form the current Central milk marketing area. The reform Final Decision, as it related to the Central marketing area, did not intend or envision that the pooling standards and pooling features adopted would result in the sharing of Class I revenues with those persons, or the milk of those persons, who would not be demonstrating a measure of service in providing the Class I needs of the Central marketing area.

The reform Final Decision examined and discussed various pooling standards and features of the pre-reform orders for applicability in new, larger consolidated milk orders. The pooling standards and features adopted for the Central order were intended to reflect and retain those standards and features of the pre-reform orders so as to not cause a significant change, and indeed to provide for the continued pooling of milk that had been pooled by market participants. The pooling provisions of the Central order were based largely on the predecessor Iowa milk marketing order (then known as Order 79). The Iowa order contained the more liberal pooling provisions of the nine orders consolidated to form the

Central order. The record of this proceeding reveals that the combination and features adopted for pool plants, especially as they apply to pool supply plants, have not been reasonable or appropriate standards for the much larger consolidated Central order.

The record of this proceeding reveals that two-thirds of the Central marketing area population (and corresponding demand for fluid milk) is located in the southern and western portions of the marketing area. However, the adoption of the Central order pooling provisions did not anticipate that the adopted pooling standards would not adequately consider the impact on the northern Central marketing area resulting from the Arkansas and southern Missouri Plains marketing area becoming part of the current Southeast marketing area. Milk produced in these regions had been regularly pooled on the Southeast milk order prior to the expansion of the Southeast order as part of milk order reform and is an integral part of the current Southeast marketing area milkshed. Changes in marketing conditions, as revealed in the record, have resulted from the pooling standards existing prior to the interim rule as an important factor in explaining why fluid handlers in the southern reaches of the Central order have had difficulties obtaining a supply of milk.

As previously indicated, pooling milk on the Central order without demonstrating actual performance in servicing the Class I needs of the market area is neither appropriate nor intended. The record indicates that the volume of milk pooled on the Central Order originating from sources far outside the marketing areas of the nine predecessor marketing areas increased by 186 percent when comparing, for example, the pre-reform month of December 1998 with the post-reform month of December 2000. Of the increase shown in this comparison, milk pooled on the order and originating within the marketing area increased by only 10 percent. Of the additional milk pooled on the Central order, the greatest increase is represented by milk priced at lower class prices. Additionally, testimony by Upper Midwest Cooperatives' witnesses clearly indicated that under the Central order's current pooling provisions, milk pooled on the Central order is not necessarily available to fill the Central market's fluid needs.

The tentative decision as well as this final decision agree with the proponents and those entities who expressed support for adopting Proposal 1 that the order's pooling standards warrant

changes. Both the tentative decision and this final decision find, however, that the performance standards of Proposal 1 are unreasonably high when considering the complete context of the pooling provision modifications made in this decision. If adopted as proposed, together with the other amendments adopted in this decision, milk that has had a long-established association in supplying those pre-reform marketing order areas consolidated to form the Central order may no longer be pooled on the Central order. Most of this milk originates from areas in the Upper Midwest marketing area. The performance standards sought in Proposal 1 may unintentionally compound the difficulties of Central order distributing plants in securing needed milk supplies that could be made available if not for unreasonably high performance standards. Accordingly, this final decision proposes to adopt on a permanent basis the following amendments to the pooling standards and features of the order that were adopted in the interim final rule:

1. Performance standards for supply plants are reduced to (1) 20 percent in each of the months of August through February and (2) 15 percent in each of the months of March through July. Lower supply plant shipping performance standards are established because of accompanying adjustments to the order's other pooling provisions and features. Lowering supply plant performance standards also addresses the concern by Upper Midwest Cooperatives that a "tightening" of the order's performance standards would erect an unreasonable barrier in supplying to, and to pooling milk on, the Central order. As noted in the tentative decision, it should also be emphasized in this final decision that, to the extent that the supply plant performance standards may warrant further refinement, the order provides the means for initiating a change by providing authority for the Market Administrator to consider and make needed changes.

Given that performance standards are specified in every month, the need to continue with the automatic pool plant feature for supply plants during the 3-month period of May through July is rendered unnecessary and contrary to establishing such standards of performance in the first place. The adoption of year-round performance standards, adjusted seasonally, will better assure that a consistent and reliable supply of milk will be provided to the fluid market throughout the year.

August should be included for those months in which a higher performance standard is warranted. Including August in the higher performance months is supported by record evidence which reveals August as the beginning of seasonal increased demand due to the opening of schools occurring at the same time as a general overall decline in milk supplies.

2. As in the tentative decision, this final decision would eliminate a handler's ability to qualify plants located outside the marketing area by cooperative handlers (as defined in § 1000.9(c)) or diversions from a pool plant of the Central order to another pool plant of the Central order. The record supports a finding that milk pooled in this manner does not actually demonstrate real service in meeting the Class I needs of the Central marketing area. Milk pooled in this manner was often referred to in record testimony as "pyramiding." No reasonable basis can be found in the record evidence to conclude that milk pooled in this manner warrants receiving the Central order blend price. The record can only support concluding that milk pooled in this manner serves to lower the blend price paid to producers who actually do supply the market's Class I needs.

3. The tentative decision and this final decision find that shipments of milk to distributing plants regulated by another Federal milk marketing order should not be considered in determining if a supply plant meets the specified performance standard of the Central order for pooling. The performance standards proposed to be adopted by this decision for the Central order are designed so that its distributing plants are adequately supplied with milk. Milk shipments to distributing plants regulated by another Federal order only serve the Class I needs of that other order. Pooling standards for the Central marketing area provide the criteria for determining the milk of those producers who are serving the Class I needs of the Central marketing area and who would thereby receive the Central order blend price. It is reasonable in light of this objective to conclude that serving the needs of another market is not providing a service to the Central marketing area. Accordingly, such milk should not be considered as a qualifying shipment for meeting the supply plant performance standards of the Central order.

4. The tentative decision and this final decision find that the modification of Proposal 1 offered by DFA to limit pool qualifying deliveries to distributing plants on a "net shipments" basis is warranted. Milk deliveries to

distributing plants will be limited to milk transferred or diverted and physically received by distributing pool plants, less any transfers or diversions of bulk fluid milk products from the distributing plant. Relying on net shipments for determining pool qualifying deliveries to distributing plants is applicable to both supply plant deliveries and milk moved to distributing plants directly from the farms of producers. Adoption of this feature will help ensure that milk not serving the market's Class I needs will not be counted towards meeting the specified performance standard.

Providing a net shipments feature for the Central order is reasonable and will likely not be burdensome despite opposition to its adoption. Even with the inappropriate pooling of milk on the order, lower supply plant performance standards adopted in the tentative decision and this final decision are at levels below the Central market's Class I use of milk. While distributing plants do have some transfers and diversions of milk resulting from variations in demand arising from changing fluid milk needs on weekend days and holidays, the tentative decision and this final decision find it is doubtful that the magnitude of these transfers and diversions would be such that a supply plant would risk loss of pool plant status. Additionally, other changes to the order's pooling standards continuing to be adopted in this decision (discussed below) would provide the necessary safeguards that would make it even more unlikely that a supply plant would lose its pool status. This final decision continues to find that adoption of a net shipments feature in the pooling standards of the Central order also would aid in properly identifying the milk of those producers who actually supply milk to meet the Central marketing area's fluid needs.

#### b. Cooperative Supply Plant Performance Standards

A cooperative supply plant pooling provision, together with the feature of authorizing the market administrator to adjust the performance standards for cooperative supply plants, should be retained as suggested in the tentative decision. It was unclear at the time the tentative decision was issued whether Proposals 2 and 4, seeking removal of the cooperative supply plant performance standard and the corresponding provision authorizing the market administrator to adjust those standards, should be adopted in the tentative decision. Because the evidence in the record did not support the removal of these provisions and because

there were no additional persuasive comments on this subject in response to the tentative decision, the Department has not proposed adopting these proposals in this final decision.

The Central marketing order provides for a cooperative association plant as a type of supply plant on the order provided the cooperative association's plant is located within the marketing area and that at least 35 percent of the milk which the cooperative association handles is shipped to a Central order distributing plant during any current month or in the immediately preceding 12-month period. In addition, the provision requires that the cooperative association plant not qualify as a distributing or supply plant under the Central order or any other Federal milk marketing order.

The DFA, *et al.*, witness stated that adoption of some of the other proposals considered in this proceeding, such as modifying supply plant performance standards and providing for net shipments and a one-time "touch base" standard, makes retaining this provision unnecessary. The witness also testified that the provision has not been used since implementation of the consolidated Central order.

Elimination of the provision was supported in testimony by witnesses representing both A-E and Suiza Foods. Both witnesses stated that the provision is unnecessary and is not being used. In their post-hearing briefs, both A-E and Dean Foods reiterated that no plant is presently qualified under the cooperative supply plant definition.

Although there was no opposition testimony to the removal of the cooperative supply plant provision in the Central Order, both the tentative decision and this final decision find that this provision and the corresponding provision authorizing the market administrator to make needed adjustments should be retained. The testimony contained in the record does not contain sufficient reason for a finding to eliminate this standard other than it is a provision that is not used. The provision allows pool qualification for cooperative supply plants on either an average of the preceding 12-month's shipments or the current month's shipments and provides pooling flexibility for cooperatives. The cooperative supply plant definition contains features that are unique and intentional. While the proponents and supporters of Proposals 2 and 4 testified that the cooperative supply plant provision is not currently being used, testimony received did not address the apparently diminished importance of this pooling provision that was used in

four of the nine pre-reform milk orders consolidated to form the Central order. The provision also is a pooling feature provided in most other Federal orders and, as with the Central order, is not currently being used in most of the other Federal orders containing this provision. Given the current record, removing this provision from the Central order may result in the unintended removal of a pooling provision intended for cooperative associations that may be needed at some future time. Accordingly, this final decision does not adopt Proposals 2 and 4.

#### c. Supply Plant System Standards

Proposal 3 of the hearing notice seeking to increase the performance standards for a system of supply plants—and modified at the hearing to limit supply plant system formation to single handler entities instead of currently allowing such systems to be formed by multiple handlers—was not adopted in the tentative decision and is not proposed to be adopted in this final decision. As previously discussed, the record contains evidence that distributing plants regulated by the Central milk order are having difficulty obtaining an adequate supply of milk for fluid use. While this proposal's aim is, in part, to address this problem, there nevertheless remains the potential for a supply plant system to pool milk supplies that may not demonstrate actual service to the fluid needs of the Central marketing area. The modification of the proposal seeking to limit supply plant system formation to a single handler entity has merit. However, taking into account the current record and the fact that there were no exceptions to the tentative decision on this issue, it is not adopted as a modification to the order's current system pooling provision in this final decision. It is noted that the hearing testimony often referred to supply plant systems as "supply plant units." Nevertheless, it is clear that hearing participants intended to mean "supply plant systems" and, accordingly, this final decision continues to consider the testimony in the context intended.

The supply plant system provisions of the Central order currently provide that a system of supply plants may qualify for pooling if 2 or more plants operated by one or more handlers meet the applicable performance standards established for a supply plant. A supply plant system would qualify to pool all of its milk receipts, including diversions, by meeting a performance standard of 25 percent in each of the months of September through November

and January and 35 percent for all other months. The order currently limits the formation of a supply plant system to plants located within the marketing area.

Proposal No. 3, by DFA, *et al.*, would raise the performance standards for supply plant systems by 5 percentage points for each of the months of August through November and by 3 percentage points higher in all other months. The proponent witness (representing DFA, *et al.*) testified that providing for supply plant systems extends benefits and efficiencies not otherwise available for individual handlers to reduce transportation costs by delivering milk from a more advantageously located supply plant at a volume that would satisfy the performance standards as if all supply plants not as advantageously located had individually met the indicated performance standard. According to the witness this also would avail plant efficiencies in the manufacturing operation of all supply plants that are part of the system. The witness also envisioned that the proposal could ease otherwise disruptive shipping obligations to their manufacturing operations, potentially reduce paperwork, and provide the opportunity for producers to receive prices higher than regulated minimum prices. Because system pooling offers a rewarding degree of pooling flexibility, the witness was of the opinion that a supply plant system should meet slightly higher performance standards than those applicable for a single supply plant. This rationale is consistent, the witness indicated, with the pre-reform Chicago Regional order which specified a performance standard at twice the rate for supply plant systems than was applicable for individual supply plants.

According to the DFA, *et al.*, witness, a higher performance standard for supply plant systems would contribute to making it easier to obtain additional milk supplies in the most efficient manner. Additionally, the witness was of the opinion that this change, together with other changes proposed, would eliminate the ability to "pyramid" the pooling of milk on the order and renew interest in supply plant systems for the market.

A witness from AMPI, who also testified on behalf of the Upper Midwest Cooperatives, opposed adoption of Proposal 3. The witness explained that increased performance standards would simply cause a handler to discontinue pooling its plants as a system, thus forcing the handler to ship a lower percentage of milk receipts from each of the individual supply plants. The witness asserted that this alternative

would increase transportation costs without providing additional milk to distributing plants.

The AMPI witness also testified that a supply plant system operated by multiple handlers has the potential for one handler with substantially more sales to distributing plants than needed to meet the supply plant performance standard to pool the milk receipts of other handlers. According to the witness, this could reduce the total volume of milk shipments to distributing plants while technically meeting the order's performance standards. According to the witness, such a provision allows some handlers to entirely escape responsibility for supplying the fluid market and encourages handlers to pay other handlers to qualify their milk supplies for pooling. In light of these concerns, the witness offered a modification to Proposal 3 that limits supply plant system formation to single handler entities.

A witness testifying on behalf of Foremost, AMPI, LOL, Family Dairies, Midwest Dairymen, and FDA supported the advantages supply plant systems offer as a means to promote more efficient movement of milk to distributing plants. However, given the higher performance standards called for by the proposal, the witness indicated opposition to Proposal 3. The witness was of the opinion that there is no justification for supply plant systems to be required to meet higher performance standards than individual supply plants. The witness did note that a higher performance standard for a supply plant system formed by multiple handlers may be appropriate.

Providing pooling flexibility by permitting more than a single supply plant to form into a single pooling system offers the potential to increase efficiencies by minimizing transportation costs that may not be obtainable when each supply plant of the handler would need to meet the performance standards separately for each plant. Additionally, providing for supply plant systems serves to accommodate the specialization of plant operations without otherwise encouraging such a plant to deliver milk to a distributing plant solely to retain pool status. Providing the opportunity to gain such efficiencies is intended by the supply plant system provision because it does not disrupt the flow of milk for Class I use from supply plants to distributing plants.

The record suggests that supply plant systems formed by multiple handler entities offer the potential to pool milk on the Central order without meeting

intended performance standards. The modification to Proposal 3, which would limit the formation of a supply plant system to a single handler entity, may offer a warranted change in the current supply plant system provisions without changing the current performance standards. However, the tentative decision found that the record did not provide sufficient evidence to tentatively adopt a change in the performance standards for supply plant systems or to limit the formation of supply plant systems to a single handler entity. Because there were no comments to the tentative decision on the provisions which would limit the formation of supply plant systems to a single handler entity, such provisions are not adopted in this final decision.

#### d. Standards Applicable for Producer Milk

Several changes to the pooling standards contained in the *Producer milk* definition of the Central Order that were previously adopted on an interim basis are proposed to be adopted on a permanent basis by this final decision. The adopted amendments were largely contained in a proposal, published in the hearing notice as Proposal 5, which was modified at the hearing by its proponents. The changes in the producer milk pooling standard are necessary to more accurately identify the milk of those dairy farmers who actually serve the Class I needs of the market. The amendments include: (1) Continue to establish year-round diversion limits, adjusted seasonally, for the amount of milk that a pool plant may divert to nonpool plants at 80 percent for each of the months of August through February and at 85 percent for each of the months of March through July. Accordingly, the provision, adopted on an interim basis, corrected the lack of diversion limits for the months of May through August; (2) Diversion limits for supply plants will continue to be based on deliveries to Central order pool distributing plants and will not include deliveries to other pool supply plants of the Central order. This eliminates the ability of a pool plant to pool increased volumes of milk by diversion to nonpool plants by diverting milk to a second pool plant; and (3) Continue to establish a net shipments feature for producer milk. These amendments maintain the integrity of the performance standards for pool plants of the Central marketing area and more appropriately identify those producers whose milk actually supplies the Central marketing area's Class I milk needs.

Prior to the adoption of the interim final rule, the *Producer milk* provision of the Central order provided for diversion limits of 65 percent during the months of September through November and January and limits of 75 percent during the months of February through April and December. While the Central order limits the pooling eligibility of diverted milk to nonpool plants in specified months, the order placed no limits on milk diversions to other pool supply plants of the order. Milk diverted from one pool plant to another pool plant enabled the diverting pool plant to increase the amount of milk that could be pooled but diverted to nonpool plants. During the months of May through August, an unlimited amount of producer milk could be diverted by pool plants to nonpool plants. The milk of a producer was not eligible for diversion until at least one day's production of a dairy farmer was physically received at a pool plant and the producer continually retained producer status on the Central order both before and after adoption of the interim rule. Finally, the order did not determine producer milk on a net-shipments basis until adoption of the interim rule.

Proposal No. 5, offered by DFA, *et al.*, seeks to establish new year-round diversion limits for producer milk at 75 percent for each of the months of August through November and at 80 percent for each of the months of December through July. These limits are subject to satisfying certain performance measures and would specify that at least 20 percent of receipts in each of the months of August through February and 15 percent in each month of all other months are delivered to Central order distributing plants. Because year-round diversion limits would be established for all months, the proposal is intended to eliminate the ability to pool an unlimited amount of milk on the order during May through August by diversion. As noted in the discussion of supply plant performance requirements earlier, DFA, *et al.*, repeated their argument for these diversion limits in their exceptions to the tentative decision.

Proposal 5, offered by DFA, *et al.*, was modified in testimony by the DFA witness. The modification proposed sought also to incorporate a net-shipments feature for producer milk as they had proposed as a modification to Proposal 1. According to the witness, the net-shipments feature would be used to determine pool-qualifying diverted milk on the basis of milk receipts transferred or diverted to and physically received by Central order

distributing plants less any transfers or diversions of milk from such distributing plants. In exceptions to the tentative decision, DFA, *et al.*, stated that the net shipment provision for producer milk is at least as important as it is for supply plant milk.

The DFA, *et al.*, witness testified that the core issues of the hearing are restoring orderly marketing conditions and economically justifying the appropriate performance standards that, if met, warrant receiving the Central Order blend price. The witness explained that orderly marketing embodies the principles of common terms and pricing that attracts milk to move to the highest-valued use when needed and for milk to clear the market when not needed in higher-valued uses. The DFA witness was of the opinion that the percentage of allowable diversions should be increased over those currently applicable in the Central order. The witness indicated that this becomes possible with the adoption of the other pooling provision amendments, including changing performance standards and considering milk deliveries to distributing plants on a net shipments basis.

The DFA, *et al.*, witness testified that the Central order should provide a limit on the amount of milk that can be diverted to nonpool plants each month by conditioning diversions on the basis of milk shipments to pool distributing plants or distributing plant units of the Central order. The witness stated that the aim of these features is to provide a better correlation between the order's pooling provision standards.

A witness representing several fluid milk processing plants joined in expressing their support for adopting year-round diversion limits. They were of the opinion that this would enhance pooling the milk of only those who provide an adequate supply of milk for fluid uses.

Witnesses representing the Upper Midwest cooperatives testified in opposition to the adoption of Proposal 5 and to the proposal's modification to incorporate a net-shipments feature. In their opinion, these changes would unnecessarily limit the amount of milk that could be pooled on the Central order. The witnesses indicated that this would force surplus milk supplies to be pooled instead on the Upper Midwest order. As a result, they testified, the Upper Midwest pool would be diluted and result in a lower blend price for their producers in the Upper Midwest.

A witness for the First District Association testified that diversion limits are not always needed for every month. The witness maintained that

having year-round diversion limits would reduce competition and result in lower milk prices for producers of the Central marketing area. The witness argued that diversion limits should be provided only for ensuring the orderly marketing of fluid milk but should not be used so as to constitute a barrier to pooling milk.

In their exceptions to the tentative decision, the Upper Midwest Cooperatives reiterated their opposition to the addition of a net shipments provision and the limitation on diversions to only distributing plants, not milk received by any pool plant. They stated that this provision would eliminate a large amount of the milk that does not have a committed share of the Class I market. These cooperatives believe this unfairly allows nearby suppliers to accrue a higher blend.

The Central milk order, as all other Federal milk marketing orders, provides and accommodates for diverting milk because it facilitates the orderly and efficient disposition of the market's milk not needed for fluid use without the loss of the benefits that arise from being pooled on the order. When producer milk is not needed by the market for Class I use, its movement to nonpool plants for manufacturing should be provided for without loss of producer milk status. Preventing or minimizing the inefficient movement of milk solely for pooling purposes also needs to be reasonably accommodated. However, it is just as necessary to safeguard against excessive milk supplies becoming associated with the market through the diversion process.

A diversion limit establishes the amount of producer milk that may be an integral milk supply of a pool plant. With regard to the pooling issues of the Central order, the tentative decision as well as this final decision stress that it is the lack of diversion limits to nonpool plants, in part, that significantly contributes to the pooling of much more milk on the order that does not provide service to the Class I market yet receives the Central order blend price. Such milk is not a legitimate part of the reserve supply of the plant.

According to the tentative decision and this final decision, milk diverted to nonpool plants is milk not physically received at a pool plant. However, it is included as a part of the total producer milk receipts of the diverting plant. While diverted milk is not physically received at the diverting plant, it is nevertheless an integral part of the milk supply of that plant. If such milk is not part of the integral supply of the diverting plant, then that milk should not be associated with the diverting

plant. Therefore, such milk should not be pooled.

Both the tentative decision and this final decision state that the lack of diversion limits only provides a means for associating much more milk with the market without the burden of demonstrating actual service in meeting the Class I needs of the market.

Associating more milk than is actually part of the legitimate reserve supply of the diverting plant unnecessarily reduces the potential blend price paid to dairy farmers. Without diversion limits, the order's ability to provide for effective performance standards and orderly marketing is weakened.

The lack of diversion limit standards applicable to pool plants opens the door for pooling much more milk on the market. While the potential size of the pool should be established by the order's pooling standards, the lack of diversion limits renders the potential size of the pool as undefined. With respect to the marketing conditions of the Central marketing area evidenced by the record, both the tentative decision as well as this final decision find that the lack of year-round diversion limits on producer milk has caused much more milk to be pooled on the order than can reasonably be considered part of the legitimate reserve supplies of the pool plants and does not provide any actual service in meeting the Central market's Class I needs.

The lack of standards applicable for diversions to nonpool plants for the months of May through August prior to the interim rule resulted in the pooling of much more milk than can demonstrate any actual service in meeting the Class I needs of the Central marketing area. The diversion limit standards of Proposal 5 address this concern. However, the diversion limits adopted in the tentative decision and proposed to be adopted on a permanent basis by this final decision are higher than those proposed. Increasing the diversion limit standard is made possible because of other changes adopted in the tentative decision that would also be adopted in this final decision. The changes to the diversion limits standards adopted in the tentative decision are also proposed to be adopted in this final decision at a level to appropriately complement the performance standards. Accordingly, this decision proposes to establish a diversion limit for producer milk of 80 percent for each of the months of August through February and 85 percent for each of the months of March through July. In addition, the diversion limits may be adjusted by the Market Administrator.

As previously discussed, both the tentative decision and this final decision have determined that only deliveries or diversions to pool distributing plants, and not deliveries to pool supply plants, should be allowed to qualify subsequent supply plant diversions for pooling on the order. Such conditions are carried into the producer milk definition as a condition for diversion eligibility. It is also consistent, in light of such linkage, that a net shipments feature should be provided as part of the producer milk provision. However, as discussed earlier in the section on pooling standards, the evidence contained in the record does not support the inclusion of deliveries to pool distributing plant units to qualify supply plant diversions for pooling. Accordingly, this feature of Proposal 5 is not adopted.

A proposal, published in the hearing notice as Proposal 9, seeking to allow milk to be eligible for diversion to nonpool plants and for such milk to retain its association with the market for any months during which a handler failed to pool a dairy farmer's milk under any milk marketing order is not adopted. The tentative decision as well as this final decision find that a dairy farmer's milk must be physically received at a pool plant of the Central order before it is eligible for diversion to nonpool plants. Additionally, this final decision continues to find that if milk is not continuously pooled, it again must be received at a pool plant before regaining pooling eligibility.

The Central order currently specifies that the milk of a new producer, or a producer who has broken association with the market, is not eligible for diversion until one day's production is physically received at a pool plant in the first month, and the dairy farmer continuously retained producer status in following months. The dairy farmer's milk is associated with the market if it is included in the pool each month, except as a result of a temporary loss of Grade A approval.

Proposal 9 would allow milk diverted to a nonpool plant before the producer's milk is actually delivered to a pool plant in the same month to be considered producer milk. Proposal 9 also included a provision to allow the milk of a dairy farmer to retain its association with the market for any months during which the handler failed to pool the producer's milk under any order.

Proposal 9 was offered by the Upper Midwest Cooperatives. A witness from AMPI, testifying on behalf of the Upper Midwest Cooperatives, explained that Proposal 9 is needed to assure that producers' milk can be pooled for the

entire month as long as one day's production is physically received at a pool plant any day during the month. According to the witness, producers could miss several days of being able to pool milk on the Central order due to unexpected phenomena, such as weather, trucking problems, and scheduling conflicts.

According to the AMPI witness, Proposal 9 also would allow milk to return for pooling on the order in the month following the month in which it was not pooled because the blend price was less than the Class III or Class IV price. In this regard, the witness noted that the order currently provides for milk to be pooled at least one day each month before being eligible for diversion to nonpool plants regardless of whether it is economically sound to pool milk based on the blend price that would result for the month.

The touch base standard of an order establishes an initial association by the producer, and the milk of the producer, with the market. In this way, the touch base provision serves to maintain the integrity of the order's performance standards. The record does not contain sufficient evidence for setting conditions that negate the need to properly re-establish association with the market. Doing so is neither burdensome nor unreasonable considering that only one day's milk production of a dairy farmer needs to be delivered to a plant and pooled in order to maintain association with the market. Accordingly, Proposal 9 is not adopted.

#### e. Establishing Pooling Standards for "State Units"

A proposal, published in the hearing notice as Proposal 7, seeks to establish pooling units organized and reported by State, specifying that in order to pool milk from those States located outside of the States and specified counties that comprise the Central marketing area, each State unit would need to meet the performance standards applicable for pool supply plants. This proposal was not adopted in the tentative decision and is not adopted in this final rule. The Central order does not currently provide for pooling milk located outside of the marketing area in this manner.

Proposal 7, offered by Dairy Farmers of America (DFA), would group and report milk in State units and specify performance standards for such State units as those applicable to pool supply plants. The milk that would be affected would be milk located outside the States of Colorado, Illinois, Iowa, Kansas, Missouri, Nebraska, Oklahoma, and South Dakota, the Minnesota counties of Fillmore, Houston, Lincoln, Mower,

Murray, Nobles, Olmstead, Pipestone, Rock, and Winona, and the Wisconsin counties of Crawford, Grant, Green, Iowa, Lafayette, Richland, and Vernon.

The DFA witness testified that milk is being pooled on the Central order that is located in areas so far from the marketing area that such milk cannot and does not service the Class I needs of the Central market. The witness argued that milk from such distant areas was never intended to be a source of milk or a part of the Central order milkshed. According to the witness, large portions of the States of Minnesota and Wisconsin, characterized as a "distant" source of milk, had not historically been part of the supply area for the pre-reform marketing areas consolidated to form the Central milk marketing area. DFA argued that milk from these areas should be subject to the same performance standards as milk from other distant areas such as California or New Mexico.

According to the DFA witness, distant milk currently pooled on the Central order likely would not seek to be pooled on the order because the benefits of receiving a higher blend price for milk actually delivered to Central order pool plants would not offset the costs that would be incurred in transporting milk. In attempting to clarify what would be determined as being not distant, the DFA witness offered a method to distinguish between historical and distant milk supplies. Milk from counties associated with the Central market's pre-reform orders, which in 1998 had a daily supply volume in excess of one 50,000 pound load, would be included with milk considered to be local or in-area and not distant milk.

The principal problem confronting the Central order, as identified by the DFA witness, is that the distant milk receives the order's blend price without the burden of providing any regular and consistent service to the market beyond meeting a one-day touch-base standard. The witness argued that their proposal would set standards for milk from distant areas identical to local milk as a condition for receiving the order's blend price. Providing for this would not, according to the witness, discriminate, penalize, or establish any barriers to the pooling of milk on the Central order because the standards for local milk supplies and distant milk supplies would be the same. Support was given in testimony for establishing State units by witnesses representing Prairie Farms and Suiza. In their exceptions to the tentative final decision, DFA, *et al.*, reiterated their support for requiring performance on a unit basis by out of area milk.

A number of hearing participants opposed the adoption of the State unit pooling proposal, specifically the witnesses representing Upper Midwest cooperative associations. The Foremost Farms witness argued that adoption of the proposal would discourage efficient movements of milk to distributing plants and that such a provision would be inconsistent with the Agricultural Marketing Agreement Act (AMAA). This witness questioned why an organization with milk in the Central marketing area should be required to transport milk from distant areas in Minnesota and Wisconsin when the same organizations already have enough milk in the marketing area to satisfy the order's pooling standards. The witness indicated that this could result in forcing milk located within the marketing area to be hauled long distances to make room for the receipt of milk from distant locations.

The AMPI witness agreed with the Foremost witness' testimony and the witness representing the First District Association, both of which asserted that adopting State unit pooling for distant milk would destroy the benefits of pooling milk on the Central order. They held this opinion because the differences between Class I use and blend prices between the Central and Upper Midwest orders would narrow.

In post-hearing briefs, the Upper Midwest Cooperatives continued to express opposition to DFA's Proposal 7 (and to Proposals 1, 3, and 5). They characterized their opposition as establishing barriers to pooling on the basis of where milk is located through government-mandated transportation costs. As indicated above on proposals affecting pool plants and producer milk, their brief cited case law to advance their contention that such amendments would not be legal.

The record does not support the adoption of performance standards for pooling milk on the order on the basis of its location or as the proponent and supporters of Proposal 7 describe as State units. The marketing conditions of the Central order do not exhibit the need to require additional performance standards for milk located outside of the marketing area beyond those adopted in the tentative decision and proposed to be adopted by this final decision. Accordingly, all plants, regardless of location, may become eligible to have the milk of producers pooled on the Central order by meeting the performance standards specified for the various types of pool plants.

It is not important who provides the milk for Class I use or from where this milk originates. The order boundaries of

the Central order were not intended to limit or define which producers, which milk of those producers, or which handlers could enjoy the benefits of being pooled on the Central order. What is important and fundamental to all Federal orders, including the Central order, is assuring an adequate supply of milk to meet the market's fluid needs, the proper identification of those producers who supply the market, and an equitable means of compensating those producers from the market's pool proceeds.

As discussed earlier on pooling standards for pool supply plant qualification, the provisions of the consolidated Federal milk orders were not intended to exclude any milk from being pooled on any order, as long as the fluid needs of a marketing area are being served by the milk. At the same time, reform of Federal milk orders did not adopt open pooling, but attempted to provide that each market pool would include the milk that actually is available for serving the fluid needs of the market. The determination of the boundaries of the Central marketing area was guided by the identification of the common characteristics of the predecessor orders that could be consolidated to form the marketing area and to promulgate a marketing order to provide for orderly marketing conditions. The consolidation of the pre-reform orders into the current Central order was not intended to determine those areas from which milk should, or should not, be obtained to serve the market. The adoption of revised pooling standards proposed to be adopted by this final decision should assure milk will be available for the Central market's fluid needs and therefore renders the proposed State unit provision unnecessary. Proposal 7 is not adopted.

## *2. Simultaneous Pooling of Milk on the Order and on a State-Operated Milk Order Providing for Marketwide Pooling*

A proposal, published in the hearing notice as Proposal 8, seeking to exclude the same milk from being simultaneously pooled on the Central order and any State-operated order which provides for marketwide pooling, previously adopted on an interim basis, is proposed to be adopted on a permanent basis by this final decision. The practice of pooling milk on a Federal order and simultaneously pooling the same milk on a State-operated order also has come to be referred to as "double dipping." The Central order did not prohibit milk from being simultaneously pooled on the order and a State-operated order that

provides for marketwide pooling prior to adoption of the interim rule. Proposal 8 was offered by A-E, Swiss Valley Dairy, AMPI, Family Dairies USA, FDA, Foremost, Milwaukee Cooperative Milk Producers, Manitowoc Milk Producers Cooperative, and Mid-West Dairymen's Company.

The AMPI witness, testifying on behalf of all the proponents of Proposal 8, stressed that a producer is prohibited from pooling the same milk on more than one Federal order. The witness maintained that the same restriction should be applicable between the Central order and any other regulatory authority that provides for marketwide pooling and the marketwide distribution of pooling revenue. According to the witness, this has been occurring with milk pooled under the California State-operated milk order program since March 2001 and continues.

The AMPI witness explained that the Central order pooling provisions allow a one-time minimal delivery of a single day's milk production of California producers to a Central order pool plant to qualify all subsequent milk production of those California producers on the Central order by diversion. However, the witness stressed, all of the diverted California milk is pooled on the State's milk order program and receives the pricing benefits that the California State program offers its dairy farmers.

The AMPI witness testified that the volume of California milk pooled on the Central order has been increasing since March 2001 and is unnecessarily reducing milk prices paid to Central order producers. The witness presented calculations that indicated that the impact on the Central order blend price was an average reduction of about 2 cents per hundredweight, amounting to almost \$2 million in the 7-month period of March through September 2001. The witness stated that due to the obvious injurious effect on Midwest dairy farmers, the Department should put an end to the practice of double dipping and to do so on an emergency basis.

A witness testifying on behalf of the proponents explained that the reason milk used in manufactured products is included in a marketwide pool is that such milk represents a reserve supply of milk that is available to serve fluid distributing plants when needed. Accordingly, the witness stressed that the same milk cannot be considered to be available as a supply for fluid distributing plants regulated under two different marketwide pools. The witness explained that Proposal 8 would not preclude the pooling of California milk or milk from any other jurisdiction that

has marketwide pooling on the Central order. However, the proposal would preclude the pooling of the same milk on the Central order when also pooled under some other order, like the California State milk order that provides for marketwide pooling. In this regard, the witness stated that there is no doubt that California's milk order pooling plan provides for marketwide pooling, adding that those who say it does not probably are basing their conclusion on California's quota and overbase pricing for milk.

Several other proponent witnesses representing cooperative associations whose member milk is pooled under the Central order supported the adoption of the proposal to eliminate "double dipping" as did two distributing plant operators. Both of the fluid processor representatives argued that milk originating from outside of a 500-mile radius of any of the order's distributing plants is not realistically available to serve the Class I market on a regular basis.

The representative from Land O'Lakes was opposed to adopting Proposal 8. The witness asserted that, despite evidence to the contrary, California does not have a marketwide pool. The witness explained that producers are paid on the basis of a quota price for milk used in fluid and soft dairy product uses, while the basis for non-quota milk is manufacturing values. The returns to producers arising from quota uses of milk, stated the LOL witness, are not distributed marketwide.

The LOL witness proposed a modification to Proposal 8 that would eliminate "double dipping" only with respect to the "quota" portion of the milk associated with the Central order and allow simultaneous pooling of "overbase" California milk on both the California and Central orders. The witness expressed concern that elimination of the ability of the same milk to be pooled simultaneously under a Federal order and a State order with marketwide pooling would cause problems in dealing with milk supplies from other States—such as Pennsylvania and North Dakota—that are considering modifying provisions to include marketwide pooling.

For over 60 years, the Federal government has operated the milk marketing order program. The law authorizing the use of milk marketing orders, the Agricultural Marketing Agreement Act of 1937 (AMAA), as amended, provides authority for milk marketing orders as an instrument which dairy farmers may voluntarily opt to use to achieve objectives consistent with the AMAA and that are in the

public interest. An objective of the AMAA, as it relates to milk, was the stabilization of market conditions in the dairy industry. The declaration of the AMAA is specific: "the disruption of the orderly exchange of commodities in interstate commerce impairs the purchasing power of farmers and destroys the value of agricultural assets which support the national credit structure and that these conditions affect transactions in agricultural commodities with a national public interest, and burden and obstruct the normal channels of interstate commerce."

The AMAA provides authority for employing several methods to achieve more stable marketing conditions. Among these is classified pricing, which entails pricing milk according to its use by charging processors differing milk prices on the basis of form and use. In addition, the AMAA provides for specifying when and how processors are to account for and make payments to dairy farmers. Plus, the AMAA requires that milk prices established by an order be uniform to all processors and that the price charged can be adjusted by, among other things, the location at which milk is delivered by producers (Section 608c(5)).

As these features and constraints provided for in the AMAA were employed in establishing prices under Federal milk orders, some important market stabilization goals were achieved. The most often recognized goal was the near elimination of ruinous pricing practices of handlers competing with each other on the basis of the price they paid dairy farmers for milk and in price concessions made by dairy farmers. The need for processors to compete with each other on the price they paid for milk was significantly reduced because all processors are charged the same minimum amount for milk, and processors had assurance that their competitors were paying the same value-adjusted minimum price.

The AMAA also authorizes the establishment of uniform prices to producers as a method to achieve stable marketing conditions. Marketwide pooling has been adopted in all Federal orders because of its superior features of providing equity to both processors and producers, thereby helping to prevent disorderly marketing conditions. A marketwide pool, using the mechanism of a producer settlement fund to equalize on the use-value of milk pooled on an order, meets that objective of the AMAA of ensuring uniform prices to producers supplying a market.

The California State milk order program clearly has objectives similar to

those of the AMAA. Exhibits presented at the hearing indicate that the California State order program has a long history in the development and evolution of a classified pricing plan and in providing equity in pricing to handlers and producers. Important as classified pricing has been in setting minimum prices, the issue of equitable returns to producers for milk could not be satisfied by only the use of a classified pricing plan. Some California plants had higher Class I fluid milk use than did others and some plants processed little or no fluid milk products. As with the Federal order system, producers who were fortunate enough to be located nearer Class I processors had been receiving a much larger return for their milk than producers shipping to plants with lower Class I use or to plants whose main business was the manufacturing of dairy products. Over time, disparate price differences grew between producers located in the same production area of the State which, in turn, led to disorderly marketing conditions and practices. These included producers who became increasingly willing to make price concessions with handlers by accepting lower prices and in paying higher charges for services such as hauling. Contracts between producers and handlers were the norm, but the contracts were not long-term (rarely more than a single month) and could not provide a stable marketing relationship from which the dairy farmers could plan their operations.

In 1967, the California State legislature passed and enacted the Gonsalves Milk Pooling Act. The law provided the authority for the California Agriculture Secretary to develop and implement a pooling plan, which was implemented in 1968. The California pooling plan provides for the operation of a State-wide pool for all milk that is produced in the State and delivered to California pool plants. It uses an equalization fund that equalizes prices among all handlers and sets minimum prices to be paid to all producers pooled on the State order. While the pooling plan details vary somewhat from pooling details under the Federal order program, the California pooling objectives are basically identical to those of the Federal program.

It is clear from this review of the Federal and the California State programs that the orderly marketing of milk is intended in both systems. Both plans provide a stable marketing relationship between handlers and dairy farmers and both serve the public interest. It would be incorrect to conclude that the Federal and California

milk order programs have differing purposes when the means, mechanisms, and goals are so nearly identical. In fact, the Federal order program has precedent in recognizing that the California State milk order program has marketwide pooling. Under milk order provisions in effect prior to milk order reform, and under § 1000.76(c), a provision currently applicable to all Federal milk marketing orders, the Department has consistently recognized California as a State government with marketwide pooling.

Since the 1960's the Federal milk order program recognized the harm and disorder that resulted to both producers and handlers when the same milk of a producer was simultaneously pooled on more than one Federal order. When this occurs, producers do not receive uniform minimum prices, and handlers receive unfair competitive advantages. The need to prevent "double pooling" became critically important as distribution areas expanded and orders merged. The issue of California milk, already pooled under its State-operated program and able to simultaneously be pooled under a Federal order, has, essentially, the same undesirable outcomes that Federal orders once experienced and subsequently corrected. It is clear that the Central order should be amended to prevent the ability of milk to be pooled on more than one order when both orders employ marketwide pooling.

There are other State-operated milk order programs that provide for marketwide pooling. For example, New York operates a milk order program for the western region of that State. A key feature explaining why this State-operated program has operated for years alongside the Federal milk order program is the exclusion of milk from the State pool when the same milk is already pooled under a Federal order. Because of the impossibility of the same milk being pooled simultaneously, the Federal order program has had no reason to specifically address double dipping or double pooling issues, the disorderly marketing conditions that arise from such practice, or the primacy of one regulatory program over another. The other States with marketwide pooling similarly do not double-pool Federal order milk.

The record testimony and evidence show milk pooled on the Central order originating from places distant from the area. However, the tentative decision and this decision acknowledge that with the advent of the economic incentives for California milk to be pooled on the Central order and, at the same time, enjoy the benefits of being pooled under

California's State-operated milk order program, more milk has come to be pooled on the order that has no legitimate association with the integral milk supplies of the Central order pool plants. The association was possible only through what some market participants describe as a regulatory loophole.

California milk should only be eligible for pooling on the Central order when it is not pooled on the California State order and when it meets the Central's pooling standards. It is the ability of milk from California to "double dip" that is a source of disorderly marketing conditions and for much more milk being pooled on the Central order.

Proposal 8 offers a reasonable solution for adding a prohibition on allowing the same milk to draw pool funds from Federal and State marketwide pools simultaneously. It is consistent with the current prohibition against allowing the same milk to participate in two Federal order pools simultaneously. Adoption of Proposal 8 in both the tentative and this final decision will not establish any barrier to the pooling of milk from any source that actually demonstrates performance in supplying the Central market's need for milk used in Class I.

### 3. Rate of Partial Payments to Producers

A proposal that would change the rate of the partial payment to producers and cooperatives for milk delivered during the first 15 days of the month to the lowest class price for the prior month times 110 percent, published in the hearing notice as Proposal 6, was not adopted in the tentative decision and is not proposed to be adopted in this final decision. Therefore, the partial payment rate will remain as currently provided for by the order—at the lowest class price for the prior month.

This proposal offered by DFA intends to improve producer cash flow by bringing the partial payment into a closer relationship to the final blend price and to have the partial payment more closely reflect the value of the milk delivered to handlers during the first 15 days of the month. According to the DFA *et al.*, witness, the partial payment rate has declined as a share of the final payment since the consolidation of the Central market under milk order reform.

The DFA, *et al.*, witness stressed that producers need a more consistent cash flow than they currently are experiencing. The witness acknowledged that overpayment in the partial payment could be a problem if the producer does not have enough funds coming in the month's final

payment to cover the producer's authorized deductions. The witness noted that the existing \$1.00 per hundredweight premiums above minimum order prices enjoyed by Central order producers are probably adequate to cover any overpayments made to producers.

Data provided by the DFA, *et al.*, witness sought to indicate that since order reform on January 1, 2000, the amount of the partial payment received by producers relative to the total payment for milk each month has been reduced when compared to the pre-reform orders. The analysis consisted of approximating a weighted average blend price as a proxy for a comparable order from the pre-reform order's information. The analysis, explained the witness, is a comparison of the current month's blend price with the lowest of the two lower class prices of the prior month. For the entire 56-month period, the witness stated, the average of the blend price minus the lowest class price was \$1.59; the first 36 months the average was \$1.52; and the last 20 months the average was \$1.75. The witness concluded that the main concern revealed by this data is that the spread is widening. After evaluating several differing partial payment rates, the witness concluded that a five percent inflation at the prior month's lowest class price was a reasonable adjustment to approximating the spread that existed over the first 36-month period.

The DFA, *et al.*, witness also testified that there are a wide variety of payment dates and payment levels among the 11 orders. There are currently, said the DFA witness, three groupings: the Southern orders' payments are a percentage of the prior month's blend price adjusted for location; the Northwest and Central orders set the advanced payment at the prior month's lowest class price; and the Western orders use an add-on percentage applied to the prior month's lowest class price. The witness also noted that while most orders have one partial payment, the Florida order has two partial payments before a final payment is due.

Several individual dairy farmers also testified that their cash flow situations have deteriorated since the current partial payment rate provisions became effective. In this regard, all dairy farmers testified in support of increasing the rate of partial payment.

A representative of Leprino Foods, a national cheese-processing firm, testified that USDA should reject Proposal 6 since it does not appropriately address the issue it purports to remedy and it violates the minimum pricing concepts for

manufacturers, but not because there is lack of need for an amendment. The Leprino witness testified that the cause of the disparity between the partial and final payment rates is a combination of a failure to blend the pool's higher use values into the partial payment and the use of a price level from the previous month rather than the current month. This witness argued that rather than addressing these problems in the proposal, the proposed increase in the rate merely transfers the burden to processors. The witness stated that the proposal violates minimum pricing principles by setting the partial rate above the equivalent market value for Classes III and IV, with the resulting differences in partial payment rates between orders causing disparate economic positions for competing Class III and IV handlers in different orders.

The witness from Leprino concluded that the most appropriate approach to address the root cause of the disparity between the partial and final payment would be the implementation of a similar minimum payment in pooling structure for the partial payment that exists in the final payment. However, the witness did not propose its adoption because such a remedy would require significant administration in terms of plant reporting, report analysis, pool calculation, and movement of funds into and out of the pool than the current system of minimum payment at the lowest class price. This concept was not properly noticed, the witness argued, and a more comprehensive review of all provisions of the order that would be affected and the magnitude of the impact would be necessary.

The Department reconstructed noticed data that recreated the intended analysis presented by witnesses. The Department's reconstruction relied, in part, on the partial payment provisions of the pre-reform orders. The Department used the previous month's Class III price of the pre-reform orders as the lowest class price because the Class III price was used then to set the rate of partial payment. In this regard, comparing partial payment relationship outcomes using actual historical provisions provided for comparing pre- and post-reform partial payment relationships as to the total payment for milk in a month.

Even with the limited amount of data available since the implementation of order reform, the Department's comparison of pre- and post-reform partial payment relationships to total payments does appear to support the observations made by the DFA witness. However, this initial observation alone is not a sufficient basis for changing the

rate of the partial payment. Some significant differences in certain key assumptions were made by the proponents of Proposal 6 from those assumptions used by the Department in comparing pre- and post-reform time periods.

Also of concern is the limitation inherent in comparing a 36-month period to one of only 21 months. The 36-month time period shows price trends rising and falling, while the 21-month time shows a period of generally an upward trend in prices. This may suggest that there has not yet been a sufficient period of elapsed time to infer the impact of downward trends in prices and the possible effect on the relationship between the partial and final payments to producers.

With regard to Leprino's concern about uniformity of partial payment rates between orders, the current milk orders have a variety of partial payment rates. Several orders use a partial payment rate based on a percentage of the previous month's blend price, and the Florida order, for example, provides for two partial payments. Additionally, the Western and Arizona-Las Vegas orders, both of which pool significant volumes of milk used in cheese, provide for partial payment rates of 120 and 130 percent, respectively, of the previous month's lowest class price.

There may be times when the partial payment rate exceeds the balance due for the month. In this regard, handler interests point to this outcome as requiring them to pay more for milk for part of the month than its actual total value for the month. It is appropriate to note that this exact outcome occurred several times during the pre-reform 36-month period used by DFA. This decision finds the concerns of handlers in this regard as unpersuasive.

Deductions authorized by producers are more often made in the final payments for milk. There could be times when the amount deducted from the final payment exceeds the amount of the final payment. If the deductions are high enough for this to happen, it would be reasonable to conclude that producers desiring to smooth their cash flow would opt to allow a larger portion of their deductions to be made with receipt of the partial payment, as the order allows.

The partial payment provision in Federal orders is a minimum requirement placed on handlers to pay producers for milk delivered. It is notable that cooperatives and handlers are not restricted to paying only one partial payment at the rate specified in the order; partial payments for milk can be made more often. Additionally,

cooperatives and handlers are also at liberty to negotiate agreements for more frequent billings for milk and payments for milk above the minimum established by the order. As made evident by the record, more flexible partial payment options are available to both producers and handlers than relying solely on changing the minimum payment provisions.

As the Leprino witness noted, DFA's proposal does not incorporate or blend the higher-valued uses of milk in their analysis. In response to this observation, the Department compared the relationships between the partial and total payment using various percentages of the Central order's previous month's blend price. Interestingly, if the desired objective is to more closely approximate the partial payment rate using the 36-month period before order reform, the proponents' 105 percent rate of the previous month's lowest class price does seem to best accomplish this. Nevertheless, the same limitations and concerns mentioned above prevent a finding that the Central order's rate for partial payment should be increased.

The tentative decision and this final decision find that the cash flow concerns of producers may be better served by the adoption of other proposals considered in this proceeding. Other amendments adopted in this decision affecting the pooling of milk in the Central order will likely reduce the erosion in the blend price received by Central producers. It is expected that higher blend prices would result from more accurately identifying those producers and the milk of those producers who actually serve the Class I needs of the market. Similarly, the relationship between the partial payment and the total price received by producers may change by the adoption of these pooling standard amendments. Accordingly, a finding that the rate of partial payment to producers by handlers should be increased is not supported by the evidence contained in the record of this proceeding.

#### *4. Determining Whether Emergency Marketing Conditions Existed Warranting the Omission of a Recommended Decision and the Opportunity To File Written Exceptions*

Evidence presented at the hearing established that the pooling standards of the Central order were inadequate and were resulting in the erosion of the blend price received by producers serving the Class I needs of the market and should be changed on an emergency basis. The unwarranted erosion of such producers' blend prices stems from improper performance standards as they

relate to pool supply plants and the lack of limits for pool plant diversions to pool and nonpool plants. These shortcomings of the pooling provisions have allowed milk that does not provide a reasonable or consistent service to meeting the needs of the Class I market to be pooled on the Central order. Consequently, it was determined that emergency marketing conditions existed, and the issuance of a recommended decision was therefore omitted. The record clearly established a basis, as noted above, for amending the order on an interim basis and provided an opportunity to file written exceptions to the proposed amended order.

Evidence presented at the hearing also established that California milk pooled simultaneously on the California State-operated order and the Central Federal order, a practice commonly referred to as double dipping, rendered the Central Federal milk order unable to establish prices uniform to producers and to handlers and also has contributed to the unwarranted erosion of milk prices to Central producers.

In view of this situation, an interim final rule amending the order was issued as soon as the procedures were completed to determine the approval of producers.

#### **Rulings on Proposed Findings and Conclusions**

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

#### **General Findings**

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

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

(b) The parity prices of milk as determined pursuant to section 2 of the

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

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

#### **Rulings on Exceptions**

In arriving at the findings and conclusions, and the regulatory provisions of this decision, each of the exceptions received was carefully and fully considered in conjunction with the record evidence. To the extent that the findings and conclusions and the regulatory provisions of this decision are at variance with any of the exceptions, such exceptions are hereby overruled for the reasons previously stated in this decision.

#### **Marketing Agreement and Order**

Annexed hereto and made a part hereof is one document: A Marketing Agreement regulating the handling of milk. The Order amending the order regulating the handling of milk in the Central marketing area was approved by producers and published in the **Federal Register** on February 12, 2003 (68 FR 7070) as an Interim Final Rule. Both of these documents have been decided upon as the detailed and appropriate means of effectuating the foregoing conclusions.

It is hereby ordered, that this entire final decision and the Marketing Agreement annexed hereto be published in the **Federal Register**.

#### **Determination of Producer Approval and Representative Period**

May 2003 is hereby determined to be the representative period for the purpose of ascertaining whether the issuance of the order, as amended in the Interim Final Rule published in the **Federal Register** on February 12, 2003 (68 FR 7070), regulating the handling of milk in the Central marketing area is approved or favored by producers, as defined under the terms of the order (as amended and as hereby proposed to be amended) who during such

representative period were engaged in the production of milk for sale within the aforesaid marketing area.

#### List of Subjects in 7 CFR Part 1032

Milk marketing orders.

Dated: August 18, 2003.

**A.J. Yates,**

Administrator, Agricultural Marketing Service.

#### Order Amending the Order Regulating the Handling of Milk in the Central Marketing Area

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

#### Findings and Determinations

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

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

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

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

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

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

#### Order Relative to Handling

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

The provisions of the order amending the order contained in the interim amendment of the order issued by the Administrator, Agricultural Marketing Service, on February 6, 2003, and published in the **Federal Register** on February 12, 2003 (68 FR 7070), are adopted without change and shall be and are the terms and provisions of this order.

[This marketing agreement will not appear in the Code of Federal Regulations]

#### Marketing Agreement Regulating the Handling of Milk in Certain Marketing Areas

The parties hereto, in order to effectuate the declared policy of the Act, and in

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

I. The findings and determinations, order relative to handling, and the provisions of §§ 1032.1 to 1032.86, all inclusive, of the order regulating the handling of milk in the Central marketing area (7 CFR PART 1032) which is annexed hereto; and

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

(a) Record of milk handled. The undersigned certifies that he/she handled during the month of \_\_\_\_\_ 2001, \_\_\_\_\_ hundredweight of milk covered by this marketing agreement.

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

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

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

Signature

By (Name) \_\_\_\_\_

(Title) \_\_\_\_\_

(Address) \_\_\_\_\_

(Seal)

Attest

[FR Doc. 03-21527 Filed 8-26-03; 8:45 am]

**BILLING CODE 3410-02-P**