

I am Jeffrey Sims. I serve as Assistant Secretary of Dairy Cooperative Marketing Association, Inc. and of Southern Marketing Agency, Inc., two marketing agencies in common operating in the southeast United States. My business address is 13400 U.S. Highway 42, Suite 162, Prospect, Kentucky, 40059. I testify today on behalf of Arkansas Dairy Cooperative Association; Dairy Farmers of America, Inc.; Dairymen's Marketing Cooperative, Inc.; Lone Star Milk Producers, Inc.; and Maryland & Virginia Milk Producers Cooperative Association, Inc. Together these cooperatives will be hereafter collectively referred to as the proponents. Exhibit \_\_\_\_\_, pages A1 through A5 are letters from each of the proponent cooperatives authorizing me to speak on their behalf in this matter. In addition, Dairylea Cooperative Inc. of Syracuse, New York has asked us to testify on their behalf in support of Proposals Number 1, 2, and 3 as included in the Notice of Hearing.

All of the proponents market member milk on either one or both of the Appalachian or the Southeast Federal Milk Marketing Orders. Together the cooperatives market in excess of 80 percent of the producer milk pooled on the Appalachian and Southeast Orders.

The proponents of these emergency amendments wish to thank the Secretary for hearing these proposals on an expedited schedule and for considering emergency action and the omission of a recommended decision under the rules of practice and procedure.

The proponents offer the following testimony in support of Proposals number one, two and three as listed in the notice of hearing.

Date 11/01/04 Exhibit # 24  
 Case US Dept of Agriculture  
 Deponent \_\_\_\_\_  
 Reporter Danyiel Carpenter CRS File # 8916  
 Court Reporting Services, Inc.  
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## Introduction

For at least the last twenty-five years the southeastern United States has experienced declining milk production, and at the same time has seen substantial increases in population. These two factors have combined to create a milk deficit condition in the southeast unlike any other region of the United States.

Increases in Class ■ sales, brought on by increases in population, coupled with the decreases in milk production have left the southeast in the unenviable position of seeking milk supplies from further and further away. According to market administrator statistics introduced at this hearing, during 2004 producer milk was delivered to Order 5 and 7 pool plants from not less than 28 states. Just as the milkshed for the region has expanded and milk movement distances have increased for milk moved from outside the marketing area, the distance milk moves within the marketing areas has likewise increased. Consolidation of milk processing into fewer and larger plants, and the loss of dairy farm numbers has caused what little milk remains in the region to be poorly situated with regard to Class ■ demand. Class ■ fluid milk processing plants are typically located near population centers, which unfortunately puts them distant from milk production centers.

Exacerbating the enormity of the distances milk must move to supply the Class ■ demand in the southeast is a national environment of high fuel costs.

Transportation Credit Balancing Funds are currently included in the Appalachian and Southeast Orders at sections .80, .81 and .82, and these provisions address a portion of the

costs of bringing in supplemental milk to the southeast. Proposal number one seeks to increase the Transportation Credit Balancing Fund assessment rate in each of the two Orders. Proponents have proposed increasing the maximum Transportation Credit Balancing Fund assessment by \$0.055 per hundredweight of Class ■ milk in the Appalachian Order such that the maximum rate of assessment pursuant to section 1005.81 would be \$0.15 per hundredweight; and proponents have proposed increasing the maximum Transportation Credit Balancing Fund assessment by \$0.100 per hundredweight of Class ■ milk in the Southeast Order such that the maximum rate of assessment pursuant to section 1007.81 would be \$0.20 per hundredweight. In Proposal number three, proponents seek to amend the mileage reimbursement factor utilized in the Transportation Credit payment provisions of both Orders by updating the mileage rate, and inclusion of a diesel fuel cost adjuster. Proposal number ~~two~~ seeks to add new provisions to the Orders providing for an Intra-market Transportation Credit which will offset a portion of the transport cost of supplying milk produced within the two marketing areas to pool distributing plants. The Intra-market Transportation Credit would be at least partially funded by adding a new provision to the Orders, an Intra-market Transportation Credit Fund, which will be funded by an Intra-market Transportation Credit Assessment, which is requested to be a maximum \$0.10 per hundredweight of Class ■ milk in the Appalachian Order, and is requested to be a maximum \$0.15 per hundredweight of Class ■ milk in the Southeast Order.

Proposals number 1, 2 and 3 will be dealt with separately for purposes of this testimony, but proponents consider the partial reimbursement for costs of supplying milk for Class ■ use to the southeast, whether that milk is produced inside or outside the marketing areas, to be

inextricably linked in that both provisions seek to assign a portion of the costs of supplying milk for Class ■ use onto the Class ■ purchaser.

For reasons of expediency, for the purposes of this testimony, the term southeast or southeast region shall refer to the Appalachian and Southeast Marketing Areas, or their predecessor Orders. We will attempt to be specific when referring to the two Orders as opposed to references to the region.

### **Testimony in Support Of Proposals Number One and Three.**

The current system of Transportation Credits as provided in sections .80, .81 and .82 of the two Orders was installed in the southeastern Orders in 1996, with a substantial amendment to the provisions in 1997. With the exception of conforming changes to the Order language resulting from Order consolidation, and the deletion of an unused scale ticket provision, the Transportation Credit provisions have remained basically unchanged since 1997. References in this testimony to the initial provisions of the Transportation Credits will refer mostly to the 1997 language and promulgation.

Exhibit \_\_\_\_\_, page B, is a tabular comparison of the portion of the actual cost of hauling Class ■ milk which was funded by Transportation Credits in 1997 versus the portion of the actual cost which Transportation Credits funded in 2003, 2004, and 2005.

When the current system of Transportation Credits was installed in the southeastern Orders in 1997, approximately ninety four to ninety five percent of the cost of transport on

supplemental Class ■ milk was covered by Transportation Credit Balancing Fund payments. In 1997 the prevailing quoted cost of over-the-road milk transport **was** in the range of \$1.75 to \$1.80 per loaded mile, which computes to per hundredweight per mile factors of \$0.00365 to \$0.00375, using a 48,000 pound load of milk. The mileage rate included in the 1996 Transportation Credit promulgation and decision was 0.37 cents per hundredweight per mile. The method for conversion of hauling rates per loaded mile to rates per hundredweight per mile is demonstrated in Exhibit \_\_\_\_\_ page C. In 1997 the Secretary installed a rate per hundredweight per mile in the Orders which was slightly less than the actual transport cost, deciding 0.350 cents per hundredweight per mile was a reasonable rate per hundredweight per mile, lowering the mileage rate from the 0.37 cents per hundredweight per mile included in the 1996 Transportation Credit provisions. There **was** little testimony in the 1997 proceeding regarding hauling rates, but **industry** memory is that haul rates were approximately \$1.80 per loaded mile in 1997.

Since 1997 fuel costs and other factors impacting the cost of hauling have increased substantially, and there **has** been no adjustment in the Orders' per hundredweight per mile reimbursement rate since 1997.

Exhibit pages D1 through D3 shows the monthly cost of diesel fuel for the United States and nine U.S. sub-regions, as reported by the Energy Information Administration of the United States Department of Energy on their website at <http://tonto.eia.doe.gov/oog/info/wohdp/diesel.asp>. From the exhibit we can see that the national average diesel fuel price in mid-1997 was reported to be approximately \$1.15 to \$1.17 per gallon, while the national average diesel fuel price in mid-2005 was reported to be

approximately \$2.20 to \$2.50 per gallon, roughly double the 1997 cost. Costs in the autumn months of 2005 increased even further following hurricane Katrina. While diesel prices have moderated somewhat from the highs registered in the fall of 2005, diesel fuel prices still substantially exceed the prices which existed when the Transportation Credit provisions were installed in 1997.

Another factor has also come into play which has reduced the effective rate of reimbursement of the cost of moving Class ■ supplemental milk from the Transportation Credit Balancing Funds. This factor is the necessary proration of payments by the market administrators from the Transportation Credit Balancing Funds due to insufficient Fund balances in the later months of the payment period.

As stated previously, milk moves greater and greater distances each year, in greater and greater volumes each year to serve the Class ■ needs of the southeast. These greater distances, coupled with greater volumes of supplemental milk have left the Transportation Credit Balancing Funds insufficient to cover all the claimed Transportation Credits. Recent history shows that as currently funded, the Transportation Credit Balancing Fund is sufficient to cover 100 percent of claimed Transportation Credits in the Appalachian and Southeast Orders typically only during the first couple of months of the Transportation Credit payment period. Order provisions require the market administrators to prorate available Fund dollars to claimed credits if the Fund is insufficient in a month. Looking again at Exhibit \_\_\_\_, page B, we see that the effective rate of payout of claimed credits in the Southeast Order after adjusting for this proration was a little more than thirty-nine percent in 2004, and was slightly more than fifty four percent in the Appalachian Order in that year. **These** effective rates of

payment after proration have been only slightly better in 2005, owing to the increased assessment rates applicable since November 2005. Both the Appalachian and Southeast market administrators began prorating Transportation Credits in September 2005.

Referring again to ~~Exhibit~~ page B, the factors described above, higher rates per mile for hauling and the proration of available Transportation Credits Funds, are combined into one comparison. The combined effect of these changes has left the real portion of transportation cost on Class ■ supplemental milk paid via the Transportation Credits radically lower in 2004 and 2005 than in 1997. In 1997 approximately ninety four to ninety five percent of the actual cost of hauling Class ■ supplemental milk was paid through the Transportation Credit provisions, while only approximately forty-six percent was paid in 2004, forty-six percent being the approximate simple average of the 54.6 percent in the Appalachian Order and 39 percent in the Southeast order. Proponents have estimated the assessment amounts and claimed credits for December 2005, and based on those estimates project that the final percentage of hauling costs on Class ■ milk which would be reimbursed from the Transportation Credit Balancing Funds in 2005 to be about 48 percent in the two orders combined, As stated previously, 2005 has been in practical terms very little better than 2004. In round numbers, the portion of hauling costs on Class ■ supplemental milk which is paid through the Transportation Credit Balancing Funds has been cut by more than half in 2004 and 2005, versus the levels paid in 1997. We have every reason to believe that this trend of increasing transport costs and decreasing effective Transportation Credit Balancing Fund payments will continue unless amendments to the Transportation Credit Balancing Fund provisions are installed.

Returning the effective rate of Transportation Credit payments to the levels originally foreseen and installed by the Secretary will require attacking both of the identified causal factors. We will now provide evidence and testimony in support of amending the per-hundredweight per mile rate included in the Orders, and testimony in support of increasing the maximum rate of assessment on Class I producer milk.

### **per Hundredweight Mileage Rate (Proposal No. Three)**

As demonstrated in Exhibit pages D1 through D3, the cost of fuel has escalated rapidly in recent years. This should certainly be no surprise to anyone owning an automobile. The impact on the cost of milk hauling has corresponded to the cost of fuel as one would expect. Previous testimony put the cost per loaded mile for over-the-road hauling at \$1.75 to \$1.80 per loaded mile in 1997. That rate is more like \$2.35 per mile today. Exhibit page E is a compilation of actual hauler bills to cooperative associations for the month of October 2005. Hauler bills were randomly selected from cooperative records, summarized and compiled into the exhibit. The range in costs per mile from the Exhibit invoices is \$1.89 to \$2.70, with an average of \$2.48 per loaded mile. We fully believe that the ranges in costs per mile for hauling computed from this sample of hauling bills is highly indicative of the universe of hauling costs being charged in the marketplace.

Diesel fuel costs are not the only reason transport costs have increased. General cost increases in equipment, insurance, labor, and new government regulations regarding driver rest periods and on-the-road time have all worked to increase per mile transport costs. Diesel fuel cost merely represents the most visible transport cost factor.



Proponents believe that setting the Federal Order rate of reimbursement for hauling cost at some rate less than the actual cost continues to be a reasonable approach for the Transportation Credit Balancing Fund provisions. Full reimbursement of the cost per mile of moving Class I could lead to complacency in seeking hauling efficiencies, or worse yet, could encourage uneconomic movements of milk.

The 1997 Transportation Credit Balancing Fund provisions set the rate per hundredweight per mile at 0.350 cents, and the rate has not been updated since then. Costs of hauling have increased substantially since 1997, to such a level that the 0.35 cents per hundredweight per mile would be insufficient if fuel were free! Exhibit , page F shows the mileage rate which would have been in effect in late 2004, the period of time of the Hurricane Emergency Hearing in the southeast Orders, if fuel had no cost. In the Secretary's decision on the Hurricane Emergency, it was decided that hauling costs on extraordinary movements of milk resulting from the 2004 hurricanes would receive reimbursement using a maximum rate per loaded mile of \$2.25. According to fuel data already introduced, the cost of diesel in the southeast in September 2004 was about \$1.87 per gallon. Using 5.5 miles per gallon fuel use by a tractor-trailer and removing the fuel cost from the total rate per loaded mile results in a mileage rate during late 2004 of almost 0.40 cents per hundredweight per mile, which is greater than the Order mileage rate - and this is if fuel were free. Clearly, the mileage rate under the Orders is in need of updating.

Rather than proposing the continuation of use of a fixed rate per hundredweight per mile for payments from the Transportation Credit Balancing Fund, proponents offer the following

system for the computation of a variable or moving per hundredweight per mile rate. The use of fixed rate suffers from lack of responsiveness to changes in hauling costs, as we have demonstrated above. However, if mileage rates were fixed in the Orders based on the current hauling costs, and if hauling costs were to decline from their current rates in the future due to decreases in fuel cost, the Order provisions would be left with a per-mile rate which could be too generous, and therefore might encourage inefficiencies in hauling or uneconomic movements of milk. None of the proponents offers themselves as experts in the field of predicting fuel cost changes, which are the primary mover of hauling costs in the short run. As a result, proponents have no certainty as to the direction fuel costs will move in the future. The uncertainty of future fuel cost changes makes setting the Order rate for hauling in the Transportation Credit Balancing Fund provisions based on the current rate of hauling, with no provision for making future adjustments outside the formal rulemaking process, fraught with danger.

Adjustable rates for hauling costs based on fuel changes are common in industry, and even the U.S. government has updated the allowable mileage rate for business use of automobiles over time,

Exhibit ■■■ pages G1 through G5 provides summaries of computations of hauling rates for the period of October and November 2003. During this period, diesel fuel costs were relatively stable, ranging from \$1.48125 to \$1.48225 per gallon nationally, and \$1.4210 to \$1.4308 in the Lower Atlantic and Gulf Coast EIA regions. This is the only period in recent history that fuel costs have varied less than one cent per gallon over a two month period. Exhibit ■■■ page G5 shows an average hauling rate being charged in the southeast during

October and November 2003 of approximately \$1.91 per loaded mile. Since the diesel prices were not rapidly fluctuating during this period, proponents believe this to be a fair time frame upon which to base diesel adjustments to haul rates, to use as a base-period, if you will. Proponents offer \$1.91 per loaded mile as the base rate for determining the mileage rate under the two Orders.

In determining hauling rates, industry utilizes a range of 5.0 to 6.0 miles per gallon fuel use for transporting milk, with use of 5.5 miles per gallon often cited as a fair average. Statistics on Combination Truck fuel economy from the United States Department of Transportation, included as Exhibit \_\_\_\_, page H shows that the average miles traveled per gallon of fuel for a combination truck was 5.2 miles per gallon in 2002. The United States Department of Transportation defines a Combination Truck as what would commonly be called a tractor and trailer. Combination truck fuel economy from the US DOT statistics show little change in average fuel economy per mile since 1998. The United States Department of Transportation fuel use data are copied from the **USDOT website**, and the table sourced is at [http://www.bts.gov/publications/national\\_transportation\\_statistics/2003/html/table\\_04\\_14.html](http://www.bts.gov/publications/national_transportation_statistics/2003/html/table_04_14.html) . Proponents offer 5.5 miles per gallon as the fuel consumption rate to be used in computing Federal Order Mileage Rates.

Load sizes used for industry mileage calculations range from 44,000 to 48,000 pounds per load, with 46,500 pounds being an **often-used** load volume for milk route pick up. Tankers can typically hold the full 48,000 pounds, but due to normal daily variation in farm production, 46,500 is **often** used to represent the average load size over the year in tankers completing farm pick-up. A 5,600 gallon tanker can hold at its fullest 48,160 pounds of milk. Proponents

- seek to encourage the efficient use of hauling equipment, and offer 48,000 pounds as the load size for use in the Order provisions.

Proponents propose the use of the Lower Atlantic and Gulf Coast EIA regions in the computation of mileage rates under the Appalachian and Southeast Orders. As reported by the Energy Information Administration, the Lower Atlantic region is comprised of the states of Virginia, West Virginia, North Carolina, South Carolina, Georgia, and Florida. The Gulf Coast region is comprised of the states of Alabama, Mississippi, Arkansas, Louisiana, Texas and New Mexico. The area covered by these two EIA regions fairly well mirrors the Appalachian and Southeast Order marketing areas, and would include the important reserve supply areas in the southwest. As for states in the two Order Marketing Areas, only Kentucky, Tennessee and Missouri would not be reflected in the Atlantic and Gulf Coast regions' EIA fuel data. Expansion of the number of EIA regions beyond the Lower Atlantic and Gulf Coast regions for use in the mileage rate computation would include much more territory, and likely would not appreciably impact the computed fuel costs. In fact over time, the Lower Atlantic and Gulf Coast EIA regions have shown diesel fuel costs among the lowest reported. Important in the proposals is that the monthly change in the cost of fuel be recognized. Use of a consistent base period, tied to consistent reporting regions will accomplish this. Industry in the southeast uses the Lower Atlantic and Gulf Coast regions in computing hauling cost fuel adjustments, and has seen no issues arise from their use versus use of some larger geographic fuel cost statistic.

Exhibit \_\_\_\_, page ■ shows an example computation of the proposed Mileage Rate for the month of December 2005 using the mathematical information and data set forth here. . Using

diesel fuel cost for the Lower Atlantic and Gulf Coast EIA regions for the four weeks ended December 23, 2005, the simple average diesel fuel cost for the southeast was approximately \$2.41 per gallon. Using the start-out rate per loaded mile in effect when diesel was approximately \$1.42, the October and November 2003 period previously discussed, we see that diesel fuel now exceeds the base period price by \$0.99 per gallon. We next divide the change in fuel cost by the proposed average fuel use of a milk truck, that is, 5.5 miles per gallon. The resulting figure represents the change in the cost of hauling milk one mile, for the given change in diesel fuel cost over or under \$1.42 per gallon. In this case \$0.99 divided by 5.5 equals \$0.18 per loaded mile cost increase due to fuel. Next, the change per mile in hauling costs resulting from fuel price changes is added to the reference rate of hauling costs per loaded mile, which as discussed is proposed to be \$1.91 per loaded mile. The resulting value is the fuel-adjusted cost per loaded mile. Again in this case \$0.18 plus \$1.91 equals \$2.09. Next divide the adjusted rate per loaded mile by the number of hundredweights on a typical load, which is 480, to get the mileage rate in dollars per hundredweight per mile, and multiply by 100 to get the mileage rate in cents per hundredweight per mile, again mathematically,  $\$2.09 \div 480 = \$0.004355$ , and  $\$0.004355 \times 100 = 0.436$  cents per hundredweight per mile. This rate per mile represents the fuel adjusted cost of hauling milk. Proponents have called this new process the Mileage Rate, and have proposed a new section 1005.84 and 1007.84 in the two Orders.

The mileage rate as proposed will be less than the actual cost of hauling, and does not need further reduction. As described above, the mileage rate resulting from the computation as proposed yields a rate per hundredweight per mile which is less than is actually being paid in the marketplace. The mileage rate as proposed to be computed is based on 2003 costs of

hauling and only reflects changes in the costs of fuel since that time, Other costs, as previously discussed, have increased the actual cost of hauling since then.

Also, no further adjustment in the mileage rate is necessary because the pounds reimbursed on a load are Class ■ only. Depending on whether the mileage rate is used in the current Transportation Credit provisions or the proposed Intra-market Transportation Credits, and whether it is Order 5 or Order 7, the Class ■ use on the load will be between approximately 65 percent and 90 percent.

The use of a fuel adjuster itself reduces the need to further downwardly adjust the mileage rate. As shown in Exhibit \_\_\_\_ pages J1 and J2, the mileage rate will move up and down with the cost of fuel. No longer is there any need to safeguard the mileage rate from lower fuel costs by setting the rate at less than the computed cost, because the mileage rate will be self-correcting. As seen in Exhibit \_\_\_\_ pages J1 and J2, the mileage rate as proposed would have ranged between 0.417 cents per hundredweight per mile and 0.461 cents per hundredweight per mile, with a simple average 0.433 cents per hundredweight per mile during 2005.

The computation of Transportation Credits and the proposed Intra-Market Transportation credits provide mileage safeguards which reduce the actual rate of reimbursement below the actual cost of hauling. Current Transportation Credit provisions reduce the mileage on farm direct milk by 85 miles, and the proposed Intra-Market Transportation provisions reduce the mileage by the distance a producer is from his or her nearest pool distributing plant. For all of the above reasons, proponent see no practical reason to further adjust the Mileage Rate by

any factor **after** conversion to a per-hundredweight per mile rate established on the 2003 cost of hauling and fuel costs.

Common practice in the industry is to compute the diesel fuel adjuster on the last Monday of the current month, using the most recent four weeks' diesel prices as reported by EIA. Proposal number 3, as included in the Notice of Hearing provides Order language which mirrors industry practice in setting haul rates, with a slight modification to fit market administrator price announcement schedules already in place. We propose that the mileage factor to be used in the Transportation Credit Balancing Funds provisions and the Intra-market Transportation Credit provisions be computed and announced along with the Advanced Class ■ price, such that the Mileage Rate is announced for the current month on the Friday that falls on or before the 23<sup>rd</sup> of the month. The time period used would be the most recent four weeks available prior to the announcement of the Advanced Class ■ price. For example, the December 2005 Mileage Rate would have been announced on December 23, 2005, and would have used the Energy Information Administration diesel prices for the Lower Atlantic and Gulf Coast regions announced by EIA on November 28, December 5, December 12 and December 19. In practical terms, the mileage rate announced under the Orders would be announced a week or two earlier than currently computed by industry. Industry may or may not adopt this change in timing of their actual fuel adjustment changes to haulers, but whether or not industry makes this change in computing monthly haul rates is not material to the administration of the Order. The important aspect here is that the Orders need a formalized process for keeping hauling costs reasonably current and adjusted for relative changes in diesel fuel costs, whether fuel **costs** rise or fall, and the system proposed utilizes well understood industry practice and independently announced, reliable, fuel cost data.

Adjustment of reimbursement for mileage costs from changes in fuel costs is appropriate. Industry uses fuel adjustments to pay for hauling on an ongoing basis, and even the Federal Government changes mileage rates for reimbursement of personal vehicle use based on changes in vehicle operation costs.

### **Transportation Credit Assessment Rate**

The assessments for the Transportation Credit Balancing Funds have been insufficient to fund all claims made on the Funds for the last few years. Both the Appalachian and Southeast Order market administrators have collected the maximum Transportation Credit Balancing Fund assessment in 2004 and 2005, pursuant to section 10xx.81 of the Orders, yet both Orders had insufficient funds to pay all claimed Credits. Even with the addition to the assessment rates of three cents per hundredweight of Class ■ milk which went into effect in the Orders in November 2005, proponents anticipate both the Order 5 and Order 7 Transportation Credit Balancing Funds to be insufficient for calendar year 2006. Proponents appreciate and thank the Secretary for acting to partially relieve the insufficiencies of the two Transportation Credit Balancing Funds in the recent Order proceeding, but note that the three cents per hundredweight increases in the Transportation Credit Balancing Fund assessments are still not enough, given the changes in fuel costs, supplemental milk volumes, and distances supplemental milk moves, as previously described.

Exhibit \_\_\_\_, page K shows the amount per hundredweight of Class ■ Transportation Credit Balancing Fund assessment which would have been necessary to fully fund all claims for



credits in 2004, and estimates of the amounts necessary for 2005. These credits are computed at the rate per hundredweight per mile as currently included in the Orders, that is 0.35 cents per hundredweight per mile, and do not take into account additional funds which would be necessary if the mileage rates are amended as proposed above. For the year 2004, the Transportation Credit Balancing Fund assessment of \$0.065 per hundredweight of Class I milk, the maximum allowed under the Appalachian Order, would have had to been increased to \$0.0889 to pay all claimed Credits. For that year in the Southeast Order, the \$0.070 per hundredweight maximum assessment would have had to been increased to \$0.1318 to pay all claimed Credits. Clearly, the three cents per hundredweight recent increase would have been barely sufficient to allow the payment of all claims in Order 5 in 2004, and is projected to be insufficient to fund all Transportation Credit claims in Order 7.

Claimed Transportation Credits from the Appalachian Order Transportation Credit Balancing Funds in July, September, and October 2005 exceeded the credits claimed from the Order in the same months of 2004. Claimed Transportation Credits from the Appalachian Order Transportation Credit Balancing Funds in August and November 2005 were somewhat less than claimed in the same month during 2004. In the Southeast Order, claimed credits were down slightly in July, August, September and November of 2005 versus the same month in 2004, while October 2005 claims exceeded October 2004. Marketers of milk may have shifted some supplies of supplemental milk onto Order 5 and away from Order 7 since the recent history of net payments after proration on Order 5 have exceeded Order 7. The market administrators for the two Orders have supplied these data in Exhibits \_\_\_\_ a n d \_\_\_\_ . The general trend has been for claimed Transportation Credits to increase over time. Obviously if this trend continues in 2006, the Transportation Credits Funds will be even more deficit in

available funds than was true in 2004 and in 2005. The critical milk supply condition of the southeast requires that effective action be taken to more fully fund the Transportation Credit Balancing Funds and bring equity and order to the reimbursement of costs of transporting supplemental milk for the southeast.

Proposal number three provides an increase in the per-hundredweight per mile reimbursement rate, and this raise will increase the payout from Transportation Credit Balancing Funds. Exhibit \_\_\_\_\_, page L demonstrates, based on calculations by the market administrators already introduced at this hearing, the projected increase in cost which occurs from increasing the per hundredweight per mile reimbursement rate for each of the two Orders. Based on actual 2004 and 2005 milk movements and origin points, the Transportation Credit Balancing Fund assessment rate would need to be increased by \$0.0462 per hundredweight of Class I milk in Order 5, and by \$0.0623 per hundredweight in Order 7 if the per mile reimbursement rate were 0.46 cents per hundredweight per mile. Based on the proposed system for computing Mileage Rates described above, the per mile reimbursement rate based on a \$2.40 diesel fuel price per gallon, which is the approximate average current price per gallon, would be approximately \$0.0044 cents per hundredweight per mile.

There is a cumulative effect to the changes in the Mileage Rate as proposed and the insufficiencies of the current Transportation Credit Balancing Fund assessment rate needed, which will be summarized at this time. This calculation and summary can be found in Exhibit \_\_\_\_\_, page M.

For the Appalachian Order, increasing the per hundredweight per mile reimbursement rate from 0.35 cents to 0.46 cents requires an increase in the assessment of \$0.0441 per hundredweight, and the Fund was \$0.0239 per hundredweight insufficient based on the 2004 assessment rate of \$0.065 per hundredweight, yielding a needed assessment rate of \$0.1330 per hundredweight of Class ■ milk for 2004. Proponents estimate that for 2005 the required assessment would **have had to be** \$0.1415 per hundredweight of Class ■ milk.

For the Southeast Order, increasing the per hundredweight per mile reimbursement rate from 0.35 cents to **0.46** cents requires an increase in the assessment of \$0.0609 per hundredweight, and the Fund was \$0.0618 per hundredweight **insufficient** based on the 2004 assessment rate of \$0.070 per hundredweight, yielding a needed assessment rate of \$0.1927 per hundredweight of Class ■ milk for 2004. Proponents estimate that for 2005 the required assessment would have had to be \$0.1869 per hundredweight of Class ■ milk.

If diesel fuel costs were to return to the highs experienced in 2005, the per hundredweight per mile rates under the Orders would exceed \$0.0046 and thus the amount paid for Transportation Credits **would exceed** the estimates stated here.

Proponents recommend setting the maximum rate of Transportation Credit Balancing Fund assessment, which is stated in section ~~10xx.81~~ of the Orders, at \$0.15 per hundredweight of Class ■ milk in the Appalachian Order and \$0.20 per hundredweight of Class ■ milk in the Southeast Order. These maximum rates represent an increase of \$0.055 per hundredweight of Class ■ milk in Order 5, and \$0.10 per hundredweight in Order 7, **above** the rates which were put into effect in November 2005.

Changing the relative maximum rate of assessment for the Transportation Credit Balancing Funds in the two Orders could alter the relative total Class ■ cost to handlers under the Orders. Currently, the difference in maximum assessment rate is one-half cent per hundredweight. The proposed new maximum rates would differ by \$0.05 per hundredweight.

While the proposed difference in maximum rate of Transportation Credit Balancing Fund Assessment between the two Orders may seem like a divergence from the Orders' pricing practice of having both Orders with basically the same Class ■ price, this ostensible sameness of Class ■ value has not always been as it appears. In 2002 and 2003, the market administrator for the Appalachian Order waived the assessment for the Transportation Credit Balancing Fund for two months each year. In the other ten months, the rate assessed was the Order 5 maximum rate of \$0.065 per hundredweight. During those years, the market administrator for the Southeast Order did not waive the assessment in any month. In simple terms, the annual average assessment for the Appalachian Order was \$0.054 per hundredweight, which is \$0.065 times ten months, divided by twelve months. The annual average rate of assessment in the Southeast order was \$0.07 per hundredweight, leaving an actual difference in effective rates of assessment of \$0.016 per hundredweight.

In addition, Order 7 handlers importing milk from outside the southeastern Orders would have experienced higher net costs of supplemental milk hauling in those earlier years due to the proration of Transportation Credit Balancing Fund payments in Order 7 during that period. Handlers in Order 7 thus would have had their net reimbursement of hauling costs reduced versus Order 5 importing handlers. These costs of transport certainly exist, and have been

paid, just they have been paid for outside the Transportation Credit Balancing Fund assessment system. So while on the surface the Transportation Credit Balancing Fund Assessments have appeared to be roughly equal in the two Orders, because the maximum rates of assessments defined in the two Orders have been roughly equal, differences in the true effective rate of assessment have existed, as well as differences in handler costs of supplemental supplies due to differences in Transportation Credit Balancing Fund payment prorations.

The differing rates of maximum Transportation Credit Balancing Fund Assessments between Orders 5 and 7 reflect the somewhat differing costs of supplying supplemental milk to the two Order areas. While both Order areas draw milk from the same supplemental sources in the Indiana, Ohio, and Michigan area, additional supplemental milk supplies for the Order 7 area originate in the southwestern United States, while additional supplemental milk supplies for the Order 5 area originate in the Middle-Atlantic states. The additional distance milk moves from the southwest region to the Order 7 area versus milk movements to the Order 5 area for milk originating in the Middle-Atlantic states represents the principal difference in supplemental milk hauling costs, and thus the relative differences in Transportation Credit Balancing Fund payments. It should be noted that some milk does move from the southwest region into Order 5 as supplemental milk and the miles this milk travels is often greater than if the milk were delivered into Order 7 plants.

There could be concern that the differences which exist in the distances supplemental milk must move to supply the two Orders, coupled with differences in supplemental milk volumes received in the two Orders could lead to substantially different Transportation Credit

Balancing Fund Assessment rates applicable in the Orders. If this becomes problematical, the Secretary could remedy the situation by consolidating the two Orders.

The costs of supplying supplemental milk to the southeastern Orders are real, and are ongoing. In the most recent past, the assessment for the Transportation Credit Balancing Funds has been seriously insufficient to cover even a half of the transportation costs, and thus those costs have been borne outside the regulated marketplace. Proponents seek to return order and equity to the reimbursement of these costs by having the Orders assess handlers for these costs, and standardize the reimbursement for these costs to those handlers who are incurring them.

The Transportation Credit Balancing Funds provisions afford the market administrator discretion in setting the assessment rates at or less than the maximum allowed by the Orders, based on projected Fund needs. Proponents continue to support this process, and the market administrators' discretion in setting the Transportation Credit Balancing Fund assessment rates in the two Orders insures that if payments from the fund are less than anticipated, assessments can be lowered by the market administrator accordingly.

As previously discussed, the market administrator discretion in setting the assessment rates has resulted in dissimilar assessment rates between the two Orders in the past, and that may be true in the future. Conversely, changes in the sources of supplemental supplies, or the volumes of the supplemental supplies may lead to actual assessment rates being closer in the two Orders than the differences in the maximum stated rates of assessment would suggest.

Proponents have proposed a minor modification to the market administrator discretion process in setting the Transportation Credit Balancing Fund assessment. Given that the Mileage Rate, as proposed to be adopted, will be a moving rate, the new language in sections 1005.81 and 1007.81 requires the market administrators to take into account any changes in the effective Mileage Rate between the current year and the previous year in determining the level at which to set the rate of the Transportation Credit Balancing Fund assessment.

In summary, the Appalachian and Southeast Orders, and their predecessor Orders, have had Transportation Credit Balancing Fund provisions for many years, and the Credit provisions have functioned as intended by increasing the regulated cost of Class ■ milk so that milk for Class ■ use could be procured from outside the marketing areas. The Transportation Credit Balancing Fund system should continue to be a part of the Appalachian and Southeast Orders, and needs to be improved and updated as proposed.

### **Testimony in Support Of Proposal Number Two.**

Proponents seek to amend the Appalachian and Southeast Orders by adding new provisions which would help move milk for Class ■ use within and between the two marketing areas. It is envisioned that the structure of these provisions would be analogous to the current Transportation Credit Balancing Fund system, only limited to milk movements to pool distributing plants within the two marketing areas, and applicable only to distances represented by movements to pool distributing plants beyond a producer's nearest pool distributing plant, with such credits to be known as Intra-market Transportation Credits.

Proponents propose adding a new section to each Order, sections 1005.83 and 1007.83, to accomplish these new provisions. Proponents seek additional new provisions to at least partially fund the Intra-market Transportation Credits by adding a new sub-section to each Order, sections 1005.81(d) and 1007.81(d). Proponents seek a maximum rate of \$0.10 per hundredweight of Class ■ milk in the Appalachian Order, and a maximum rate of \$0.15 per hundredweight of Class ■ milk in the Southeast Order to at least partially pay for the Intra-market Transportation Credits. The funds generated from the Intra-market Transportation Credit Assessments would be deposited into a new fund, named the Intra-market Transportation Credit Fund, and if the balance in the Intra-market Transportation Credit Fund was insufficient to pay all computed Intra-market Transportation Credits for the month, the difference would be allocated from the producer revenue pool. Conforming language in sections 1005.61 and 1007.61 is proposed to effectuate this process.

At this time proponents wish to offer two correcting and amplifying **modifications** to the Federal Order language as published in the Notice of Hearing. The first pertains to section 1005.83 and 1007.83, Payments from the intra-market Transportation credit fund. In section 1005.83(b)(2), after the words "within the marketing area" insert the phrase 'or located within the marketing area', so that the entire subparagraph now reads: '(2) Determine the total pounds of producer milk physically received from farms of producers located in the marketing area or within the marketing area of Order 1007 (7 CFR Part 1007) at each pool distributing plant;". Likewise, In section 1007.83(b)(2), after the words "within the marketing area" insert the phrase 'or located within the marketing area', so that the entire subparagraph now reads: '(2) Determine the total pounds of producer milk physically received from farms of producers located in the marketing area or within the marketing area



of Order 1005 (7 CFR Part 1005) at each pool distributing plant;". These minor correcting modifications conform the language to the intent of the provisions such that producers located within either order 1005 or 1007 would be eligible to their milk to receive an Intra-market Transportation Credit for delivery to a pool distributing plant regulated on either order 1005 or 1007. Language suggesting that producers located in either marketing area would be eligible for their milk to receive an Intra-market Transportation Credit is correctly included in the Notice of hearing in sections 1005.83(b)(1) and 1007.83(b)(1). The modified proposed language is provided in Exhibit \_\_\_\_\_.

The second modification to the Order language from that included in the Notice of Hearing regards market administrator determination of the location of producers for determining the Intra-market Transportation Credit. As described previously, the market administrator estimates of the Intra-market Transportation Credit values used the county seat of counties within the marketing areas as a proxy **starting** point versus locating each producer's farm more specifically. Proponents support revised Order language for the computation of the Intra-market Transportation Credit which would continue the use of a county seat within the marketing area as the starting point for computing mileages until such time as all producers' farms could be located at a sufficient level of specificity to satisfy the market administrator that the computation of distances from farm to plant are accurate and proper.

The Intra-market Transportation Credit provisions as proposed include two potential sources of income to fund the proposed credits. Obviously the best scenario for dairy farmers is to have the new assessment for the Intra-market Transportation Credits pay for the entirety of the expected Credits, such that the Class ■ marketplace is paying all of the cost of extra

mileages for **delivery** of milk for Class ■ use. To that end, proponents have proposed maximum rates of assessment in the Appalachian Order and Southeast Order which should cover the estimated cost of Intra-market Transportation Credits. Proponents believe that the cost of moving milk for Class ■ use should be borne by the Class ■ marketplace. However, if the Secretary elects to install assessments at less than the full amount necessary to pay for the new Intra-market Transportation Credits, provisions are proposed which would allow claimed Intra-market Transportation Credits which exceed the amount of assessment to be paid from the producer revenue pool. In order to have equity in the cost of delivering milk for Class ■ use between producers, proponents offer the process for adjustment to pool revenues to cover shortfalls in assessments as a fail-safe system. By providing this alternate source of funds, the **Intra-market** transportation credits can be paid even if Intra-market Transportation Credit assessments are **insufficient**. If assessments are not sufficient to pay all Intra-market Transportation Credits and **no** other source of funds is available to cover these costs, the shortage in Intra-market transportation credits creates inequities between those producers whose milk is traveling further than their closest pool distributing plant and those producers whose milk is able to be delivered to their nearest plant.

The installation of an Intra-market Transportation Credit system as proposed would complete the cycle of regulated cost reimbursement for Class ■ milk deliveries by setting up a system for cost recovery on intra-Order milk movements complementary to inter-Order milk movements provided by the current Transportation Credit Balancing Fund system. In this way, the regulated cost of Class ■ milk would reflect reimbursement of extraordinary costs of supplying milk for Class ■ use to the southeast region no matter where the milk was produced.

Exhibits \_\_\_\_\_ and \_\_\_\_\_ contain maps which show graphically the location of milk supplies and pool distributing plants in the Appalachian and Southeast Order Marketing Areas, as well as the location of pool and nonpool manufacturing facilities. These maps were prepared by the Market Administrators at our request. Of particular note is the concentration of milk production in the northernmost and northwestern-most areas, with pockets of milk production in southern Mississippi and eastern Louisiana, central Tennessee and lesser pockets of milk scattered throughout the marketing areas. Also of note is the location of pool distributing plants which are typically positioned near population centers, often in the interior of the marketing areas, distant from the more concentrated milk production areas.

Inherently difficult in the marketing of milk in the southeast is the distance milk must move within the marketing areas to supply Class ■ needs. While producer location adjustments do provide some incentive to pull milk generally north to south, the location adjustment effect is typically insufficient to reimburse the true cost of milk movements to supply Class ■.

Moving and providing milk for Class ■ use, while influenced by a number of institutional factors, remains an activity governed by the immutable laws of economics. The decision on whether or not to undertake a business activity rests on the opportunity for that particular business activity to cover the variable costs of taking on the activity. For example, a farmer will only harvest a drought impacted field of corn if the sales value of the harvested grain will exceed the cost of harvesting and delivery to the customer.

Such is true of the delivery of milk for Class I use. Since producers pay the cost of delivering their milk to the processing plant, they will, in the interest of reducing their costs in marketing their product, seek to deliver milk to the plant nearest them. A producer should only agree to deliver milk to a more distant plant if the return on the milk to deliver to that more-distant plant is greater than or equal to the increased cost incurred in moving milk beyond the nearest plant. Alternately, the producer should agree to make the more-distant delivery if a process is in place which equalizes the cost of hauling realized by the producer in making the distant delivery with the cost of the most-near delivery.

Plants and producers, for any number of institutional and practical reasons, are often not closely located. Production agriculture, and animal agriculture in particular, is being forced further and further away from population centers, while Class I processors have tended to locate their facilities near urban or developed areas. This push of milk production away from population centers has left the producer in the unenviable position of having to send milk further and further to supply Class I processors. The Class I price surface under Federal Orders has not kept pace with this dynamic, and producers are footing the bill for ever increasing costs of delivery of milk for Class I use. It is important that the regulated marketplace recognizes this dynamic and brings order and equity to the allocation of these costs of supplying milk for Class I use.

Proponents offer here a compromise solution to the sharing of these Class I supply costs which places bearing of the costs both on producers and on Class I, if the Secretary elects to establish Intra-market Transportation Credits assessments at an amount which is less than the amount of the Credits themselves. Since these costs are of great consequence, fairness

requires that they be equitably distributed, or the supply of milk for Class ■ use will be threatened in the Order 5 and 7 marketing areas.

In support of their proposal, proponents offer substantial evidence that there are significant costs incurred by marketers of milk in the delivery of milk for Class ■ use beyond a producer's nearest pool distributing plant.

Proponents have already testified regarding Exhibit \_\_\_\_\_, which provides the results of a computer model analyzing milk delivery patterns for a significant portion of the milk supply for the southeast.

The problem faced by real-life marketers of milk is that milk can't always stop at the closest plant. Using the Exhibit \_\_\_\_\_ map as an example, milk moves from blue to yellow to red circles. These costs of getting milk to where it has to go for Class ■ use are unfortunately not borne evenly.

Also described in Exhibit \_\_\_\_\_, previously described by Mr. Darr is the relative milk production and processing by state for the southeast. As can be seen from the exhibit, milk is not proportionately located with regard to Class ■ demand. Even within the southeast, which is milk deficit as a whole, there are states and sub-regions that have more milk than there is Class ■ processing demand. The movement of the milk from the areas of relative abundance, if that can be said of the southeast at all, to the areas of greater deficit is the relief asked for under Proposal number 2.

At the request of the Proponents, and already introduced at this hearing, the market administrators for the Appalachian and Southeast Orders computed hypothetical Inter-market Transportation Credits for the months of April and October 2005, using the provisions as proposed by the proponents, These data were presented in Exhibits \_\_\_\_ and \_\_\_\_.

As described by the market administrator witnesses, using the monthly mileage cost computation process described earlier, Mileage Rates for intra-market movements of \$0.0042, ~~\$0.0044~~, 0.0046 and \$0.0048 were applied to the additional miles milk moved beyond each producers' closest plant, and adjusting for revenues generated from milk moving to higher-priced zones, yields Intra-market Transportation Credits costs in the average month of between \$725,000 and \$850,000, for Orders 5 and 7 combined, depending on the cost of fuel, with a range of calculated Intra-market transportation credits of \$650,000 to \$940,000 depending on the season and the cost of fuel. Costs of this magnitude are hardly inconsequential.

Relating the general economic theory of whether or not to take on a business activity to these milk movements and their enormous cost leaves one to wonder why any dairy farmer would undertake delivery to a plant beyond their nearest plant, and we concede this would be a very good question. Federal Order Class ■ differentials do offer some economic incentive for moving milk generally north to south, but zone differences are typically insufficient at current haul costs to compensate producers for taking on this activity. If these substantial costs are ignored in the regulated milk marketing system, then producers will question why they should pay for making sure milk is supplied to Class ■, and will ultimately decide that they are not

going to do it any more. The supply of milk for Class I in the southeast will be threatened, and the need for any regulated process of pricing Class I milk will be negated.

Exhibit \_\_\_\_, pages N1 and N2 shows the loss incurred by marketers of milk in four more-or-less typical milk movements within the marketing areas, and the loss incurred when milk must move against the price grain. We will not for this purpose attempt to quantify any impact of blend price differences between Orders 5 & 7, although the examples do include a movement from the Order 5 marketing area to the Order 7 marketing area. The four example movements represent somewhat representative intra-market milk deliveries. In each of the examples, the cost of moving milk from a milk production center to a Class I processing center exceeds the amount received from location adjustment differences plus the local producer-paid hauling, even for those movements which go with the price grain. As demonstrated in the exhibit, it is typical in the southeast for producers to have a deduction for local hauling in the form of route assembly charge plus mileage to the producer's nearest plant, without regard to the plant at which the producer's milk is actually delivered.

A problem of milk marketing in the southeast, which is likely not very much a problem in other parts of the country is pointed out by page N2 of Exhibit \_\_\_\_. There is a milk production center located north of Lake Ponchartrain in Louisiana and Mississippi, and this area has the highest Class I differentials in the Southeast Order. This milk has no opportunity to move to higher priced zones, and the milk is sometimes needed outside the eastern Louisiana milk processing centers. When this milk moves out of its "home area", it incurs both hauling costs and location adjustment losses.

As distances between milk sheds and processing centers have grown, the producer location adjustment structure has become less relevant in the moving of milk. In earlier times, when producers may have been located more closely to cities and hauling costs were less, the Order producer location adjustments provided a greater portion of the hauling cost reimbursement than is currently the case. Exhibit, pages O1 and O2 shows how as milk must move further within the Order areas, the producer location adjustment fades in relevance to the cost of hauling. In the Exhibit example milk is moved from Asheville, North Carolina to Spartanburg, South Carolina and also to Charleston, South Carolina. The Class ■ differentials in Asheville, Spartanburg and Charleston are \$2.95, \$3.10 and \$3.30, respectively.

The location adjustment difference between Asheville and Spartanburg pays just less than half of the cost of hauling. However, when the movement is stretched to Asheville to Charleston, the location adjustment difference pays only slightly more than one fourth of the cost of haul. The same situation is experienced in Order 7, as can be seen from page O2 of Exhibit \_\_\_\_\_. In this example milk is moved from Springfield, Missouri to Little Rock, Arkansas; to Kosciusko, Mississippi, and to Cowarts, Alabama. The Class ■ differentials in Springfield, Little Rock, Kosciusko and Cowarts are \$2.20, \$2.80, \$3.10 and \$3.45, respectively. The location adjustment difference between Springfield and Little Rock pays slightly more than half of the cost of hauling, however as the milk moves farther, the percentage of haul cost which the location adjustment pays diminishes to slightly less than 38 percent for the movement to Kosciusko, and only slightly more than 35 percent for the movement to Cowarts.



As we can readily see, the Class ■ and producer location adjustment surface is insufficient to cover a reasonable portion of the cost of moving milk within the marketing areas. The proponents' proposal for Intra-market Transportation Credits in the Appalachian and Southeast Orders supplement the current insufficient incentives to move milk present in the existing location adjustment process, without the need to tackle the national issue of Class ■ prices, differentials, and location adjustment structure.

The proposals described here fit the need as suggested by the general economic theory previously discussed. In this case the additional business activity is the delivery of milk for Class ■ use beyond a producer's most desirable plant, which is presumed to be his or her nearest plant. The parties taking on these additional costs, that is, the variable costs of supplying milk for Class ■ use, and taking on the additional business activity need to be reasonably assured that they will be reimbursed for the additional costs at a level which will continue to allow them to undertake this extra business activity. The marketers of milk will not be guaranteed that their additional costs will be completely covered, since hauling costs are reimbursed at less than full cost and costs of transport will apply only to the Class ■ portion of the load. The application of traditional economic theory to the additional business analysis, while not quite perfect in its application, will aid in moving milk represented in the additional business activity, and bring order and equity to the allocation of these costs.

The question may be raised, does this new process of cost allocation through the Federal Order pooling mechanism reduce economic incentives for production of milk and processing of milk to relocate as near to each other as practical? The answer is no, the incentive for producers to locate close to plants, and vice versa, will still exist. First, producers will

- continue to have their milk mailbox price reduced by the value of hauling to nearest plant. The provisions as proposed presume the continuation of this system by reimbursement of costs only on milk which moves beyond the distance to the producer's nearest pool distributing plant. Further, if a producer is determined to be the same distance from two plants, as the producer's nearest plant, the plant to be used as the producer's nearest plant is to be the plant with the highest Class I price. This process mirrors the economic decision-making of a producer in that if a producer is indifferent as to the plant to which he or she desires to deliver their milk because the distances to the plants are the same, then the producer will seek to deliver milk to the higher priced plant.

Under the proposed provisions, plants will continue to seek near-by supplies, even when offered a Intra-market Transportation Credit, since the full cost of acquisition of the milk is less than fully covered for the distant producers.

Producers should not be rewarded for being relatively distant from their nearest pool distributing plant, and the use of the distance to their nearest pool distributing plant recognizes that. However, a producer, as an individual entity, should not be disadvantaged versus other producers on the Order, because that producer's milk must move to a more distant plant to supply the Order's Class I needs.

Proponents have no interest in seeing a regulatory system devised and implemented that will encourage milk to move in uneconomic ways. To that end, proponents have built certain safeguards into the proposed Order language to forestall such a possibility. These are:

1. Only mileages for actual movements to pool distributing plants beyond the distance to the producer's nearest pool distributing plant will be eligible for an Intra-market Transportation Credit.
2. Movements of milk to pool supply plants and to nonpool plants, regardless of use classification at the receiving plant, will not be eligible for an Intra-market Transportation Credit.
3. Reimbursement is for Class ■ milk movements only, using the monthly average Class ■ utilization percentage of all pool distributing plants to compute the presumed volume of Class ■ milk delivered by each producer to pool distributing plants.
4. The calculation of the Intra-market Transportation Credit takes into account any revenue generated from moving milk to a pool distributing plant located in a higher priced zone than the zone price applicable to the producer's nearest pool distributing plant. If the amount of revenue generated by movement to a higher priced zone exceeds the additional hauling cost, no Intra-market Transportation Credit is available.
5. The use of a monthly Mileage Rate which is based on current fuel costs will prevent any over-reimbursement of costs if fuel prices decline.

These extra costs of moving milk produced within the marketing areas to pool distributing plants exist now, but currently these costs are disproportionately borne by cooperative marketers of milk and their cooperative member producers. All producers in the Order benefit from the activity of supplying milk for Class ■ use through an enhanced blend price, but all producers do not share equitably in the costs of supplying the milk to Class ■.

One of the purposes of marketwide pooling in a Federal Order marketing area is to make producers indifferent as to the use classification at the plant to which their milk is delivered. This indifference can only continue if a producer's net revenue of supplying milk to a plant is likewise not dependent on the use of milk at a plant, or when delivery to a distant plant results in the same net revenue to the producer as a nearby plant. In the southeast, as in many Federal Order marketing areas, pool or nonpool manufacturing plants exist nearby the larger pockets of milk production. This can be seen graphically in the milk density and plant location maps prepared by the market administrators and previously received as Exhibits \_\_\_\_ and \_\_\_\_\_. If a producer is no longer indifferent as to the delivery point of his or her milk because revenue losses of supplying milk to Class ■ plants exceeds the reimbursed value to the producer through pool location adjustments, then the producer will seek to have their milk delivered to the nearest plant, which may be a manufacturing facility. Competition between producers to supply closest plants will likely ensue, creating pressure on over order prices.

Unfortunately, as described above, milk production locales, and Class ■ processing locales do not often coincide geographically. Further, plant processing volumes do not necessarily match available local supplies. More simply put, there are some producers whose milk must move to a Class ■ plant which is not their closest plant due to imperfections in the location of milk supply versus Class ■ processing. These imperfections create costs in moving milk. When these extra costs of supplying milk for Class ■ use are borne disproportionately by some producers, the value of marketwide pooling is diminished and disorderly marketing results. A hallmark of the Federal Milk Marketing Order program is equitable returns for producers without regard to the use classification of milk they deliver, and when that equity is

- threatened, marketing becomes disorderly, since returns to producers will vary based on producer locale and cost of supplying milk for Class ■ use.

Proposal number two provides that producer milk produced within either the Appalachian or Southeast marketing areas and delivered to a pool distributing plant on either Order which moves a distance greater than the distance of the producer to the producer's nearest pool distributing plant will be eligible to receive a Intra-market Transportation Credit. The Credit is available to any handler; both cooperative and pool distributing plant handlers alike. Since there is value received from the Order provisions in moving milk from a lower priced zone to a higher priced zone, these zone differences, if any, reduce the amount of the Intra-market Transportation Credit.

The process for computation of the Intra-market Transportation Credit is exemplified in Exhibit \_\_\_\_\_, page P. In the example described in the Exhibit, a producer is located within the marketing area of Order 5 or Order 7, and that producer's nearest pool distributing plant is 25 miles away, and that nearest pool distributing plant is located in the \$2.80 differential zone of the Order. During the month, the producer's milk was actually delivered to two pool distributing plants, one in the \$3.10 differential zone of the Order and the producer is located 125 miles from this plant, and the other plant is in the \$2.60 differential zone of the Order, and the producer is located 75 miles from this plant. The producer delivered 100,000 pounds to the two pool distributing plants, split equally between the two plants. The average Class ■ use at all pool distributing plants on the Order during the month was 90 percent, thus 45,000 pounds of the milk delivered by the producer to each pool distributing plant is computed to be

Class ■. In the example, neither plant had shipments out of the plant which would have offset any of the receipts from the producer.

To compute the Intra-market Transportation Credit for the delivery to the plant in the \$3.10 differential zone the market administrator would do the following:

1. Determine the extra miles the milk moved beyond the producer's nearest pool distributing plant. In this case the extra miles would be 100 miles, that is 125 miles moved to the plant of actual receipt, less the 25 miles the producer is from his or her nearest pool distributing plant.
2. Multiply the extra miles by the mileage rate applicable for the month, to get the gross mileage rate per hundredweight. In this example, 100 miles times \$0.0044 per hundredweight per mile equals \$0.44 per hundredweight.
3. Determine if the movement netted any increase in location adjustment. In the example, the producer's nearest pool distributing plant is in the \$2.80 differential zone and the delivery was to the \$3.10 differential zone, so that in this case there is an increase in zone value of \$0.30 per hundredweight from the movement of the milk.
4. If the movement of milk resulted in an increase in **zone** value, net the zone increase value against the gross credit per hundredweight. In this case the gross credit of \$0.44 per hundredweight is reduced by the zone increase value of \$0.30 per hundredweight, leaving a net credit of \$0.14 per hundredweight.

5. The net credit per hundredweight is multiplied by the number of hundredweights of Class ■ milk to determine the Intra-Market Transportation Credit. In the Exhibit example, \$0.14 per hundredweight is multiplied by 450 hundredweights of Class ■ milk to generate an Intra-Market Transportation Credit of \$63.00.

To compute the Intra-market Transportation Credit for the delivery to the plant in the \$2.60 differential zone the market administrator would do the following:

1. Determine the extra miles the milk moved beyond the producer's nearest pool distributing plant. In this case the extra miles would be 50 miles, that is 75 miles moved to the plant of actual receipt, less the 25 miles the producer is from his or her nearest pool distributing plant.
2. Multiply the extra miles by the mileage rate applicable for the month, to get the gross mileage rate per hundredweight. In this example, 50 miles times \$0.0044 per hundredweight per mile equals \$0.22 per hundredweight.
3. Determine if the movement netted any increase in location adjustment. In the example, the producer's nearest pool distributing plant is in the \$2.80 differential zone and the delivery was to the \$2.60 differential zone, so that in this case there is no increase in zone value as a result of the movement.
4. If the movement of milk resulted in an increase in zone value, net the zone increase value against the **gross** credit per hundredweight. In this case the gross credit of \$0.22 per hundredweight is not reduced,

5. The net credit per hundredweight is multiplied by the number of hundredweights of Class ■ milk to determine the **Intra-Market Transportation Credit**. In the Exhibit example, \$0.22 per hundredweight is multiplied by 450 hundredweights of Class ■ milk to generate an Intra-Market Transportation Credit of \$99.00.

The provisions as proposed use the Order's monthly average producer milk Class I utilization of pool distributing plants in computing the Class ■ milk for determining the Intra-market Transportation Credits. Since Intra-market Transportation Credits are only applicable to deliveries to pool distributing plants, this statistic was deemed the most appropriate measure of Class ■ milk on inside the marketing area milk movements.

As testified earlier, proponents do not desire to create incentives for uneconomic movements of milk. There are circumstances when on the surface the Intra-market Transportation Credit may appear to reward longer movements of milk versus shorter, but since the Mileage Rate is less than the true cost of hauling, additional or more lengthy movements of milk will not be encouraged.

Exhibit \_\_\_\_, pages Q1 and Q2 give an example of how the milk routing decision-making process would be followed if the Orders contained the Intra-market Transportation Credit provisions as proposed. In the example, milk is needed in Winston Salem, North Carolina and in Charleston, South Carolina. Milk is available on that day in Mt. Crawford, Virginia and in Statesville, North Carolina. Absent the Intra-market Transportation Credit provisions in the



Orders, the choice for routing the milk would be, all other things being equal, to move the load from Mt. Crawford to Winston Salem and the load from Statesville to Charleston since that generates 16 fewer miles to travel and pay for.

If Intra-market Transportation Credits were a part of the Orders, on the surface it would appear that the dispatcher would seek to route the milk from Mt. Crawford to Charleston and from Statesville to Winston Salem because the total Intra-market Transportation Credit would be greater by \$29.93, which is the difference between the \$695.80 earned under the Mt. Crawford to Winston Salem and Statesville to Charleston routing, versus \$665.87 earned under the Mt. Crawford to Charleston and Statesville to Winston Salem routing. However, since the true cost of hauling is greater than the Mileage Rate used under the Orders, the dispatcher would continue to seek to minimize miles because the net loss from moving the milk would be less in the fewer-miles routing, even though the Intra-market Transportation Credit would be less. It should be noted that in making these calculations the actual cost of hauling was used as the mileage factor for reimbursement under the Intra-market Transportation Credit provisions. The actual Mileage Rate which would be applicable under the Orders would be less than the actual cost of hauling, so the incentive to route milk over the shortest miles would be even greater than demonstrated in the example.

As long as the mileage rate under the Orders is inferior to the actual cost of moving milk, and the location adjustments under the Order do not fully compensate for moving milk, prudent business will result in seeking to travel fewer miles rather than more.

Proposal number two seeks to increase the regulated cost of Class ■ milk by a maximum of \$0.10 per hundredweight in the Appalachian Order and by a maximum of \$0.15 per hundredweight in the Southeast Order to at least partially fund the Intra-market Transportation Credits. The Intra-market Transportation Credit provisions as proposed provide that the revenues generated from the Intra-market Transportation Credit assessment flow into the newly created Intra-market Transportation Credit Fund, and if the costs of the Intra-market Transportation Credits exceed the available balance in the Intra-market Transportation Credit fund, then the difference be allocated from the producer revenue pool prior to the computation of the producer blend price. The amount of funds which may be allocated from the producer revenue pool in a month is limited to the balance in the Intra-market Transportation Credit Fund,

It is estimated that the revenue generated from the proposed \$0.10 per hundredweight maximum Intra-market Transportation Credit Assessment would have been approximately \$4.19 million during calendar year 2005 in the Appalachian Order, and at the \$0.15 per hundredweight maximum Intra-market Transportation Credit Assessment would have been approximately \$6.96 million during calendar year 2005 in the Southeast Order. Based on milk movement data provided by the market administrator analysis, it is estimated that during calendar year 2005 Intra-market Transportation Credits, after inclusion of the adjustment for zone price enhancements, would have totaled \$3.8 million for the Appalachian Order and \$6.39 million for the Southeast Order using a 0.48 cents per hundredweight per mile Mileage Rate. Thus the \$0.10 per hundredweight and \$0.15 per hundredweight maximum increase in Class ■ cost would be expected to be sufficient at current hauling costs to cover all applicable

Intra-market Transportation Credits, see Exhibit \_\_\_\_, page R for the calculation of the amount of assessment necessary to cover the estimated Intra-market Transportation Credits.

If the Secretary elects to set the assessment for the Intra-market Transportation Credits at less than what is necessary to fund all Credits, the differences between the revenue generated from the Intra-market Transportation Credit assessment as proposed at the \$0.10 per hundredweight and \$0.15 per hundredweight, would reduce the producer blend prices. Any reduction in producer blend price would be dependent upon how short the Intra-market Transportation Credit Fund was compared to the monthly Credit obligation amount. Proponents have included Federal Order language which would require the market administrators to collect Intra-market Transportation Credit assessments sufficient to keep the Intra-market Transportation Credit Fund at a level approximating two-month's Intra-market Transportation Credit payments. If the Secretary elects to set the assessment for the Intra-market Transportation Credits at less than what is necessary to fund all Credits, the need for the market administrators to carry a reserve in the Intra-market Transportation Credit Fund will be moot.

Estimating the cost of the credits monthly, seasonally, annually, and based on possibly rapidly changing costs of fuel may prove to be an inexact science. Additionally, assessment rates will by necessity be announced in advance of mileage rates. The process of providing for possible funds to pay Intra-market Transportation Credit from the producer pool provides a fail safe process for insuring that a substantial portion of the Intra-market Transportation Credit will be able to be paid.

The proposed system will enhance producer equity in the allocation of these costs and will preserve handler Class ■ price equity. Since all producers will share more-or-less equally in the additional costs of moving milk for Class ■ by a reduction in their blend prices, if any, equity in cost allocation between producers will be enhanced, regardless of the producer's proximity to a pool distributing plant, or whether the producer's milk moved to a pool distributing plant other than the producer's nearest pool distributing plant.

The reduction in pool revenue which could occur under the proponents' proposal if the assessment is less than the Intra-market Transportation Credit obligation may well sound onerous to some. It may seem unusual or novel or even unfair on the surface to allow a process of allocating pool funds because a producer group moves their milk further than their nearest plant. In reality, Federal Orders every month reduce producer blend prices to encourage milk to move to certain plants.

The system of marketwide pooling along with Class ■ and producer location adjustments currently provides, in every Federal Milk Marketing Order, a process for reducing producer blend prices for delivery of producer milk to certain plants. The Class ■ location adjustment structure and the producer location adjustment structure is the same in Orders 5 and 7, as is true in all Orders. For example, a plant located in Charleston, South Carolina pays \$0.20 per hundredweight more on that plant's Class ■ producer milk than does a plant located in Spartanburg, South Carolina. Likewise, a dairy farmer delivering producer milk to the plant in Charleston receives \$0.20 per hundredweight more on his or her producer milk than does a dairy farmer delivering producer milk to the plant located in Spartanburg. The delivery of milk

to Charleston lowers the blend price for the producer delivering to Spartanburg. How can this be true?

The plant in Charleston is never going to be 100 percent Class I, so the amount of money the producer revenue pool is increased by the Charleston Class I location adjustment, in this case the \$0.20 per hundredweight, is always going to be less than the amount of money the producer revenue pool is drawn down by the Charleston producer location adjustment, since the producer location adjustment is paid on all producer milk delivered to the Charleston plant. Put another way, the total producer revenue pool is reduced by the amount of the producer location adjustment per hundredweight times the Class II, Class III and Class IV producer milk volume in the Charleston plant. This scenario is true for all plants receiving producer milk which have a positive location adjustment. Of course the opposite is true for milk delivered to plants with a negative location adjustment. This process and effect is more fully explained in Exhibit \_\_\_, page S.

In this example we have added a new pool distributing plant to a hypothetical existing Federal Order pool. In the pre-changed pool all milk is delivered to the base pricing zone. The pool distributing plant which is added to the pool has the same utilizations in all classes as the pre-changed pool, but the new pool distributing plant is located in a zone with a \$0.50 per hundredweight higher Class I price than the pre-changed pool. As is the case in Federal Orders currently, the producer location adjustment is the same as the Class I location adjustment. In the example, the blend price to producers delivering milk to the base zone plants, the pre-change producers if you will, see their blend price reduced from the addition of a new pool distributing plant. The utilization of the pre-change producers' milk did not

change, the place where their milk is delivered did not change, the Class prices received for their milk did not change, but their blend price went down. The plain truth is, the producers delivering milk in the **base** pricing zone helped pay to move milk to the new pool distributing plant, and this payment came in the form of a reduction in their **blend** price, Federal Orders do indeed take funds from one group of producers and give those funds to another group of producers, all as a result of moving milk.

The essence of the proponents' proposal with regard to use of pool funds to cover shortfalls in the Intra-market **Transportation** Credit Fund is **an** extension of the location adjustment concept, but is much more limited and targeted because it only applies to Class ■ milk. If milk moves further than its nearest pool distributing plant for Class ■ use, and those movements are not reimbursed through the existing location adjustment, then the difference is borne equally by all producers.

An allocation of funds from the producer revenue pool if the Intra-market Transportation Credit Fund balance is insufficient to pay all Intra-market Transportation Credits **may** seem like a process for pooling "production costs", since the producer is presumed to pay for milk delivery to his or her plant. Such is not the case. Hauling costs borne **by** the producer are an adjustment **to** the producer's marketing revenue, much in the same way as high somatic cell counts are an adjustment to the producer's revenue in a multiple component pricing Order. Producers **may** experience higher than average somatic cell counts due to production system, climate, or bad management, or who knows what, and these factors may or may not be under the producer's complete control. No matter what the reason, a high SCC by one producer will enhance the Order blend price for other producers. The Orders seem to have

no issue with this **cost/revenue** pooling concept, which impacts one group of **producers** at the expense of another. Such should be true of extra costs of moving milk to Class ■ as well.

As to **the** question of whether producer farm to plant hauling is a production cost or a reduction of farm revenue, each month Dairy Market News reports a price series known as the Mailbox Milk Price. This data series seeks to compare regionally the revenue received for milk at the farm gate after mandatory deductions for milk promotion, marketing services, increases or decreases in price resulting from quality, volume and component adjustments, and **after** the producer milk check deduction for hauling. In this series, published by **AMS/Dairy Programs**, hauling is considered a function of net producer revenue, not a cost of production.

There has been expressed the sentiment that any revenue enhancements to help cover these extra costs of hauling should be a rising tide that **lifts** all boats. We can agree with that. However, the problem faced by marketers of milk in the southeast is that the waning tide of milk movement costs does not lower all boats uniformly, and not all boats are currently sitting on level seas. The process proposed by the proponents systematizes the collection of the revenues which raise the boats, and **allocates** fairly the costs which lower all boats.

The proposals as submitted are designed to return equity to the allocation of the costs among producers of supplying milk for Class ■ use. **These** costs exist currently, but are not shared proportionally, while Class ■ revenues are. The total revenue to dairy farmers, if proposals 1, 2 and 3 are adopted as proposed would increase dairy farmer income by shifting these costs of supplying milk for Class ■ use off of dairy farmers onto the Class ■ marketplace.

### Need For These Provisions In the Orders

The question may be raised as to why these amendments are sought under the Federal Order program as opposed to charges to handlers in excess of Federal Order minimums, This is a good question. Proponents offer these amendments to the Federal Orders as opposed to seeking these revenues through over order prices for a number of reasons.

First, the costs identified in these proposals are tangible and quantifiable. Actual milk transport costs can be determined in a quantitative manner, can be **verified**, and can be readily converted mathematically into a regulatory pricing formula. Additionally, milk movements are discrete actions which generate an extensive paper trail, verifiable by the market administrator. Thus, **reimbursement** of these costs through an unbiased regulatory mechanism is achievable, cost effective, transparent and desirable.

Second, proponents have demonstrated that these costs are ongoing, and more importantly, the costs are not impacted by the overall level of milk price. Oftentimes over order prices are influenced by the general milk price level. Just because Federal Order prices are perceived as high or are rising, does not stop milk from having to move. Comparatively high regulated milk prices or substantial increases over a short period of time in Federal Order prices can lead to pressure to decrease over order prices. In fact, some of the factors that increase hauling costs can in fact lead to eventual increases in Federal Order prices, for example a regional or national shortage of milk. It is intrinsically unreasonable to rely on over order prices to pay the entirety of these costs of delivery of milk for **Class I** use when the very thing



which increases these costs can put downward pressure on over order prices. This revenue and cost conundrum can be diminished by the inclusion of these revenues and costs in the regulated price system.

Third, over order prices are often dependent upon broad recognition of those prices by marketers of milk all along the milk marketing chain, and thus over order prices can be transitory. Simply put, they can be here today, gone tomorrow. The perpetual nature of milk transport costs to supply Class I needs makes reliance on the possibly ephemeral revenues generated by over order prices risky for the suppliers of milk for Class I. The assurance that these funds will be available to help cover the costs of supplying milk for Class I use makes marketers of milk much more likely to take on this marketing function. Installation of these cost reimbursement processes in the Federal Orders make much more sure the reimbursement of these costs than dependence on over order prices. Harkening back to our discussion of economic theory, the assurance that a significant portion of the variable costs of providing milk to Class I, in this case the variable cost as associated with delivery to a distant plant, will be covered by regulated revenues makes the decision to undertake this additional business activity much more likely, and fulfills the responsibilities of the Agricultural Marketing Agreement Act's requirements for assuring an adequate supply of milk for fluid use.

Fourth, there is provided confidence to those Order participants that are bearing these regulated Class I costs, namely Class I processors, that the payments are made for actual work performed, costs are actually incurred, and payment for these services is uniformly applied.

Lastly, the payment for these services of marketwide benefit must be uniformly allied to all Class ■ handlers and to their consumers, who are the ultimate beneficiaries of a marketing system which provides an adequate supply of Class ■ milk.

The cruelest irony concerning over order prices is that reliance on over order prices to cover these extra costs of hauling can lead to the degradation of the over order prices. If the location adjustment structure under Federal Milk Marketing Orders does not reasonably compensate producers for moving milk to Class ■ plants beyond their nearest plant, they will seek to deliver to that nearer plant, so as to enhance the producer's net revenue. If over order prices exist, a producer may be willing to bid down the over order price to the nearer plant to a level which equates the producer's net revenue which would have accrued if the producer had delivered his or her milk to the next most advantageous plant.

A bedrock principle upon which Federal Milk Marketing Orders are founded is that producers have limits to their opportunity to impact the price they receive for their milk. Proponents desire the Order program to recognize the limits in the ability to generate revenues to cover hauling costs that benefit all producers, processors and consumers; standardize the payment for these costs through the regulatory system; establish uniformity of bearing of these costs; and help insure that milk will continue to be provided for Class ■ use in the two marketing areas.

## Recent History of Over Order Prices

Over order prices in the southeast have risen in recent months. Exhibit \_\_\_\_, page T shows the Announced Cooperative Class ■ Over Order Price for 30 cities as published each month in Dairy Market News for calendar year 2005. Over Order prices for Class ■ milk in the reported southeastern cities were generally \$0.99 per hundredweight greater in December 2005 than in January 2005. Cities in the southwestern states have also shown increases over the year, but these increases in the southwest were about \$0.34 less than in the southeast. It should be noted that two cities in the southeast have experienced over order price increases more akin to the southwest than the rest of the southeast. Most cities outside the southeast and southwest showed little or no increase in over order prices during 2005, with some cities showing a decline in over order Class ■ price.

Some of the recent increase in **Class ■** over order prices is related to recognition of increases in the cost of fuel. Current declines in fuel costs have put downward pressure on over order prices in the southeast. The Class ■ over order price for January 2006 in most southeastern cities is less than December 2005 and that change is related to lower fuel costs.

Exhibit \_\_\_\_ pages U1 and U2 displays the basic diesel fuel cost data and the Dairy Cooperative Marketing Association, **Inc.** Class ■ Fuel Cost Surcharge, as computed, and as charged for April 2000 through December 2005. As can be seen from the data, the **Class ■** Fuel Cost Surcharge has sometimes not followed the increases in fuel cost. As is the case with over order prices generally, the Fuel Cost Surcharge has tended to **follow** the **fuel cost**, then plateau, then after some period of fuel cost increases the Fuel Cost Surcharge increases

- and catches up with fuel cost, it then again plateaus, and so on. It takes time for over order price increases to be accepted throughout the milk pricing system. Decreases in over order prices seem to be more readily accepted by processors on a shorter term notice, we have observed.

Changes in over order prices must make their way through a labyrinth of customers and customer-supplier relationships. The pricing relationship is not just cooperative to plant; it is also plant to distributor; plant to retailer; distributor to retailer; and ultimately, retailer to consumer. For example, in the Commonwealth of Kentucky alone, there are more than 180 school districts. Price adjustments must filter through to grocery stores, drug stores, convenience stores, restaurants, nursing homes, schools, colleges and universities, military establishments and even prisons. Some of these supply contracts are bid out on a base cost per packaged milk unit with escalator clauses, and often the escalator clauses reflect only changes in the regulated cost of Class ■ milk. At the request of proponents, the market administrators have reviewed their respective mailing lists for Class price announcements. These data were previously introduced as Exhibits\_\_\_\_ and \_\_\_\_\_. Users of milk and milk products receive market administrator price announcements, and as such seem to accept these changes in the regulated cost of Class ■ milk as announced. Over order charges seem to be another matter. As one would expect, the market administrator price announcements carry the weight of a United States governmental declaration. The market administrator price announcements are transparent, and issued by a neutral government agency, while over order prices are not.

As evidenced in Exhibits \_\_\_ and \_\_\_\_\_ many industry participants receive the market administrator price announcements, and have accepted, however grudgingly, the volatility in prices which the Federal Order Class I prices display. The problem with over order prices is that customers do not appear to accept the same kind of volatility in them. The fuel cost surcharge previously described is an excellent example of this phenomenon.

Page T of Exhibit \_\_\_ also displays the 2005 annual average Class I over order price as reported in Dairy Market News for the 30 subject cities. Of particular note is the relative over order price in cities bordering or just inside the southeast versus cities outside the southeast. As is the case for Federal Order Class I prices, Class I price alignment in the total Class I price, that is the Federal Orders Class I price plus the over order Class I price, must be a concern. Prices too divergent over too short a distance can cause competitive disruptions and disorderly marketing.

Exhibit \_\_\_, page V is a map which shows for November 2005, the Federal Order Class I differential for selected cities from Exhibit \_\_\_, page T; the Class I over order price applicable for that city; and for cities in the Order 5 and Order 7 marketing areas, the Transportation Credit assessment rate; and the total of the three Class I price elements. This exhibit reinforces the differences which exist in total Class I price for plants located in the southeast versus plants located nearby but outside the southeast.

Competitive relationships between plants develop over time, and are reflective of the geographic scope of a plant's business; the plants' relative internal cost structures, the

regulated price **configuration** and any over order prices which might exist. The most visible of these elements is the Federal Order Class I price structure.

Industry, and plants in particular, view the Class I price relationships as established under the Federal Orders as the "Gold Standard" for price differences, in effect saying that if differences in Class I prices must exist between plants, those differences should be as reflective of the Class I differential surface established by the Orders. Consequently, it is very difficult to establish over order prices between plants which are greater than the Order's Class I price differences. As a result, over order price areas tend to be rather large geographically, and as such suffer from even less variability plant to plant, than do Federal Order Class I prices.

When the Federal Order Class I price surface varies substantially from the actual cost of moving Class I milk, location value imperfections are institutionalized into the Federal Order price structure. Since Federal Order Class I differentials are the most transparent aspect of Class I price relationships, the message seems to get lost that there needs to be corrections to these location value imperfections through over order prices. The conundrum facing the industry is that the Orders establish a Class I price surface which is viewed as absolute, yet industry is left to its own devices to correct what is wrong. Proponents offer here an opportunity for the Secretary to address the cost of moving milk for Class I use, without substantially changing the Orders' Class I price surface, by adopting a new mechanism for encouraging milk to move within the marketing areas.

Currently all of the costs incurred in supplying milk for Class I use which are not reflected in the Class I price surface are borne outside Order-regulated values. The proponents seek more

of these revenues to be regulated to simply give more assurance that the revenues will be there to help cover costs of supplying Class ■ milk for the southeast, to offer assurances to the Class ■ marketplace that the cost for which reimbursement is sought are indisputable, to recognize the limits in over order pricing to address these issues and costs, and to insure uniform application of the revenues and uniform sharing of the costs.

### **Need For Emergency Action**

The notice of hearing invited comments on emergency conditions present in the marketing areas and seeks comments on considering emergency action and the omission of a recommended decision under the rules of practice and procedure.

Proponents have demonstrated substantial losses which are currently incurred in supplying milk for Class ■ use in the Appalachian and Southeast marketing areas, whether that milk originates inside or outside the marketing areas. These costs are significant, amounting to in excess of \$15,000,000 annually at current **hauling** costs.

As has been stated, the costs defined in these **proposals** are currently not borne equitably by all producers, exacerbating the problem. Delay in implementing these amendments only worsens the inequities present. Since these costs fall disproportionately on one segment of the producer population, the cost per hundredweight borne by those producers exceeds the cost per hundredweight for the Orders as a whole.

- The costs associated with delivering milk for Class ■ use in the Appalachian and Southeast marketing areas are considerable and are ongoing. Failure to address these issues through the Federal Order program puts in jeopardy the adequate supply of milk for the southeast. Delay will not lessen the costs, will not see a reversal in cost trends, nor see an equitable reapportioning of the costs onto all parties in the marketing areas.

The current process for payment of the costs of milk delivery for Class ■ use in the Appalachian and Southeastern Orders, as has been demonstrated, does not offer marketers of milk even short-term reassurance that additional costs of supplying milk for Class ■ use will be covered. If the provisions of the Orders are left unchanged, the economics in the delivery of milk for Class ■ will, likely sooner than later, make such deliveries unworkable, and the supply of Class ■ milk in the marketing areas will be threatened. Only quick action on the part of the Secretary will forestall such a lamentable occurrence.

The provisions as proposed to be amended here are pursuant to the marketwide service payment provisions of the Agricultural Marketing Agreement Act, and therefore deserve quick action.

### **Summary**

The proponents again wish to thank the Secretary for the opportunity to propose these amendments to the Appalachian and Southeast Federal Milk Marketing Orders, and look **forward** to a quick decision installing the needed changes to the Orders.