



# FEDERAL REGISTER

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Vol. 78

Thursday,

No. 26

February 7, 2013

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## Part IV

### Department of Agriculture

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Agricultural Marketing Service

7 CFR Part 1000

Milk in the Northeast and Other Marketing Areas; Final Decision on Proposed Amendments to Marketing Agreements and Orders and Termination of a Portion of the Proceeding; Proposed Rule

**DEPARTMENT OF AGRICULTURE****Agricultural Marketing Service****7 CFR Part 1000**

[Doc. No. AMS-DA-07-0026; AO-14-A77 et al.; DA-07-02]

**Milk in the Northeast and Other Marketing Areas; Final Decision on Proposed Amendments to Marketing Agreements and Orders and Termination of a Portion of the Proceeding**

**AGENCY:** Agricultural Marketing Service, USDA.

**ACTION:** Proposed rule.

**SUMMARY:** This document is the final decision proposing to permanently adopt changes to the manufacturing cost allowances and the butterfat yield factor used in Class III and Class IV product-price formulas applicable to all Federal milk marketing orders. These amendments were adopted by an interim final rule issued on, July 25, 2008, that became effective on October 1, 2008. This document also terminates the proceeding with regard to additional proposals that addressed the collection of manufacturing cost information, the use of an energy cost adjuster and providing for a cost add-on feature to Class III and Class IV product-price formulas. The orders amended by this decision require producer approval. Referenda will be conducted in three markets and dairy farmer cooperatives will be polled in the other seven markets to determine whether dairy farmers approve the issuance of the orders as amended.

**FOR FURTHER INFORMATION CONTACT:**

William Francis, Director, Order Formulation and Enforcement Division, USDA/AMS/Dairy Programs, Order Formulation and Enforcement, Stop 0231—Room 2971—S, 1400 Independence Avenue SW., Washington, DC 20250-0231, (202) 720-7183, email address: [william.francis@ams.usda.gov](mailto:william.francis@ams.usda.gov).

**SUPPLEMENTARY INFORMATION:** This final decision proposes to permanently adopt amendments to the manufacturing (make) allowances for cheese, butter, nonfat dry milk (NFDM) and dry whey contained in the Class III and Class IV product price formulas (Proposal 1). Specifically, this decision proposes to permanently adopt the following make allowances: \$0.2003 per pound of cheese; \$0.1715 per pound of butter; \$0.1678 per pound of nonfat dry milk (NFDM); and \$0.1991 per pound of dry whey. This decision also proposed to

permanently increase the butterfat yield factor in the butterfat price formula from 1.20 to 1.211 (Proposal 6). These make-allowances and butterfat yield factor have been in use since October 1, 2008, following producer approval of the tentative final decision (73 FR 51352).

This decision also addresses proposals published in the hearing notice as Proposals 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16 and 18 that seek to change various features of the Class III and Class IV product-price formulas. This document also terminates the proceeding with regard to Proposals 2, 17 and 20.

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

The amendments to the rules proposed herein have been reviewed under Executive Order 12988, Civil Justice Reform. They are not intended to have a retroactive effect. The amendments would not preempt any state or local laws, regulations, or policies, unless they present an irreconcilable conflict with this rule.

The Agricultural Marketing Agreement Act of 1937 (Act), as amended (7 U.S.C. 604–674), provides that administrative proceedings must be exhausted before parties may file suit in court. Under section 608c(15)(A) of the Act, any handler subject to an order may request modification or exemption from such order by filing with the U.S. Department of Agriculture (USDA) a petition stating that the order, any provision of the order, or any obligation imposed in connection with the order is not in accordance with the law. A handler is afforded the opportunity for a hearing on the petition. After a hearing, USDA would rule on the petition. The Act provides that the district court of the United States in any district in which the handler is an inhabitant, or has its principal place of business, has jurisdiction in equity to review the USDA's ruling on the petition, provided a bill in equity is filed not later than 20 days after the date of the entry of the ruling.

**Regulatory Flexibility Act and Paperwork Reduction Act**

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601–612), the Agricultural Marketing Service has considered the economic impact of this action on small entities and has certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. For the purpose of the Regulatory Flexibility Act, a dairy farm is considered a small

business if it has an annual gross revenue of less than \$750,000, and a dairy products manufacturer is a small business if it has fewer than 500 employees.

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

For the month of February 2007, the month the initial public hearing was held, the milk of 49,712 dairy farms was pooled on the Federal order system. Of the total, 46,729 dairy farms, or 94 percent, were considered small businesses. During the same month, 352 plants were regulated by or reported their milk receipts to be pooled and priced on a Federal order. Of the total, 186 plants, or 53 percent, were considered small businesses.

This decision proposes to permanently amend the make allowances contained in the formulas used to compute component prices and the minimum class prices in all Federal milk orders that were implemented October 1, 2008, on an interim basis, without change. Specifically, the make allowance for cheese continues to be \$0.1715 per pound (initially increased from \$0.1682 per pound); the make allowance for NFDM continues to be \$0.1678 per pound (initially increased from \$0.1570); the make allowance for butter continues to be \$0.1715 per pound (initially increased from \$0.1202); and the make allowance for dry whey continues to be \$0.1991 (initially increased from \$0.1956). The butterfat yield factor in the butterfat price formulas continues to be 1.211 (initially increased from 1.20).

The make allowances serve to approximate the average cost of producing cheese, butter, NFDM and dry whey for manufacturing plants located in Federal milk marketing areas. The established criteria for the make allowance changes are applied in an identical fashion to both large and small businesses and will not have any different impact on those businesses producing manufactured milk products.

An economic analysis has been performed that discusses impacts of the

proposed amendments on industry participants including producers and manufacturers. It can be found on the AMS Web site at [www.ams.usda.gov/dairy](http://www.ams.usda.gov/dairy). Based on that economic analysis, the proposed amendments will not have a significant economic impact on a substantial number of small entities.

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

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

#### Economic Analysis

In order to assess the impact of the proposed changes in Federal order product price formulas, the Department conducted an economic analysis. This analysis was discussed in the tentative partial final decision (73 FR 35306) and remains unchanged. The complete analysis is available on the Dairy Programs Web site which can be accessed at [www.ams.usda.gov/dairy](http://www.ams.usda.gov/dairy).

#### Prior documents in this proceeding

*Notice of Hearing:* Issued February 5, 2007; published February 9, 2007 (72 FR 6179).

*Supplemental Notice of Hearing:* Issued February 14, 2007; published February 20, 2007 (72 FR 7753).

*Notice to Reconvene Hearing:* Issued March 15, 2007; published March 21, 2007 (72 FR 13219).

*Notice to Reconvene Hearing:* Issued May 2, 2007; published May 8, 2007 (72 FR 25986).

*Tentative Partial Final Decision:* Issued June 16, 2008; published June 20, 2008 (73 FR 35306).

*Interim Final Rule:* Issued July 25, 2008; published July 31, 2008 (73 FR 44617).

*Delay of Effective Date:* Issued August 28, 2008; published September 3, 2008 (73 FR 51352).

#### Preliminary Statement

Notice is hereby given of the filing with the Hearing Clerk of this final decision and termination of proceeding with respect to the proposed adopted amendments to the tentative marketing agreements and the orders regulating the handling of milk in the Northeast and other marketing areas. This notice is issued pursuant to the provisions of the Act and applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900).

A public hearing was held upon proposed amendments to the marketing agreements and the orders regulating the handling of milk in the Northeast and other marketing areas. The hearing was held, pursuant to the provisions of the Act, as amended (7 U.S.C. 601–674), and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900.)

The proposed amendments set forth below are based on the record of the first session of a public hearing held in Strongsville, Ohio, on February 26–March 2, 2007, pursuant to a notice of hearing issued February 5, 2007, published February 9, 2007 (72 FR 6179); a second session of a public hearing held in Indianapolis, Indiana, on April 9–13, 2007, pursuant to a reconvened hearing notice issued March 15, 2007, published March 21, 2007 (72 FR 13219); and a third session of a public hearing held in Pittsburgh, Pennsylvania, on July 9–11, 2007, pursuant to a reconvened hearing notice issued May 2, 2007, published May 8, 2007 (72 FR 25986).

The material issues on the record of the hearing relate to:

A. Amending the product-price formulas used to compute Class III and Class IV prices.

B. Terminating the proceeding with respect to proposals 2, 17 and 20.

#### Findings and Conclusions

##### *A. Amending the Product-Price Formulas Used To Compute Class III and Class IV Prices*

This final decision proposes to adopt a proposal published in the hearing notice as Proposal 1 which seeks to amend the manufacturing allowances for butter, cheese, NFD and dry whey using the most currently available data, and a portion of Proposal 6 that increases the butterfat yield in the butterfat price formula. The provisions contained herein were adopted on an interim basis and became effective October 1, 2008. Specifically, this decision finalizes the following

manufacturing allowances: Cheese—\$0.2003 per pound, butter—\$0.1715 per pound, NFD—\$0.1678 per pound and dry whey—\$0.1991 per pound. This decision also increases the butterfat yield factor in the butterfat price formula from 1.20 to 1.211.

The Federal Milk Marketing Order (FMMO) program uses wholesale product-price formulas to compute prices handlers must account for in the marketwide pooling of milk used in the four classes of products. These formulas rely on the price of finished products to determine the minimum classified prices handlers pay for raw milk. In addition, the Class III and Class IV prices form the base from which Class I and Class II prices are determined. This end-product pricing system was implemented on January 1, 2000 (published February 12, 1999; 64 FR 70868).

The product-price formulas are computed by using component values from Agricultural Marketing Service (AMS) surveyed prices of manufactured dairy products.<sup>1</sup> The pricing system determines butterfat prices for milk used in products in each of the four classes from a surveyed butter price; protein and other solids prices for milk used in Class III products from surveyed cheese and dry whey prices; and a nonfat solids price for milk used in Class II and Class IV products from surveyed nonfat dry milk product prices.<sup>2</sup> The skim milk portion of the Class I price may be derived from either the protein and other solids price, or from the nonfat dry milk price depending on the relationship between the Class III and IV price. The butterfat, protein, other solids and nonfat solids prices are all derived in a similar manner: Average AMS survey price minus a manufacturing (make) allowance times a yield factor. The yield factor is an approximation of the quantity of a specific product that can be made from a hundredweight (cwt) of milk. The yield factors were last amended on April 1, 2003 (published February 12, 2003; 68 FR 7063).

The make allowance factor represents the cost manufacturers incur in processing raw milk into one pound of product. Federal milk order pricing

<sup>1</sup> Official Notice is taken of a Final Rule (77 FR 8717) published February 15, 2012. Effective April 1, 2012, USDA's AMS began collecting and reporting wholesale dairy product prices. This was previously managed by the National Agricultural Statistic Service (NASS).

<sup>2</sup> Official Notice is taken of a Notice (77 FR 2282) published April 13, 2012. Effective April 18, 2012, AMS surveyed prices are used in the price discovery mechanism for the component values of raw milk. These component prices are then used to determine FMMO minimum classified prices.

formulas currently contain the following make allowances: Cheese—\$0.2003 per pound, butter—\$0.1715 per pound, NFD—\$0.1678 per pound and dry whey—\$0.1991 per pound. These make allowances were adopted on July 25, 2008, (73 FR 44617) and became effective on October 1, 2008, on an interim basis as a result of this proceeding. The make allowances were determined on the basis of California Department of Food and Agriculture (CDFA) and Cornell Program on Dairy Markets and Policy (CPDMP) surveys of product manufacturing costs. The current make allowances for butter and nonfat dry milk were determined by using a weighted average of the CDFA and CPDMP surveys over national production volumes. The cheese make allowance was determined by relying on the CDFFA 2006 survey average cheese manufacturing cost and the dry whey make allowance was determined by relying on the CPDMP 2006 survey. All make allowances were adjusted for marketing costs.

Nineteen proposals were published in the hearing notice for this proceeding. Proposals 4, 5 and 11 were withdrawn at the hearing by proponents in support of other noticed proposals. No further reference to these proposals will be made.

A proposal published in the hearing notice as Proposal 1, offered by Agri-Mark Cooperative (Agri-Mark), seeks to amend the Class III and Class IV make allowances by using the most current plant cost survey data available. Agri-Mark is a Capper-Volstead cooperative with approximately 1,400 member-owners throughout New England and New York, and operates 4 manufacturing plants.

Agri-Mark was also the proponent of Proposal 2 that seeks to amend the Class III and Class IV product price formulas to annually update the manufacturing allowances using an annual manufacturing cost survey of cheese, whey powder, butter, and nonfat dry milk plants (located outside of California). The proposed amendments would grant authority to Market Administrators to administer the survey, select the sample plants, and collect, audit, and assemble cost information.

A proposal published in the hearing notice as Proposal 3, offered by Dairy Producers of New Mexico (DPNM), seeks to amend the manufacturing allowances contained in the Class III and Class IV product price formulas. Specifically, this proposal seeks to set the make allowances at the following levels: \$0.1108 per pound for butter; \$0.1638 per pound for cheese; \$0.1410 per pound for NFD; and \$0.1500 per

pound for dry whey. DPNM is an association of dairy producers located in New Mexico and West Texas.

DPNM was the proponent of Proposals 6, 7 and 8 that seek to amend the yield factors and the butterfat recovery rate of the Class III and Class IV product price formulas. Proposal 6 seeks to amend the butter price formula by increasing the butterfat yield factor from 1.20 to 1.211 and to amend the protein price formula by increasing the butterfat recovery rate from 90 percent to 94 percent. Proposal 7 seeks to eliminate the farm-to-plant shrinkage and butterfat shrinkage adjustments of all yield factors. Proposal 8 seeks to increase the nonfat solids yield factor from 0.99 to 1.02, and increase the protein price yield factor for cheese from 1.383 to 1.405 and for butterfat from 1.572 to 1.653.

Proposal 9 was offered by the International Dairy Foods Association (IDFA). Proposal 9 seeks to amend the Class III and Class IV product-price formulas by adjusting the protein price formula to reflect the lower value and reduced volume of butterfat recoverable as whey cream. IDFA is a trade association with 530 members representing manufacturers, marketers, distributors, and suppliers of fluid milk and related products.

Proposal 10 was submitted on behalf of Agri-Mark. Proposal 10 seeks to amend the Class III and Class IV product-price formulas by reducing the protein price to reflect the lower selling price of whey butter.

Proposal 12 was offered by IDFA. Proposal 12 seeks to amend the Class III and Class IV product price formulas by eliminating the 3-cent cost adjustment for cheese manufacturing of 500-pound barrels contained in the protein price formula.

Proposal 13 was offered by Dairy Farmers of America, Inc. (DFA) and the Northwest Dairy Association (NDA). Proposal 13 seeks to amend the Class III and Class IV product-price formulas by removing the barrel cheese price as a cost component of the protein price formula. DFA is a Capper-Volstead cooperative with 13,500 member-owners producing milk in 49 states. NDA is a Capper-Volstead cooperative with approximately 610 member-owners, and operates 6 manufacturing plants and 4 distributing plants in the western United States.

Proposal 14 was advanced by Agri-Mark. Proposal 14 seeks to amend the Class III and Class IV product price formulas by using a combination of the weekly NASS and Chicago Mercantile Exchange (CME) cheese price series to determine the cheese price contained in

the Class III and Class IV product-price formulas.

Proposal 15 was offered by DPNM. This proposal seeks to replace the NASS commodity price surveys with CME commodity prices in each of the price formulas except for the other solids formula. The dry whey price in the other solids formulas would continue to be derived from the NASS dry whey price survey.

Proposal 16 was offered by National All-Jersey, Inc. (NAJ). Proposal 16 seeks to amend the Class III and Class IV product-price formulas by eliminating the other solids price and adding the equivalent value of dry whey to the protein price formula. NAJ is a breed organization with more than 1,000 members.

Proposal 17 was offered by the National Milk Producers Federation (NMPF). The proposal seeks to amend the Class III and Class IV product-price formulas to incorporate a monthly energy cost adjustment based on monthly changes in the manufacturing price indices for industrial natural gas and industrial electricity as published by the Bureau of Labor Statistics. NMPF is an association consisting of 33 dairy-farmer cooperative members representing nearly three-quarters of U.S. dairy farmers.

Proposal 18 was offered by the Maine Dairy Industry Association (MDIA). Proposal 18 seeks to amend the Class III and Class IV product-price formulas by incorporating a factor to account for any monthly spread between component price calculations for milk and a competitive pay price for equivalent Grade A milk. MDIA is an association that represents all of Maine's 350 dairy farmers.

A proposal published in a supplemental hearing notice as Proposal 20 was submitted on behalf of Dairylea Cooperative, Inc. (Dairylea). Proposal 20 seeks to amend the Class III and Class IV price formulas by establishing cost-of-production add-ons that manufacturers could include in the selling price of their products but would not be included in the determination of the NASS survey prices. Dairylea is a Capper-Volstead cooperative with 2,400 member-owners located in seven northeastern states.

To provide order to the hearing testimony, post-hearing briefs and comments and exceptions to the tentative final decision, the summary of testimony is organized as follows:

1. Make Allowances: Proposals 1, 2 and 3
2. Product Yields and Butterfat Recovery Percentage: Proposals 6, 7 and 8
3. Value of Butterfat in Whey: Proposals 9 and 10

4. Barrel Cheese Price: Proposals 12 and 13
5. Product Price Series: Proposals 14, 15 and 18
6. Other Solids Price: Proposal 16
7. Energy Cost Adjuster; Proposal 17
8. Cost-of-Production Add-on; Proposal 20

#### 1. Make Allowances

A witness from Cornell University (Cornell witness) testified regarding the 2006 manufacturing cost survey (2006 survey) conducted by the Cornell Program on Dairy Markets and Policy (CPDMP), to assess the manufacturing costs of plants producing cheddar cheese, dry whey, butter and NFD. The witness did not testify in support of or in opposition to any proposal presented at the hearing. The witness explained that an earlier study, the CPDMP 2005 manufacturing cost survey (2005 survey), was contracted in part by USDA and was presented at a 2006 rulemaking hearing (71 FR 52502), and was a factor considered by USDA in developing the make allowances that became effective March 1, 2007, (71 FR 78333). The witness said that some manufacturing plants that participated in the 2005 survey requested a new survey to reflect more current cost information.

The Cornell witness said that the plants that participated in the 2005 survey were asked to participate in the 2006 survey. The witness stated that 21 plants agreed to participate and of those plants, 19 were deemed to have acceptable data to be included in the 2006 survey. Plants submitted data corresponding to their most recent fiscal year; most of the data observations occurred in calendar year 2006, the witness said. The data was not audited by the witness. The witness explained that if a plant produced multiple products they were asked to allocate manufacturing costs for each product. However, if they failed to do so the witness allocated costs on a per pound of solids basis in the finished product. The average manufacturing costs detailed in the study were on a per pound of finished product basis and were not adjusted for moisture content, the witness said.

The Cornell witness said that 11 cheese plants participated in the 2006 survey compared with 16 cheese plants in the 2005 survey. Eight of those plants (one classified as a large plant and the other seven as small plants) also participated in the 2005 survey; the three remaining plants that participated in the 2006 survey were asked to participate in 2005 but submitted data too late for inclusion. The witness testified that five small cheese plants that were included in the 2005 survey

opted not to participate in the 2006 survey. Of the 11 plants, the witness classified 7 as small plants and the remaining 4 as large volume plants. The witness testified that the weighted average manufacturing cost of the 2006 cheese plant sample was \$0.1584 per pound, a decrease of \$0.0054 per pound from 2005. The witness said that comparing the costs for the 8 plants that participated in both surveys revealed a weighted average cost increase of \$0.017 per pound between the 2005 and 2006 surveys. The total pounds covered by the 2006 survey increased from approximately 60 million pounds in 2005 to nearly 119 million pounds in 2006. The Cornell witness asserted that the 2005 survey over-sampled small plants while the 2006 survey over-sampled large plants. The witness noted that the average packaging cost for cheese in the 2006 survey was only for 40-pound block production. If a plant produced barrel cheese the witness assigned it an average 40-pound block packaging cost before computing the average manufacturing costs for the entire sample.

The Cornell witness said that 7 whey plants participated in the 2006 survey and their weighted average cost was \$0.1976 per pound—an increase of \$0.0035 per pound from the 2005 survey. According to the witness, the 7 participating whey plants were associated with cheese plants that were also included in the 2006 survey. The witness noted that 12 whey plants participated in the 2005 survey.

The Cornell witness said that 4 butter plants participated in the 2006 survey; 3 of the plants also participated in the 2005 survey. The weighted average cost of the 4 plants was \$0.1846 per pound, an increase of \$0.0738 per pound over the 2005 survey. The survey accounted for 57.6 million pounds of butter. The witness testified that significant cost allocation problems and data quality problems with the 2005 butter data were major reasons for the large increase in the weighted average cost from 2005 to 2006. The witness testified that the 2005 survey butter data was not accurate, but asserted that the allocation problems were corrected in the 2006 survey. While maintaining that the 2006 survey data was reliable, the witness said that a larger sample size would have been preferred. The witness also noted that the manufacturing costs submitted by one of the butter plants in the 2006 survey did include the cost of transporting cream from its drying plant to its butter plant.

The Cornell witness said that the 2006 survey for NFD consisted of 7 of the 8 NFD plants that participated in the

2005 survey. According to the witness, the weighted average cost of the 7 plants was \$0.1662 per pound, an increase of \$0.0239 per pound from 2005. The witness explained that the weighted average cost increase is partially explained by increases in real costs (labor, packaging, etc.), but also partly because of a change in the methodology of indirectly allocating costs between butter and NFD. According to the witness, there were flaws in the method used to indirectly allocate costs for NFD in the 2005 study that resulted in understating the cost of processing NFD. The witness claimed that an attempt was made in the 2006 survey to correct this understated processing cost. The witness did not explain the reported flawed methodology in the 2005 survey or the methodological changes for the 2006 survey. According to the witness, the 2006 survey accounted for 70.1 million pounds of NFD, an increase of 15 million pounds.

A witness appearing on behalf of Agri-Mark testified in support of Proposals 1 and 2. The witness explained that Proposal 1 seeks to update the make allowances adopted on an interim final basis (71 FR 78333), effective March 1, 2007, using 2005 CDF data. The witness asserted that this update would increase the butter, NFD and cheese make allowances by \$0.0014, \$0.0092 and \$0.0029 per pound, respectively. The witness was of the opinion that the dry whey make allowance should incorporate the 2005 CDF data which reflects an average cost of \$0.2851 per pound.

The witness reiterated Agri-Mark's position expressed in comments to a previous tentative final decision (71 FR 67467) that proposed adoption of the make allowances that were adopted in 2006. The witness concluded that using this weighting methodology (including a \$0.0015 per pound marketing cost factor) the resulting make allowances should be: \$0.1780 per pound for cheese, \$0.1351 per pound for butter, \$0.1510 for NFD and \$0.2090 per pound for dry whey.

The Agri-Mark witness conceded that increasing the make allowances would assist high-cost plants in covering their costs while creating a financial windfall for low-cost plants. In turn, the witness said, the low cost plants could use the additional revenue to sell products at a lower cost, pay producers a higher price, or increase their financial returns. The witness said that any financial gains low-cost plants in the southwestern region earn from a high make allowance would not harm high-cost plants in the Northeast because it

is too costly to transport milk from the southwestern U.S. to the northeast region. The witness believed that competitive issues resulting from high make allowances would only arise if a low-cost plant was located next door to a high-cost plant that competes for the same milk supply.

The Agri-Mark witness advanced Proposal 2 seeking to establish an annual manufacturing cost survey, administered by USDA that would automatically update make allowances without requiring a rulemaking proceeding. On brief, Agri-Mark withdrew the automatic updating portion of this proposal. The witness explained that manufacturing input prices fluctuate in the short-run and an annual survey would ensure more timely recognition of these fluctuations in make allowances. The witness said that the CPDMP survey should provide the basic methodology needed to conduct the survey and that any changes to the methodology should be done through the formal rulemaking process. The witness asserted that the survey should be administered by Market Administrator audit personnel and the plant sample, preferably larger than the CPDMP sample, should be selected by random sampling. The witness also supported auditing surveyed plants and asserted that this function should be funded by payments from the Market Administrator's administrative assessment funds. The witness said that if the survey was audited, the use of CDFA cost data would no longer be necessary in determining make allowances. The witness also supported addressing the proposed manufacturing cost survey in a recommended decision to allow for public comments.

The Agri-Mark witness was of the opinion that based on the CPDMP 2006 survey the make allowances should be set at the higher of: (1) A level that would allow a minimum of 80 percent of the producer milk used by Class III and Class IV plants to cover their costs; or (2) A level that would allow a minimum of 25 percent of the producer milk volume used by Class III and Class IV plants in any specific Federal order annually pooling at least 4 billion pounds of milk to cover their costs. The Agri-Mark witness opposed Proposal 3.

A witness appearing on behalf of Land O'Lakes (LOL) testified in support of Proposals 1 and 2. According to the witness, LOL is a Capper-Volstead cooperative with over 3,000 members that owns 4 manufacturing plants in the United States. The witness supported updating the current make allowances with CDFA manufacturing cost data as

advanced in Proposal 1. The witness advocated that the audited CDFA whey manufacturing cost data be included in the whey make allowance computation. The witness asserted that the make allowances should be recalculated by weighting the CDFA and CPDMP data by the survey sample volumes, not national product volumes which the witness argued was not statistically valid. The witness concluded that the new make allowances (using LOL's proposed weighting) should be as follows: \$0.1780 for cheese; \$0.2090 for dry whey; \$0.1560 for NFDM; and \$0.1351 for butter.

The LOL witness supported the annual cost survey offered in Proposal 2, with technical modifications. The witness stated that the authority for collecting plant cost data should be granted to the AMS Administrator, that the plant sample be limited to plants located outside of California that receive pooled (producer) milk, and that the survey results be combined with the CDFA data to determine appropriate Federal order make allowance levels. The witness opposed the portion of Proposal 2 that would set make allowances at a level that would cover the cost of manufacturing for the highest cost Federal order marketing area. The witness said that classified prices are determined on a national, not a regional basis, and therefore relying on regional costs is inappropriate. The witness was of the opinion that USDA should clearly identify the target product volume and percentage of plants that should be covered by new make allowances that result from this proceeding.

The LOL witness opposed Proposal 3 seeking to exclude CDFA manufacturing cost data when computing new make allowances. The witness argued that since 2000 the Department has continuously considered CDFA manufacturing cost data when determining new make allowance levels and asserted that there is no justification to modify that policy. The witness elaborated that classified prices are determined using a national survey that includes California plants and therefore including California plant costs when determining make allowance levels is appropriate.

A witness testifying on behalf of Michigan Milk Producers Association (MMPA) testified in support of Proposals 1 and 2, and in opposition to Proposal 3. According to the witness, MMPA is a Capper-Volstead cooperative with approximately 2,400 members that markets 3.5 billion pounds of milk annually and operates 2 manufacturing plants. The witness offered support for Proposal 1 to update the make

allowances based on the most currently available data. The MMPA witness stressed support for Proposal 2's annual survey of manufacturing costs that would be administered by AMS through its Market Administrators.

A witness appearing on behalf of NDA testified regarding the CPDMP 2005 survey that was used to determine 2006 make allowance levels. The witness said that NDA participated in the study and that costs for its NFDM plants were incorrectly allocated. The witness estimated that NDA's NFDM production represented approximately 54 percent of the total volume contained in the CPDMP 2005 survey for NFDM. In the survey, cream costs were allocated on a butterfat solids basis rather than as a percent of total solids, the witness said. However, according to the witness NDA's NFDM plants separate the cream that is stored in silos to be sold or transported to its butter manufacturing plant resulting in an over-allocation of costs to cream in the CPDMP 2005 survey. According to the witness, this misallocation inaccurately lowered NDA's NFDM manufacturing costs by \$0.036 per pound. The witness asserted that after correcting for this error, the CPDMP 2005 survey for NFDM weighted average cost should have been \$0.019 per pound higher. The witness urged USDA to issue an emergency decision addressing make allowances because of the errors contained in the CPDMP 2005 survey.

A post-hearing brief was filed on behalf of Agri-Mark, Foremost Farms USA, LOL, MMPA, NDA and Associated Milk Producers, Inc. (Agri-Mark et al.). The members of Agri-Mark et al. are all Capper-Volstead cooperatives who market their members' milk in the Federal order system and operate manufacturing plants.

The Agri-Mark et al. brief emphasized support for product-price formulas because, in their opinion, no truly independent competitive price series exists to determine milk prices. The brief summarized the evolution of the Federal order pricing system and asserted that USDA's past policy has been to set make allowances at levels that cover the processing costs for most Federal order plants. The brief expressed the opinion that USDA deviated from this policy when determining current make allowance levels.

The Agri-Mark et al. brief supported adoption of Proposal 1 and argued that make allowances should be updated using the 2005 CDFA and the CPDMP 2006 surveys. Agri-Mark et al. was of the opinion that USDA should continue to use the same national product

volume weighting methodology that determined the current make allowances, incorporate CDFAs whey cost data, use the CPDMP 2005 survey cheese plant population average cost instead of the sample average cost and continue to include a marketing cost factor of \$0.0015 per pound in each make allowance.

In their post-hearing brief, Agri-Mark et al. proposed that the cheese make allowance be set at \$0.2154 per pound. Agri-Mark et al. wrote that the CPDMP 2005 survey cheese plant population average of \$0.2028 per pound was most representative of average size plants and is therefore the best available information to determine an appropriate cheese make allowance. Agri-Mark et al. endorsed the methodology explained in the IDFA brief that derived a cheese make allowance of \$0.2154 per pound.

The Agri-Mark et al. brief proposed a dry whey make allowance of \$0.2080 per pound by combining the 2005 CDFAs and 2006 CPDMP surveys. Using this same methodology, the brief proposed a butter make allowance of \$0.1725 per pound and the NFDMS make allowance of \$0.1782 per pound (though stipulating that the CDFAs medium-sized plant cost should be used for NFDMS.) The brief summarized the Cornell witness' testimony regarding the errors with the 2005 butter and NFDMS survey methodology and concluded that the current make allowances that were determined with this data are unrepresentative of actual costs. Agri-Mark et al. requested that Proposal 1 be adopted on an emergency basis to rectify the current unrepresentative make allowances.

In their brief, Agri-Mark et al. expressed support for the portion of Proposal 2 that would authorize USDA to develop and conduct periodic manufacturing cost surveys of plants located outside of California. The brief explained that this data could then be relied upon in future rulemaking proceedings to amend the product price formulas.

Comments and exceptions to the tentative partial final decision submitted on behalf of Agri-Mark et al. expressed support for the proposed make allowances. According to Agri-Mark et al. the proposed make allowances reasonably reflect the record evidence of 2006 surveyed plant cost data. However, they argued that the make allowances should incorporate a one-time adjustment for energy costs because energy costs have significantly increased from 2006 through June 2008. Based on energy cost data from the Bureau of Labor Statistics, Agri-Mark et al. proposed that the following

adjustment should be added to the make allowances: \$0.0036 for cheese, \$0.0029 for butter, \$0.0114 for NFDMS and \$0.0105 for dry whey.

In its exceptions, Agri-Mark et al. also stated that USDA had shifted policy from adopting make allowances that allow most manufacturing plants receiving pooled milk to recover their manufacturing costs to make allowances that allow the manufacturing plants receiving most of the pooled milk to cover their manufacturing costs. Such a policy shift, from covering "most plants" to covering "most milk" noted Agri-Mark et al. should be explained in the final decision. Agri-Mark et al. also requested that in the final decision USDA reaffirm the exclusion of balancing costs as a make allowance factor.

A witness testified on behalf of DPNM, Select Milk Producers, Inc., and Continental Dairy Producers, Inc. (DPNM et al.). The witness said that Select and Continental are Capper-Volstead cooperatives whose members are located in New Mexico, Texas, Kansas, Ohio, Michigan and Indiana. According to the witness, the DPNM et al. testimony was endorsed by Lone Star Milk Producers and Zia Milk Producers, Inc., who are also Capper-Volstead cooperatives.

The DPNM et al. witness testified in support of Proposal 3. The witness was of the opinion that CDFAs cost data should not be used to determine new make allowance levels because the data are only representative of California manufacturing plants which the witness asserted have higher manufacturing costs than the rest of the country. The witness testified that CDFAs data had been utilized in the past when make allowances were determined using Rural Business Cooperative Service (RBCS) cost data because the audited CDFAs data broadened the available data and was used to verify the information contained in the RBCS study. However, the witness insisted that the CPDMP cost surveys are far more representative of the population of manufacturing plants and should now be relied upon as the sole determinant of make allowances.

The DPNM et al. witness testified that make allowances should be set at the following levels: \$0.1108 per pound for butter; \$0.1638 per pound for cheese; \$0.1410 per pound for NFDMS; and \$0.1500 per pound for dry whey. The witness stated that, except for dry whey, the proposed make allowances are identical to the weighted average costs contained in the CPDMP 2005 survey. The witness proposed that the dry whey make allowance be determined by

adding \$0.0090 per pound to the NFDMS make allowance to account for the additional energy needed to produce dry whey. The witness estimated that if the make allowances proposed by DPNM et al. were adopted, blend prices would increase by \$0.22 per cwt.

A second witness, a dairy accountant and dairy farmer appearing on behalf of DPNM et al. testified regarding dairy farm operating costs, accounting and business analysis of large modern dairy farm operations. According to the witness, the firm provides accounting and other business services to dairy producer operations in 27 states whose production volume represents about 10 percent of the milk produced in the United States. The witness testified that based on data collected during the 1990's, large dairy farms in six Western states had an average annual net profit per cwt of \$1.31. The witness testified that based on 10 years' worth of client data, dairy farms in the west and eastern states must earn a net income of \$1.50 and \$2.00 per cwt, respectively, for a dairy farmer to collect a salary and retire debt. The witness predicted that, for 2007, producer client gross income would average \$15.51 per cwt. At an average cost of production of \$15.17, the witness went on to predict that their clients would face a net profit of \$0.34 per cwt. The witness said that this amount is far from the \$1.50 per cwt net profit needed for their clients to reduce debt or cover living expenses.

The second DPNM et al. witness stated that low milk prices in 2005 reduced dairy farm client income to an average of \$206 per cow. The witness noted that during the 1990's, average production cost per cwt in western states was \$11.87 but this has risen to \$13.50 for 2004–2005. The witness testified that rising input costs combined with lower milk prices in 2004–2005 made large-scale, highly efficient dairy farming unprofitable, even in low-cost operating areas such as western Texas and New Mexico. The witness provided additional testimony to show that increasing make allowances depressed dairy farmer income during a period of increasing costs and reduced opportunities for profitability. The witness supported this testimony with 2006 client data showing that a farm milking 1,800 cows would have lost \$284,000. The witness provided detailed client data showing that the major higher-cost milk production factors during 2005 and 2006 were increased energy and feed costs.

A third witness, a dairy farmer, appearing on behalf of DPNM et al. testified in support of Proposal 3. The

witness operates a farm in New Mexico that milks approximately 3,800 cows and testified that they have been receiving \$1.50 cwt below the Southwest order's blend price because of hauling costs. The witness said that over the last few years any increase in producer milk prices have been consumed by rapidly increasing production costs. The witness supported all proposals submitted by DPNM and articulated opposition to adoption of Proposals 1 and 2.

The DPNM et al. post-hearing brief explained that its opposition to all other proposals included in the hearing to adjust the make allowances was based on three principles: (1) The data used to determine the appropriate level of manufacturing allowances for establishing Federal order prices should be drawn from plants operating within the Federal order system; (2) adjustments to Federal order pricing regulations should always be subject to formal rulemaking; and (3) make allowances should be set at a level deemed appropriate by USDA, after taking into consideration all statutorily required factors and current milk marketing conditions, rather than prescribed geographic or volumetric factors. The brief explained why the CPDMP 2005 survey is the best data available and met their criteria for use in establishing Federal order make allowances and why the 2006 survey is flawed and should not be relied upon in determining make allowances.

Exceptions filed by DPNM et al. in response to the tentative partial final decision argued that in proposing new make allowances the Department failed to consider producer costs of feed and fuel in each marketing area as mandated by the Food, Conservation and Energy Act of 2008 (2008 Farm Bill). DPNM et al. took exception with the Department's national Economic Analysis of the proposed changes. It argued that Federal orders do not encompass the entire national market and therefore regional economic analyses should also be conducted.

DPNM et al. also took exception with the use of 2006 CDFA manufacturing cost data (released October 3, 2007) to compute the make allowances without input from interested parties about the applicability of the new data. It specifically took exception with the use of the weighted average cheese manufacturing cost and argued that the record did not indicate if the number of high-cost versus low-cost plants in the California survey is similar to the plant make-up of the rest of the country.

DPNM et al. also stated in their comments that the Department has

denied dairy farmers due process and provided a list of examples. They also took exception to the notion advanced in the tentative partial final decision that milk production costs are reflected in the supply and demand conditions for dairy products. Instead, DPNM et al. argued that the cost of producing milk is reflected in the supply and demand conditions of the various inputs, such as feed, labor and fuel. DPNM et al. stated that contrary to the Department's findings, the increase in the number of manufacturing plants from 2005 to 2007 indicates that make allowances were not too low, and that only CPDMP 2005 data (released in 2006) should be used to determine new make allowance levels.

A witness appearing on behalf of IDFA testified in support of Proposal 1 and the annual manufacturing cost survey advanced in Proposal 2. However, the witness did not support adoption of the portion of Proposal 2 that would result in the automatic update of make allowances. The witness requested emergency adoption of Proposal 1 and this request was reiterated in IDFA's post-hearing brief.

The IDFA witness testified that the product-price formulas determine the minimum prices manufacturers must pay for their raw milk and that those whose costs exceed the fixed make allowances in the price formulas are unable to recoup their higher costs. The witness asserted that any increase in the manufacturer's end product prices would only result in an increase in the minimum raw milk price they must pay. According to the witness, manufacturers also face financial problems if any of the product-price formula factors are incorrect. The witness illustrated by example the impacts of both inaccurate product prices and inaccurate make allowances on manufacturers.

The IDFA witness testified that before January 1, 2000, the Federal order system utilized a market-based pricing system which automatically reflected current market conditions. However, under the end product pricing system, market factors (e.g. yields, butterfat retention) are set at a point in time and can only be changed through the formal rulemaking process, the witness said.

The IDFA witness espoused that setting make allowances too high or yield factors too low may result in low milk prices but that should not be of concern to USDA. In this regard, the witness was of the opinion that the Federal order system should only determine minimum prices and allow market responses through over-order premiums to remedy any regulated prices that are too low. However, the witness conceded that if a plant can

manufacture products at costs lower than those reflected by the make allowance levels then the difference could be used to make plant investments, secure a larger milk supply to the detriment of higher-cost plants or return higher margins to plant owners.

The IDFA witness testified in support of updating the current make allowances with the most current cost data available (Proposal 1). The witness was of the opinion that the CDFA dry whey cost data should be a factor in determining a new dry whey make allowance for Federal orders. The witness asserted that the CDFA average dry whey plant size more closely resembled the NASS average dry whey plant size than did the CPDMP survey. Furthermore, the witness asserted that the CDFA dry whey data was skewed toward low-cost plants, not high-cost plants as asserted by USDA. The witness maintained that using the CDFA data in determining the dry whey make allowance would not cause the make allowance to be set too high. The witness concluded that both the CDFA and CPDMP dry whey weighted average costs should be used to determine the dry whey make allowance. This position was reiterated in the IDFA post-hearing brief.

Also in its post-hearing brief, IDFA stated that any decision made by USDA on the Class III and Class IV pricing formulas should not directly consider hearing testimony regarding dairy farmer cost-of-production. The brief asserted that it is already captured indirectly through the supply and demand for manufactured dairy products and therefore should not be given additional consideration in this proceeding.

The IDFA witness testified that USDA needs to correct for CPDMP's stratified cheese plant sampling which in IDFA's opinion over-represents low-cost cheese plants. The witness highlighted the testimony of the Cornell witness which compared the 8 cheese plants that participated in both surveys revealing an average manufacturing cost increase of 1.7 cents per pound. IDFA was of the opinion that since the same cheese plant sample was not used in the two CPDMP surveys, the most appropriate method for determining a new cheese make allowance would be to use the weighted average cost from the 2005 survey (\$0.2028) plus 1.7 cents for a total of \$0.2198 per pound. In its brief, IDFA concluded that the new make allowances should be set no lower than the following: \$0.2154 per pound for cheese; \$0.1725 per pound for butter; \$0.1782 for NFD; and \$0.2080 for dry whey.



The IDFA witness supported adopting an annual manufacturing cost survey as contained in Proposal 2 but opposed any automatic updating of make allowances. The witness said that an annual survey would provide industry participants information regarding trends in plant costs and such information could be used in future hearings to adjust make allowances. However, the witness did not support automatically updating make allowances outside of the hearing process because it would prohibit industry input regarding how the data should be utilized. IDFA reiterated these views in its post-hearing brief.

The IDFA witness testified in opposition to Proposal 3. The witness argued that audited CDFA data should continue to be included when determining new make allowance levels. The witness asserted that the elimination of the CDFA data would result in lower make allowances that, in their opinion, are already too low. In its post-hearing brief, IDFA asserted that the proponents of Proposal 3 had presented no evidence that manufacturing costs have decreased to levels similar to the manufacturing costs reflected in make allowances that were effective prior to February 1, 2007.

Comments and exceptions filed by IDFA expressed support for the proposed make allowances contained in the tentative partial final decision. IDFA also indicated support for comments filed by Agri-Mark et al. requesting that the make allowances be adjusted to reflect increased energy costs through June 2008. IDFA also continued to support adoption of a manufacturing cost survey (Proposal 2) as a means to provide accurate and timely manufacturing cost data for use at future rulemaking proceedings, and expressed continued support for the denial of Proposal 3.

A witness appearing on behalf of Lactalis American Group, Inc. (Lactalis) testified in support of Proposal 1 and in opposition to Proposal 3. According to the witness, Lactalis operates six cheese plants in the United States. The witness expressed support for IDFA's positions. The witness said that the Class III and Class IV product-price formulas should be amended to give more flexibility to market participants in establishing market prices. The witness was of the opinion that increasing make allowances by adopting Proposal 1 would give processors the flexibility to make short-term adjustments in response to changing market conditions. The witness argued that the increasing milk supply, not make allowances which are too high, is the cause of low

milk prices received by dairy farmers. Therefore, the witness opposed any proposals that would result in lower make allowances.

A witness appearing on behalf of Leprino testified in opposition to Proposal 3 stating that there is no basis to set make allowances below current levels. According to the witness, Leprino operates nine manufacturing plants throughout the United States that produce Italian style cheeses. The post-hearing brief filed by Leprino expressed support for the make allowances proposed in IDFA's post-hearing brief. Leprino was of the opinion that make allowances should be set no lower than the following: \$0.2154 for cheese; \$0.2080 for dry whey; \$0.1725 for butter; and \$0.1782 for NFDM.

A witness appearing on behalf of Saputo Cheese USA (Saputo), a dairy product manufacturer, testified in support of IDFA's positions. The witness testified that Saputo opposed any proposal which would add complexity to the Federal milk order system. The witness supported updating the current make allowances to reflect the most current available data as sought in Proposal 1 and that updated make allowances for dry whey should use CDFA data.

A post-hearing brief filed on behalf of Twin County Dairy (Twin County), an Iowa-based cheese manufacturer, expressed support for the proposals offered by IDFA and Agri-Mark that seek to increase make allowances. However, the brief asserted that the proposals do not go far enough to ensure that medium-sized plants, such as the one operated by Twin County, remain profitable. The brief argued that the proposed make allowances are heavily weighted toward large, low-cost plants and their adoption, especially the dry whey make allowance, would cause financial hardship for many cheese manufacturing plants that are similar in size to Twin County. Twin County insisted that even though product-price formulas are applied identically to large and small plants, USDA should conduct a regulatory impact analysis because in Twin County's opinion, product-price formulas have a disproportionate impact on small businesses compared with larger entities that may benefit from advantages of economies of scale.

A witness appearing on behalf of HP Hood LLC (HP Hood) testified in opposition to Proposals 1, 2 and 3. According to the witness, HP Hood is a manufacturer of Class I and Class II dairy products that are distributed nationally. The witness opposed Proposals 1, 2 and 3 because their adoption would change the Class III and

Class IV milk pricing formulas that in turn are used to determine the Class I and Class II prices that HP Hood pays for its raw milk supply. The witness opposed adoption of any proposal that would result in the automatic or periodic updating of the Class III and Class IV pricing formulas arguing that such updates should be made through the formal rulemaking process.

A witness appearing on behalf of NAJ offered an amendment to Proposal 2. The witness said the amendment would expand the manufacturing cost survey to include gathering manufacturing cost data for whey protein concentrates (WPC's) and lactose. This inclusion was reiterated in NAJ's post-hearing brief.

A Michigan dairy farmer testified regarding the profitability of dairy farmers and in opposition to adopting any proposals that would increase make allowances. The witness was opposed to increasing make allowances until the price formulas are amended to recognize a farmer's cost of production. The witness stated that on-farm fuel costs were \$35,000 in 2004 and had risen to \$70,000 in 2006. The witness asserted that there are many Michigan dairy farmers considering leaving the dairy industry because of increased costs and low milk prices. The witness also expressed the opinion that NASS NFDM prices were misreported or under-reported during the prior 12 months.

A post-hearing brief submitted on behalf of O-AT-KA Milk Products Cooperative, Inc., (O-AT-KA) expressed support for Proposals 1 and 2, and opposition to Proposal 3. According to the brief, O-AT-KA is a Capper-Volstead cooperative located in New York and its plant manufactures 600 million pounds of milk annually into butter and NFDM. The brief stressed that changes to the make allowances and other factors of the product price formulas need to accurately represent the current manufacturing market. O-AT-KA expressed support for Proposal 1 and was of the opinion that the CPDMP 2006 survey should be considered a minimum when setting make allowances. According to the brief, O-AT-KA's plant manufacturing costs are higher than the CPDMP 2006 survey weighted average NFDM cost. O-AT-KA also wrote that they compete directly with California plants and requested that USDA keep the Class IV and California Class 4a prices aligned if it recommends any changes to the product price formulas. O-AT-KA noted support for Proposal 2, but not the portion that calls for automatically updating make allowances. The O-AT-KA brief opposed adoption of Proposal 3 because it would inhibit their ability

to provide balancing services to the market and a fair return to its member-owners.

A joint post-hearing brief filed on behalf of Dairylea and DFA (Dairylea et al.), opposed adoption of Proposals 1 and 2. The brief expressed the opinion that the current make allowances should be used with the addition of the energy adjuster advanced in Proposal 17 and cost add-ons described in Proposal 20. The Dairylea et al. brief supported the NAJ modification of Proposal 2 to expand the NASS product price survey to include information on whey protein concentrates.

Separate comments filed on behalf of Grande Cheese Company (Grande), Glanbia Foods, Inc. (Glanbia) and Kraft Foods (Kraft) expressed support for the proposed make allowances contained in the tentative partial final decision. Grande is a cheese manufacturer located in Wisconsin processing over 1.5 billion pounds of milk annually. Glanbia is a cheese manufacturer with plants located in Idaho and New Mexico. Kraft operates numerous manufacturing plants located throughout the country. Grande, Glanbia and Kraft all endorsed the comments and exceptions filed by IDFA.

Grande's comments also took exception to the exclusive use of CDFA data in determining the cheese make allowance and the sole use of CPDMP data to determine the dry whey make allowance. Glanbia and Kraft urged USDA to include CDFA dry whey cost data in the make allowance computation because CDFA has the only audited whey cost data available. Grande, Glanbia and Kraft also noted support for adopting a manufacturing cost survey (Proposal 2).

Comments filed by Leprino Foods in response to the tentative final partial decision expressed support for the proposed make allowances. Leprino also supported adoption of a one-time energy cost adjustment as proposed by Agri-Mark et al.

Comments filed in response to the tentative partial final decision submitted on behalf of the Wisconsin Cheese Makers Association (WCMA) offered support for the make allowances in the tentative partial final decision and urged USDA to adopt the annual manufacturing cost survey advanced in Proposal 2. WCMA is an organization representing 75 proprietary organizations and cooperatives that manufacture or process dairy products. WCMA argued that because small- and medium-sized plants typically do not have whey drying capacity, they are forced to pay more for the whey in their producer milk than what can be

recouped in the market. WCMA stated that this is mostly because a plant's inability to dry whey for sale in the market forces them to sell a lower-valued whey product such as wet whey. According to WCMA, a higher whey make allowance keeps small- and medium-sized cheese plants from losing revenue in times of high dry whey prices. WCMA was of the opinion that USDA should include CDFA dry whey cost data in the make allowance computation as it would provide a higher make allowance than currently proposed.

An Indiana dairy farmer took exception with the increased make allowances contained in the tentative partial final decision. The dairy farmer stated that producer paychecks should not be reduced to cover the cost of manufacturing milk into finished products.

Comments filed in response to the tentative partial final decision submitted on behalf of the National Family Farm Coalition (NFFC) and the Ohio Farmers Union (OFU) opposed the increased make allowances. NFFC and OFU contend that the tentative partial final decision did not take into account farmers' costs of production. The two groups argued that make allowances should not be increased during a time when milk production costs also have increased.

Exceptions to the tentative partial final decision filed by St. Albans Cooperative Creamery, Inc., (St. Albans) requested USDA to consider dairy farmer production costs before permanently adjusting make allowances. St. Albans is a dairy farmer-member Capper-Volstead cooperative that operates a milk manufacturing plant. St. Albans was of the opinion that the 2008 Farm Bill requires a dairy farmer cost analysis before any final adjustments to make allowances.

## 2. Product Yields and Butterfat Recovery Percentage

A witness appearing on behalf of DPNM et al. testified in support of Proposals 6, 7 and 8. The witness testified that before January 1, 2000, the Federal milk order price discovery mechanism took into account dairy farmers' cost of production when determining minimum regulated prices. If farmers' cost of production increased, the witness said that manufacturers were able to pay farmers higher prices because on-farm production costs could be passed on to their customers. However, under the current pricing system, the witness argued, minimum prices to dairy farmers are based on the average prices of dairy products sold

nationally during the month. As a result, the witness asserted, dairy farmers have experienced financial hardship because they are unable to pass on their higher costs to the marketplace.

The DPNM et al. witness was of the opinion that Proposals 6, 7 and 8 should be considered jointly as coordinated adjustments to the various yield factors to ensure that dairy farmers receive a fair minimum price. In its post-hearing brief, DPNM et al. added that Proposals 3 and 15 should also be considered in conjunction with Proposals 6, 7 and 8 because together they address all parts of the current product price formulas.

The DPNM et al. witness testified in support of Proposal 6 seeking to increase the butterfat yield factor from 1.20 to 1.211. The witness said that this change would correct for a mathematical error in calculating farm-to-plant shrinkage. The witness explained that in the 2002 final decision that established the current farm-to-plant shrinkage factor, shrinkage allocated to butterfat loss should have been calculated on a per cwt of milk basis, not on a per pound of butterfat basis. DPNM et al. noted on brief that no witnesses at the hearing disagreed with this assertion.

The DPNM et al. witness also offered a modification to Proposal 6 seeking to amend the butterfat credit in the protein price. The witness explained that when USDA adjusted the butterfat yield factor in the protein price formula to 1.572 in 2002 to account for farm-to-plant shrinkage, the butterfat credit portion of the protein formula was not adjusted to an equivalent of 89.4 percent. The witness estimated that increasing the butterfat yield factor from 1.20 to 1.211 and decreasing the butterfat credit portion of the protein formula from 90 to 89.4 percent would, on average, have increased blend prices by \$0.07 per cwt.

The DPNM et al. witness testified in support of Proposal 7 seeking to eliminate the farm-to-plant shrinkage factor. The witness was of the opinion that accounting for farm-to-plant shrinkage allows producers and processors to mask inefficiencies. According to the DPNM et al. witness their farm-to-plant shrinkage is well below the 0.25 percent assumed in the pricing formulas. The witness attributed lower farm-to-plant shrinkage to large producers who ship tanker loads of milk. The witness insisted that shrinkage is not a result of milk solids being unrecoverable from the milk tanker and hoses but rather the result of imprecise measuring at the farm.

The DPNM et al. witness testified that the yield factors in the product pricing

formulas should be amended to reflect current technology. The witness proposed that the protein price formula be changed to reflect a 94 percent butterfat recovery in cheese manufacturing, that the casein percentage in milk be increased to 83.25 percent, and that the butterfat-to-protein ratio in cheese be changed to 1.214 to reflect average producer tests. According to the witness, the adoption of a 94 percent butterfat recovery rate also implies that the butterfat yield factor in the protein price should be increased from 1.587 to 1.653 as proposed in Proposal 8.

The DPNM et al. witness estimated that increasing the butterfat recovery rate from 90 to 94 percent would result in a \$0.105 increase in producer blend prices. The witness said that the currently assumed 90 percent butterfat recovery rate is based on technology that is more than 20 years old while new technology enables manufacturers to achieve a much higher recovery rate. Using CDFA plant cost survey data for 2002 through 2005, the witness used a mass balance analysis to estimate the flow of milk components through a cheddar cheese plant and the allocation of milk components to products and by-products. Through this analysis the witness derived a 94 percent butterfat recovery rate for plants participating in the CDFA cost survey. The witness estimated the butterfat recovery rate for cheese plants that participated in the 2004 RBCS cost study to be 95.25 percent for all cheeses.

The DPNM et al. witness testified in support of Proposal 8. The witness argued that the percentage recovery factor for casein in milk should be increased from 82.2 to 83.25, to reflect average producer tests, which would result in a 2.3-cent per cwt increase in producer blend prices. However, in their post-hearing brief, DPNM et al. stipulated that a casein recovery factor of 83.10 percent was appropriate. DPNM et al. explained in their brief that changing the casein recovery factor would raise the protein yield factor from 1.383 to 1.405; and increasing the butterfat recovery rate to 94 percent would change protein price formulas by increasing the protein to butterfat ratio from 1.17 to 1.214 and increasing the butterfat yield from 1.587 to 1.653. These changes would update the protein price formula to reflect current industry recovery standards and return revenue to producers who, according to the DPNM brief et al. have received lower pay prices.

The DPNM et al. witness estimated that increasing the butterfat-to-protein ratio from 1.17 to 1.24 would result in

a 3.7-cent increase in producer blend prices. The witness said that the current butterfat-to-protein ratio of 1.17 represents standardized milk tests at 3.5 percent butterfat and 2.9915 percent true protein. However, according to the witness the 2004 average producer milk test for milk contained in the 2004 RBCS study was 3.69 percent butterfat and 3.04 percent true protein which more accurately represents a butterfat-to-protein ratio of 1.214.

The DPNM et al. witness concluded that the current butterfat to protein ratio of standardized milk undervalues more than one half of the producer milk marketed on Federal orders. The witness also stated that since plants purchase milk at test, not at the standardized values, it is more appropriate to use weighted average milk tests in the pricing formulas. In brief, DPNM asserted that standardized milk tests are lower than average producer tests and result in yield factors in the protein price formula that are artificially low which in turn understates what the protein price paid to producers should be.

The DPNM et al. witness concluded that if the DPNM et al. proposals to change the butterfat recovery percentage, butterfat-to-protein ratio, and true protein in casein percentage are adopted, producer blend prices would increase by \$0.20 per cwt.

The DPNM et al. witness also testified that the NFDM yield factor should be increased from .99 pounds of NFDM per pound of solids nonfat (SNF) to 1.02 pounds of NFDM per pound of SNF. The witness stressed that according to current FDA standards of identity, one pound of SNF can produce as much as 1.05 pounds of NFDM. The witness elaborated that NFDM is often sold with approximately 5 percent moisture, whereas SNF is assumed to contain 0 percent moisture. Therefore, concluded the witness, the current formula is incorrect in assuming that one pound of SNF actually produces less than one pound of NFDM. The witness referred to various studies conducted by CDFA and CPDMP that demonstrated a combined NFDM and buttermilk powder yield in excess of 1.025 pounds per pound of SNF. The witness was of the opinion that after taking into account the lower market value of buttermilk powder, a NFDM yield of 1.02 is appropriate. The witness estimated that this proposed change would increase producer blend prices by 4 cents.

The witness concluded that if all the DPNM et al. yield changes were adopted, blend prices would increase by \$0.42 per cwt and on average, producers would receive \$9,787 in additional

income per year. The witness was of the opinion that any adjustment in yield factors should also be accompanied by an adjustment in make allowances because the two are inherently linked.

Exceptions to the tentative partial final decision filed on behalf of DPNM et al. opposed the denial of the butterfat recovery rate portion of Proposal 6, and Proposals 7 and 8. DPNM et al. reiterated their testimony presented at the hearing that the butterfat recovery in cheese is in excess of 90 percent. DPNM et al. also argued that the USDA did not properly evaluate the CDFA yield data for cheese and the relevance of the factors in determining butterfat retention in cheese making. They offered a calculation using the butterfat tests, solids nonfat tests, cheese yield and cheese moisture content for California plants which purported to show that those plants had a butterfat retention rate in the range of 94 percent. They also commented that similar results were obtainable from the RBCS data.

DPNM et al. noted in their comments to the tentative partial final decision that the farm-to-plant shrinkage allowances should be removed from the product-price formulas as advanced in Proposal 7. DPNM et al. explained that in the western part of the country, where the producers it represents operate, milk is delivered from the farm-to-plant in full tanker loads and therefore shrinkage is not a problem. Accordingly, they argued that DPNM et al. producers should not be penalized through lower component prices for being more efficient than producers who ship smaller loads and therefore experience farm-to-plant shrink.

Exceptions by DPNM et al. also requested the Department to reconsider adoption of Proposal 8. They argued that yields contained in the product-price formulas should be based on average producer tests, not on milk standardized to 2.9915 percent protein and 3.5 percent butterfat. They expressed the view that since cheese prices, butterfat prices and make allowances are based on weighted averages, yields should also be based on the weighted average component tests of producer milk. The exception also reiterated their position that the casein retention rate of 82.2 percent is incorrect and that the factor should be 83.25 percent.

A witness appearing on behalf of Leprino testified in opposition to Proposals 6, 7 and 8. The witness opposed the portion of Proposal 6 seeking to increase the butterfat recovery rate in cheese manufacturing from 90 to 94 percent. In the witness'

opinion, the proponents for increasing the butterfat recovery rate provided no evidence to support this increase aside from hypothetical examples. The witness also opposed the amendment to Proposal 6 to decrease the butterfat credit in the protein formula below the 90 percent butterfat recovery rate that is assumed in the cheese yield formula. The witness explained that this would cause cheese manufacturers to pay for more butterfat than is actually contained in the raw milk. The witness agreed that there is an error regarding how butterfat shrink is applied in the butterfat formula. However, the Leprino witness did not support increasing the butterfat yield factor to 1.211 because of milk component losses that occur in cheesemaking that are not recognized in the formula.

The Leprino witness testified in opposition to elimination of the farm-to-plant shrinkage factor advanced by Proposal 7. The witness said that the loss of milk when shipping from the farm to the plant is well documented and adjusting the Class III price to reflect this loss is appropriate. The witness said that Leprino experiences farm-to-plant milk losses of approximately 0.25 percent. The witness disagreed with the rationale offered by the proponent that increasing farm sizes and single producers shipping whole tanker loads of milk has remedied farm-to-plant shrinkage. The Leprino witness testified that deliveries to the Leprino plant in Waverly, New York, often have the milk of 15 to 18 producers per tanker. The witness argued that milk losses from farm-to-plant remain a reality that should continue to be acknowledged in the Class III price formula.

The Leprino witness testified in opposition to increasing the cheese protein yield factor from 1.383 to 1.405 (Proposal 8.) The witness said that the proponent's assumption of 83.25 percent casein in true protein content that would lead to a cheese protein yield factor of 1.405 was not based on actual laboratory casein tests. Leprino's post-hearing brief reiterated its opposition to Proposals 6, 7 and 8.

A witness appearing on behalf of IDFA testified in opposition to proposals seeking to increase yield factors (Proposals 6, 7 and 8). The witness was of the opinion that the yield factors should actually be decreased to reflect in-plant shrinkage and the sale of lower-valued products such as whey cream and buttermilk. In its post-hearing brief, IDFA espoused that proponents of increasing yield factors made erroneous assumptions. The brief stated that hearing evidence

documents that farm-to-plant losses are a marketplace reality and should continue to be recognized in the product price formulas. The brief also argued that hearing evidence does not support proponent's claim that a 94 percent butterfat recovery rate is achievable by most cheese manufacturing plants. Lastly, the brief insisted that the 83.25 percent casein in true protein assumed by the proponents is not based on any actual milk tests.

Comments and exceptions filed by IDFA to the tentative partial decision expressed continued support for the denial of Proposal's 6, 7 and 8.

A food technologist witness appearing on behalf of IDFA testified regarding the cheese manufacturing process and specifically about cheese production at Alto Dairy Cooperative (Alto Dairy) during 1985—2003. The witness discussed the evolution of cheese processing technology and testified that the greatest loss of milkfat during the cheese making process occurs during the cutting of the coagulum. The witness estimated that in moving from the use of traditional open vats to newer horizontal enclosed vats, the loss of milkfat during the cutting of the coagulum was reduced from 9.6 percent to 6 percent. However, the witness said, this does not account for losses during other stages of the cheesemaking process. The witness was of the opinion that the industry average butterfat recovery rate in cheddar cheese is approximately 90 percent.

A witness appearing on behalf of Kraft testified in support of the positions and proposals advocated by IDFA. The Kraft witness opposed eliminating the farm-to-plant shrinkage factor in the Class III price formula (Proposals 7 and 8.) The witness said that Kraft manufacturing plants experience farm-to-plant milk shrinkage and that this factor should continue to be acknowledged in the price formulas so that the butterfat recovery percentages and yields are not arbitrarily inflated.

A witness appearing on behalf of Davisco Foods (Davisco) testified as being unable to use whey cream in standardized full-fat cheddar production. The witness explained Davisco sells whey cream to a butter manufacturer at a price lower than that reflected in the Class III pricing formula. According to the witness, Davisco owns and operates manufacturing plants in Idaho, Minnesota and South Dakota.

A witness appearing on behalf of HP Hood opposed adoption of increasing yield factors. According to the witness, the proposed yield factors are not reflective of industry data provided in record testimony. Furthermore, the

witness said, the shrinkage factor should remain in the pricing formulas and claimed that HP Hood experiences an average total shrinkage (farm-to-plant and in-plant loss) of 1.5 percent.

A witness appearing on behalf of LOL testified in opposition to Proposal 6. The witness asserted that when determining the current farm-to-plant shrinkage factor USDA did not clearly state if the butterfat loss was based on product pounds or cwt of milk. The witness said that an increase in the butterfat yield would increase the raw milk costs for manufacturers who already contend with a make allowance that does not cover their cost of processing. The witness opposed increasing the butterfat recovery percentage to 94 percent and revealed that the LOL cheese plant in Kiel, Wisconsin, recently experienced an average annual cheese yield of 10.21 pounds per cwt. According to the witness, assuming a 90 percent butterfat recovery rate and applying the plant's average milk tests, the Van Slyke formula estimates a cheese yield of 10.16 pounds. The witness indicated that the theoretical Van Slyke result and observed plant yield validates the continued use of the 90 percent butterfat recovery rate in the Class III price formula.

The LOL witness also testified in opposition to Proposals 7 and 8 seeking to amend the yield factors by eliminating farm-to-plant and butterfat shrinkage factors. The witness said proponents' claim that minimal comingled milk in the Florida, Southwest, Arizona and Pacific Northwest orders fails to recognize that comingled milk in the Northeast and Upper Midwest is commonplace given that the milk of 10 or more producers is commonly comingled on a single load. According to the witness, this makes farm-to-plant shrinkage between farm and plant weights inevitable. The witness indicated that in 2006, the LOL butter and NFDM plant in Carlisle, Pennsylvania, experienced an average difference of 0.343 percent between farm and plant weights and a 0.511 percent butterfat shrinkage. The witness insisted that the LOL shrinkage percentages validate the continued incorporation of farm-to-plant and butterfat shrinkage factors in the pricing formulas.

A witness appearing on behalf of MMPA testified in opposition to Proposal 7 seeking to eliminate the farm-to-plant shrinkage factor. The witness elaborated that even though MMPA pays its farmers based on farm weights and tests, some milk solids are lost during transportation of milk from

the farm to the plant. According to the witness, MMPA plants experience approximately a 0.3 percent loss of milk from farm-to-plant. Without the farm-to-plant shrinkage factor in the product price formulas, the witness said that MMPA would have to pay farmers for milk that is lost in transport and cannot be manufactured into a saleable product.

The MMPA witness also opposed Proposals 6 and 8 that seek to amend the Class IV NFDM and butter yield factors. The witness provided evidence that MMPA experiences butter and NFDM plant yields that are slightly lower than those used by the Class IV formula. The MMPA witness claimed that their yields typically generate a milk value of \$11.11 per cwt, while the assumed yields in the product price formulas generate a milk value of \$11.06 per cwt. The witness asserted that this \$0.05 per cwt advantage is eliminated because of the off-grade products it produces and sells at discounted prices. The witness concluded that the current Class IV yield factors are appropriate and that the current calculation is superior to the complicated alternatives in Proposals 6, 7 and 8.

A witness appearing on behalf of Foremost testified regarding cheese production at Foremost's manufacturing plants. The witness entered a declaration for the record describing the types of cheese produced by Foremost and the specific butterfat retention rate achieved at its cheese manufacturing plant in Marshfield, Wisconsin. Using a mass balance analysis, the witness stated that in 2006 the Marshfield plant had an average butterfat retention rate of 90.25 percent. The witness said that Foremost considered investing in more modern cheese vats that would yield a higher butterfat retention rate but chose not to do so because it would take at least 13 years to recoup any return on such a large investment.

The Agri-Mark et al. post-hearing brief expressed opposition to the adoption of Proposals 6, 7 and 8. The brief argued that the proponent's methodology in computing product yields was flawed because it ignored that milk solids and/or cream are sometimes added to farm milk during processing resulting in increased vat yields. Therefore, Agri-Mark et al. concluded that the product yields advanced in Proposals 6 through 8 are not representative of the volume of products that can be produced from a hundredweight of milk. Agri-Mark et al. also took exception to proponent's statements that dairy farmers are paying for the costs of new plant equipment designed to increase yields through increased make allowances and reduced

producer income. Agri-Mark et al. argued that enhanced yields increase production thus lower manufacturing costs per pound of product from which make allowances are derived. Agri-Mark et al. also opposed the elimination of a farm-to-plant shrinkage factor used in the product price formulas.

The Agri-Mark et al. brief stated that increasing the butterfat recovery rate from 90 percent to 94 percent is not justified. Agri-Mark et al. insisted that the proponent's claim that cheese plants recycle their whey cream into the cheese vat and are then able to achieve a 94 percent butterfat recovery was contradicted by many witnesses at the hearing. Agri-Mark et al. also wrote that the record lacks sufficient evidence to justify increasing the NFDM yield factor from .99 to 1.02. The brief supported USDA's reasoning for relying on the current NFDM yield factor and said that the farm-to-plant shrinkage factor is still valid.

In comments and exceptions to the tentative partial final decision, Agri-Mark et al. expressed support for amending the butterfat yield factor, and to the denial of the portion of Proposal 6 seeking to increase the butterfat recovery rate and the entirety of Proposals 7 and 8.

The post-hearing brief filed on behalf of Dairylea et al. agreed with proponents of Proposal 6 that an arithmetic error in calculating the shrinkage factor in the butterfat yield had been made by USDA. Therefore, the brief advocated that the butterfat yield factor in the butterfat price formula be increased to 1.211. The brief also discussed the butterfat recovery percentage in the protein price formula and supported increasing the butterfat retention factor in cheese manufacturing but did not specify a factor. The brief explained that currently the formula assumes that 90 percent of the butterfat in the cheese vat ends up in the finished product. The brief emphasized the importance of recognizing that the butterfat retention factor is based on butterfat going into the vat, not butterfat coming from the farm. The brief asserted that a 90 percent recovery rate of butterfat going into the cheese vat is equivalent to 89.4 percent of the butterfat coming from farms going into the finished product after accounting for farm-to-plant shrinkage. The brief detailed that the cheese manufacturers who testified to achieving a butterfat recovery percentage of 90.25 percent on the basis of farm tests actually experienced a butterfat recovery of 90.9 percent of fat that entered the cheese vat. The brief concluded that this evidence, combined with additional testimony regarding

available technology, makes higher butterfat recovery possible and should be reflected in the protein price formula.

The Dairylea et al. brief opposed the elimination of the farm-to-plant shrinkage factor as advanced in Proposal 7. The brief asserted that while some production areas are dominated by large farms, a large portion of the country is dominated by small farms where farm-to-plant shrinkage is prevalent. However, the brief noted that farm-to-plant shrinkage is reflected in the product-price formulas because yield data provided by manufacturers is commonly based on farm weights and tests.

The post-hearing brief submitted on behalf of O-AT-KA stated that the hearing record does not justify adoption of Proposals 6, 7 and 8, and that the proposed changes to yield factors would increase its raw milk costs and inhibit its ability to provide balancing services to the market. O-AT-KA was of the opinion that Proposal 6 should only be adopted if USDA simultaneously amends the product-price formulas to account for in-plant losses and off-grade products that are sold at a discount.

Comments to the tentative partial final decision filed separately by Grande, Glanbia, Kraft, Leprino and WCMA expressed continued support for the denial of Proposals 7 and 8.

### 3. Value of Butterfat in Whey

A witness appearing on behalf of IDFA testified in support of Proposal 9 seeking to adjust the protein price formula to reflect the lower value and volume of butterfat recoverable from whey cream and was of the opinion that Proposal 9 was superior to Proposal 10. The witness asserted that the current Class III price formula values the butterfat not captured in the cheese at the Grade AA butter price even though it is sold as whey butter which has a lower value in the marketplace. In its brief, IDFA supported the testimony of the Leprino witness regarding saleable volume and the value whey cream has in the marketplace. The brief also highlighted testimony that some processors do not return whey cream back into their cheese vats. The brief concluded that the butterfat adjustment contained in the protein price formula should be reduced by \$0.016 to account for the lower value and saleable volume of whey cream.

Comments filed by IDFA in response to the tentative partial final decision took exception with the denial of Proposal 9. IDFA argued that record evidence demonstrates that whey cream has a lower value in the marketplace than butterfat used to produce Grade

AA butter. According to IDFA, opponents of Proposal 9 speculated as to how much whey cream is re-used in cheese manufacturing but did not provide any specific examples where the whey cream is valued at or above the value of butterfat in Grade AA butter. IDFA referenced hearing testimony from numerous cheese manufacturers who testified that they did not use whey cream in the cheese manufacturing process.

The witness appearing on behalf of Agri-Mark supported adoption of adjusting the Class III protein price component to account for the lower value of whey butter (Proposal 10). The witness estimated that 0.42 pounds of whey butter is made from a hundredweight of milk and is sold at a price below the Grade AA butter price. According to the witness, Agri-Mark sells its whey butter for \$0.074 per pound less than its Grade AA butter. The witness was unaware of any public data or published reports on market prices for whey butter and was of the opinion that there are very few manufacturers making whey butter in the United States.

The post-hearing brief filed on behalf of Agri-Mark et al. contended that the product price formulas should recognize the lower value and saleable volume of whey cream and urged the adoption of Proposal 9. The brief summarized record evidence regarding plant whey cream prices and volumes and insisted that lower whey cream values are a market reality that should be reflected in the product-price formulas. Agri-Mark et al. reiterated this view in comments and exceptions filed in response to the tentative partial final decision. Agri-Mark et al. stated that despite a lack of widely available whey cream price data, USDA should still make an adjustment to the price formulas to recognize its lower market value.

A witness appearing on behalf of Leprino testified in support of Proposal 9. The Leprino witness reviewed the derivation of the current cheese yield per pound of fat in the Class III product-price formula using a Van Slyke formula with an assumed butterfat recovery rate of 90 percent and a moisture content of 38 percent. The witness asserted that the Class III formula implies that 0.035 pounds of butterfat per cwt of milk is recoverable as whey cream but is valued in the Class III pricing formula as if it was used to produce 0.042 pounds of Grade AA butter. However, the witness asserted that all whey cream is used to produce Grade B butter which has a lower value than Grade AA butter. Based on testimony from Agri-Mark,

LOL and NDA, the witness estimated that under the Class III price formula, cheese manufacturers in the Northeast and Pacific Northwest are being charged 12.5 and 20.4 cents, respectively, per pound of butterfat in the whey cream more than what these products can be sold for in the marketplace. The witness was unaware of any publicly available data on national whey cream production volumes and prices.

The Leprino witness testified that the Class III formula also overestimates the volume of butterfat recoverable as whey cream. With an assumed 90 percent butterfat recovery rate, the witness said that the formulas infer the remaining 10 percent of butterfat is captured as whey cream. However, the witness explained that only 7.8 percent of the butterfat is actually recoverable because some butterfat is incorporated into dry whey or the skim portion of the salt whey that must be disposed.

The Leprino witness testified that Proposal 9 would amend the Class III formula to better account for overvaluing the theoretical volumes and market values of whey cream. The witness explained that the butterfat credit in the protein portion of the Class III formula should be increased from 90 to 92.20 percent to acknowledge and correct for the 7.8 percent of butterfat that is recoverable as whey cream. In addition, the witness maintained that the butterfat portion of the Class III formula should be reduced by \$0.016 to account for the lower price manufacturers receive for Grade B butter. The witness estimated that these changes would have lowered the Class III price by \$0.169 per cwt over the last five years. The witness revealed that Leprino uses all of its whey cream in its cheese production and therefore is able to recoup the cheese value for all its milk components.

A post-hearing brief filed on behalf of Leprino stressed that the butterfat portion of the Class III formula should actually be reduced by \$0.021 because hearing testimony from other witnesses revealed that 2007 whey prices in the Pacific Northwest were significantly lower than those in 2005 and 2006. The brief highlighted testimony that the 2005–2006 Pacific Northwest average whey cream sale price was 94.4 percent of the average Grade AA butter price while the 2005–2007 average whey price fell to 89.4 percent of the Grade AA butter price.

Comments to the tentative partial final decision filed by Leprino took exception to the denial of Proposal 9. Leprino reiterated arguments made during the hearing that the market value and volume of whey cream recoverable

in the cheesemaking process is overvalued in the product-price formulas, and that the decision ignored record evidence demonstrating these market realities. Leprino wrote that opponents of Proposal 9 did not offer any evidence of other higher-valued uses for whey cream, but they did acknowledge that whey cream for use in Grade B butter has a lower market value. Leprino also argued that even if there are higher-valued end uses for whey cream, that the ultimate use of whey cream is irrelevant. According to Leprino, if whey cream is sold at a discount to regular cream, then that should be reflected in the price formulas.

A witness appearing on behalf of Kraft supported adoption of Proposal 9. The witness indicated that on average, Kraft receives \$0.10 per pound less for whey butter than for Grade AA butter.

Comments to the tentative partial final decision filed by Kraft took exception to the denial of Proposal 9. Kraft argued that Proposal 9 should be adopted because the record demonstrates that whey cream has a lower market value than cream used to produce Grade AA butter.

A witness appearing on behalf of Saputo testified that the Class III pricing formula wrongly presumes that all cheese manufacturers have dry whey processing capabilities and can obtain a high value for dry whey in the marketplace. In reality, the witness said, manufacturers sell whey as whey protein concentrates, whey protein isolates or in liquid form that have widely disparate market values. According to the witness, assumptions regarding the production of dry whey may financially harm cheese manufacturers and could result in the accelerated consolidation of milk manufacturing. For these reasons, the witness supported the adoption of Proposal 9.

A witness appearing on behalf of Great Lakes Cheese (GLC) testified in support of adoption of Proposal 9. According to the witness, GLC is a cheese manufacturer whose plant in Adams, New York, annually processes 410 million pounds of milk into American style cheeses and by-products. The witness said that because milk components are lost in many stages of the cheesemaking process, the Federal order system should not have class prices that require manufacturers to pay for milk components that they are unable to use and sell. The witness illustrated by example the in-plant milk losses incurred from sanitizing equipment and the removal of sludge from the whey separator. In the

example, the witness estimated that in 2006, GLC lost \$23,770 worth of whey solids in the desludging process.

The GLC witness said that GLC's Adams facility produces one million pounds of whey cream annually and usually sells it for the Grade AA butter market price. In 2006, the witness stated, GLC received \$1.2425 per pound of whey cream fat and the average CME AA butter price was \$1.2405. However, the witness explained, because the average Class III butterfat price was \$1.3185 per pound (a \$0.076 price difference), it had to pay a higher price for the butterfat in raw milk than it could recover in the market.

A witness appearing on behalf of NDA testified that Federal orders should establish fair minimum prices for producer milk while ensuring that the product-price formulas reflect the true value of dairy products in the market. The witness stated that NDA receives significantly less for its whey cream sales than it does for sweet cream sales and that Proposal 9 or Proposal 10 should be adopted to reflect this reality in the product-price formulas. The witness estimated that, on average, from 2005 through 2007, on a butterfat basis, NDA sold its whey cream for 36 percent less than it sold its sweet cream and \$0.0244 per pound less than the Class III butterfat price. Therefore, the witness said, NDA supports IDFA's proposal to adjust the protein price to reflect the lower value of whey cream.

The NDA witness also explained that its average selling price for manufactured products is less than its reported prices to NASS because some of its production does not meet NASS specifications. The witness testified that products not meeting NASS specifications are either products made to meet specific customer orders or off-grade production such as cheese fines. The witness said that in fiscal year 2007, 3.98 percent of NDA's cheese production did not meet NASS specifications either by design or error. The volume was sold for a weighted average price of \$0.0218 per pound less than its NASS reported cheddar—lowering NDA's total average cheese price for the year by \$0.009 per pound, the witness said. The witness described similar scenarios for NDA's whey, NFD and buttermilk production.

The NDA witness revealed that in fiscal year 2007, NDA's Sunnyside, Washington, plant, which uses modern horizontal cheese vats, experienced a cheese yield of 10.22 pounds of cheese per cwt of milk with an average moisture content of 38 percent and a butterfat recovery rate of 92 percent. The witness noted that NDA's yield

reflects the use of whey cream added to the cheese vats.

A witness for Twin County testified in support of adopting Proposal 9. The witness asserted that the Class III price formula and current make allowances for cheese and dry whey overvalue milk components, particularly other solids, leading to reduced plant profitability. As a result, explained the witness, manufacturers are required to account to the marketwide pool for some components at the Class III price of milk even though they receive less than the Class III price for them in the marketplace.

The witness explained that Twin County produces cheddar cheese that meets particular customer specifications which do not allow for returning whey cream into its cheese-making process. Consequently, the witness said that Twin County invested in a whey processing facility to process its skim whey into whey protein concentrates (WPC), ultra filtered milk and permeate. According to the witness, Twin County sells all of its whey cream in the marketplace for approximately the Grade AA butter price times a multiplier of 1.12. The witness said that Twin County does fortify its cheese vats with additional milk solids when it is economically feasible and its average cheese yield (including fortification) is seasonal and ranges from nine to ten pounds of cheese per 100 pounds of milk. The witness said that while Twin County is required to account to the marketwide pool for all milk components at the Class III price, it sells the whey produced at a reduced price in the market resulting in a net loss to the company for those components. Additionally, while the current make allowances (effective March 2007) did improve the profitability of Twin County, the witness insisted that the whey make allowance is still inadequate in covering the whey manufacturing costs of the plant.

The Twin County witness conceded that the premiums it pays for milk could be adjusted downward to offset revenue losses. However, the witness indicated, renegotiating premiums with suppliers may have the unintended consequence of impeding or damaging long-standing relationships with suppliers and disrupt their ability to procure milk as needed.

The witness appearing on behalf of HP Hood also supported adoption of Proposal 9 or 10.

The post-hearing brief submitted on behalf of DairyIdea et al. opposed the adoption of Proposals 9 or 10. The brief did not dispute that whey cream has a lower value in the marketplace, but noted that there are also higher valued

uses for butterfat that are not recognized in the butterfat price. The brief concluded that it would be inappropriate to amend the butterfat value to recognize lower-valued whey cream without also recognizing higher-valued butterfat uses.

The post-hearing brief submitted on behalf of DPNM et al. opposed adoption of Proposals 9 or 10. The brief stressed that there is no publicly announced information regarding prices and volumes for whey cream or whey butter. The brief argued that record evidence demonstrates that a significant portion of whey cream is returned to the cheese vat and not sold as whey cream in the market. Exceptions to the tentative partial final decision filed by DPMN et al. expressed their continuing opposition to Proposal 9.

The post-hearing brief submitted on behalf of NAJ also expressed opposition to the adoption of Proposals 9 or 10. The brief said that if the value of whey butter is as low as the proponents claim, then a separate whey butterfat price should be established in lieu of lowering the protein price.

Separate comments to the tentative partial final decision submitted on behalf of Grande and Glanbia each took exception to the denial of Proposal 9. Grande and Glanbia both argued that record evidence indicates that whey cream has a lower market value than cream processed into Grade AA butter. Glanbia further insisted that while opponents to Proposal 9 claimed that other higher-value uses for whey cream exist, they provided no examples. Grande and Glanbia comments concluded that Proposal 9 should be adopted so cheese manufacturers will not be required to pay more for whey cream than can be recouped in the market.

Comments filed by WCMA also took exception with the denial of Proposal 9 in the tentative partial final decision. WCMA argued that whey cream is overvalued in the current product-price formulas because it is made into lower valued Grade B butter. WCMA was of the opinion that NASS should collect data on end uses and values of whey cream.

#### 4. Barrel-Block Cheese Price

The witness appearing on behalf of IDFA testified in support of eliminating the current 3-cent barrel-block price adjustment (Proposal 12). The witness maintained that there is no cost difference between block and barrel production, therefore the 3-cent adjustment should be eliminated. Furthermore, the witness said, the CPDMP data used to determine the

current make allowances takes into account the manufacturing cost difference between barrels and blocks. Maintaining the 3-cent adjustment would, the witness said, result in double counting of any purported cost difference. In its post-hearing brief, IDFA reiterated the need to eliminate the 3-cent barrel-block price adjustment.

Comments filed by IDFA in response to the tentative partial final decision opposed the denial of Proposal 12. IDFA argued that because cost data contained in the record demonstrates no difference in packaging costs between block and barrel cheese production, elimination of the 3-cent barrel-block spread is warranted.

A witness appearing on behalf of Davisco testified in support of Proposal 12. The witness offered evidence on Davisco's manufacturing costs for 40-pound block and 500-pound barrel cheese production at its LeSueur, Minnesota, plant. The witness explained that the LeSueur plant has separate block and barrel production lines that enable Davisco to easily isolate and compare packaging and capital costs. After discussing the differences in packaging and equipment needed to produce block cheese and barrel cheese, the witness testified that Davisco spends \$0.0012 per pound more to produce block cheese. According to the witness, its de minimis cost differences in producing block and barrel cheese warrant eliminating the 3-cent adjustment.

The witnesses appearing on behalf of Kraft, NDA and Saputo expressed support for adoption of Proposal 12. The Kraft witness testified that the 3-cent adjustment historically represented the additional cost of producing blocks instead of barrels. However, the Kraft witness asserted, the gross return between blocks and barrels (adjusted to 38 percent moisture) is approximately \$0.0075 per pound. Therefore, concluded the Kraft witness, it is no longer necessary to add 3-cents to the barrel cheese price because that cost difference is being recouped in the marketplace.

Separate comments filed by Grande and Kraft in response to the tentative partial final decision opposed the denial of Proposal 12. Grande and Kraft argued that record evidence demonstrates that there is no processing cost difference between block and barrel cheese. Kraft elaborated that the cost data contained in this hearing record is the first actual cost data contained in any hearing record that addressed the 3-cent barrel adjustment. Therefore, Grande and Kraft urged USDA to adopt Proposal 12 in the final decision.

While no testimony was received from proponents DFA and NDA regarding Proposal 13, a witness appearing on behalf of Kraft testified in opposition to eliminating the barrel cheese price from the Class III price formula (Proposal 13). The witness asserted that since 2000, the NASS cheese price survey represented approximately 57 percent barrels and 43 percent blocks. Therefore, the witness was of the opinion that it would be inappropriate to eliminate the barrel price from the Class III price formula because it would not reflect the actual prices of such a large part of the national cheese market.

The witness appearing on behalf of Leprino supported eliminating the 3-cent block-barrel adjustment. The witness asserted that the adjustment was originally added to the barrel cheese price because it was considered the standard cost difference between producing block and barrel cheese. The witness testified that the 3-cent adjustment was no longer necessary because the CPDMP cheese manufacturing cost survey used to derive the current make allowances already accounts for the cost difference. The witness explained that keeping the 3-cent adjustment would be double counting cost differences that may exist. According to the witness, the 3-cent adjustment was never based on actual cost data; rather it was a generally accepted valuation of the average production cost difference between producing 40 pound blocks and 500 pound barrel cheese at a 39 percent moisture standard. However, the witness noted that after January 2001 the barrel cheese price was adjusted to a 38 percent moisture standard. The witness asserted that this moisture standard change, on average, increased the barrel cheese price 2.2 cents per pound during the last 5 years. The witness estimated that eliminating the 3-cent barrel-block adjustment would reduce the Class III price by \$0.1624 per cwt.

The Leprino witness also opposed adoption of Proposal 13 because it would reduce the amount of data used to compute the classified milk prices. The witness said that the barrel cheese price should continue as a factor in computing the Class III price because of the additional cheese volume for which it accounts.

Comments to the tentative partial final decision submitted by Leprino opposed the denial of Proposal 12. Leprino disagreed with the reasoning advanced in the tentative partial final decision that differences in selling prices have no causal relationship to

differences in manufacturing costs. Leprino argued that the 3-cent cost add-on was originally incorporated into the product-price formulas because historically the selling price difference between blocks and barrels was 3-cents. This difference in selling prices, Leprino asserted, has always been attributed to manufacturing cost differences. Regardless, Leprino added that the Davisco plant cost data contained in the record proves that the difference in packaging costs between blocks and barrels is negligible; therefore Proposal 12 should be adopted. Leprino's comments were endorsed by Glanbia.

The post-hearing brief submitted on behalf of Agri-Mark et al. maintained that the 3-cent barrel adjustment should be eliminated and supported the views of the IDFA witness and its post-hearing brief urging the adoption of Proposal 12. Agri-Mark et al. reiterated this view in its comments and exceptions on the tentative partial final decision. Agri-Mark et al. argued that proponents of the elimination of the 3-cent add-on had provided enough record evidence to meet their administrative burden. Agri-Mark et al. summarized the regulatory history of the 3-cent barrel adjustment. They argued that record evidence by the Davisco witness demonstrated that the packaging cost difference between block and barrel cheese is negligible, and maintained that opponents of its elimination offered no rebuttal evidence.

The post-hearing brief submitted on behalf of Dairylea et al. opposed eliminating the 3-cent per pound barrel-block cheese adjustment as advanced in Proposal 12. The brief expressed the opinion that cost data from one cheese plant offered by Davisco Foods is not adequate to support adopting the proposed change. According to the brief, cost data presented by Davisco Foods only compared packaging and capital costs for producing barrel and block cheese. The brief argued that despite Davisco's belief that total manufacturing costs before packaging were the same, there may be differences in other processing costs because block and barrels are produced at different moisture contents. The brief asserted that if Davisco Foods cost data is adjusted to reflect average moisture content for blocks (37.75 percent) and barrels (34 percent), the cost of capital and packaging for blocks would be 10 percent higher than for barrels.

The Dairylea et al. brief also addressed the proponents' assertion that incorporating CPDMP data into the determination of new make allowances provides the necessary recognition of



the cost difference between block and barrel production. The brief argued that CDF data only includes cost data from block production and its continued use would mean that new make allowances would be too heavily weighted towards block production. The brief also asserted that evidence showing the market price relationship between blocks and barrels does not provide a basis to conclude that similar cost changes have occurred in the manufacturing costs of block and barrel cheese.

In its brief, DPNM et al. opposed the reduction or elimination of the 3-cent barrel price adjustment (Proposal 12) unless Proposal 15 was adopted. The brief explained that Proposal 15 (using the CME to determine product prices) is intended to use only the CME block cheese price, not an average of the 500-pound barrel and 40-pound block prices. If Proposal 15 is adopted as intended, DPNM et al. wrote, the 3-cent barrel adjustment would no longer be necessary.

Comments filed by DPNM et al. in response to the tentative partial final decision supported the continued use of the 3-cent barrel price adjustment if USDA continues to use both block and barrel survey prices in the Class III price formulas.

##### 5. Product Price Series

A witness appearing on behalf of Agri-Mark testified in support of Proposal 14. The witness said that the proposed price series would use a combination of the NASS and CME cheese prices in the Class III product-price formula. The witness said that Proposal 14 seeks to incorporate current CME data to reduce the monthly differences between prices that most manufacturers sell their cheese and the cheese price from which the manufacturers cost of raw milk is determined. The witness said that cheese manufacturers use the CME cheese price to set their base cheese price which is then reflected in the NASS cheese price announced two weeks later. The witness explained by example that the two week lag between CME and NASS price releases was a problem in 2004 when cheese prices were rapidly changing from week-to-week causing the two price series to vary by more than 10 cents per pound during seven months of the year. According to an analysis conducted by the witness from January 2000 until February 2007, 98 percent of the variation in the NASS block cheese price and 87 percent of the variation of the NASS barrel cheese price could be explained by the CME price.

The Agri-Mark witness provided an example to illustrate how Proposal 14 could be administered. The witness explained that the cheese price in the Class III formula for April 2007 would be calculated as follows: (1) Compute the average CME cheese price for the four weeks in April; (2) add the average NASS cheese price for the last two weeks of March and the first two weeks of April; and (3) subtract the average CME cheese price for the four weeks of March. The Agri-Mark witness explained that the cheese price used to determine the advanced Class I price should be as follows: (1) Compute the average CME cheese price for the second and third weeks of March; (2) add the average NASS cheese price for the first and second weeks of March; and (3) subtract the average CME cheese price for the last two weeks of February. The witness was of the opinion that these new formulas would enable USDA to use current CME prices while in the long-run the NASS price series would continue as the primary determinant of cheese prices. The witness was of the opinion that the resulting "hybrid price" would reduce large monthly price variations like those experienced in 2004. The witness said that Agri-Mark does not support the sole use of CME prices in the price formulas because of low trading volume and the possibility of price manipulation.

The Agri-Mark witness indicated that adopting this hybrid price would not significantly change the average USDA cheese prices or FMMO producer blend prices. The witness estimated that the average Class III prices would have been approximately \$0.005 per pound less and the Northeast order producer blend prices would have averaged \$0.003 per cwt less using this hybrid price during 2003–2006. The witness did not see a need to compute a hybrid price for butter because the lag between the CME and NASS price reporting is not a problem.

In their post-hearing brief, Agri-Mark et al. reiterated their support for adoption of Proposal 14 and opposition to adopting Proposals 15 and 18, both of which are discussed subsequently.

In their comments and exception to the tentative partial final decision, Agri-Mark et al. expressed support for USDA's decision to deny Proposals 14, 15 and 18.

A witness appearing on behalf of DPNM et al. testified in support of using CME product prices in the FMMO price formulas as advanced in Proposal 15. The witness was of the opinion that the CME is a superior price discovery mechanism. The witness asserted that the time lag associated with the NASS

price survey has, at times, created huge differences between the advanced Class I and Class II prices and the monthly prices that are incorporated into the Class III and Class IV formulas. The witness opined that the time lag associated with using the NASS price survey sends incorrect price signals to producers and that it creates a disincentive for manufacturers to seek higher product prices in the market as it results in increased raw milk costs.

The DPNM et al. witness testified that NASS product prices track closely with CME prices for cheese and butter. However, the witness said, the NASS NFDM price does not reflect the current cash market. The witness stated that the NFDM market is unique because there are only a few sellers and they tend to use the previous week's NASS NFDM price to sell their products. The witness stated that there has been a growing price disparity between the NASS NFDM price and the NFDM price reported by Dairy Market News. According to the witness, during the first quarter of 2007, the monthly NASS NFDM prices averaged \$0.12 per pound less than what was reported as the average Western Mostly NFDM price by Dairy Market News. The witness calculated that this resulted in Class II and Class IV prices that were \$1.03 per cwt lower. The witness asserted that the price discrepancy could be a reporting error, noting that NASS does not have the authority to audit its surveyed price data.

The DPNM et al. witness testified that CME product prices could become the preferred price discovery mechanism because they originate in a public market that, since 1997, has expanded trading times and the number of dairy products traded. The witness stressed that CME product prices are more reflective of the current market for cheese, butter and dry whey because many manufacturers refer to the current CME product price when making their sales. The witness added that the involvement of the Commodity Futures Trading Commission (CFTC) provides for regulatory oversight. However, the witness testified that NFDM is not actively traded on the CME because packaging specifications require that NFDM traded on the CME be in government-specified bags. The witness was of the opinion that if the packaging requirement was changed, then the CME would become a viable market for NFDM.

The brief submitted by DPNM et al. expressed support for adoption of Proposal 15 and reiterated the position that NASS product price surveys should be replaced by CME product prices in

each of the price formulas except for the other solids formula. According to the brief, since the other solids formula uses the NASS dry whey price and the CME does not have a cash traded dry whey price, continued use of the NASS dry whey price is appropriate. The brief indicated that the use of CME prices would alleviate timing and circularity issues associated with relying on NASS survey prices. The brief noted that this position is supported in a June 2007 General Accountability Office (GAO) study.

The DPNM et al. brief expressed support for using a competitive pay price series to establish classified Federal order milk prices. However, the brief expressed the opinion that Proposal 18 needs to be more fully developed. It further requested that USDA investigate the use of a competitive pay price and convene a hearing to consider it as an alternative to NASS survey price information.

DPNM et al. exceptions to the tentative partial final decision stated their opposition to the denial of Proposal 15. They reiterated arguments made in their hearing testimony that the NASS survey is vulnerable to manipulation. Consequently, DPNM et al. advocated use of the CME prices in the product-price formulas to provide for transparent market signals.

A witness appearing on behalf of the Maine Dairy Industry Association (MDIA) testified in support of Proposal 18. According to the witness, MDIA is an association that represents all of Maine's 350 dairy farmers. The witness said that Proposal 18 seeks to establish an average competitive pay price for milk by incorporating a factor into the other solids portion of the Class III price formula to account for any monthly spread between the component prices for milk and a competitive pay price for equivalent Grade A milk. The witness was of the opinion that a competitive pay price is a superior method to product-price formulas in determining the value of milk used to set regulated minimum prices. The witness contended that butter, NFDM, cheese and dry whey each have a separate market that responds to unique supply and demand factors. The witness explained that in a competitive pay price system, buyers pay for raw milk according to the supply and demand conditions of the particular market in which they operate.

The MDIA witness stated that USDA has previously considered competitive pay price mechanisms for pricing Class III milk. The witness explained that a 1994–1996 simulated analysis conducted by USDA revealed several

difficulties with competitive pay prices, such as: (1) The inability to eliminate the influence of regulated minimum prices; (2) inadequate vigorous competition among buyers of milk; and (3) the problems associated with using a competitive pricing scheme based on the competitive situation for milk in Minnesota and Wisconsin. The witness explained that these limitations formed the basis for Proposal 18.

The MDIA witness explained how Proposal 18's competitive pay price would be administered. The witness said that geographic areas where an adequate level of competition for milk exists should be determined by computing a Herfindahl index for each county. The witness said this index is a measurement of market competitiveness wherein a low Herfindahl index indicates more competition for milk. For example, competition for milk in a county with a value of 0.3450 is greater than in a county with a value of 0.3500. The witness proposed that competitive price zones be determined by aggregating clusters of ten or more contiguous counties with values below 0.33. The witness said that an ideal situation would be if at least a third of the manufacturing milk in Federal order marketing areas were competitive price zones. The witness explained that handlers purchasing milk within these zones would be exempt from paying minimum classified prices, but would still be required to pay current differentials for Class I and Class II milk. According to the witness, these differentials would be pooled and producers within the competitive price zones would receive a 12-month rolling average producer price differential (PPD). Handlers would still pay regulated classified prices for milk produced outside of these zones, the witness said.

According to the MDIA witness, market administrators would collect actual payment data from handlers for milk purchased within the competitive price zones for the preceding month and estimated payments for the current month. The market administrators would then compute a weighted average price and deduct from that price the 12-month rolling average PPD for the month. This residual would be the value of manufacturing milk in the competitive price zone. A national average competitive manufacturing milk price would then be computed by aggregating the average price and volume data from all reporting competitive price zones. This result would become the new minimum Class

III price for milk purchases outside of the competitive price zones.

The MDIA witness said that the computation of protein and fat prices would be unchanged under its competitive price proposal. However, the other solids price would be the residual value of the Class III price once the values of butterfat and protein were deducted. The witness explained that indirect compensation to farmers, such as hauling charges, would not be included in the computation of a weighted average price. However, the witness also noted that Class III milk prices could potentially be decreased if manufacturers choose to exploit a "loophole" and shift more monies into hauling subsidies.

The MDIA witness asserted that, over the long run, producers located inside competitive price zones would receive the same revenue for their milk as producers located outside of competitive price zones. The witness did not know if Proposal 18's pricing method would generate higher or lower prices to all producers than the prices generated by the current end-product pricing system.

The MDIA witness was of the opinion that the largest group of counties in competitive price zones would be in the Upper Midwest (UMW) marketing area because of the large number of cheese plants competing for a milk supply. The witness predicted that this would most likely lead to a weighted average competitive pay price that is heavily influenced by prices paid by UMW plants that historically have been higher than Federal order minimum prices. The witness conceded that a competitive pay price heavily weighted to conditions in the UMW would not reflect national supply and demand conditions.

A Maine dairy farmer appearing on behalf of the MDIA testified in support of Proposal 18. The witness testified that Maine is not an area regulated by the Federal milk marketing order program, but that producer prices in Maine are heavily influenced by those established under the Northeast order. The witness stated that, in the face of Federal minimum prices that are too low and driven by unpredictable price swings for dairy products, Maine dairy farmers have had to turn to alternative sources of income including state subsidies and increased equity financing to keep their farms operating. After adjusting USDA cost of production information for Vermont to account for lower labor and feed costs, the MDIA witness estimated the cost of production for a Maine dairy farmer in 2004, 2005 and 2006, to be \$19 per cwt, \$20 per cwt

and \$24 per cwt, respectively. The witness compared this price to the Northeast Federal order mailbox prices of \$16.29 per cwt, \$15.39 per cwt and \$13.22 per cwt in 2004, 2005 and 2006, respectively. Using the Vermont cost data and the Northeast Federal order price data, the witness estimated that for a medium-sized Maine dairy farm with 150 cows, average net income fell by \$70,000 in 2004, \$140,000 in 2005, and \$320,000 in 2006. The witness asserted that this increasing difference between revenue and costs illustrates why the Federal order pricing system needs to be amended to more fully reflect dairy farmer cost-of-production.

The MDIA witness also testified regarding two programs operated by the State of Maine. One program boosts revenue to Maine dairy farmers by distributing an over-order price payment determined by the Maine Milk Commission, and a second program provides for a subsidy payment from the State's general fund. However, the witness said that during recent months these payments have not been enough to make up for the difference between declining milk prices and increasing production costs. The witness was of the opinion that, in the long-run, these State programs cannot be relied upon to provide a stable marketplace for dairy farmers.

A post-hearing brief filed on behalf of MDIA reiterated the position that end-product pricing does not result in high enough prices for the dairy farmers of the northeastern region of the United States. MDIA stated that Proposal 18 is "a good starting point" from which to develop a competitive price scheme that would replace the current scheme which derives prices from the values of manufactured dairy products. The brief acknowledged that MDIA's proposal is complex and lacks much of the detail needed for its adoption. However, MDIA reiterated its position that the adoption of a competitive pay price system would improve the valuation of producer milk and the subsequent determination of minimum classified prices.

The MDIA brief argued that price discovery based on competitive conditions for milk is superior to milk prices derived from the market prices of manufactured dairy products. The brief insisted that prices derived using sound economic principles and accurate market data are crucial to accurate price determination. The brief stressed that ending a competitive pay price series for milk has harmed dairy farmers, especially in the northeastern, midwestern and southeastern regions of the country. The brief attributed observed price volatility in milk prices

to the use of end-product price formulas. The brief asserted that the product-price formulas and the logic underlying component pricing do not meet the articulated policy of the AMAA. The brief argued that the AMAA's paramount objectives are the stabilization and enhancement of producer income.

Exceptions to the tentative partial final decision filed by MDIA opposed the denial of MDIA's motion to reopen the hearing. The witness appearing on behalf of DairyLea supported using the CME cheese and butter prices as substitutes for the NASS surveyed prices as advanced in Proposal 15. The witness said that the industry already uses the CME to set base selling prices. The witness asserted that using NASS surveys to set minimum prices has resulted in disorderly market conditions because the time lag of NASS product price reporting results in short-term manufacturing losses. According to the witness, using the CME prices for butter and cheese to set minimum classified milk prices would eliminate the time lag issue and price circularity issues.

A post-hearing brief submitted on behalf of DairyLea et al. opposed adoption of Proposal 18 based on the conclusion that the record evidence is insufficient to support its adoption. Their post-hearing brief specifically expressed support for the portion of Proposal 15 proposing the use of CME prices for cheese and butter in the product price formulas. This was not supported by DFA. While DairyLea's brief expressed the opinion that using CME prices would address the issue of price circularity inherent in the NASS price survey, they did not support the use of CME prices for dry whey and NFDM.

In a separate post-hearing brief, DFA specifically expressed support for adoption of the hybrid price series advanced in Proposal 14. DFA emphasized that the hybrid price series would transmit more timely market signals to processors and producers by aligning the purchase price of milk with the market prices of milk products.

The witness appearing on behalf of IDFA testified in opposition to adoption of Proposal 14. The witness was of the opinion that using the proposed hybrid price would result in unnecessarily complex price formulas that would provide no tangible benefit to the industry. The witness acknowledged the problems associated with the time-lag of the NASS price series, but stated that there are alternative ways to address the lag adding complexity to the price formulas. Similar arguments were offered in IDFA's post-hearing brief.

The IDFA witness also testified in opposition to adoption of Proposal 15. The witness stated that the NASS product price survey provides the largest possible sample of wholesale prices and should continue to be relied upon in the product price formulas. The witness said that USDA's reasoning for relying on the NASS price survey in the Federal order reform decision is still relevant. The witness was of the opinion that many of the complaints associated with the NASS price series could be remedied if price reporting to NASS were electronic, mandatory and audited. IDFA insisted in its post-hearing brief that using the CME to determine product prices could result in product prices unrepresentative of actual market sale prices and could encourage product trading on the CME solely to manipulate the minimum classified milk prices established under Federal orders.

The IDFA witness also testified in opposition to adopting a competitive pay price series as advanced in Proposal 18. The witness indicated that currently no reliable unregulated milk supply of adequate size exists to become the basis for a competitive pay price series.

The witness appearing on behalf of Kraft opposed adoption of Proposal 15 and supported the continued use of the NASS price survey to determine classified prices. The witness explained that the NASS price survey is national in scope and represents a significantly larger proportion of national cheese production than does the CME. The witness was of the opinion that if CME prices are used to determine classified prices, the growing volume of cheese production and sales in the western states would not be adequately represented. Therefore, the witness concluded, NASS survey prices best reflect the settled sales prices at the plants. The witness acknowledged the time lag between CME prices and the NASS survey prices and insisted that a better solution to the time lag problem would be to require timelier reporting of prices to NASS rather than abandon the NASS price survey.

The witness appearing on behalf of Saputo opposed the adoption of Proposals 14 or 15 and indicated support for the continued use of the NASS price survey. The witness was of the opinion that timelier reporting of prices to NASS would counter asserted problems associated with the lag between the CME and NASS survey prices. The Saputo witness opposed using the CME to set minimum prices because, in the witness' opinion, the CME is too thin a market to provide accurate market signals.

The witness appearing on behalf of Leprino testified in opposition to Proposal 15 because of the low volume of cheese that is traded on the CME as compared to the volume of cheese production that is represented in the NASS survey. The witness also testified that Leprino is not concerned with the time lag between the CME prices and the NASS price survey. The witness was of the opinion that the time lag is predictable and manageable for manufacturers.

The witness appearing on behalf of LOL testified in opposition to Proposal 15. The witness was of the opinion that the more appropriate solution to the problem of increased manufacturing costs is a more timely method of updating make allowances and not the use of the CME to derive classified prices. The witness argued that the NASS price survey is more representative of the national cheese market while the CME continues to remain a thinly traded market.

The witness appearing on behalf of HP Hood opposed adoption of Proposal 18 because of the lack of analysis available to determine its utility.

A post-hearing brief filed on behalf of O-AT-KA stated that Proposal 18 may warrant further consideration but it should not be adopted in this proceeding.

Comments to the tentative final partial decision filed separately by IDFA, Grande, Glanbia, Kraft, Leprino and WCMA expressed support for the denial of Proposals 14, 15 and 18.

#### 6. Other Solids Price

A witness appearing on behalf of NAJ testified in support of adopting Proposal 16. The witness was of the opinion that the value of dry whey should be derived primarily from its protein content, rather than its other solids content as it is currently computed. The witness acknowledged that from August 2006 to February 2007 the NASS dry whey price more than doubled from 29.65 cents per pound to 60.05 cents per pound and the lactose price reported in Dairy Market News increased from 33.89 cents per pound to 59.34 cents per pound. The witness was of the opinion that the recent increase in lactose prices is reflective of a shortage in lactose processing capacity and not a lack of available lactose. The witness believed that the higher dry whey and lactose prices prior to the fall of 2006 justify valuing dry whey on a protein rather than on an other solids basis. According to the NAJ witness, if Proposal 16 had been in place from April 2003 to September 2006, the Class III price would have been one-cent per cwt

higher and only marginally higher since September 2006.

The NAJ witness testified that from 2003 to 2006 dry whey production only increased 1.5 percent, while the increased production of whey protein concentrates (WPCs) ranged from 6.6 percent to 45.5 percent depending on the percent protein in the WPC. The witness concluded that purchasers of whey solids prefer WPC products that are high in protein. It is this preference that led the witness to conclude that dry whey should be priced on a protein basis.

Using Dairy Market News' monthly prices since January 2000, the witness discussed the costs of buying a pound of protein (protein parity) and a pound of lactose (lactose parity) in dry whey or WPC-34 (34 percent protein). The witness concluded that, in all months, the average price per pound of protein in dry whey or WPC-34 exceeded the average price per pound of lactose. The witness also asserted that the cost per pound of lactose in WPC-34 is higher than if lactose were purchased separately. According to the witness, this price relationship reveals that buyers of dry whey and WPCs are purchasing these products for their protein content rather than for their lactose content. The witness also emphasized that the value of protein in dry whey and WPC-34 more closely reflect each use than does lactose value contained in the two products.

The NAJ witness also offered a modification to Proposal 16 such that the NASS price surveys would be expanded to include collection and reporting of market prices for various WPC's and lactose. The witness said this would build a dataset for use in future rulemakings to consider the appropriate valuation of whey solids.

A post-hearing brief filed on behalf of NAJ reiterated positions given in testimony. According to the brief, the current other solids price formula does not reasonably connect the market value of whey solids which NAJ maintains is based on its protein content and how producers are paid for whey.

NAJ stated its opposition to the denial of Proposal 16 in its exceptions to the tentative partial final decision. NAJ argued that counter to what USDA found as a flaw in Proposal 16, one of its strengths is its revenue neutrality. NAJ was of the opinion that adoption of Proposal 16 would give producers a financial incentive to increase their milk protein content. NAJ reiterated arguments that Proposal 16 would allow manufacturers to account to the pool for protein, the component in whey that is most valued, while also simplifying the

product-price formulas. NAJ was also of the opinion that USDA's decision to only make changes in the product-price formulas to the make allowances and the butterfat yield factor indicates its unwillingness to amend other factors in the formulas.

The witness appearing on behalf of IDFA opposed adoption of Proposal 16 because it was too complex and would inappropriately value whey based on its protein content when it is comprised mainly of other solids. The witness said that USDA's preliminary economic analysis demonstrates that adoption of Proposal 16 could increase the cost of high protein milk while lowering the cost of low protein milk. However, milk's other solids content (primarily whey) does not change in relationship to the protein content, the witness said. The witness also stated it would be inappropriate to price dry whey on its protein content since protein does not affect whey yields.

The witness appearing on behalf of Leprino testified in opposition to Proposal 16 because its adoption would result in distorted milk component values. The witness insisted that since dry whey yields are primarily driven by the lactose content of milk and the other solids composition, it would be inappropriate to price whey on its protein content.

The post-hearing brief filed on behalf of Agri-Mark et al. opposed adoption of Proposal 16 arguing that the price of other solids would then be determined on its protein component which has no impact on yield. The brief claimed that since there is no standardized protein content for whey, adoption of Proposal 16 could result in significant over-valuing of the protein in whey. However, the brief supported NAJ's call for USDA to collect manufacturing cost and price data for WPCs and lactose on the basis that it would provide data on how to appropriately value whey solids for use in future proceedings.

The post-hearing brief filed on behalf of Dairylea et al. opposed adoption of Proposal 16 because it would not add value or efficiency to the product price formulas.

The post-hearing brief filed on behalf of DPNM et al. opposed the adoption of Proposal 16. However, the brief did express support for NAJ's call for USDA collection of prices, manufacturing costs and volumes for whey protein concentrates and whey protein isolates.

Comments filed separately by Agri-Mark et al.; DPNM et al.; IDFA; Grande; Glanbia; Kraft and Leprino in response to the tentative partial final decision expressed support for the denial of Proposal 16.

A witness from Pennsylvania State University offered testimony on the use of an econometric model framework to analyze changes to the Federal milk marketing orders from all the proposals under consideration and provided the results at the hearing. The testimony was not given on behalf of the Pennsylvania State University. The witness testified neither in support of, nor in opposition to, any proposals. The witness explained that the model is a short-run, supply-side model that does not take into account changes in milk demand. The witness said that the model was used to analyze scenarios as outlined in the USDA preliminary economic analysis that was based on the USDA Baseline Projections to 2015. The witness concluded that the USDA preliminary economic analysis did not accurately reflect changes in the milk supply because it did not adequately account for the increase in feed prices and the resulting effect on producer decisions.

A witness testifying on behalf of the Ohio Farmers Union (OFU), National Farmers Union (NFU) and the National Family Farm Coalition (NFFC) called for the hearing to be terminated because dairy farmers continuously face low milk prices and high input costs, and that these concerns were not being addressed in this proceeding. The witness was of the opinion that the FMMO system was no longer accomplishing its mission of returning market power to dairy farmers.

#### 7. Energy Cost Adjuster

A witness from NMPF testified that energy costs are the most volatile manufacturing input cost in dairy manufacturing. The witness asserted that increases in energy costs have countered many of the measures manufacturers have taken to increase productivity and efficiency.

The NMPF witness testified that the current make allowance levels reliance on a fixed energy cost derived from information that existed at a single point in time is no longer appropriate. The witness said USDA should instead adopt a monthly energy price adjuster to capture the change in energy prices that may occur from month to month. The witness explained that the base energy cost should be derived from surveyed energy costs in the manufacturing cost surveys used to determine the make allowances. If two or more surveys were used to determine make allowances, then the energy costs of each survey should be weighted accordingly, the witness said. According to the witness, an energy price adjuster would then be

added (or subtracted) to the base energy cost value.

The NMPF witness explained that the energy price adjuster should be computed using the Bureau of Labor Statistics Producer Price Indexes for Industrial Electricity and Industrial Natural Gas (PPI). The witness said that the time period selected for the energy price adjuster should correspond with the same time period of the manufacturing cost survey data. The witness suggested the use of the monthly PPI series for several energy products and proposed 2005 as the base period from which percentage changes would be calculated. The witness stressed that if an energy price adjuster is not adopted, then the make allowances that are determined as a result of the current proceeding may become obsolete prior to implementation.

The NMPF witness said that the adoption of a monthly energy price adjuster would help maintain equity between producers and manufacturers given that processors would not be unduly harmed when energy prices rise while producers would not be harmed when energy prices fall. The witness was of the opinion that it was not necessary to establish monthly indexes for other cost factors contained in the make allowances.

The NMPF witness asserted that if an annual manufacturing survey as offered in Proposal 2 is adopted, then an energy cost factor should be used in making monthly adjustments to make allowances. The witness was of the opinion that even if make allowances were updated on an annual basis, manufacturing cost data as old as 24 months would be incorporated. According to the witness, energy prices vary so much over short time periods that make allowances are essentially using a fixed energy cost factor which results in make allowances that are neither timely nor accurate.

A post-hearing brief filed on behalf of NMPF reiterated their testimony in support of the adoption of Proposal 17. NMPF's brief offered various methods USDA could use to determine an appropriate base energy cost factor and corresponding monthly energy price adjuster.

The NMPF brief also addressed other hearing participants' objections that an energy price adjuster would inhibit a plant's ability to use the futures markets to hedge risk. The brief said that while energy futures can be used to reduce energy price volatility, a plant is more likely to lock in a high energy price if that plant predicts energy costs will rise above levels covered by current make

allowances. The brief also argued that the use of energy futures may not be applicable for balancing plants facing unpredictable energy costs due to large seasonal fluctuations in product output.

A witness appearing on behalf of MMPA testified in support of Proposal 17. The witness said that the large fluctuations in gas and energy prices in recent years demonstrate the need for an energy price adjuster in the determination of make allowances. The witness also stated that adoption of the adjuster would ensure that manufacturers could recover increased energy costs while also preventing financial windfalls should energy prices decrease. Agri-Mark, Dairylea and O-AT-KA also offered support for Proposal 17 in their post-hearing briefs.

The witness appearing on behalf of IDFA testified in opposition to the adoption of Proposal 17 and was of the opinion that adoption of the proposal would complicate manufacturers' ability to manage risk. IDFA reiterated these arguments in its post-hearing brief. Kraft, Lactalis, HP Hood and Leprino supported IDFA's position opposing the adoption of Proposal 17.

With the exception of DPNM et al., Proposal 17 was supported by all producer organizations that market the milk of dairy farmers who participated in this proceeding, including those who manufacture NFDM and dry whey. The record reflects that manufacturers of NFDM and dry whey, in particular, intensively use either natural gas or electricity in their drying processes. Accordingly, proponents favored the ability of an energy cost adjuster to reflect actual natural gas or electricity prices in minimum prices paid for producer milk. Supporters also testified that this feature would account for monthly energy price changes without permanently decreasing the value of producer milk until subsequent rulemaking changes to make allowance levels can be made.

Opposition to Proposal 17 was universal among IDFA, along with its member companies Saputo, Kraft, H.P. Hood and Leprino, who testified at the hearing. The central themes of their opposition were that a monthly energy adjuster would undermine the value of existing risk management tools, and increase the complexity of product price formulas. DPNM et al. also opposed adoption of Proposal 17 because, they assert, it would add complexity to the pricing system.

#### 8. Cost-of-Production Add-on

A witness appearing on behalf of Dairylea testified that manufacturing plants would negotiate a price for the

applicable product with wholesale customers that included a factor reflecting manufacturing costs not reflected in the pricing formula make allowances. The witness said that these surcharges, or "add-ons," would not be included in the NASS price survey and therefore would not affect Class III and Class IV prices. According to the witness, the negotiated add-ons would be capped at a maximum amount to be determined through a separate formal rulemaking.

The Dairylea witness explained that when a dairy manufacturer attempts to pass on its higher manufacturing costs by charging higher prices to its customers, the price increase is captured in the NASS price survey which, in turn, increases a manufacturer's raw milk costs through higher Class III and Class IV prices. The witness described this as a "price circularity" problem. The witness was of the opinion that Proposal 20 provided a method whereby dairy processors could pass on higher manufacturing costs not reflected in the product-price formulas to customers without those higher prices being reflected in the NASS price survey. According to the witness, classified prices would not be affected by a change in manufacturing costs.

The Dairylea witness acknowledged that manufacturers have experienced higher processing costs than those that are represented by the current make allowances. However, according to the witness, higher make allowances cause dairy farmers to receive lower prices for their milk even though they also face higher production costs. The witness said that because dairy farmers are unable to pass on their higher costs of production, as a matter of fairness and equity, processors should seek needed manufacturing cost recovery through the price they charge their customers, rather than through the price they pay dairy farmers for raw milk.

The Dairylea witness emphasized that while the manufacturing cost add-ons would not be included in the NASS price survey, any amount a manufacturer charged in excess of the cost add-ons would be required to be reported to NASS. The witness testified that the maximum manufacturing cost add-on should only be changed through formal rulemaking and that the value of a cost add-on should never be negative. The witness was of the opinion that the National Fluid Milk Processors Promotion Program (MilkPEP) check-off assessment administered by AMS and the in-state over-order premium program administered by the Pennsylvania Milk Marketing Board are

examples of successful programs providing for surcharges.

The Dairylea witness viewed adoption of an energy price adjuster to modify make allowances as detailed in Proposal 17 to be a complement to Proposal 20. The witness explained that any change in the energy price adjuster should be subtracted from the value of the manufacturing cost add-on. For example, the witness explained that for a given month, if the manufacturing cost add-on for cheese was determined to be \$0.0029 per pound and the energy price adjuster was \$0.0023 per pound, then the maximum cheese manufacturing cost add-on for that month would be \$0.0006 per pound. In months when the energy price adjustment was greater than the maximum cost add-on, then the cost add-on for that month would be zero, the witness said.

A joint post-hearing brief filed on behalf of Dairylea and Dairy Farmers of America (Dairylea et al.) reiterated that adoption of the cost add-on would address the price circularity problem inherent to the NASS price survey. The brief argued that the Federal order system needs to evolve such that manufacturing cost increases can be fully passed on to consumers without lowering the value of producer milk used to make Class III and Class IV products.

The Dairylea et al. brief emphasized that opposition to the adoption of Proposal 20 was based on the invalid assumptions that: (1) Manufacturing plants would not be able to negotiate cost add-ons, and (2) manufacturing plants regulated by Federal orders would become disadvantaged. The brief noted that a NFDM processor has been successful in negotiating an energy cost surcharge with its customers, despite competition from non-pool NFDM plants located in the United States and abroad. The brief also countered opposition arguments suggesting that a buyer would simply purchase finished products on a spot basis from the Chicago Mercantile Exchange (CME) to avoid paying a manufacturing cost add-on. The brief asserted that manufacturing plants, regardless of pool status, would not give up the opportunity to maximize profit by charging a cost add-on.

The witness appearing on behalf of HP Hood testified as being receptive to the manufacturing cost add-on feature of Proposal 20 without offering any further details or justification.

The witness appearing on behalf of IDFA testified in opposition to the adoption of Proposal 20. The witness disagreed with the assertion that all manufacturers would be able to

negotiate cost add-ons with their customers. The witness insisted that manufacturers unsuccessful in negotiating the cost add-on would only be able to recoup manufacturing costs equal to the product-price formula's make allowances. The witness argued that the examples of successfully administered surcharges—the Milk PEP check-off assessment and the Pennsylvania Milk Marketing Board over-order premiums—are misleading because they involve regulated charges that processors are required to pay. The witness was of the opinion that Federally regulated manufacturers would be harmed by the adoption of manufacturing cost add-ons because customers would simply seek a lower-cost product from other manufacturers whose milk is not priced by an order or would make spot purchases of product from the CME.

In characterizing that all cheeses have a price relationship in the market, the IDFA witness strongly disagreed that a commodity cheddar cheese manufacturer could include a cost add-on in its sales price. According to the witness, cost add-ons change the price relationship of commodity cheddar to other cheese varieties in the marketplace and as a result, cheesemakers buying pooled milk would be at a competitive disadvantage to those buying non-pooled milk. IDFA reiterated their opposition to the adoption of Proposal 20 in their post-hearing brief.

The witness appearing on behalf of Lactalis found merit with the intent of Proposal 20 but thought its method too complex and impractical, and therefore opposed its adoption. According to the witness, Lactalis operates six cheese plants in the United States. The witness was of the opinion that Federally regulated manufacturers would not be able to consistently and successfully negotiate a higher sales price with their customers to compensate for higher manufacturing costs.

In their post-hearing brief, Agri-Mark et al. opposed adoption of Proposal 20 on the grounds that it assumes plants can successfully negotiate manufacturing cost add-ons to recoup increased manufacturing costs. The brief expressed the opinion that a manufacturing cost add-on scheme would only be successful if all plants, including unregulated plants, simultaneously increased prices and clearly labeled the cost add-on on all invoices so that the add-on would not be included in the NASS price survey. The brief asserted that unregulated manufacturing plants have no incentive to report a manufacturing cost add-on

because NASS prices do not impact their raw milk costs in the same way as plants regulated by Federal orders. The brief also stressed that if plants were unsuccessful in negotiating a manufacturing cost add-on, they would likely be unable to obtain cost relief elsewhere.

In their post-hearing brief, DPNM et al. opposed the adoption of a manufacturing cost add-on in an attempt to eliminate the circularity problem inherent to the NASS survey (now administered by AMS). DPNM et al. was of the opinion that USDA resources should instead be concentrated on developing a competitive pay price to replace the product-price formulas.

A post-hearing brief filed on behalf of O-AT-KA stated that while Proposal 20 may warrant further consideration, it should not be adopted in this proceeding.

## Discussion and Findings

### 1. Amending the Product Price Formulas

This proceeding offered a wide array of proposals aimed at changing FMMO end-product pricing formulas used to establish classified prices in all orders. The original 19 proposals noticed range from those that seek to abandon the current product-price formulas used to compute minimum Class III and Class IV prices to those that seek a variety of changes to the product-price formulas including manufacturing cost factors (make allowances), yield factors, technical factors and the authority to separate a portion of manufactured product sales prices from what otherwise is used to establish subsequent raw milk prices. The diversity of proposals considered indicates a lack of consensus within the dairy industry concerning how the Federal order program should set minimum milk prices in general and more specifically, how the many features of the product-price formulas should be altered.

Witnesses representing Agri-Mark, NMPF, Leprino, Twin County and IDFA provided evidence that energy, transportation, labor and packaging costs for manufacturing processors have increased since the adoption of the March 2007 make allowances. As pointed out by IDFA, make allowances account for manufacturing costs in the Class III and Class IV price formulas but do not change as those costs change, therefore, increasing make allowances is the only reasonable way that those increased costs can be recovered.

The ability of a manufacturer to offset cost increases is limited by the level of make allowances in the Class III and Class IV price formulas. Manufacturing processors are charged the FMMO minimum price for producer milk used to produce Class III and Class IV products. However, plant manufacturing cost increases may not be recovered because Class III and Class IV product-price formulas use make allowances that are fixed regardless of market conditions and change only by regulatory action. Simply put, when manufacturing cost increases result in higher costs than those provided for in the formula make allowance factors, the value of milk used to make those products may be over-valued.

Product-price formulas are relied upon to establish the minimum class prices of raw producer milk used to make Class III and Class IV products, which in turn establish Class I and Class II prices. The product-price formulas use market prices collected by AMS for cheddar cheese, Grade AA butter and dry whey to set a minimum price for Class III milk, and NFDM and Grade AA butter to set a minimum price for Class IV milk. No competitive pay price series currently exists that can be relied upon to establish a price for raw milk nationally. While some proponents look to the CME, the futures prices of the CME use the FMMO minimum class prices as the starting points for Class III and Class IV milk futures contracts.

In the absence of a competitive pay price series, product-price formulas based on cheese, dry whey, NFDM and butter serve as the only practical basis that the value of raw producer milk used in their production can be derived. A raw milk value is, in part, derived from sales price data collected by AMS from manufacturers who produce and market these commodity products. The information is aggregated weekly and reported in the AMS Dairy Product Sales Report. The Class III and Class IV product-price formulas use, among other factors, the wholesale market prices of the manufactured products from which make allowance factors are subtracted. The remaining value, when converted to a milk equivalent basis, is the value of raw milk. Accordingly, the accuracy of deriving the minimum value of raw milk is dependent on the accuracy of the commodity sale prices reported and, in large part, the accuracy of the manufacturing cost factors, or make allowance factors, that are used in the pricing formulas.

The Agri-Mark proposal, Proposal 1, seeks to change make allowances used in the Class III and Class IV product formulas by relying on manufacturing

cost data contained in the record of this proceeding and combining such data for plants outside of California with the most current manufacturing cost data published by the CDFA.<sup>3</sup> The two sets of manufacturing costs for cheese, NFDM, dry whey and butter would be combined on a weighted average basis in a manner consistent with the development of the current make allowances used in determining Class III and Class IV prices. Other proponents seek to use the most recently available publications of the CDFA.<sup>4</sup> This method was used in earlier rulemakings to develop the make allowances used in the product-price formulas.<sup>5</sup>

Opponents of increasing make allowances argue a number of points—that they are already set at too high a level, that dairy farmer production costs also have increased significantly due to higher energy and feed costs, that processors should look beyond asking dairy farmers to receive less for their milk by charging more for manufactured products, and that make allowance increases should be made only when all dairy farmer production costs are captured in their milk pay price. These are not valid arguments for opposing how make allowances should be determined or what levels make allowances need to be in the Class III and Class IV product-price formulas. The record evidence demonstrates that make allowance levels are not reflective of the costs manufacturers incur in processing raw milk into the finished products of cheese, butter, NFDM and dry whey.

Additionally, the Class III and Class IV product-price formulas establish derived classified prices for producer

<sup>3</sup> Official Notices are taken of amendments to make allowances and all related documentation by the State of California in the Determinations, Findings, Conclusions and Order of the Secretary of Food and Agriculture, November 20, 2007, by the Office of the California Secretary of Agriculture. See: [http://www.cdffa.ca.gov/dairy/dairy\\_hearings\\_matrix.html](http://www.cdffa.ca.gov/dairy/dairy_hearings_matrix.html), and [http://www.cdffa.ca.gov/dairy\\_hearings.html](http://www.cdffa.ca.gov/dairy_hearings.html). and Summary of Weighted Average Manufacturing Costs, Butter, Nonfat Dry Milk, Cheddar Cheese, and Dry Whey Powder, Released September 18, 2007; See <http://www.cdffa.ca.gov/dairy/pdf/manufcostexhibit2006.pdf>.

<sup>4</sup> Ibid

<sup>5</sup> Official notice is taken of 67 FR 67906 November 7, 2002, and 68 FR 7063, February 12, 2003, final decision and final rule respectively, and 66 FR 54064, 65 FR 76832.

<sup>6</sup> Official notice is taken of 71 FR 67467, November 22, 2006, 71 FR, 78333, December 29, 2006, as well as hearing testimony, exhibits, and post hearing briefs for the hearing and hearing continuations originally noticed in 71 FR 545, January 5, 2006, and related materials concerning make allowances and dairy product manufacturing costs, and published for the convenience of the public on the USDA, AMS Dairy Programs Web site at [www.ams.usda.gov/dairy](http://www.ams.usda.gov/dairy).

milk that are used nationally in all Federal milk orders. When dairy farmer production costs exceed the value that products are sold in the marketplace, no source of revenue from the marketplace is available to cover those costs.

In the aggregate, the costs of producing milk are reflected in the supply and demand conditions for the dairy products. When the supply of milk is insufficient to meet the demand for Class III and Class IV products, the prices for these products increase as do regulated minimum milk prices paid to dairy farmers because the milk is more valuable and the greater value is captured in the pricing formulas. Dairy farmers face no regulatory minimums in their costs and face no regulated minimum payment obligation in the way that regulated handlers must pay dairy farmers for milk.

It is reasonable to conclude that the make allowances used in the Class III and Class IV product-price formulas should be updated to reflect changes in the costs manufacturers incur in producing cheese, butter, dry whey and NFDM. It is necessary to reflect changes in manufacturing costs so that with the prevailing market prices for manufactured products, minimum Federal order classified prices can be set. In the record of this proceeding, the evidence demonstrates that the manufacturing costs of producing cheese, dry whey, NFDM and butter have increased since the implementation of the make allowances that were adopted on an interim basis, effective March 1, 2007.<sup>7</sup>

The record reveals an absence of industry consensus concerning the method that make allowances should be changed which in turn determines the level of the make allowances used in the Class III and Class IV product-price formulas. The differing proposed make allowance levels offered during this proceeding represent the changes in

opinions concerning which manufacturing costs, which manufacturing cost survey(s) and which other factors should be considered. For example, some proponents seeking higher make allowances argued that only CPDMP survey data and/or RBCS survey data volumes should be relied upon as they are most reflective of costs borne by plants that pay Federal order prices.

Proposal 3, proposed by DPNM, was offered in opposition to increasing make allowances annually through a USDA administered manufacturing cost survey, as contained in Proposal 2 offered by Agri-Mark. DPNM argued that because the CPDMP 2005 survey represents manufacturing costs of plants not located in California, it should be relied upon exclusively in determining new make allowances. This argument is rejected. Proponents of increasing make allowances have clearly demonstrated that costs of producing Class III and Class IV products have increased. Continuing with the method previously relied upon—relying on manufacturing cost data from CPDMP’s cost survey and CDFA in combination—has provided effective and useable make allowances in the pricing formulas.

At issue in this proceeding, in part, is whether make allowance levels should be increased and what method should be relied upon to determine those levels. On its face, the DPNM proposal to rely only on the CPDMP 2005 survey data in determining make allowances may seem reasonable as the survey excludes California plants. However, the argument does not consider other important factors that affect the marketing conditions for milk and dairy products represented by California’s dairy sector and its impact on the supply and demand for milk and dairy products nationally. Cheese, butter, dry whey and NFDM compete in a national marketplace and as such, the prices

established under the Class III and Class IV product-price formulas need to be reflective of marketing conditions that directly affect the determination of the minimum value of raw milk.

Accordingly, Proposal 3 is not adopted.

Others participants supported the use of CDFA data. However, CDFA data represents a cost survey of only California processing plants. Federal order Class III and Class IV prices must be derived, as much as possible, from national estimates of manufacturing cost information. AMS survey prices, used to establish minimum Federal order prices, include California processing plants. Accordingly, it is reasonable to conclude that appropriately combining CDFA cost data with cost survey data of manufacturing plants not located in California will produce a measure of national manufacturing costs. This combination removes as much bias as possible in manufacturing costs measurements that may otherwise result from the exclusive use of one set of cost survey data over another.

While many hearing participants support the general method of determining make allowances proposed to be adopted in this decision, the record nevertheless reveals a lack of industry consensus in determining the specific factors to be used in the Class III and Class IV product-price formulas. This is illustrated by the information presented in Table 1 below. The seven sets of suggested make allowances represent proposals from four different groups at various points during this proceeding. The Agri-Mark, LOL and DPNM proposals were advanced by producer groups with different milk marketing and processing interests. Regulated processors, including some producer groups who are also regulated in their capacity as processors, are represented in this regard by the proposals advanced by IDFA and Leprino.

TABLE 1—PROPOSED MAKE ALLOWANCES

Proponents	Cheese \$/lb	Butter \$/lb	NFDM \$/lb	Dry whey \$/lb
Agri-Mark et. al. (Brief Pg 20–24) .....	0.2154	0.1725	0.1782	0.2080
IDFA (Brief pg 11) .....	0.2154	0.1725	0.1782	0.2080
IDFA (Brief pg 12) .....	0.2198	0.1846	0.1662	0.1976
Leprino (Brief pg 2) .....	0.2154	0.1725	0.1782	0.2080
DPNM Proposal .....	0.1638	0.1108	0.1410	0.1500
DPNM Brief (pg 1) .....	0.1638	0.1150	0.1410	0.1590
DPNM Brief (pg 20) .....	0.1638	0.1108	0.1410	0.1498

<sup>7</sup> Ibid. Official notice is taken of 72 FR 36341, July 3, 2007.



The range of proposed make allowances presented in Table 1 varies more than 30 percent between the highest and lowest proposed make allowance levels for cheese and dry whey and about 25 percent for NFD. Similarly, the range from highest to lowest proposed make allowances for butter varies by more than 60 percent.

This final decision continues to find that it is appropriate to rely on the CPDMP 2006 survey of manufacturing costs in establishing the methodology of how make allowances should be determined. Its use is consistent with the methodology relied upon in determining the previous make allowance levels (effective March 1, 2007) in the Class III and Class IV product-price formulas that utilized the CPDMP 2005 survey. The CPDMP 2006 survey results provide a new estimation of manufacturing costs for plants not located in California. The CPDMP 2006 survey results, when used in conjunction with the most current survey results from CDFA, improve the estimation of manufacturing costs on a national basis and is consistent with the methodology relied upon in determining the previously set make allowances.

The CPDMP 2006 survey is essentially a new cost survey. The manufacturing cost data presented in the survey is similar to CPDMP's earlier cost survey in that they both rely on cost information provided from manufacturing plants not located in California. The surveys also are similar in that they collect manufacturing cost data for cheese, butter, NFD and dry whey. However, there are differences with the most important one being the use of different samples of plants.

In the CPDMP 2005 survey, 16 cheese plants provided cost data that were incorporated to represent the weighted average costs to manufacture cheese. The 2006 survey represents data from 11 cheese plants, 8 of which were among the 16 plants that participated in the 2005 survey. For butter, 4 plants provided cost data in both the 2006 survey and the 2005 survey, but the surveys represent different collections of sampled plants with different production volumes. In addition, the butter manufacturing cost data in the 2006 survey differs from the earlier survey because it employed a different method for allocating costs between butter and NFD production in plants that jointly manufacture these products. For NFD, the plants sampled and reported in the 2006 survey included 7 of the 8 plants sampled as part of the 2005 survey.

The purpose of this proceeding, in part, is to determine if make allowances should be updated. Central to this question is determining the proper methodology for determining new make allowances given the available public data. Proponents of Proposal 1 argued that both CDFA and CPDMP data were used to determine the 2006 make allowances and that they should continue to be used because their combination better reflects conditions in the national marketplace. This decision continues to find that incorporating CDFA data into the make allowance computations is justified to best reflect the national market where dairy commodity products are sold. AMS prices used in the product-price formulas incorporate sales from across the country, including California. Despite comments filed by DPNM et al. this decision finds that it is appropriate to rely on cost data from California (CDFA survey) and the rest of the country (CPDMP survey). It is also appropriate, contrary to comments from DPNM et al. to assess the economic impact of the changes on the national market. Consequently, the record supports use of the 2006 CDFA data to determine make allowances.

DPNM et al. also commented that the Department failed to consider producer feed and fuel costs as mandated by the Food, Conservation and Energy Act of 2008 (2008 Farm Bill, (Pub. L. 110-246)). At the hearing, official notice was taken of USDA data pertaining to various producer costs. This information is part of the hearing record and as such, was considered by the Department in determining whether make allowances should be amended.

Comments regarding the tentative final decision from Agri-Mark et al. request that make allowances be updated to reflect energy costs through June 2008. Their comments cite the Bureau of Labor Statistics Producer Price Indexes for Industrial Natural Gas and Industrial Electric Power that demonstrate an increase in these energy prices through June 2008. Agri-Mark et al. assert that energy prices would remain high through 2009. Updating energy costs would result in make allowances that may give an inappropriate weight to one cost factor in an array of cost factors that are considered in determining make allowances. This would lock in an artificially high make allowance based solely on the costs of electricity and natural gas. Accordingly, the request by Agri-Mark's et al. is denied. The determination of the adopted make allowances for cheese, butter, NFD and dry whey are discussed below. The

make allowances proposed to be permanently adopted represent national manufacturing cost averages for cheese, butter, NFD and dry whey. As found and determined in previous rulemakings on this issue, an estimation of manufacturing costs for national application requires that national production volumes of these commodities be considered in determining the level of make allowances to be relied upon and used in the Class III and Class IV product-price formulas. This is critical because Class III and Class IV prices are the same in all Federal milk marketing orders.

#### Butter Make Allowance

The butter manufacturing cost data presented in the CPDMP 2006 survey reports weighted average costs based on a sample of four plants. These data are combined with the average cost data from the most recent CDFA survey and averaged over the 2006 national production volume as published by NASS. The combination of the weighted average costs from the CPDMP and CDFA surveys over the national production volume plus a marketing cost adjustment of \$0.0015 yields a make allowance \$0.1715 per pound for butter.

#### NFD Make Allowance

The NFD manufacturing cost data presented in the CPDMP 2006 survey reports weighted average costs based on a sample of 7 non-California plants. These data are combined with the weighted average costs reported by CDFA and averaged over the 2006 national NFD production volume as reported by NASS. The combination of the weighted average costs from the CPDMP and CDFA surveys by the national production volume plus a marketing cost adjustment of \$0.0015 yields a make allowance \$0.1678 per pound of NFD.

#### Cheese Make Allowance

The cheese manufacturing cost data presented in the CPDMP 2006 survey reports an average cost of producing a pound of cheese of \$0.1584 per pound. This is significantly below the cost of producing a pound of cheese reported by the CPDMP 2005 survey. The cost difference was explained by the inclusion of fewer small plants in the 2006 survey. In addition, cheese manufacturing costs of a larger plant were included in the 2006 survey that did not participate in the 2005 survey. This led to 2006 survey results that are heavily weighted towards larger volume plants.

The record reveals that eight cheese plants participated in both the 2005 and 2006 surveys and that their costs increased an average of \$0.017 per pound of cheese between the two survey years. The Cornell researcher who administered both surveys conceded that this was the strongest conclusion which can be drawn from the cheese manufacturing data of the two surveys. Supporters of relying on the \$0.017 factor to compute a new make allowance purport that this number can simply be added to the 2005 CPDMP plant average population cost of \$0.2028. This decision finds that combining those two figures to compute a new cheese make allowance is procedurally incorrect. While a cost increase of \$0.017 is significant and may be factually correct, it cannot be a factor in determining a new make allowance unless the original 2005 average manufacturing cost of the eight plants is included in the record. Therefore, use of the \$0.017 cost increase in determining a new cheese make allowance is denied.

While the \$0.017 cannot be used to determine a new cheese make allowance, the cost comparison between the same samples of plants does reveal that average manufacturing costs have increased. However, comparing the weighted average cheese costs of the two CPDMP surveys indicates that processing costs have actually declined \$0.0054 per pound. This decision finds that the inconsistencies between the two CPDMP surveys call into question whether either survey is representative of cheese manufacturing costs. Accordingly, for the purpose of determining a make allowance for cheese, the CPDMP 2006 survey results for cheese are rejected.

This decision finds that the CDFA 2006 survey of average cheese manufacturing costs is the best available information representing the manufacturing cost of producing a pound of cheddar cheese. Accordingly, the make allowance proposed to be permanently adopted for cheddar cheese is \$0.2003 per pound including a \$0.0015 per pound marketing cost adjustment.

#### Dry Whey Make Allowance

Estimating the cost of manufacturing dry whey presents a problem similar to that for cheese. Despite exceptions to the tentative partial final decision from Kraft, Glanbia and WCMA that CDFA whey data should be factored into determining a dry whey make allowance, this decision continues to reject relying on CDFA data in determining the dry whey make allowance. The CDFA 2006

manufacturing cost survey reveals that CDFA was not satisfied with the precision in estimating the average cost per pound for whey products. Accordingly, it is unreasonable to rely on information that may not be reflective of market conditions. Adopting an artificially high make allowance for dry whey would result in the unwarranted decrease of producer revenue. Accordingly, CDFA dry whey manufacturing cost data is not relied upon in determining the dry whey make allowance in the product-price formulas.

This decision continues to rely on the CPDMP 2006 survey of the average manufacturing cost to produce a pound of dry whey. Relying solely on the CPDMP 2006 survey is identical to the approach used in determining the make allowance for dry whey used in the Class III price formula effective March 1, 2007. The 2006 survey value of \$0.1976 plus a marketing cost adjustment of \$0.0015 yields a dry whey make allowance of \$0.1991 per pound.

An issue was raised by Twin County in its brief concerning an alleged differential impact on small and large businesses if make allowances or Class III and IV price formulas are amended. However, the purpose of the Class III and IV price formulas and make allowances is to set individual minimum class prices for the Federal milk order program on a national basis.

#### Butterfat Yield Factor

A proposal, published in the hearing notice as Proposal 6, was included in a package of proposals advanced by DPNM seeking to amend the product-price formulas to more accurately capture the use of modern manufacturing technology and its impact on milk value. A portion of Proposal 6 seeks to amend the butterfat yield factor in the butterfat price formula from 1.20 to 1.211 to account for what DPNM and other participants in this proceeding characterized as a misapplication of farm-to-plant shrinkage when the Class III and Class IV product-price formulas were adopted in November 7, 2002 (67 FR 67906), and became effective on April 1, 2003 (68 FR 7063).<sup>8</sup>

Specifically, DPNM explained that the butterfat recovery factor of 1.20 used in the butterfat pricing formula was the result of the incorrect application of the butterfat shrinkage factor of 0.015 percent on a per pound of butterfat basis rather than on a per cwt basis. As

<sup>8</sup> Official notice is taken of 67 FR 67906, published November 7, 2002, and 68 FR 7063, effective April 1, 2003.

explained by DPNM, the shrinkage factor was, however, properly applied to the butterfat adjustment portion of the protein price formula. Correction of this mathematical error removes this inconsistency between the butterfat pricing formula and the protein price formula.

This decision agrees with DPNM and others who support correction of this error. In the 2002 final decision adopting the butterfat yield of 1.20, USDA correctly explained that when accounting for the farm-to-plant loss of milk, there is a 0.25 percent butterfat loss per pound of butterfat, plus an additional loss of 0.015 pounds per cwt of milk. However, when mathematically accounting for the loss in the price formulas, the additional 0.015 pound of loss was applied on a per pound of butterfat basis. This decision corrects that error and proposes to permanently adopt a butterfat yield of 1.211.

Opponents of amending this factor do not dispute that the 1.20 butterfat yield factor used in the pricing formulas was in error. Rather, opposition rests on the premise that manufacturing processors are already paying too much for raw milk and they attribute this to the in-plant shrinkage of butterfat that cannot be processed into a finished product. Furthermore, adopting the 1.211 factor would result, all other factors unchanged, in a higher minimum price for raw milk. This decision rejects such arguments. The arguments are based on an unwanted outcome and not on the basis of the proper application of this factor. The other features of Proposal 6 are not proposed to be adopted and those features are discussed later in this decision.

Other proposals considered in this proceeding address the three major elements of the product-price formulas—end-product prices used in the formulas, manufactured product yield factors and other intra-formula cost factors. A proposal (Proposal 18) advanced to establish an alternative approach to determining prices of raw milk by attempting to develop a competitive pay price also is considered.

#### Product Yields and Butterfat Recovery Percentage

A package of proposals, advanced by DPNM, seek to amend the product-price formulas to capture the use of more modern manufacturing technology and its impact on milk value (Proposals 6, 7, and 8). As already discussed, a part of Proposal 6 seeking to amend the butterfat yield factor in the butterfat price formula from 1.20 to 1.211 is proposed to be permanently adopted.

However, Proposal 6 also seeks to increase the butterfat recovery percentage in the protein price formula from 90 percent to 94 percent. The argument for increasing this factor is that new cheese manufacturing technology has increased the amount of butterfat that manufacturers can potentially recover when making cheese. A 94 percent recovery rate also will increase the blend price paid to producers by \$0.07 per cwt.

Opponents to increasing the butterfat recovery rate, including LOL, NDA, Sorrento, Leprino, MMPA, and H. P. Hood presented evidence countering the DPNM claim that a butterfat recovery in excess of 90 percent is achievable industry-wide. Many manufacturer witnesses testified that their butterfat recovery percentage in cheese is, on average, 90 percent.

While the record contains evidence of what butterfat recovery rate in cheese production is possible through the use of more modern manufacturing methods and technology, the preponderance of evidence reflects that many cheese manufacturers generally achieve butterfat recovery near 90 percent. DPNM et al. failed to make a compelling argument for an increase in the butterfat recovery rate in their exceptions to the tentative partial final decision. While they did offer several references to articles published by dairy scientists providing examples of cheese yields with higher butterfat retention rates, they did not provide examples of manufacturing facilities currently experiencing those higher rates. Furthermore, the use of advertisements claiming that a specific cheese vat will result in higher butterfat retention rates does not merit the conclusion that those rates are, on average, achieved. It is important that the product-price formulas reflect current plant conditions, not plant conditions that may be possible but not reflective of general industry wide conditions. Accordingly, this final decision continues to reject adoption of this feature of Proposal 6.

Proponents also commented that plants whose butterfat recovery rate is greater than 90 percent are not paying for all of the protein used to make cheese. This final decision rejects that assertion. All of the protein contained in producer milk, regardless of if its end use in cheese or in the whey stream, is priced at the protein price. The protein price is not reduced to reflect a lower value for the protein in the whey stream.

A second proposal of the DPNM package of proposals, Proposal 7, seeks to eliminate the farm-to-plant shrink

adjustment factors in the Class III and Class IV product-price formulas. The argument by proponents is that modern measurement and milk-handling techniques, and the trend of transporting full loads of milk from single producers negate the need to retain the shrinkage adjustment factors. Opponents argue that in many marketing areas, milk shipments are commonly assembled from multiple farms and some farm-to-plant shrinkage is inevitable.

Record evidence supports concluding that farm-to-plant shrinkage remains a reality for manufacturers. Numerous witnesses testified regarding actual average farm-to-plant shrinkage experienced at their plants: LOL (0.343 percent); MMPA (0.3 percent); Leprino (0.25 percent); and HP Hood (1.5 percent including in-plant losses). While DPNM argued at the hearing and in its exceptions that its members' farm-to-plant shrinkage is well below the 0.25 percent contained in the Class III and Class IV product-price formulas, no evidence was offered for examination as an alternative other than its elimination. Furthermore, while proponents assert that shipping full tanker loads of milk is common in the southwest where they operate, record evidence does not demonstrate this reality in the rest of the country.

This final decision continues to find that the Class III and Class IV product-price formulas should recognize the loss of milk that occurs when milk is moved from the farm to a receiving plant. Record evidence demonstrates that farm-to-plant shrinkage occurs, for example, from imprecise stick readings and sampling at the farm or from product remaining on tanker walls after emptying the load at the plant. In most cases, producers are paid based on farm weights and tests, in which case the handler pays for product that is not ultimately received. It is therefore reasonable when determining component prices charged to handlers to make an adjustment for the lost product. The 0.25 percent shrinkage factor contained in the formulas is a reasonable factor that represents the loss of producer milk when shipped from farm-to-plant. Accordingly, Proposal 7 is not proposed to be adopted.

A third proposal of the DPNM package of proposals, Proposal 8, seeks to increase the nonfat solids (NFS) yield factor in the Class IV product price formula and the yield factors for protein and butterfat in the protein price formula components of the Class III product-price formula. Proponents computed the proposed conversion factors to be used in the protein price

formula by assuming: a) that the percentage of casein in true protein is actually 83.25 percent (resulting in a cheese yield per pound of protein of 1.405); b) the butterfat recovery rate in cheese is 94 percent (resulting in a cheese yield per pound of butterfat of 1.653); and c) that average producer tests should be used in the price formulas (resulting in a fat to protein ratio of 1.214). The conversion factor for computing the nonfat solids should be 1.02 based on actual nonfat dry milk yield per pound of nonfat solids. Opponents counter that the methodology used to derive the proposed yield factors are flawed and that no actual studies were offered to support their conclusion that product yields are higher than those currently provided in the formulas. This final decision continues to find no record evidence to support amending the yield factors as proposed in Proposal 8.

Despite comments to the tentative partial final decision by DPNM et al., record evidence does not support making changes to the yield factors in the protein price formula. Proponents continue to argue that based on producer tests, the actual percentage of casein in true protein is 83.25 percent. The formulas currently assume that the percentage of casein in true protein is 82.2 percent. This factor, adopted in 2002 (67 FR 67928),<sup>9</sup> was based on evidence provided at that proceeding by a university researcher whose studies demonstrated a casein in true protein range of 82.2 percent to 82.4 percent. The record of this proceeding does not contain data from any studies that would indicate that the casein in true protein percentage has increased. Accordingly, this decision does not propose increasing the percentage of casein in true protein to 83.25.

In their exceptions DPNM et al. reiterated its arguments that a butterfat recovery rate of 94 percent should be adopted. Its adoption would result in an increase in the cheese yield per pound of butterfat to 1.653. This final decision has already discussed why a 94 percent butterfat recovery rate is not proposed to be adopted. Consequently, the butterfat yield factor in the protein formulas is not amended.

Proposal 8 also seeks to increase the fat-to-protein ratio in the protein formula to 1.214. Proponents claim that the increased ratio reflects the use of average producer milk tests of 3.04 percent true protein and 3.69 percent butterfat. The current ratio of 1.17 was computed using standardized milk tests

<sup>9</sup> Official notice is taken of 67 FR 67928, published November 7, 2002.

of 2.9915 percent true protein and 3.5 percent butterfat. Record evidence does not support using average producer tests in determining yield factors. Proponents claim that other yield factors were determined using average producer tests. This statement is incorrect. Other yield factors in the product price formulas take into account the amount of the component in the product; there is no consideration of average producer tests. For example, the yield factor in the butterfat price formula is 1.211. This value was derived from the percentage of butterfat in butter, and was later adjusted for farm-to-plant shrinkage. Weighted average producer tests have no bearing on this yield number. This final decision continues to find that increasing the fat-to-protein ratio to account for weighted average producer tests is not justified.

The last portion of Proposal 8 seeks to increase the nonfat solids yield factor from .99 to 1.02. DPNM et al. claims that it is impossible for 1 pound of solids nonfat to yield less than one pound of nonfat dry milk. In their exceptions, DPNM et al. claims that the California milk pricing formulas actually use a yield factor of 1.02. According to a December 2007 California Milk Pricing Formulas publication release by CDFa, California price formulas utilize a nonfat solids yield factor of 1.<sup>10</sup> The .99 yield factor currently contained in the nonfat solids price formula was adopted on April 1, 2003 (68 FR 7063).<sup>11</sup> This factor was reduced from 1.02 to account for farm-to-plant shrinkage. USDA continues to find it appropriate to acknowledge farm-to-plant shrinkage in the product price formulas. Therefore, the nonfat solids yield factor is unchanged.

#### Value of Butterfat in Whey

Two proposals advanced by IDFA and Agri-Mark, Proposals 9 and 10 respectively, seek to change the protein price formula feature of the Class III product-price formula by reducing the protein price to reflect the lower market value of whey cream. Proposal 9 also seeks to further lower the protein price to reflect the reduced recoverable volume of whey cream in the cheese making process. (During the proceeding Agri-Mark withdrew its support of Proposal 10 in support of IDFA's Proposal 9.) The argument for seeking these changes is that that the volume of

milkfat contained in whey cream is currently valued at the Grade AA butter price but can only be sold as whey butter (Grade B butter) or for other uses with values below the Grade AA butter price. Record evidence does indicate that Grade B is often marketed to commercial food service establishments such as bakeries and is marketed at a discount to the Grade AA butter price. Some hearing participants (NAJ) suspect that the volumes of whey cream produced and the extent of a secondary market for whey butter are relatively small. Record evidence contains very limited data regarding plant sales of whey cream or Grade B butter. More importantly, there is no known publically available data for U.S. market prices and volumes of whey cream or Grade B butter produced or sold.

Opponents (Dairyalea et al.) to IDFA's proposal acknowledge that while whey cream does have a lower value than that reflected in the Grade AA butter price, other higher-value uses for whey cream exist that also are not recognized. Opponents argue that it would be inappropriate to amend the butterfat value to reflect a selected measure of whey cream value while not considering whey cream value in other (possibly higher-value) uses.

After considering the comments and exceptions to the tentative partial final decision for reducing the protein price to reflect the lower market value of whey cream, this decision continues to reject this proposal. Whey cream may have a lower market value, but without publicly available market data that provides whey cream volumes and prices, no reasonable and objective means is available to determine if or how whey cream is distorting the protein price formula feature contained in the Class III product-price formula. Supporters of Proposal 9 did not offer market information that could be relied upon as a basis for changing the protein price. While there is record evidence from some manufacturers as to their individual saleable volumes and values of whey cream, that limited data does not provide for a reasonably complete assessment of the national market for whey cream and its various competing uses. The lack of verifiable data concerning whey cream and/or its applicability to any additional costs or value loss experienced by cheese manufacturers across the industry is unknown. Accordingly, Proposals 9 and 10 are not proposed to be adopted.

#### Barrel-Block Cheese Price Spread

Proposal 12 offered by IDFA and supported by Leprino, DFA, NDA, Agri-Mark, and others, seeks to eliminate the

3-cent addition to the barrel price in the protein price formula. The argument for elimination from the protein price formula is that the average price difference between block and barrel cheese was 3-cents when first incorporated into the formula but now there is virtually no difference in the packaging costs of blocks and barrels. Proponents also argue that even if there were a cost difference, that difference would have been captured in the CPDMP 2006 survey of manufacturing costs. Other proponents add to the argument that after the NASS barrel cheese price was adjusted from 39 percent to 38 percent moisture content in January 2001, the price difference between barrels and blocks has averaged \$0.008 per pound.

The record contains only one cheese manufacturer's (Davisco) specific packaging cost data for a single plant located in Minnesota that produces cheese in both blocks and barrels. That plant's average packaging cost for block cheese was \$0.0012 per pound more than for barrels. Another cheese manufacturer (Twin County) producing cheese exclusively in barrels in Iowa was unable to indicate whether it was advantageous to their business to support or oppose any change in the 3-cent adjustment advanced in Proposal 12.

This final decision does not support adoption of Proposal 12. The argument that any packaging cost differences that exist between barrel and block cheese is captured in the CPDMP 2006 survey is inadequately supported. The record reveals that all packaging costs reported in the CPDMP 2006 survey were for 40-pound block cheese production. If a surveyed plant produced barrel cheese, an average packaging cost for 40-pound blocks was assigned to the plant.

Additionally, proponents assert that since the price difference between blocks and barrels is almost zero, it can be concluded that that any packaging cost difference must also be nearly zero. This decision does not find a causal relationship between selling prices and manufacturing costs. Even though the price spread between blocks and barrels has narrowed over time and recently averaged near zero, the cost difference between block and barrel packaging cannot be assumed to also be zero. Blocks and barrels have different supply and demand functions. Comparing average prices over a period of time does not therefore automatically reflect cost differences. Since barrel cheese prices exceed block cheese prices at certain times, due to different supply and demand curves, average prices will not in and of themselves indicate cost

<sup>10</sup> Official notice is taken of "California Milk Pricing Formulas", December 2007, Dairy Marketing Services Branch, California Department of Agriculture: [http://www.cdffa.ca.gov/dairy/pdf/steps\\_for\\_calc\\_minprices.pdf](http://www.cdffa.ca.gov/dairy/pdf/steps_for_calc_minprices.pdf).

<sup>11</sup> Official notice is taken of 68 FR 7063, February 12, 2003.

differences. While the record contains packaging cost information for a single plant that suggests similar packaging costs of barrel and block cheese, such evidence is insufficient to conclude that this is representative across Federal order manufacturing plants or should be the basis for adopting the proposal. Accordingly, Proposal 12 is denied.

The proposal by DFA and NDA, Proposal 13, seeks to eliminate the cheese barrel price from the protein price formula feature of the Class III product-price formula but no testimony was given in support of this proposal. In addition to NDA proponent support during the hearing and DFA opposition to the adoption of the proposal in their post-hearing brief, significant opposition from others was given. Opponents argue that because barrel cheese represents roughly half of the NASS price survey cheese volume (now captured in the AMS survey), removing the barrel price from the protein price formula would greatly reduce the total AMS survey volume thereby making the price survey less representative of the cheddar cheese market.

This final decision continues to find that retaining the cheese barrel price in the protein price formula is necessary to ensure that the protein price is representative of the national cheese market. The Class III product-price formula needs to be reasonably representative of the market for cheese that determines the value of milk. Record evidence reveals that barrel production in the AMS survey is often in excess of 50 percent of the total cheese volume surveyed. Eliminating the barrel price from the protein price formula would significantly and needlessly reduce the volume of cheese used in the Class III product price formula which could lead to protein prices that are not as representative of the national cheese market. Accordingly, Proposal 13 is not proposed to be adopted.

#### Product Price Series

Proposal 14, advanced by Agri-Mark, seeks to change the price data used in the Class III and protein price formula by combining the NASS price survey data for cheddar cheese (now the AMS price survey data for cheddar cheese) with the weekly average CME cheese prices as a method that results in a superior benchmark price for cheese. The argument rests on the assertion that the 2-week timing difference, or lag, between the CME price and the AMS price survey for cheese fails to capture changes in market prices in the current value of cheese and the near-actual Class III value. The proponent also

argues that adoption of this new price series would reduce price volatility and provide more up-to-date market information than that provided by the AMS price survey. In other words, more current market information would be transmitted through minimum Class III prices and provide more accurate pricing signals to processors and producers.

Opponents to adoption of Agri-Mark's Proposal 14, including IDFA and its members, collectively argue that combining the CME price with the AMS price would reduce the usefulness of currently available risk management tools. These tools include the use of futures contracts and the use of forward contracts. Opponents also note that (1) the CME is a spot market representing only about 4.1 percent of all cheddar cheese traded and is not representative of cheese being more commonly produced and marketed on a longer-term contract basis, (2) it adds a degree of complexity to a pricing-formula which is already too complex without any discernible benefit and (3) its adoption would tend to bias price reporting to the market conditions of the Chicago area. All comments to the tentative partial final decision regarding Proposal 14 supported USDA's denial of the proposal.

It is reasonable to expect that adding a degree of complexity may tend to reduce transparency and lessen the understanding of the Class III and Class IV product-price formulas. Other than assertions by the proponent, the record lacks evidence that combining CME prices with AMS survey prices would improve price discovery or market information or would offer superior transmission of economic signals through the minimum Class III price.

In addition, rulemaking action on mandatory product price reporting overtakes the need to consider adoption of a new price series that combines CME prices with AMS survey prices. Improved mandatory price reporting that provides for the auditing of prices reported to AMS makes the accuracy, but not the timing, of price data less of an issue than envisioned throughout this proceeding. Accordingly, Proposal 14 is not proposed to be adopted.

A proposal advanced by DPNM, Proposal 15, seeking to replace the AMS price series for cheese with the CME price has similarities to that of Proposal 14. It seeks to eliminate the 2-week lag between CME prices and AMS price reporting. DPNM has argued throughout this rulemaking proceeding that the use of CME prices in the price formula for cheese would provide producers, marketers and manufacturers of cheddar

cheese with more timely and transparent prices as the CME represents actual current cheese prices.

In opposition to the adoption of Proposal 15, the opponents, including IDFA, NDA, Agri-Mark and DFA, as in their opposition to the adoption of Proposal 14, argue that (1) The CME is too thin a market to be relied upon for use in the Class III product-price formula, (2) the CME represents only about 4.1 percent of all cheddar cheese traded, (3) its exclusive use would tend to bias and limit the price reporting for cheese to the market conditions of the Chicago market, and (4) being a spot market for cheese, the CME ignores other sales agreements and marketing arrangements that account for more than 95 percent of the cheese marketed and largely captured in the AMS price survey.

This final decision continues to find that cheese prices used in product-price formulas should reflect broad markets and not rely exclusively on a smaller subset of cheese prices and spot marketing conditions as represented by the CME. The record also makes clear that more industry confidence is placed in AMS price surveys than in spot market prices for cheese. Accordingly, Proposal 15 is not adopted.

#### Other Solids Price

Proposal 16, advanced by NAJ, seeks to eliminate the other solids price and expand the protein price formulas to include the value of dry whey because, according to NAJ, the value of whey lies in its protein content. The proponent asserts that the other solids price formula does not connect the market value of whey solids to how producers are paid for whey. Therefore, the proponent advocates that the value of dry whey in the price formulas be determined on the basis of its protein content which will make the other solids price formula no longer necessary.

IDFA and other opponents argue that it would be inappropriate to value dry whey on a component (protein) that has no measurable effect on the product yield. Except for comments filed by the proponent, comments filed by both producer and manufacturer groups in response to the tentative partial final decision expressed opposition to the adoption of Proposal 16.

This decision continues to find that Proposal 16 would add no additional value arising from protein to the marketwide pool. It would simply shift the money attributed to other nonfat solids into the protein price formula and add a level of complexity to the product

price formulas that would yield no measurable benefit.

Record evidence regarding Proposal 16 does not support eliminating the other nonfat solids prices and shifting the value of dry whey into the protein price formula. Other solids in milk are composed primarily of lactose, whey protein, ash and other non-protein solids. Numerous component markets, such as lactose and dry whey, were evaluated during Federal order reform to determine an appropriate market to base the other solids price. It was determined that because no reliable lactose market existed, the dry whey market was the next best alternative. At this time, there is still no reliable market for lactose on which the other solids price could be based. Therefore, this final decision finds that dry whey, despite the opinion of NAJ, remains the most relevant market on which to base the other solids price. Accordingly, Proposal 16 is not adopted.

#### Competitive Price Series

Proposal 18, advanced by the Maine Dairy Industry Association (MDIA), seeks to determine Class III and Class IV prices with a competitive pay price series rather than the current product-price formulas. The proposal seeks a return to a competitive pay price used by the FMMO program prior to 2000. The proponent argues that adoption of the proposed competitive pay price series would eliminate the need for establishing make allowances that, when increased, reduce prices received by dairy farmers.

A competitive pay price series previously existed for nearly 40 years and provided the foundation for all classified prices set in the system of milk marketing orders. A competitive pay price series would negate the need to directly consider manufacturing costs and other factors such as product yields and their relationship in deriving the value of raw milk.

However, there are many details that need resolution before the FMMO program could return to using a competitive pay price series. For example, the proposed method is based on geographic areas (zones) wherein strong competition for raw milk prevails. A competitive pay price would be derived by averaging prices from all the competitive price zones. As conceded by the proponent, these areas would most likely be surrounded by Federal milk marketing areas where minimum classified prices prevail. Milk prices within the competitive price zones would therefore be influenced by milk priced under adjoining Federal orders. Other considerations, including

an accounting of various forms of in-kind payments to producers, also need to be addressed. Ignoring consideration of such payments would allow plants to increase (decrease) their hauling charges as a way of reducing (increasing) the actual pay price to dairy farmers.

Therefore, this final decision finds that Proposal 18 cannot be implemented as proposed and is herein denied.

#### *B. Termination of a Portion of the Proceeding*

Proposal 2, offered by Agri-Mark, proposed to amend the Class III and Class IV product formulas to annually update the manufacturing allowances using an annual manufacturing cost survey of cheese, whey powder, butter and non-fat dry milk plants. The proposal would give authority for selecting the sample and conducting the survey to the market administrators. The manufacturing cost data would then be used to update manufacturing allowances to prescribed levels. On brief, Agri-Mark withdrew the automatic-updating portion of the proposal.

The record of hearing reflects a mixture of support and opposition to this proposal. This wide variance in industry response clearly demonstrates a lack of unity and policy direction. Opposition to Proposal 2 tended to stem primarily from the implementation of an automatic adjuster to manufacturing allowances, which was subsequently withdrawn by Agri-Mark. However, amongst supporters there was a clear lack of consensus as to how and by whom the survey should be implemented, what regions should comprise the survey sample, and specifics as to how the survey data were to be used. The only clear assertion made by the record was that some participants supported establishing a manufacturing cost survey.

Proposal 17, advanced by NMPF, would have amended the Class III and Class IV product price formulas to incorporate a monthly energy cost adjustment based on monthly changes in the producer price indices for industrial natural gas and electricity as published by the Bureau of Labor Statistics. Proponents argued that the implementation of an energy price adjuster would update make allowances in response to fluctuating energy prices. As mentioned earlier, this proposal was broadly supported by producer organizations, many of which manufacture NFDM and dry whey. These two products, in particular, require the use of energy-consuming driers in their production processes.

Opponents to Proposal 17 were overwhelmingly manufacturers of dairy products. They argued that the inclusion of an energy cost adjuster in the make allowance would complicate the milk pricing system and reduce the effectiveness of certain risk management tools.

Proposal 20, advanced by Dairylea, would amend the Class III and Class IV product price formulas by establishing cost-of-production add-ons that manufacturers could include in the selling price of their products, but which would not be included as part of the NASS (now AMS) dairy product price survey. Proponents noted that increases in wholesale prices on dairy products are captured by product price surveys and subsequently drive up the costs of raw milk, through higher Class III and Class IV prices. The proposed mechanism, they argued, would break the existing price circularity, allowing processors to increase wholesale prices without affecting input costs.

Opponents, many of whom are dairy processors, argued that it would be difficult to negotiate cost add-ons with wholesalers. Those handlers unable to successfully negotiate a higher cost add-on would be limited to the cost allowance included in the manufacturing allowance. Similarly, handlers operating outside of the Federal order system could potentially gain market share over regulated competitors. Additionally, opponents noted, the implementation of a cost add-on would further complicate the existing price discovery mechanism used by the Federal order system.

In the time following the implementation of the interim final rule (73 FR 44617), the Department received a request, which has been made part of the Official Record, from the Greater Northeast Milk Marketing Agency (GNEMMA) to finalize those proposals from this proceeding implemented on an interim basis and terminate the remainder (Proposals 2, 17 and 20). GNEMMA is a marketing agency in common comprised of: Agri-Mark, Inc.; Dairy Farmers of America, Inc.; Dairylea Cooperative, Inc.; Dairy Marketing Services, LLC; Land O'Lakes, Inc.; Maryland and Virginia Milk Producers Cooperative Association, Inc.; St. Albans Cooperative Creamery, Inc.; and Upstate Niagara Cooperative, Inc. GNEMMA members market in excess of 64 percent of all milk in the Northeast milk marketing area. The petitioners argue that certain market conditions have changed in the time since the hearing and certain data reflected in the record of hearing in regards to Proposals 2, 17 and 20 are no longer valid.

Other proposals proposed to be permanently adopted by this decision have already been implemented on an interim basis. This decision continues to support their adoption, and in essence the status quo.

While evidence regarding Proposals 2, 17 and 20 was collected during the hearing, the Department has never issued a decision on their merits. The hearing was initially held in 2007. The hearing record reflects marketing conditions at that time. Marketing conditions since the 2007 hearing have changed. Accordingly, given these circumstances, it is reasonable to terminate the proceeding in regards to Proposals 2, 17 and 20 in their entirety.

In view of the foregoing, it is hereby determined that the proceeding with respect to Proposals 2, 17 and 20 should be and are hereby terminated.

#### Rulings on Motions

A motion for official notice of a publication<sup>12</sup> and a final decision<sup>13</sup> by the CDFA was submitted by Agri-Mark et al. joined by Twin County Dairy, Inc., (Twin County) and supported by IDFA. This decision takes official notice of these publications.

In their comments to the tentative partial final decision, Agri-Mark et al. and Twin County also filed a motion for official notice of specific energy price statistics and projections of the U.S. Department of Labor and the U.S. Department of Energy. This motion was supported by IDFA. The motion advocated use of this data for a one-time energy cost adjustment to the manufacturing allowances adopted in the final decision. Previous publications of these statistics were officially noticed during the hearing. This final decision takes official notice of these publications through March 2009.

A motion and supplemental information in support of the motion seeking a continuance of the hearing for the limited purpose of offering additional data and analysis in advancing Proposal 18 were submitted by MDIA. A counter motion opposed to MDIA's motion was made by IDFA. Offering new data and analysis by continuing or re-opening the hearing for the limited purpose of reconsidering Proposal 18 would put all other hearing participants advancing or opposing

proposals during the proceeding at a disadvantage. This proceeding lasted for 3 weeks over a 6 month period from February 2007 through July 2007. It also was preceded by an information session in December 2006. The tentative final decision found that sufficient time was made available to all known parties to develop and present noticed proposals and the motion was denied.

Exceptions to the tentative partial final decision filed by MDIA requested that USDA reconsider their original motion for a continuance of the hearing. MDIA argued that because a decision has yet to be issued on three other noticed proposals, the hearing—in regard to those proposals—remains open. Therefore, concluded MDIA, USDA has the latitude to grant MDIA's motion for a continuance on Proposal 18. MDIA also stated that in denying its first motion, USDA did not give proper weight to the support for the basic concept of Proposal 18 (a competitive pay price series) expressed in numerous post-hearing briefs that were submitted by various hearing participants.

MDIA also took exception with the tentative partial final decision's characterization that the MDIA's witness conceded problems with the proposed competitive pay price series. MDIA wrote that Proposal 18 was designed to be a beginning framework for a functioning competitive pay price series that would be superior to end-product pricing formulas. MDIA argued that it intended to use the hearing process as a method for determining concerns with the proposal and then recommend to the Department a procedure for further development of the proposal.

MDIA's motion for a continuance continues to be denied. Though a continuation might allow for further development of Proposal 18 with USDA and industry participants, there is a necessity to proceed with finalizing the rulemaking on the Class III and Class IV price formulas. While MDIA's motion is denied, this does not prevent future consideration of a competitive pay price system.

#### Rulings on Proposed Findings and Conclusions

Briefs and proposed findings and conclusions were filed on behalf of certain interested parties. These briefs, proposed findings and conclusions, and the evidence in the record were considered in making the findings and conclusions set forth above. To the extent that the suggested findings and conclusions filed by interested parties are inconsistent with the findings and conclusions set forth herein, the

requests to make such findings or reach such conclusions are denied for the reasons previously stated in this decision.

#### General Findings

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

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

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

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

#### Rulings on Exceptions

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

#### Marketing Agreement and Order

Annexed hereto and made a part hereof is one document: A Marketing Agreement regulating the handling of milk. The order amending the order regulating the handling of milk in the Northeast and other marketing areas was approved by producers and published in the **Federal Register** on July 31, 2008 (73 FR 44617), as an Interim Final Rule.

<sup>12</sup> California Department of Food and Agriculture: Summary of Weighted Average Manufacturing Costs, Butter, Nonfat Dry Milk, Cheddar Cheese, and Dry Whey Powder, Released September 18, 2007.

<sup>13</sup> California Department of Food and Agriculture: Final Results for Class 4a and 4b Pricing Formula Hearing of October 10, 2007, released November 20, 2007.

Both of these documents have been decided upon as the detailed and appropriate means of effectuating the foregoing conclusions.

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

#### **Referendum Order To Determine Producer Approval; Determination of Representative Period; and Designation of Referendum Agent**

It is hereby directed that referenda be conducted and completed on or before the 30th day from the date this decision is published in the **Federal Register**, in accordance with the procedure for the conduct of referenda (7 CFR 900.300–311), to determine whether the issuance of the orders as amended and as hereby proposed to be amended, regulating the handling of milk in the Upper Midwest, Mideast, and Northeast marketing areas is approved or favored by producers, as defined under the terms of the orders (as amended) and as hereby proposed to be amended), who during such representative period were engaged in the production of milk for sale within the aforesaid marketing areas.

The representative period for the conduct of such referenda is hereby determined to be May 2012.

The agents of the Secretary to conduct such referenda are hereby designated to be the respective market administrators of the aforesaid orders.

#### **Determination of Producer Approval and Representative Period for All Other Orders**

May 2012 is hereby determined to be the representative period for the purpose of ascertaining whether the issuance of the orders, as amended and hereby proposed to be amended, regulating the handling of milk in the Appalachian, Florida, Southeast, Central, Pacific Northwest, Arizona, and Southwest areas is approved or favored by producers, as defined under the terms of each of these orders as amended and as hereby proposed to be amended, who during such representative period were engaged in the production of milk for sale within the aforesaid marketing areas.

#### **List of Subjects in 7 CFR Part 1000**

Milk marketing orders.

#### **Order Amending the Orders Regulating the Handling of Milk in the Northeast and Other Marketing Areas**

This order shall not become effective until the requirements of 7 CFR section 900.14 of the rules of practice and procedure governing proceedings to formulate marketing agreements and marketing orders have been met.

#### **Findings and Determinations**

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

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

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

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

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

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

#### **Order Relative to Handling**

*It is therefore ordered*, that on and after the effective date hereof, the

handling of milk in the Northeast and other marketing areas shall be in conformity to and in compliance with the terms and conditions of the order, as amended, and as hereby amended, as follows:

The provisions of the order amending the order contained in the interim amendment of the order issued by the Administrator, Agricultural Marketing Service, on July 25, 2008, and published in the **Federal Register** on July 31, 2008 (73 FR 44617), are adopted without change and shall be and are the terms and provisions of this order.

[**Note:** The following will not appear in the Code of Federal Regulations.]

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

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

I. The findings and determinations, order relative to handling, and the provisions of § \_\_\_\_\_ to \_\_\_\_\_ all inclusive, of the order regulating the handling of milk in the \_\_\_\_\_ marketing area (7 CFR part \_\_\_\_\_); and

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

(a) Record of milk handled. The undersigned certifies that he/she handled during the month of \_\_\_\_\_,

\_\_\_\_\_ hundredweight of milk covered by this marketing agreement.

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



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

In Witness Whereof, The contracting handlers, acting under the provisions of the Act, for the purposes and subject to

the limitations herein contained and not otherwise, have hereunto set their respective hands and seals.

Signature

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

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

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

(Seal)

Attest \_\_\_\_\_

Dated: February 1, 2013.

**David R. Shipman,**  
*Administrator, Agricultural Marketing Service.*

[FR Doc. 2013-02623 Filed 2-6-13; 8:45 am]

**BILLING CODE 3410-02-P**