## DEPARTMENT OF AGRICULTURE

### Agricultural Marketing Service

### 7 CFR Part 1000

**[Docket No. AMS–DA–07–0026; AO–14–A77, et al.; DA–07–02–A]**

## Milk in the Northeast and Other Marketing Areas; Tentative Partial Final Decision on Proposed Amendments and Opportunity To File Written Exceptions to Tentative Marketing Agreements and Orders

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

**ACTION:** Proposed rule; tentative partial final decision.

**SUMMARY:** This tentative partial final decision proposes to 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 on an interim basis. A separate decision regarding the collection of manufacturing cost information, the use of an energy cost adjustor and providing for a cost add-on feature to Class III and Class IV product-pricing formulas will be addressed in a separate decision. This tentative partial decision requires determining if producers approve the issuance of the amended orders on an interim basis.

**DATES:** Comments should be submitted on or before August 19, 2008.

**ADDRESSES:** Comments (six copies) should be filed with the Hearing Clerk, Stop 9200—Room 1031, United States Department of Agriculture, 1400 Independence Avenue, SW., Washington, DC 20250–9200. Comments may also be submitted at the Federal eRulemaking portal: *http://www.regulations.gov*.

**FOR FURTHER INFORMATION CONTACT:** Jack Rower, Marketing Specialist, USDA/AMS/Dairy Programs, Order Formulation and Enforcement, Stop 0231—Room 2971–S, 1400 Independence Avenue, SW., Washington, DC 20250–0231, (202) 720–2357, e-mail address: *jack.rower@usda.gov*.

**SUPPLEMENTARY INFORMATION:** This tentative partial final decision proposes to adopt on an interim final and emergency basis, amendments to the manufacturing (make) allowances for cheese, butter, nonfat dry milk (NFDM) and dry whey powder contained in the Class III and Class IV product price formulas. Specifically, this decision proposes to adopt the following make allowances: Cheese—$0.2003 per pound; butter—$0.1715 per pound; NFDM—$0.1678 per pound; and dry whey—$0.1991 per pound. This decision also proposes increasing the butterfat yield factor in the butterfat price formula from 1.20 to 1.211.

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. Proposals seeking to establish a manufacturing cost survey (Proposal 2), establish an energy cost adjustor (Proposal 17) and establish a cost add-on (Proposal 20), will be addressed in a separate recommended decision.

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. If adopted, the proposed 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 habitant, 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 producers, it should be an inclusive standard for most small dairy farmers. For purposes of determining a handler's size, if the plant is part of a larger company operating multiple plants that collectively exceed the 500-employee limit, the plant will be considered a large business even if the local plant has fewer than 500 employees.

For the month of February 2007, the month the initial public hearing was held, the milk of 49,712 dairy farmers was pooled on the Federal order system. Of the total, 46,729 dairy farmers, 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 that all orders be amended by changing the make allowances contained in the formulas used to compute component prices and the minimum class prices in all Federal milk orders. Specifically, the make allowance for butter increases from $0.1202 to $0.1715 per pound; the make allowance for cheese increases from $0.1682 to $0.2003 per pound; the make allowance for NFDM increases from $0.1570 to $0.1678 per pound; and the make allowance for dry whey increases from $0.1956 to $0.1991 per pound. The butterfat yield factor in the butterfat price formulas is increased from 1.20 to 1.211.

The proposed adoption of these new make allowances serves 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 Dairy Web site at *http://www.ams.usda.gov/dairy*. Based on the economic analysis we have concluded that 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 tentative partial final 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.

Interested parties were invited to submit comments on the probable regulatory and informational impact of this proposed rule on small entities.

**Economic Analysis**

In order to assess the impact of the proposed changes in Federal order producer price formulas, the Department conducted an economic analysis. The complete analysis is available at on the Dairy Programs Web site which can be accessed through *http://www.ams.usda.gov*.

The impacts of the proposed changes to the Class III and Class IV pricing formulas contained in the tentative final decision are summarized as changes from the USDA baseline on an annual basis and as a nine-year average change from 2008–2016. Impacts on the Federal order system are considered to be in the context of the broader U.S. market for milk and dairy products.

*Producers:* The U.S. all-milk price falls an average $0.06 per cwt (0.39 percent) from a baseline level of $16.22 per cwt over the nine-year projection period. The average Federal order minimum blend price at test averages $0.11 per cwt (0.68 percent) below the baseline level of $16.43 per cwt. The lower milk prices result in a tightening of production. In turn, Federal order marketings fall an average 145 million pounds (0.11 percent) below the baseline average of 126.5 billion pounds. Federal order cash receipts decrease an average $165 million (0.79 percent) from the $20.8 billion baseline receipts. U.S. marketings come in an average 240 million pounds (0.13 percent) per year below the baseline average of 187.8 billion pounds. The lower marketings coupled with lower prices across the board result in an average decline of $156 million (0.51 percent) in producer revenue from the baseline average of $30.4 billion.

*Milk Manufacturers and Processors:* Increases to the make allowances in Federal order minimum price formulas are advantageous for dairy product manufacturers. Average wholesale prices over the projection period exceed baseline by the following: Cheddar cheese by $0.0176 per pound (1.14 percent), butter by $0.0346 per pound (1.89 percent), nonfat dry milk by $0.0090 per pound (0.88 percent), and dry whey by $0.0034 per pound (0.94 percent).

In spite of the higher product prices, the make allowance changes are substantial enough that the nine-year average component prices fall from baseline levels. The changes are as follows: Butterfat by $0.0014 per pound (0.07 percent), protein by $0.0451 per pound (1.96 percent), nonfat solids by $0.0018 per pound (0.22 percent) and the other solids price by $0.001 per pound (0.05 percent). Lower component prices are carried through to lower skim milk pricing factors. The Class III skim price falls an average $0.14 per cwt (1.72 percent) from a baseline average level of $8.16 per cwt and remains the Class I price mover.

*Consumers:* The retail price of fluid milk is expected to decrease an average of $0.0094 per gallon (0.27 percent) from the baseline average price of $3.4135 over the nine-year projection period due to the lower Class I price. Consumers respond, albeit modestly, to the decreased prices as evidenced by the average 32 million pound (0.07 percent) increase in Class I marketings from a baseline average of 45 billion pounds over the projection period. Class II marketings increase overall, indicating an increase in consumption of soft products consistent with the slight decline in Class II prices. At the same time, consumers face higher prices for hard manufactured dairy products such as cheese, butter and nonfat dry milk and as a result, Class III and Class IV marketings fall from baseline levels. Consumer demand for hard manufactured dairy products is more elastic than for fluid milk and soft products; consumers are more responsive to changes in price.

*Government Outlays:* With the expiration of the Milk Income Loss Contract (MILC) program, and no activity under Dairy Export Incentive Program (DEIP), any change to government outlays occurs through Milk Price Support Program (MPSP) purchases. Baseline level prices are high enough that few government purchases are expected. Under the proposed changes, removals change only slightly at the beginning of the projection period; remaining unchanged in from baseline in the long run projection.

The proposed changes to Class III and Class IV pricing formulas result in lower Federal order prices as well as higher manufactured product prices. Thus, the gap between the price of milk and the wholesale prices received by processors widens. At the same time, milk producers face lower prices and respond by cutting back on production, leading to lower marketings and producer revenue losses.

The decrease in the Federal minimum price for Class I milk is passed on to consumers in the form of a slightly lower retail price for fluid milk which increases consumption. However, tighter milk supply bolsters manufactured product prices and in turn lowers consumption of cheese, butter, and NDFM. Class I and Class II marketings increase, but not enough to counteract the lower prices, allowing average receipts to fall across all classes. Though prices for Class III and Class IV milk decrease under the proposed changes, the decreased consumption of the associated dairy products and the increase in Class I and Class II product consumption causes a shift in dairy product allocation, increasing the amount of milk allocated to Class II production.

*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).

*Preliminary Statement*

Notice is hereby given of the filing with the Hearing Clerk of this tentative partial final decision with respect to the proposed 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 Agricultural Marketing Agreement Act (AMAA) and applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900).

Interested parties may file written exceptions to this decision with the Hearing Clerk, United States Department of Agriculture, Room 1031—Stop 9200, 1400 Independence Avenue, SW., Washington, DC 20250–9200, by the August 19, 2008, deadline. Six (6) copies of the exceptions should be filed. Comments may also be submitted at the Federal eRulemaking portal: *http://www.regulations.gov*.

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 Agricultural Marketing Agreement Act of 1937 (AMAA), 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 March 21, 2007 (72 FR 13219); 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:

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

2. Determination of Emergency Marketing Conditions.

*Findings and Conclusions*

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

This tentative final decision adopts on an interim basis, a proposal published in the hearing notice as Proposal 1 which seeks to amend the manufacturing allowances for butter, cheese, nonfat dry milk (NFDM) 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. Specifically, this decision adopts the following manufacturing allowances: Cheese—$0.2003 per pound, butter—$0.1715 per pound, NFDM—$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 currently uses 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 National Agricultural Statistic Service (NASS) surveyed prices of manufactured dairy products. 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. 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 price relationships. The butterfat, protein, other solids and nonfat solids prices are all derived in a similar manner: Average NASS 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 making raw milk into one pound of product. Federal milk order pricing formulas currently contain the following make allowances: Cheese—$0.1682 per pound, butter—$0.1202 per pound, NFDM—$0.1570 per pound and dry whey—$0.1956 per pound. These make allowances were adopted in 2006 (71 FR 78333) and became effective on March 1, 2007, and were determined on the basis of a California Department of Food and Agriculture (CDFA) and a Cornell Program on Dairy Markets and Policy (CPDMP) survey of manufacturing costs. The current make allowances, except dry whey, were computed by taking a weighted average of the CDFA and CPDMP surveys using National commodity production as the weights, and adjusting for marketing costs. The dry whey make allowance was computed by relying solely on the CPDMP 2005 survey and adjusting 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 four manufacturing plants.

Agri-Mark is 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 the Market Administrator to administer the survey, select the sample plants, and collect, audit, and assemble cost information. This proposal will also be addressed in a separate decision.

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 NFDM; and $0.1500 per pound for dry whey. DPNM is an association of dairy producers located in New Mexico and West Texas.

DPNM is 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 shrink and butterfat shrink 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 butter 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 40 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 CME cheese price series to determine the cheese price contained in the Class III and Class IV product-price formulas.

Proposal 15 also 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. This proposal will be addressed in a separate decision.

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 states. This proposal also will be addressed in a separate decision.

To provide order to the volume of hearing testimony and post-hearing briefs, 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

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 NFDM. The witness did not testify in support or 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 were factors 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 each of 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 its 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 eleven plants, the witness classified seven as small plants and the remaining four 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 eight 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 seven 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 seven participating whey plants were associated with a cheese plant that was also included in the 2006 survey. The witness noted that 12 whey plants participated in the 2005 survey.

The Cornell witness said that four butter plants participated in the 2006 survey; three of the plants also participated in the 2005 survey. The weighted average cost of the four 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 NFDM consisted of seven of the eight NFDM plants that participated in the 2005 survey. According to the witness, the weighted average cost of the seven 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 NFDM. According to the witness, there were flaws in the method used to indirectly allocate costs for NFDM in the 2005 study that resulted in understating the cost of processing NFDM. 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 or the methodological changes for 2006. According to the witness, the 2006 survey accounted for 70.1 million pounds of NFDM, 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 CDFA data. The witness asserted that this update would increase the butter, NFDM 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 CDFA data which reflects an average cost of $0.2851 per pound.

The witness reiterated Agri-Mark's position expressed in comments to the tentative final decision (71 FR 67467) that proposed adoption of the current make allowances. 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 NFDM 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 Southwest 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 Southwest to the Northeast. 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 the timelier 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 fund. 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 new CPDMP 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 own 4 manufacturing plants in the United States. The witness supported updating the current make allowances with 2005 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 are 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, specifically the 2005 CDFA manufacturing cost 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 current 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 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., hereinafter referred to as 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 its 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 CDFA 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 the most representative of average size plants and therefore it is 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 CDFA and the CPDMP survey of 2006 weighted average costs. Using this same methodology, the brief proposed a butter make allowance of $0.1725 per pound and the NFDM make allowance of $0.1782 per pound (though stipulating that the CDFA medium-sized plant cost should be used for NFDM.) The brief summarized the Cornell witness' testimony regarding the errors with the 2005 butter and NFDM 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.

A witness testified on behalf of DPNM, Select Milk Producers, Inc. (Select), and Continental Dairy Producers, Inc. (Continental). Hereinafter, these entities will be referred to as 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 CDFA 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 CDFA data had been utilized in the past when make allowances were determined using Rural Business Cooperative Service (RBCS) cost data because the audited CDFA 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 NFDM; 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 NFDM make allowance to account for the additional energy needed to produce dry whey. The witness estimated that if the DPNM, et al's., proposed make allowances are 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 average gross income of $15.51 per cwt and an average cost of production of $15.17 per cwt, would yield an average net profit of $0.34 per cwt. The witness said that this was 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 1990s, 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 west 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 has 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 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.

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 price formula 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 and reiterated this position in its 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 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 testimony of the Cornell witness which compared the eight 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 NFDM; 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.

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 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 those 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 on 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 should 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, hereinafter referred to as Dairylea, et al., opposed adoption of Proposals 1 and 2. The brief opined that the current make allowances should be used with the addition of the energy adjustor 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.

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' costs 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 also should 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 witness, DPNM, et al., 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 10.5-cent 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 83.2, 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 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 ration 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 zero 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 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.

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 cheese yield formula. However, the Leprino witness did not support increasing the cheese 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 an 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.

A food technologist witness appearing on behalf 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 using 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 Foods (Kraft) testified in support of the positions and proposals advocated by IDFA. According to the witness, Kraft purchases and manufacturers dairy products and operates numerous plants located throughout the country.

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 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 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 of 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 as 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 an 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.

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 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 cheese manufacturers that testified achieving a fat 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 are commonly based on farm weights and tests.

The post-hearing brief submitted on behalf of O–AT–KA stated 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.

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 it 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 in the marketplace. The brief also highlighted testimony that some processors do not return whey cream back into its 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.

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 were 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.

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 witness conceded that Leprino does not make cheddar cheese and uses all its whey cream in its cheesemaking.

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 with 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.

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.

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 in 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, processes 410 million pounds of milk annually 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 removing 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 which usually can be sold at 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, NFDM 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 overvalues 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 prices 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 cwt. 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 to cover 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 the 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 Dairylea, 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.

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 value of whey butter is as low as the proponents claim, then a separate whey butterfat price should be established instead of lowering the protein price.

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 and 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.

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.

No proponent testimony was received regarding Proposal 13.

The Kraft witness opposed 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 insisted 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 39 percent moisture standard. However, the witness noted that after January 2001 the barrel cheese price was adjusted to 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 five 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.

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.

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 determining new make allowances provides the necessary recognition of the cost difference between block and barrel production. The brief argued that CDFA data in fact 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.

5. Product Price Series

The 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 becomes 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 in seven months of the year. According to 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 hypothesized by example 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 the low volume of trades 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.

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 because it will result 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 asserted that sellers 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 being $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 it is a public market and since 1997 has expanded trading times and the number of traded dairy products. 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 oversight by 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 such packaging requirement was changed, the CME would become a viable market for NFDM.

DPNM, et al.'s, brief 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 concluded this position is supported in a General Accountability Office (GAO) study of June 2007.

The DPNM, et al., brief expressed support for using 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 and requested that USDA further investigate the use of a competitive pay price and convene a hearing to consider this alternative.

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 for determining the value of milk and setting regulated minimum prices than are product-price formulas. The witness contended that butter, NFDM, cheese and whey each have a separate market that responds to separate and unique supply and demand factors. The witness explained that in a competitive pay price system buyers pay for raw milk based on 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 influence of regulated minimum prices could not be eliminated; (2) inadequate vigorous competition among buyers of milk; and (3) competitive pricing was based on the competitive situation for milk in Minnesota and Wisconsin. The witness explained that these limitations formed the analysis 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 where a low Herfindahl index indicates more competition for milk. For example, competition for milk in a county with an index of 0.3450 is greater than in a county with an index of 0.3500. The witness proposed that competitive price zones be determined by aggregating clusters of 10 contiguous counties or more with indexes less than 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 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. The witness said indirect compensation to farmers, such as hauling charges, would not be included in the computation of a weighted average price but could be a ''loophole'' used by manufacturers to lower the Class III milk price by shifting 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 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. 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, predicted the witness. 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 order program, but producer prices are heavily influenced by those established under the Northeast order. The witness stated that Maine dairy farmers have turned to alternative sources of income such as state subsidies and increased equity financing to keep their farms operating because Federal minimum prices are too low and driven by unpredictable price swings for dairy products.

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 of a Maine dairy farmer to be $19 per cwt, $20 per cwt and $24 per cwt in 2004, 2005 and 2006, respectively. The witness compared this price to the Northeast Federal order mailbox price of $16.29 per cwt, $15.39 per cwt and $13.22 per cwt in 2004, 2005 and 2006, respectively. Using those 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 that gives a subsidy payment from the State general fund. However, the witness said 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 these State programs cannot be relied upon in the long-run to provide a stable marketplace for dairy farms.

A post-hearing brief filed on behalf of MDIA reiterated its 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 pricing derived 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 how producer milk is valued and through which minimum classified prices would be determined.

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, mid-western and southeastern regions of the country. The brief attributed observed price volatility in milk prices to the use of end product price formulas. In this regard, the brief asserted that the product-pricing 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 stabilization and enhancement of producer income.

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 their base selling prices. The witness asserted that using NASS surveys to set minimum prices has resulted in disorderly market conditions because of 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 by concluding that record evidence is insufficient to support its adoption. Their post-hearing brief specifically expressed support for the portion of Proposal 15 for using 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 a 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 other than 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 the price reporting to NASS became electronic, mandatory and audited. IDFA insisted in its post-hearing brief that using the CME to determine product prices could result in product prices that are not representative 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 price at the plant. The witness acknowledged the time lag between CME prices and the NASS price survey 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 price reporting 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 was 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 the timelier updating of 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.

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 primarily be derived from its protein content, rather than its other solids content as 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 by 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 reflects a shortage in lactose processing capacity and not a lack of available lactose. The witness believed that the high dry whey and lactose prices prior to the fall of 2006 justify valuing dry whey on a protein rather than 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 and therefore 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 in that NASS price surveys be expanded to collect and report market prices of 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.

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 in 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 because doing so 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 calling for USDA to collect prices, manufacturing costs, and volumes for whey protein concentrates and whey protein isolates.

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 or 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 analyzed scenarios as outlined in the USDA preliminary economic analysis 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.

*Discussion and Findings*

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 abandonment of the current product-price formulas used to compute minimum Class III and Class IV prices to proposals that seek a variety of changes to the product-pricing formulas including manufacturing cost factors (make allowances), yield factors, technical factors, and authority to separate a portion of manufactured product sales prices from what otherwise is used to establish subsequent raw milk prices. The record of this proceeding encompassed a total of 12 hearing days over a 6-month period from February through July, 2007 and consists of more than 3000 pages of testimony, plus 78 exhibits and 10 post hearing briefs. 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 specifically how the many features of the product-price formulas should be altered.

Proponents for increasing make allowances have requested that regardless of the method adopted, USDA should omit a recommended decision and immediately adopt higher make allowances for butter, NFDM, cheese and dry whey because manufacturing costs have increased since the implementation of the current make allowances. The proponent from Agri-Mark for example, provided direct testimony that electricity and other fuel costs in cheese making had increased for plants operated by the cooperative. NMPF's proposed use of BLS energy cost data for an energy cost adjustor for make allowances as sought by Proposal 17 (addressed in a separate decision) provided reinforcement of the continued and rapid increases in those energy costs. Proposal 2, advanced by Agri-Mark, seeking to formally regularize the methodology for updating manufacturing cost data, and Proposal 20, advanced by Dairylea, to establish a cost add-on also are addressed in a separate decision.

Proponent witnesses representing Leprino, Twin County, and IDFA provided specific and general information that also support concluding that energy, transportation, labor and packaging costs for manufacturing processors have increased since the current make allowances became effective in March 2007. As pointed out by IDFA, because make allowances account for manufacturing costs in the Class III and Class IV price formulas but do not change as those costs change, increasing make allowances is the only reasonable way by which those increased costs can be recovered.

The ability of a manufacturer to offset cost increases are 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 costs higher than those provided by 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-pricing formulas use market prices collected by NASS 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 competitive pay price series, product-price formulas for cheese, dry whey, NFDM and butter serve as the only practical basis from which the value of raw producer milk used in their production can be derived. A raw milk value is, in part, derived from NASS collecting and aggregating weekly reported sales price data from manufacturers who produce and market these commodity products and are presented in the NASS Dairy Product Price Survey.

The Class III and Class IV product-price formulas, among other factors, use the 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 costs 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 by combining such data for plants outside of California with the most current manufacturing cost data published by the CDFA.[1] The 2-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.[2] This method was used in earlier rulemakings to develop make allowances used in the product-price formulas.[3] [4]

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-pricing formulas. The record demonstrates that current 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 milk that are used nationally in all Federal milk orders. When dairy farmer production costs exceed the value for which 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 this greater milk 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, evidence demonstrates that the manufacturing costs of producing cheese, dry whey, NFDM and butter have increased since the implementation of current make allowances on an interim basis and during the 6-month period when this proceeding occurred.[5]

The record reveals an absence of industry consensus concerning the method (how) make allowances should be changed that in turn determines the level of the make allowances used in the Class III and Class IV product-pricing formulas. The differing proposed make allowance levels offered over the course of the proceeding represent the changes in opinions concerning which manufacturing costs, which manufacturing cost survey(s) and 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 these surveys are most reflective of costs by plants who pay Federal order prices. CDFA data represents a cost survey of only California processing plants. It is important to Federal order classified pricing that Class III and Class IV prices be derived, as much as possible, from national estimates of manufacturing cost information and because NASS survey prices include California. Accordingly, it is reasonable to conclude that appropriately combining this cost data with cost survey data of manufacturing plants not located in California will tend to produce a measure of national manufacturing costs. Doing so will tend to not bias manufacturing costs measurements that may otherwise result from the exclusive use of one set of cost survey data over another.

The proposal (Proposal 3) by DPNM is offered in opposition to increasing make allowances in the manner offered by Agri-Mark. DPNM argues that because the CPDMP 2006 survey represents manufacturing costs of plants not located in California, then that survey should be exclusively relied upon 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

[1] 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.cdfa.ca.gov/dairy/dairy_hearings_matrix.html*, and *http://www.cdfa.a.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.cdfa.ca.gov/dairy/pdf/manufcostexhibit2006.pdf.*

[2] Ibid.

[3] 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.

[4] 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 *http://www.ams.usda.gov/dairy.*

[5] Ibid. Official notice is taken of 72 FR 36341, July 3, 2007.

cost survey and CDFA in combination—has provided effective and useable make allowances in the pricing formulas even though it is clear that the current levels of make allowances need to be updated.

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 2006 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 and NFDM compete in a national marketplace and as such the prices established under the Class III and Class IV product-pricing formulas need to be reflective of marketing conditions that directly affect determining the minimum value of raw milk. Accordingly, Proposal 3 is not adopted.

While many hearing participants support the general method of determining make allowances adopted in this decision, the record nevertheless reveals a lack of industry consensus in determining specific factors to be used in the Class III and Class IV product-pricing formulas. This is illustrated by the information presented in Table 1 below. The seven sets of suggested make allowances represent proposals from 4 different groups at various points of 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

| Proponents | Make allowances | | | |
|---|---|---|---|---|
| | 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 |

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. Similarly, the range from highest to lowest proposed make allowance for butter remarkably varies by more than 60 percent and about 25 percent for NFDM.

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 make allowances currently in the Class III and Class IV product-price formulas. 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, improves estimation of manufacturing costs on a national basis and is consistent with the methodology relied upon in determining the make allowances currently in the Class III and Class IV product-pricing formulas.

The manufacturing cost data presented in the CPDMP 2006 survey is essentially a new cost survey. The data presented in the survey is similar to CPDMP's earlier cost survey in that both surveys rely on cost information provided from manufacturing plants not located in California. The surveys are similar in that they collect manufacturing cost data for cheese, butter, NFDM, and dry whey. However there are differences, the most important of which is using different samples of plants than those reported in the earlier CPDMP 2005 survey.

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 of which 8 were among the 16 plants participating in the 2005 survey. For butter, 4 plants provided cost data in the 2006 survey and 2005 survey, but the surveys represent different collections of sampled plants with different production volumes. Regarding butter manufacturing cost data, the 2006 survey differs from the early survey in that the 2006 survey employed a different method for allocating costs between butter and NFDM production in plants that jointly manufactured these products. For NFDM, the plants sampled and reported in the 2006 survey included all but one of the plants sampled as part of the 2005 survey.

The determination of the adopted make allowances for cheese, butter, NFDM and dry whey are discussed below. The make allowances adopted represent national manufacturing cost averages for cheese, butter, NFDM 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-pricing 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.

NFDM Make Allowance

The NFDM 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 NFDM 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 NFDM.

Cheese Make Allowance

The cheese manufacturing cost data presented in the 2006 CPDMP 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 2005 CPDMP 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 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 rejected.

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 for adoption for cheddar cheese is $0.2003 per pound including $0.0015 per pound marketing cost adjustment.

Dry Whey Make Allowance

Estimating the manufacturing cost of producing dry whey presents a problem similar to that for cheese. The most recent published CDFA manufacturing cost survey reveals that CDFA was not satisfied with the precision in estimating the average cost per pound for whey products it discovered through plant audits. In light of this concern regarding dry whey manufacturing costs, this decision does not rely on the CDFA data.

This decision does 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 currently used in the Class III price formula. 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 2002 (67 FR 67906), and became effective on April 1, 2003 (68 FR 7063).

Specifically, DPNM explained that the current butterfat recovery factor of 1.20 used in the butterfat pricing formula is 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 explained by DPNW, 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 current 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 adopts a butterfat yield of 1.211.

Opponents of amending this factor do not dispute that the current butterfat yield factor used in the pricing formulas is in error. Rather, opposition rests on the premise that manufacturing processors are already paying too much for raw milk and attribute paying too much 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 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 was advanced by DPNM that 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 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 could possibly recover when making cheese. A 94 percent recovery rate will also 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 in cheese production is possible by 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. It is important that the product-price formulas reflect current market conditions, not market conditions that may be possible but not widely achieved or not reflective of general industry wide conditions. Accordingly, this decision rejects adoption of this feature of DPNM Proposal 6.

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). While DPNM argued 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.

This decision finds that the Class III and Class IV product-price formulas should continue to recognize the loss of milk that occurs when milk is moved from the farm to a receiving plant. The record also supports concluding that some losses are outside the control of the manufacturer. 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 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. The argument for increasing these yield factors is that that new technology could allow manufacturers to achieve higher product yields increasing the value of a cwt of raw milk. Opponents counter that the methodology used to derive the proposed yield factors are flawed and that no actual studies were offered to support concluding that product yields are higher than those currently provided in the formulas.

As with the rejection of a portion of Proposal 6 discussed above, the preponderance of record evidence does not support concluding that the NFS yield or the cheese yield based on protein and butterfat retention in cheese manufacturing should be changed. The record does not contain credible data that shows that the proposed yields are achievable. While the proponent offered proposed yield factors from published data, it failed to take into account whether the addition of milk solids to cheese vats was the likely source of higher product yields. In fact, numerous cheese manufacturers testified that when economically feasible they fortified their cheese vats to increase vat yields. For these reasons this decision finds that the current product yield factors used in the Class III and Class IV product-price formulas are reasonable. Accordingly, Proposal 8 is not adopted.

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 milk 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 butter is marketed at a discount to the Grade AA butter price and is often marketed to commercial food service establishments such as bakeries. Although 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 also contains very limited data regarding plant sales of whey butter. More importantly, there is no known publically available data for U.S. market prices and volumes of whey butter produced or sold.

Opponents (Dairylea, 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.

The record does not support reducing the protein price to account for unknown volumes and values of whey cream. Without publicly available market data that measures and reports whey cream volumes and prices, no reasonable and objective means is available to determine if or how whey cream is unreasonably distorting the protein price formula feature contained in the Class III product-pricing formula. 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, Proposal 10 is not 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 now 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 exclusively cheese 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.

The record does not support a finding for adopting 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 any packaging cost difference must also be nearly zero. This decision does not find a causal relationship between selling prices and costs. While evidence does support that market prices of blocks and barrels can sometimes be identical, it cannot be concluded that any purported cost difference arising from packaging cost differences must have also disappeared. The sometime relatively similar market prices of block and barrels could be explained by a multitude of factors not relating to manufacturing and packaging costs.

Packaging cost differences between barrels and blocks may well be negligible. 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 not adopted.

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 not testimony 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, removing the barrel price from the protein price formula would greatly reduce the total NASS survey volume and thus make the price survey less representative of the cheddar cheese market.

This decision finds 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-product price formula needs to be as reasonably representative of the market for cheese that determines the value of milk. Record evidence reveals that barrel production in the NASS 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 adopted.

Product Price Series

Proposal 14 advanced by Agri-Mark, seeking to change the price data used in the Class III and protein price formula by combining NASS price survey data for cheddar cheese with weekly average CME cheese prices is presented as a superior benchmark price for cheese. The argument rests on the assertion that 2-week timing difference, or lag, between the CME price and the NASS 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 currently provided by the NASS 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 NASS price would reduce the usefulness of currently available risk management tools. Those tools include the use of futures contracts and the use of forward contracts. Opponents also note that 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, that it adds a degree of complexity to a pricing-formula that is already too complex without any discernible benefit and its adoption would tend to bias price reporting to the market conditions of the Chicago area.

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-pricing formulas. Other than assertions by the proponent, the record lacks evidence that combining CME prices with NASS survey prices will improve price discovery, market information, or offer a superior transmission of economic signals through the minimum Class III price.

A rulemaking action on mandatory product price reporting overtakes the need to consider adoption of a new price series that combines CME prices with NASS survey prices. Improved mandatory price reporting that provides for auditing prices reported to NASS and will make the accuracy, but not the timing, of price data less of an issue than envisioned during the course of the hearing.

It would not be appropriate to compare NASS and CME prices as being coincident after accounting for their 2-week lag until adequate data has been collected against which a reasonable price comparison can be made. If the reported cheese prices in the NASS reports are largely and similarly reflective of CME prices, then the proponent's analysis and conclusions retain validity. If large differences are discovered between audited mandatory

price reports compared with price reporting that does not include auditing, then Agri-Mark's analysis of the 2 price series being nearly identical may no longer be reasonably recreated by a time lag adjustment. Unaudited price reporting includes all reporting prior to the effective date of August 2, 2007, for implementation of the mandatory price reporting and auditing rulemaking. Accordingly, Proposal 14 is not adopted.

A proposal advanced by DPNM, Proposal 15, seeking to replace the NASS 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 NASS price reporting. DPNM argues that using CME prices in the price formula for cheese would provide producers, marketers, and manufacturers of cheddar cheese with timelier prices and that CME represents actual current cheese prices.

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

This decision agrees with opponents in that cheese prices used in product-price formulas should reflect broad market trends and not rely exclusively on a smaller subset of cheese prices and spot marketing conditions represented by the CME. The record also makes clear that more industry confidence is placed on NASS price surveys than 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 inappropriate to value dry whey on a component (protein) that has no measurable effect on the product yield.

This decision finds 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 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 on which 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 decision finds that dry whey 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 can return to basing classified prices on 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 and therefore milk prices within the competitive price zones would be influenced by milk priced under adjoining Federal orders. Other considerations, such as accounting for various forms of in-kind payments to producers, also need to be addressed. Ignoring consideration of such subsidies would allow plants to increase (decrease) their hauling subsidies as a way of reducing (increasing) the actual pay price to dairy farmers.

For the same reasons articulated regarding the need to abandon a competitive price series, the only current practical method upon which to establish minimum Federal order prices are product-price formulas. While other methods have been considered, none had superior benefits or had broad-based industry support other than product-price formulas.

Therefore, this decision finds that Proposal 18 cannot be implemented as proposed. Accordingly, Proposal 18 is not adopted.

Rulings on Motions

A motion for official notice of publications and a final decision by the CDFA was submitted by Agri-Mark, et al., joined by Twin County Dairy, Inc., and supported by IDFA. This decision takes official notice of these publications. Accordingly, the motion is rendered moot.

A motion and supplemental information in support of that 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 occurred for 3 weeks held over the 6 month period of February 2007 through July 2007. It also was preceded by an information session in December 2006. This decision finds that sufficient time was made available to all known parties to develop and present noticed proposals. Accordingly, the motion is denied.

2. Determining Whether Emergency Marketing Conditions Exist That Would Warrant Omission of a Recommended Decision

Evidence presented at the hearing and in post-hearing briefs establishes that current manufacturing allowances contained in the product price formulas do not reflect the current costs of manufacturing milk into cheese, butter, NFDM and dry whey. Data presented at the hearing demonstrates that manufacturing costs have increased since manufacturing allowances were last updated and implemented on March 1, 2007. The method of determining the new make allowances proposed to be adopted in this tentative decision is the same method used when the current make allowances were adopted and implemented. Issuance of a recommended decision is not reasonable as it would only delay implementation of make allowances that more reasonably reflect higher manufacturing costs being incurred by manufacturers. Additionally, the method of determining the proposed make allowances is the same as that used in determining the make allowances currently in use and is known by handlers. The record also shows that the yield factor in the butterfat formula is not accurate. This factor should be amended from the current 1.20 to 1.211 to improve the accuracy of the Class III and Class IV product-pricing formulas. Improving the accuracy of the formulas upon which all classified milk prices are set in all orders is critical in providing processors with adequate revenue to maintain operations and in providing producers with market-based pricing signals from which they base production and marketing decisions. Accordingly, the record clearly establishes a basis for amending the orders on an interim basis.

Consequently, it is determined that emergency marketing conditions exist that warrant omitting the issuance of a recommended decision. The record clearly establishes a basis as noted above for amending the orders on an interim basis. The opportunity to file comments to the proposed amended orders remains.

In view of these findings, an interim final rule amending the orders will be issued as soon as the procedures to determine the approval of producers are completed.

*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 interim 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 interim 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.

*Interim Marketing Agreements and Interim Order Amending the Orders*

Made a part hereof are two documents—an Interim Marketing Agreement regulating the handling of milk and an Interim Order amending the orders regulating the handling of milk in the Northeast and other marketing areas—which have been decided upon as the detailed and appropriate means of effectuating the foregoing conclusions.

It is hereby ordered, that this entire tentative partial decision and the interim orders and the interim marketing agreements 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 Appalachian, Arizona, Central, Florida, Mideast, Northeast, Pacific Northwest, Southeast, Southwest and Upper Midwest 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 July 2007.

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

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

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

*Findings and Determinations*

The findings and determinations hereinafter set forth supplement those that were made when the 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.

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

Milk marketing orders.

**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:

## PART 1000—GENERAL PROVISIONS OF FEDERAL MILK MARKETING ORDERS

1. The authority citation for 7 CFR part 1000 is amended to read as follows:

**Authority:** 7 U.S.C. 601–674, and 7253.

2. Section 1000.50 is amended by:
a. Revising paragraph (l);
b. Revising paragraph (m);
c. Revising paragraph (n)(2);
d. Revising paragraph (n)(3)(i);
e. Revising paragraph (o); and
f. Revising paragraph (q)(3).
The revisions read as follows:

**§ 1000.50 Class prices, component prices, and advanced pricing factors.**

* * * * *

(l) *Butterfat price.* The butterfat price per pound, rounded to the nearest one-hundredth cent, shall be the U.S. average NASS AA Butter survey price reported by the Department for the month, less 17.15 cents, with the result multiplied by 1.211.

(m) *Nonfat solids price.* The nonfat solids price per pound, rounded to the nearest one-hundredth cent, shall be the U.S. average NASS nonfat dry milk survey price reported by the Department for the month, less 16.78 cents and multiplying the result by 0.99.

(n) * * *

(1) * * *

(2) Subtract 20.03 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by 1.383;

(3) * * *

(i) Subtract 20.03 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by 1.572; and

* * * * *

(o) *Other solids price.* The other solids price per pound, rounded to the nearest one-hundredth cent, shall be the U.S. average NASS dry whey survey price reported by the Department for the month minus 19.91 cents, with the result multiplied by 1.03.

* * * * *

(q) * * *

(1) * * *

(2) * * *

(3) An advanced butterfat price per pound rounded to the nearest one-hundredth cent, shall be calculated by computing a weighted average of the 2 most recent U.S. average NASS AA Butter survey prices announced before the 24th day of the month, subtracting 17.15 cents from this average, and multiplying the result by 1.211.

[**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 ____ [6] all inclusive, of the order regulating the handling of milk in the _____ [7] marketing area (7 CFR part ____); [8] and

II. The following provisions: § ____ [9] 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 ____ [10], ____ 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 Sec. 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: June 16, 2008.

**David R. Shipman,**

*Acting Administrator, Agricultural Marketing Service.*

[FR Doc. E8–13943 Filed 6–19–08; 8:45 am]

**BILLING CODE 3410–02–P**

[6] First and last section of order.

[7] Name of order.

[8] Appropriate Part number.

[9] Next consecutive section number.

[10] Appropriate representative period for the order.