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DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

7 CFR Parts 1000, 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, and 1131

[Docket No. AO-14-A76, et al.; DA-07-01; AMS-DA-07-0116]

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

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Final decision and termination of proceeding.

7 CFR part	Marketing area	AO Nos.
1001	Northeast	AO-14-A76
1005	Appalachian	AO-388-A20
1006	Florida	AO-356-A41
1007	Southeast	AO-366-A49
1030	Upper Midwest	AO-361-A42
1032	Central	AO-313-A51
1033	Midwest	AO-166-A75
1124	Pacific Northwest ..	AO-368-A37
1126	Southwest	AO-231-A70
1131	Arizona	AO-271-A42

SUMMARY: We are denying proposals that would have increased Class I and Class II prices and modified the formulas used to determine Class I and II prices in all Federal milk marketing orders. This document terminates the proceeding on the five proposed amendments.

DATES: Effective December 29, 2008.

FOR FURTHER INFORMATION CONTACT:

Gino Tosi, Associate Deputy Administrator for Order Formulation and Enforcement, USDA/AMS/Dairy Programs, Stop 0231-Room 2971, 1400 Independence Avenue, SW., Washington, DC 20250-0231, (202) 720-2357, e-mail: gino.tosi@usda.gov.

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

Small Business Consideration

Actions under the Federal milk order program are subject to the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). This Act seeks to ensure that, within the statutory authority of a program, the regulatory and information collection requirements are tailored to the size and nature of small businesses. For the purpose of the Act, a dairy farm is 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 (13 CFR 121.201). Most parties subject to a milk order are considered as a small business.

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.

USDA has identified that during 2005 approximately 51,060 of the 54,652 dairy producers whose milk is pooled on Federal orders are small businesses. Small businesses represent about 93 percent of the dairy farmers who participate in the Federal milk order program.

On the processing side, during June 2005 there were approximately 350 fully regulated plants (of which 149 or 43 percent were small businesses) and 110 partially regulated plants (of which 50 or 45 percent were small businesses). In addition, there were 48 producer-handlers, of which 29 were considered small businesses for the purposes of the initial regulatory flexibility analysis, who submitted reports under the Federal milk order program during this period.

The fluid use of milk represented more than 45.0 percent of total Federal milk marketing order producer deliveries during January 2006. Almost 237 million Americans, approximately 80 percent of the total U.S. population reside within the geographical boundaries of the 10 Federal milk marketing areas.

Because this action terminates the rulemaking proceeding without amending the present rules, the economic conditions of small entities remain unchanged. Also, this action does not change reporting, record keeping, or other compliance requirements.

Preliminary Economic Analysis

The Notice of Hearing in this proceeding contained a Preliminary Economic Analysis. The analysis is available at <http://www.ams.usda.gov/dairy/hearings.htm>. For further information contact Howard McDowell, Senior Economist, USDA/AMS/Dairy Programs, Office of the Chief Economist, Room 2753, South Building, U.S. Department of Agriculture, Washington, DC 20250, (202) 720-7091, e-mail address howard.mcdowell@usda.gov.

Prior Documents in This Proceeding:

Notice of Hearing: Issued November 17, 2006; Published November 22, 2006 (71 FR 67489).

Statement of Consideration

A public hearing was held December 11-15, 2006, in Pittsburgh, PA, with respect to proposed amendments to the tentative marketing agreements and to the orders regulating the handling of milk in all marketing areas.

The hearing was called pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601-674), and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR Part 900). The purpose of the hearing was to receive evidence with respect to the economic and marketing conditions that relate to the proposed amendments to the tentative marketing agreements and to the orders.

The hearing was held at the request of the National Milk Producers Federation (NMPF), a trade group representing dairy farmers and dairy farmer cooperatives, to consider proposals that would have increased Class I and Class

II prices and modified the formulas used to determine Class I and Class II prices. Consideration of the proposals was requested on an emergency basis.

Summary of Testimony

NMPF submitted five proposals that were addressed in this proceeding. The proposals would: (1) Increase the Federal order minimum Class I milk price by \$0.77; (2) Utilize an "advanced cheese skim milk price", or (3) An "advanced butter powder skim milk price" and a modified advanced butterfat price as replacements to the advance Class III and IV skim milk prices; (4) Modify the calculation of the Class II skim price; and (5) Modify the calculation of the Class II butterfat price.

Proponents testified that dairy farmers have experienced an extended period of below-average milk prices, high production costs and low farm returns. NMPF is of the opinion that the formulas used to price milk used in Class I and II products are outdated and inadequate to ensure orderly marketing conditions. NMPF is also of the opinion that although Class I and II prices move in concert with Class III and IV prices, they do so in a way that does not properly consider the costs of supplying fluid milk to the market. NMPF supports adoption of Proposals 1–5 to compensate dairy farmers for increases in the costs borne in supplying the fluid milk needs of the market. NMPF is of the opinion that adoption of Proposals 1–5 will help maintain the appropriate relationship between class prices and dairy product prices.

Proposal 1 would increase the Federal order minimum Class I price by \$0.77 while eliminating reference to the advanced Class III and Class IV skim milk prices in the Class I skim milk price formula. Proponents argue that an increase in the Class I price is necessary to reflect increased costs faced by dairy farmers in supplying the Class I market. The witness argued that the increased costs of maintaining a "Grade A" dairy farm along with marketing and transportation costs justify a \$0.77 per hundredweight (cwt) increase in the Class I price. Specifically, NMPF testified that increased costs of maintaining Grade A status on dairy farms require a \$0.15 per cwt increase, increased "marketing" costs require a \$0.23 per cwt increase and increased "competitive factor" costs require a \$0.39 per cwt increase.

Proposal 1 would replace the current Class I price mover (the higher of the Class III or Class IV price) with the higher of either:

A. Nonfat dry milk price \times 8.9 – \$0.63; or

B. Cheese price \times 10.0 + Dry whey price \times 6.1 – Butter Price \times 3.9 – 1.63.

The NMPF witness stated that the costs of establishing and maintaining "Grade A" status on dairy farms have increased. The witness was of the opinion that since the Class I price is intended to compensate producers for establishing and maintaining Grade A status, increases in the costs of establishing and maintaining Grade A status should be reflected in the Class I price. The witness presented USDA Economic Research Service (ERS) data that showed a 38 percent increase in "non-feed" costs for dairy farmers, including labor and utility expenses. The NMPF witness also presented a study published by the University of Wisconsin-Madison in 1977¹ detailing some of the costs associated with maintaining a Grade A dairy farm. The witness opined that many of the cost factors outlined in the 1977 study are the same type of costs faced by Grade A dairy farmers in 2006. The witness estimated that increases in non-feed costs of milk production including hot water, animal bedding and other supplies, justify a \$0.15 increase in the Class I minimum price.

The witness also cited increases in "marketing" costs to justify increasing the Class I price. Specifically, the witness was of the opinion that the costs of assembling, balancing and transporting milk to meet minimum delivery standards have increased.

The NMPF witness stated that energy and processing costs to dairy farmer cooperative owned manufacturing plants have also increased, and should be offset by an increase in the Class I minimum price. The witness testified that supply plants often sacrifice profits in order to meet the demands of the Class I and II market. The NMPF witness added that shifts in the location of milk production and consolidation of manufacturing plants require longer hauls to Class I plants. The witness estimated that an increase in the minimum Class I price of \$0.23 per cwt is necessary to offset these increased marketing costs.

The NMPF witness testified that other "competitive factor" costs have also increased. These costs reflect the amount of money that distributing plants are willing to pay to assure adequate supplies of milk. The witness stated that recent increases in over-order premiums demonstrate an increased "competitive factor," which justifies the

need for an increase in the minimum Class I price. The witness testified that increasing levels of over-order premiums indicate inadequate Class I prices to attract supplies of milk to fluid distributing plants, and that while certain "load-specific" costs are best addressed by over-order premiums, other costs should be covered by the regulated minimum Class I price. The witness, relying on Market Administrator data, added that over-order premiums have increased nearly 65 percent from 1995 to 2005 in the states of Minnesota and Wisconsin. The witness was of the opinion that increases in over-order premiums justify an increase of \$0.39 per cwt in the minimum Class I price.

Proposals 2 and 3 detail the specific changes necessary to utilize the proposed formula in Proposal 1. Proposals 2 and 3 would implement an advanced "cheese skim milk price" per cwt, an "advanced butter-powder skim milk price" per cwt and an "advanced butterfat price" per pound to replace the current advanced Class III and Class IV skim milk prices per cwt. Proposal 2 would change the current advanced Class III skim milk pricing factor per cwt to an advanced cheese skim milk price per cwt factor. The cheese skim milk pricing factor per cwt would be determined by:

(a) Multiplying the weighted average of the 2 most recent NASS average weekly prices for block and barrel cheese by 10; multiplying the weighted average of the 2 most recent NASS average weekly survey prices for dry whey announced before the 24th day of the month times 6.1;

(b) Multiplying the weighted average of the 2 most recent NASS weekly survey prices for butter announced before the 24th day of the month times 3.9;

(c) Adding the amounts computed in paragraph a, then subtracting the amount computed in paragraph b; and

(d) Subtracting \$1.44.

(e) The advanced butterfat price per pound would be determined by multiplying the weighted average of the 2 most recent NASS survey prices for butter by 1.20 and from this product subtracting \$0.1307.

Proposal 3 would change the current advanced Class IV skim milk pricing factor to an advanced "butter-powder skim milk price." The advanced butter powder skim milk price per cwt would be determined by:

(a) Multiplying the weighted average of the 2 most recent NASS weekly survey prices for nonfat dry milk announced before the 24th day of the month by 8.9; and

¹ Frank, Gary G., G.A. Peterson, and Harlan Hughes. "Class I Differential: Cost of Production Justification", in *Economic Issues*, Number 8, April 1977.

(b) From the product subtracting \$0.52.

Proposals 4 and 5 would adjust the way the Class II price is determined. Proposal 4 would change the manner in which the Class II skim milk price is computed. While the skim portion of milk used in Class II would continue to be announced in advance, it is proposed to be computed by:

(a) Multiplying the weighted average of the 2 most recent NASS survey prices for nonfat dry milk per pound announced before the 24th day of the month by 8.9; and

(b) From the product subtracting \$0.53.

The NMPF witness testified in support of Proposal 4. The witness was of the opinion that the current Class II skim milk formula incorrectly accounts for the costs of drying condensed skim milk and encourages substitution of condensed skim milk for nonfat dry milk (NFDM) in Class II products. The witness was of the opinion that their proposed revised formula more accurately reflects the full value of NFDM derived from a hundredweight of skim milk.

Proposal 5 would modify the calculation of the Class II butterfat price. The Class II butterfat price would be determined by:

(a) Multiplying the NASS AA butter survey price multiplied by 1.20; and
(b) From the product subtracting \$0.1147.

The NMPF witness testified in support of Proposal 5. The witness was of the opinion that the proposed formula would set the Class II butterfat price equal to the minimum Class I butterfat price, without applying any location differential, so the price would be uniform across the entire country. The witness stated that average butterfat tests for Class I and II use were 1.97 percent and 7.42 percent, respectively, in 2005. The witness noted that when Class I and II milk marketings were combined, their average butterfat test was 3.34 percent, close to the Federal order standard of 3.5 percent. The witness testified that milk supplies for Class I and II products are complementary, with much Class II butterfat use coming from the surplus butterfat at Class I bottling plants.

The NMPF witness was of the opinion that Class II butterfat, unlike Class II skim, cannot be substituted with Class III or IV butterfat in Class II products. The witness stated that Class III and IV butterfat can be used to produce butter, butteroil, plastic cream and anhydrous milkfat, however, these products are not viable economic substitutes for cream in Class II products. The witness noted

that the lack of substitutability between Class II cream and manufactured butterfat products requires that Class II butterfat be priced at a level near the Class I butterfat price and their proposal meets that intent.

The NMPF witness offered as an exhibit a letter of support for adoption of Proposals 1–5 from the National Farmers Organization (NFO). NFO is a Capper-Volstead cooperative headquartered in Ames, Iowa. The NFO letter stated that an increase in Class I and II minimum prices is needed by dairy farmers who are continually experiencing increased fuel, feed and fertilizer costs.

The NMPF witness also offered as an exhibit a letter of support for adoption of Proposals 1–5 from Cass-Clay Creamery (Cass-Clay). Cass-Clay is a Capper-Volstead cooperative headquartered in Fargo, North Dakota. The Cass-Clay letter stated that adoption of Proposals 1–5 is necessary because Class I and II price formulas should not have to directly rely on Class III and IV prices and make allowances. According to the letter, costs to produce Class I milk have increased and should be reflected in the Class I formula. Cass-Clay added that the Class I butterfat price should equal the Class II butterfat price.

The Secretary of Agriculture for the commonwealth of Pennsylvania appeared in support of adoption of Proposals 1–5. Pennsylvania is home to 8,600 dairy farms producing over 10.6 billion pounds of milk annually. The Secretary testified that adoption of Proposals 1–5 is necessary to account for decreases in producer prices resulting from a recent decision to increase make allowances as well as increases in transportation and energy costs. The Secretary stated that Pennsylvania has lost over 2,000 dairy farms since 1997 because of low milk prices. The Secretary was of the opinion that adoption of Proposals 1–5 would help to ensure the viability of the Pennsylvania dairy industry in the future. A post-hearing brief was submitted by the Pennsylvania Farm Bureau in concurrence with the testimony of the Secretary.

A representative from Dairylea Cooperative, Inc. (Dairylea), testified in support of emergency adoption of Proposals 1–5. Dairylea is a Capper-Volstead cooperative whose milk is primarily pooled on the Northeast order. The Dairylea witness testified that Proposals 1–5 should be adopted to compensate farmers for significant increases in the costs to produce milk along with reductions in pay prices resulting from increased make

allowances for manufactured dairy products.

A witness appeared on behalf of the Northeast Farm Credit Associations (NEFCA). The NEFCA represents four Farm Credit associations who collectively provide credit and other financial services to over 4,500 dairy farmers in the Northeast U.S. The witness provided analysis showing increases in the costs to produce milk. The witness testified that significant increases in labor, supplies, utilities and transportation demonstrate the need to update Federal order minimum prices.

A witness appeared on behalf of the Michigan Milk Producers Association (MMPA) in support of expedited adoption of Proposals 1–5. MMPA is a Capper-Volstead cooperative that pools milk on the Mideast order. The MMPA witness testified that the costs of servicing the needs of the Class I and II market, which include maintaining Grade A status, assembly, hauling and balancing have substantially increased since 2000. The witness testified that MMPA supported recent increases in the make allowances for manufactured dairy products and stressed the need for balancing facilities. The witness testified that the increasing costs faced by dairy farmers need to be recognized and adoption of Proposals 1–5 would accomplish that intent.

A witness appeared on behalf of United Dairymen of Arizona (UDA) in support of Proposals 1–5. UDA is a Capper-Volstead cooperative that pools milk on the Arizona order. The UDA witness testified that Proposals 1–5 represent the input and interests of dairy farmers across the U.S. The witness stated that adoption of Proposals 1–5 would compensate dairy farmers for recent increases in make allowances for manufactured dairy products. The witness added that adoption of Proposals 1–5 would also simplify the calculations of the cheese-based skim milk price and the butter-powder based skim milk price for determining Class I and II skim milk prices.

A representative from Southeast Milk, Inc. (SMI), testified in support of expedited adoption of Proposals 1–5. SMI is a Capper-Volstead cooperative headquartered in Florida. The witness testified that recent decisions to increase make allowances for manufactured dairy products will decrease the prices received by farmers. The witness also testified that producers who supply the fluid market are incurring higher costs including balancing, transportation and energy. The witness testified that adoption of Proposals 1–5 would help to

compensate producers for these increases in costs.

A witness appeared on behalf of Dairy Farmers of America (DFA) in support of the adoption of Proposals 1–5 on an expedited basis. DFA is a Capper-Volstead cooperative that pools milk on 9 of the 10 Federal milk marketing orders. The DFA witness testified that the adoption of Proposals 1–5 would more accurately reflect the cost of producing and marketing milk. The witness was of the opinion that failure to address this issue will be detrimental to DFA members.

The DFA witness testified that the adopted changes to the make allowances for manufactured products were reflective of the costs of manufacturing dairy products, especially increased energy costs. However, when Class III and IV prices are lowered, prices for Class I and II products are lowered at the same time and returns to dairy farmers decrease, noted the witness.

The DFA witness also testified that the cooperative owns and operates plants that condense milk. The witness testified that cost data from their plants is similar to those relied upon by other proponents for nonfat solids and re-hydration of nonfat dry milk. The witness testified that DFA owns and operates plants that manufacture butter and concentrated milk fat products, and the cooperative also operates a cream marketing agency. The witness testified that typically Class II manufacturers do not substitute butter or concentrated fat products for cream since cream has other milk proteins and other solids in addition to butterfat.

The DFA witness testified that the costs to provide fluid milk have risen dramatically because of increased energy costs. The witness cited the increasing distance between farms and difficulties in balancing as justification to increase Class I and II minimum prices.

Two dairy farmer members of DFA also testified in support of Proposals 1–5. Both dairy farmers testified that the adoption of Proposals 1–5 is necessary to compensate dairy farmers for increased make allowances and to recognize the increasing costs in producing milk.

A witness appeared on behalf of the Association of Dairy Cooperatives in the Northeast (ADCNE) in support of the adoption of Proposals 1–5 on an emergency basis. The ADCNE is comprised of Agrimark, Dairy Farmers of America, Dairy Lea, Land O' Lakes, Maryland & Virginia Milk Producers, O-AT-KA Milk Producers Cooperative, St. Albans Cooperative Creamery and Upstate Niagara Cooperative. These

organizations represent a majority of the milk pooled on the Northeast order.

The ADCNE witness testified that adoption of Proposals 1–5 would update the production and marketing cost factors of the Class I and II price formulas. The witness was of the opinion that updating these factors is important in the Northeast since Federal Order 1 pools the largest volume of Class I and II milk in the Federal order system.

The ADCNE witness testified that recent increases in the make allowances for manufactured dairy products compensated dairy product manufacturers for increased production costs. The witness stated that dairy farmers are also experiencing increased costs in servicing Class I and II markets and should also be compensated through adoption of Proposals 1–5.

The ADCNE witness testified that the costs of servicing the needs of the Class I and II market in the Northeast have increased over the last 10 years. The witness stated that these costs are borne by dairy farmers and dairy farmer cooperatives and should be accounted for in Class I and II minimum prices. The witness stated that one of the largest cost increases has been transportation due to increased fuel costs along with consolidation of plants.

A witness testified on behalf of Lanco-Pennland Quality Milk Producers (Lanco) in support of Proposals 1–5. Lanco is a Capper-Volstead cooperative with members located primarily in Pennsylvania, Maryland and West Virginia. The Lanco witness testified that recent changes in the make allowances for manufactured dairy products will lower the prices that dairy farmers receive for their milk. The witness also testified that the costs in producing milk including feed and energy have increased substantially. The witness was of the opinion that adoption of Proposals 1–5 will compensate their dairy farmer members for these recent cost increases.

A post-hearing brief was submitted by the Kentucky Dairy Development Council (KDDC) in support of Proposals 1–5. The KDDC is an organization of Kentucky dairy farmers whose purpose is to increase profitability and address issues that foster the sustainability and viability of the dairy industry. The KDDC brief said that adoption of Proposals 1–5 would help maintain a direct relationship between dairy product prices and Class I and II prices. The brief explained how dairy farmers will face substantial financial hardship if Proposals 1–5 are not adopted.

A witness appearing on behalf of Nestlé USA and Dreyer's Grand Ice

Cream (Nestlé) testified in opposition to Proposals 1–5. Nestlé and its subsidiaries manufacture and distribute a variety of ice cream and frozen dessert products. The Nestlé witness was of the opinion that adoption of Proposals 1–5 would increase the price they pay for milk used to make Class I and II products. The witness stated that Nestlé has not experienced difficulties in attracting an adequate milk supply. The witness stated that U.S. milk production is increasing and the utilization (share) of milk in Class I and Class II products is decreasing. The witness, relying on Economic Research Service (ERS) data, stated that per capita consumption of non-flavored, whole, reduced, lowfat and nonfat milks declined by 21 percent from 1990 to 2005. The witness concluded from this information that demand for milk used in Class I and II products will only increase through innovation and marketing, not increases in the Class I and II minimum price.

The Nestlé witness testified that they have not needed to pay additional over-order premiums and have not experienced difficulties in attracting an adequate supply of milk due to the increases in costs noted by proponents. The witness testified that Nestlé is currently building a new Class I and Class II plant in Anderson, Indiana, and had been solicited by multiple potential milk suppliers.

The Nestlé witness stated that an emergency situation does not exist. The witness was of the opinion that the milk supply has been adequate nationwide for Class I and Class II needs and encouraged the Department to thoroughly examine whether Class I and Class II milk needs are not being met. The witness opined that the focus of the Federal order program is to balance and allocate milk supplies, and that increasing Class I and II prices during a period of ample supply does not meet this intent.

A witness appearing on behalf of the International Dairy Foods Association (IDFA) testified in opposition to Proposals 1–5. IDFA is a trade association that represents the nation's manufacturers, marketers, distributors and suppliers of fluid milk and dairy products. IDFA has a membership of 530 companies and is composed of 3 constituent organizations that include: the Milk Industry Foundation (MIF), the National Cheese Institute (NCI) and the International Ice Cream Association (IIAC).

The IDFA witness stressed that the proposed changes would create disorderly marketing conditions and that the data used to support the proponents' positions is flawed and

contradictory. The witness was of the opinion that there is no need to adopt Proposals 1–5 to ensure orderly marketing or a sufficient quantity of pure and wholesome milk to meet current or projected needs.

The IDFA witness said that ensuring the adequacy of the fluid milk supply is one of the fundamental purposes of the Federal order program. The IDFA witness stated that the current U.S. milk supply is adequate to meet the demands of the fluid milk market. The witness noted that total milk production is growing while fluid sales are declining. The IDFA witness said that milk production has increased in the last 30 years as a result of increased demand for manufactured dairy products, not fluid milk products. The witness, relying on ERS data, explained that milk production in the U.S. was 115.4 billion pounds in 1975 and grew to 177.0 billion pounds in 2005. The witness noted that ERS projections for 2006 showed a 4.9 billion pound increase for a total of 181.9 billion pounds of milk being produced in the U.S. As milk production grew during 1975–2005, the IDFA witness said, fluid milk product sales grew by 800 million pounds during that same time period. According to the witness, fluid sales hit a record high of 55.1 billion pounds in 1991 and have trended downward ever since. The witness concluded that with increasing production and decreasing fluid milk consumption, there is plenty of milk to serve a declining fluid market.

The IDFA witness acknowledged a Tentative Final Decision published November 22, 2006 (71 FR 67467) that updated the manufacturing allowances for Class III and Class IV products. The witness stated that those changes accomplish what the proponents are requesting by updating the factors representing the costs of processing for plants that manufacture Class III and Class IV products. The witness stated that adjusting balancing costs through Class I and Class II prices was addressed in a January 2005 decision to reject a proposal that would have covered the cost of balancing in the Northeast marketing area through marketwide service payments. The decision noted, the witness said, that opponents accurately testified that the costs of balancing were accounted for in the Class IV product price formula make allowances used for establishing the Class IV milk price.

The IDFA witness referenced an Interim Final Rule published October 25, 2006 (71 FR 62377) that addressed transportation costs in the Appalachian and Southeast marketing areas. The adopted changes, that became effective

on December 1, 2006, increased the transportation credit rate, among other things, in the Appalachian and Southeast marketing areas. The witness was of the opinion that transportation credits can more effectively address pricing issues than the suggestions outlined in Proposals 1–5. The witness stated that transportation credits are preferred to changes in the Class I differentials. The witness noted that a similar set of regulations exists in the Upper Midwest marketing area to help move milk from supply plants to distributing plants.

The IDFA witness testified that adoption of Proposals 1–5 would lead to disorderly marketing conditions and referenced the Department's preliminary impact analysis to support that conclusion. The witness stated that the baseline analysis provided by the Department showed that U.S. milk production would be adequate to meet current and future demands for milk and dairy products. The witness highlighted points from the baseline analysis and said Federal order marketings would increase by over 9.6 billion pounds over the next 9 years. During that same 9 year period, the witness stated that the baseline showed only a 147 million pound increase in Class I marketings. According to the witness, the analysis prepared by the Department supports the claim that milk production over the next 9 years will exceed the needs of the Class I market.

The IDFA witness testified that the economic analysis prepared by the Department prior to the hearing neglected to analyze the impacts of Proposals 1–5 on a regional/marketing area basis. The witness said the missing information could be crucial to producers when deciding their vote in a referendum since adoption of Proposals 1–5 would create disparities between regions with different Class I utilizations. The witness noted that dairy farmers whose milk is pooled in marketing areas with low Class I and Class II utilization could experience depressed prices for their milk if Proposals 1–5 were adopted.

The IDFA witness testified that one of the initial goals of the Federal milk marketing order program was to encourage the conversion of Grade B farm operations to Grade A operations. The witness, relying on National Agricultural Statistics Service (NASS) data, testified that 98 percent of the nation's milk now comes from Grade A farms. The witness was of the opinion that since there is an adequate supply of milk for Class I needs, there is no need to provide incentives for maintaining or converting to Grade A status.

The IDFA witness testified that proponents did not provide data as to the costs of operating a Grade A dairy farm versus a Grade B dairy farm. The witness stated the most recent research on the cost difference between Grade A and Grade B farms was published in 1977. The IDFA witness said the request to update the 40 cent difference between Grade A and Grade B ignores the fact that the standards for producing Grade A and Grade B milk have narrowed over time.

The IDFA witness was also of the opinion that marketing costs, including balancing, have not increased to the levels advanced by proponents. The IDFA witness testified that proponents provided inadequate evidence regarding the actual costs of balancing and instead relied on plant cost of manufacturing data. The IDFA witness was of the opinion that this approach overlooks relevant data, for example, the decreasing seasonality in milk production since 1998.

The IDFA witness questioned the logic of requiring milk processors to pay dairy producers for post farm gate marketing costs like seasonal and daily balancing, shrinkage, administrative costs and give-up charges. The witness was of the opinion that these costs could not be addressed by increases in payments to dairy farmers, and need to come from elsewhere in the marketing channel. The witness again added that make allowances used in the Class IV price formula already account for balancing costs.

The IDFA witness presented information from the Minnesota Department of Agriculture to show that average hauling rates paid by producers in Minnesota declined between 1982 and 2003. The witness said some of the decreases in costs were probably related to subsidization of some of the costs by the buyer of the milk, and that the adoption of proposals 1–5 would not ensure that the entity bearing the cost of hauling would receive the benefit of a higher Class I price.

The IDFA witness testified that adjustments in over-order premiums serve to attract milk more efficiently than adjustments in Class I minimum prices. The witness was of the opinion that over-order premiums can quickly adjust to changing market conditions over time and regions, while it could take months or years to change the Class I minimum price.

The IDFA witness stated that the Department should also reject proposals to increase the Class II price because a greater amount of substitution of Class IV products for fresh cream would occur.

A consultant witness from Texas A&M University testified on behalf of IDFA in opposition to Proposals 1–5. The witness testified that adoption of Proposals 1–5 are unnecessary since disorderly marketing conditions are not occurring. The witness testified that there is no economic evidence to support a change in Class I and Class II price policies and that there is ample milk available to meet fluid milk demands. The witnesses stated that Federal milk orders were designed to help facilitate “least-cost” milk movements with a minimum of government involvement and are successful in meeting this end. The witness stated that the current dairy industry is not the same as when the AMAA was enacted, nor is it the same as when order reform occurred in the late 1990s. The dairy industry has shifted into increased regional production and larger farms resulting from higher feed costs, more complex dairy nutrition issues and more competition from nondairy products, the witness noted.

The witness said that the Department’s challenge is to evaluate economic conditions relevant to Class I and Class II pricing and determine if they warrant a change in regulation. The witness stated that the issue of Class I and Class II pricing can not be adequately addressed under emergency conditions. The witness cited previous hearings such as the January 2006 Class III and Class IV make allowance hearing where 90 days notice was given before a hearing was held to consider changes. The witness also noted that a pre-hearing information session was held in preparation for the upcoming Class III and Class IV pricing hearing. Changes to Class I and Class II pricing, the witness said, should be given the same time for consideration. When ample time is given, the witness said, decision-makers can make critical decisions and rely on analysis and facts.

If Proposals 1–5 were adopted, the IDFA consultant witness said, an unintended market distortion would occur. Dairy farmers in high utilization markets would experience higher returns than dairy farmers in low utilization markets. The witness stated that adoption of the proposals would also lower Class III and Class IV prices, harming dairy farmers in the Upper Midwest region of the country.

The witness was of the opinion that it would be impossible to raise Class I and Class II prices without adversely affecting Class III and Class IV prices. The witness said that the benefits of an increased Class I price become diluted by lower Class III and Class IV prices.

An additional unintended consequence for the Upper Midwest, the IDFA expert witness said, would occur if the MILC program was extended in the 2007 Farm Bill because of further price signals to increase production, ultimately lowering the Class III/IV price.

The witness stated that since 98 percent of all U.S. milk is produced on Grade A farms, the cost of conversion is no longer relevant. The witness stated that the dairy industry converted to Grade A decades ago and that all Federal order milk is produced to meet Grade A standards. The witness stated that the costs of maintaining Grade A milk is born by all classes of milk, not just Class I. The witness stated that the Department cannot determine that the costs for converting to Grade A status have increased since a study has not been done. The witness stated there has not been a study conducted since 1977 that shows the differential cost between Grade A and Grade B. The study, the witness said, was conducted by Gary G. Frank, G. A. Peterson and Harlan Hughes and titled *Class I Differential: Cost of Production Justification*. The witness said that the cost of converting to Grade A is no longer relevant and that the proponents do nothing to show that the costs of maintaining Grade A status on a dairy farm have increased.

The witness stated that proponents cite that marketing costs have increased and focus mainly on balancing and transportation costs. However, the witness said, both of those cost issues are addressed and provided for in other Federal order provisions. Balancing, the witness said, has been addressed in at least four hearings since 1980, said the witness, and has been rejected because the conclusion of all four is that balancing costs are a part of Class III and Class IV prices. The witness also stated that the costs of balancing are a component of contract services provided by cooperatives assessing over-order premiums and handling charges. The witness said that considering these costs would be double counting.

The witness also stated that there is no economic justification for relying on increased over-order premiums as a basis for increasing the Class I price. The witness said that over-order premiums reflect the value of milk used in manufacturing and the amount of money required for a manufacturing plant to give up milk for Class I uses. Some of this, the witness said, is related to the supply obligations of cooperatives. The witness said that increasing the Class I minimum price does not substitute for the function of

over-order premiums and will not reduce the amount of premiums.

A witness appearing on behalf of Prairie Farms, Inc. (Prairie Farms), testified in opposition to Proposals 1–5. Prairie Farms is a cooperative that owns and operates a number of fluid milk plants that are pooled under several Federal milk marketing orders. Prairie Farms is a member of IDFA and NMPF. The Prairie Farms witness stated that the cooperative has not had any long-term problems attracting fluid milk. The witness was of the opinion that the adoption of Proposals 1–5 would create confusion and inequities in the marketplace. The witness was of the opinion that adoption of Proposals 1–5 would provide greater benefit to dairy farmers whose milk is pooled in areas of the country with higher Class I utilization than to dairy farmers whose milk is pooled in areas with lower Class I utilization. The witness testified that adoption of Proposals 1–5 would not represent the interests of all dairy farmer member cooperatives in an equitable manner.

The Prairie Farms witness stated that the Class I price should assign a value to fluid milk to account for the transportation costs from production areas to deficit areas. The witness was of the opinion that the Class I price should also reflect current market values of manufactured dairy products. The witness stated that Prairie Farms prefers the use of transportation credits, pooling standards, assembly credits and over-order premiums to attract milk for Class I use rather than increasing the Class I price. The witness said that changing the Class I differentials is unnecessary and would not serve to attract more milk to Class I handlers.

The witness testified that an increase in the Class I minimum price will raise the uniform prices received by dairy farmers, who will in turn produce more milk. More milk, the witness said, would lower Class III and Class IV prices because more milk will be used in manufactured products, eventually decreasing the uniform price. The witness stressed that farmers who pool milk in orders with lower Class I utilizations would experience greater negative impacts from the decreases in Class III and IV prices.

A witness appearing on behalf of H.P. Hood (Hood) testified in opposition to Proposals 1–5. Hood operates 14 Class I plants in the Northeast marketing area and 6 plants in the Upper Midwest marketing area. The witness was of the opinion that an adequate supply of milk is available for Class I and Class II use and adoption of Proposals 1–5 could negatively affect dairy producers located

in the Upper Midwest region of the country. The Hood witness questioned why proponents are seeking compensation for transportation costs through increases in Class I and Class II minimum prices. The witness was of the opinion that manufacturers of all classes of milk face increased transportation costs and Proposals 1–5 place an inequitable burden on Class I and II markets.

A witness appearing on behalf of Wells Dairy, Inc. (Wells), testified in opposition to Proposals 1–5. According to the witness, Wells is the world's largest family-owned dairy processor in the United States. Wells is located in Le Mars, Iowa, and their ice cream can be found throughout the United States and in 20 countries. The dairy operates five plants: A bottling plant and two ice cream plants in Iowa, a yogurt plant in Omaha, Nebraska, and an ice cream plant in St. George, Utah. The witness said that Wells' procures milk from more than 70 independent producers and many cooperatives located in South Dakota, Kansas, Nebraska and Iowa.

The Wells witness stated that they have not experienced difficulties in procuring fluid milk and that they pay their milk suppliers a premium. The witness stated that the proposed changes could reduce fluid milk consumption, increase milk production and increase regional differences in farm milk prices. The witness said the issue of pricing is regional in nature and therefore should be addressed regionally. The Wells witness added that a higher minimum Class II butterfat price could cause their plants to substitute Class IV butterfat products for Class II cream in their Class II products.

A witness appearing on behalf of Mid-West Dairymen's Company, Manitowoc Milk Producers Cooperative, Milwaukee Cooperative Milk Producers and Lakeshore Federated Dairy Cooperative (Mid-West, *et al.*) testified in opposition to Proposals 1–5. Mid-West, *et al.*, represents dairy farmers whose milk is mostly pooled on Orders 30 and 32. The Mid-West, *et al.*, witness stated that NMPF, in seeking to have Proposals 1–5 adopted, was not working in the best interest of the nation's dairy farmers. The witness was of the opinion that many of NMPF's member cooperatives did not agree with the proposals and that many of the largest NMPF members have producers in areas not regulated or pooled on Federal orders. The witness stated that the milk supply was adequately meeting Class I and Class II market needs and emergency conditions did not exist. The Mid-West, *et al.*, witness testified that the Class I price has historically been linked to

manufacturing prices and the adoption of Proposals 1–5 would insulate the Class I and Class II prices from realities of marketplace changes.

The Mid-West, *et al.*, witness testified that other than assembly or transportation credits received from the pool, there is no direct incentive to ship milk for fluid use because the Class I value is shared with all pool participants. The incentive, if any, the witness said, comes from over-order premiums; the minimum Class I price does not cover any costs such as balancing and "give-up" charges.

The Mid-West *et al.*, witness testified that adoption of Proposals 1–5 will cause regional price disparities. The witness said the Upper Midwest could see a 15 cent increase while Florida could see an increase of 65 cents or more. The witness reasoned that a higher Class I price would also result in more milk production which would lead to a lower cheese price and lower mailbox prices.

A representative from Associated Milk Producers, Inc. (AMPI), testified in opposition to adoption of Proposals 1–5 on an emergency basis. AMPI is a Capper-Volstead cooperative whose members' milk is pooled on Orders 30 and 32. The AMPI witness testified that although the costs to produce and supply milk for the Class I and II market has increased, it is an insufficient reason to raise the Class I and II price at all locations. The witness testified that there is an adequate supply of milk to meet the fluid needs of the market. The witness was of the opinion that individual order regulations and over-order premiums serve to move milk when needed with fewer burdens on consumers and producers than increasing Class I and II minimum prices.

The witness testified that although increasing Class I and II minimum prices may increase proceeds to dairy farmers, dairy farmers whose milk is pooled in Federal orders with higher Class I utilizations would receive a larger increase. The witness stated that an increase in minimum prices would cause a supply response which would depress Class III and IV prices. This would turn the limited Class I benefit in a low utilization market into a net negative result, said the witness.

The witness testified that maintaining the linkage between Class III and IV prices and Class I and II prices is important. The witness added that the Federal milk marketing order program is a marketing tool, not a support price program.

A professor from the University of Wisconsin-Madison testified in

opposition to adoption of Proposals 1–5. The witness testified that the disparate regional impacts that would result from adoption of Proposals 1–5 are of major concern. The witness and other colleagues from the University of Wisconsin performed an analysis on the possible impacts of the proposed changes.

The witness testified that most dairy farmers and handlers across the country have been experiencing increased energy costs. The witness testified that if Class I prices were increased it would generate an increase in the supply of milk. An increase in the supply of milk would increase the volume of milk used in Class III and IV, ultimately lowering the blend price, said the witness. These effects would be amplified, said the witness, in Federal milk orders with lower Class I utilizations.

A witness appeared on behalf of Kraft Foods (Kraft) in opposition to adoption of Proposals 1–5. Kraft is a manufacturer of mostly Class II and III products. The Kraft witness testified that adoption of Proposals 4–5 would have a negative impact on markets for Class II products. The witness stated that increasing the minimum Class II price would decrease sales of Class II products and encourage the substitution of milk powders or non-dairy based ingredients. The witness also noted that currently a change in the Class IV formulas and therefore the Class IV price would automatically change the Class II price but the NMPF proposal would sever the link.

The Kraft witness was also of the opinion that adoption of the NMPF proposals would result in benefits that are regionally disproportionate. The witness stated that increasing the minimum Class I and II prices would have a greater positive impact on the milk of producers that is pooled on orders with higher Class I utilization.

A witness appeared on behalf of Dean Foods (Dean) in opposition to adoption of Proposals 1–5 on an emergency basis. The witness stated that Dean owns and operates distributing plants that are located in or regulated by all 10 Federal milk marketing orders. The Dean witness testified that there is an adequate supply of milk to meet Class I and II demand. The witness, summarizing the economic analysis prepared by the Department for the hearing, stated that the analysis predicts government purchases of surplus nonfat dry milk absent of adoption of the NMPF proposals. The witness concluded that adoption of Proposals 1–5 would increase government outlays to purchase surplus dairy products while increasing the retail prices of Class I and II dairy products. The

witness testified that increases to Class I and II prices would decrease demand for fluid milk.

The Dean witness testified that increases in Class I and II minimum prices would not be returned to the dairy farmers that supply the Class I and II market. The witness testified that an increase in the Class I and II minimum price benefits all producers whose milk is pooled on a market, not the producers actually supplying the Class I and II market.

The Dean witness testified that adoption of Proposals 1–5 would have disparate impacts on producers depending on the Class I utilization of the order on which their milk is pooled. This could lead to opportunities for pool-riding, said the witness, which could require another round of hearings to tighten pooling standards.

The Dean witness testified that adoption of Proposals 1–5 would be a major policy shift for the Federal milk marketing order program. The witness testified that the NMPF proposals would sever the connection between Class I and II prices and Class III and IV prices. The witness predicted that adoption of the NMPF proposals could also encourage the substitution of nonfat dry milk for Class II skim milk.

A witness appeared on behalf of the Center for International Food and Agriculture Policy at Citizens Against Government Waste (CAGW). CAGW is a nonprofit organization that aims to eliminate waste and inefficiency in the Federal Government. The CAGW witness testified that adoption of Proposals 1–5 will increase the retail price of milk, reduce fluid milk consumption, increase costs to taxpayers and increase regional disparities in the prices dairy farmers receive for their milk. The witness was of the opinion that adequate amounts of milk are available to meet fluid milk demands.

A witness appearing on behalf of New York State Dairy Foods (NYSDF) and Queensboro Farm Products, Inc. (Queensboro), testified in opposition to Proposals 4 and 5. According to the witness, NYSDF is a trade organization made up of a variety of New York dairy industry participants. Queensboro, the witness said, is a proprietary handler pooled in the Northeast marketing area. Queensboro distributes Class I and Class II products to metropolitan New York City. The witness stated that NYSDF and Queensboro are concerned about possible inequities that could result from adoption of Proposals 4 and 5.

The NYSDF/Queensboro witness explained that if Proposals 4 and 5 are adopted, the price of a 50,000 pound

tanker of 40 percent cream would increase \$328. The witness said this would occur because the proposal would increase the difference on butterfat from 0.7 cents per pound to 2.33 cents per pound, altering the relationship between Class IV butterfat and skim prices and Class II butterfat and skim prices. The witness added that an increase in the price of milk used to manufacture Class II products could encourage customers to substitute Class II cream with butter, butter oil and anhydrous milkfat.

A witness appearing on behalf of Galloway Company (Galloway), located in Neenah, Wisconsin, testified in opposition to Proposals 4 and 5. Galloway manufactures Class II products including sweetened condensed milk, ice cream mixes and beverage bases that are used in food and beverage processing. The witness stated that the changes proposed are too complex to be properly addressed in an emergency hearing.

The Galloway witness stated that adoption of Proposals 4 and 5 would distort the relationship between Class II and Class IV prices. The witness was of the opinion that adoption of Proposals 4 and 5 would increase the Class II price to a point where their customers (ice cream and confectionary manufacturers) would substitute Class IV products or other unregulated products as ingredients. The witness presented data demonstrating decreased production of Class II bulk sweetened condensed whole and skim milk from 1995–2005. The witness attributed the reduced production to pricing disparities between Class II and IV. The witness continued that there must be a tie between Class II and Class IV price formulas to prevent disorderly marketing because manufacturers can alternate between Class II and Class IV components. The witness stated that the processes for making condensed skim milk, sweetened condensed milk and NFDM all require the same condensing processes and costs. The witness questioned why there would be a make allowance for a process in one class and a different rate for the same process in another class. The witness urged the Department to not adopt Proposals 4 and 5 and further distort the relationship between Class II and IV.

The Galloway witness stated that 52 percent of the milk pooled in Federal orders was Class I and Class II. Of that milk, the witness said that 39 percent was Class I and 13 percent was Class II. The witness stated that if the proposals are adopted, processors who use Class II ingredients will face hardships in competing with processors who use

alternative ingredients. The witness also stated that producers will be negatively affected because the substitution for Class II ingredients will decrease blend prices.

Findings and Conclusions

Class I Discussion

NMPF argues that dairy farmers are experiencing increased costs in supplying fluid milk and should be compensated by an increase in the Class I price. NMPF attempts to justify an increase in the Class I price through claims that on-farm and farm to plant costs associated with Grade A milk production, transportation, balancing and “competitive costs” have recently increased. Specifically, NMPF argues that the increases in milk supply costs justify an increase of \$0.77 per cwt over the current minimum Class I differential value of \$1.60.

Evidence submitted at the hearing does not support claims that the costs incurred by dairy farmers in supplying fluid milk have increased to the levels advanced by NMPF. Proponents do not provide adequate data to justify that the additional costs faced by dairy farmers in supplying the needs of the Class I market have increased. Proponents do not reasonably analyze the actual differences in costs of maintaining Grade A production versus Grade B production or demonstrate the cost differences that could be expected between the two. Proponents do not analyze the actual impacts of these cost factors on the minimum level of the Class I differential borne by producers in servicing fluid milk needs, or the costs of balancing in the marketplace. Proponents also do not demonstrate how the “competitive costs” faced by fluid plants in attracting milk away from manufacturing uses have increased. Multiple opponents including dairy product manufacturers and dairy-farmer cooperatives agree that data supplied by proponents is inadequate.

The NMPF proposals would also revise the formula used to calculate the Class I price. The revised formula would “de-couple” the Class I price from the Class III or Class IV price by using a different formula. The Class I price is directly linked to the (higher of) Class III or IV price to ensure that supply and demand conditions for milk are reflected throughout all classes. All classified uses must compete for the same supply of milk. If a change is made to the Class III or IV price formulas, the change will equally affect the Class I price. Rather than maintaining this direct link, the NMPF proposal essentially “locks in” the current Class

III and IV price formulas and breaks the necessary link between Class I prices and any future changes in Class III and IV pricing formulas.

Class II Discussion

Proponents argue that the formula used to determine the Class II price does not properly account for the costs of drying and re-hydrating NFDM and encourages the substitution of NFDM for fresh skim milk in Class II products. They claim that a \$0.17 per cwt increase in the Class II minimum price is necessary to reflect increased costs of drying and re-hydrating skim milk. Additionally, they proposed that the Class II butterfat price be the same as the Class I butterfat price. Proponents argue that since milk supplies for Class I and II products are complementary, and that the Class II butterfat supply is primarily from surplus butterfat at Class I bottling plants, the butterfat values should be the same. Proponents fail, however, to provide relevant data demonstrating that condensing and re-hydrating costs have actually increased to levels advanced, or a compelling argument as to why Class I and II butterfat values should be equal.

Adoption of NMPF's proposed Class II skim milk formula would also sever the relationship between Class IV and Class II product prices, just as it would to the relationship of the Class I price to Class III and IV prices. If a change was made to the Class IV price formula in future proceedings, for example, a make allowance proceeding, the change would not be reflected in the Class II price.

Rulings on Findings and Conclusions

All briefs, findings and conclusions, and the evidence in the record were considered in reaching the findings and conclusions set forth above. The petition to consider proposals that would have increased Class I and Class II prices and modified the formulas used to determine Class I and Class II prices is denied for the reasons stated in this decision.

Termination of Proceeding

At issue in this proceeding is whether the level of the Class I and II prices, and the manner in which the Class I and II prices are determined, are successful in promoting orderly marketing conditions and meeting the intent of the Agricultural Marketing Agreement Act of 1937 (AMAA). As reflected in the above Class I and Class II discussions, the record does not demonstrate that the proposed modifications to the Class I and Class II price formulas are supportable. While some evidence may

indicate that dairy farmers have faced increased additional costs in supplying the needs of the fluid market, other evidence suggests that other costs may have decreased. In any case, the evidence is neither compelling nor provides a basis to make a reasoned decision for either recommending adoption or denial of the proposals. Accordingly, the proceeding is terminated.

List of Subjects in 7 CFR Parts 1000, 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, and 1131

Milk marketing orders.

The authority citation for 7 CFR Parts 1000, 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, and 1131 continues to read as follows:

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

Dated: December 19, 2008.

James E. Link,

Administrator, Agricultural Marketing Service.

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