

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## 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-A72, et al.; DA-03-08]

### Milk in the Northeast and Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Orders

7 CFR part	Marketing area	AO Nos.
1001 .....	Northeast .....	AO-14-A72
1005 .....	Appalachian .....	AO-388-A13
1006 .....	Florida .....	AO-356-A36
1007 .....	Southeast .....	AO-366-A42
1030 .....	Upper Midwest .....	AO-361-A37
1032 .....	Central .....	AO-313-A46
1033 .....	Mideast .....	AO-166-A70
1124 .....	Pacific Northwest .....	AO-368-A33
1126 .....	Southwest .....	AO-231-A66
1131 .....	Arizona-Las Vegas .....	AO-271-A38

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

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

**SUMMARY:** This document proposes to adopt as a final rule, order language contained in the interim final rule published in the **Federal Register** on April 23, 2004, concerning classification of milk use provisions in all Federal milk marketing orders. This document sets forth the final decision of the Department and is subject to approval by producers. Specifically, this final decision would reclassify milk used to produce evaporated milk in consumer-type packages or sweetened condensed milk in consumer-type packages from Class III to Class IV.

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

These proposed amendments have been reviewed under Executive Order 12988, Civil Justice Reform. This rule is not intended to have a retroactive effect. If adopted, this proposed rule will not preempt any State or local laws, regulations, or policies, unless they present an irreconcilable conflict with this rule.

The Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601-674), provides that administrative proceedings must be exhausted before parties may file suit in court. Under section 608c(15)(A) of the Act, any handler subject to an order may request modification or exemption from such order by filing with the Secretary

a petition stating that the order, any provision of the order, or any obligation imposed in connection with the order is not in accordance with the law. A handler is afforded the opportunity for a hearing on the petition. After a hearing, the Secretary would rule on the petition. The Act provides that the district court of the United States in any district in which the handler is an inhabitant, or has its principal place of business, has jurisdiction in equity to review the Secretary's ruling on the petition, provided a bill in equity is filed not later than 20 days after the date of the entry of the ruling.

### Regulatory Flexibility Act and Paperwork Reduction Act

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

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

During June 2003—the most recent representative period at the time of the hearing—there were a total of 60,096 dairy producers whose milk was pooled under Federal milk orders. Of the total, 56,818 dairy producers—or about 95 percent—were considered small businesses based on the above criteria. During this same period, there were about 1,622 plants associated with Federal milk orders. Specifically, there were approximately 387 fully regulated plants (of which 143 were small businesses), 92 partially regulated plants (of which 41 were small businesses), 44 producer-handlers (of which 23 were considered small businesses), and 108 exempt plants (of which 98 were considered small businesses). Consequently, 950 of the 1,622 plants meet the definition of a small business.

Total pounds of milk pooled under all Federal milk orders was 10.498 billion for June 2003 which represented 73.5 percent of the milk marketed in the United States during June 2003. Of the 10.498 billion pounds of milk pooled under Federal milk orders during June 2003, 1.78 million pounds—or 1.7 percent—was used to produce evaporated milk and sweetened condensed milk products in consumer-type packages. Additionally, during this same period, total pounds of Class I milk pooled under Federal milk orders was 3.475 billion pounds, which represents 82.3 percent of the milk used in Class I products (mainly fluid milk products) that were sold in the United States.

This final decision adopts proposals that would reclassify milk used to produce evaporated milk or sweetened condensed milk in consumer-type packages from Class III to Class IV in all

Federal milk orders. This decision is consistent with the Agricultural Agreement Act of 1937 (Act), which authorizes Federal milk marketing orders. The Act specifies that Federal milk orders classify milk "in accordance with the form for which or purpose for which it is used."

Currently, the Federal milk order system provides for the uniform classification of milk in provisions that define four classes of use for milk (Class I, Class II, Class III, and Class IV). Each Federal milk order sets minimum prices that processors must pay for milk based on how it is used and computes weighted average or uniform prices that dairy producers receive.

Under the milk classification provisions of all Federal milk orders, Class I consists of those products that are used as beverages (whole milk, low fat milk, skim milk, flavored milk products like chocolate milk, etc.)<sup>1</sup> Class II includes soft or spoonable products such as cottage cheese, sour cream, ice cream, yogurt, and milk that is used in the manufacture of other food products. Class III includes all skim milk and butterfat used to make hard cheeses—types that may be grated, shredded, or crumbled; cream cheese; other spreadable cheeses; plastic cream; anhydrous milkfat; and butteroil. Class III also consists of evaporated milk and sweetened condensed milk in consumer-type packages. Class IV includes, among other things, butter and any milk product in dried form such as nonfat dry milk.

Evaporated milk and sweetened condensed milk in consumer-type packages should be classified as Class IV because their product characteristics and yields are tied directly to the solids content of the raw milk used to make these products as opposed to the protein content as for Class III products. Like other Class IV products, evaporated milk and sweetened condensed milk in consumer-type packages have a relatively long shelf-life (*i.e.*, the products can be stored for more than one year without refrigeration). These products also may be substituted for other Class IV products (*e.g.*, dry whole milk or nonfat dry milk) and compete over a wide geographic area with products made from non-federally regulated milk. Additionally, like other Class IV products, evaporated milk and sweetened condensed milk in

consumer-type packages are competitive outlets for milk surplus to the Class I needs of the market.

The amendments adopted in the tentative final decision and this final decision should not have a significant economic impact on dairy producers or handlers associated with Federal milk orders. Since the reclassification of evaporated milk and sweetened condensed milk in consumer-type packages will be uniform in all Federal milk orders, dairy producers and handlers associated with the orders will be subject to the same provisions. The classification change should have only a minimal impact on the price dairy producers receive for their milk due to the small quantity of milk pooled under Federal milk orders that is used to produce evaporated milk or sweetened condensed milk in consumer-type packages. For example, using the Department's production data provided in the hearing record for milk, skim milk, and cream used to produce evaporated milk and sweetened condensed milk in consumer-type packages by handlers regulated under Federal milk orders for the three years of 2000 through 2002, the reclassification of the milk used to produce these products from Class III to Class IV would have affected the statistical uniform price for all Federal milk orders combined by only \$0.0117 per hundredweight.

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

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

<sup>1</sup> Federal milk orders do not classify products but instead classify the milk (skim milk and butterfat) disposed of in the form of a product or used to produce a product. This decision references "Class I products," "Class II products," "Class III products," and "Class IV products" to simplify the findings and conclusions.

### *Prior Documents in This Proceeding*

*Notice of Hearing:* Issued September 2, 2003; published September 8, 2003 (68 FR 52860).

*Correction of Notice of Hearing:* Issued October 9, 2003; published October 16, 2003 (68 FR 59554).

*Tentative Final Decision:* Issued February 27, 2004; published March 2, 2004 (69 FR 9763).

*Interim Final Rule:* Issued April 19, 2004; published April 23, 2004 (69 FR 21950).

Since this proceeding commenced, the Western order was terminated, effective April 1, 2004, as published in the **Federal Register** on February 24, 2004 (69 FR 8327). The termination, which removed all operating provisions of the order, was based on producers' disapproval of the issuance of the Western order as amended by a tentative final decision issued in August 2003 and published in the **Federal Register** on August 18, 2003 (68 FR 49375), and comments received in response to the proposed termination—published January 13, 2004 (69 FR 1957). The remaining administrative provisions of the order will be terminated at a later date.

### **Preliminary Statement**

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, as amended (7 U.S.C. 601–674), and the applicable rules of practice (7 CFR part 900), in Alexandria, Virginia, on October 21, 2003. Notice of such hearing was issued September 2, 2003, and published September 8, 2003 (68 FR 52860), and a Correction of Notice of Hearing was issued October 9, 2003, and published October 16, 2003 (68 FR 59554).

Upon the basis of the evidence introduced at the hearing and the record thereof, the Administrator, on February 27, 2004, issued a Tentative Final Decision containing a notice of the opportunity to file written exceptions thereto.

The material issues, findings, conclusions, rulings, and general findings of the tentative final decision are hereby approved and adopted and are set forth herein.

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

1. Classification of evaporated milk and sweetened condensed milk in consumer-type packages;
2. Classification of monthly bulk milk ending inventory; and

3. Determination as to whether emergency marketing conditions exist that would warrant the omission of a recommended decision and the opportunity to file written exceptions.

### **Findings and Conclusions**

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

1. *Classification of evaporated milk and sweetened condensed milk in consumer-type packages.* Proposals that would amend all 10 Federal milk marketing orders to reclassify milk used to produce evaporated milk or sweetened condensed milk in consumer-type packages from Class III to Class IV were adopted in the tentative final decision and are adopted in this final decision. The proposed amendments are consistent with the statutory authority for Federal milk orders which specifies that milk should be classified “in accordance with the form in which or purpose for which it is used.”

A proposal by O–AT–KA Milk Products Cooperative, Inc. (O–AT–KA), published in the hearing notice as Proposal 1, seeks to reclassify evaporated milk in consumer-type packages (canned evaporated milk) from Class III to Class IV. Proposal 2, published in the hearing notice as proposed by Diehl, Inc., and Milnot Holding Corporation, would reclassify sweetened condensed milk in consumer-type packages (canned sweetened condensed milk) from Class III to Class IV. The proponents for Proposals 1 and 2 ask that the proposals be considered on an emergency basis and, in this regard, that a recommended decision be omitted.

A witness appearing on behalf of O–AT–KA testified in support of the reclassification of evaporated milk from Class III to Class IV and supported the reclassification of sweetened condensed milk from Class III to Class IV. The witness stated that O–AT–KA is owned by over 2,000 dairy producers who are members of Upstate Farms Cooperative, Inc., Niagara Milk Cooperative, Inc., and Dairylea Cooperative Inc. In 2002, the witness noted that over 700 million pounds of milk was processed by O–AT–KA.

The witness estimated that O–AT–KA is the second largest manufacturer of canned evaporated milk products in the United States. According to the witness, the largest manufacturer of canned evaporated milk is Nestle Foods Company, which produces its product in California from milk likely pooled on the California State order. Other Federal

order manufacturers of canned evaporated milk, the witness indicated, include Diehl, Inc., based in Ohio and Milnot Holding Corporation, located in Missouri.

The O–AT–KA witness also provided a historical background on the classification of canned evaporated milk. The O–AT–KA witness explained that milk used to produce canned evaporated milk products had traditionally been classified in the lowest use class of Federal milk orders. The witness cited the uniform classification decision of 1974 in which USDA stated (referencing a 3-class system): “A Class II classification should not apply to evaporated or condensed milk or skim milk in consumer-type containers as the cooperatives proposed. Such storable products should remain in the lowest price class. A Class III classification for milk in these products will permit such uses to remain as a competitive outlet for milk surplus to the needs of the Class I market. Such products made from milk regulated under these orders must compete over wide areas with the same products processed from ungraded milk or other graded milk that is often priced at no more than the Minnesota-Wisconsin price. Comparable pricing should prevail under these 32 orders.” published March 5, 1974 [39 FR 8461–8462]. The witness noted that the Class III classification determination of canned evaporated milk was left unchanged when the national uniform classification of Federal milk marketing orders was reviewed in 1993.

The O–AT–KA witness explained that the reform of Federal milk marketing orders, effective in January 2000, continued to classify milk used to produce canned evaporated milk as Class III even though the lowest use manufacturing class was definitively split into Class III and Class IV. He stated that Class III became a cheese use class based on a cheese yield and cheese pricing formula. According to the witness, the reclassification of canned evaporated milk to a more appropriate Class IV milk use was simply overlooked.

The O–AT–KA witness testified that the characteristics and composition of canned evaporated milk—including the yields, nonfat solids content, and shelf life—all support a Class IV classification of the product. The witness explained that evaporated milk products are made by the evaporation of water resulting in a milk solids content of a minimum of 6.5 percent butterfat and 23 percent total solids. Like nonfat dry milk, the witness stressed, the yields of evaporated milk products are impacted

by the nonfat solids content of the raw milk used to produce the products. Thus, the witness asserted, the higher the nonfat solids content of the raw milk used to produce the product the less water needs to be evaporated and the more cans of the product can be made. In addition, the witness stated that evaporated milk products are packaged in steel cans so that the products are sterile with a shelf life that can exceed 12 months. Accordingly, the witness contended that canned evaporated milk products are more appropriately classified as a Class IV rather than Class III milk use.

The O-AT-KA witness testified that the current Class III classification contributes to improper pricing and potential raw milk product cost inequity because the yields of evaporated milk products are nonfat-solids based rather than protein-based. Also, the witness stated, evaporated milk products are not a substitute for cheese products but may be substituted for nonfat dry milk. Additionally, the witness stressed evaporated milk products can be and are produced from reconstituted nonfat dry milk, stressing that these products cannot be produced from cheese.

The O-AT-KA witness provided actual price data from January 1998 through September 2003 and forecasted price data from October 2003 through December 2004. According to the witness, the higher raw milk costs dictated by the higher minimum Class III prices of late cannot be competitively recovered in the marketplace for canned evaporated milk products. The witness also speculated that the disadvantageous price relationship was likely to continue into the foreseeable future and threatens the continued production of these products at their associated plants.

The O-AT-KA witness also indicated that label recognition, competing handlers who are supplied by non-federally regulated milk sources, and the contract bidding processes are exacerbating the disadvantageous conditions that are now being borne by O-AT-KA members in the form of reduced returns. If the mis-classification is allowed to continue, the witness forecasted evaporated milk plants like O-AT-KA could ultimately be forced out of producing these products, which would likely cause raw milk to be ultimately diverted to nonfat dry milk and butter (Class IV classification). Thus, the witness indicated that a reclassification to Class IV would deter such unfavorable potential outcomes.

The O-AT-KA witness was of the opinion that blend prices to producers would not be significantly affected if

Proposal 1 was adopted because of the relatively low volume of pooled milk used to produce evaporated milk products when compared to the higher volumes of milk used to produce all other dairy products. The witness contended that the current competitive disparity between Federal milk order manufacturers and non-Federal order manufacturers of these products will continue until this classification issue is resolved. The witness concluded by asking that USDA consider this proposal on an emergency basis and take immediate action by issuing a final decision.

O-AT-KA filed a post-hearing brief reiterating its support for the reclassification of canned evaporated milk and canned sweetened condensed milk from Class III to Class IV.

A witness representing the Milnot Holding Corporation (Milnot) testified in support of Proposals 1 and 2 to reclassify canned evaporated milk and canned sweetened condensed milk as Class IV. The witness testified that Milnot is a small business that employs about 422 employees and processes approximately 200 million pounds of raw milk annually into evaporated milk and sweetened-condensed milk in consumer-type packages. The witness stated that milk used to make these products should be classified in the lowest manufacturing use class because of the products' shelf-life and characteristics.

The Milnot witness stated that canned evaporated milk and canned sweetened condensed milk products are packaged in shelf-stable packages that provide a shelf life of a year or more without refrigeration. The witness stressed that canned evaporated milk and canned sweetened condensed milk products are driven by the nonfat solids composition of the raw milk used to produce the products which is similar to nonfat dry milk—a Class IV product. Similar to the O-AT-KA representative, the Milnot witness explained that the higher the nonfat solids content of the raw milk, the less water needs to be removed and the more cans of product result from the raw milk. Thus, the witness concluded that canned evaporated milk and canned sweetened condensed milk products are closely related and that such products, therefore, should be classified as Class IV since “the production of these milk items is not related to the protein-driven curd development” associated with cheese production.

The Milnot witness also cited the 1974 uniform classification decision, published March 5, 1974 (38 FR 8461–8462), which stated that evaporated

milk or condensed milk or skim milk products in consumer-type containers are storable products that should remain in the lowest price class (Class III). Like the O-AT-KA witness, the witness pointed out that the reform of milk marketing orders provided a definitive split between Class III and Class IV and overlooked canned evaporated milk and canned sweetened condensed milk products by continuing the Class III classification for milk used to make these products.

The Milnot witness also testified that the disadvantageous price relationship between Class III and Class IV had become increasingly acute over the past year, and it is now especially critical that the Department handle the matter expeditiously.

A witness representing Eagle Family Foods (Eagle) also testified in support of reclassifying milk used to produce canned evaporated milk products, as well as canned sweetened condensed milk, as a Class IV use of milk. The witness explained that Eagle is a small business, employing about 300 people and operating two manufacturing plants located in Wellsboro, Pennsylvania, and Starkville, Mississippi. According to the witness, the primary business of the company is manufacturing sweetened condensed milk products for national distribution.

The Eagle witness explained that the milk purchased by their plants for manufacturing canned sweetened condensed milk products is pooled on Federal milk orders. The cost of the raw milk, the witness contended, makes it more difficult to compete and can drastically affect the viability of their business. The witness also asserted that sweetened condensed milk products are solids-based rather than protein-based products and therefore should be classified as Class IV use of milk. As did the O-AT-KA and Milnot witnesses, the Eagle witness asked that the issue be handled on an emergency basis.

A witness appearing on behalf of Diehl, Inc. (Diehl), testified in support of reclassifying milk used to produce both canned evaporated milk and canned sweetened condensed milk products from Class III to Class IV because milk used to produce such products are solids-based products versus protein-based products. The witness testified that Diehl is a family-owned and operated small business which manufactures canned dairy products, including canned evaporated milk and canned sweetened condensed milk products. The witness stated that Diehl has plants in Ohio, Michigan, and Idaho that purchase milk pooled under Federal milk orders. The witness also

asked that the proposals be handled on an emergency basis due to what they view as the improper classification of milk used to make these products.

A witness appearing on behalf of Association of Dairy Cooperatives of the Northeast (ADCNE) testified in favor of the proponents' proposals concerning the reclassification of canned evaporated milk and canned sweetened condensed milk products as Class IV. According to the witness, ADCNE is comprised of several cooperatives that collectively represent more than 65 percent of the producers pooled under the Northeast milk order.

The ADCNE witness testified that it is important for Federal milk orders to appropriately classify products. Canned evaporated milk and canned sweetened condensed milk, the witness asserted, are long shelf-life products that fit best in Class IV under the current system of product classification and end-product pricing. He pointed out that large price differences between Class III and Class IV can place Federal order manufacturers of canned evaporated milk and canned sweetened condensed milk products—which are distributed nationally—at a substantial competitive disparity with non-Federal order manufacturers. The witness supported USDA adopting Proposals 1 and 2 on an emergency basis.

ADCNE also filed a post-hearing brief reiterating their position and asserting that the mis-classification of canned evaporated milk and canned sweetened condensed milk products in Class III (cheese use category) has resulted in a \$4.00 per hundredweight price discrepancy between Class III and Class IV that is extremely burdensome to Federal order processors of these products, including the ADCNE member O-AT-KA. ADCNE stated that it is imperative the changes be made on an expedited basis to restore order to the national market for these products.

A witness appearing on behalf of New York State Dairy Foods, Inc. (NYSDF), testified in support of Proposal 1. The witness contended that O-AT-KA can no longer effectively compete in evaporated milk markets without incurring very large losses due to the current price disparity between Federally regulated milk used to produce evaporated milk consumer products and non-Federally regulated milk used to make such products.

The NYSDF witness also testified that a Class IV classification is appropriate since evaporated milk, like dried milk powders, is a product end use involving extensive special processing and the removal of the water from milk. The witness asserted that evaporated milk is

similar to nonfat milk powder and butter because it has a relatively long storage capability. The witness also supported the reclassification of milk used to produce canned sweetened condensed milk from Class III to Class IV.

The National Milk Producers Federation (NMPF) filed a brief in support of the reclassification of canned evaporated milk and canned sweetened condensed milk from Class III to Class IV. NMPF represents nearly 60,000 dairy farmers that produce the majority of the United States milk supply.

NMPF's brief asserted that Class III is fundamentally for cheese products which is consistent with the Class III cheese based pricing formula, whereas Class IV is a class for milk ingredients such as butter and milk powders. NMPF believes evaporated and sweetened condensed milk products are more appropriately associated with products such as milk powders and butter rather than cheese products.

NMPF encouraged USDA to consider, with respect to adopting Proposals 1 and 2, the compatibility with State regulations, which would contribute to more orderly marketing both in and outside of Federal milk marketing order areas. NMPF also supported the handling of the action on an emergency basis to remove the competitive disadvantage currently imposed on Federal order manufacturers of canned evaporated milk and canned sweetened condensed milk products.

There was no opposition testimony for the adoption of Proposals 1 and 2 given at the hearing or contained in post-hearing briefs. However, two exceptions were filed in response to the tentative final decision pertaining to reclassification amendments for milk used to produce canned evaporated milk or canned sweetened condensed milk.

A comment from Nestle' USA (Nestle') requested that a decision be postponed for 90 days because the emergency reclassification, in their view, is based on data and statistics that do not reflect appropriately on the longer term historical reality and is not in the best immediate and future interests of the consumer—commercial customers as well as Federal aid recipients through USDA purchasing programs. According to Nestle', the selective use of Class III and Class IV price data, USDA bid award data, and instances of contradictory information and projections within the hearing record requires further investigation to ensure adoption of a decision that would best represent the long-term needs of all parties.

Another comment was submitted stating that the invitation for a public hearing did not adequately invite all interested parties, resulting in record evidence and a decision that are biased and one-sided.

#### *Findings & Conclusions:*

The tentative final decision and this final decision finds that the record evidence of this proceeding strongly supports the reclassification of milk used to produce evaporated milk in consumer-type packages or sweetened condensed milk in consumer-type packages from Class III to Class IV. The proposed amendments adopted in the tentative final decision and this final decision reclassify milk used to produce canned evaporated milk or canned sweetened condensed milk to a Class IV use of milk. The milk used to produce these products, like other Class IV dry milk products, has a relatively long shelf life, may be stored without refrigeration, is sold over a wide geographic area competing for sales with milk from non-Federally regulated sources, and remains an outlet for milk not needed for fluid use. Most importantly, the yields of these products are based directly on the nonfat solids content of the raw milk used to make these products. Thus, the reclassification appropriately classifies and prices milk used to produce evaporated milk or sweetened condensed milk products in consumer-type packages under all Federal milk orders.

As noted in the tentative final decision, the Agricultural Marketing Agreement Act of 1937 specifies that Federal milk marketing orders classify milk "in accordance with the form in which or the purpose for which it is used." Currently, Federal milk orders establish uniform classification of milk provisions for all Federal milk orders consisting of four classes of use (Class I, Class II, Class III, and Class IV) for pricing milk.

The classes of use can be categorized as a fluid/beverage class and three manufacturing classes of milk. Class I consists of those products that are used for fluid/beverage use with certain exceptions for formulas especially prepared for infant feeding or dietary use in hermetically-sealed containers. Class II includes soft or sponable products such as cottage cheese, sour cream, ice cream, yogurt, and milk that is used in the manufacture of other food products. Class III consists of milk used in hard cheeses, cream cheese, and other spreadable cheese. Class IV consists of butter or any milk product in dried form and bulk milk that is in inventory at the end of the month.

Federal milk marketing orders establish and maintain orderly marketing conditions for dairy farmers and handlers through classified pricing (pricing milk based on use) and the pooling of the proceeds of milk used in a marketing area. These provisions allow Federal milk marketing orders to establish minimum prices that handlers must pay for milk based on use and return a weighted average or uniform price that dairy farmers receive for their milk. These provisions ensure that all dairy farmers supplying a market share in the benefit that arises from classified pricing through marketwide pooling of milk.

Federal milk orders provide a pricing system for manufactured dairy products that is based on end-product price formulas. Under this system of pricing, the Class III price for milk is derived from the price of butterfat, protein, and other nonfat/non-protein milk solids (other solids). The butterfat, protein, and other solids prices are dependent upon the wholesale prices of butter, cheese, and dry whey, respectively, and make allowances and yield factors for the dairy products. The Class IV price is derived from the price of butterfat and nonfat milk solids. The price of butter and nonfat milk solids are dependent upon the wholesale price of butter and nonfat dry milk, respectively, and make allowances and yield factors for the products.

As concluded in the tentative final decision, the record evidence clearly indicates that product yields for canned evaporated milk and canned sweetened condensed milk products are based exclusively on the solids content of the raw milk used to make the product. The record reveals that evaporated milk must have a minimum of 6.5 percent butterfat and 23 percent total solids and that sweetened condensed milk must have a minimum of 8 percent butterfat and 28 percent total solids. The higher the milk solids content of the raw milk used to make canned evaporated milk or canned sweetened condensed milk the less water needs to be removed, which results in more cans of these products produced at the above standards. The protein content of the raw milk is not relevant to the production of these condensed milk products. Accordingly, the tentative final decision and this final decision concludes that the reclassification of milk used to produce canned evaporated and canned sweetened condensed milk products as a Class IV use will ensure that the milk used to produce these products is properly classified and priced.

The uniform classification of milk decision of 1974 stated that canned

evaporated milk and canned sweetened condensed milk are storable products that should remain in the lowest manufacturing use class based on a 3-class system. The 1974 decision further states that "A Class III classification for producer milk in these products will permit such uses to remain as a competitive outlet for milk surplus to the needs of the Class I market." The 1974 decision also states such products made from milk regulated under these orders must compete over wide areas with the same products processed from ungraded milk or other graded milk." These characteristics of canned evaporated and canned sweetened condensed milk products remain applicable today, some 30 years later.

The Class III classification determination of canned evaporated milk and canned sweetened condensed milk was left unchanged during the review of the national uniform classification of milk provisions for Federal milk marketing orders in 1993. During the reform of the Federal milk order program the classification of milk used to produce canned evaporated milk and canned sweetened condensed milk products remained as Class III milk use products even though Federal order reform resulted in a definitive split between milk used to produce Class III and Class IV products. The Class III designation in all Federal milk orders was determined for milk used to produce cheese with the corresponding Class III price based primarily on cheese prices, the make allowance for cheese, and cheese yields from a hundredweight of milk.

On the basis of the record evidence, the tentative final decision and this final decision find that the product characteristics of evaporated milk and sweetened condensed milk are more similar to nonfat dry milk (a Class IV product) rather than cheese (a Class III product). Like dry milk powders, these products can be stored for long periods of time without refrigeration. These products also are competitive outlets for milk that is surplus to the Class I needs of a Federal order market. Most importantly, the yields for canned evaporated and canned sweetened condensed milk products are tied directly to the milk solids contained in the raw milk used to produce these products versus the protein content as for Class III products.

The record evidence of this proceeding provided historical data of class prices covering the period since Federal milk orders were reformed in January 2000 through September 2003. According to this data, the Class IV price exceeded the Class III price by an

average of \$2.13 per hundredweight in 2000, \$0.91 per hundredweight in 2001, and \$0.42 per hundredweight in 2002. However, the Class III price for the period of January 2003 through September 2003 has exceeded the Class IV price by an average of \$1.07 per hundredweight. The monthly Class III price for milk, generally, was below the Class IV price from the implementation of Federal milk marketing order reform in January 2000 through June 2003. The monthly Class III price increased above the Class IV price beginning in July 2003, and the price difference increased to a level of \$4.25 per hundredweight in September 2003. As determined in the tentative final decision, this data clearly demonstrates that the Class III and Class IV price relationship has shifted since the reform of Federal milk orders in 2000 and that the Class III and Class IV prices move independently of each other.

The price difference between Class III and Class IV gave rise to proponents' concerns of competitive inequities. The predictions of competitive inequities that would likely continue if the Department determined that milk used to produce such products remain classified as a Class III use of milk may or may not be valid. These concerns alone do not provide adequate rationale for determining if the milk used to produce such products are properly classified under the Federal milk order system. What is most important is that milk is properly classified in accordance with form and use and in doing so promotes orderly marketing conditions.

All of the proponents of Proposals 1 and 2 are handlers who operate nonpool plants and, accordingly, are not regulated by any Federal milk marketing order. However, the record reveals that these entities purchase and receive milk that is pooled and priced under a Federal milk marketing order. Unlike pool handlers, nonpool handlers do not pool their milk receipts or share in the returns that are determined through the marketwide pooling of milk. Nonpool handlers are not required to purchase milk already pooled and priced under the terms of an order. In this regard, the price paid by nonpool handlers is not known if purchased through nonpool sources, and even if purchased through pool sources, such purchase may or may not have transacted at minimum class prices. Such is especially true when a nonpool handler receives milk through diversion from pool handlers. A pooled handler diverting milk to a nonpool plant is the entity that incurs the payment obligation to dairy farmers and accounts to the marketwide pool for the volume of milk at the classified use

value of milk so diverted. Consequently, the price a nonpool handler actually pays for such milk is not known. Therefore, the tentative final decision and this final decision find that it cannot be determined whether a competitive advantage or disadvantage may arise in those times when the Class III price for milk rises above the Class IV price, which results in the Class IV price being the lowest valued use of milk.

Hearing participants expressed concern about price disparities that result from the improper classification of milk used to produce evaporated milk and sweetened condensed milk products as Class III with entities that do not use milk priced under a Federal milk marketing order. Like the tentative final decision, this final decision does not rely on findings with respect to such concerns as a reason for changing the classification of milk used to produce these products from the current Class III milk use classification to a Class IV use.

As indicated by the record, milk used to produce canned evaporated milk or canned sweetened condensed milk products is directly tied to the value of the milk solids content of raw milk and resulting yields based on the solids content of raw milk as opposed to the protein content for Class III products. The current inappropriate classification of milk used to produce canned evaporated milk or canned sweetened condensed milk products as a Class III use of milk has implications affecting both handlers and producers. From the handler perspective, the misclassification of milk may affect the price they pay for milk in these uses and may affect their competitive position with milk from non-Federally regulated sources. From the producer viewpoint, the misclassification of milk affects the total value of the marketwide pool of milk and thus affects the blend price dairy farmers receive for their milk. Analysis of production data from 2000 to 2002 for canned evaporated milk and canned sweetened condensed milk reveals that the blend price for all orders would have increased by \$0.0117 per hundredweight. From either viewpoint, all market participants should be assured that orderly marketing conditions are advanced by properly classifying milk in accordance with form and use. Record evidence clearly indicates that the impact of reclassification of milk used to produce these dairy products is of nominal impact to producer milk value.

The Nestle' comment requesting a 90-day delay in the issuance of a decision is denied due to the lack of record evidence to support the claim. Nestle

suggested that the official record data was inadequate and did not include historical realities; and thus, the decision adopting the reclassification proposals was not in the best interest of consumers. The record evidence of this proceeding—as specified in the tentative decision—clearly and strongly supports the reclassification of canned evaporated milk and canned sweetened condensed milk from Class III to Class IV based on the products' characteristics, composition, and production yields. In addition, record data indicates that the reclassification amendments will not have a significant economic impact on affected entities.

The comment submitted in response to the tentative final decision claiming the public was inadequately notified of the public hearing and that the decision issued pertaining to the reclassification of canned evaporated milk and canned sweetened condensed milk was one-sided—reflecting only the views of the proponents—and not in the public interest is unfounded. Notices informing interested persons that a public hearing would be held to consider proposed amendments to certain classification of milk use provisions of all Federal orders were published in the **Federal Register**. Interested persons were also notified through other means such as notifications by Market Administrators and the posting of the Notices on the USDA, Agricultural Marketing Service, Dairy Programs Internet site. In addition, the formal rulemaking process provides an opportunity for interested parties, which includes dairy industry participants—producers and processors—and consumers, to participate in the public hearing proceeding by presenting record evidence in the form of testimony, views, data, arguments, and/or comments concerning the proposals being considered. Accordingly, it must be concluded that adequate notice was provided to interested parties. Also, the findings and conclusions specified in the tentative final decision and adopted in this final decision are based on the hearing record evidence that clearly supports the reclassification of canned evaporated milk and canned sweetened condensed milk from Class III to Class IV.

Based upon the official record it is therefore concluded that milk used to produce evaporated milk or sweetened condensed milk in consumer-type packages should be classified as a Class IV use of milk.

2. *Classification of monthly bulk milk ending inventory.* Proposal 3 of the hearing notice, seeking to classify milk in bulk ending inventory each month to

the lowest priced class of Class III or Class IV, was not adopted in the tentative final decision and is not adopted in this final decision. Currently, bulk fluid milk products and bulk fluid cream products in inventory at the end of the month are classified as a Class IV use of milk.

A witness testifying on behalf of New York State Dairy Foods, Inc. (NYSDF), testified that the classification of bulk ending inventories beginning with Class IV often tends to increase the volume of other source milk assigned to a higher-valued class at the transferee plants than is accorded producer milk pooled on an order. The witness asserted that this was not the intent of the present provision dealing with the proper classification of milk in ending inventory. The witness presented data and testimony which indicated that class prices often fluctuate independently and do not always maintain a constant relationship to one another. According to the witness, the typically higher-valued classes can experience a price inversion resulting in a negative producer price differential. The witness asserted that a more equitable sharing of pool proceeds would result from bulk ending inventories being classified at the lowest-valued class. There was no opposing testimony provided at the hearing.

The Association of Dairy Cooperatives in the Northeast (ADCNE) filed a post-hearing brief in opposition to the proposal to change the classification of monthly bulk ending inventory. The ADCNE brief stated that testimony supporting the adoption of the proposal was only provided by Northeast milk order handlers even though the proposal would affect all Federal milk orders in the United States. According to ADCNE, the "tilt" in USDA/Commodity Credit Corporation butter/powder support price purchase prices will continue into the foreseeable future thus mitigating the need to reclassify milk in ending inventories as a Class IV use of milk. ADCNE indicated there could be unintended consequences of making such a change that could result in losses of producer income. Accordingly, ADCNE concluded that the proposal is not critical and should not be adopted without further input and a complete examination of the issue.

The National Milk Producers Federation (NMPF) also filed a post-hearing brief in opposition to the adoption of Proposal 3 on an emergency basis. According to NMPF, the impact of the proposal to reclassify monthly bulk ending inventory of fluid milk products and fluid cream products from Class IV to the lowest-priced class of Class III or



Class IV cannot be analyzed without knowledge of the specific conforming changes to other affected sections.

The NMPF brief stated that Proposal 3 seemed reasonable in that it would allow processors to avoid advancing money to the pool that could be returned for ultimate use in a lower priced class. The NMPF brief argued that the "lower-of" concept for classifying inventories is supportable as an analog to the "higher-of" principle for Class I milk. Accordingly, the NMPF brief requested that interested parties be provided ample opportunity to comment on the proposed rule should Proposal 3 be recommended for adoption.

#### *Findings and Conclusions:*

The tentative final decision and this final decision find that the hearing record does not provide sufficient evidence to adopt a change in the classification rules applicable to monthly bulk ending inventory. Specifically, the hearing record does not provide information on the potential impact of the proposed amendment on affected parties. Accordingly, the bulk ending inventory reclassification proposal is not adopted.

3. *Determining whether emergency marketing conditions exist that would warrant the omission of a recommended decision and the opportunity to file written exceptions.* The hearing record for this proceeding clearly established that the proposals to reclassify milk used to produce evaporated milk or sweetened condensed milk in consumer-type packages from Class III to Class IV should be adopted on an emergency basis. Record evidence clearly established that milk used to produce these products was inappropriately classified as a Class III milk use. The hearing record indicates that the milk used to produce these products should be classified as Class IV and should be priced under Federal milk orders accordingly.

Milk used to produce canned evaporated milk or canned sweetened condensed milk products is more appropriately related to the solids content of the raw milk used to make these products, which has a direct bearing on the yields of these products. The current Class III classification of milk is tied to a value determined primarily to reflect the protein content of milk, which distorts the basis for determining the appropriate value of milk used to produce canned evaporated milk and canned sweetened condensed milk products where the solids content determines the appropriate milk value. Thus, the misclassification of milk results in

improper pricing of such milk under Federal milk orders which causes disorderly marketing conditions affecting both handlers and producers. Consequently, it was determined that emergency marketing conditions exist, and therefore the issuance of a recommended decision was omitted.

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

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

#### **General Findings**

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

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

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

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

#### **Rulings on Exceptions**

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

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

Annexed hereto and made a part hereof is a Marketing Agreement regulating the handling of milk. The Order amending the orders regulating the handling of milk in the Northeast and all other marketing areas was approved by producers and published in the **Federal Register** on April 23, 2004 (69 FR 21950), as an Interim Final Rule. Both of these documents have been decided upon as the detailed and appropriate means of effectuating the foregoing conclusions.

It is hereby ordered that this entire decision and the marketing agreement annexed hereto be published in the **Federal Register**.

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

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

The representative period for the conduct of such referenda is hereby determined to be January 2004.

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

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

January 2004 is hereby determined to be the representative period for the purpose of ascertaining whether the issuance of the orders, as hereby



proposed to be amended, regulating the handling of milk in the Appalachian, Florida, Southeast, Upper Midwest, Central, Pacific Northwest, Southwest, and Arizona Las Vegas 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.

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

Milk marketing orders.

Dated: September 20, 2004.

**A.J. Yates,**

*Administrator, Agricultural Marketing Service.*

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

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

*Findings and Determinations*

The findings and determinations hereinafter set forth supplement those that were made when the 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 areas. The minimum prices specified in the orders 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 are applicable only to persons in the respective classes of industrial or commercial activity specified in, marketing agreements upon which a hearing has been held.

*Order Relative to Handling*

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

The provisions of the order amending the orders contained in the interim amendment of the orders issued by the Administrator, Agricultural Marketing Service, on April 19, 2004, and published in the **Federal Register** on April 23, 2004 (69 FR 21950), are adopted without change and, shall be the terms and provisions of this order.

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

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

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

I. The findings and determinations, order relative to handling, and the provisions of §§ \_\_\_\_\_<sup>1</sup> to \_\_\_\_\_, all inclusive, of the order regulating the handling of milk in the (\_\_\_\_ Name of order\_\_\_\_) marketing area (7 CFR Part\_\_\_\_<sup>2</sup>) which is annexed hereto; and

II. The following provisions: § \_\_\_\_\_<sup>3</sup> 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 \_\_\_\_\_<sup>4</sup>, \_\_\_\_\_ 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.

§ \_\_\_\_\_<sup>3</sup> Effective date. This marketing agreement shall become effective upon the execution of a counterpart hereof by the Secretary in accordance with Section 900.14(a) of the aforesaid rules of practice and procedure.

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

Signature

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

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

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

(Seal)

Attest

[FR Doc. 04–21416 Filed 9–23–04; 8:45 am]

**BILLING CODE 3410–02–P**

<sup>1</sup> First and last sections of order.

<sup>2</sup> Appropriate Part number.

<sup>3</sup> Next consecutive section number.

<sup>4</sup> Appropriate representative period for the order.