

DEPARTMENT OF AGRICULTURE**ACTION:** Proposed rule; Final Decision.**Agricultural Marketing Service**

7 CFR Parts 1000, 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, 1131, and 1135

[Docket No. AO-14-A69, et al.: DA-00-03]

Milk in the Northeast and Other Marketing Areas; Decision on Proposed Amendments to Tentative Marketing Agreement and To Order

AGENCY: Agricultural Marketing Service, USDA.

7 CFR part	Marketing area	AO Nos.
1001	Northeast	AO-14-A69.
1005	Appalachian	AO-388-A11.
1006	Florida	AO-356-A34.
1007	Southeast	AO-366-A40.
1030	Upper Midwest	AO-361-A34.
1032	Central	AO-313-A43.
1033	Midwest	AO-166-A67.
1124	Pacific Northwest	AO-368-A27.
1126	Southwest	AO-231-A65.
1131	Arizona-Las Vegas	AO-271-A35.
1135	Western	AO-380-A17.

SUMMARY: This decision adopts revised product-price formulas for establishing Class III and Class IV milk prices. The formulas are applicable to all Federal milk marketing orders. The orders amended by this decision require producer approval. Referenda will be conducted in two markets, and dairy farmer cooperatives will be polled in the other nine markets to determine whether dairy farmers approve the issuance of the orders as amended.

This final decision differs from the recommended decision by modifying the Class III and IV formulas to include farm-to-plant component losses. Modifications are adopted to the butterfat price formula, the protein price formula, the other solids price formula, and the nonfat milk solids price formula. Additionally, this decision converts the Class III and IV formula divisors to multipliers in order to simplify and promote consistency with all end-product pricing formulas.

FOR FURTHER INFORMATION CONTACT: Clifford M. Carman, Associate Deputy Administrator, USDA/AMS/Dairy Programs, Order Formulation and Enforcement Branch, Stop 0231, Room 2968, South Building, 1400 Independence Avenue, Washington, DC 20250-0231, (202) 720-6274, e-mail address clifford.carman@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.

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 Department 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 Department will 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 Department'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 Analysis

This final decision responds to a Congressional mandate to reconsider the Class III and Class IV pricing formulas included in the final rule for the consolidation and reform of Federal milk orders. The mandate was included in the Consolidated Appropriations Act, 2000 (Pub. L. 106-113, 115 Stat. 1501).

In accordance with the Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*), the Agricultural Marketing Service (AMS) has considered the economic impact of this action on small entities and has prepared this regulatory flexibility analysis. When preparing such analysis an agency shall address: The reasons, objectives, and legal basis for the anticipated proposed rule; the kind and number of small entities which would be affected; the projected recordkeeping, reporting, and other requirements; and federal rules which may duplicate, overlap, or conflict with the proposed rule. Finally, any significant alternatives to the proposal should be addressed. This regulatory flexibility analysis considers these points and the impact of this proposed regulation on small entities. The legal basis for this action is discussed in the preceding section.

The RFA seeks to ensure that, within the statutory authority of a program, the regulatory and informational

requirements are tailored to the size and nature of small businesses. For the purpose of the RFA, 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.

USDA has identified as small businesses approximately 62,240 of the 65,464 dairy producers (farmers) that have their milk pooled under a Federal order. Thus, small businesses constitute approximately 95 percent of the dairy farmers in the United States. On the processing side, there are approximately 1,621 plants associated with Federal orders, and of these plants, approximately 928 qualify as "small businesses," constituting about 57 percent of the total.

During January 2002, there were approximately 410 fully regulated handlers (of which 148 were small businesses), 75 partially regulated handlers (of which 39 were small businesses), and 46 producer-handlers (of which 24 were considered small businesses) for the purpose of this regulatory flexibility analysis. In addition, there were ninety-three exempt handlers with Class I sales of less than 150,000 pounds during the month.

Producer deliveries of milk used in Class I products (mainly fluid milk products) totaled 4.085 billion pounds in January 2002, representing 37.7 percent of total Federal order producer deliveries. The volume of milk pooled under Federal orders represents 76 percent of all milk marketed in the U.S. and is estimated at 78 percent of the milk of bottling quality (Grade A) sold in the country. More than 200 million Americans reside in Federal order marketing areas, representing approximately 81 percent of the total U.S. population (2001).

In order to accomplish the goal of imposing no additional regulatory burdens on the industry, a review of the

current reporting requirements was completed pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). In light of this review, it was determined that these proposed amendments would have no impact on reporting, recordkeeping, or other compliance requirements because these would remain identical to the current Federal order program. No new forms have been proposed, and no additional reporting would be necessary.

This proposed rule does not require additional information collection that requires clearance by the OMB beyond the currently approved information collection. The primary sources of data used to complete the forms are routinely used in most business transactions. The forms require only a minimal amount of information 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.

No other burdens are expected to fall upon the dairy industry as a result of overlapping Federal rules. This proposed rulemaking does not duplicate, overlap or conflict with any existing Federal rules.

Consideration of Impacts on Small Businesses

To ensure that small businesses are not unduly or disproportionately burdened based on these proposed amendments, consideration was given to mitigating negative impacts.

A comment filed in regard to the tentative final decision by the managing partner of a large dairy farm argued that dairy producers selling less than 326,000 pounds of milk per month may comprise the majority of dairy farms, but not the majority of milk sold. The comment further stated that it is not appropriate to identify one sector and imply that they are most in need of protection and preservation.

Under the Regulatory Flexibility Act, the definition of a "small" dairy farm has been redefined from a business having an annual gross revenue of less than \$500,000 to a business having an annual gross revenue of less than \$750,000. Therefore, the production guideline of 326,000 pounds per month has been increased to 500,000 pounds per month in identifying "small" dairy farms.

The production guideline of 500,000 pounds per month in identifying "small" dairy farms is an attempt to relate a measure of size for which data

is available (pounds of production per farm) with the criteria specified by the Small Business Administration (revenue from sales), for which data is not readily available to USDA on an individual farm basis. The Regulatory Flexibility Analysis does not represent an attempt to create special privileges for farms defined as small, but to examine the regulations to assure that they do not create a disproportionate burden or competitive disadvantage for such farms.

As was stated in the RFA in the recommended decision, one of the principal issues considered at the hearing was the source of price data that should be used to generate prices for milk components and, thereby, prices to be paid to producers. The options considered were the National Agricultural Statistics Service (NASS) surveys of selling prices of manufactured dairy products, Chicago Mercantile Exchange (CME) prices, and producer costs of production. The recommended decision selected the NASS-reported prices as the most appropriate for use in determining product prices because of the considerably larger volume of product represented in those price series than in the CME price data. Producer cost of production was not included in the calculation of prices because assuring dairy farmers that their costs of production will be covered addresses only the milk supply side of the market and ignores factors underlying demand or changes in demand for milk and milk products.

Various proposals to reduce or increase the levels of the manufacturing (make) allowances of butter, nonfat dry milk, cheddar cheese and dry whey were considered. The present method adjusted these make allowances from the levels adopted under Federal order reform on the basis of data and testimony contained in the hearing record. Most of the adjustments are minimal. Primarily, manufacturing cost surveys performed by USDA's Rural Cooperative Business Service (RBCS) and the California Department of Food and Agriculture (CDFA) were used to determine the most appropriate levels of make allowance for the products used in calculating Federal order class prices.

The only other actual collection of manufacturing cost data for cheddar cheese and dry whey that was cited in the hearing record was a survey of cheddar cheese and dry whey manufacturing costs arranged for by the National Cheese Institute (NCI). This survey was conducted by persons unfamiliar with the dairy industry among cheese processors who did not

testify about the data that they submitted for the survey and was entered into the hearing record by a witness who had no firsthand knowledge of the data included. As a result, the NCI survey should be relied upon to a lesser degree than the two studies used to determine the cheddar cheese make allowance. In the case of the RBCS study, the person who gathered the data testified about its collection and what it represented. In the case of the CDFA-collected data, a manual detailing the method by which the data was collected and presented was made available, and several witnesses familiar with the survey testified about it.

In addition, one nonfat dry milk manufacturer testified to costs of manufacture that exceeded those of the two studies by a significant amount, mostly in the areas of return on investment and marketing costs. The data did not include any information about the pounds of product manufactured and could not have been weighted with the data from the two other studies.

Several proposals to change the factor reflecting the yield of nonfat dry milk from nonfat solids in milk would have increased the nonfat solids price and the Class IV skim price, but ignored the need to reflect the generally lower price and higher manufacturing cost of buttermilk powder that also must be considered in calculating the Class IV nonfat solids price. Testimony and data in the record were used to determine a factor more representative of nonfat dry milk yield and the effect of buttermilk powder price and cost. The alternatives to the formula adopted either did not include consideration of the price, cost, and volume of buttermilk powder relative to those of nonfat dry milk or gave those factors too great an influence.

Proposals were made to reduce the butter and cheese product prices used in calculating the butterfat price and the Class III component prices. The record of this proceeding continues to support the use of the product prices adopted in the final rule in the Federal milk order reform process as representing accurately the values of these products. In the case of adjusting the Grade AA butter price to reflect the value of Grade A butter, the record fails to reveal any source of information for obtaining current prices for Grade A butter. In the case of proposals to remove the 3-cent adjustment between the barrel and 40-pound block cheese prices, there was no testimony about the actual difference in cost between the two types of packaging that overcame testimony that 3 cents is the actual cost difference, or any data

that indicates that the customary price difference is not at least 3 cents.

Proposals to reconsider the class price relationships in the orders were considered, although a proposal to use a weighted average of the Class III and Class IV prices as a Class I price mover was not noticed for hearing in this proceeding. The hearing record supports the continued relationships between the Class IV and Class II prices and between the higher of the manufacturing class prices and the Class I price.

A proposal that the Class II differential be changed to negate any changes in the Class IV price formula that would affect the current price relationship between nonfat dry milk and Class II failed to consider that the Class II–Class IV price difference adopted in Federal order reform is based on the difference in the value of milk used to make dry milk and the value of milk used to make Class II products.

Proposals that any increases resulting from changes to the Class III and Class IV price formulas not be allowed to result in increases in Class I prices did not address the rationale for the current Class I price differentials above the manufacturing price levels for the purpose of obtaining an adequate supply of milk for fluid (drinking) use.

The changes to the Class III and Class IV price formulas included in the recommended decision would have had no special impact on small handler entities. All handlers manufacturing dairy products from milk classified as Class III or Class IV would remain subject to the same minimum prices regardless of the size of their operations. Such handlers would also be subject to the same minimum prices to be paid to producers. These features of minimum pricing are required by the Agricultural Marketing Agreement Act and should not raise barriers to the ability of small handlers to compete in the marketplace. It is similarly expected that small producers would not experience any particular disadvantage to larger producers as a result of any of the proposed amendments.

An analysis was performed on the effects of the alternatives selected and is summarized below.

Final Decision Analysis

In order to assess the impact of changes in Federal order milk pricing formulas, the Department conducted an economic analysis. While the primary purpose of this decision is to amend the product pricing formulas used to price milk regulated under Federal milk marketing orders and classified as either Class III or Class IV milk, these product price formulas also affect the prices of

regulated milk classified as Class I and Class II.

The modifications in this decision are analyzed simultaneously as a change from the set of Court-ordered formulas as implemented in January 2001. This analysis focuses on impacts on milk marketed under Federal milk marketing orders. Milk marketed in California, milk marketed under other state regulations, and unregulated milk are treated separately.

Scope of Analysis

Impacts are measured as changes from the model baseline as adapted from the USDA baseline developed in June 2002 for the mid-session budget review. The baseline projections are a Departmental consensus on a long-run scenario for the agricultural sector. Included is a national, annual projection of the supply-demand-price situation for milk. The mid-term review reflects the provisions of the Farm Security and Rural Investment Act of 2002. Baseline assumptions for dairy are: (1) The price support program will extend through December 31, 2007, supporting the price of milk (3.67 percent butterfat) at \$9.90; (2) the Dairy Export Incentive Program will continue to be utilized; (3) the Federal Milk Marketing Order Program will continue as reformed on January 1, 2000, as modified by the Select, *et al.* vs. Veneman decision in January 2001, and (4) the National Dairy Market Loss Program will make payments to dairy farmers when the Class I price in Boston is less than \$16.94 per cwt.

In the model the U.S. is divided into 14 milk marketing regions, 11 that generally correspond to the Federal order areas, California, other West, and Alaska-Hawaii. The 11 Federal orders share of the U.S. milk marketings is about 70 percent. About 83 percent of all fluid milk and about 65 percent of all manufactured milk is marketed under Federal order regulations. Given the prominence of Federal order marketings, prices paid for both fluid and manufactured milk outside of the order system are generally aligned with prices paid in the Federal order system. California stands out as the state with the highest production and has its own set of comprehensive market regulations similar to the Federal order system. California milk marketings are estimated as a function of the California pool price. Milk marketed through the Federal order system is the predominant subset of milk marketings in the United States. Fluid grade milk prices for the 11 Federal order regions are estimated as functions of Federal order minimum prices and dairy product prices. The regional all-milk prices, which are used

in the regional milk supply responses, are in turn estimated from the regional fluid grade milk price and the national dairy product prices.

Demands for fluid milk and manufactured dairy products are functions of per capita consumption and population. Per capita consumption for the major milk and dairy products are estimated as functions of own prices, substitute prices, and income. Retail and wholesale margins are assumed unchanged from the baseline. The regional demands for fluid milk and soft manufactured products are satisfied first by the eligible supply of milk. The milk supply for manufacturing hard products is the volume of milk marketings remaining after satisfying the volumes demanded for fluid and soft manufactured products. Milk is manufactured into cheese or butter/nonfat dry milk according to returns to manufacturing in each class. Wholesale prices for cheese, butter, nonfat dry milk, and dry whey reflect national supply and demand for these products. These prices underlie the Federal order pricing system.

Summary of Results

The impacts of the changes to the Class III and Class IV formulas that are adopted in this decision are summarized using annualized five-year, 2003–2007, average changes from the model baseline. The results presented for the Federal order system are in the context of the larger U.S. market. In particular, the Federal order price formulas use national manufactured dairy product prices.

The formula changes increase the protein prices and reduce the prices for butterfat and nonfat solids. The results are higher Class III prices, lower Class IV and Class II prices, and lower Class I prices. The advanced Class I base price is the higher of the Class III or Class IV advance pricing factors. The Class I base price is the Class IV price in all years of the analytical period for the baseline, while Class III becomes the Class I base price in 2003 through 2005 under this decision. The Class I price falls in 2003, 2006 and 2007. The resulting increases in Class I and Class II demand for nonfat and fat solids, sufficiently absorbs production increases to very slightly increase cheese and butter prices and only slightly decrease nonfat dry milk prices.

Producers. Over the five-year period, the Federal order minimum Class price for milk at test increases about \$0.06 per hundredweight. The average fluid grade price for Federal order regions, which includes premiums, increases by about \$0.03 per hundredweight. Federal order

marketings increase by an average 58 million pounds annually due to the production increase in response to higher producer prices. Federal order milk cash receipts increase by an average \$47.2 million annually (0.28 percent) from baseline receipts of \$16,729 million.

The distribution of the 2003–2007 annual average changes in the Federal order minimum blend prices across the 11 orders range from (–)\$0.05 to (+)\$0.08 per hundredweight, reflecting declines in premiums associated with Class III milk. Estimates of annual average price and quantity changes by order are provided in the economic analysis for this decision.

The five-year annual average U.S. all-milk price increases by \$0.03 per hundredweight over the baseline. U.S. milk marketings increase by an average 73 million pounds annually (0.04 percent), yielding an average cash receipts increase of \$67.2 million annually (0.29 percent) from average baseline receipts of \$23,535 million.

Milk Manufacturers and Processors. Annual Class IV and Class II skim milk prices decline each year for an average of \$0.07 per hundredweight (1.0 percent) for the 2003–2007 period. This decline results from changing the conversion factor for nonfat dry milk to nonfat solids from 1.0 to 0.99. The minimum butterfat prices decline from baseline levels by an average of 2.1 cents per pound. This decline is the result of recognizing farm-to-plant losses of milk which reduce the yield factor from the equivalent of 1.22 pounds of butter per pound of butterfat to 1.20. The Class IV price at test (about 8.45 percent butterfat) declines by an average of \$0.26 per hundredweight, and the Class II price at test (7.92 percent butterfat) declines by an average \$0.23 per hundredweight over 2003–2007.

The annual average Class III price increase at test (3.52 percent butterfat) is about \$0.23 over baseline (1.9 percent), increasing steadily from \$0.15 in 2003 to \$0.34 in 2007. The increase is the result of the protein price increase of \$0.14 per pound, ranging from \$0.10 to \$0.18 per pound. The increase in the protein price is the result of reducing the impact of the butterfat price on the protein price. The butterfat price effect is reduced by multiplying the butterfat price by 0.90, reflecting a 90 percent butterfat retention rate in the cheese, and replacing the 1.28 factor with 1.17 reflecting the butterfat to protein ratio of milk standardized at 3.5 percent butterfat and 2.99 percent protein.

The Class I base price shifts from the Class IV to the Class III price in 2003–

05. The Class I skim milk price increases over baseline levels on average by nearly \$0.04 cents per hundredweight, ranging from increases of about 18 cents in 2004–05 to declines of about 7 cents in 2006–07. The Class I price at test (about 2 percent butterfat) declines by an average \$0.01 per hundredweight from the baseline, and is similar to the skim milk price change pattern, ranging from 13-cent increases to 12-cent declines.

Consumers. The expected \$0.01 per hundredweight decrease in the minimum Class I price for 2003–2007 results in an average \$0.001 decrease in the price per gallon of fluid milk for consumers. Annual consumer costs for fluid milk over 2003–2007 are estimated to decrease on average by about \$3.25 million in the Federal order system and by \$4.1 million in the U.S.

The price for manufactured dairy products are estimated to increase over baseline by an average \$0.004 per pound for butter and \$0.001 per pound of cheese. Average annual consumer expenditures over the five-year period are estimated to increase over baseline levels by \$5.6 million on butter, and by \$4.1 million on American cheese.

A complete Economic Analysis for the Final Decision on Class III and Class IV Price Formulas is available upon request from 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.

Civil Rights Impact Statement

This final decision is based on the record of a public hearing held May 8–12, 2000, in Alexandria, Virginia, in response to a mandate from Congress included in the Consolidated Appropriations Act, 2000, that required the Secretary of Agriculture to conduct a formal rulemaking proceeding to reconsider the Class III and Class IV milk pricing formulas included in the final rule for the consolidation and reform of Federal milk orders. The consolidated orders were implemented on January 1, 2000. A tentative final decision on the issues considered at the hearing was issued November 29, 2000 (65 FR 76832), and an interim final order (65 FR 82832) became effective January 1, 2001. A preliminary injunction enjoining portions of the interim final order was granted in the U.S. District Court for the District of Columbia on January 31, 2001.

Pursuant to Departmental Regulation (DR) 4300–4, a comprehensive Civil Rights Impact Analysis (CRIA) was

conducted and published with the final decision on Federal milk order consolidation and reform. That CRIA included descriptions of (1) the purpose of performing a CRIA; (2) the civil rights policy of the U.S. Department of Agriculture; and (3) basics of the Federal milk marketing order program to provide background information. Also included in that CRIA was a detailed presentation of the characteristics of the dairy producer and general populations located within the former and current marketing areas.

The conclusion of that analysis disclosed no potential for affecting dairy farmers in protected groups differently than the general population of dairy farmers. All producers, regardless of race, national origin, or disability, who choose to deliver milk to handlers regulated under a Federal order will receive the minimum blend price. Federal orders provide the same assurance for all producers, without regard to sex, race, origin, or disability. The value of all milk delivered to handlers competing for sales within a defined marketing area is divided equally among all producers delivering milk to those handlers.

The issues addressed at the May 2000 hearing are issues that were addressed as part of Federal milk order consolidation and reform. Establishing representative make allowances in the formulas that price milk used in Class III and Class IV dairy products is an issue that affects the obligations of handlers of those products to the Federal milk order pool, and similarly the pool obligations of Class I and Class II handlers. The decision should result in no differential benefits in dividing the pool among all producers delivering milk to those regulated handlers. Therefore, USDA sees no potential for affecting dairy farmers in protected groups differently than the general population of dairy farmers.

Decisions on proposals to amend Federal milk marketing orders must be based on testimony and evidence presented on the record of the proceeding. The hearing notice in this proceeding invited interested persons to address any possible civil rights impact of the proposals being considered in testimony at the hearing. No such testimony was received.

Copies of the Civil Rights Impact Analysis done for the final decision on Federal milk order consolidation and reform can be obtained from AMS Dairy Programs at (202) 720-4392; any Milk Market Administrator office; or via the Internet at: <http://www.ams.usda.gov/dairy/>.

Prior documents in this proceeding:

Notice of Hearing: Issued April 6, 2000; published April 14, 2000 (65 FR 20094).

Tentative Final Decision: Issued November 29, 2000; published December 7, 2000 (65 FR 76832).

Interim Final Rule: Issued December 21, 2000; published December 28, 2000 (65 FR 82832).

Recommended Decision: Issued October 19, 2001; published October 25, 2001 (66 FR 54064).

Extension of Time: Issued November 26, 2001; published November 29, 2001 (66 FR 59546).

Preliminary Statement

Notice is hereby given of the filing with the Hearing Clerk of this final decision with respect to proposed amendments to the tentative marketing agreements and orders regulating the handling of milk in the Northeast and other marketing areas. This notice is issued pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601 *et seq.*), and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900).

The Hearing Notice specifically invited interested persons to present evidence concerning the probable regulatory and informational impact of the proposals on small businesses. To the extent that this issue was raised, it is considered in the following findings and conclusions.

This final decision responds to a Congressional mandate to reconsider the Class III and Class IV pricing formulas included in the final rule for the consolidation and reform of Federal milk orders. The mandate was included in the Consolidated Appropriations Act, 2000 (Pub. L. 106-113, 115 Stat. 1501). The findings and conclusions set forth below are based on the record of a public hearing to consider proposals submitted by the industry to change the pricing formulas in the marketing agreements and the orders regulating the handling of milk in the Northeast and ten other marketing areas held in Alexandria, Virginia, on May 8-12, 2000. Notice of such hearing was issued on April 6, 2000, and published on April 14, 2000 (65 FR 20094).

The recommended decision responded to comments received on the tentative final decision (issued November 29, 2000; 65 FR 76832) on the above hearing and was consistent with the injunction issued by the U.S. District Court for the District of Columbia on January 31, 2001. This final decision responds to comments

received on the recommended decision (issued October 19, 2001; 66 FR 54064).

Material Issues to Class III and IV Formulas

As instructed by the legislation requiring this proceeding, the Class III and IV pricing formulas and all of the elements of the formulas were reconsidered in developing the tentative final decision, the recommended decision, and this final decision.

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

1. Role of producer costs of production.
2. Commodity prices (CME vs. NASS).
3. Commodity and component price issues.
 - a. General approaches on make allowances.
 - b. Class IV butterfat and nonfat solids prices.
 - c. Class III butterfat, protein, and other nonfat solids prices.
 - d. Effects of changes to Class III and Class IV price formulas.
4. Class price relationships.
5. Class I price mover.
6. Miscellaneous and conforming changes.
 - a. Advance Class I butterfat price.
 - b. Classification.
 - c. Distribution of butterfat value to producers.
 - d. Inclusion of Class I other source butterfat in producer butterfat price computation.
7. Reopening of hearing or issuance of a final decision.

Summary of Changes to the Interim Amendments

The recommended decision differed from the tentative final decision in several respects and included summaries of comments submitted on each of the issues within the discussion of the issue. The key changes that were made to the interim order amendments in the recommended decision were as follows:

1. In Issue 3c, changes were made to the formulas for calculating the protein and other solids prices, and the Class III butterfat price would be the same as that calculated for Class IV on the basis of butter.
2. In Issue 3d, the changes made in the Class III component price formulas would result in different effects on Class III component, skim, and hundredweight prices.
3. In Issue 6b, the classification of frozen cream, plastic cream and anhydrous milkfat would be changed back to Class III.
4. In Issue 6c, butterfat values would be pooled for the purpose of calculating

producer butterfat prices in the orders in which producers are not paid on a component basis. In orders under which producers are paid on a multiple component basis, however, the producer butterfat price would be the same as that for butterfat used in Classes III and IV.

5. In Issue 6d, the butterfat in other source milk used in Class I is included in calculating the producer butterfat price in marketwide pools that do not use multiple component pricing, but would continue to be included in the producer price differential calculation in multiple component pricing pools.

6. Issue 7 was changed to explain the reasons for issuing a recommended decision at this point in this proceeding, instead of a final decision.

Summary of Changes to the Recommended Decision by This Final Decision

The changes to the recommended decision formulas by this final decision are primarily the result of incorporating a farm-to-plant product loss:

1. In issue 3a, an adjustment to the component price formula yield factors to account for farm-to-plant component losses is added.

2. In issue 3b, changes are made to the yield factor used for computing both the nonfat solids price and the Class III and Class IV butterfat price to reflect farm-to-plant component losses. In addition, the yield factor used for computing the nonfat solids price and the butterfat price is converted from a divisor to a multiplier.

3. In issue 3c, the yield factors used to compute the protein price are adjusted to account for farm-to-plant component losses and to reflect a reevaluation of the quantity of casein retained in the cheese making process. The other solids yield factor is adjusted to account for farm-to-plant component losses. In addition, the yield factor used for computing the other solids price is converted from a divisor to a multiplier.

Findings and Conclusions

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

1. Role of Producer Cost of Production

Proposal 29 in the hearing notice proposed that producers' costs of production be incorporated into the Class III and Class IV pricing formulas. A number of dairy farmer witnesses testified that, just as manufacturing processors are assured that their costs of processing milk products will be covered, dairy farmers should also have some assurance that they will be able to

continue to operate their dairy farms without losing money. Under the current system, according to the National Farmers Union (NFU) witness, incorporating a make allowance for processors but not for producers leaves dairy farmers to bear the entire burden of changes in supply and demand.

Support for using cost of production in the Class III and IV pricing formulas was reiterated in the comments received in response to the tentative final decision issued November 29, 2000, and the recommended decision of October 25, 2001. The NFU comments expressed disappointment that no portions of the milk pricing formulas were based on producer cost of production. The American Raw Milk Producers Pricing Association suggested that the USDA ignored existing law as written in the 1937 Agricultural Agreement Act, section 608c(18). Two dairy farmers also mentioned their concern about the need to follow 608c(18). Another dairy farmer advocated a producer-influenced supply control/price control system.

Comments filed by the Maine Dairy Industry Association (MDIA) in response to the recommended decision joined in supporting cost of production as a part of the pricing formulas. They expressed the opinion that cost of production should be included because their producers' costs are higher than the price received. The MDIA also voiced the unfairness of processors' being assured some ability to offset their costs through product make allowances while producers are not able to receive such adjustment. Comments received from Schreiber Foods indicated agreement with the recommended decision to not use the cost of production in setting Class prices.

As explained in both the proposed rule and final decision under Federal order reform and in the tentative final decision and the recommended decision in this proceeding, assuring producers that their costs of production will be covered addresses only the milk supply side of the market and ignores factors underlying demand or changes in demand for milk and milk products. As noted by the Dairy Farmers of America (DFA) witness, although pricing proposals incorporating cost of production have been noticed and reviewed several times in the last decade without success, if a sound mechanical concept could be advanced that overcomes the objections relative to supply and demand, it should be considered.

The proposals by NFU and National Farmers Organization (NFO) that advocated adoption of make allowances that would be adjusted for changes in

indexes reflecting dairy farmers' production costs are discussed under Issue 3a, General Approaches on Make Allowances.

In this final decision, consideration has again been given to cost of production proposals. As noted by the NFO witness, the current pricing system uses the interaction of supply and demand for milk products as an indirect method of meeting the pricing requirements of the Agricultural Marketing Agreement Act of 1937 (the Act) for milk. According to the recommended decision, the record contained no new dairy farmer cost of production data that could be used to reflect both the supply and demand sides of the market for dairy products. The recommended decision continued to state that there was no evidence in the record that either USDA's Economic Research Service or the CDFA costs of production had ever been used to price milk.

The Act stipulates that the price of feeds, the availability of feeds, and other economic conditions which affect market supply and demand for milk and its products be taken into account in the determination of milk prices. This requirement currently is fulfilled by the Class III and Class IV component price calculations. If conditions increase supply costs, the quantity of milk produced would be reduced due to lower profit margins. As the milk supply declines, plants buying manufacturing milk would pay a higher price to maintain an adequate supply of milk to meet their needs. As the resulting farm profit margins increase, so should the supply of milk. Likewise, the reverse would occur if economic conditions reduce supply costs. The price of feed is not directly included in the determination of the price for milk, but rather is one economic condition which may cause a situation in which the price of milk may increase or decrease. A change in feed prices may not necessarily result in a change in milk prices. For instance, if the price of feed increases but the demand for cheese declines, the milk price may not increase since milk plants would need less milk and therefore would not bid the price up in response to lower milk supplies. Also, other economic conditions could more than offset a change in feed prices and thus not necessitate a change in milk prices.

The pricing system, according to the recommended decision, accounted for changes in feed costs, feed supplies, and other economic conditions, as explained above. The product price formulas adopted in the recommended decision would reflect accurately the market

values of the products made from producer milk used in manufacturing. As supply costs increase with a resulting decline in production, commodity prices would increase as manufacturers secure additional milk to meet their needs. Such increases in commodity prices would mean higher prices for milk. The opposite would be true if supply costs were declining. Additionally, since Federal order prices are minimum prices, handlers may increase their pay prices in response to changing supply/demand conditions even when Federal order prices do not increase.

Additionally, the pricing formulas contained in the recommended decision and this final decision are applicable to handlers, since handlers are the regulated parties under Federal milk order regulation. The formulas are used to establish minimum prices for milk used in making particular dairy products, not for determining payments to dairy farmers.

2. Commodity Prices (CME vs. NASS)

As adopted in the interim final rule in this proceeding (published on December 28, 2000 (65 FR 82832)), commodity prices determined by surveys conducted by USDA's National Agricultural Statistics Service (NASS) continue to be used in the component price formulas that replaced the BFP. The recommended decision proposed no changes in the source of product price data. Likewise, this final decision adopts no changes in the source of product price data.

Several proposals (1, 5, 10 and 19) were considered during the current proceeding that recommended using prices reported by the Chicago Mercantile Exchange (CME) instead of the NASS surveys to determine commodity prices. Both the CME and the NASS surveys were supported by testimony at the hearing and in briefs. Several comments to the recommended decision supported continuing to use the NASS surveys.

The CME is a cash market where speculators, producers, and processors can buy and sell products. It is a mechanism for establishing prices on which the dairy industry relies. Thus, many contracts to buy and sell dairy products are based on CME prices. A USDA witness testified that he is unaware of any other indices used to price cheese in the U.S. According to several witnesses, cheese and butter processors generally base their contract sales on CME prices.

The NASS price survey gathers selling prices of cheddar cheese, Grade AA butter, nonfat dry milk, and dry whey

from a number of manufacturers of these products nationwide. At the time the proposed rule on Federal order reform was published (January 30, 1998), the NASS survey included prices for cheddar cheese only. This survey began in March 1997. In September 1998, before the final decision was published in April 1999, NASS began surveys of Grade AA butter prices, dry whey prices, and nonfat dry milk prices. In developing these commodity surveys, input was obtained from the dairy industry on appropriate types of products, packaging, and package sizes to be included for the purpose of obtaining unbiased representative prices. A sale is considered to occur when a transaction is completed, the product is shipped out, or title transfer occurs. In addition, all prices are f.o.b. the processing plant/storage center, with the processor reporting total volume sold and total dollars received or price per pound. NASS Dairy Product Prices reports wholesale cheddar cheese prices for both 500-pound barrels and 40-pound blocks, USDA Grade AA butter, USDA Extra Grade or USPH Grade A non-fortified dry milk, and USDA Extra Grade edible non-hygroscopic dry whey. A more detailed description of the surveys can be found in the final decision of April 2, 1999 (64 FR 16093).

The proponents of proposal 1, Western States Dairy Producers Trade Association, *et al.* (WSDPTA), a group of several trade associations and cooperatives, proposed that the NASS commodity prices for butter, cheese, and nonfat dry milk that currently are used for computing the Federal order component prices be replaced with prices determined by trading on the CME. Dry whey was not included in the proposal because there is no dry whey cash contract traded on the CME. A witness from WSDPTA did not oppose the collection and reporting of NASS data, but expressed the opinion that while it serves an important function as information, it should not be used to establish prices. The proponents presented several benefits of using the CME over the NASS survey for commodity prices.

Proponents explained that by using CME prices in the formulas, prices would be known immediately rather than a week later when the NASS prices are published, reflecting more quickly the supply-demand conditions for dairy products. The one-week delay is caused by the time necessary to collect data. A witness for NFO noted that interested persons are able to check the CME value of products on a daily basis and use the reported prices as a factor in

establishing what they will pay, or what they will be paid, for cheese.

A witness from WSDPTA went on to explain that buyers, sellers, and speculators trade the CME, trying to obtain a price in their favor, while the price actually is determined by supply and demand forces. He described the rules as fair and the results as transparent, with participants having a number of interests. The witness continued by noting that the CME price result is instant and results cannot be altered. In contrast, he stated, NASS prices are reported by sellers only, who are not disinterested parties. He argued that NASS respondents can modify their numbers or file an initial report after calculating the price impact of the latest reports.

The proponents also concluded that the urging by many hearing participants that the NASS price series include mandatory participation and be audited proves that the NASS series is not reliable enough to be used as a price-discovery method.

Finally, the witness from WSDPTA expressed the view that the NASS price series would feed on itself and result in price setting, not price discovery. He continued by noting that plants and their buyers will obtain prices one week and sell the commodity in the following week at a price derived in large part from the price obtained in the prior week. The witness compared the NASS survey to the CDFA survey of powder prices which, he claimed, results in a circular pricing system that is mathematically incapable of fully reflecting the top of the market price for powder because so little of the survey volume is priced off of the spot market. Proponents expressed the belief that this circularity causes prices to remain lower than they would without it and that prices would increase more slowly and decrease more rapidly than would prices on the CME, causing overall lower prices for dairy farmers.

In the comments filed on the tentative final decision, the proponents of changing from NASS to CME prices commented only that USDA should reconsider the use of NASS prices. A partner/manager of a dairy farm stated that there is little correlation between the NASS and wholesale prices, and questioned the accuracy of NASS survey numbers. He also stated that block and barrel cheese is traded only between manufacturers and that they therefore have an influence on setting the price, especially if the percentage of the product traded is very low. He argued that a fair price would reflect retail prices or at least true wholesale price,

not the value of the last pound of product produced.

Opponents of changing from NASS to CME prices to compute component prices included International Dairy Foods Association (IDFA), DFA, and National Milk Producers Federation (NMPF). Witnesses for these parties argued that the NASS survey includes pricing based on a significantly larger volume of product than does the CME. In the case of the nonfat dry milk market, the table of 1999 monthly CME Cash Markets data from the 1999 Annual Dairy Market Statistics showed that there were no sales reported for either extra grade or Grade A in the year 1999.

According to a witness from IDFA, the volume of cheddar cheese in the NASS survey is equal to 26.4 percent of all cheddar cheese production in the U.S. for the period September 1998 through February 2000. During the same period, the CME volume of cheddar cheese traded represented only 1.7 percent of U.S. cheddar cheese production. The witness stated that for the same 18-month period, the NASS survey volumes represented 14.4 percent of all U.S. butter production while CME trading consisted of only 2.6 percent. He also noted that switching from the NASS survey data to the CME data would result in a change from a very broad to an extremely thin representation of actual product transactions.

Opponents to the proposal to use CME prices also pointed out that prices at the CME are Chicago or Midwest prices based on the delivery location specification of the contract. Therefore, they argued, the scope of the reported prices for cheese, butter, and nonfat dry milk are not national. A witness for Kraft noted that reliance on the CME alone would exclude the substantial and growing volume of cheese produced in the western United States (U.S.), particularly California. A witness for Northwest Dairy Association suggested that a transportation credit would need to be used with CME prices, at least in the West, to reduce the value of the CME to a more representative level. Opponents went on to explain that since the NASS survey contains data from plants located all over the United States, NASS prices represent a national scope of the prices of each of the particular commodities.

Several of the comments filed in response to the tentative final decision supported use of the NASS price series to determine product prices. Furthermore, there were several comments filed on the recommended decision and they all supported using

NASS prices. The Michigan Milk Producers Association (MMPA) comment noted that NASS "provides the broadest range of price information and is representative of the product prices realized by the dairy industry." In response to the recommended decision, DFA indicated that legislation enacted subsequent to the recommended decision improved the reliability, completeness, and integrity of the NASS price surveys. On November 22, 2000, the Dairy Market Enhancement Act of 2000 was enacted thereby authorizing mandatory and verifiable price reporting.

According to the testimony in the record and a number of the briefs, cheese and butter sellers and buyers look to the CME to identify the most current price levels. As a result, prices move in response to supply and demand conditions in the marketplace as reflected at the CME. Since the transaction prices of commodities are based off of the CME, it is difficult to see how the NASS survey can cause, or result in, circularity. The NASS prices reflect the CME prices with a short lag but are based on a much greater volume, enhancing the stability of the price series. Continued use of the NASS price survey appears to be the best method of obtaining reliable data about commodity prices.

As stated in the final decision on Federal order reform, NASS data traditionally has been collected via a survey with voluntary participation. The price information, like most NASS data, has not been audited. NASS, however, applies various statistical techniques and cross-checking with other sources to provide the most reliable information available. The issue of mandatory and audited NASS data was not within the scope of the rulemaking and could not be addressed on the basis of the hearing record. At the time of the hearing NASS was not authorized to conduct such activities. As noted above, however, the Dairy Market Enhancement Act of 2000 authorized mandatory and verifiable price reporting.

3. Commodity and Component Price Issues

a. General Approaches on Make Allowances

Make Allowances. Changes to the make allowances for each of the product formulas used in calculating component prices were proposed and discussed at length during this proceeding. Except in the case of dry whey, make allowances adopted in the component price formulas in the recommended decision

were calculated using a weighted average of the most recent California Department of Food and Agriculture (CDFA) study and the Rural Business Cooperative Service (RBCS) study. A marketing cost of \$0.0015 per pound is added to both the CDFA costs and the RBCS costs, and the CDFA value for return on investment is used to adjust the RBCS cost. This is generally the same approach used to determine the appropriate make allowances under Federal order reform, and results in values that differ little from the formulas adopted at that time.

For the calculation of the Class III "other nonfat solids" price, neither the CDFA nor RBCS studies included information on the cost of making dry whey. The tentative final decision determined that the make allowance for dry whey should remain the same as that for nonfat dry milk. However, the results of a survey conducted for this proceeding under the auspices of IDFA were included in the recommended decision to determine the make allowance for dry whey.

A number of the proposals considered in this proceeding would change the manufacturing, or make, allowances adopted for the pricing formulas under Federal order reform. There was considerable testimony on the appropriate factors to be considered in establishing make allowances, and several sources of data were cited as the most accurate to use for such a purpose.

Two surveys of product manufacturing costs that were averaged for use in calculating make allowances under Federal order reform were the CDFA study, which is done annually and includes nearly 100 percent of dairy products manufactured in California, and the RBCS study, which is conducted annually by USDA as an in-plant benchmark study for participating cooperative associations. These two surveys had both been updated since earlier versions had been used in determining the manufacturing allowances used in the component pricing formulas adopted under Federal order reform. In addition, the National Cheese Institute (NCI), an affiliate of International Dairy Foods Association (IDFA), contracted with a third party to conduct a survey of the costs of manufacturing cheese and whey powder for use in this proceeding.

A witness for National Milk Producers Federation (NMPF) stated that make allowances should reflect the costs incurred by average plants manufacturing the particular dairy product used in the component/Class price formulas: butter, nonfat dry milk, cheese, and dry whey. The witness went

on to explain that the procedure used by the Department for determining the make allowances under Federal order reform, using an average of the CDFA cost of production studies and the RBCS study, was sound and that the same procedure should be used as a result of this hearing, using the updated data from both surveys. In calculating an appropriate make allowance, the witness supported the addition of a marketing cost of \$0.0015 per pound to both the CDFA costs and the RBCS costs, as under Federal order reform, and the CDFA value for return on investment used to adjust the RBCS costs under Federal order reform. The witness explained that both of these factors should be included as they are legitimate and necessary costs incurred in operating manufacturing plants. The witness for IDFA supported inclusion of the CDFA cost studies in the computation of the make allowance; however, the witness stated that the appropriate procedure for computing the make allowance for cheese was to compute a weighted average of the CDFA cost studies and the NCI survey. The witness explained that the RBCS study does not include all the necessary costs that must be recovered in the make allowance and that the NCI survey is needed to determine what the additional cost values should be. The costs that the IDFA witness pointed out—those which are not included in the RBCS survey but which are included in the NCI survey—are general plant administrative costs, such as the plant manager's salary and corporate overhead, return on investment or capital costs, and marketing costs.

The IDFA representative testified that the danger inherent in regulated prices is setting the manufacturing allowance at a level too low to assure that manufacturers will be able to recover their costs of manufacturing finished products and to have the money needed to invest in new plants. The witness pointed out that an inadequate make allowance would force manufacturers either to move to areas that do not have regulated pricing or go out of business. At the very least, the witness explained, the manufacturers would not invest in new plants and equipment, which in the long run would cause a decline in the productivity of the dairy industry. A number of briefs filed on the basis of the hearing transcript emphasized the importance of covering all handlers' costs of manufacturing and not just average costs.

The IDFA witness explained that if make allowances are established at too low a level, proprietary plants are placed at a competitive disadvantage

relative to cooperative-owned plants. The witness explained that since cooperatives do not have to pay their producers the minimum order price, as proprietary plants are required to do, cooperative plants can reduce the prices paid to member producers to make up the difference in cost.

The IDFA witness explained further that the problem with a make allowance established below the amount needed to cover plant costs occurs because the plant sells the finished product at the same price that is used in the formula for establishing the minimum price the plant must pay for the raw material (milk). The manufacturing allowances are the only place the plant has the opportunity to cover its costs, and those allowances are fixed in the formula that determines the raw material price.

The witness for IDFA asserted that there is very little risk in setting a make allowance too high. He explained that if the make allowance is established at a level above plant costs, the additional revenue stream will be corrected through market forces by requiring the plant operators to pay competitive over-order premiums to milk suppliers to obtain an adequate supply of milk.

A witness for WSDPTA explained that the most important part of determining a manufacturing allowance is to pick a method and stick with that method. The witness testified that the appropriate method is to use the results of the RBCS study with adjustments to include factors for marketing costs and for capital costs. The witness pointed out that use of the RBCS study is appropriate because the study is voluntary and represents the costs of making the particular commodities, and the plants are geographically widely dispersed. The WSDPTA witness stated that including the results of the CDFA study in the computation of the make allowance for pricing Federal order milk is inappropriate since there is no logical reason for considering the manufacturing costs of plants that do not procure any of the milk that would be priced using those costs.

Witnesses testifying on behalf of NFU and NFO both supported the concept of variable make allowances, in which changes in dairy farmer production cost indexes would be used to adjust handler make allowances. The NFU proposal would use an average national cost of production, presumably as published by USDA's Economic Research Service, and the NFO proposal would use the CDFA milk production cost index. The witnesses supported such an approach as a means of addressing the problem of manufacturers being insulated from

changes in supply and demand by their fixed make allowances.

The NFU and NFO witnesses explained that a fixed make allowance, as contained in the current pricing system, does not vary with market conditions and creates a situation in which manufacturers will not respond to market signals since the manufacturers will receive a profit no matter what the supply and demand is for the finished products. The witnesses testified that as long as the make allowance allows manufacturers a sufficient return, the manufacturers will continue to produce the finished product even if there is limited demand for the product, thus resulting in a continued low price paid to producers for their milk. As a result, they argued, producers are left to bear the burden of changes in supply and demand. The NFO witness characterized a variable make allowance tied to the cost of producing milk as a market-oriented system.

The NFU witness described the California milk pricing system, in which manufacturers' production costs are covered through the make allowance, as an example of the problems encountered by producers with the use of product price formulas incorporating make allowances. He testified that California continues to produce a large quantity of lower-valued products because the pricing system makes the manufacturer immune to the supply of and demand for the products. The witness blamed the California make allowance system for the traditionally low milk prices in California that, he claimed, result in expansion of dairy herds to make up for reduced cash flow. The witness predicted that if the Federal order system follows the same pricing path, the same production patterns as witnessed in California would follow in the rest of the United States.

In comments filed in response to the tentative final decision, NFU stated that producers, as well as processors, will fail if they don't attain their costs of production. NFU also argued in its comments that under a variable make allowance, processors can avoid reduced make allowances by increasing product prices.

The NFU comment overlooks the fact that the make allowances included in the component price formulas do not cover all of the costs of all processors, and probably allow for greater costs than are experienced by some processors. In this sense, the margins experienced by processors under product price formulas are variable between plants. Also, it is likely that processors share some of their margin

with producers in the form of over order prices. The degree to which this sharing occurs certainly may vary with producers' cost/price situations, as perceived by processors. Although increased product prices would have the effect of increasing manufacturing margins, the ability of processors to increase prices while maintaining sales is limited by the fact that the marketplace in which they sell their products is competitive.

There appears to be no logical or economic reason for changing make allowances for processing plants because of a change in the cost of producing milk. If milk is to clear the market, plants must be willing to accept it. Make allowances that decline as a result of increasing milk production costs would squeeze plant margins, and manufacturers will have to choose between not receiving milk, refusing to receive pooled milk, or paying less than order prices to cooperative associations for milk used in manufactured products. None of these outcomes would be in the best long-term interests of dairy farmers, processors, or consumers. Many dairy farmers, facing increased costs of production, would have to find alternative outlets for their milk. Decisions on the part of many processors to cease operating, use only nonpool milk, or buy milk below order prices likely would result in very disorderly conditions among dairy farmers looking for outlets for their milk.

Most hearing participants agreed that the make allowance should cover the cost of converting milk to a finished manufactured dairy product. However, several participants disagreed with the IDFA contention that there is very little risk in setting the make allowance too high. They argued that if the make allowance is set in excess of the cost to manufacture finished products, the additional revenue would be kept by the manufacturing plants as higher profits and not distributed to the producers supplying milk to the plant. They explained that in many parts of the country there is little if any competition for the dairy farmers' milk and therefore no incentive for a plant to pay above the minimum Federal order price. These plants, according to the witnesses, could be expected to keep the extra make allowance for themselves. Comments filed by Michigan Milk Producers Association (MMPA) on the tentative final decision and the recommended decision continued to urge caution against logic that suggests a low risk of setting make allowances too high. The cooperative stated that not all of its 2,700 members might survive a market

adjustment period if make allowances were set too high, even if theoretically greater premiums might be returned to producers.

Several witnesses opposed the idea of setting make allowances at levels that guarantee plants a profit, or at least a return on investment, when the dairy farmers supplying milk to the manufacturing plants have no similar assurances for covering the costs of producing milk. These witnesses pointed to the Agricultural Marketing Agreement Act of 1937, sec. 608c(18), as justification for setting a lower make allowance for plants, resulting in higher milk prices that would come closer to covering dairy farmers' costs of producing milk.

As supported by most of the hearing participants, the make allowances incorporated in the component price formulas under the Federal milk orders should cover the costs of most of the processing plants that receive milk pooled under the orders. In part, this approach is necessary because pooled handlers must be able to compete with processors whose milk receipts are not priced in regulated markets. The principal reason for this approach, however, is to assure that the market is cleared of reserve milk supplies.

In comments on the tentative final decision, IDFA continued to argue that some legitimate manufacturing costs are excluded from the RBCS survey and attacked the data gathered as "inherently suspicious and unreliable." IDFA also stated that the survey is not taken seriously by some of its participants. Both IDFA and Leprino Foods Company argued in comments on the tentative final decision that adding factors for costs excluded in the RBCS study constitutes a less accurate result than if those costs were included in a comprehensive study. IDFA also commented that the need to allow for changes in cost factors that might occur over time (such as recent increases in energy costs) also supports the need for a make allowance that is too high rather than one that is too low.

Several comments filed on the recommended decision indicated opposition to establishing make allowances based on an average of plant manufacturing costs. Agri-Mark Dairy Cooperative argued that using an average manufacturing cost in the pricing formulas would result in half of all handlers having higher manufacturing costs. IDFA noted in their comments that mechanically adopting a make allowance survey "would by definition mean that the one-half of cheese produced in plants with greater than average costs would be

forced out of business." Comments received from Northwest Dairy Association and Westfarm Foods, Inc., stated that USDA's use of "a simple average risks half the industry."

This final decision finds that continuing to use an average make allowance of dairy manufacturing plants' costs is appropriate. Reliance on product-price formulas necessitates the need to reflect and to offset the manufacturing costs incurred and is supported by the record even though there is disagreement on exactly how to accomplish this. Using an average make allowance provides a reasonable measure to reflect and offset manufacturing costs and is the only reasonable measure that can be supported by the record evidence.

Although the RBCS survey does not include such costs as general plant administrative costs, return on investment or capital costs, and marketing costs, it is a survey that has been done for sixteen years with the same fundamental methodology and with some continuity of participants. Because the survey is done for the benefit of the participating organizations (cooperatives) to help them identify their costs and compare them with those of their peer group, there is every reason to believe that the costs provided are as accurate as possible. In addition, the years of experience with the survey have enabled USDA to shape the questions to obtain more accurate results.

When the RBCS survey results are adjusted to include the factors that were mentioned above as not included by using the values for those factors from the CDFA survey, the two surveys' costs are comparable, especially considering that the RBCS survey represents manufacturing plants with a wide distribution around the U.S., while the CDFA survey includes only California plants. The CDFA survey is also done every year and is done according to a published procedure manual, with the costs being audited by personnel employed by the State for that purpose. Although no CDFA employee was available to respond to questions about the conduct of the survey, official notice was taken of the procedure manual and of California publications associated with manufacturing cost data. In addition, several witnesses who are deeply involved with the California dairy industry testified regarding the perceived reliability of the survey results.

The use of manufacturing plant data from California plants that do not procure any of the milk that would be priced using those costs should not

cause concern. The costs of manufacturing dairy products may vary slightly by region, but adoption of representative make allowances in product price formulas should not fail to use a well-documented study that includes a large amount of audited data, such as the CDFA survey.

In contrast to the RBCS and CDFA surveys, the survey of cheese and whey powder manufacturing costs arranged for by NCI was developed solely for the purpose of establishing costs to be used in determining make allowances for this proceeding. The survey was conducted by persons unfamiliar with the dairy industry among cheese processors who would benefit from the adoption of overgenerous make allowances. No one who actually conducted the survey was made available to testify, and although the IDFA witness stated that survey participants would testify regarding their responses to the survey later in the hearing, none of the participating firms' witnesses would respond to questions about their firms' results.

Although less weight must be given the NCI survey than either the RBCS or the CDFA surveys for the reasons stated above, the NCI survey's resulting manufacturing costs for cheese are not considerably different from a weighted average of the RBCS and the CDFA surveys. In fact, although the IDFA hearing participants went to great lengths to discredit the RBCS study for use in identifying an appropriate level of manufacturing costs, the hearing record reflects that the NCI survey of cheese and dry whey manufacturing costs used the RBCS 1996 survey results to identify outliers (plus or minus 10 percent) in the study commissioned by NCI.

In comments filed regarding the tentative final decision, IDFA urged that USDA use the NCI and CDFA studies for use in determining make allowances for cheese and whey powder rather than using the RBCS and CDFA studies. IDFA stated that the RBCS study was neutral and was not developed or commissioned for use in this proceeding. Cooperative associations attending the National Milk Producers Federation annual meeting were encouraged to participate in the survey so the results could be used in this proceeding. Since the RBCS study was developed and has continued for sixteen years for purposes other than establishing make allowances, and the methodology did not change from past years for the study used in the hearing, it is unlikely that it was designed for any purpose other than the one for which it was developed and has been used for that period. If the comment is

intended to raise concerns that cooperative associations generally favor lower make allowances, it should be noted that only manufacturing cooperatives were surveyed. The record contains ample evidence that many manufacturing cooperatives desire make allowances just as generous as those favored by proprietary manufacturers.

A comment filed on behalf of the Association of Dairy Cooperatives in the Northeast (ADCNE), some of which are national in scope, argued that use of the NCI data would demean the importance of sworn first-hand testimony that is subject to cross-examination.

As a result of the differences in conduct of the three surveys, manufacturing costs used to determine appropriate make allowances for cheddar cheese, butter, and nonfat dry milk in this proceeding are calculated primarily from a weighted average of the RBCS and CDFA surveys, with a check against the NCI survey cost of manufacturing cheddar cheese. Since the record lacks any other data regarding the cost of making whey powder, the NCI survey results are used for the make allowance in the other solids formula.

One proposal included in the hearing notice would have eliminated any marketing allowance from the make allowances, and a number of witnesses' testimony objected to the inclusion of return on investment. The American Farm Bureau witness questioned the need for a marketing allowance since producers already pay a 15-cent assessment for promotion and research. A brief filed by the proponent of eliminating the marketing allowance stated that the allowance appears to be an "adjustment" or a "hedge," since it is not defined in the final decision in the Federal order reform process.

There was general agreement among those testifying that a marketing allowance should be included in manufacturing costs, but no consensus about the appropriate number. Some of the costs covered by the marketing allowance include maintaining and staffing warehouses, supporting a marketing and sales staff, and transporting product to market, as well as accounting costs associated with the sale of products. The NCI survey identified a marketing cost of \$0.0011 per pound of product, while the DFA witness stated that DFA's costs were approximately \$0.0018. The DFA witness testified that because the costs included in the activities designated as marketing generally fall within a common department under common management, it is appropriate to apply the same allowance to each product.

A witness for Northwest Dairy Association (NDA), a cooperative association in the Pacific Northwest, stated that NDA's marketing costs are \$0.0026 but identified costs associated with the aging of cheese as included in that number. Since the NASS survey price does not include cheese intended for aging, the marketing allowance certainly should not include costs of aging cheese. The Associated Milk Producers, Inc. (AMPI), witness used a \$0.0024 marketing allowance in the calculation of AMPI's proposed make allowance for nonfat dry milk. The witness for Agri-Mark, Inc., a large Northeast cooperative association with several processing plants, stated that Agri-Mark's estimates of marketing costs ranged from \$0.0025 to \$0.005 per pound.

The costs identified as those included in a marketing allowance are necessarily incurred in getting a product to market and are not related to the consumer education and advertising activities covered by the National Dairy Board assessment. The recommended decision stated that since the marketing cost determined by NCI was the only estimate included in the hearing record that was supported by a survey. It varies from the \$0.0015 rate included in Federal order reform by only 4 one-hundredths of a cent and applies only to cheese and dry whey. The recommended decision concluded that there was no basis for making any change to the marketing allowance.

Some producer witnesses objected to the inclusion of any allowance for return on investment in manufacturing allowances on the basis that dairy farmers are assured of no such return. The CDFA manufacturing cost surveys include allowances for depreciation, which is included in the non-labor processing costs; and for return on investment, which represents the opportunity cost of the processors' resources invested in the business. These costs are supported by audited data.

Both the marketing allowance and return on investment factors should be included in the manufacturing allowances provided in the component price formulas at the rates supported by the CDFA data. If processors are not provided enough of a manufacturing allowance to market the product they process, or to earn any return on investment, they will not continue to provide processing capacity for producers' milk. At the same time, the manufacturing allowances incorporated in the formulas will not provide enough of an allowance to assure that every processor, no matter how inefficient or

high-cost, will earn a profit. Allowances set at such a level certainly could result in the situation warned of by producer groups in which processors manufacture greater volumes of product than the market demands because they are guaranteed a profit on all their production. As a result, the only way to market all of the product would be to reduce prices, with a profit to processors still locked in through the make allowance, which would result in decreasing prices paid to producers. In addition, manufacturers who are assured a profit on all of their output would have a lesser incentive to make a sufficient quantity of milk available for fluid use—a basic goal of the Federal milk order program.

Farm-to-plant losses. One area addressed by several hearing participants in testimony and in briefs as appropriate to consider in establishing make allowances or yields was the loss of milk components during manufacturing processes.

Two cheese manufacturers, IDFA and Land O'Lakes (LOL), continued to argue in their comments on the tentative final decision that make allowances should be increased, or yields reduced, to reflect shrinkage between farms and warehouses.

The tentative final decision and the recommended decision stated that orders have always provided an allowance for shrinkage and that inflating costs of production or reducing yield factors to reflect shrinkage would not properly reflect the value of producers' milk used in manufactured products. The recommended decision also stated that processing costs determined by surveys underlie the manufacturing costs incorporated in the pricing formulas and were expressed in cents per pound of end product manufactured, not in the cost per hundredweight of converting milk to manufactured products. The recommended decision went on to state that the component pricing formulas were based on the content of those components in the finished products for which a manufacturing cost per pound had been established. The recommended decision concluded that both the CDFA and RBCS cost surveys allocated all plant costs to actual end products and that the yield factors in the formulas referred to the amount of finished product resulting from the processing of a given volume of input or to the amount of component present in the finished product.

Comments on the recommended decision from Kraft Foods, Inc., Leprino Foods Company, IDFA, Hilmar Cheese Company, Agri-Mark Dairy Cooperative,

Davisco Foods International, Glanbia Foods, Inc., Winger Cheese, Inc., and Northwest Dairy Association and WestFarm Foods (NDA) expressed concern that the Class III and IV milk pricing formulas offered in the recommended decision do not sufficiently address the costs incurred in the assembly, transportation, and delivery of milk and its components. Kraft, Leprino, Hershey, Dairy Farmers of America (DFA), and Dr. David Barbano of Cornell University testified at the hearing as to the need to specifically account for the losses in milk solid components that occur between moving milk from the farm or diverting plants and the receiving manufacturing plant. The witnesses and comments provided testimony that these losses are inherent in the handling of milk and that this issue was inadequately addressed in the recommended decision. This final decision finds the arguments for specific consideration of the impact of shrinkage in the product price formula persuasive.

The hearing testimony as well as comments to the recommended decision provide sufficient evidence to conclude that the recommended decision formulas do not properly consider farm-to-plant losses that occur. Testimony indicates that these losses are 0.25 percent on all milk solids, and that butterfat solid losses are an additional 0.015 pounds per hundredweight of milk. These losses need to be represented in the pricing formula, according to these claimants, to account for the out-of-plant losses that occur prior to processing raw milk into finished products such as cheese or butter/powder.

Witnesses for Kraft, Leprino, DFA, and Hershey, among others, testified that the difference between the quantity of milk, including components, received at the plant should be accounted for in the price formulas, since the formulas are based on yields attributable to components received at the plant. Milk unrecoverable in the movement from farm-to-plant cannot yield finished product.

Comments received from Select Milk Producers, Inc., and Continental Dairy Products, Inc., supported the Class III and IV pricing formulas as offered in the recommended decision, offering that including an adjustment for farm-to-plant loss would cause confusion.

As indicated earlier, Federal orders have always contained provisions for "shrinkage." Since handlers have to account for all receipts and utilization, the shrinkage provision allows assigning a value to milk losses at the lowest priced class, providing explicit

recognition that some milk loss is inevitable in farm-to-plant movement. If, however, the loss exceeds the allowable level, the excess shrinkage is priced at Class I. This "shrinkage," as discussed above, refers to milk losses associated with how the order classifies and pools milk. Current shrinkage provisions are associated with pool distributing plants that produce fluid milk products. In this context, shrinkage provisions also provide fluid milk handlers the ability to assign milk losses to a lower class use value within certain parameters.

The loss allowances in the Class III and IV formulas are intended to reflect actual losses that are beyond the processing handler's ability to control. In addition, farm-to-plant losses cannot be assigned to a lower class value since the milk solids unavailable for processing effectively have no value in the Class III and IV formulas.

The price formulas in the recommended decision included typical plant losses associated with the conversion of raw milk to the final dairy product and relied on Federal order reform findings that the value of Class III and IV milk would be determined from the NASS survey prices collected on butter, cheese, dry whey, and nonfat dry milk. Pricing formulas generally include both yield factors and make allowances which together account for the entire conversion of raw milk to a final dairy product. Comments received on the recommended decision indicated that milk solid losses between the farm and the receiving plant are real, unavoidable, and common.

Prior to Federal order reform, milk pricing for all Federal milk marketing orders relied on the Grade B Minnesota-Wisconsin (M-W) price series and later the Basic Formula Price (BFP). These prices were determined by manufacture milk plant survey reports of Grade B milk purchases free of government price regulation and represented a competitive pay price for milk. The competitive pay price factored the entire cost of processing milk purchased from farms into finished dairy products. In contrast to the competitive pay prices, Federal order reform could no longer rely on a competitive pay price and purposefully chose NASS surveys of end-product prices and sales to establish Class III and IV prices with product price formulas. Many of the plants reporting to NASS purchase large quantities of milk from individual producer cooperatives. The end-product pricing formulas developed under reform were based in part upon the cost to process raw milk into finished dairy products.

After reevaluation of the hearing testimony and comments, this final decision reverses the recommended decision by including an adjustment for farm-to-plant losses of butterfat and nonfat solids. It is necessary to include such an adjustment in using end-product pricing formulas for determining component prices. Since the handlers receiving milk from producers pay the producers on the basis of farm weights and tests, handlers do not receive all of the milk components due to farm-to-plant losses. An adjustment to the price formulas to account for the difference in milk components paid for versus components actually received is appropriate. Based on the hearing record and comments filed by numerous parties, the farm-to-plant adjustment will reflect a 0.25 percent loss of nonfat solids, including protein and other solids, and a 0.25 percent loss of butterfat plus a 0.015 pounds loss of butterfat. These adjustments are reasonable and are reflected in the respective yield factors used for computing the milk component prices.

These loss allowances are adopted into the Class III and IV pricing formulas. The farm-to-plant losses are reflected on the end-products that result from Class III and IV milk, namely, cheese, dry whey, nonfat dry milk, and butter. They are reflected in this way to ease the concerns raised by Select Milk and Continental Dairy who indicated that reflecting farm-to-plant losses on the front-end of the product formulas (based on farm milk) may cause confusion.

A detailed description of the amendments to each of the respective pricing formulas is provided below. This final decision incorporates an adjustment to the respective yield coefficients of each milk component. The adjustment is based on an overall factor of 0.25 percent loss of each milk component and an additional 0.015 pounds of butterfat lost between the farm and the receiving plant.

In-plant losses. Several handlers commented that in-plant losses should be included in the formulas used for computing the component prices. In this regard in-plant losses represent milk that cannot be processed into dairy products due to the handling of milk by the plant. This final decision does not include an adjustment for in-plant losses because a manufacturing plant has control over the magnitude of in-plant losses and therefore should not be compensated for such losses, unlike the farm-to-plant loss which is outside the control of the plant operator. This adjustment is reflected by recognizing

that the cost of converting 100 pounds of milk into a finished product is not significantly affected by the quantity of finished product produced. For example, if it costs \$20 to convert 100 pounds of milk into 10 pounds of cheese assuming absolutely no losses, the make allowance would be \$2 per pound. However, if there is a loss of a half pound of cheese prior to the final packaging of the cheese, only 9.5 pounds of cheese is "produced." In this example, the make allowance would be \$2.11 per pound of finished product. Thus the make allowance based on pounds of product produced does account for at least a portion of in-plant losses.

Ratemaking. In comments received to the recommended decision, Kraft, joined by NDA, argued that including make allowances in the pricing formulas was "ratemaking." Kraft stated that the make allowances formulated and used in the Class III and Class IV formulas have not followed the standards needed to comply with ratemaking. Kraft stated that the make allowances are not constitutionally valid because they do not ensure that manufacturing costs provide for a reasonable rate of return for manufacturers.

In seeking to characterize the provisions of make allowances in Class III and Class IV pricing formulas as ratemaking, the commentors are ignoring the unique and longstanding treatment of the milk pricing provisions, including make allowances, in Federal milk marketing order regulations. The make allowances in the Class III and Class IV pricing formulas do not constitute ratemaking despite arguments that they do. The make allowances adopted are used in establishing minimum prices for milk under the authority and requirements of the Agricultural Marketing Agreement Act and are different in kind from the ratemaking referred to by the commentors.

Other issues. A comment filed by Lamers Dairy to the tentative final decision argued that using make allowances to calculate Class III and Class IV prices but not Class I and Class II prices constitutes unequal treatment. The comment disregarded that make allowances in the Class III and Class IV price calculations are used to determine prices for milk used in those classes, and that the prices for milk used in Classes I and II are based on those milk prices. The Class I and II prices are determined for the purpose of valuing milk in uses that are alternatives to manufacturing uses. Once the Class III and IV prices have been established, the Class I and II prices can be calculated

using differentials from the base prices. No further comments on this issue were received.

b. Class IV Butterfat and Nonfat Solids Prices

Butterfat Price. This final decision continues to use the NASS price for Grade AA butter in calculating the butterfat price to be used in Class IV, and uses the current and the recommended decision's make allowance of \$0.115. However, this final decision changes the use of a 0.82 divisor in the price formula to a multiplier of 1.20 in order to provide consistency to price formulas and to account for farm-to-plant milk losses.

The recommended decision continued to use the NASS price for Grade AA butter for calculating the butterfat price to be used in Class IV, and it continued to change the manufacturing allowance in the butterfat formula by $\frac{1}{10}$ of a cent per pound of butter from the allowance used under Federal order reform. The recommended decision also recommended that the 0.82 divisor in the price formula be unchanged. The make allowance change is the same as that included in the tentative final decision, and neither it nor the other factors were affected by the injunction. However, the injunction resulted in the same butterfat price formula being used to value both Class III butterfat and Class IV butterfat.

Several proposals were heard that would reduce butterfat prices, either by reducing the butter price used in the computation of the butterfat prices for all classes or by subtracting a fixed amount from the butterfat price computed for Class IV. Proposals also were made that would change the make allowance used in calculation of the butterfat prices. There were no proposals to change the butterfat divisor of 0.82, although one witness representing a western cooperative association suggested that it be reconsidered as he felt it did not include a shrinkage factor.

Product Price (Butter). This final decision continues to use the NASS price for Grade AA butter in calculating the butterfat price to be used in Class IV. Several witnesses for proprietary processor proponents of the proposal to deduct six cents from the butter price before computing the butterfat price stated that historically the value of butterfat in the Federal milk orders has been based on the price of Grade A butter. The witnesses explained that an equivalent price determination had been issued in 1998 (when the CME discontinued trading Grade A butter)

where nine cents would be subtracted from the Grade AA butter price for use in calculating Federal order butterfat prices. This equivalent price, according to the witnesses, was found to be "essential" to the continued operation of the Federal milk order program. Further, they argued that its adoption continued the policy of basing butterfat pricing under the Federal milk orders on a value below that of Grade AA butter.

The witnesses complained that under Federal order reform the butterfat value is determined by using the NASS Grade AA price of butter, which effectively increases the butterfat value under Federal milk orders. According to proponents' calculations, the increase does not amount to a full nine cents but is tempered by the use of the NASS Grade AA price, which has averaged approximately three cents below the CME Grade AA price, in the butterfat pricing formula. Therefore, they stated, the actual increase in the butter price used to calculate butterfat prices is approximately six cents. According to the witnesses, subtraction of six cents from the NASS butter price would return the relationship between the butterfat value under the orders and the selling price of butter to the relationship that existed prior to Federal order reform.

Several witnesses explained that when handlers must pay for butterfat on the basis of the Grade AA butter market they cannot then sell cream or finished products at a price that would allow them to recover their costs. They testified that cream is sold at a price that is termed a "multiple" of the butter price, and that the multiples used when the butterfat price was calculated from the Grade A butter price have not adjusted to the new pricing formula using Grade AA butter.

The IDFA witness pointed out that the IDFA proposal to subtract six cents from the NASS Grade AA butter price would apply not only to the butterfat formula for Class II, Class III, and Class IV but would apply to the advance butterfat formula used for computing the Class I butterfat price. The witness testified that by applying the same formula to all classes of butterfat, the current relationship between the class prices would be maintained. The witness contended that there is no justification for changing the relationships between the class prices, particularly if the adjustment would widen the class price spreads or, in effect, increase the Class I and Class II differentials.

Witnesses for NMPF and several large cooperative associations testified in support of NMPF's proposal to reduce

the calculated butterfat price by six cents, with the reduction applied to Class IV butterfat only. Under this proposal, the computation of the butterfat prices for other classes would not contain the six-cent adjustment. Several witnesses representing cooperative associations that process butter explained that butter manufacturers incur additional costs when procuring cream used for manufacturing butter as opposed to the cost of converting producer milk to butter. The witnesses explained that these additional costs include transportation, additional handling, and additional pasteurization. The witness for LOL testified that the additional costs amounted to 4.57 cents per pound of butterfat for transportation and 0.4 cents per pound for receiving, storing, and repasteurization. A witness for Agri-Mark stated that Agri-Mark's transportation costs are slightly less than LOL's, probably due to the proximity of the Agri-Mark plant to the sources of cream, but that the other additional costs are slightly higher than the LOL costs, at 0.5 cents per pound of butterfat.

The proponents of reducing the Class IV butterfat value also referred to the computation of the California Class 4a butterfat price, which involves a subtraction of 4.5 cents per pound from the CME Grade AA butter price to adjust for the costs of moving butter from the west coast to the Midwest.

Those parties who favored reducing the butter price before using the butterfat price formula to calculate any of the butterfat prices disagreed vehemently with the proposal to reduce only the Class IV butterfat price. They argued that such a reduction would distort the relationship between the Class II and Class IV prices, resulting in a greatly-increased price for Class II butterfat in relation to Class IV butterfat. Specifically, the projected increase in the Class II-Class IV butterfat price difference was cited as 6.7 cents per pound (from the current difference of 0.7 cents). These parties argued that butterfat values would most appropriately be reduced by the same degree in all classes.

The price to be used for butterfat in Class III and Class IV should be computed by subtracting a make allowance of 0.115 dollars per pound from the monthly average NASS Grade AA butter price and dividing the result by 0.82 since 1.2213 pounds of butter can be made from 1 pound of butterfat. The Class II butterfat price should continue to be the Class IV butterfat price plus 0.007 cents, while the Class I butterfat price will be the advance

butterfat price plus the applicable Class I differential.

Contrary to the belief stated by some witnesses, the use of the Grade AA butter price for computing the butterfat price under Federal order reform was not an "oversight." Trading of Grade A butter on the CME ended June 26, 1998 (not by USDA, as implied in one brief, but by the CME) because the volume of Grade A butter traded was not great enough to warrant maintaining a trading venue. One brief argued that the Grade A butter price represents a minimum price, and that there is no need for concern that there will not be an available market for Grade A and Grade B butter. However, with the end of trading in Grade A butter on the CME, there is no published (or any other known) source for obtaining a price for Grade A butter.

The use of the Grade AA butter price for establishing butterfat prices is appropriate since that is the only grade of butter that has significant enough trading volume to warrant a publicly-reported price. Grade AA butter prices are the only butter prices regularly available and represent the vast majority (about 95 percent) of the butter sold. Although the "multiples" of the butter price apparently had not adjusted to the use of the Grade AA price during the first 4 months of experience under the revised orders and probably should not be expected to adjust during the period in which this proceeding is under consideration, the marketplace should, in time, make the needed adjustments.

Various witnesses estimated that Grade A and Grade B butter combined make up 3-7 percent of the butter in the U.S. Although a witness noted that the Minnesota-Wisconsin (M-W) price for non-Grade A milk continued to be surveyed even after the percentage of milk eligible for the survey had fallen below a 5 percent level, it was widely recognized for some time that a pricing alternative to the M-W must be found because the M-W eventually would no longer provide a representative price for a large volume of unregulated milk. Similarly, with the decline of Grade A butter (and the unavailability of prices for that product), the only alternative available for determining price is Grade AA butter. A finding in the equivalent price determination that a Grade A butter price was "essential" to continued operation of the orders referred solely to the fact that the Grade A price was specified in all of the orders at that time, not that the butterfat value under Federal milk orders could never be based on any other price.

Making an adjustment to a clearly valid price series to approximate a price

series that has been discontinued for several years due to insufficient volume for trading is inappropriate. Comments to the tentative final decision from IDFA and Schreiber Foods continued to encourage the use of an estimate of the discontinued Grade A price series for the current formulas. Since it has been about four years since a publicly-traded price for Grade A butter has been available, it is impossible to determine what the current difference between these prices would be because there are no reports of the Grade A price available. The vast majority of butter made and sold in the U.S. is Grade AA, and that is the appropriate product to which to base a value of butterfat used in producing butter.

The 3-cent average difference between the CME and NASS butter prices makes up $\frac{2}{3}$ of the 4.5-cent adjustment made by CDFA in calculating the value of butterfat used in butter. An additional 6 cents deducted from the butterfat price calculated from the NASS price would much more than make up the remaining 1.5-cent difference. Also, the 4.5-cent CDFA adjustment is made for the purpose of reflecting the cost of moving butter from California to Chicago. The butterfat price calculated under the Federal order program is not intended to apply to only one state. The NASS price is a nationwide survey and likely includes a significant representation of California butter prices. If there are additional costs involved in making butter, they would more appropriately be included in the make allowance for butter.

Make Allowance (Butter). This final decision continues to use the current and the recommended decision's make allowance of \$0.115. The make allowance factor in the butterfat price formula should be derived from a combination of the manufacturing costs determined by CDFA and by RBCS, as they were in the tentative final and recommended decision. The CDFA cost data is divided into two groups representing high cost and low cost butter plants, with the four plants in the high cost group manufacturing, on average, about the same average number of pounds of butter as the seven plants in the RBCS study. Use of the data for the CDFA high-cost group of butter plants is more appropriate than use of the weighted average cost for all of the California plants because it is more likely that the high-cost plants, like the plants in the RBCS survey, serve a predominately balancing function.

When the RBCS data is adjusted for packaging cost, general and administrative costs, and return on investment with the CDFA data for the

high cost group, and with a marketing allowance of \$0.0015 added to both sets of data, the weighted average of the two data sets is \$0.115. This butter manufacturing allowance was very close to the Federal order reform allowance of \$0.114. As adopted in the tentative final decision, the make allowance of \$0.115 continues to represent the costs of making butter in plants that serve a balancing function.

The increased costs of making butter, not including transportation, cited by the proponents of reducing the butterfat price are expected to be included in this manufacturing allowance, which exceeds the low cost group in the CDFA survey by 3 cents per pound. The only class of use for which adjustments for transportation have regularly been included under Federal order regulation is Class I. Assuring that the order provides an allowance for moving milk used in manufactured products would interfere with provisions designed to assure an adequate supply of milk for fluid use.

Comments to the recommended decision from IDFA again encouraged lowering the Grade AA butter price by subtracting six cents from the NASS Grade AA butter price before computing the Class III and Class IV butterfat prices. IDFA added that if the Grade AA butter price was not reduced then the make allowance should be increased by 4.5 cents.

For the same reasons as stated above in response to comments on the tentative final decision and the recommended decision, this final decision will continue to use the NASS Grade AA butter price to compute the Class III and Class IV butterfat price.

Yield (Butter). As discussed above, this final decision provides an allowance for butterfat lost in moving milk from the farm to the processing plant. In response to the recommended decision, numerous Class III and IV processors provided comments expressing concern that the Class III and IV milk pricing formulas did not allow for general and common losses associated with the assembly, transportation, and delivery of milk and its components. The record supports concluding that the Class III and IV butterfat losses from the farm-to-the plant be computed as follows:

$$\text{Class III \& IV Fat Loss} = (\text{Fat Pounds} \times 0.0025) + 0.015$$

The loss allowance for butterfat will be reflected by adjusting the 0.82 divisor in the butterfat price formula. Testimony and comments indicate that farm-to-plant losses on all milk solids is 0.25 percent (0.0025) with butterfat

incurring an additional loss of 0.015 per 100 pounds of milk. The butterfat price formula is determined as follows:

- For every pound of butterfat, 0.0025 pounds is lost in the farm-to-plant transfer ($1.000 - 0.0025 = 0.9975$).
- In addition, for every pound of butterfat, there is an additional 0.0150 farm-to-plant loss on butterfat solids ($0.9975 - 0.0150 = 0.9825$ pounds of butterfat).
- Dividing 0.9825 by 0.82 results in a butterfat factor of 1.20 ($0.9825/0.82 = 1.20$).
- Therefore, the Class III and IV butterfat value per pound is computed as follows:

$$(\text{NASS butter price} - 0.115) \times 1.20$$

This final decision chooses to multiply the NASS butter price by 1.20 instead of dividing the NASS butter price by 0.82. This change in the formula from division to multiplication is made to simplify and provide consistency in the pricing formulas used for all milk components and includes an allowance for farm-to-plant losses.

Although one witness suggested that the divisor in the butter price formula that reflects the butterfat content of butter be reconsidered, he did not indicate any number more appropriate than the 0.82 divisor used in the current formula. There was no other testimony in the record questioning the butter content factor. In fact, the only data in the record applicable to the issue was a CDFA report on butter and powder yields at California plants in 1996 that was included in an exhibit. This report shows a 1.2213 weighted average butter yield (1 pound of butterfat results in 1.2213 pounds of butter), which corresponds to the use of the 0.82 divisor.

The record does not support adoption of a Class IV butterfat price that is not reflected directly in the Class II butterfat price. There was testimony from several witnesses that the current Class IV–Class II price relationship is rational and appropriate, and an adjustment to the Class IV butterfat price that is not reflected in the Class II butterfat price would disrupt the current relationship. In addition, it would seem reasonable that some of the extra costs claimed by butter manufacturers, such as transportation costs for supplemental cream supplies, butterfat standardization of outside cream sources, and additional pasteurization would be as applicable for Class II manufacturers of high-fat products using surplus cream as for butter makers. Accordingly, reduction of the Class IV butterfat price only is not considered appropriate.

This final decision modifies the Class III and IV butterfat price formula as follows:

(NASS AA Butter Price $- 0.115$) $\times 1.20$

Class IV Nonfat Solids Price. This final decision maintains the use of the NASS survey price reported for nonfat dry milk and maintains the make allowance of 14 cents per pound of nonfat dry milk as indicated in the previous decisions issued in this proceeding. This final decision also changes the divisor from 1 to 0.99 in order to account for farm-to-plant losses of nonfat solids and to simplify and provide consistency to price formulas. Nonfat milk solids in buttermilk are removed from the computation of the Class IV nonfat solids price.

The tentative final decision eliminated the 1.02 divisor in the nonfat solids price formula to reflect the incorporation of dry buttermilk (with a lower product price and higher make allowance).

Six proposals to change some part of the nonfat solids price formula were considered at the hearing. Three of the proposals dealt with the manufacturing allowance for nonfat dry milk (NFDM), with two of the proposals advocating use of the RBCS survey results and one proposal supporting an increase in the make allowance. The other three proposals supported changes in the yield factor of the nonfat solids price formula that would reflect greater powder yield from a pound of nonfat solids. Two of the proposals to change yield factors included using CME NFDM prices instead of the NASS survey. As discussed in the recommended decision, the product prices used in the component pricing formulas will continue to be obtained from the NASS survey.

Product Price (Nonfat dry milk). This final decision maintains the use of the NASS survey price reported for nonfat dry milk. No proposals were considered that would have changed the product price used in the nonfat solids price formula, and the record contains no basis for making any change in this formula factor.

Make Allowance (Nonfat dry milk). This final decision maintains the make allowance of \$0.140 per pound of nonfat dry milk as indicated in the previous decisions issued in this proceeding. At the time the hearing notice was issued, the most recent RBCS data were not available, and those costs were not specified in the proposals. By the time the hearing was held, however, the RBCS data had been released and were included in the information introduced at the hearing. NMPF supported

continued use of a weighted average of the CDFA and the RBCS manufacturing cost surveys, with inclusion of a marketing allowance and the CDFA factor for return on investment. NMPF proposed that the NFDM make allowance be \$0.140 per pound.

Southeast Dairy Farmers Association also proposed that the RBCS survey be used to determine a make allowance for NFDM, but did not propose that a marketing allowance be included. The necessity of including a marketing allowance was discussed in the recommended decision.

Associated Milk Producers, Inc. (AMPI), proposed that the NFDM manufacturing allowance be increased from \$0.137 to \$0.1563 per pound, a rate based on AMPI's cost of making NFDM at its own three plants in the Upper Midwest over a 5-year period. The AMPI witness stated that in addition to a processing and packaging cost of \$0.1254, the make allowance should include a marketing allowance of \$0.0024 and return on investment of \$0.026, for a total allowance of \$0.1538 per pound, modified from the level proposed in the hearing notice. The witness testified that the three AMPI plants operate at approximately 80 percent of capacity.

No comments were filed that specifically addressed the adopted make allowance for use in the nonfat solids price.

On the basis of the data and testimony included in the hearing record, the manufacturing cost level that appears to be most appropriate for use in the pricing formula for nonfat solids is \$0.14 per pound. This value is calculated by using a weighted average of the RBCS survey and the two lowest-cost California groups of plants, adding the CDFA General and Administrative costs and Return on Investment expenses for those two groups to the RBCS numbers, and adding a \$0.0015 marketing allowance to both sets of data. The basis for using the two lowest-cost groups of California plants is that the mid-cost group is of a similar average size as the group included in the RBCS survey, and that the lowest-cost California group has a very similar total cost to the mid-cost group. These three groups of plants (the RBCS plants and the two California groups) are similar enough in size and cost to consider as fairly representative, and should encompass those plants that perform a market balancing function. The highest-cost California group should not be included since its average cost is more than ten cents per pound of NFDM above the RBCS group or

either of the other two California groups.

The AMPI cost numbers cannot be included in the weighted average since the number of pounds of NFDM associated with those costs is not available. When the AMPI marketing allowance and return on investment estimates are replaced with the more moderate numbers used in the make allowance calculation, the AMPI manufacturing costs do not differ much from the other two sources. This is true despite the wide discrepancy in the capacity utilization percentage estimates for the two data sets (80 percent for the AMPI plants versus less than 50 percent for the plants in the RBCS survey). Inclusion of the AMPI costs in the RBCS survey would have included a larger representation of NFDM manufactured outside California. However, the record indicates that a high percentage of the NFDM manufactured in the U.S. comes from California and the proportion of cost data representing California in the manufacturing allowance is reasonable.

"Yield" (Nonfat solids). This final decision adopts changes to the Class IV nonfat solids formula in order to account for farm-to-plant losses, more accurately reflect the value of the nonfat milk solids in nonfat dry milk and buttermilk powder, and provide simplification and consistency to the milk price formulas.

The tentative and recommended decisions included buttermilk solids in the value of nonfat milk solids. However, a reevaluation of the Class IV nonfat solids pricing formula finds that recognizing a minimum value for buttermilk powder does not materially affect the Class IV skim milk price. Record evidence indicates that the price of buttermilk powder can be a low of 70 percent of the nonfat dry milk price for the same period. In addition, according to the record, the make allowance of buttermilk powder is an additional 2 cents per pound higher than the nonfat dry milk make allowance. Official notice of weekly Dairy Product Prices published by the National Agricultural Statistics Service for January 2000 through May 2002 is hereby taken. Copies of Dairy Product Prices can be located at the Web site: <http://www.usda.mannlib.cornell.edu/reports/nassr/price/dairy/>.

Using the 2-cent higher make allowance for buttermilk and prices for nonfat dry milk and buttermilk powder for the period of January 2000 through May 2002 it was determined that the effect of including buttermilk powder in the nonfat solids price and the Class IV skim milk price was negligible. Therefore, this decision eliminates the

consideration of nonfat solids that end up in buttermilk powder from the Class IV nonfat solids pricing formula.

According to the Economic Research Services publication *Weights, Measures, and Conversion Factors for Agricultural Commodities and Their Products*, nonfat milk solids in dry buttermilk are 0.0479 pounds per pound of nonfat milk solids and are calculated as follows:

- For every pound of dry buttermilk there are 0.919 pounds of nonfat milk solids.

- Assuming a dry buttermilk yield of 0.0521, the nonfat milk solids that end up in dry buttermilk are 0.0479 pounds per pound of nonfat dry milk solids ($0.919 \times 0.0521 = 0.0479$).

The Class IV nonfat milk solids price can therefore be calculated as follows:

- For every pound of nonfat milk solids (nfms), 0.0025 pounds is lost in the farm-to-plant transfer.

- One pound of nfms minus the farm-to-plant loss of 0.0025 equals 0.9975 pounds of nfms at the plant.

- For every pound of nfms, 0.0479 pounds of these solids end up in dry buttermilk powder.

- 0.9975 pounds of nfms minus the 0.0479 pounds of solids in dry buttermilk equals 0.9496 pounds of nfms in the form of nonfat dry milk.

- Since each pound of nonfat dry milk contains 96.2 percent nfms (3.8 percent moisture) then, $0.9496/0.962 = 0.9871$ (rounded to 0.99)

Therefore, the Class IV nonfat milk solids price per pound is computed as follows:

(NASS nonfat dry milk price—0.14) \times 0.99

A considerable portion of the testimony dealing with the nonfat solids pricing formula pertained to the 1.02 divisor. The divisor is not strictly a yield factor but is intended to reflect the amount of nonfat solids in NFDM, with an adjustment for the small amount of buttermilk powder that is made in conjunction with the manufacture of butter and NFDM. Testimony by a number of witnesses asserted that the product price minus the make allowance should be either multiplied by a number greater than 1 (such as 1.02) or divided by a number smaller than 1 (such as 0.99 or 0.975) to reflect the fact that more than 1 pound of NFDM can be expected to be manufactured from 1 pound of nonfat solids due to the moisture content of NFDM.

Many of the hearing participants supported the 1.02 divisor, adopted under Federal order reform, and expressed understanding of the approach of adjusting the “yield” of

NFDM to compensate for the fact that some of the powdered product made from Class IV milk is buttermilk powder (BMP). Although 1.03 to 1.05 pounds of NFDM generally can be obtained per pound of nonfat solids, the formula also recognizes a lower value and higher manufacturing cost for BMP.

Several witnesses correctly assessed an alternate solution to the dilemma of calculating a component price from two commodities with different prices and different make allowances as one requiring addition of dry buttermilk as another component price in the Federal milk order pricing system. As described by at least one witness, such an undertaking would require adding dry buttermilk to the NASS price survey, determining a separate make allowance, and calculating a yield factor. This procedure would be a burdensome undertaking for very little benefit, since dry buttermilk represents only about 5 percent of the dry products resulting from the manufacture of butter and nonfat dry milk. The issue that remains is how best to reflect the value of nonfat solids used in both NFDM and BMP in the same component pricing formula.

The IDFA witness testified that for the 19-month period beginning with September 1998, the Central States’ dry buttermilk price had averaged \$0.798 per pound, while the Central States’ “mostly” price for NFDM averaged \$1.043. The LOL witness similarly testified that the 1999 Northeast “mostly” price for NFDM averaged \$1.0389, while the BMP price was \$0.7686 per pound. On the basis of these numbers, it would appear that the price of BMP is roughly 75 percent that of NFDM. However, comparison of BMP and NFDM prices for the years of 1996 through 1999 and into 2000 reflects a more complex relationship between these prices than the hearing testimony would indicate. The BMP price as a percentage of the nonfat dry milk price (using Western prices) was 100.9 percent in 1996, 94.5 percent in 1997, 88 percent in 1998, and 71 percent in 1999. During the first third of 2000, BMP prices generally averaged less than 70 percent of NFDM prices. As the year 2000 progressed, however, the percentage increased, being at levels up to 100 percent in late July and remaining above 85 percent for the second half of the year in all areas.

The witness representing Agri-Mark stated that Agri-Mark employees engaged in manufacturing operations had estimated that the costs of producing BMP range from 1 to 3 cents more per pound than those of producing NFDM. Given that the manufacturing costs estimated by the Agri-Mark

witness for other products were somewhat higher than those supported by the bulk of the hearing record, it is reasonable to consider the extra cost of manufacturing BMP to be generally not more than 2 cents in excess of the cost of manufacturing NFDM. In addition, it is difficult to justify increasing the powder make allowance for all of the powdered product represented in the make allowance since the RBCS witness testified that manufacturing costs of BMP manufactured at the plants included in the RBCS survey are included in the powder costs reported by RBCS.

Testimony regarding actual yields of NFDM and BMP were provided by only one witness representing a manufacturing plant operator. The numbers provided, while not complete enough for an exact accounting of the ultimate disposition of the plant’s receipts of producer milk, indicate strongly that the approximate loss of nonfat solids used in the manufacture of NFDM at the specific plant was 3 percent, with 16 percent lost in the manufacture of BMP, for a combined weighted average loss of more than 3.5 percent of nonfat solids. In comparison, data published by the State of California showed a weighted average loss of solids not fat of 2.13 percent in the manufacture of butter and powdered products.

The California data indicate a weighted average powder yield of 1.0252 pounds of NFDM and BMP from 1 pound of nonfat solids. One witness discounted this data by observing that the “high” California yield was reported as 1.0406, which would represent a higher-than-allowable moisture content. This number may be influenced by the “high” reported BMP yield of 0.0749.

As noted above, the general impression conveyed by testimony in the hearing record, that BMP is worth considerably less than NFDM and that the cost of processing it is significantly greater than that of processing NFDM, is misleading. The average BMP price over the period 1996–July 2000 is approximately 87 percent of the NFDM price, and the cost of manufacturing BMP is, on the basis of the information available, no more than 2 or 3 cents in excess of the \$0.14 recommended as the NFDM make allowance.

The following information from the hearing record was used to determine a multiplier or divisor for the total nonfat solids pricing formula that would result in a minimum price for nonfat solids while incorporating the data and testimony in the record about the manufacture of NFDM and BMP. To assure that the result represents a

minimum price, the low or high areas of ranges of numbers related to the manufacture of these two products were used. The CDFA report on butter and powder yield in California plants in 1996 was used in making some of the calculations regarding this factor.

a. The price of BMP represents roughly 80 percent of the price of NFDM (80 percent is less than the average historical relationship of these prices over the past 5 years).

b. The cost of manufacturing BMP is not more than 2 cents greater than the make allowance for manufacturing NFDM.

c. Using a theoretical yield of 1.03 pounds of powder containing 3 percent moisture made from milk containing 8.62 percent nonfat solids would result in 0.054 pounds of BMP and 0.976 pounds of NFDM.

d. Adjusting the theoretical yield of 1.03 pounds to the minimal yield of 1.01 pounds (the "low" yield in the CDFA report) and prorating the BMP and NFDM to 1.01 pounds instead of to 1.03 pounds, the amount of BMP manufactured from a pound of nonfat solids used in butter/powder is approximately 0.053 pounds. When the NFDM yield is prorated, the resulting minimum yield is 0.957 pounds.

Using a NFDM price of \$1.03 per pound, a make allowance of \$0.14 cents per pound of NFDM, and a divisor of 1, the resulting calculation is: $\$1.03 - \$0.14 = \$0.89$ per pound of nonfat solids. The same result is achieved through a more complicated calculation using both product prices and make allowances, as follows:

Buttermilk powder:

$(\$1.03 \times 0.80) - \$0.16 = \$0.664$

$\$0.664 \times 0.053 = \$0.03519 + \text{Nonfat dry milk:}$

$\$1.03 - \$0.014 = \$0.89$

$\$0.89 \times 0.957 = \0.85173

$\$0.88692$ (Rounded to \$0.89)

On the basis of this analysis, no multiplier or divisor would be necessary in this formula (same as a multiplier or divisor of 1).

A number of comments were filed in response to this aspect of the tentative final decision, with some supporting the use of a divisor of "1," two comments suggesting that a divisor of 1.01 would be more appropriate (but one determining that such a change would not be possible on the record of this proceeding), and several insisting that the above analysis is flawed by use of incorrect or inappropriate data and that the divisor should be returned to the 1.02 level in effect before January 1, 2001.

The IDFA comments stated that, in the interest of establishing minimum

pricing, no more than 70 percent of the NFDM value should be assumed for the BMP price and that 3 cents should be added to the BMP make allowance instead of 2. IDFA also indicated that the formula should include shrinkage. NDA and LOL criticized the use of the California yield data in determining the comparative yields of NFDM and BMP, both because some of the data reflected information that included powder with higher-than-allowable moisture and because no witnesses who had participated in the survey were present to testify about it. LOL criticized USDA's use of Western prices rather than the Northeast and Central prices quoted by witnesses who discussed the relative values of NFDM and BMP.

Comments filed by Agri-Mark protested elimination of the 1.02 divisor, arguing that USDA relied on a casual remark about the difference between the cost of manufacturing BMP and NFDM rather than on detailed cost information as in the other make allowances. Agri-Mark also stated that the role of Class IV in balancing surplus cream from Class I use increases the ratio of BMP to NFDM over that calculated from an assumption about uses of the nonfat solids in producer milk.

Criticism of use of the Western BMP and NFDM price series to analyze the relative values of BMP and NFDM in the tentative final decision did not consider the fact that the Western price (mostly) series is the only one with an uninterrupted data series for the five years considered. In addition, the percentage of the NFDM price represented by the BMP price for the Western region was lower during each of the years 1996–2000 than for the Central region; and very similar, with some years averaging higher and some lower, to the Northeast region. Criticism of the CDFA yield data ignores the fact that the yield factors used in the initial analysis for the tentative final decision adjusted the relative "weighted average" yields of BMP and NFDM to the "low" yield.

The hearing record contains enough information on the issue of the relative weights, values, and costs of manufacturing NFDM and BMP to support the conclusion reached in the tentative final decision about the appropriate divisor in the nonfat solids price formula. The 0.96 divisor considered in the proposed rule on Federal order reform represented the pounds of nonfat solids in NFDM rather than the yield of nonfat dry milk from nonfat solids. Use of the divisor of 1 recommended in the tentative final decision accounted for all of the nonfat

solids used in Class IV and resulted in 3–4 cents less per pound of nonfat solids (over a NFDM price range of \$0.86–\$1.10) than the value that would be calculated if the formula attributed all of the Class IV skim value to NFDM.

The Agri-Mark comment emphasized that the ratio of BMP to NFDM milk considered in the nonfat solids price calculation should be calculated on the basis of the butterfat content in Class IV because butterfat surplus to Class I use is used in butter. The Agri-Mark comment observed that the butterfat percentage of milk used in Class IV in the Northeast over a 3-month period averaged 5.67 percent.

Even if the national average of butterfat in Class IV (6.4 percent) is used to determine the breakdown between nonfat solids used in BMP and nonfat solids used in NFDM, less than 0.8 pounds of nonfat solids out of the 8.4 contained in a hundredweight of Class IV milk at 6.4 percent butterfat should be attributed to use in BMP. In effect, the price of each of the 8.4 pounds would be reduced by 3–4 cents. Such a calculation results in 25.2–33.6 cents per hundredweight of milk containing 6.4 percent butterfat to cover the additional costs of making 0.8 pounds of BMP and the lower value of 0.8 pounds of BMP compared to the NFMP manufacturing cost and price. A 3-cent additional cost per pound of manufacturing 0.8 pounds of BMP would equal 2.4 cents, and a 25-percent reduction of the BMP value from that of NFDM would equal approximately 20 cents. These calculations would still leave 2.8–11.2 cents per hundredweight to cover any additional costs of making and selling BMP over those of NFDM.

The recommended decision noted that the additional 3 cents per pound cost of making BMP is on the high end of the information in the hearing record, and that the 25 percent reduction in value of BMP compared to NFDM is on the low end. It was also noted that over the past 5 years, only during the period cited by witnesses testifying about the relative values of BMP and NFDM and during the first 4 months of 2000 had the BMP price as a percentage of the NFDM price fallen below eighty percent. It was also mentioned in the recommended decision that calculations assumed that all of the nonfat solids not used in NFDM were used in BMP, whereas some are used in whole milk powder, which has a higher value than either NFDM or BMP.

In considering all of the above discussion, the record supports the finding that this final decision's incorporation of a Class IV nonfat dry

milk yield factor of 0.99 is appropriate. The formula is as follows:

$$((\text{NASS nonfat milk solids price} - 0.14) \times 0.99$$

c. Class III Butterfat, Protein, and Other Nonfat Solids Prices

In a change from the orders promulgated under the Federal order reform process, the tentative final decision calculated a Class III butterfat price from the value of butterfat in cheese rather than using the butterfat price calculated from the value of butter for both Classes III and IV. The Class III butterfat price in the tentative final decision was calculated to represent the value of the component in the NASS cheddar cheese price, as was a revised protein price formula.

Before the interim final rule became effective on January 1, 2001, several petitions were filed requesting the Secretary to delay implementation because industry participants objected to the effects of the separate Class III butterfat price.

Implementation could not be stayed because of the Congressional deadline on the rulemaking procedure, and partial implementation was not possible because the interim final rule had been approved by producers in its entirety. Before the separate Class III and Class IV butterfat prices could become effective, implementation of the separate butterfat prices was enjoined in the Federal District Court for the District of Columbia at the urging of organizations representing most of the interests in the dairy industry. The Court's order returned the price formulas for the Class III components to their earlier forms, with the new make allowances and cheese moisture adjustment incorporated.

By the end of the comment period on the tentative final decision, comments representing nearly 100 interested parties from most segments of the industry were received that objected to separating the Class III and Class IV butterfat prices and reducing the level of the protein price. The comments urged USDA to continue to calculate the Class III butterfat price on the basis of the value of butterfat in butter, and return to the Class III price formula formats in use before effectuation of the interim final rule.

Several reasons were given for rejecting the change to Class III component prices based on the contribution of butterfat and protein to cheese yield. Numerous commenters cited the negative effects of a marked increase in the cost of milk for use in high-fat cheeses and the incentive created for handlers to substitute lower-

valued Class IV forms of butterfat for use in cheese-making. Others stressed the difficulties created by the decision in marketing cream. Several commenters argued that the shift in value from protein to butterfat caused by the decision did not make sense in light of the importance of protein in cheese-making, and that the reduced protein price would send incorrect economic signals to dairy farmers. One particular concern was the potential significant reduction in the Class I skim value if the Class III price at 3.5 percent butterfat became the mover for the Class I price.

Based on comments received, this final decision determines that the Class III butterfat price be the same as the Class IV butterfat price, calculated from the value of butterfat in butter. In addition, the portion of the protein price formula that adjusts the protein price to accommodate the differential value of butterfat in cheese, as opposed to butter, will continue to be incorporated into the protein price formula. The technical corrections to the protein price formula made in the recommended decision to make the protein price correlate somewhat more closely with the cheese price are adopted in this final decision.

The tentative final decision made only one modification to the specifications of the cheese price, currently a weighted average of the prices of cheese sold in 40-pound blocks and 500-pound barrels (with a 3-cent addition to the barrel price). That change, to adjust the price of 500-pound barrels to 38 percent moisture instead of the 39 percent moisture price currently reported by NASS, is continued in this final decision. Also, as in the tentative final and recommended decisions, this final decision reduces the make allowance for cheese from \$0.1702 to \$0.165 per pound.

As proposed in the recommended decision, the other nonfat solids price adopted in this final decision will continue to be calculated by subtracting the make allowance from the NASS-reported price for dry whey. However, the result will now be multiplied by 1.03 instead of dividing by 0.968. In addition, the recommended make allowance of 15.9 cents per pound of dry whey is also adopted.

Class III Product Price (Cheese). As proposed in the recommended decision, this final decision continues to utilize the NASS cheese price survey as a basis for determining a value for protein in computing a Class III milk price. The NASS 40-pound block price will continue as presently used. In addition, the NASS 500-pound barrel price will continue to be used as previously

recommended at 38 percent moisture and a 3-cent addition to the barrel price.

Several proposals included in the hearing notice would, if adopted, have changed the NASS cheese price used in the Class III pricing formulas. One proposal would limit the cheese prices included to 40-pound blocks reported by the CME, while another would add 640-pound blocks to the prices surveyed by NASS for inclusion in the cheddar cheese price. A third proposal would replace the current 3-cent price adjustment between 500-pound barrel prices and 40-pound block prices to a value that reflects the actual differential industry cost of making 40-pound blocks over 500-pound barrels. Still another proposal would adjust 40-pound block cheese prices for moisture, as 500-pound barrel prices are adjusted.

As discussed above in Issue 2, CME commodity prices should not be used as the basis for calculating component prices. Eliminating 500-pound barrels, which represent approximately two-thirds of the cheese represented in the NASS survey, from calculation of the market value of cheddar cheese would reduce greatly the degree to which the current product prices represent U.S. cheddar cheese prices. The record of this hearing provides no support for relying solely on prices for 40-pound blocks to identify a market price of cheddar cheese.

Several parties testified that the NASS weighted average cheese price should include the value of 640-pound block cheese in the cheese price computation. They contended that such inclusion would improve the reliability of the average cheese price by adding a substantial quantity of cheese to the price survey. Witnesses' estimates of the percentage of U.S. cheddar cheese production represented by 640-pound blocks ranged from 20 to 27 percent. Witnesses testified that the increased volume would better reflect the true value of cheese and additionally would reduce the potential for price distorting manipulation by individual handlers.

In comments filed on the tentative final decision, IDFA stated that USDA had erred by excluding 640-pound blocks. IDFA reiterated the argument that 640-pound blocks represent as much as 27 percent of total cheddar cheese production. Furthermore, the comment noted that past data-collection problems are irrelevant because "all participation in NASS surveys regarding data used to calculate federal order minimum prices is now mandatory." IDFA concluded that the argument that 640-pound blocks should not be used due to their being made on a custom basis to customers' specifications is not

valid because adjustments can be made, as they are for moisture in barrel cheese.

Opponents to inclusion of the 640's in the cheese price computation explained that the vast majority of 640's are made on a custom basis to customers' specifications and therefore are not sufficiently uniform to have a standard identity. One witness noted that much of the commerce in 640's is made on a long-term contractual basis and as such would rarely be reflective of changing market conditions.

The Association of Dairy Cooperatives in the Northeast (ADCNE) comments on the tentative final decision reiterated USDA's position, stating that "the market in 640-pound blocks of cheddar cheese does not involve sufficient buyers and sellers in arms-length transactions to provide good data to establish the Class III price for producer milk in all federal milk orders." As stated in the tentative final decision, standardized pricing cannot be developed without a standard identity for the product, which 640-pound blocks lack. In addition, there appears to be an insufficient volume of 640-pound block cheese transactions to warrant inclusion. At the beginning of the NASS survey, price data for 640-pound blocks was collected but was discontinued due to lack of volume and too few participants to allow disclosure of data. Even earlier (1995-96), the former National Cheese Exchange attempted to include trading in 640-pound blocks but discontinued doing so because of lack of interest. Testimony from witnesses representing organizations that manufacture cheese in 640-pound blocks, and who favored inclusion of such product in the NASS survey, stated that the 640-pound blocks manufactured by their organizations are used internally, making that cheese ineligible for inclusion. Therefore, even though price reporting is now mandatory, 640-pound blocks of cheese do not meet the criteria necessary for the prices of these products to be eligible for inclusion in the NASS survey.

Elimination or reduction to one cent of the three-cent adjustment that is added to the barrel price for computing the weighted average cheese price was advocated in testimony at the hearing, comments contained in post-hearing briefs, and comments responding to the tentative final decision. The witnesses argued that since the barrel cheese price is adjusted to 39 percent moisture and block cheese is approximately 38 percent moisture, at least 2 cents of the observed difference in price between 40-pound blocks and 500-pound barrels is due to moisture and has nothing to do with actual differences in costs. In fact,

they argued that there is no difference in packaging costs between block and barrel cheese.

The witness for DFA, a cooperative that manufactures cheese packaged in both 40-pound blocks and 500-pound barrels, testified that three cents is an acceptable and reasonable spread between blocks and barrels and that there is no compelling reason to change the three-cent addition to the barrel price. The witness for LOL testified that the three cents is an appropriate difference between blocks and barrels and that adding three cents to the barrel price when computing the weighted cheese price is an appropriate adjustment. DFA and ADCNE argued, in a brief filed on behalf of both parties, that the record supports a conclusion that the 3-cent adjustment of the barrel price is attributable to volume utility and cost differences in packaging and handling.

The National Cheese Institute, which proposed reducing or eliminating the 3-cent adjustment, argued that the adjustment should include only the actual cost differences involved in manufacturing and packaging the two sizes of cheese. Although a number of witnesses representing cheese manufacturers testified in favor of reducing or eliminating the adjustment, including one whose employer makes both sizes of cheddar, none of them addressed the actual cost differences of packaging and manufacturing 40-pound blocks and 500-pound barrels. Instead, the only testimony that was offered involved attributing a 2-cent difference to the moisture-adjusted value of the two sizes of cheese packages. In comments responding to the tentative final decision, ADCNE argued that the 3-cent adjustment is representative of the historical difference in market value between barrel cheese and block cheese after adjustments for moisture.

If the difference between the block and barrel prices were due to the difference in moisture, the difference between the prices should widen as the cheese price increases since the moisture adjustment is based on the price and moisture of the cheese. An analysis of historical cheese prices indicates that the difference between the block cheese and barrel cheese prices does not change with changes in price level. In fact, three of the largest differences between the block and barrel prices occurred at approximately the 40-month NASS weighted average monthly prices.

In comments filed by Leprino Foods Company (Leprino) on the tentative final decision, Leprino argued that comparisons of the block and barrel

cheese prices from May 1995 through December 1999 are not valid because of artificial market distortions. Leprino stated that valid relative price data is available only for calendar year 2000, during which the average spread is 1.54 cents. Leprino continued, in its comment, that the price spread between blocks and barrels does not move in lock-step because it is affected by many factors, and will continue to be driven by current market forces.

In comments to the recommended decision, Kraft reiterated their position that at equal moisture tests of 38 percent, the appropriate value to add to the barrel price is 1-cent. In comments to the recommended decision, Glanbia stated that the difference in cost of production between blocks and barrels is \$0.008 per pound of cheese at their plant. In comments received to the recommended decision, DFA and Select indicated that the 3-cent adjustment is the correct adjustment to the barrel price.

The record contains no basis for concluding that the actual cost of manufacturing and packaging the two sizes of cheese is not the historical 3-cent price spread. In fact, during the period September 1998 through June 2000 the difference between the block and barrel prices has been 4.4 cents per pound. The record supports maintaining the 3-cent addition to the barrel cheese price.

An expert witness, and several other witnesses, testified that the moisture content of the cheese used for determining the NASS cheese prices and the moisture content used in the Van Slyke cheese yield formula used for computing the "yield" coefficients in the protein formula should be the same. The witnesses explained that failure to align the formula and the moisture content represented by the cheese price survey would result in overstating or understating the formula coefficients.

The expert witness explained that the barrel cheese price is reported at 39 percent moisture after being adjusted from the actual moisture, while the block cheese price is reported at an unknown moisture level. The only testimony dealing with the actual moisture level of block cheese indicates that it averages about 38 percent.

The coefficients originally used for determining the Class III protein price and the Class III butterfat price and used in the formulas in the recommended decision were derived from using the Van Slyke cheese yield formula at 38 percent moisture. Therefore, it is appropriate to use cheese prices that reflect cheese containing 38 percent moisture. The current practice of using

the 40-pound block cheese price unadjusted for moisture and the 500-lb barrel price adjusted for moisture should be continued, but with the barrel price adjusted to 38 percent moisture instead of 39.

In several comments on the tentative final decision, commenters stated that the 38-percent moisture adjustment to the barrel price requires an adjustment to 1 cent and not 3 cents for the price spread between 500-pound barrels and 40-pound blocks. Other interested persons filed comments supporting both adjustments. DFA argued in its comment that eliminating either adjustment should result in use of only 40-pound block cheese prices.

The hearing record provides no basis for altering the composition of cheese prices surveyed for use in the Class III pricing formulas or for changing the calculation of the NASS weighted average cheese price, other than the moisture adjustment to 38 percent for 500-pound barrels.

Several witnesses testified that types of cheeses other than cheddar should be included in the NASS price survey as a more comprehensive basis for identifying a cheese price, although such a proposal was not included in the hearing notice. The cheddar cheese included in the NASS survey meets certain standard criteria that makes prices for the reported cheese sales comparable. If the survey included other descriptions of cheddar and other types of cheese, such as mozzarella, it would not be possible to consider the reported price as representative of the value of any particular product. Further, the manufacturing costs surveyed are, to a great extent, limited to the costs of processing cheddar cheese.

Class III Make Allowance (Cheese). As in the tentative final and recommended decisions, this final decision reduces the make allowance for cheese from \$0.1702 to \$0.165 per pound. Several proposals to adjust the manufacturing allowance for cheese were included in the hearing notice and considered at the hearing. The NMPF witness testified that the organization had determined that the most appropriate cheese make allowance would be a weighted average of the updated RBCS and CDFA surveys, with addition of a marketing allowance. Thus, the NMPF supported adoption of a cheese make allowance of \$0.1536 per pound of cheese. Several witnesses representing cooperative associations supported the NMPF \$0.1536 proposal but also would have included a cost factor for return on investment. One witness testified that the make allowance should be based on data from actual plant operations through the

surveys conducted by RBCS and CDFA and testimony from individual plant operators; that it should include California data, as California plants represent a large proportion of cheese manufacture; and that it should be generous enough to assure adequate plant capacity for continued manufacture of cheese.

The witness representing NCI testified that the cheese make allowance should be no less than \$0.1687, the weighted average of the NCI-sponsored and CDFA surveys with the addition of a marketing cost of \$0.0011. He stated that such an allowance would represent the production of 24 cheese plants and 53 percent of U.S. cheese. Several cheese manufacturer representatives supported use of the NCI-supported make allowance, stressing the importance of adoption of an allowance that covers *all* of the costs of manufacturing cheese.

A witness representing Farmers Union and the American Farm Bureau witness both supported adoption of a make allowance of \$0.1521, as a weighted average of RBCS and CDFA data; and a witness for National Farmers Organization supported a make allowance of \$0.141 composed of the RBCS cost with the addition of a marketing allowance and return on investment.

Although ADCNE, in its comments on the tentative final decision, supported the use of California data as compiled and audited by a state agency, ADCNE disagreed with inclusion in the cheese make allowance of the CDFA "general and administrative expense" item, which added 1.9 cents per pound to the make allowance. ADCNE described this allowance as "generous, to say the least," as it represents \$2–\$3.5 million for the newest, largest, and most efficient cheese plants, and stated a preference for having some basis in testimony before building that sort of expense level into plant costs at the expense of minimum producer prices.

The general and administrative expense was one of the cost factors included in the CDFA weighted average cost study, but not in the RBCS study. Therefore, it must be added to the RBCS data to make the two cost studies comparable.

The make allowance used for computing the Class III protein and butterfat prices, \$0.165, was determined by combining the CDFA plant survey with the RBCS survey. As was pointed out by several witnesses at the hearing, several cost factors that are necessary to maintain the viability of processing plants are not represented in one or both of the RBCS and the CDFA studies. These cost factors include marketing

costs, return on investment, and general and administrative expenses. A discussion of these expenses is included earlier. Neither the CDFA nor the RBCS survey included a marketing cost, so the \$0.0015 marketing allowance was added to both studies. In addition, the CDFA return on investment cost of \$0.0103 and the general and administrative expense of \$0.0190, both of which were included in the CDFA weighted average cost, were added to the RBCS study, which included neither factor. The resulting adjusted costs for each survey are \$0.1708 for CDFA and \$0.15996 for RBCS. A weighted average of the two studies was computed using the respective adjusted make allowances and the pounds of cheese reported in each study—466,396,548 for the CDFA study and 633,142,812 for the RBCS study—to arrive at the Class III price make allowance of \$0.165.

In a comment filed in response to the tentative final decision, NFU stated that the reduction in the cheese make allowance should have been greater than \$0.0052, but that the cooperative could support an increased make allowance if it were tied to producer cost of production and market price through implementation of a variable make allowance. The \$0.165 make allowance is based on actual costs discovered by two surveys, the conduct of which were open to review in the hearing record, and is very close to the results of another that was conducted in a somewhat less accessible manner. There is no basis in the record for adopting a lower make allowance and, as discussed earlier, no acceptable rationale for implementing variable make allowances.

Class III Butterfat Price. As discussed in the introductory portion of the Class III price section of the recommended decision, the Class III butterfat price adopted in the tentative final decision was changed by a court injunction to be the same as the Class IV butterfat price. This final decision continues to calculate butterfat prices for all classes based on the value of butterfat in butter. The order will refer to both the Class III and Class IV butterfat prices as "the butterfat price," as it did previously.

The tentative final decision was based on the observation that market distortions occur due to using the Class IV butterfat price calculated from the value of butterfat in butter to also represent the value of butterfat in cheese (Class III), and trying to incorporate the difference in value in the protein price. Analysis shows that there is very little relationship between the cheese price and either the current butterfat price or the current protein price.

As a result, instances have occurred when the protein price declines while, at the same time, the cheese price is increasing. This outcome is contrary to the concept of pricing components on the basis of the value of the products in which they are used. The same inverse price scenario has affected the butterfat price, with occurrences in which the Class III butterfat price increases because the butter price has increased while the cheese market has been declining.

Although reflection of the value of a manufactured product in the prices for the milk components that are instrumental in the yield of that product would require that the Class III protein and butterfat prices be tied more directly to their value in cheese than the result obtained from the Federal order reform price formulas, that outcome cannot be accomplished on the basis of this hearing record. However, any distortion between the Class III butterfat and protein prices and the cheese price should be ameliorated partially by the following changes included in the protein formula.

Protein price. The protein price in this final decision is changed from the recommended decision by changing the 1.405 factor to 1.383 to reflect an adjustment for farm-to-plant losses and to reflect a change from a 0.8325 casein factor to a casein factor of 0.822 based on a reevaluation of the hearing record and comments filed in response to the recommended decision. In addition, the butterfat yield coefficient is changed from 1.582 to 1.572 to reflect the farm-to-plant butterfat losses. The remainder of the protein price formula is unchanged.

The tentative final decision on the hearing record for this proceeding derived formulas for calculating a Class III butterfat price and a protein price that considered only the contribution of each of those components to cheese yield and resulted in a 100 percent correlation with the cheese market. Therefore, the individual factors in the portion of the earlier protein price formula that adjusted the contribution of protein to cheese yield to account for differences in value between butterfat used in cheese and in butter and accounted for much debate in the hearing record were not considered in any detail.

The protein price formula resulting from the tentative final decision took the following form:

(NASS weighted average cheese price
– 0.165) × 1.405.

This formula eliminated the following butterfat adjustment portion of the earlier protein price formula:

+{[(NASS weighted average cheese price – 0.165) × 1.582] – [the butterfat price]} × 1.28

This butterfat adjustment portion of the formula represents the difference between the value of butterfat used in cheese and the value of butterfat used in butter. The butterfat adjustment portion became unnecessary when the Class III butterfat price was calculated from the value of butterfat in cheese in the tentative final decision.

Reconsideration of the protein formula in light of the determination that there should be only one butterfat price for Class III and Class IV resulted in the following recommended protein price formula:

[(NASS weighted average cheese price – 0.165) × 1.405] + {[(NASS weighted average cheese price – 0.165) × 1.582] – [the butterfat price × 0.9]} × 1.17).

Leprino, in response to the tentative final decision, urged that the 1.405 factor used to reflect the yield effect of one pound of protein in milk be reduced to 1.367 because the 1.405 factor assumes that true protein contains more casein (83.3 percent) than is supported by testimony in the record (82.2–82.4 percent).

The hearing record contained much discussion of the derivation of the 1.32 cheese yield factor per pound of crude protein used to determine the 1.405 cheese yield factor per pound of true protein. Two explanations of the factor were advanced. The first involved assumption of 75 percent casein retention, 90 percent butterfat retention, and 38 percent moisture content in the cheese. Holding butterfat and moisture constant and changing the protein content by 0.1 results in a 0.1318 (rounded to 0.132) pound change in the cheese yield, or a one percent change in protein results in a 1.32 pound change in cheese yield. The second method assumes 78 percent casein retention, 90 percent butterfat retention, and a 38 percent moisture content in the cheese. In this second method the cheese yield is computed using a 3.2 percent protein and zero butterfat. The resulting cheese yield is divided by 3.2 to arrive at 1.316 pounds of cheese per pound of protein. The 1.316 was rounded to 1.32. Given these particular assumptions, both methods resulted in the same answer—1.32. A witness for National All Jersey testified that the second method is the appropriate procedure and was the one used to compute the 1.32 yield factor in past Federal order protein price

decisions. However, if 78 percent is a more appropriate factor to use as the appropriate value for casein retention, then the first method yields a 1.37 yield factor. The 1.32 factor was used in the protein price formula in the Federal order reform proposed rule and in the five Upper Midwest markets beginning in January 1996 to compute the protein price prior to Federal order reform. The 1.32 yield factor generally has been accepted as an appropriate factor to use for computing a protein price.

When the final decision on Federal order reform was issued, the protein price computation was changed to compute the protein price on the basis of true protein rather than crude protein, which had been the basis for protein price computations in the past. As in determining the 1.32 factor, certain assumptions were made to arrive at the current 1.405 yield factor. The 1.405 factor was computed based on the assumption that milk testing 3.3 percent crude protein has an equivalent true protein test of 3.1 percent. The relationship between crude protein and true protein was based on the results of laboratory testing of producer milk for both crude and true protein. The resulting percentage change in protein is 1.0645 (3.3/3.1), which was then multiplied by 1.32 to arrive at 1.405. In addition, use of the 1.405 yield factor when pricing true protein results in a protein value equivalent to use of the 1.32 factor in pricing crude protein.

Regardless of which procedure is used, assumptions must be made with regard to the various factors used in the formulas. These assumptions directly affect the outcome of the factors used in the protein formula and the resulting protein price and value. Since use of the 1.405 factor resulted in an equivalent protein value to use of 1.32—and there was no testimony or comments filed that the 1.32 factor was not appropriate—there was no reason to change the 1.405 cheese yield factor in the recommended decision.

Leprino argued that the appropriate casein recovery should be 82.3 percent which, when using the second procedure above with a 2.99 true protein level, would result in a factor of 1.388. However, the majority (2/3) of the difference between 1.405 and the 1.367 factor advocated by Leprino accounts for shrinkage between the farm and the cheese vat. The issue of including shrinkage as an additional make allowance or yield factor in the calculation of component prices was discussed in the tentative final decision and was determined to be inappropriate at that time. Eliminating shrinkage from the 1.367 protein factor resulted in a

factor close to the recommended decision's 1.405. The recommended decision also stated that using the second procedure and a 82.95 casein recovery, which an expert witness testified was equivalent to the 78 percent casein recovery used for crude protein, and a true protein test of 3 percent, which was equivalent to the 3.2 percent used in the second procedure, the protein factor would have been 1.3997, again, not significantly less than the recommended decision's 1.405. Testimony from other parties also stated that the 1.405 was appropriate and should be continued. Based on the hearing record, comments filed in response to the hearing and tentative final decision, and the analysis prior to the recommended decision, it was determined that there was no justification for reducing the 1.405 cheese yield factor.

Comments received from Leprino, IDFA, Kraft, NDA and others explained that the recommended decision did not correct what these parties considered as errors in the protein price formula. With regard to the protein price computation, the parties argued that the percentage of casein in true protein used in the Van Slyke formula was too high. They were of the opinion that since the Van Slyke formula is generally used to analyze in-plant efficiencies, an adjustment needs to be made for applying the formula to milk priced on farm weights and tests. Leprino, commenting on behalf of cheese processors, stated that, "In order to properly adopt the Van Slyke formula for use in setting milk price policy * * * it is critical to understand the context for its use." Leprino further commented that the Van Slyke formula is commonly used by the industry to measure in-plant operational performance, namely, product yield. Leprino expressed the importance of including an allowance in the Van Slyke formula for farm-to-plant shrinkage. Leprino stated that "The Van Slyke yield formula can be used to determine cheddar yields of milk measured at the farm, but only if component losses [farm-to-plant] are accounted for. Although the Van Slyke yield formula was developed to measure production efficiency starting at the vat, the yield formula can still be useful in determining the yield of farm level milk. However, if the Van Slyke formula is to be used for this purpose, component losses prior to the vat must be accounted for to accurately reflect the composition of milk actually entering the vat." Nine other comments supported Leprino's position on the need to include an allowance for farm-

to-plant losses within the Van Slyke cheese yield computation in order for it to accurately determine the value of Class III farm milk.

This final decision finds that good reason exists to provide for incorporating farm-to-plant loss allowances into the Van Slyke cheese yield formula for determining the Class III milk price. As explained earlier in this final decision, the record supports a finding that such losses are 0.25 percent on all milk solid components and that butterfat losses are fractionally higher. Butterfat losses are an additional 0.015 pounds on top of the 0.25 percent farm-to-plant loss. When farm-to-plant losses are incorporated into the Van Slyke cheese yield formula, the Van Slyke formula results in the protein price factors from which the Class III protein price is derived.

The Van Slyke formula as proposed under reform and in the recommended decision utilized a casein-to-protein ratio of 83.25 percent or 0.8325.

Comments received on the recommended decision indicated that the cheese industry considers 82.2 percent casein as a reasonable and appropriate reflection of milk composition nationally. An expert witness testified that the casein from true protein ranges between 0.822 and 0.824. In this regard, according to Leprino, "The Hearing Record contains clear evidence regarding milk chemistry * * * that true protein contains 82.20 percent casein."

This final decision finds that using a casein percentage of 82.2 is appropriate. The 0.822 is at the lower end of the range indicated by the expert witness and is appropriate for use in determining minimum Federal order prices. This casein-to-protein ratio is included in the Van Slyke formula for determining the Class III protein formula factors. In addition, this final decision computes the protein yield factor by dividing the cheese yield attributable to protein by the protein test. This method is consistent with record evidence and, according to comments received in response to the recommended decision, is superior to using the additional cheese yield that occurs when additional protein is added. This results in reducing the 1.405 factor in the protein price formula to 1.383. The computation of 1.383 is shown later in this discussion.

As was proposed in the recommended decision, this final decision adopts a butterfat-to-protein ratio of 1.17. The recommended decision proposed a fat-to-protein ratio of 1.17 that was based upon the fat-to-protein ratio of standard milk at the dairy farm ($3.5/2.9915 =$

1.17). The recommended decision concluded that a 1.17 (or lower) butterfat-to-protein ratio assured that the value adjustment for butterfat in butter to the value of butterfat in cheese (included in the protein price formula) would account for the total value of butterfat in producer milk.

Comments received in response to the recommended decision from NMPF, Select, Leprino and others supported the use of the 1.17 butterfat-to-protein ratio in the protein price formula. This final decision continues to use the 1.17 factor.

This final decision uses the following variables in the Van Slyke formula for computing the protein and butterfat yield factors used for computing the protein price:

1. *Butterfat at the farm*: 3.50 pounds per hundredweight.
2. *Protein at the farm*: 2.9915 pounds per hundredweight.
3. *Butterfat retention*: 0.9.
4. *Casein to true protein ratio*: 0.822.
5. *Moisture*: 38 percent.

For illustration purposes how the Van Slyke cheese yield formula has been relied upon since Federal order reform is provided below for ease in comparing the adopted changes to previous formulas.

The Van Slyke Formula Used Under Order Reform

- Cheddar cheese pounds attributable to butterfat = $((0.9 \times 3.5) \times 1.09) / (1 - 0.38) = 5.5379$ pounds of cheddar cheese

- Cheddar cheese pounds attributable to protein = $((0.8325 \times 2.9915) - 0.01) \times 1.09 / (1 - 0.38) = 4.2025$ pounds of cheddar cheese

- Cheddar cheese pounds attributable to standard farm milk =

5.5379	pounds of cheese from butterfat
+4.2025	pounds of cheese from protein
<hr/>	
9.7404	total pounds of cheese from standard milk

- Cheddar cheese yield contribution per pound of fat at farm = $5.5379 \text{ pounds of cheddar} / 3.5 \text{ pounds of fat at farm} = 1.582$

- Cheddar cheese yield contribution per pound of protein at farm = $4.2025 \text{ pounds of cheddar} / 2.9915 \text{ pounds of protein at farm} = 1.405$

- Protein pounds in standard milk = $3.1 \times 0.965 = 2.9915$

- The butterfat-to-protein ratio factor used under reform was a fixed 1.28

The Van Slyke Formula as Proposed Under the Recommended Decision

- Cheddar cheese pounds attributable to butterfat = $((0.9 \times 3.5) \times 1.09) / (1 - 0.38) = 5.5379$ pounds of cheddar cheese

- Cheddar cheese pounds attributable to protein = $((0.8325 \times 2.9915) - 0.01) \times 1.09 / (1 - 0.38) = 4.2025$ pounds of cheddar cheese

- Cheddar cheese pounds attributable to standard farm milk =

5.5379	pounds of cheese from butterfat
+4.2025	pounds of cheese from protein
<hr/>	
9.7404	total pounds of cheese from standard milk

- Cheddar cheese yield contribution per pound of fat at farm = 5.5379 pounds of cheddar/3.5 pounds of fat at farm = 1.582

- Cheddar cheese yield contribution per pound of protein at farm = 4.2025 pounds of cheddar/2.9915 pounds of protein at farm = 1.405

- The butterfat-to-protein ratio factor proposed under the recommended decision was 1.17 and was derived by dividing the butterfat in standard milk by the protein in standard farm milk (*i.e.* 3.5 pounds of butterfat/2.9915 pounds of protein = 1.17).

The Van Slyke Formula Used in This Final Decision

- Cheddar cheese pounds attributable to butterfat = $((0.9 \times 3.5) \times 1.09 / (1 - 0.38)) = 5.5379$ pounds of cheddar cheese

- Cheddar cheese pounds lost due to the 0.015 farm-to-plant butterfat loss = $((0.9 \times 3.5) \times 1.09 / (1 - 0.38)) = 0.0237$ pounds of cheddar cheese, $5.5379 - 0.0237 = 5.5142$ of cheese after farm-to-plant loss.

- Cheddar cheese pounds lost due to the 0.25 percent solids loss on fat solids = 5.5142 pounds of cheese from butterfat $\times (1 - 0.0025)$, $5.5142 \times 0.9975 = 5.5004$ pounds of cheese from farm butterfat

- Cheddar cheese yield contribution per pound of fat at farm = 5.5004 pounds of cheddar / 3.5 pounds of fat at farm = 1.572

- Cheddar cheese pounds attributable to protein = $((0.8220 \times 2.9915) - 0.01) \times 1.09 / (1 - 0.38) = 4.1473$ pounds of cheddar cheese

- Cheddar cheese pounds lost due to the 0.25 percent solids loss on protein solids = 4.1473 pounds of cheese from protein $\times (1 - 0.0025)$ for farm-to-plant loss = $4.1473 \times 0.9975 = 4.1369$ pounds of cheese from farm protein

- Cheddar cheese yield contribution per pound of protein at farm = 4.1369 pounds of cheddar / 2.9915 pounds of protein at farm = 1.383

- Cheddar cheese pounds from standard farm milk =

5.5004	pounds of cheese from standard farm butterfat
+4.1369	pounds of cheese from standard farm protein
<hr/>	
9.6615	total pounds of cheese from standard farm milk

- The butterfat-to-protein ratio factor in this final decision is 1.17 and is derived by dividing the farm butterfat by the farm protein (*i.e.* 3.5 pounds of butterfat / 2.9915 pounds of protein = 1.17).

The results of the above computations yield the following protein price formula:

$$((\text{NASS cheese price} - 0.165) \times 1.383) + (((\text{NASS cheese price} - 0.165) \times 1.572) - (\text{butterfat price} \times 0.9)) \times 1.17$$

As stated in the recommended decision, since all of the butterfat used in Class III is to be priced on the basis of its value in butter, an adjustment must be made to account for the difference in butterfat values between cheese and butter. The butterfat adjustment portion of the protein price formula is the method chosen for making that adjustment. The first part of the butterfat adjustment portion of the protein price formula calculates the value of butterfat in Cheddar cheese using the Van Slyke formula, assuming a 90 percent recovery of butterfat in the finished cheese. The resulting cheese yield factor attributable to butterfat is a multiplier of 1.582. Testimony in the hearing record and comments on the tentative final decision urged adoption of different multipliers in the butterfat adjustment portion of the protein price formula that represents the effects of butterfat on cheese yield. Suggestions to increase the butterfat recovery factor of 1.582 (to 1.6 or 1.617) were made by DFA; Select, Elite, et. al; and National All-Jersey, Inc. These commenters relied on hearing testimony that butterfat recovery in cheddar cheese generally ranges between 90 and 93 percent, although Kraft testified that their butterfat recovery is lower. The commenters favored use of a factor that reflected 91 or 92 percent fat recovery because that level of recovery is common. In a comment filed by Leprino, the cheese manufacturer urged that the 1.582 factor not be increased, as any increase would exacerbate the overvaluation of whey fat in the current formula and because the 90 percent

recovery factor reflects results from many cheese vats installed prior to the late 1980's.

The recommended decision stated that even though many cheese makers may be able to achieve a higher fat retention in cheese, the use of the 1.582 factor representing 90 percent fat recovery in cheese continued to be appropriate. The recommended decision also stated that as a result of the 90 percent level, butterfat in cheese was not overvalued, and those cheese makers who fail to recover more than 90 percent of the fat would not suffer a competitive disadvantage. The preponderance of the record indicates that most cheese manufacturers should be able to obtain a 90 percent butterfat recovery.

In testimony at the hearing and comments filed on the tentative final decision the issue was raised of whether the butterfat adjustment portion of the protein price formula in which the value of butterfat in butter is subtracted from the value of butterfat in cheese is based on equivalent amounts of butterfat. The 1.582 factor represents 90 percent recovery in cheese of one pound of butterfat used in its manufacture, while the butterfat price represents the value of one pound of butterfat used to make butter. Clearly, subtracting the value of a pound of butterfat in butter from the value of 0.9 pounds of butterfat in cheese reduces the actual value of butterfat used in cheese. Therefore, the value of butterfat used in butter should be reduced by 10 percent in this calculation.

Comments received from Select, NMPF, LOL and National All-Jersey (NAJ), in response to the recommended decision, supported the use of the factor resulting from multiplying the butterfat price by 0.9 prior to subtracting the butterfat price from the value of butterfat in cheese. NAJ was of the opinion that the 0.9 adjustment is appropriate in that it recognizes that only ninety percent of the butterfat is retained in cheese. Select explained that using an adjustment to the value of butterfat in cheese (the 0.9) provides an important factor for correcting the relatively low butterfat retention in cheese, but maintained that the butterfat retention factor should be larger. LOL supported the addition of the 0.9 factor and indicated that it represented a more consistent margin across a wide range of butter and cheese prices.

Opponents to the use of the 0.9 adjustment factor to the butterfat value included Leprino, Kraft, IDFA, and the Wisconsin Cheese Makers Association (WCMA). These parties instead favored using a 0.95 factor. They explained that

not all of the butterfat attributable to the 0.9 factor is represented in whey cream, but rather is lost in the handling process. They were of the opinion that the portion that is lost in the handling process should be accounted for in the protein price by using a factor of 0.95. They explained that butterfat in whey cream is overvalued in the Class III pricing formulas and that sweet cream is worth approximately 40 cents more than whey cream. In addressing this difference in value, the commenters suggested subtracting 2-cents from the butterfat adjustment portion of the protein price formula.

As explained in the previous discussion on shrinkage, this final decision makes a purposeful adjustment for farm-to-plant milk losses, but not for in-plant losses. The use of the 0.9 factor is more appropriate than a 0.95 factor since the Van Slyke formula uses a 0.9 butterfat retention factor for computing the cheese yield attributable to butterfat. The aforementioned adjustment for farm-to-plant loss is also contained in the butterfat factor (1.572) used for computing the protein price, as well as an adjustment for farm-to-plant losses in the Class III butterfat price. It would not be appropriate to include additional reductions in the protein price for butterfat losses. This finding is also supported by testimony by several witnesses indicating that whey cream is often returned to the cheese vat for use in cheese making, thus increasing the value of whey cream above the value of whey cream used for whey butter, which is not accounted for in the protein formula.

As stated in the recommended decision, testimony at the hearing and analysis of the relationship between the current cheese, butterfat, and protein prices revealed that the current Class III pricing formulas cause inequities in producer payments based on the relationship between producers' butterfat and protein tests. The inequities were attributed to the use of the 1.28 factor used in the portion of the protein price formula that is designed to incorporate the butterfat value of milk used in cheese that is not already accounted for by the Class III and IV butterfat price. Such a factor is necessary to reflect the fact that there is more than one pound of butterfat in cheese for every pound of protein. The record supports a conclusion that when the price of butter increases, the price paid for milk used in cheese and for milk delivered by producers will decline if the milk has a fat to protein ratio of less than 1.28, and decline at a more rapid rate than that at which the butter price increases. According to the

record and numerous comments filed, most milk delivered by producers has a fat-to-protein ratio less than 1.28.

In a number of the comments filed in response to the tentative final decision, commenters argued that this factor should be reduced—to 1.22, 1.19, or 1.17—to better reflect the fat-to-protein ratio in producer milk. The factor, which originally appeared in a comment filed early in the Federal order reform process as 1.20, was calculated by dividing 1.582 by 1.32. When the change was made from crude protein to true protein, 1.20 was multiplied by 1.0645 to reflect that change, becoming 1.28. The recommended factor of 1.17 in the protein price formula represented a minimum value for the ratio of butterfat to true protein in producer milk. Its use assures that the value adjustment for butterfat in butter to butterfat in cheese included in the protein price formula accounts for the full amount of butterfat in producer milk.

The Alliance of Western Milk Producers argued in a comment filed in response to the tentative final decision that the Class III component price formulas adopted in that decision would lead to disorderly marketing and provide an incentive for processors to seek alternative sources of butterfat, resulting in negative effects on producer income. The Alliance favored a return to the Federal order reform Class III component price formulas, but suggested that a snubber to prevent the butterfat value adjustment to the protein price from becoming negative would mitigate the potential for undervaluing protein under the formula.

This final decision concludes that the Class III protein formula to be adopted is as follows:

$$\begin{aligned} & ((\text{NASS Cheese} \\ & \text{Price} - 0.165) \times 1.383) + \\ & (((\text{NASS Cheese} \\ & \text{Price} - 0.165) \times 1.572) - \\ & (\text{Class III \& IV Butterfat} \\ & \text{Price} \times 0.9)) \times 1.17) \end{aligned}$$

Class III—Other Nonfat Solids price (Dry Whey). As discussed above, this final decision provides a loss allowance for the other solids lost in moving milk from the farm to the processing plant. This loss is reflected in the Class III dry whey formula by adjusting the 0.968 divisor for farm-to-plant losses. The divisor is also converted to a multiplier in order to provide simplification and consistency in the price formulas.

As proposed in the recommended decision, the manufacturing allowance for dry whey is increased from the 14 cents per pound adopted in the tentative final decision to 15.9 cents per pound of dry whey to reflect a higher cost of

drying whey relative to the cost of drying nonfat dry milk.

The hearing included several proposals that would change the dry whey or other solids price formula by changing the make allowance. Although the hearing notice included a proposal to use the CME average dry whey price, the proponent withdrew support for the proposal when it became apparent that the CME has no cash exchange market for dry whey. The NASS survey that currently is being used to identify commodity prices has included price data on dry whey since September 1998. There were no proposals to change the 0.968 yield factor in the other solids price formula. The 0.968 factor reflects the solids content of dry whey, given a 3.2 percent moisture content.

As explained earlier in this decision, an adjustment factor for farm-to-plant losses on all milk solids is 0.0025. Application of this loss adjustment to the other solids price computation formula is as follows:

- One pound of dry whey minus 0.0025 farm-to-plant solids loss equals 0.9975 pounds of dry whey.
- Since each pound of dry whey contains 96.8 percent milk solids, 0.9975 is divided by 0.968 to equal a dry whey factor of 1.03.
- Therefore, the Class III dry whey price per pound is computed as follows: (NASS butter price - 0.159) × 1.03

The other solids formula divisor is converted to a multiplier to simplify and provide consistency with the other formulas contained in this final decision.

Make Allowance (Dry Whey). This final decision continues to use a dry whey make allowance of 0.159 as contained in the recommended decision.

Since the most recent CDFA and RBCS cost surveys did not include costs for drying whey, there is no information from those two studies to use for computing the dry whey make allowance. A witness from NMPF suggested using the nonfat dry milk manufacturing cost allowance for dry whey since both products involve similar processing equipment and then adding \$0.01 per pound to reflect the additional energy and higher equipment costs incurred in drying whey. Since the make allowance for nonfat dry milk adopted under the tentative final decision is \$0.140, this procedure would result in a dry whey make allowance of \$0.150. DFA proposed a dry whey make allowance of \$0.1478 per pound based on costs at its plant at Smithfield, Utah. The plant is a cheddar block plant running throughout the year

that condenses and dries whey from the cheese manufactured in this Smithfield plant only. The DFA costs include both direct and indirect costs, and return on investment and marketing cost data.

A witness from Western States Dairy Producers Trade Association, et al. (WSDPTA) testified that there is no reason to change the other solids price computation from the current formula, and that it is a necessary component of the cheese pricing formula. He noted that the use of dry whey as a commodity is correct and that the 0.968 factor in the pricing formula reflects 96.8 pounds of solids in 100 pounds of dry whey.

Most witnesses who testified about the cost of drying whey expressed the belief that drying whey costs more than drying nonfat dry milk. Two cooperative association witnesses testified that their organizations have determined that the returns from whey powder with the current make allowance would not cover the costs associated with building and operating whey powder plants. At the hearing, IDFA presented the results of the survey contracted for by NCI. The IDFA witness testified that the survey showed a dry whey manufacturing cost of at least \$0.1592. The IDFA witness testified that using the nonfat dry milk make allowance significantly understates the manufacturing cost of dry whey due to the relatively higher percentage of water in liquid whey compared to skim milk and the additional crystallization process required.

A witness representing Leprino testified on the differences in the manufacturing processes for dry whey and nonfat dry milk that result in higher costs to produce whey powder. The witness concluded that the cost of making dry whey is \$0.02559 above the cost of drying nonfat dry milk.

The brief submitted by Leprino argued that the additional costs of processing whey powder over those of processing nonfat dry milk should include additional staffing, cleaning, and maintenance associated with the additional equipment for whey product.

A witness from Kraft agreed that the dry whey manufacturing costs are about 2.6 cents per pound greater than the nonfat dry milk manufacturing costs. Although Kraft described its Tulare plant as large and efficient, it also represents a recent capital investment, meaning that depreciation costs are likely higher than average.

Comments on the dry whey make allowance portion of the tentative final decision generally followed the lines of the testimony in the hearing record. WSDPTA favored maintaining the 14-cent make allowance adopted in the

tentative final decision, and ADCNE/DFA supported not using the NCI survey on the manufacturing cost of dry whey. IDFA, Leprino, and Northwest Dairy Association advocated adoption of a dry whey make allowance of at least 15.92 cents per pound, the level determined in the NCI survey. These comments cited testimony in the record that the cost of drying whey is as much as 2.6 cents greater than that of drying skim milk, a calculation that would result in a make allowance of 16.6 cents. Kraft favored adding a value reflecting the reduced value of butterfat in whey to the whey make allowance and increasing the make allowance by at least 2 cents.

Since information regarding the costs of drying whey was not available from the sources used for determining the other make allowances in product price formulas, the tentative final decision determined that the dry whey make allowance should remain the same as that for nonfat dry milk. However, in the recommended decision it was determined that the dry whey make allowance should be changed to reflect testimony and other evidence in the hearing record that the cost of drying whey is greater than that of drying nonfat dry milk.

The recommended decision concluded that the other solids price would be computed by subtracting the make allowance of \$0.159 from the NASS weighted average dry whey price and dividing the result by 0.968. The differential costs of manufacturing whey powder, from one source, over those of nonfat dry milk, from others, did not provide close enough agreement with the NCI-sponsored survey to use them with any confidence. Neither of the witnesses who testified that the extra costs of drying whey are 2.6 cents greater than the costs of drying nonfat dry milk testified about the total costs of either operation.

In lieu of other studies and direct evidence of the total cost of drying whey, the recommended decision concluded that the NCI-commissioned study results, rounded to the nearest $\frac{1}{10}$ cent, should be used for determining the dry whey make allowance. National Milk Producers, in their comments on the recommended decision, stated that the dry whey make allowance was acceptable. Schreiber and Leprino also stated that they supported the dry whey make allowance of 0.1592 (essentially 0.159).

DFA and Select/Continental, in their comments to the recommended decision, opposed the recommended decision's proposed increase from 0.14

to 0.159. They based their opposition on lack of credible evidence.

The comments opposing the recommended decision's increase to the dry whey make allowance are not persuasive. This final decision concludes that the NCI-commissioned study should be utilized in the absence of other studies or direct evidence of the total cost of drying whey. This final decision adopts the \$0.159 make allowance as proposed in the recommended decision.

Snubber/Other Solids Price. The tentative final decision snubbed the other solids price at zero. Thus, if the NASS dry whey price minus the make allowance resulted in a negative number, the other solids price would become zero. Michigan Milk Producers Association supported the inclusion of such a "snubber" concept for the whey price in a brief, citing testimony in which the DFA witness referred to the difficulty of explaining to producers a negative component price. Snubbing the other solids price to zero would have prevented it from negatively affecting the value of other Class III components or having a negative impact on the producer price differential. Support was expressed for use of the snubber in two additional comments received on the tentative final decision.

The snubber in the other solids price formula was opposed in comments filed by two parties. Leprino stated that sound policy should allow not only positive, but negative net revenues to be reflected in the milk price to prevent overvaluing milk. IDFA opposed the snubber on the grounds that it would prevent manufacturers of dry whey from covering all manufacturing costs if wholesale prices for dry whey failed to fully cover manufacturing costs. Both commenters suggested that if the component price were to become negative, the negative value could be pooled as part of the producer price differential, as inferred by the DFA witness.

The prices calculated for the components in Class III milk are intended to reflect the value of those components in the products from which the prices are calculated. Use of a snubber to limit the other nonfat solids price would be inconsistent with the purpose of a pricing formula to reflect a component value and would appear to be an arbitrary adjustment to the price formula. After a thorough review of the record, including briefs and the comments on the tentative final decision and the recommended decision, USDA has determined that the snubber on the other solids price should be eliminated.

d. Effects of Changes to Class III and Class IV Price Formulas

The changes to the Class III and Class IV component price formulas discussed above would result not only in changes to the respective component prices, but also to the resulting Class III and Class IV skim milk and hundredweight milk prices at 3.5 percent butterfat. The changes discussed are relative to the formulas resulting from Federal order reform. The calculations that were made in the recommended decision showed some increase in the level of the Class III price. USDA believed that the Class III pricing formulas incorporated in the recommended decision were more technically correct than those adopted as a result of Federal order reform because they were based on more complete information derived through the formal rulemaking process. The product-price formulas adopted as part of Federal order reform have contributed to further industry analysis and participation in developing more precise and accurate measures of determining the pricing formulas adopted herein.

It is important to note that these calculated class price differences, or the "static effect" of the recommended changes, are based on historical product price data and not on product prices that will occur in the future. The price differences calculated in this portion of the decision cannot be used to calculate or estimate changes in revenue that would have occurred or may occur in the future because changing intersections of supply and demand for each product result in different prices.

The 19-month comparisons included in the recommended decision were calculated based on the NASS weighted average commodity prices from January 2000 through July 2001. NASS weighted average commodity prices for that time period were available, and no estimates of the relevant commodity prices were needed. Although that time period was relatively short, a number of interesting price relationships occurred in the data series.

For instance, during that period the cheddar cheese (39 percent moisture) market ranged from a low of \$1.0245 per pound during November 2000 to a high of \$1.6434 per pound during July 2001. The November low was about 7.5 cents below the \$1.10 per pound support price for 40-pound blocks of cheddar. During this same 19-month period the NASS weighted average nonfat dry milk price showed little movement until July 2001, ranging from a high of \$1.0165 per pound during January 2001 to a low of \$0.9634 per pound during July 2001.

The July 2001 decline was the result of a reduced support price. In fact, the nonfat dry milk price stayed within about one cent of support over the January 2000 through June 2001 period.

Unlike the cheese and nonfat dry milk market, the butter price did not trade anywhere near the butter support price of \$0.65 per pound or the revised support price of \$0.8548 per pound. The butter price traded in a range from a low of \$0.8820 per pound during January 2000 to a high of \$1.9263 per pound during June 2001. It is important to keep in mind that since all milk is priced on the basis of butterfat and skim or nonfat components under Federal orders, focusing on the calculated hundredweight prices at 3.5 percent butterfat that are announced for comparison purposes may result in misleading conclusions.

The formulas used for computing the Class IV prices in the recommended decision were unchanged from those contained in the tentative final decision which currently are being used.

Changing the butterfat price make allowance from \$0.114 to \$0.115 would have resulted in a calculated average decline in the Class IV butterfat price of \$0.0012 over the 19-month period included in the recommended decision. The two changes to the Class IV nonfat solids formula—increasing the make allowance from \$0.137 to \$0.140 and eliminating the 1.02 divisor—would have resulted in a net increase of \$0.0141 per pound in the Class IV nonfat solids price in the absence of any other changes. Since the Class II prices were to continue to be computed on the basis of the Class IV formulas plus the Class II differential of \$0.70 per hundredweight, changes to the Class II prices would have been the same as the changes to the Class IV prices. The calculated Class IV skim milk price would have increased by an average of \$0.127 per hundredweight. The calculated 3.5 percent Class IV milk price would have increased by an average of \$0.118 per hundredweight, reflecting the net difference between the increase in the skim milk price and the very small decline in the Class IV butterfat price.

As a result of the 38 percent moisture adjustment to barrel cheese prices, the NASS weighted average cheese price used for computing the Class III protein price would have been calculated to be higher by \$0.011 per pound over the 19-month period January 2000 through July 2001. Use of this cheese price increase in the recommended protein price formula would have resulted in an increase of 3.6 cents per pound of protein. The decrease in the make

allowance from \$0.1702 to \$0.165 in the recommended protein price formula would have accounted for an increase of 1.7 cents per pound of protein. The two changed factors in the protein price formula (0.9 and 1.17), using data for the 19-month period, would have resulted in an increase in the calculated protein price averaging approximately 14.8 cents. The total increase in the protein price as a result of three changes to aspects of the Federal order reform protein price formula (moisture adjustment, make allowance, and formula changes) would have been approximately 20.6 cents above the price that would have been computed based on the formula prior to 2001.

At the same time, the increase from \$0.137 to \$0.159 in the dry whey make allowance for calculating the other solids price would have resulted in a calculated decline in the other solids price of \$0.0227 over the 19-month period. Elimination of the snubber on the other solids price would have made no difference during the period considered. The combination of the changes in both the protein price and the other solids price would have resulted in an average of about \$0.50 per hundredweight increase in the Class III skim milk price over the 19-month period if cheese and dry whey prices were unchanged.

The recommended decision showed that the changes in the protein price formula improved significantly the relationship between the cheese price and the protein price, from a correlation coefficient of 0.54, using the Federal order reform protein formula, to a correlation coefficient of 0.70 using the formula recommended in that decision. In addition to improving the relationship between the cheese price and the protein price, the recommended protein formula reduced the variability of the protein price and moderated the extremes that occurred under the Federal order reform protein formula, thereby giving producers a more consistent and positive protein price signal.

The calculation of the Class III price at 3.5 percent butterfat, based on the formulas contained in the recommended decision, would have averaged about \$0.48 per hundredweight above the 3.5 percent Class III price based on the Class III formulas implemented under Federal order reform.

In comments filed in response to the tentative final decision, IDFA and Leprino urged that in no case should the Class III price be enhanced relative to price levels under Federal order reform. Leprino reiterated the importance of assuring that yield factors not be too

high or make allowances too low for cheese plants to retain sufficient revenue to maintain their operations. IDFA focused on the negative long-term effects on producer prices, as described in USDA's analysis, of adopting enhanced Class III and Class IV prices. As described in detail above (in Issue 3c), the factors incorporated in the Class III component price calculations are based solidly on testimony and data in the hearing record.

The recommended decision stated that the record provided ample basis for believing that the margins provided in the formulas would have been adequate for cheesemakers to maintain their operations. As observed at the hearing and in comments filed in response to the tentative final decision by the expert witness from Cornell, a break-even point would be where the value of cheese plus whey cream plus whey powder equals the value of the milk price plus the make allowances. According to the witness, under Federal order reform, and to a greater extent in the tentative final decision, the total value of these products exceeded the sum of the milk price and the make allowances.

The discussion at the hearing centered specifically on the make allowance used in the protein formula, with the implication that it represented the entire make allowance for cheese. The recommended decision stated that unlike the Class IV price formulas, where the make allowances used in the butterfat and nonfat solids price formulas can be attributed directly to butter and nonfat dry milk, the make allowances used for butterfat, protein, and other solids in the pricing formulas for Class III must be looked at in aggregate. The recommended decision also stated that all three components are involved in the cheesemaking process and have a significant effect on cheesemakers' costs and returns.

The recommended decision stated that gross margins (including make allowances) could be compared using both the cost of milk based on the Federal order reform Class III formulas, and the cost of milk based on the Class III formulas. For this purpose, gross margins in the recommended decision

were defined as the difference between the sum of the selling price of cheese and dry whey based on monthly average NASS prices and whey butter, estimated at nine cents below the NASS AA butter price, and the cost of milk under the two sets of formulas. The gross margins therefore reflected the amount of money available to processors to procure, process, and market the end products of milk used in Class III: cheese, whey butter and dry whey.

The recommended decision stated that using Class III component tests from the Upper Midwest market to estimate product yields, the estimated gross margins would have averaged approximately \$3.00 per hundredweight using the Federal order reform Class III formulas and \$2.52 per hundredweight over the 19-month period of January 2000 through July 2001 if the recommended Class III formulas had been in effect. The gross margins indicated in the recommended decision were significantly different than the cheese make allowances of \$0.1702 and \$0.165 used in the formulas, which would have been equivalent to approximately \$1.70 and \$1.65 per hundredweight of milk with an estimated yield of 10 pounds of cheese. Such a difference was expected since the make allowances for whey butter and dry whey were significantly lower than the cheese make allowance. Any residual value could have been used by the handler to improve returns or increase producer pay prices. Also, the lower gross margins under the recommended formulas could have lead to reduced over-order premiums to reflect increased milk costs and maintain current gross margins.

Comments received from Leprino, IDFA, and NDA expressed concern with the accuracy of gross margin analysis contained in the recommended decision. Comments received from Select and Continental stated that the gross margins presented in the recommended decision effectively restored the margins to their computed "implied margin" offered in their testimony at the hearing. Because of industry concerns regarding the accuracy of the gross margin analysis

together with the industry's concern regarding the definition of "implied margin," the gross margin analysis was not considered in adopting the provisions contained in this final decision.

This final decision compares prices over the period of January 2000 through May 2002 instead of the more limited 19-month price period from January 2000 to July 2001. Nevertheless, the 29-month period from January 2000 through May 2002 used in this final decision arrives at similar conclusions as those reached in the recommended decision. In particular, the conclusions made in the recommended decision regarding make allowances continue to be valid. Product yield formulas have been amended to include a farm-to-plant loss allowance and to provide simplification and consistency in pricing formulas. The effects on class prices are different due to the amendments adopted in this final decision together with their application to the expanded 29-month period.

It is important to again note that these calculated class price differences, or the "static effect" of the following adopted changes, are based on historical product price data and not on product prices that will occur in the future. The price differences calculated in this portion of the decision cannot be used to calculate or estimate changes in revenue that would have occurred or may occur in the future because changing intersections of supply and demand for each product result in different prices.

Class III Butterfat. When the Class III formulas adopted in this decision are applied to the 29-month period from January 2000 through May 2002, the value of Class III fat would have been \$0.0247 per butterfat pound lower from the announced price of \$1.5126 per butterfat pound. The adopted formula results in an average of \$1.4879 per butterfat pound. As proposed in the recommended decision, Class III formulas would have resulted in an average butterfat price of \$1.5121. The following table is provided for comparison purposes:

CLASS III BUTTERFAT PRICE

[\$/lb]

	Announced price	Recommended decision	Final decision
2000 average	1.2522	1.2509	1.2309
2001 average	1.8480	1.8480	1.8184
Jan-May 2002 average	1.3325	1.3325	1.3112
29-month average	1.5126	1.5121	1.4879

Class III Protein. Using the same 29-month period, the Class III protein price would have been higher if the formula adopted herein had been used. The Class III protein price would have

increased from the announced average of \$1.8610 per protein pound to \$2.0213 per protein pound. The Class III protein price as proposed in the recommended decision would have resulted in an

average protein price of \$2.0334. The following table is provided for comparison purposes:

CLASS III PROTEIN PRICE

[\$/lb]

	Announced price	Recommended decision	Final decision
2000 average	1.6938	1.8631	1.8513
2001 average	1.9613	2.1612	2.1498
Jan-May 2002 average	2.0218	2.1352	2.1210
29-month average	1.8610	2.0334	2.0313

Class III Other Solids. Using the 29-month period, the Class III other solids price would have been lower if the formula adopted herein had been used. Most of this difference is explained by using the increased dry whey make

allowance of \$0.159 instead of \$0.140. Under the same conditions, the Class III other solids price would have decreased from the announced average of \$0.0904 per other solids pound to \$0.0692 per other solids pound. The Class III other

solids price as proposed in the recommended decision would have resulted in an average other solids price of \$0.0694. The following table is provided for comparison purposes:

CLASS III OTHER SOLIDS PRICE

[\$/lb]

	Announced price	Recommended decision	Final decision
2000 average	0.0509	0.0282	0.0281
2001 average	0.1343	0.1146	0.1143
Jan-May 2002 average	0.0796	0.0600	0.0598
29-month average	0.0904	0.0694	0.0692

Class III Standard Skim. Using the 29-month period, the Class III standard skim milk price would have been higher if the formula adopted herein had been used. The Class III standard skim price

would have increased from the announced average of \$6.30 per hundredweight to \$6.67 per hundredweight. The Class III skim price as proposed in the recommended

decision would have resulted in an average Class III skim price of \$6.71 per hundredweight. The following table is provided for comparison purposes:

CLASS III STANDARD SKIM MILK PRICE

[\$/cwt]

	Announced price	Recommended decision	Final decision
2000 average	5.55	5.94	5.90
2001 average	6.87	7.38	7.34
Jan-May 2002 average	6.74	6.97	6.93
29-month average	6.30	6.71	6.67

Class III Standard Milk. Using the 29-month period, the Class III standard milk price would have been higher if the formula adopted herein had been used. The Class III standard milk price

would have increased from the announced average of \$11.38 per hundredweight to \$11.65 per hundredweight. The Class III milk price as proposed in the recommended

decision would have resulted in an average Class III standard milk price of \$11.77 per hundredweight. The following table is provided for comparison purposes:

CLASS III STANDARD MILK PRICE
[\$/cwt]

	Announced price	Rec-ommended decision	Final decision
2000 average	9.74	10.11	10.01
2001 average	13.10	13.59	13.45
Jan-May 2002 average	11.16	11.39	11.27
29-month average	11.38	11.77	11.65

Class IV Butterfat (same as Class III butterfat). When the Class IV formulas adopted in this decision are applied to the 29-month period from January 2000 through May 2002, the value of Class IV fat would have been \$0.0247 per

butterfat pound lower from the announced price of \$1.5126 per butterfat pound. The adopted formula results in an average of \$1.4879 per butterfat pound. As proposed in the recommended decision, Class IV

formulas would have resulted in an average butterfat price of \$1.5121. The following table is provided for comparison purposes:

CLASS IV BUTTERFAT PRICE
[\$/lb]

	Announced price	Rec-ommended decision	Final decision
2000 average	1.2522	1.2509	1.2309
2001 average	1.8480	1.8480	1.8184
Jan-May 2002 average	1.3325	1.3325	1.3112
29-Month average	1.5126	1.5121	1.4879

Class IV Nonfat Milk Solids (NFMS). When the Class IV formulas in this decision are applied to the 29-month period the prices of Class IV nonfat milk solids would have been lower. Using the

29-month period, the Class IV NFMS solids price would have decreased from an average of \$0.8340 per NFMS pound to \$0.8315 per NFMS pound. Class IV NFMS as proposed in the recommended

decision would have resulted in an average NFMS price of \$0.8399 per hundredweight. The following table is provided for comparison purposes:

CLASS IV NONFAT MILK SOLIDS PRICE
[\$/lb]

	Announced price	Rec-ommended decision	Final decision
2000 average	0.8574	0.8715	0.8629
2001 average	0.8391	0.8391	0.8306
Jan-May 2002 average	0.7656	0.7658	0.7580
29-month average	0.8340	0.8399	0.8315

Class IV Standard Skim. Using the 29-month period, the Class IV standard skim milk price would have been lower if the pricing formulas adopted herein had been used. The Class IV standard

skim milk price would have decreased from the announced average of \$7.51 per hundredweight to \$7.48 per hundredweight. The Class IV skim milk price as proposed in the recommended

decision would have resulted in an average Class IV skim price of \$7.56 per hundredweight. The following table is provided for comparison purposes:

CLASS IV STANDARD SKIM MILK PRICE
[\$/cwt]

	Announced price	Rec-ommended decision	Final decision
2000 average	7.72	7.84	7.77
2001 average	7.55	7.55	7.48
Jan-May 2002 average	6.89	6.89	6.82
29-month average	7.51	7.56	7.48

Class IV Standard Milk. The Class IV milk price over the 29-month period would have decreased from the announced average price of \$12.54 per hundredweight to a \$12.43 per

hundredweight price (a decrease of \$0.11/cwt) if the formulas adopted herein had been used. Class IV milk as proposed in the recommended decision would have resulted in an average Class

IV milk price of \$12.59 per hundredweight. The following table is provided for comparison purposes:

CLASS IV STANDARD MILK PRICE
[\$/cwt]

	Announced price	Recommended decision	Final decision
2000 average	11.83	11.95	11.80
2001 average	13.76	13.76	13.58
Jan-May 2002 average	11.31	11.31	11.17
29-month average	12.54	12.59	12.43

Class Price Relationships

The price relationships between Classes I, II, III and IV established under the Federal order reform process should be maintained. One proposal heard in this proceeding would have reduced the Class IV butterfat price without affecting the computation of other butterfat or product prices. That proposal is addressed specifically in the Class IV Butterfat price.

The current pricing system uses the same formulas for computing the advance component prices used to compute the Class I skim milk and butterfat prices and Class II skim milk price as are used to calculate the Class III and Class IV component prices. Several witnesses testified as to what the class price relationships should be if changes were made to any of the Class III or Class IV component price formulas. The witness for IDFA and several other parties stated that any changes to the Class III and Class IV formulas should also apply to the advance price formulas used for computing the Class I and Class II prices. The witness explained that failure to use the same formulas between the related classes of use would result in a direct impact on the Class I and Class II differentials which was clearly not the intent of Congress when it instructed the Secretary to conduct a rulemaking proceeding concerning the Class III and Class IV price formulas.

A witness for Hershey Foods pointed out that the Secretary went to great lengths to justify the 70-cent Class II differential above the Class IV price. In support of Proposal 31, the witness said that there is no justification or new evidence for changing the current price relationship that exists between the manufactured products (butter and nonfat dry milk) and the Class II price if the Class IV formulas were revised as suggested in several proposals. The witness stated that such changes in

price relationships clearly were not the intent of Congress. A brief filed on behalf of IDFA in support of Proposal 31 stated that the correct price relationship between NFDM and Class II is 70 cents and that the record provides no basis for changing that relationship. Actually, as explained in the final decision on Federal order reform, 70 cents represents the correct price relationship between milk used to make dry milk powder and milk used in Class II, as nearly as can be determined from the information available.

A proposal (Proposal 30) by two parties that any increases resulting from changes to the Class III and Class IV price formulas not be allowed to result in increases in Class I prices was supported in testimony by one of the parties, who argued that any increases in the Class I price mover should be balanced with reductions in Class I differentials. The witness stated that the proponents want to be sure that Class I prices are not further decoupled from Class III and Class IV pricing formulas, or that Class I prices are not artificially inflated.

Neither Proposal 30 nor Proposal 31 was adopted under the tentative final decision.

In comments on the tentative final decision filed by ADCNE and fully supported by DFA, consideration of Proposal 30 was opposed as being beyond the scope of the Congressional mandate and not fully debated at the hearing. ADCNE further opposed any modifications to Proposal 30, such as the Family Dairies' testimony supporting a weighted average Class I price mover, or to a similar proposal relative to the Class II price, that would change the basis for Class I and Class II prices or Class I and Class II differentials. ADCNE continued that there was no evidence presented at the hearing that would support the substantial revenue reductions in

farmers throughout the Federal order system which Proposals 30 and 31 would cause. ADCNE urged that the conclusions of the tentative final decision to deny proposals 30 and 31 be affirmed.

The recommended decision also did not adopt Proposal 30 or Proposal 31. Comments received on the recommended decision from DFA indicated agreement with the Department's reasoning for rejecting these proposals and any modifications to those proposals that called for changing how Class I and Class II prices as established. Accordingly, this final decision continues with the findings contained in the recommended decision for not adopting Proposal 30 or 31.

According to the recommended decision, neither the price relationships established in the tentative final decision between milk used in Class III and Class IV, nor milk used in Classes I and II, should be changed. The recommended decision stated that changes should be reflected in the Class I and Class II prices to the extent that there may be differences in the Class III or Class IV prices between the current prices as a result of adjustments to the component pricing formulas. Any reevaluation of the formulas used to price the components used in manufactured products should be carried through to the class prices that are based on those component prices. A change in the computation of the nonfat solids price, for instance, is intended to better reflect the value of those solids in dry milk products. If the new nonfat solids price formula results in an increase in the Class IV price, the record provides no basis for changing the difference in the value of the milk used in those solids between Class IV and Class II use. Similarly, the availability of milk for use in Class I is related to the higher of the alternative manufacturing

values for that milk. The current relationships should be maintained.

California Price Relationships

Many witnesses provided comments on the recommended decision in regard to the relationship of Federal order Class III prices as compared to the California 4b prices. These two prices are considered to be minimum prices that reflect the value of producer milk used to make cheese. Multiple comments received indicated the importance of maintaining a close relationship between these prices.

Northwest Dairy Association expressed concern that the recommended decision "simply ignored" the "issue of price alignment with the nation's largest dairy producing state" and that there are "differences between the Federal and California pricing systems that the Department has utterly failed to explore and explain."

A comment received from Agri-Mark stated that "USDA must take in consideration the competitive situation between California and Federal Order Class III and IV plants."

In their comments, DairyLea stated that "It is important that manufacturers buying Federal order milk pay Class prices that are competitive with similar manufacturers in California and Idaho."

A comment received from Western United Dairymen stated that, "It is imperative that California's prices maintain a close relationship with Federal order prices."

Lastly, a comment received from Select Milk Producers and Continental Dairy Products stated that, "Considering the fact that California has transformed itself into the number one dairy state and soon to be number one cheese producing state in little more than a decade, it is appealing to consider modeling the decision in this hearing off the California system." They go on to state that "Producer groups in California along with others are now seeking to have California adjust to the Federal scheme. It would be a sad day indeed if the [Department] reduced prices to meet California's while California was in the process to make such an effort unnecessary."

Class III and Class IV prices established under the Federal milk order program should not be based upon, aligned with, or identical to the equivalent class prices established for milk under California's State milk order program. The equivalent class prices established under the California milk order program are based largely on the conditions unique to California while the Class III and Class IV prices

established under Federal milk orders are based on national dairy product prices which reflect the national supply and demand conditions of milk used in these two classes. The California milk program is single-state oriented while the Federal program is national in scope.

Class III and Class IV dairy products compete in a national market. Because of this, Class III and Class IV milk prices established for all Federal milk marketing order areas are the same. The Federal milk order program gradually adopted the Minnesota-Wisconsin (M-W) price as the Class III price in all Federal milk marketing orders. Although the M-W was first adopted in 1963, it was not until the mid 1970's that the M-W established a uniform class price for milk used in Class III products in all Federal milk orders. Observations of the market place for cheese, butter, and nonfat dry milk provided the basis for concluding that these products compete in a market that is national in scope. Such findings were upheld with the adoption of the Basic Formula Price (BFP), which provided an interim pricing method for milk (due largely to the declining statistical reliability of the M-W price series) until a more long-term pricing method could be developed.

The implementation of milk order reform in January 2000 continued finding that Class III and Class IV dairy products compete in a national marketplace. However, a competitive price for milk, as represented by the M-W and BFP prices, was no longer viable. As an intended long-term method, the Federal milk order program has adopted end-product price formulas, valuing Class III and Class IV milk on the basis of the value of Class III and Class IV end-products in the marketplace. The NASS price survey for dairy products used as a basis for establishing Class III and Class IV prices includes all dairy product prices and sales volumes in all regions of the country, including California. In this regard, the Federal order program has and will continue to reflect California's impact on dairy product prices while establishing Class III and Class IV prices that are reflective of national supply and demand conditions.

With the adoption of end-product pricing formulas under order reform, the need for periodic adjustments that would arise with the changes in marketing conditions is acknowledged. Although the relationship of Federal Order prices to California prices is important, the record does not indicate how California and Federal order prices should be aligned or what the

appropriate relationship between the California and the Federal order program should be.

5. Class I Price Mover

A proposal that was not included in the hearing notice was made at the hearing by a Family Dairies, USA, witness on behalf of that cooperative and the Midwest Dairy Coalition, which represents 13 additional organizations of dairy farmers. The proposal would change the Class I price mover from the higher of the Class III and Class IV prices to a weighted average of the two. The witness for Family Dairies testified that the results of the current regulation are disturbing and unanticipated with the unexpected strength of the Class IV price relative to Class III.

In testimony at the hearing, the Family Dairies representative complained that 10 percent of production under Federal orders (milk used to make nonfat dry milk) has been driving the Class I price that applies to 40 percent of the milk. As a result, he testified, milk production for fluid purposes is encouraged in markets with high Class I differentials and relatively high Class I use at a time when marketing conditions (an oversupply of milk) should have the opposite effect. As fluid-oriented markets are receiving increased prices relative to markets in which cheese is the dominant use, he complained, inequities in blend prices between markets are increasing.

A group representing Upper Midwest producer interests filed a brief describing the recent movement of milk from the Upper Midwest pool onto the Central and Mideast marketwide pools as disorderly marketing caused by increases of Class I prices in these higher-Class I use markets.

An argument in another brief stated that since the 1960's the dairy industry has used a Class I mover tied to a market-clearing price represented by a weighted average of milk used in butter, cheese, and powder.

In several briefs it was argued that the Regulatory Impact Analysis (RIA) published with the final decision on Federal order reform stated that the price formulas adopted therein were expected to generate a sufficient quantity of milk, and that both the adoption of Class I pricing option IA and use of the higher of the Class III and IV prices as the price mover have worked to enhance Class I price levels.

A brief filed by a group representing fluid milk handlers suggested that USDA should give careful consideration to the proposal to use a weighted average of the Class III and Class IV prices to move Class I prices.

Based on analysis of the hearing record and briefs filed by interested persons, the tentative final decision continued use of the higher of the advance Class III or Class IV prices as the mover for Class I prices.

In comments on the tentative final decision, the Midwest Dairy Coalition repeated its position that the existing mover should be changed to a weighted average of the advanced Class III and advanced Class IV prices, with the weight based on the portion of manufacturing milk used for Class III and Class IV during the prior year. The Coalition stated that using the higher of Class III or Class IV prices could result in setting a minimum fluid milk price that is actually above the market clearing price for milk, especially if the higher of the Class III and IV prices were not representative of manufacturing markets. The Coalition also expressed concern that the tentative final decision adopted, as an unnoticed and unsupported change, the higher of the advanced Class III or Class IV milk prices at 3.5 percent butterfat as the new Class I mover instead of using the skim value.

In comments, NMPF noted that significant fluctuation that could occur in the Class I skim milk price mover due to using the higher of the advanced Class III or Class IV prices at 3.5 percent butterfat. Several parties noted that use of the advanced price at 3.5 percent butterfat could cause the Class III price to be the Class I price mover, even with a very low Class III skim milk price, causing significant month-to-month changes in the Class I skim milk price.

Michigan Milk Producers Association (MMPA) filed comments, stating that using a weighted average to set the Class I mover would severely impact fluid users' ability to attract sufficient quantities of milk when there were large differences between Class III and Class IV prices. MMPA and NMPF supported the continued use of the higher of the Class III or Class IV prices as the Class I mover.

ADCNE's comments to the tentative final decision, fully supported by DFA, expressed opposition to the Family Dairies' proposal for a weighted average Class I price mover or any other proposal that would change the basis for Class I and Class II prices or Class I and Class II differentials. ADCNE argued that there was no evidence presented at the hearing that would support the substantial revenue reductions to farmers throughout the Federal order system which would result from adoption of the weighted average Class I price mover. ADCNE urged that the conclusions of the tentative final

decision to continue to use the higher of the advanced Class III and IV prices as the basis for calculating the Class I price mover be affirmed.

The shift in the pooling of milk from the Upper Midwest to higher-valued markets complained of in one Upper Midwest brief has been a long-sought outcome on the part of Upper Midwest producer groups. It is difficult to understand why it is now seen as a manifestation of disorderly marketing.

Those briefs that cited the sufficient level of milk production projected under the RIA for Federal order reform appeared to base their arguments in opposition to use of the "higher of" Class I price mover on that projection. It should be noted that Congressional action relative to Class I prices following issuance of the final decision on Federal order reform applied only to the Class I pricing surface. Use of the higher of the Class III and IV prices as the Class I price mover was included in Federal order reform and in the accompanying RIA.

The Upper Midwest Coalition's concern that the tentative final decision adopted the higher of the advanced Class III or Class IV milk prices at 3.5 percent butterfat instead of using the skim value as the new Class I mover, and the NMPF criticism that doing so would result in significant fluctuations in the Class I skim price is now moot because of the return to the use of one butterfat price. Use of the same butterfat price for the Class III and Class IV prices will result in the "higher of" the two being determined by the relative skim milk prices. Therefore, the recommended decision concluded that fluctuations in the Class I skim milk price projected under the tentative final decision should be reduced.

The price referred to in the brief expressing preference for the historical use of a weighted average of prices paid for milk used in butter, cheese, and powder was, at first, the Minnesota-Wisconsin price series (the M-W). The M-W, and later the M-W adjusted by a weighted average of current product prices for manufactured products, was specific to the Upper Midwest area and included very little NFDM, since that area manufactures a higher percentage of cheese, relative to NFDM, than the rest of the U.S. The current pricing system is much more representative of national supply and demand for manufactured dairy products than either of the versions of the former Class I mover.

As explained in the final decision on Federal order reform, the higher of the Class III or Class IV prices are used to move the Class I price to assure that

fluid plants will be better able to attract milk away from manufacturing uses. Use of the weighted average of the two prices when there is a significant difference between them would provide no assurance that milk would be available as needed for fluid uses and would be more likely to result in Class price inversions (where the Class I price falls below one or more of the manufacturing class prices). In addition, use of a weighted average Class I price mover would increase the occurrence of the blend price falling below the Class III or IV price in markets with low Class I utilization.

Aside from the fact that the proposal to use a weighted average of the Class III and Class IV prices as the Class I mover was not noticed for consideration in this proceeding, it should be rejected on the basis of its lack of merit.

Comments received on the recommended decision from the Kroger Company opposed using the higher of Class III or Class IV for establishing the Class I price for milk. They suggested a review of alternatives that would not lead to higher Class I milk prices. Comments received from MMPA and DFA on the recommended decision, however, continued to express their support for using the "higher of." MMPA was of the opinion that using the higher of the Class III or Class IV prices as the Class I mover establishes farm milk prices that assure priority in providing milk for Class I uses. After consideration of the entire record on this proceeding this final decision adopts the recommended decision provision to continue to use the higher of the advance Class III or Class IV prices for establishing the Class I base price or, as it is sometimes referenced, the Class I mover.

6. Miscellaneous and Conforming Changes

a. *Advanced Class I butterfat price.* Because of the change made between the interim rule and this final decision—to use only one butterfat price for butterfat used in both Class III and Class IV—the conforming change made in the interim final rule to the procedure for calculating the Class I butterfat and hundredweight prices is no longer necessary. The advanced butterfat price used for pricing Class I butterfat will continue to be calculated by the application of the Class III and Class IV price formulas to the advanced NASS prices as announced.

b. *Classification.* The classification of anhydrous milkfat, butteroil, and plastic cream was changed in the tentative final decision from Class III to Class IV as a conforming change required by the

adoption of separate butterfat prices for the two classes. The hearing notice contained no proposal to change the classification of these products, and there was no testimony in the record of the proceeding supporting their reclassification. Therefore, with the elimination of the separate Class III butterfat price, the sole basis for the change in classification also is eliminated.

As noted in the tentative final decision, a difference between the classification of these products, which have a very high butterfat content, and butter should not cause any market dislocation in a pricing plan where butterfat used in Class III products has the same value as butterfat used in Class IV products. One commenter to the tentative final decision opposed changing the classification of these products.

In comments to the recommended decision, MMPA disagreed with returning anhydrous milkfat, butteroil, and plastic cream back to Class III classification because, in their opinion, the products compete with butter and therefore should have a cost base similar to butterfat. Comments received from NDA and WestFarm Foods also indicated opposition to returning these products back to Class III.

As a result of the elimination of the separate Class III butterfat price, this final decision finds that anhydrous milkfat, butteroil, and plastic cream is most appropriately classified as Class III.

In a comment filed in response to the tentative final decision, Hershey Foods urged that the Federal orders adopt a 2-class pricing system. Such a suggestion is entirely outside the scope of the current proceeding.

c. Distribution of Butterfat Value to Producers. There were several responses in comments on the tentative final decision to the issue of whether the butterfat price paid to producers should be the result of pooling butterfat prices from the different classes or continue to reflect the value of butterfat in Class III. A witness from Northwest Dairy Association testified that being able to line up the Class III price to plants with the component value calculation for producers is helpful, especially with regard to forward pricing. In a brief filed on behalf of DFA and ADCNE, the co-op groups supported continued use of the Class III butterfat price as the producer butterfat price. According to the brief, changes in direct pricing to the producer are not prudent at this time, and any change between the Class III and Class IV butterfat price should be settled through the producer price

differential mechanism in the market order pools. The brief continued that the producer price differential is a blending of various debits and credits in the pooling process and the additional equalizing of any butterfat pricing adjustments through this procedure currently makes the most sense.

In a post-hearing brief, National All-Jersey (NAJ) urged that USDA retain the current practice of using Class III milk component values to price producer component values. NAJ noted that this scenario makes it easier to use accepted hedging tools, such as Class III futures contracts, and helps simplify pricing for producers. NAJ further stated that the current procedure maintains the same producer butterfat price in all Federal orders with multiple component pricing (MCP).

Seventy-nine dairy organizations supported payment to producers on the basis of the milk components priced in Class III, including the Class III butterfat price instead of a pooled butterfat price, plus the producer price differential in a comment filed in response to the tentative final decision. The commenters argue that payment to producers on the basis of Class III components facilitates the use of risk management tools by producers and avoids wider fluctuations in Class I and producer fat, skim, and component values.

One of the principal reasons given in the tentative final decision for changing the pooling provisions of the MCP orders was that potential large differences between the Class III and Class IV/II butterfat prices would be likely to result in significant distortions in the effect of those differences on the producer price differential. The recommended decision also concluded that according to observation made under the tentative final decision, it was possible that pool calculations in some markets would result in a negative producer price differential if the producer butterfat price was not changed to represent a blend of the values of butterfat in the four classes of use.

The reversal to calculate separate Class III and Class IV butterfat prices invalidated the principal reason for pooling butterfat under the MCP orders.

Therefore, in the recommended decision it was determined that producer payments under the MCP orders would continue to be made on the basis of the prices for milk components used in Class III rather than pooling the butterfat values of the four classes and this continues in this final decision. The four orders that do not have component pricing will continue

to pool the class use butterfat values and return a weighted average butterfat price to producers. The difference adopted in this final decision may result in some inconsistency between the producer butterfat prices under MCP and non-MCP orders. However, it is expected that such inconsistency will not result in disorderly marketing.

d. Inclusion of Class I other source butterfat in producer butterfat price computation. In the process of promulgating the tentative final decision, it was determined that the value associated with the occasional classification of other source milk as Class I should be included in pooling the class butterfat values to determine butterfat prices to producers. For the orders under which butterfat is pooled, this change was made in the interim final rule and should continue so that the value of all of the butterfat in the pool will be reflected in the producer butterfat price.

In the component pricing orders, the changes made in the interim final rule to include the Class I other source butterfat value in the butterfat pool should be reversed. Although the District Court's injunction had the effect of reversing these changes and the Federal order reform language has continued in effect, the order language in the Code of Federal Regulations reflects the provisions adopted in the interim final rule. The proposed order language amendments in the recommended decision and in this final decision reflect the language that is currently in effect in the MCP orders, reversing the changes that were made to include Class I other source butterfat in the butterfat pool.

7. Issue of Reopening of the Hearing, or Issuance of a Final Decision

The statute requiring that this proceeding be held to reconsider the Class III and Class IV pricing formulas also required that a final decision be published by December 1, 2000, with any amendments to the orders to be effective January 1, 2001.

The hearing record reflected unanimity among those addressing the issue that the industry should be afforded the opportunity to comment on a decision before its content results in a final rule. Consequently, a tentative final decision was issued affording interested persons an opportunity to comment even though the amendments adopted in the decision were to become effective January 1, 2001. An injunction was issued on January 31, 2001, to prevent some of the provisions adopted in the interim final rule from becoming effective.

The recommended decision noted that several interested parties commented in opposition to reopening the proceeding with regard to the Class III butterfat and protein price formulas. The only commenter that favored revisiting any of the issues involved stated that some way of reflecting increased energy costs in make allowances should be explored. The commenter seemed to refer to conducting an entirely new proceeding rather than reopening the current proceeding. At that time it was decided that reopening the proceeding would not be considered due to the lack of interest in pursuing development of Class III component prices that are more closely correlated with cheese prices.

Two commenters on the tentative final decision urged that USDA act quickly to conclude the proceeding. The most rapid conclusion to the proceeding was through issuance of a tentative final decision, followed by a determination of producer approval and issuance of a final rule for the orders approved. However, because significant changes were made to the tentative final decision by the District Court order and by the recommended decision, interested parties were given an additional opportunity to comment on those changes. Therefore, USDA issued the recommended decision and provided for a 30-day comment period. Additional time to file comments was requested by a number of proprietary and cooperative handlers in order to allow for more thorough analysis of the impacts of the technical changes in the pricing formulas.

Several comments on the recommended decision were received urging prompt implementation of the amendments recommended. The National Milk Producers Federation (NMPF) supported the recommended decision's amendments in their entirety. They stated that, "In the absence of a clear-cut industry consensus for change, and without clear evidence of a market failure caused by federal order provisions, we believe it would be detrimental to the industry to reopen these proceedings in the near future."

Several comments from both processors and producers on the recommended decision suggested reopening the hearing. A few comments noted the outdated nature of some of the data, while other comments indicated a need to further study the impacts that new price formulas would have on cheese plants that are small businesses. The proceeding is not being reopened and this final decision is being issued.

Rulings on Proposed Findings and Conclusions

Briefs, proposed findings and conclusions, and comments on the tentative final decision and the recommended decision were filed on behalf of certain interested parties. These briefs, the proposed findings and conclusions, the comments, 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 final decision.

General Findings

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

The following findings are hereby made with respect to each of the aforesaid tentative marketing agreements and orders;

(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 aforesaid marketing areas, and the minimum prices specified in the tentative marketing agreements and the orders, as hereby proposed to be amended, are such prices as will reflect the aforesaid factors, insure a sufficient quantity of pure and wholesome milk, and be in the public interest; and

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

Rulings on Exceptions

In arriving at the findings and conclusions, and the regulatory provisions adopted in this final

decision, all exceptions received were considered in conjunction with the record evidence. To the extent that the findings and conclusions and the regulatory provisions of this final decision are at variance with any of the exceptions, such exceptions are hereby overruled for the reasons previously stated in this final decision.

Marketing Agreement and Order

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

It is hereby ordered that this entire decision and the two documents 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 issued, 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 are approved or favored by producers, as defined under the terms each of the orders, as amended and as hereby proposed to be amended, who during such representative period were engaged in the production of milk for sale within the aforesaid marketing areas.

The representative period for the conduct of such referenda is hereby determined to be May 2002.

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

Determination of Producer Approval and Representative Period for All Other Orders

May 2002 is hereby determined to be the representative period for the purpose of ascertaining whether the issuance of the orders, as amended and as hereby proposed to be amended, regulating the handling of milk in the Appalachian, Florida, Southeast, Upper Midwest, Central, Pacific Northwest, Southwest, Arizona Las-Vegas, and Western marketing areas is approved or favored by producers, as defined under

the terms of each of these orders as amended and as hereby proposed to be amended, who during such representative period were engaged in the production of milk for sale within the aforesaid marketing areas.

List of Subjects in 7 CFR Parts 1000, 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, 1131, and 1135.

Milk marketing orders.

Dated: October 25, 2002.

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 proposed marketing agreements and orders amending the orders contained in the recommended decision issued by the Associate Administrator, Agricultural Marketing Service, on October 19, 2001, and published in the **Federal Register** on October 25, 2001 (66 FR 54064), as modified herein, shall be and are the terms and provisions of this order, amending the orders, and are set forth in full herein.

1. The authority citation for 7 CFR parts 1000, 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, 1131, and 1135 continues to read as follows:

Authority: 7 U.S.C. 601–674.

PART 1000—GENERAL PROVISIONS OF FEDERAL MILK MARKETING ORDERS

1. Section 1000.40 is amended by adding paragraph (c)(1)(ii) and revising paragraph (d)(1)(i) to read as follows:

§ 1000.40 Classes of Utilization.

- (c) * * *
- (1) * * *
- (ii) Plastic cream, anhydrous milkfat, and butteroil; and
- (d) * * *
- (1) * * *
- (i) Butter; and

2. Section 1000.50 is amended by revising the last sentence of the introductory text; by revising paragraphs (a), (b), (c), (g), (h), (j), (l), (m), (n), (o), (p)(1), and (q)(3); and by removing paragraph (q)(4) to read as follows:

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

* * * The price described in paragraph (d) of this section shall be derived from the Class II skim milk price announced on or before the 23rd day of the month preceding the month to which it applies and the butterfat price announced on or before the 5th

day of the month following the month to which it applies.

(a) *Class I price.* The Class I price per hundredweight, rounded to the nearest cent, shall be 0.965 times the Class I skim milk price plus 3.5 times the Class I butterfat price.

(b) *Class I skim milk price.* The Class I skim milk price per hundredweight shall be the adjusted Class I differential specified in § 1000.52 plus the higher of the advanced pricing factors computed in paragraph (q)(1) or (2) of this section.

(c) *Class I butterfat price.* The Class I butterfat price per pound shall be the adjusted Class I differential specified in § 1000.52 divided by 100, plus the advanced butterfat price computed in paragraph (q)(3) of this section.

* * * * *

(g) *Class II butterfat price.* The Class II butterfat price per pound shall be the butterfat price plus \$0.007.

(h) *Class III price.* The Class III price per hundredweight, rounded to the nearest cent, shall be 0.965 times the Class III skim milk price plus 3.5 times the butterfat price.

* * * * *

(j) *Class IV price.* The Class IV price per hundredweight, rounded to the nearest cent, shall be 0.965 times the Class IV skim milk price plus 3.5 times the butterfat price.

* * * * *

(l) *Butterfat price.* The butterfat price per pound, rounded to the nearest one-hundredth cent, shall be the U.S. average NASS AA Butter survey price reported by the Department for the month less 11.5 cents, with the result multiplied by 1.20.

(m) *Nonfat solids price.* The nonfat solids price per pound, rounded to the nearest one-hundredth cent, shall be the U.S. average NASS nonfat dry milk survey price reported by the Department for the month less 14 cents and multiplying the result by 0.99.

(n) *Protein price.* The protein price per pound, rounded to the nearest one-hundredth cent, shall be computed as follows:

(1) Compute a weighted average of the amounts described in paragraphs (n)(1)(i) and (ii) of this section:

(i) The U.S. average NASS survey price for 40-lb. block cheese reported by the Department for the month; and

(ii) The U.S. average NASS survey price for 500-pound barrel cheddar cheese (38 percent moisture) reported by the Department for the month plus 3 cents;

(2) Subtract 16.5 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by 1.383;

(3) Add to the amount computed pursuant to paragraph (n)(2) of this section an amount computed as follows:

(i) Subtract 16.5 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by 1.572; and

(ii) Subtract 0.9 times the butterfat price computed pursuant to paragraph (l) of this section from the amount computed pursuant to paragraph (n)(3)(i) of this section; and

(iii) Multiply the amount computed pursuant to paragraph (n)(3)(ii) of this section by 1.17.

(o) *Other solids price.* The other solids price per pound, rounded to the nearest one-hundredth cent, shall be the U.S. average NASS dry whey survey price reported by the Department for the month minus 15.9 cents, with the result multiplied by 1.03.

(p) * * *

(1) Multiply 0.0005 by the weighted average price computed pursuant to paragraph (n)(1) of this section and round to the 5th decimal place;

* * * * *

(q) * * *

(3) An advanced butterfat price per pound, rounded to the nearest one-hundredth cent, shall be calculated by computing a weighted average of the 2 most recent U.S. average NASS AA Butter survey prices announced before the 24th day of the month, subtracting 11.5 cents from this average, and multiplying the result by 1.20.

PART 1001—MILK IN THE NORTHEAST MARKETING AREA

1. Section 1001.60 is amended by revising paragraphs (c)(3), (d)(2), and (h) to read as follows:

§ 1001.60 Handler's value of milk.

* * * * *

(c) * * *

(3) Add an amount obtained by multiplying the pounds of butterfat in Class III by the butterfat price.

(d) * * *

(2) Add an amount obtained by multiplying the pounds of butterfat in Class IV by the butterfat price.

* * * * *

(h) Multiply the difference between the Class I price applicable at the location of the nearest unregulated supply plants from which an equivalent volume was received and the Class III price by the pounds of skim milk and butterfat in receipts of concentrated fluid milk products assigned to Class I pursuant to § 1000.43(d) and § 1000.44(a)(3)(i) and the corresponding step of § 1000.44(b) and the pounds of skim milk and butterfat subtracted from

Class I pursuant to § 1000.44(a)(8) and the corresponding step of § 1000.44(b), excluding such skim milk and butterfat in receipts of fluid milk products from an unregulated supply plant to the extent that an equivalent amount of skim milk or butterfat disposed of to such plant by handlers fully regulated under any Federal milk order is classified and priced as Class I milk and is not used as an offset for any other payment obligation under any order.

* * * * *

2. Section 1001.61 is revised to read as follows:

§ 1001.61 Computation of producer price differential.

For each month, the market administrator shall compute a producer price differential per hundredweight. The report of any handler who has not made payments required pursuant to § 1001.71 for the preceding month shall not be included in the computation of the producer price differential, and such handler's report shall not be included in the computation for succeeding months until the handler has made full payment of outstanding monthly obligations. Subject to the conditions in this paragraph, the market administrator shall compute the producer price differential in the following manner:

(a) Combine into one total the values computed pursuant to § 1001.60 for all handlers required to file reports prescribed in § 1001.30;

(b) Subtract the total of the values obtained by multiplying each handler's total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to § 1001.60 by the protein price, other solids price, and the butterfat price, respectively;

(c) Add an amount equal to the minus location adjustments and subtract an amount equal to the plus location adjustments computed pursuant to § 1001.75;

(d) Add an amount equal to not less than one-half of the unobligated balance in the producer-settlement fund;

(e) Divide the resulting amount by the sum of the following for all handlers included in these computations:

(1) The total hundredweight of producer milk; and

(2) The total hundredweight for which a value is computed pursuant to § 1001.60(h); and

(f) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (e) of this section. The result, rounded to the nearest cent, shall be known as the producer price differential for the month.

3. Section 1001.62 is amended by revising paragraphs (e) and (g) to read as follows:

§ 1001.62 Announcement of producer prices.

* * * * *

(e) The butterfat price;

* * * * *

(g) The statistical uniform price for milk containing 3.5 percent butterfat computed by combining the Class III price and the producer price differential.

4. Section 1001.71 is amended by revising paragraphs (b)(2) and (b)(3) to read as follows:

§ 1001.71 Payments to the producer-settlement fund.

* * * * *

(b) * * *

(2) An amount obtained by multiplying the total pounds of protein, other solids, and butterfat contained in producer milk by the protein, other solids, and butterfat prices respectively; and

(3) An amount obtained by multiplying the pounds of skim milk and butterfat for which a value was computed pursuant to § 1001.60(h) by the producer price differential as adjusted pursuant to § 1001.75 for the location of the plant from which received.

5. Section 1001.73 is amended by revising paragraphs (a)(2)(ii) and (b)(3)(vi) to read as follows:

§ 1001.73 Payments to producers and to cooperative associations.

(a) * * *

(2) * * *

(ii) Multiply the pounds of butterfat received by the butterfat price for the month;

* * * * *

(b) * * *

(3) * * *

(vi) Multiply the pounds of butterfat in Class III and Class IV milk by the butterfat price for the month;

* * * * *

PART 1030—MILK IN THE UPPER MIDWEST MARKETING AREA

1. Section 1030.60 is amended by revising paragraphs (c)(3), (d)(2), and (i) to read as follows:

§ 1030.60 Handler's value of milk.

* * * * *

(c) * * *

(3) Add an amount obtained by multiplying the pounds of butterfat in Class III by the butterfat price.

(d) * * *

(2) Add an amount obtained by multiplying the pounds of butterfat in Class IV by the butterfat price.

* * * * *

(i) Multiply the difference between the Class I price applicable at the location of the nearest unregulated supply plants from which an equivalent volume was received and the Class III price by the pounds of skim milk and butterfat in receipts of concentrated fluid milk products assigned to Class I pursuant to § 1000.43(d) and § 1000.44(a)(3)(i) and the corresponding step of § 1000.44(b) and the pounds of skim milk and butterfat subtracted from Class I pursuant to § 1000.44(a)(8) and the corresponding step of § 1000.44(b), excluding such skim milk and butterfat in receipts of fluid milk products from an unregulated supply plant to the extent that an equivalent amount of skim milk or butterfat disposed of to such plant by handlers fully regulated under any Federal milk order is classified and priced as Class I milk and is not used as an offset for any other payment obligation under any order.

* * * * *

2. Section 1030.61 is revised to read as follows:

§ 1030.61 Computation of producer price differential.

For each month the market administrator shall compute a producer price differential per hundredweight. The report of any handler who has not made payments required pursuant to § 1030.71 for the preceding month shall not be included in the computation of the producer price differential, and such handler's report shall not be included in the computation for succeeding months until the handler has made full payment of outstanding monthly obligations. Subject to the conditions of this paragraph, the market administrator shall compute the producer price differential in the following manner:

(a) Combine into one total the values computed pursuant to § 1030.60 for all handlers required to file reports prescribed in § 1030.30;

(b) Subtract the total values obtained by multiplying each handler's total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to § 1030.60 by the protein price, other solids price, and the butterfat price, respectively, and the total value of the somatic cell adjustment pursuant to § 1030.30(a)(1) and (c)(1);

(c) Add an amount equal to the minus location adjustments and subtract an amount equal to the plus location

adjustments computed pursuant to § 1030.75;

(d) Add an amount equal to not less than one-half of the unobligated balance in the producer-settlement fund;

(e) Divide the resulting amount by the sum of the following for all handlers included in these computations:

(1) The total hundredweight of producer milk; and

(2) The total hundredweight for which a value is computed pursuant to § 1030.60(i); and

(f) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (e) of this section. The result shall be known as the producer price differential for the month.

3. Section 1030.62 is amended by revising paragraphs (e) and (h) to read as follows:

§ 1030.62 Announcement of producer prices.

* * * * *

(e) The butterfat price;

* * * * *

(h) The statistical uniform price for milk containing 3.5 percent butterfat, computed by combining the Class III price and the producer butterfat price differential.

4. Section 1030.71 is amended by revising paragraphs (b)(2) and (b)(4) to read as follows:

§ 1030.71 Payments to the producer-settlement fund.

* * * * *

(b) * * *

(2) An amount obtained by multiplying the total pounds of protein, other solids, and butterfat contained in producer milk by the protein, other solids, and butterfat prices respectively;

* * * * *

(4) An amount obtained by multiplying the pounds of skim milk and butterfat for which a value was computed pursuant to § 1030.60(i) by the producer price differential as adjusted pursuant to § 1030.75 for the location of the plant from which received.

5. Section 1030.73 is amended by revising paragraphs (a)(2)(ii), (c)(2)(v), and (c)(3)(ii) to read as follows:

§ 1030.73 Payments to producers and to cooperative associations.

(a) * * *

(2) * * *

(ii) The pounds of butterfat received times the butterfat price for the month;

* * * * *

(c) * * *

(2) * * *

(v) The pounds of butterfat in Class III and Class IV milk times the butterfat price;

* * * * *

(3) * * *

(ii) The pounds of butterfat received times the butterfat price for the month;

* * * * *

PART 1032—MILK IN THE CENTRAL MARKETING AREA

1. Section 1032.60 is amended by revising paragraphs (c)(3), (d)(2), and (i) to read as follows:

§ 1032.60 Handler's value of milk.

* * * * *

(c) * * *

(3) Add an amount obtained by multiplying the pounds of butterfat in Class III by the butterfat price.

(d) * * *

(2) Add an amount obtained by multiplying the pounds of butterfat in Class IV by the butterfat price.

* * * * *

(i) Multiply the difference between the Class I price applicable at the location of the nearest unregulated supply plants from which an equivalent volume was received and the Class III price by the pounds of skim milk and butterfat in receipts of concentrated fluid milk products assigned to Class I pursuant to § 1000.43(d) and § 1000.44(a)(3)(i) and the corresponding step of § 1000.44(b) and the pounds of skim milk and butterfat subtracted from Class I pursuant to § 1000.44(a)(8) and the corresponding step of § 1000.44(b), excluding such skim milk and butterfat in receipts of fluid milk products from an unregulated supply plant to the extent that an equivalent amount of skim milk or butterfat disposed of to such plant by handlers fully regulated under any Federal milk order is classified and priced as Class I milk and is not used as an offset for any other payment obligation under any order.

* * * * *

2. Section 1032.61 is revised to read as follows:

§ 1032.61 Computation of producer price differential.

For each month the market administrator shall compute a producer price differential per hundredweight. The report of any handler who has not made payments required pursuant to § 1032.71 for the preceding month shall not be included in the computation of the producer price differential, and such handler's report shall not be included in the computation for succeeding months until the handler has made full payment of outstanding monthly obligations.

Subject to the conditions of this paragraph, the market administrator shall compute the producer price differential in the following manner:

(a) Combine into one total the values computed pursuant to § 1032.60 for all handlers required to file reports prescribed in § 1032.30;

(b) Subtract the total values obtained by multiplying each handler's total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to § 1032.60 by the protein price, the other solids price, and the butterfat price, respectively, and the total value of the somatic cell adjustment pursuant to § 1032.30(a)(1) and (c)(1);

(c) Add an amount equal to the minus location adjustments and subtract an amount equal to the plus location adjustments computed pursuant to § 1032.75;

(d) Add an amount equal to not less than one-half of the unobligated balance in the producer-settlement fund;

(e) Divide the resulting amount by the sum of the following for all handlers included in these computations:

(1) The total hundredweight of producer milk; and

(2) The total hundredweight for which a value is computed pursuant to § 1032.60(i); and

(f) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (e) of this section. The result shall be known as the producer price differential for the month.

3. Section 1032.62 is amended by revising paragraphs (e) and (h) to read as follows:

§ 1032.62 Announcement of producer prices.

* * * * *

(e) The butterfat price;

* * * * *

(h) The statistical uniform price for milk containing 3.5 percent butterfat, computed by combining the Class III price and the producer price differential.

4. Section 1032.71 is amended by revising paragraphs (b)(2) and (b)(4) to read as follows:

§ 1032.71 Payments to the producer-settlement fund.

* * * * *

(b) * * *

(2) An amount obtained by multiplying the total pounds of protein, other solids, and butterfat contained in producer milk by the protein, other solids, and butterfat prices respectively;

* * * * *

(4) An amount obtained by multiplying the pounds of skim milk and butterfat for which a value was computed pursuant to § 1032.60(i) by the producer price differential as adjusted pursuant to § 1032.75 for the location of the plant from which received.

5. Section 1032.73 is amended by revising paragraphs (a)(2)(ii), (c)(2)(v), and (c)(3)(ii) to read as follows:

§ 1032.73 Payments to producers and to cooperative associations.

(a) * * *

(2) * * *

(ii) The pounds of butterfat received times the butterfat price for the month;

* * * * *

(c) * * *

(2) * * *

(v) The pounds of butterfat in Class III and Class IV milk times the butterfat price;

* * * * *

(3) * * *

(ii) The pounds of butterfat received times the butterfat price for the month;

* * * * *

PART 1033—MILK IN THE MIDEAST MARKETING AREA

1. Section 1033.60 is amended by revising paragraphs (c)(3), (d)(2), and (i) to read as follows:

§ 1033.60 Handler's value of milk.

* * * * *

(c) * * *

(3) Add an amount obtained by multiplying the pounds of butterfat in Class III by the butterfat price.

(d) * * *

(2) Add an amount obtained by multiplying the pounds of butterfat in Class IV by the butterfat price.

* * * * *

(i) Multiply the difference between the Class I price applicable at the location of the nearest unregulated supply plants from which an equivalent volume was received and the Class III price by the pounds of skim milk and butterfat in receipts of concentrated fluid milk products assigned to Class I pursuant to § 1000.43(d) and § 1000.44(a)(3)(i) and the corresponding step of § 1000.44(b) and the pounds of skim milk and butterfat subtracted from Class I pursuant to § 1000.44(a)(8) and the corresponding step of § 1000.44(b), excluding such skim milk and butterfat in receipts of fluid milk products from an unregulated supply plant to the extent that an equivalent amount of skim milk or butterfat disposed of to such plant by handlers fully regulated under any Federal milk order is

classified and priced as Class I milk and is not used as an offset for any other payment obligation under any order.

* * * * *

2. Section 1033.61 is revised to read as follows:

§ 1033.61 Computation of producer price differential.

For each month the market administrator shall compute a producer price differential per hundredweight. The report of any handler who has not made payments required pursuant to § 1033.71 for the preceding month shall not be included in the computation of the producer price differential, and such handler's report shall not be included in the computation for succeeding months until the handler has made full payment of outstanding monthly obligations. Subject to the conditions of this

paragraph, the market administrator shall compute the producer price differential in the following manner:

(a) Combine into one total the values computed pursuant to § 1033.60 for all handlers required to file reports prescribed in § 1033.30;

(b) Subtract the total values obtained by multiplying each handler's total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to § 1033.60 by the protein price, the other solids price, and the butterfat price, respectively, and the total value of the somatic cell adjustment pursuant to § 1033.30(a)(1) and (c)(1);

(c) Add an amount equal to the minus location adjustments and subtract an amount equal to the plus location adjustments computed pursuant to § 1033.75;

(d) Add an amount equal to not less than one-half of the unobligated balance in the producer-settlement fund;

(e) Divide the resulting amount by the sum of the following for all handlers included in these computations:

(1) The total hundredweight of producer milk; and

(2) The total hundredweight for which a value is computed pursuant to § 1033.60(i); and

(f) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (e) of this section. The result shall be known as the producer price differential for the month.

3. Section 1033.62 is amended by revising paragraphs (e) and (h) to read as follows:

§ 1033.62 Announcement of producer prices.

* * * * *

(e) The butterfat price;

* * * * *

(h) The statistical uniform price for milk containing 3.5 percent butterfat, computed by combining the Class III price and the producer price differential.

4. Section 1033.71 is amended by revising paragraphs (b)(2) and (b)(4) to read as follows:

§ 1033.71 Payments to the producer-settlement fund.

* * * * *

(b) * * *

(2) An amount obtained by multiplying the total pounds of protein, other solids, and butterfat contained in producer milk by the protein, other solids, and butterfat prices, respectively;

* * * * *

(4) An amount obtained by multiplying the pounds of skim milk and butterfat for which a value was computed pursuant to § 1033.60(i) by the producer price differential as adjusted pursuant to § 1033.75 for the location of the plant from which received.

5. Section 1033.73 is amended by revising paragraphs (a)(2)(ii) and (b)(3)(v) to read as follows:

§ 1033.73 Payments to producers and to cooperative associations.

(a) * * *

(2) * * *

(ii) The pounds of butterfat received times the butterfat price for the month;

* * * * *

(b) * * *

(3) * * *

(v) The pounds of butterfat in Class III and Class IV milk times the butterfat price;

* * * * *

PART 1124—MILK IN THE PACIFIC NORTHWEST MARKETING AREA

1. Section 1124.60 is amended by revising paragraphs (c)(3), (d)(2), and (h) to read as follows:

§ 1124.60 Handler's value of milk.

* * * * *

(c) * * *

(3) Add an amount obtained by multiplying the pounds of butterfat in Class III by the butterfat price.

(d) * * *

(2) Add an amount obtained by multiplying the pounds of butterfat in Class IV by the butterfat price.

* * * * *

(h) Multiply the difference between the Class I price applicable at the location of the nearest unregulated supply plants from which an equivalent

volume was received and the Class III price by the pounds of skim milk and butterfat in receipts of concentrated fluid milk products assigned to Class I pursuant to § 1000.43(d) and § 1000.44(a)(3)(i) and the corresponding step of § 1000.44(b) and the pounds of skim milk and butterfat subtracted from Class I pursuant to § 1000.44(a)(8) and the corresponding step of § 1000.44(b), excluding such skim milk and butterfat in receipts of fluid milk products from an unregulated supply plant to the extent that an equivalent amount of skim milk or butterfat disposed of to such plant by handlers fully regulated under any Federal milk order is classified and priced as Class I milk and is not used as an offset for any other payment obligation under any order.

* * * * *

2. Section 1124.61 is revised to read as follows:

§ 1124.61 Computation of producer price differential.

For each month the market administrator shall compute a producer price differential per hundredweight. The report of any handler who has not made payments required pursuant to § 1124.71 for the preceding month shall not be included in the computation of the producer price differential, and such handler's report shall not be included in the computation for succeeding months until the handler has made full payment of outstanding monthly obligations. Subject to the conditions of this paragraph, the market administrator shall compute the producer price differential in the following manner:

(a) Combine into one total the values computed pursuant to § 1124.60 for all handlers required to file reports prescribed in § 1124.30;

(b) Subtract the total values obtained by multiplying each handler's total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to § 1124.60 by the protein price, the other solids price, and the butterfat price, respectively;

(c) Add an amount equal to the minus location adjustments and subtract an amount equal to the plus location adjustments computed pursuant to § 1124.75;

(d) Add an amount equal to not less than one-half of the unobligated balance in the producer-settlement fund;

(e) Divide the resulting amount by the sum of the following for all handlers included in these computations:

(1) The total hundredweight of producer milk; and

(2) The total hundredweight for which a value is computed pursuant to § 1124.60(h); and

(f) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (e) of this section. The result shall be known as the producer price differential for the month.

3. Section 1124.62 is amended by revising paragraphs (e) and (g) to read as follows:

§ 1124.62 Announcement of producer prices.

* * * * *

(e) The butterfat price;

* * * * *

(g) The statistical uniform price for milk containing 3.5 percent butterfat, computed by combining the Class III price and the producer price differential.

4. Section 1124.71 is amended by revising paragraphs (b)(2) and (b)(3) to read as follows:

§ 1124.71 Payments to the producer-settlement fund.

* * * * *

(b) * * *

(2) An amount obtained by multiplying the total pounds of protein, other solids, and butterfat contained in producer milk by the protein, other solids, and butterfat prices respectively; and

(3) An amount obtained by multiplying the pounds of skim milk and butterfat for which a value was computed pursuant to § 1124.60(h) by the producer price differential as adjusted pursuant to § 1124.75 for the location of the plant from which received.

5. Section 1124.73 is amended by revising paragraphs (a)(2)(ii), (c)(2)(v), and (c)(3)(ii) to read as follows:

§ 1124.73 Payments to producers and to cooperative associations.

(a) * * *

(2) * * *

(ii) The pounds of butterfat received times the butterfat price for the month;

* * * * *

(c) * * *

(2) * * *

(v) The pounds of butterfat in Class III and Class IV milk times the butterfat price;

* * * * *

(3) * * *

(ii) The pounds of butterfat received times the butterfat price for the month;

* * * * *

PART 1126—MILK IN THE SOUTHWEST MARKETING AREA

1. Section 1126.60 is amended by revising paragraphs (c)(3), (d)(2), and (i) to read as follows:

§ 1126.60 Handler's value of milk.

* * * *

(c) * * *

(3) Add an amount obtained by multiplying the pounds of butterfat in Class III by the butterfat price.

(d) * * *

(2) Add an amount obtained by multiplying the pounds of butterfat in Class IV by the butterfat price.

* * * *

(i) Multiply the difference between the Class I price applicable at the location of the nearest unregulated supply plants from which an equivalent volume was received and the Class III price by the pounds of skim milk and butterfat in receipts of concentrated fluid milk products assigned to Class I pursuant to § 1000.43(d) and § 1000.44(a)(3)(i) and the corresponding step of § 1000.44(b) and the pounds of skim milk and butterfat subtracted from Class I pursuant to § 1000.44(a)(8) and the corresponding step of § 1000.44(b), excluding such skim milk and butterfat in receipts of fluid milk products from an unregulated supply plant to the extent that an equivalent amount of skim milk or butterfat disposed of to such plant by handlers fully regulated under any Federal milk order is classified and priced as Class I milk and is not used as an offset for any other payment obligation under any order.

* * * *

2. Section 1126.61 is revised to read as follows:

§ 1126.61 Computation of producer price differential.

For each month the market administrator shall compute a producer price differential per hundredweight. The report of any handler who has not made payments required pursuant to § 1126.71 for the preceding month shall not be included in the computation of the producer price differential, and such handler's report shall not be included in the computation for succeeding months until the handler has made full payment of outstanding monthly obligations. Subject to the conditions of this paragraph, the market administrator shall compute the producer price differential in the following manner:

(a) Combine into one total the values computed pursuant to § 1126.60 for all handlers required to file reports prescribed in § 1126.30;

(b) Subtract the total of the values obtained by multiplying each handler's

total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to § 1126.60 by the protein price, other solids price, and the butterfat price, respectively, and the total value of the somatic cell adjustment pursuant to § 1126.30(a)(1) and (c)(1);

(c) Add an amount equal to the minus location adjustments and subtract an amount equal to the plus location adjustments computed pursuant to § 1126.75;

(d) Add an amount equal to not less than one-half of the unobligated balance in the producer-settlement fund;

(e) Divide the resulting amount by the sum of the following for all handlers included in these computations:

(1) The total hundredweight of producer milk; and

(2) The total hundredweight for which a value is computed pursuant to § 1126.60(i); and

(f) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (e) of this section. The result shall be known as the producer price differential for the month.

3. Section 1126.62 is amended by revising paragraphs (e) and (h) to read as follows:

§ 1126.62 Announcement of producer prices.

* * * *

(e) The butterfat price;

* * * *

(h) The statistical uniform price for milk containing 3.5 percent butterfat, computed by combining the Class III price and the producer price differential.

4. Section 1126.71 is amended by revising paragraphs (b)(2) and (b)(4) to read as follows:

§ 1126.71 Payments to the producer-settlement fund.

* * * *

(b) * * *

(2) An amount obtained by multiplying the total pounds of protein, other solids, and butterfat contained in producer milk by the protein, other solids, and butterfat prices respectively;

* * * *

(4) An amount obtained by multiplying the pounds of skim milk and butterfat for which a value was computed pursuant to § 1126.60(i) by the producer price differential as adjusted pursuant to § 1126.75 for the location of the plant from which received.

5. Section 1126.73 is amended by revising paragraphs (a)(2)(ii) and (b)(3)(v) to read as follows:

§ 1126.73 Payments to producers and to cooperative associations.

(a) * * *

(2) * * *

(ii) Multiply the pounds of butterfat received times the butterfat price for the month;

* * * *

(b) * * *

(3) * * *

(v) The pounds of butterfat in Class III and Class IV milk times the butterfat price;

* * * *

PART 1135—MILK IN THE WESTERN MARKETING AREA

1. Section 1135.60 is amended by revising paragraphs (c)(3), (d)(2) and (h) to read as follows:

§ 1135.60 Handler's value of milk.

* * * *

(c) * * *

(3) Add an amount obtained by multiplying the pounds of butterfat in Class III by the butterfat price.

(d) * * *

(2) Add an amount obtained by multiplying the pounds of butterfat in Class IV by the butterfat price.

* * * *

(h) Multiply the difference between the Class I price applicable at the location of the nearest unregulated supply plants from which an equivalent volume was received and the Class III price by the pounds of skim milk and butterfat in receipts of concentrated fluid milk products assigned to Class I pursuant to § 1000.43(d) and § 1000.44(a)(3)(i) and the corresponding step of § 1000.44(b) and the pounds of skim milk and butterfat subtracted from Class I pursuant to § 1000.44(a)(8) and the corresponding step of § 1000.44(b), excluding such skim milk and butterfat in receipts of fluid milk products from an unregulated supply plant to the extent that an equivalent amount of skim milk or butterfat disposed of to such plant by handlers fully regulated under any Federal milk order is classified and priced as Class I milk and is not used as an offset for any other payment obligation under any order.

* * * *

2. Section 1135.61 is revised to read as follows:

§ 1135.61 Computation of producer price differential.

For each month the market administrator shall compute a producer price differential per hundredweight. The report of any handler who has not made payments required pursuant to § 1135.71 for the preceding month shall

not be included in the computation of the producer price differential, and such handler's report shall not be included in the computation for succeeding months until the handler has made full payment of outstanding monthly obligations. Subject to the conditions of this paragraph, the market administrator shall compute the producer price differential in the following manner:

(a) Combine into one total the values computed pursuant to § 1135.60 for all handlers required to file reports prescribed in § 1135.30;

(b) Subtract the total values obtained by multiplying each handler's total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to § 1135.60 by the protein price, the other solids price, and the butterfat price, respectively;

(c) Add an amount equal to the minus location adjustments and subtract an amount equal to the plus location adjustments computed pursuant to § 1135.75;

(d) Add an amount equal to not less than one-half of the unobligated balance in the producer-settlement fund;

(e) Divide the resulting amount by the sum of the following for all handlers included in these computations:

(1) The total hundredweight of producer milk; and

(2) The total hundredweight for which a value is computed pursuant to § 1135.60(h); and

(f) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (e) of this section. The result shall be known as the producer price differential for the month.

3. Section 1135.62 is amended by revising paragraphs (e) and (g) to read as follows:

§ 1135.62 Announcement of producer prices.

* * * * *

(e) The butterfat price;

* * * * *

(g) The statistical uniform price for milk containing 3.5 percent butterfat computed by combining the Class III price and the producer price differential.

* * * * *

4. Section 1135.71 is amended by revising paragraph (b)(2) and removing and reserving paragraph (b)(3) to read as follows:

§ 1135.71 Payments to the producer-settlement fund.

* * * * *

(b) * * *

(2) An amount obtained by multiplying the total pounds of protein, other solids, and butterfat contained in producer milk by the protein, other solids, and butterfat prices respectively; and

(3) [Reserved]

* * * * *

5. Section 1135.73 is amended by revising paragraphs (a)(2)(ii) and (b)(3)(v) to read as follows:

§ 1135.73 Payments to producers and to cooperative associations.

(a) * * *

(2) * * *

(ii) The pounds of butterfat received times the butterfat price for the month;

* * * * *

(b) * * *

(3) * * *

(v) The pounds of butterfat in Class III and Class IV milk times the butterfat price;

* * * * *

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 §§ _____¹ to _____, all inclusive, of the order regulating the handling of milk in the (_____) Name of order (_____) marketing area (7 CFR PART _____²) which is annexed hereto; and

II. The following provisions: § _____³ 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 _____⁴, 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.

§ _____³ 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. 02-27570 Filed 11-6-02; 8:45 am]

BILLING CODE 3410-02-P

¹ First and last sections of order.

² Appropriate Part number.

³ Next consecutive section number.

⁴ Appropriate representative period for the order.