

# Proposed Rules

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

## DEPARTMENT OF AGRICULTURE

### Agricultural Marketing Service

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

[Docket no. AO-14-A74, et al.; DA-06-01]

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

7 CFR part	Marketing area	AO Nos.
1001	Northeast .....	AO-14-A73
1005	Appalachian .....	AO-388-A14
1006	Florida .....	AO-356-A37
1007	Southeast .....	AO-366-A43
1030	Upper Midwest .....	AO-361-A38
1032	Central .....	AO-313-A47
1033	Mideast .....	AO-166-A71
1124	Pacific Northwest .....	AO-368-A34
1126	Southwest .....	AO-231-A67
1131	Arizona .....	AO-271-A39

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

**ACTION:** Proposed rule.

**SUMMARY:** This tentative final decision proposes to adopt, on an interim final and emergency basis, changes to the manufacturing allowances contained in the Class III and Class IV product price formulas applicable to all Federal milk marketing orders. This decision is subject to producer approval.

**DATES:** Comments should be submitted on or before January 22, 2007.

**ADDRESSES:** Comments (four copies) should be filed with the Hearing Clerk, Stop 9200-Room 1031, United States Department of Agriculture, 1400 Independence Avenue, SW., Washington, DC 20250-9200. Comments may also be submitted at the Federal eRulemaking portal: <http://www.regulations.gov> or by submitting comments via e-mail to:

[amsdairycomments@usda.gov](mailto:amsdairycomments@usda.gov).

Reference should be made to the title of action and docket number.

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

**SUPPLEMENTARY INFORMATION:** This tentative final decision adopts on an interim final and emergency basis, amendments to the manufacturing (make) allowances for cheese, butter, nonfat dry milk (NFDM) and dry whey powder contained in the Class III and Class IV product price formulas. Specifically, this decision proposes the following manufacturing allowances:

	Adopted make allowance
Cheese .....	\$0.1682/lb
Butter .....	0.1202/lb
NFDM .....	0.1570/lb
Dry whey .....	0.1956/lb

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

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

The Agricultural Marketing Agreement Act of 1937 (Act), as amended (7 U.S.C. 604-674), provides that administrative proceedings must be exhausted before parties may file suit in court. Under Section 608c(15)(A) of the Act, any handler subject to an order may request modification or exemption from such order by filing with the 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 would rule on the petition. The Act provides that the district court of the

United States in any district in which the handler is an inhabitant, or has its principal place of business, has jurisdiction in equity to review the USDA's ruling on the petition, provided a bill in equity is filed not later than 20 days after the date of the entry of the ruling.

#### Regulatory Flexibility Act and Paperwork Reduction Act

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Agricultural Marketing Service has considered the economic impact of this action on small entities and has certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. For the purpose of the Regulatory Flexibility Act, a dairy farm is considered a "small business" if it has an annual gross revenue of less than \$750,000, and a dairy products manufacturer is a "small business" if it has fewer than 500 employees.

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

For the month of January 2006, the month the initial public hearing was held, the milk of 52,570 dairy farmers was pooled on the Federal order system. Of the total, 49,153 dairy farmers, or 94 percent, were considered small businesses. During the same month, 536 plants were regulated by or reported their milk receipts to be pooled and price on a Federal order. Of the total, 286 plants, or 53 percent, were considered small businesses.

This decision provides that all orders be amended by changing the make allowances contained in the formulas used to compute component prices and the minimum class prices in all Federal milk orders. Specifically, the make allowance for butter would increase from \$0.1150 to \$0.1202 per pound; the

make allowance for cheese would increase from \$0.1650 to \$0.1682 per pound; the make allowance for NFDM would increase from \$0.1400 to \$0.1570 per pound; and the make allowance for dry whey would increase from \$0.1590 to \$0.1956 per pound.

The adoption of these new make allowances serves to approximate the average cost of producing cheese, butter, NFDM and dry whey for manufacturing plants located in Federal milk marketing areas.

The established criteria for the make allowance changes are applied in an identical fashion to both large and small businesses and will not have any different impact on those businesses producing manufactured milk products. The following economic analysis discusses impacts of the order amendments on order participants including producers and manufacturers. Based on the economic analysis we have concluded that the proposed amendments will not have a significant economic impact on a substantial number of small entities.

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

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

Interested parties are invited to submit comments on the probable regulatory and informational impact of this proposed rule on small entities. Also, parties may suggest modifications of this proposed rule for the purpose of tailoring its applicability to small businesses.

## Economic Analysis

### Analysis

In order to assess the impact of make allowance changes in Federal order

product pricing formulas, the Department has conducted an economic analysis. While the primary purpose of this tentative final 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.

### Scope of Analysis

Impacts of increasing make allowances were measured as changes from the USDA Agricultural Baseline Projections to 2015 (OCE-2006-1, [http://www.usda.gov/oce/commodity/ag\\_baseline.htm](http://www.usda.gov/oce/commodity/ag_baseline.htm)). 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 USDA baseline and the model baseline assume: (1) The Milk Price Support Program (MPSP) will continue unchanged; (2) The Dairy Export Incentive Program will be utilized to the maximum extent allowed beginning in the 2006/07 fiscal year; (3) The Milk Income Loss Contract (MILC) program will continue through September 2007<sup>1</sup>; and (4) The Federal Milk Marketing Order Program will continue unchanged. This analysis maintains the first three assumptions as unchanged. The only changes to the Federal Milk Marketing Order Program are those that are brought about by the changes in make allowances adopted in this decision. Since the model is an annual model, a simplifying assumption is made that the make allowance changes become effective January 1, 2007.

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 margins are assumed unchanged from the baseline. The demands for fluid milk and soft manufactured products are satisfied first by the eligible supply of milk. The milk supply for manufactured 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, butter or nonfat dry milk

(NFDM) according to returns to manufacturing in each class. Wholesale prices for cheese, butter, NFDM and dry whey reflect supply and demand for these products. These manufactured dairy product 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 set forth in this tentative final decision are summarized using annual and nine-year, 2007-2015, 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.

**Producers.** Over the nine-year period, the average Federal order minimum blend price for milk at test decreases \$0.08 (0.55 percent) from a baseline level of \$14.71 per hundredweight (cwt). The average U.S. all-milk price decreases by about \$0.05 (0.35 percent) from a baseline level of 14.79 per cwt. Federal order marketings decrease by an average 136 million pounds annually due to the production decrease in response to lower producer milk prices. Federal order milk cash receipts decrease by an average \$125 million annually (0.65 percent) from baseline receipts of \$19,165 million. U.S. milk marketings decrease by an average 206 million pounds annually (0.11 percent), yielding an average producer revenue decrease of \$125 million annually (0.44 percent) from average baseline receipts of \$28,396 million.

**Milk Manufacturers and Processors.** Increasing Federal order make allowances benefits dairy manufacturers by widening the spread between Federal order minimum prices and the prices that they receive for manufactured dairy products. While prices paid for milk are lower, prices received for dairy products are higher due to the tighter milk supply. Over the nine year projection period, wholesale dairy product prices increase as follows: \$0.0119 per pound (0.82 percent) for cheddar cheese, \$0.0305 (1.99 percent) for butter, \$0.0012 (0.14 percent) for NFDM, and \$0.0015 (0.56 percent) for dry whey.

With the proposed increases in make allowances, most Federal order component prices decrease on average over the nine-year projection period: \$0.0038 per pound (0.16 percent) for protein, \$0.0156 (2.24 percent) for nonfat solids, and \$0.0361 (30.22 percent) for other solids. For the butterfat price, the increase in the butter price more than offsets the increase in the butter make allowance, resulting in

<sup>1</sup> Dairy producers are not eligible to choose September 2007 as a month for which MILC payments are to be applied. This provision was included so that it would not be necessary to include MILC payments in the Federal budget for fiscal year 2007-08.

an average increase of \$0.0303 per pound (1.78 percent) over the projection period. Changes in Federal order component prices translate into reductions for Federal order skim milk pricing factors at 3.5 percent butterfat over the nine-year period: \$0.22 per cwt for Class I and Class III, \$0.14 per cwt for Class II and Class IV. Federal order Class I and III average prices decrease by \$0.11 per cwt over the projection period, while Class II and IV prices decrease by \$0.03 per cwt.

There are notable differences between changes in Federal order class prices at 3.5 percent butterfat and changes in Federal order class prices at class butterfat percentages. Butterfat tests for the four Federal order milk classes differ from one class to another due to the mix of products within each class. Butterfat proportions are higher for Class II and IV milk than for Class I and III milk. Average Class I and III prices at test are below baseline levels over the nine-year period: \$0.16 per cwt (1.12 percent) for Class I and \$0.11 per cwt (0.83 percent) for Class III. For Class II and Class IV prices at test, the increase in the butterfat price more than offsets the increase in the make allowances, resulting in prices above baseline levels for the nine-year period: \$0.12 per cwt (0.58 percent) for Class II and \$0.03 per cwt (0.20 percent) for Class IV.

**Consumers.** The expected \$0.16 per cwt (1.12 percent) decrease in the minimum nine-year average Class I price at test results in an average \$0.0137 per gallon decrease in the price of fluid milk for consumers. Consumers increase consumption of fluid milk products slightly, resulting in an increase of 17 million pounds (0.04 percent) in Federal order Class I marketings. Consumers reduce consumption of manufactured dairy products in response to higher dairy product prices. All of the manufacturing Federal order class marketings decrease as follows: 26 million pounds (0.15 percent) for Class II, 30 million pounds (0.06 percent) for Class III and 97 million pounds (0.62 percent) for Class IV.

**Government Outlays.** In 2007, with lower milk prices, MILC payments increase by \$25 million (12.94 percent) above the baseline level of \$190 million. This impact rounds to approximately \$0.01 per cwt averaged over all of the milk production.

With an increase in Federal order make allowances, dairy product prices increase, milk production declines and government removals decrease relative to baseline levels. The analysis assumes that current MPSP make allowances will remain in effect throughout the

projection period. Over the projection period government removals of NFDM decrease by an average of 9 million pounds (2.95 percent) per year. This reduces government outlays by an average \$7 million per year over the projection period.

#### *Detailed Analysis Information*

A complete Economic Analysis, Class III and IV Make Allowances, Tentative Final Decision is available on the Internet at [http://www.ams.usda.gov/dairy/proposals/classIII\\_IV\\_make\\_all.htm](http://www.ams.usda.gov/dairy/proposals/classIII_IV_make_all.htm). For further information contact Howard McDowell, Senior Economist, USDA/AMS/Dairy Programs, Office of the Chief Economist, Room 2753, South Building, U.S. Department of Agriculture, Washington, DC 20250, (202) 720-7091, e-mail address [howard.mcdowell@usda.gov](mailto:howard.mcdowell@usda.gov).

#### *Prior Documents in This Proceeding*

**Notice of Hearing:** Issued December 30, 2005; published January 5, 2006 (71 FR 545).

**Notice of Intent to Reconvene Hearing:** Issued June 28, 2006; published June 23, 2006 (71 FR 36715).

**Notice to Reconvene Hearing:** Issued August 31, 2006; published September 6, 2006 (71 FR 52502).

#### *Preliminary Statement*

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

Interested parties may file written exceptions to this decision with the Hearing Clerk, United States Department of Agriculture, Room 1031-Stop 9200, 1400 Independence Avenue, SW., Washington, DC 20250-9200, by the January 22, 2007. Four (4) copies of the exceptions should be filed. All written submissions made pursuant to this notice will be made available for public inspection at the office of the Hearing Clerk during regular business hours (7 CFR 1.27(b)).

A public hearing was held upon proposed amendments to the marketing agreement and the orders regulating the handling of milk in the Northeast and other marketing areas. The hearing was held, pursuant to the provisions of the Agricultural Marketing Agreement Act

of 1937 (AMAA), as amended (7 U.S.C. 601-674), and the applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR Part 900).

The hearing notice specifically invited interested persons to present evidence concerning the probable regulatory and informational impact of the proposals on small businesses. Some evidence was received that specifically addressed these issues, and some of the evidence encompassed entities of various sizes.

The proposed amendments set forth below are based on the record of the first session of a public hearing held in Alexandria, Virginia, on January 24-27, 2006, pursuant to a notice of a hearing issued December 30, 2005; published January 5, 2006 (71 FR 545) and a second session of a public hearing held in Strongsville, Ohio, on September 14-15, 2006, pursuant to a reconvened hearing notice issued August 31, 2006; published September 6, 2006 (71 FR 52502).

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

1. Amending the manufacturing allowances.
2. Determination of emergency marketing conditions.

#### *Findings and Conclusions*

1. Amending the Manufacturing Allowances

This tentative final decision adopts on an interim basis, a proposal published in the hearing notice as Proposal 1 which seeks to amend the manufacturing allowances for butter, cheese, NFDM and dry whey. Specifically, this decision adopts the following manufacturing allowances: cheese—\$0.1682 per pound, butter—\$0.1202 per pound, NFDM—\$0.1570 per pound and dry whey—\$0.1956 per pound.

The Federal Milk order system currently uses product price formulas to compute prices handlers must account for in the marketwide pooling of milk used in Class III and Class IV products. Class III and Class IV prices form the base from which Class I and Class II prices are determined.

The price formulas used to compute Class III and Class IV prices contain a factor called a manufacturing (make) allowance. The make allowance factor represents the cost manufacturers incur in making raw milk into one pound of product. Federal milk order pricing formulas currently contain the following make allowances: cheese—\$0.1650 per pound, butter—\$0.1150 per pound, NFDM—\$0.1400 per pound and dry

whey—\$0.1590 per pound. These make allowances were last amended in 2003 and were determined on the basis of a California Department of Food and Agriculture (CDFA) and a USDA Rural Business Cooperative Service (RBCS) survey of 1998 manufacturing costs. The current make allowances were computed by taking a weighted average of the CDFA and RBCS surveys and adjusting for return on investment, general and administrative costs and marketing costs.

a. *The following summary of testimony and post-hearing briefs pertains to the first session of the public hearing held January 24–27, 2006, in Alexandria, Virginia.*

A proposal published in the hearing notice as Proposal 1 seeking to amend the current make allowances was offered by Agri-Mark Dairy Cooperative (Agri-Mark). Agri-Mark is a Capper-Volstead cooperative with approximately 1300 member-owners located throughout New England and

New York and operates 4 manufacturing plants. Proposal 1 seeks to amend the make allowances for cheese, butter, NFDm and dry whey powder contained in the Class III and Class IV price formulas based upon the results of the California State 2004 dairy products manufacturing cost survey conducted by the CDFA and a 2004 manufacturing cost survey conducted by the RBCS. The results of these surveys, reported in dollars per pound, are as follows:

	All cheese	40-lb. block cheese	Dry whey powder	Butter	NDFM
RBCS <sup>2</sup> .....	\$0.13295	\$0.15136	\$0.11409	\$0.16588	\$0.16816
CDFA .....	Not reported	0.1769	0.2673	0.1368	0.1543

<sup>2</sup> Results do not include factors for return on investment, general and administrative costs, marketing costs and milk transportation and procurement costs.

A witness from the RBCS testified regarding the methodology used by RBCS in conducting the 2004 Dairy Product Plant Costs Survey. The witness did not testify in either support of or in opposition to Proposal 1. The witness said the study was conducted at the request of dairy-farmer owned cooperatives as a technical assistance project from which cooperatives could compare their costs to average costs of all participating cooperatives. The witness stated that 9 cooperatives voluntarily submitted 2004 cost data for 17 cheese plants, 8 butter plants and 16 NFDm plants. Due to data incompatibility, the witness said that one butter plant and two NFDm plants were not included in the final study. The witness noted that the number of plants surveyed in 2004 was greater than the number of plants surveyed in 1998. The witness testified that the study represents the second time that this technical assistance project collected and analyzed cost data for dried and condensed dry whey processing. The witness reported that the data collected did not include costs from privately owned manufacturing plants and that none of the plants surveyed were located in the State of California.

The RBCS witness testified that the plant data represented each plant's cost of producing butter, NFDm, commodity cheese and condensed dry whey or dried dry whey depending on the product(s) produced at the individual plants. The RBCS witness explained the basic data collection methodology used in requesting data from individual plants and testified that the manufacturing costs provided by the cooperatives represented only those costs incurred by the plant from the

receiving deck to the shipping deck of the plant. The witness testified that milk procurement, milk transportation, as well as plant administrative and management overhead, return on investment costs and marketing costs were not included in the data collected. The witness also noted that the cost of producing dry whey was excluded from the cost of cheese manufacturing. According to the witness, the data provided were not audited or verified by an independent party. The witness explained that the cost data were aggregated by product category and a weighted average cost of production for each product type was then calculated. The witness said that the RBCS data did not support concluding that as plant size increased, costs of production decreased on a per unit basis.

Two witnesses from CDFA testified regarding the methodology used in conducting a 2004 processing costs survey for cheddar cheese, butter, NFDm and dry whey powder for manufacturing plants located in the State of California. The witnesses noted that 2003 was the first year that CDFA included dry whey processing costs in their manufacturing cost survey. The witnesses did not testify in either support of or in opposition to Proposal 1.

The CDFA witnesses explained that plant participation in the cost survey is voluntary and that the 2004 survey represented 99.9 percent of butter production, 98.5 percent of Cheddar and Monterey Jack production, 99.17 percent of NFDm production and 79 percent of dry whey powder production in the State of California. The witnesses testified that all cost survey data collected is from audited plant cost records. The CDFA witnesses noted that

the audited costs for California plants demonstrated that costs per unit of output are inversely related to plant size. The witnesses elaborated that as plant size increases, the costs of production on a per unit basis decrease consistently across manufacturing product categories.

A witness appearing on behalf of Agri-Mark testified in support of Proposal 1. The witness testified that the costs of manufacturing dairy products have increased since the make allowances were amended in 2003 by relying on cost data from 1998 and 1999. The witness asserted that many manufacturing plants are unable to recoup their increased costs in the marketplace and, the witness asserted, caused some plants located in the Northeast marketing area to cease operating. The witness argued that the Class III and Class IV make allowances should be updated using 2004 data contained in the CDFA and RBCS surveys to reflect current manufacturing costs.

The Agri-Mark witness asserted that the role of Class III and Class IV plants is to balance the milk needs of the Class I and II markets. According to the witness, monthly Class III milk volumes as a percentage of the annual average monthly volume in the Northeast order for 2005 ranged from a high of 107 percent in May to a low of 92 percent in October. Class IV usage for that same time period ranged from 145 percent in May to 48 percent in September, said the witness. The witness also stated that when milk production in the Northeast marketing area increased in 2000, it was primarily Class IV plants that balanced the increased supply.

The Agri-Mark witness stressed that even though Class IV plants are

balancing the market by processing the additional producer milk supply, they are not profitable in the Northeast marketing area. The witness explained that one dairy processor attempted to recoup their increased energy costs in the market through an energy surcharge on its finished products. However, stated the witness, the surcharge was captured in the NASS survey price and subsequently the Class IV milk price paid by manufacturing plants also increased.

The Agri-Mark witness estimated that its members lost \$15.5 million in 2004 because manufacturing costs were not adequately covered in the pricing formula for cheese. According to the witness, this resulted in a loss of \$0.6500 per hundredweight (cwt) on all its producer-member milk. In this regard, the witness asserted that Agri-Mark members were subsidizing the Northeast order blend price because they are paying a classified price for Class III and Class IV milk that is higher than the value of the milk used to make these products. The witness conceded, however, that despite incurring a loss on its producer-member milk Agri-Mark does pay premiums for milk it purchases for processing into Class III and Class IV products.

The Agri-Mark witness proposed that the updated cheese make allowance is computed by taking a weighted average of the RBCS 40-pound block cheddar and the all California total cheese manufacturing plant costs. The witness calculated this value to be \$0.1794 per pound. The witness was of the opinion that the RBCS 40 pound block cost should be used because the CDFA survey had standardized its reported costs to plants that produce 40 pound blocks.

The Agri-Mark witness proposed that the butter make allowance should be computed by using the weighted average cost for all RBCS butter plants with the weighted average costs of all CDFA butter plants. The witness calculated this value to be \$0.1515 per pound. The witness explained that only the high cost sub-group of CDFA butter plants was used in 2003 when the current make allowances were adopted. The witness was of the opinion that using only the high cost sub-group would now be inappropriate because those plants were not similar in size to the RBCS butter plants.

The Agri-Mark witness proposed that the NFDN make allowance should be computed using the RBCS weighted average cost for all NFDN plants and the weighted average cost of the medium cost sub-group of CDFA NFDN plants. The witness calculated this

value to be \$0.1867 per pound. The witness was of the opinion that this methodology and value was appropriate because of the comparable plant volumes between the two groups. The low cost plants in the CDFA survey produce a large volume of NFDN, the witness said, and including those plants in the calculation would distort the average costs of the plants in the RBCS study. The witness explained that using a weighted average by product volume implies that half of the product will be produced at a cost lower than the weighted average and half of the product would be produced at a cost higher than the weighted average. If the low cost CDFA plants were included in the make allowance calculation, the witness concluded that because of their high product volume more than half of the product and a majority of plants regulated by the Federal order system would not be able to cover their manufacturing costs.

The Agri-Mark witness expressed concern regarding the large variation in the CDFA survey cost of dry whey (\$0.2673 per pound) and the RBCS survey cost of dry whey (\$0.11409 per pound). According to the witness, CDFA has only collected data on dry whey processing for two years and during that same time period the survey cost of dry whey (\$0.2670 per pound) was not recommended as the appropriate make allowance—instead, a make allowance of \$0.2000 per pound was adopted. This was also the second time the RBCS survey collected data for dry whey production and the witness was of the opinion that there may have been problems regarding the reporting and allocation of dry whey costs that resulted in the RBCS survey product cost far below the CDFA cost. The witness insisted that because dry whey cost accounting methodology is new and not standardized, the Department should not rely on, or adopt the RBCS or CDFA survey costs for dry whey. Rather, the witness asserted that it would be more appropriate to use the methodology adopted when make allowances were last amended which added a factor of \$0.0190 to the NFDN make allowance. The witness was of the opinion that either a \$0.0190 or \$0.0250 factor would be appropriate and would result in a dry whey make allowance of either \$0.2057 or \$0.2117 per pound.

The Agri-Mark witness also supported updating the return on investment, administrative and marketing cost factors that are incorporated into the make allowance calculations. The previous Department decision amending the make allowances adopted the cost factors that were contained in the CDFA

survey, and the witness was of the opinion that the same cost factors contained in the 2004 CDFA survey should again be used.

The Agri-Mark witness submitted data estimating the impact the proposed make allowances would have on class and component prices. According to the witness, the price of butterfat would fall \$0.0440 per pound, the price of protein would remain the same, the price of nonfat solids would fall \$0.0460 per pound, and the price of other solids would fall either \$0.0480 per pound or \$0.0540 per pound depending on the factor used to calculate the dry whey powder make allowance. Additionally, the witness predicted that the Class III price would fall either \$0.4300 per cwt or \$0.4600 per cwt (depending on the dry whey powder factor) and the Class IV price would fall \$0.5500 per cwt.

The Agri-Mark witness also offered data regarding increased energy costs that have occurred over the past 4 years. Referring to U.S. Department of Energy data, the witness asserted that crude oil prices increased 33 percent in 2004 and 36 percent in 2005, and those prices are expected to increase 52 percent and 45 percent above 2004 levels in 2006 and 2007, respectively. Other similar increases were seen in natural gas prices, the witness noted. In this regard, the witness offered a modification to Proposal 1 to include an energy adjustment for 2005 using the Producer Price Indexes for Industrial Natural Gas and Industrial Electric Power Distribution. According to the witness, those indexes recorded a 6 percent increase in electric power costs and a 23.8 percent increase in industrial natural gas costs from 2004 to 2005.

If the energy adjustment were incorporated into the make allowance, the Agri-Mark witness proposed that the make allowances be set at \$0.1815 per pound for cheese, \$0.1543 per pound for butter, \$0.1965 per pound for NFDN, and either \$0.2155 per pound or \$0.2117 per pound for dry whey powder. This set of proposed make allowances would result in a decrease of the Class III price of either \$0.5100 or \$0.5400 per cwt and a decrease in the Class IV price by \$0.6500 per cwt.

The Agri-Mark witness conceded that adoption of Proposal 1 would decrease the blend prices paid to all dairy farmers. The witness was of the opinion that their proposed higher make allowances would lead to lowering blend prices by \$0.09 to \$0.13 per cwt over 5 years. However, the witness said, if the make allowances are not amended to reflect current costs, manufacturing plants that are unable to recoup their increased costs would go out of business

causing disorderly marketing conditions because there would be fewer local outlets for producer milk. The witness claimed that some cooperatives are currently decreasing the price paid to their members in an effort to recoup some of their increased manufacturing costs. The witness said that while Agri-Mark pays premiums above the minimum Federal order blend price to its members, they also are collecting a \$0.15 per cwt assessment on all of their members' milk to offset some of the cooperative's losses. The witness said that if the make allowances were not increased, dairy farmers who are members of cooperatives would continue to lose money as cooperatives that operate manufacturing plants would further need to decrease the price they pay to their members in an effort to recoup additional losses. The Agri-Mark witness strongly urged the Department to expedite the rulemaking process by eliminating a recommended decision.

A second witness appearing on behalf of Agri-Mark offered testimony regarding the production costs experienced at Agri-Mark plants. The witness asserted that their production costs have steadily increased since 1998 when that cost data was used in establishing current make allowances. According to the witness, Agri-Mark has taken many steps to increase efficiency and to lower costs, such as installing more efficient equipment, purchasing supplies in bulk quantities and forward pricing their energy needs. Despite these efforts, explained the witness, Agri-Mark has still been unable to offset increases in most production costs. To support their claim of increased production costs, the witness provided data which listed various costs experienced at Agri-Mark manufacturing plants from 2001 to 2005.

A post-hearing brief submitted on behalf of Agri-Mark; Northwest Dairy Association; Foremost Farms USA Cooperative; Associated Milk Producers, Inc.; and Land O'Lakes, Inc. expressed support for updating the make allowances. Hereinafter, these entities will be referred to as "Agri-Mark, et al." The brief argued that the hearing record clearly establishes that manufacturers are incurring higher processing costs since current make allowances were adopted. The brief asserted that the current make allowances force many manufacturers to operate at a financial loss. The brief estimated that Agri-Mark members alone are incurring losses in excess of \$700,000 per month.

The Agri-Mark, et al., brief stated that unlike the competitive pricing system,

the current pricing system does not give manufacturers the ability to recoup increased processing costs from the marketplace. The current set of fixed make allowances, wrote Agri-Mark, et al., do not reflect current manufacturing costs which are shown in the most current CDFA and RBCS surveys. The brief asserted that the inadequate make allowances have played a role in many manufacturing plant closures in recent years, and claimed that more plants would be forced out of business if the make allowances were not updated as quickly as possible.

The Agri-Mark, et al., brief asserted that the RBCS and CDFA surveys are reliable and representative of manufacturing costs throughout the country. The brief also stressed the importance of including a 2005 energy adjuster in determining any amended make allowances. The brief reiterated Agri-Mark's concern with the dry whey cost data contained in both the RBCS and CDFA surveys and advocated deriving the dry whey make allowance by adding a 1.9 cent per pound factor to the NFDM make allowance, noting that the same methodology was used to derive the current dry whey make allowance.

The Agri-Mark brief conceded that any increase in the make allowances will reduce producer income. However, the brief stated that the Department did not account for the current loss of revenue by cooperative members whose manufacturing plants are currently operating at a financial loss in their baseline analysis. The brief also asserted that the baseline analysis did not include the impact on producer revenue due to closures which might result from fewer local outlets for their milk supply. The brief concluded that if these and other factors were included in the baseline analysis, the reduction in producer revenue would not be as large as projected.

A witness appearing on behalf of National Milk Producers Federation (NMPF) testified in support of Proposal 1. According to the witness, NMPF consists of 33 dairy-farmer cooperative associations that represent 75 percent of the country's dairy farmers. The witness said that NMPF supports updating the make allowances to reflect current manufacturing costs to provide needed cost relief to the dairy product manufacturing industry. The witness stated that the current make allowances were derived from manufacturing cost data collected in 1998 and that costs have increased making the current make allowances obsolete. The witness maintained that the updated CDFA and RBCS survey data should be combined

according to the same basic methodology used by the Department when the current make allowances were established. The witness urged the Department to implement these changes on an emergency basis and omit a recommended decision.

The NMPF witness explained that make allowances set the maximum margin a manufacturer can earn for its products. According to the witness, if a manufacturer is able to produce at a per unit cost less the make allowance, then they generate a processing premium. However, the witness said, if a manufacturer's per unit cost is greater than the make allowance they do not earn a processing premium and have no method under the current pricing formulas to recoup those costs from the marketplace. The witness asserted that this undermines the ability of manufacturing plants to provide market balancing services and the Federal orders the ability to provide for orderly marketing conditions.

The NMPF witness testified that the CDFA and RBCS surveys together represent a large portion of the domestic manufacturing industry—41 percent of cheddar cheese production, 51 percent of butter production, 81 percent of NFDM production and 45 percent of dry whey production. While the witness supported using the Department's methodology for establishing the current make allowances, NMPF proposed a modification. The current butter make allowance was determined after excluding the lower-cost CDFA butter plants from the calculation of the average plant cost, the witness explained. According to the witness, this exclusion is no longer justified because that group represents a large share of U.S. butter production and should now be included.

The NMPF witness also explained that the most volatile input cost of manufacturing is energy and asserted that recent increases in energy costs have countered many cost reducing measures undertaken by manufacturers to increase productivity or efficiency. The witness was of the opinion that the energy cost factor contained in the make allowances should be indexed and adjusted monthly to take into account the volatile energy market. The witness insisted that this was an appropriate way to maintain equity between producers and manufacturers explaining that processors would not be unduly harmed when energy prices rise and producers would not be harmed when energy prices fall. Therefore, the witness said, the Department should adopt a monthly energy price adjuster using the monthly Bureau of Labor Statistics

Producer Price Indexes for Industrial Electricity and Industrial Natural Gas, and use the weighted average 2004 electricity and fuels costs from the RBCS and CDFA surveys as the initial base for the adjuster. The witness added that if an energy index is not adopted, the make allowances that are determined as a result of the proceeding may become obsolete before they are implemented if there are large fluctuations in energy prices. The witness supported delaying implementation of an energy cost factor until the issuance of a final decision if its consideration would delay adopting adjustments in the make allowances. A post-hearing brief submitted on behalf of NMPF reiterated their support for updating the make allowances.

A witness appearing on behalf of Land O' Lakes (LOL) testified in support of Proposal 1. According to the witness, LOL is a Capper-Volstead cooperative with more than 4,000 members that owns manufacturing plants located throughout the United States. The witness explained that Class III and Class IV prices are determined in part by taking the market price of various manufactured goods and subtracting the cost of converting milk into that specific commodity (make allowance). The witness said that the current classified pricing system was implemented in 2000 and the current make allowances were last adopted in 2003 relying on data that was collected in 1998. The LOL witness stated that all of LOL's plants have experienced increased manufacturing costs since 1998. The witness emphasized that despite efforts by LOL to reduce costs increase in processing costs could not be completely offset.

The LOL witness stressed that relative plant size, comparable per unit costs and recognition of balancing costs should be criteria used by the Department in appropriately weighting the CDFA and RBCS surveys to determine the make allowances. The witness further suggested that when establishing the butter make allowance, the weighted average of the CDFA and RBCS butter plants should be used because the costs of the average plant size measured by both surveys are comparable. According to the witness, this would result in a butter make allowance of \$0.1515 per pound. The NFDN make allowance should be computed using the weighted average of the RBCS NFDN plants and Group II of the CDFA NFDN plants, the witness stated. The costs of those two groups, after adjusting the RBCS data for return on investment, general and administrative costs and marketing

expenses, are similar, the witness said, and would result in a NFDN make allowance of \$0.1867 per pound.

For determining the cheese make allowance, the LOL witness advocated using the weighted average RBCS cost with the weighted average CDFA cost because those costs are similar. The witness asserted that the resulting cheese make allowance should be \$0.1710 per pound. The witness also insisted that the RBCS and CDFA survey costs for dry whey processing are counter-intuitive and supported Agri-Mark's modification to add a factor to the NFDN make allowance to determine the dry whey make allowance.

The LOL witness maintained that the make allowances need to be amended to reflect current manufacturing and to remedy an error in the RBCS cost data presented at a 2000 hearing on Federal order product price formulas that contained some California plants. The witness also recognized that lower blend prices would result if Proposal 1 is adopted. However, the witness said, LOL cooperative members are currently bearing the additional cost of processing manufactured products which the witness asserted should be born by all producers. The witness emphasized that all of the LOL butter, cheese, and NFDN plants that participated in the RBCS survey lost money in 2004 even though the average selling price for the products were above the NASS average price for the year. The witness urged the Department to expedite the hearing process and omit a recommended decision to provide cost relief to manufacturing operations.

A post-hearing brief submitted on behalf of LOL reiterated their support of adoption of Proposal 1. The brief supported adoption of the specific make allowances advanced by Agri-Mark including a 2005 energy adjuster and adoption of an energy index in the calculation of the make allowances that would be updated quarterly. The brief expressed opposition to reopening the hearing record to take evidence regarding the proper make allowances to be included in the Class I and Class II price formulas.

A witness appearing on behalf of the National Cheese Institute (NCI) testified in support of Proposal 1. NCI is a trade association with 70 member companies representing manufacturers, marketers, distributors and suppliers of cheese. The witness said that the make allowances should be updated with the 2004 CDFA and RBCS survey data using the methodology that established the current make allowances and that they be adjusted for 2005 energy cost increases. The witness specified that

after adding an energy adjustment the make allowance should be set no lower than the following: \$0.1810 per pound for cheese, \$0.2220 per pound for dry whey, \$0.1540 per pound for butter and \$0.1970 per pound for NFDN.

The NCI witness explained that the Federal order pricing system prior to Federal order reform was based on the competitive market prices paid for unregulated milk in the Upper Midwest region. The witness asserted that this pricing scheme reacted to changes in manufacturing costs and therefore manufacturers did not need to seek government intervention to recover any cost increases. However, the current pricing system determines the classified prices received by farmers based on the products' finished wholesale prices minus fixed make allowances that represents the handlers' costs incurred to make the finished products, explained the witness. The current system, the witness said, does not react to cost changes. If a manufacturer's costs of production increases, the plant still only receives the fixed make allowance to produce that specific product, the witness said even if this does not cover all of its processing costs. The witness noted that while a plant could increase its finished product prices to recover additional expenses, the higher prices would be included in the NASS product price survey and would consequently increase their cost for raw milk. According to the witness this circularity in price determination undercuts market forces and justifies increasing the make allowances.

The NCI witness maintained that manufacturing costs have increased substantially since RBCS and CDFA survey data for 1998 was used to establish the current make allowances. The witness asserted that if the make allowances are not updated, cheese manufacturers will either have to decide to lose money on each pound of product or stop production entirely. While the witness supported the methodology used by the Department to set the current make allowances, NCI offered their views regarding what CDFA cost sub-groups should be used in establishing new make allowances. The witness also insisted that because the 2004 CDFA and RBCS survey results do not include 2005 energy cost increases, an adjustment as proposed by Agri-Mark, to reflect these increases, is justified. The witness testified that a 2.5 cent factor should be added to the NFDN make allowance to establish the dry whey make allowance. The NCI witness concluded that the increasing differences between current make allowances and actual manufacturing

costs justifies the need for emergency action by the Department through the omission of a recommended decision.

A post-hearing brief submitted on behalf of NCI reiterated their support for updating the make allowances using CDFR and RBCS 2004 survey data, adjusted for 2005 energy costs, on an emergency basis. The brief stated that such an update should result in new make allowances that would be set no lower than the following: \$0.1810 per pound for cheese, \$0.1540 per pound for butter, \$0.1970 per pound for NFDM and \$0.2220 per pound for dry whey. The brief stated that the hearing record is replete with evidence demonstrating a significant increase in manufacturing costs and the manufacturers' inability to recoup those costs through the marketplace. The brief also argued that the RBCS data regarding the costs of producing dry whey do not include all input costs and are not representative of typical U.S. dry whey drying plants. Therefore, the brief said, the Department should continue the methodology used in the past and establish a dry whey make allowance by adding a differential to the NFDM make allowance.

A witness appearing on behalf of Lactalis America Group (Lactalis) testified in support of Proposal 1. According to the witness, Lactalis produces and markets a variety of cheeses across the United States. The witness testified that their manufacturing costs of production have increased 14 percent since 1998 even though their plant capacity had increase by 25 percent during that time frame. The witness projected that Lactalis' costs of production would increase 16 percent in 2006 as compared to 2005. The witness urged the Department to expedite the rulemaking process and omit a recommended decision.

A witness appearing on behalf of Alto Dairy Cooperative (Alto) testified in support of Proposal 1. According to the witness, Alto is a Capper-Volstead cooperative located in Wisconsin that markets over 1.5 billion pounds of milk annually and operates 2 manufacturing plants. The witness stated that a financially stable dairy manufacturing industry which provides numerous local outlets for milk is vital to maintaining a stable market for dairy farmers. The witness was of the opinion that the current make allowances disadvantage cheese manufacturers because they do not adequately account for the current costs of manufacturing. The witness stated that even though Alto has become more efficient, their costs of production still increased 3 cents per pound because of increases in costs for natural gas, packaging

materials and transportation. The witness urged the adoption of Proposal 1 on an expedited basis.

A witness appearing on behalf of Associated Milk Producers, Inc. (AMPI) testified in support of Proposal 1. According to the witness, AMPI is a Capper-Volstead cooperative that represents 4,000 dairy farmers in 7 Midwestern states and whose milk is pooled on the Upper Midwest and Central orders. The witness expressed support for increasing the make allowances because of increased manufacturing costs, particularly for energy, that have occurred since 2001. The witness was of the opinion that adequate make allowances are critical in allowing a manufacturing plant to cover their processing costs and earn a competitive rate of return on equity. The witness said that if the make allowances remained too low plant profitability will continue to erode and investment in plants and manufacturing equipment will decrease. The witness emphasized that manufactured dairy products compete in a national market against other unregulated or state-regulated plants that either have no regulated pricing system or have a make allowance that more accurately reflects current marketing conditions.

The AMPI witness also supported the inclusion of a 2005 energy adjuster as advanced by Agri-Mark. The witness said that AMPI experienced 31 percent higher average natural gas costs in 2005 than in 2004. The witness noted that for the months of September through December 2005, AMPI's natural gas costs were on average 65 percent higher than during the same time period in 2004. The witness asserted that the steep increases in energy prices that occurred in 2005 need to be reflected in any update of the make allowances. The witness also supported indexing energy costs as proposed by NMPF, provided its inclusion would not delay the issuance of a decision, and that its inclusion should be contained in a later decision. The witness urged the Department to expedite the hearing process and omit a recommended decision.

A witness appearing on behalf of Foremost Farms USA Cooperative (Foremost) testified in support of Proposal 1. According to the witness, Foremost is a Capper-Volstead cooperative with 3,476 members that markets 5.05 billion pounds of milk and operates 15 manufacturing plants and 2 distributing plants. The witness said the current make allowances have dramatically risen since 1998 and is causing manufacturing plants to lose substantial amounts of money.

The witness explained that Foremost has taken numerous steps since 2000 to increase their competitiveness and efficiency by reconfiguring their product mix, closing numerous plants and a storage and distribution facility, increasing employee health care contributions, and purchasing packaging, ingredients, and other supplies in bulk. Despite these efforts Foremost has been unable to completely offset as the cost increases in energy, employee healthcare, and packaging materials, the witness stated. The witness claimed that at their Lancaster, Wisconsin, cheese plant, 2004 manufacturing costs per pound for cheese had increased 25.6 percent since 1999. According to the witness, the increased costs were linked to higher natural gas, electricity, and employee fringe benefits. The witness added that the 2005 manufacturing costs per pound of cheese at the same plant was 14.1 percent higher than 2004. The witness also emphasized that Foremost has attempted to raise its product prices and premiums but those increases were incorporated into the NASS Dairy Product Price survey that in turn, resulted in higher Federal order minimum class prices for their raw milk.

The Foremost witness stressed that make allowances need to be increased quickly; otherwise they will be unable to continue absorbing cost increases without paying their members less for their milk. The witness supported adoption of Proposal 1 with an energy adjuster and urged its adoption on an emergency basis.

A witness appearing on behalf of Davisco Foods International (Davisco) testified in support of Proposal 1. According to the witness, Davisco operates three manufacturing plants that collectively produce 1 million pounds of cheese per day. The witness offered support for the testimony offered by the NCI. The witness stated that the price Davisco is able to charge for products is not high enough to return the classified price to the marketwide pool and cover their manufacturing costs. According to the witness, many of Davisco's processing costs have increased from 1998 to 2004. During this time period, the witness explained, labor costs have increased 25 percent per man hour, employee benefits have increased 92 percent and natural gas costs have increase 149 percent per therm. The witness said energy costs increased substantially again in 2005. The witness insisted that in order to maintain a viable dairy manufacturing industry, make allowances need to be amended



on an emergency basis to reflect current market conditions.

A witness appearing on behalf of Michigan Milk Producers Association (MMPA) testified in support of Proposal 1. According to the witness, MMPA is a Capper-Volstead cooperative with approximately 2,400 members that markets over 3.3 billion pounds of milk per year and operates 2 manufacturing plants. The witness said that MMPA participated in the 1998 and 2004 RBCS manufacturing cost surveys and presented data revealing their cost increases during that time period. According to the witness, MMPA's manufacturing costs per pound of NFDM were 54 percent higher in 2004 than in 1998 and represent \$2.1 million in additional processing costs that they were unable to recoup from the marketplace. During that same period, the witness noted, the manufacturing costs per pound of butter increased 14.3 percent, reducing their profit margin by \$207,000. The witness insisted that energy costs have been the major driver of cost increases and said that in 2006 MMPA forecasts their gas costs to increase by nearly \$1.3 million. The witness stressed that MMPA tried to increase their product prices but those higher prices were captured by the NASS product price survey which in turn resulted in higher raw milk costs.

The MMPA witness emphasized the need for increasing make allowances to reflect current manufacturing costs and urged the Department to act on an emergency basis. The witness also offered support for indexing fuel costs and periodically adjusting make allowances to reflect changes in energy costs.

A post-hearing brief submitted on behalf of MMPA reiterated support for adoption of Proposal 1. The brief stated that MMPA manufacturing plants have been incurring financial losses because processing costs are not fully recovered by current make allowances. The brief supported the make allowances advanced by Agri-Mark and NMPF. The brief also advocated that the make allowances be adjusted for 2005 energy cost increases and that the new allowances include a monthly energy adjuster. MMPA wrote that by indexing energy costs in the make allowances, manufacturers would not be harmed if future energy costs continue to increase and if energy costs decrease producers would share in the additional revenue resulting from lower processing costs. The brief described large financial losses that MMPA member-owned plants would incur if make allowances are not adjusted as quickly as possible.

A witness appearing on behalf of Northwest Dairy Association (NDA) testified in support of Proposal 1. According to the witness, NDA is a Capper-Volstead cooperative with approximately 640 dairy-farmer members, of which 520 pool their milk on the Pacific Northwest order and also operates manufacturing plants in the northwest through its subsidiary, WestFarm Foods. The witness said that make allowances need to be updated to reflect the current marketing conditions. The witness insisted that the current make allowances do not reflect the higher costs of energy, labor and packaging and that efforts to recoup these costs from the marketplace have been unsuccessful. Therefore, the witness asserted that updating the make allowances is a logical step to ensure that manufacturing plants do not continue to lose money from higher costs that cannot be recouped.

The NDA witness stressed that balancing costs should be considered as part of determining the appropriate make allowances for Class IV products—butter and NFDM. The witness claimed that NDA's NFDM processing costs were 2 to 5 cents per pound higher in their NFDM plants that specifically are used to balance the market. The witness said that NDA provided dry whey cost data for the RBCS survey and noted an error in their data—NDA did not include the purchase of a large amount of condensed dry whey in their total dry whey processing cost. The witness claimed that after accounting for this purchase, their dry whey processing cost increased 1.969 cents per pound for all dry whey manufactured by NDA.

The NDA witness offered support for adjusting the make allowances to reflect 2005 energy costs and for indexing energy costs to periodically adjust the make allowances as proposed by NMPF. However, the witness insisted that manufacturing plants need immediate cost relief. The witness urged the Department to first amend the make allowances on an emergency basis and by including a 2005 energy adjuster. Then if necessary, the witness added, consider the NMPF proposal to index energy costs.

A post-hearing brief submitted on behalf of NDA reiterated support for emergency action by the Department. The NDA brief focused on the appropriate level on the appropriate make allowance for dry whey. The brief expressed concern over the large cost difference in CDFA and RBCS dry whey cost survey data and the unintended exclusion of some input costs for dry whey processing by some of the RBCS

survey participants. The brief recommended that the dry whey make allowance be derived by adding a factor to the NFDM make allowance.

A witness appearing on behalf of WestFarm Foods (WestFarm) testified in support of Proposal 1 and offered testimony explaining the processing differences and related manufacturing cost differences between NFDM and dry whey powder. According to the witness, WestFarm performs the processing and marketing operations for NDA. The witness reviewed the testimony contained in a 2000 hearing record on make allowances and concluded that the assumptions made about dry whey processing are still valid. The witness updated the 2000 testimony with costs from the RBCS study, described the process of dry whey processing using reverse osmosis, and compared those costs to manufacturing NFDM. The witness concluded that in 2004 the additional cost of producing a pound of dry whey powder was 2.905 cents higher than producing a pound of NFDM with energy costs accounting for 1.120 cents. The witness attributed the higher cost of producing dry whey powder partly to the larger volume of milk needed to produce a pound of dry whey powder than a pound of NFDM. The witness noted that WestFarm uses reverse osmosis technology to produce dry whey, and in 2004 their additional production costs were 2.7151 cents higher than producing NFDM. The witness concluded that regardless of the process used to produce dry whey, the cost of dry whey production is higher than that of NFDM production and urged the Department to take this into consideration when setting a make allowance for dry whey.

A witness appearing on behalf of O-AT-KA Milk Products Cooperative, Inc. (O-AT-KA) testified in support of Proposal 1. According to the witness, O-AT-KA is owned by three producer-owned cooperatives—Upstate Farms Cooperative, Inc.; Niagara Milk Cooperative, Inc.; and Dairy Farmers of America, Inc.—and which operates manufacturing plants that produce a variety of manufactured milk products. The witness stated that O-AT-KA plants provide a vital balancing function to maintain orderly marketing of milk in the Northeast order. However, the witness said, the current fixed make allowances do not reflect the increased manufacturing costs that O-AT-KA members have had to bear and as a result, O-AT-KA producers are not being adequately compensated for the service they provide to the entire market. The witness asserted that efforts to recoup their increased costs by

increasing their product prices would only result in an increase in their raw milk costs. Accordingly, the witness concluded that updating the make allowances remains the only method to provide manufacturers with cost relief.

The O-AT-KA witness explained that after adjusting their 2005 manufacturing costs to include a return on investment factor, their cost of producing NFDM was \$0.2218 per pound (\$0.0818 more than the current NFDM make allowance) and their cost of producing butter was \$0.1497 per pound (\$0.0347 per pound more than the current butter make allowance.) The witness concluded that these higher manufacturing costs resulted in a \$1.9 million loss in revenue for O-AT-KA members in 2005. The witness expressed concern with O-AT-KA's ability to continue manufacturing milk products while continuously experiencing financial losses.

The O-AT-KA witness offered support for adoption of Proposal 1 and the specific make allowances proposed by Agri-Mark. The witness was also of the opinion that the make allowances should be updated to include an energy adjustor to reflect the large changes in 2005 energy costs. The witness offered support for a monthly energy cost adjustment to ensure that energy price changes are reflected in make allowances.

The O-AT-KA witness recognized that increasing make allowances reduces producer income but asserted that not updating the make allowances would result in more plant closings, increased hauling costs, and lower producer premiums. The witness urged the Department to take emergency action and omit a recommended decision.

A post-hearing brief submitted on behalf of O-AT-KA and Upstate Farms Cooperative, Inc. reiterated their support for updating the make allowances on an emergency basis. The brief stated that the make allowances should be updated with data from the CDFA and RBCS 2004 costs surveys, include an adjustment for 2005 energy costs and adjust make allowances by changes in energy.

A witness appearing on behalf of Saputo Cheese USA, Inc. (Saputo) testified in support of Proposal 1. According to the witness, Saputo owns and operates 15 manufacturing plants throughout the United States and purchases 3 to 4 billion pounds of milk annually. The witness stated that the current make allowances are causing cheese manufacturers to operate their plants at a financial loss because of dramatic increases in manufacturing

costs. The witness explained that Saputo has experienced a 96 percent increase in electricity costs, a 125 percent increase in natural gas costs and an increase in excess of 150 percent in packaging costs from March 31, 2000, to December 31, 2005. The witness admitted that Saputo does not produce cheddar cheese but claimed that they are still unable to recoup their increased costs in the marketplace because of the competitive environment. The witness stated that manufacturing costs have increased since the 1998 cost data was used to establish the current make allowances. The witness urged the Department to take emergency action to provide manufacturers with some cost relief and omit issuing a recommended decision.

A witness appearing on behalf of Glanbia Foods, Inc. (Glanbia) testified in support of Proposal 1. According to the witness, Glanbia operates three manufacturing plants in Idaho and the milk that they purchase is not pooled on any Federal order. The witness said that even though they are not Federally regulated they still pay prices for their milk supply that must be competitive with Federal order class prices. The witness said that Glanbia has experienced significant increases in manufacturing costs since 1999 and particularly so over the past 12-18 months. The witness said that Glanbia's electricity costs from 1999-2005 increased by 34 percent; 370 percent for natural gas; 111 percent for diesel; 44 percent for labor and 90 percent for employee health insurance. The witness expressed the opinion that the Department should act swiftly to update the make allowances.

A witness appearing on behalf of Hilmar Cheese Company, Inc. (Hilmar) testified in support of Proposal 1. According to the witness, Hilmar operates a cheese and dry whey manufacturing plant in California and is currently building a cheese plant in Texas that will be receiving Federal marketing order priced milk. The witness stated that Hilmar has increased its efficiency between 1998 and 2004 but those gains have not fully compensated for increased manufacturing costs. The witness attributed increased manufacturing costs to, among other things, packaging—an increase of 56 percent, supplies—an increase of 11 percent, and repairs and maintenance—an increase of 113 percent. The witness stressed that their cost increases from 2004 to 2005 alone were higher than the total increase in costs for the entire period of 1998 to 2004. The witness was of the opinion that the make allowances should be

updated and adjusted for higher 2005 energy costs as proposed and modified by Agri-Mark.

A witness appearing on behalf of Kraft Foods (Kraft) testified in support of Proposal 1. According to the witness, Kraft owns and operates numerous manufacturing plants throughout the United States and also purchases dairy products as ingredients for other products. The witness said the long-run viability of the dairy industry depends on both the profitability of the dairy farm sector and the manufacturing sector. Current make allowances do not accurately represent current manufacturing costs and attempts to increase the price of finished products to recoup some of the increased costs have proved futile, the witness emphasized. The witness said that this situation hampers manufacturer's efforts to operate profitably. The witness explained that manufacturing input costs have dramatically increased since the 1997-1999 time period when manufacturing cost data was collected to determine the current make allowances. Relying on Department of Energy and Department of Labor data, the witness claimed that from 1998 to October 2005, electricity prices increased 24 percent per kilowatt hour, natural gas prices increased 155 percent per thousand cubic feet and labor costs increased 32 percent per hour. The witness concluded that these cost increases demonstrate the higher costs manufacturers face in operating and the need for higher make allowances to be adopted on an emergency basis.

A witness appearing on behalf of the Association of Dairy Cooperatives in the Northeast (ADCNE) testified in support of Proposal 1. According to the witness, ADCNE members include Agri-Mark; Dairy Farmers of America, Inc.; Land O'Lakes, Inc.; Maryland and Virginia Milk Producers Cooperative Association, Inc.; O-AT-KA Milk Products Cooperative, Inc.; St. Albans Cooperative Creamery, Inc. and Upstate Farms Cooperative, Inc. and collectively represent more than 65 percent of the milk pooled on the Northeast order. The ADCNE witness offered support for testimony given by NMPF regarding the need to raise make allowances. The witness was of the opinion that the make allowances should be updated using the CDFA and RBCS 2004 survey data and should contain a monthly energy cost adjustor to reflect price fluctuations in the energy market. Dairy Farmers of America, Inc. and Dairy Farmers of America, Inc. withdrew their support for increasing the make allowances during

the hearing and in their post-hearing brief.

The ADCNE witness asserted that because the Northeast marketing area has the largest Class IV utilization in the Federal order system, marketing 2.9 billion pounds of milk in 2005, Northeast order Class IV plants play a vital role in balancing the market's fluid needs. In this regard, the witness stressed that make allowances need to be amended on an emergency basis to ensure that Northeast order Class IV plants are able to recover their processing costs and continue their important role in balancing the fluid needs of the marketing area.

A post-hearing brief submitted on behalf of ADCNE reiterated their support for adoption of Proposal 1. The brief stated that current make allowances are not equitable to manufacturers because individual plant processing costs have significantly increased since the current make allowances were set using 1998 costs. The brief also argued that the CDFR and RBCS survey data are reliable and together represent a wide variety of plant sizes located throughout the United States. The ADCNE brief supported using the methodology proposed by NMPF as the best approach for updating the make allowances.

A witness appearing on behalf of Leprino Foods Company (Leprino) testified in support of Proposal 1. According to the witness, Leprino operates nine manufacturing plants in the United States, of which receive milk pooled on the Federal order system. The witness said that the current make allowances no longer accurately reflect the manufacturing costs to produce cheese and urgently need to be updated. The witness was of the opinion that the RBCS, adjusted for return on investment, general and administrative costs and marketing costs, together with CDFR survey results should be used to update the make allowances.

However, the Leprino witness believed that the RBCS results for dry whey costs were not accurate and should not be relied upon in setting the make allowance for dry whey. The witness explained that the average dry whey plant size in the RBCS survey was much larger than the average size of all U.S. dry whey plants which, because of economies of scale inherent in larger plants, could have caused the RBCS survey result for dry whey to be too low. The witness also expressed concern that some input costs relevant for producing dry whey were not included in the RBCS survey such as the cost of condensing dry whey in other plants and transporting the condensed dry

whey to a drying facility. Had these factors been included, the witness speculated, the RBCS dry whey processing cost may have been higher. The Leprino witness supported adding a factor to the NFDM make allowance to set the dry whey make allowance and concluded that a dry whey make allowance of \$0.2215 per pound was appropriate.

A post-hearing brief filed on behalf of Leprino reiterated their support for updating the make allowances. The brief stated that the hearing record contains voluminous amounts of evidence to demonstrate that manufacturing costs have significantly increased from the base period of 1997–1999 relied upon to set the current make allowances. The Leprino brief offered specific justification to set each of the make allowances to: 18.1 cents per pound for cheese, 22.22 cents per pound for dry whey, 15.4 cents per pound for butter and 19.7 cents per pound for NFDM. The brief urged the Department to take emergency action.

A dairy-farmer member of Agri-Mark whose milk is pooled on the Northeast order testified in support of Proposal 1. The witness testified that while Agri-Mark producer members do not like paying an assessment on their production, they recognize that their manufacturing plants are in need of immediate cost relief due to increased processing costs. The witness said that Agri-Mark members are currently incurring a 15-cent per cwt assessment on their milk checks in order to cover some of the operating losses of the cooperative. The witness noted that unless the make allowances are updated, the assessment could soon be raised to 30 cents per cwt. The witness insisted that having a strong dairy processing sector is important to ensure that all producers have a market for their milk. Therefore, the witness urged the Department to update the make allowances to provide some cost relief to dairy manufacturers.

A witness appearing on behalf of Rich Dairy Products (RDP) testified in support of Proposal 1. According to the witness, RDP buys and sells a variety of dairy products but does not own any manufacturing facilities. The witness supported updating the make allowances to reflect cost increases that have occurred since the establishment of the current make allowances.

A dairy farmer witness appearing on behalf of Select Milk Producers (Select), Lone Star Milk Producers (Lone Star) and Zia Milk Producers (Zia), testified in opposition to Proposal 1. Hereinafter, these entities will be referred to as "Select, *et al.*" Select, *et al.*, are Capper-

Volstead cooperatives who collectively market approximately 40 percent of the milk pooled on the Southwest order. The witness stated that dairy farmers have also been experiencing rising costs for inputs such as fertilizer, fuel and electricity. To recoup these costs, the witness asserted that dairy farmers and their cooperatives have to become more efficient to lower their manufacturing costs.

The Select, *et al.*, witness cited consolidated hauling routes, building reverse osmosis plants and only shipping full tanker loads of milk as steps Select and other cooperatives have taken to lower their costs. The witness insisted that processors should seek out similar processing efficiencies instead of seeking to raise manufacturing allowances which would lower producer milk prices paid to dairy farmers. The witness claimed that if the blend price is reduced 25 cents per cwt as a result of raising the make allowances, Select, *et al.* farm revenue would be reduced by \$300,000 to \$400,000 a year. The witness also added that Select has long term contracts with its buyers that are based on the Class III price. If the make allowances were raised, the witness claimed that Select producers would be unable to recover lost revenue.

A dairy farmer witness appearing on behalf of Continental Dairy Products, Inc. (Continental) testified in opposition to Proposal 1. According to the witness, Continental is a dairy-farmer owned cooperative with 21 producers located in Indiana, Michigan and Ohio. The witness was opposed to increasing make allowances because it would result in lower prices paid to dairy farmers. The witness stressed that farmers have also experienced higher costs for inputs such as energy, fertilizer and labor, and have had to either absorb these costs by becoming more efficient. Like processors, the witness said that dairy farmers similarly have no recourse for recouping cost increases from the marketplace. The witness insisted that instead of reducing producer revenue to pay for increased make allowances, manufacturing plants should seek out efficiencies to lower their processing costs.

A brief submitted on behalf of Select, *et al.*, Continental and the Dairy Producers of New Mexico (DPNM) opposed the adoption of Proposal 1. The brief stated that the DPNM is a trade association of producers located in New Mexico and Texas. Hereinafter, these entities will be referred to as "Continental, *et al.*"

The Continental, *et al.*, brief argued that while supporters of Proposal 1

claimed that the 2004 RBCS study was an update of the 1998 study, it was actually a completely different study. The brief stated that the 2004 study differed from the 1998 survey because it surveyed twice as many plants, was designed specifically for the purpose being used as a basis for changing the make allowances and contained cost information for a different set of commodities. The brief claimed that because the 2004 RBCS survey is fundamentally different than the 1998 survey, relying on the 2004 data to update the make allowances is not appropriate.

The Continental, et al., brief also noted the lack of plant profitability information in the RBCS survey. While the CDFA survey results contained information regarding the percentage of plants that produce at costs above or below the average cost, the brief stated that similar information is not available in the RBCS survey. Continental, et al., wrote that plant profitability should be taken into account when determining make allowances or, as a result, the Department could set make allowances at a rate that would guarantee profitability for some inefficient plants at the expense of producer revenue.

The Continental, et al., brief also insisted that the make allowances should not be changed because no consideration was given to changing the yield factors contained in the Class III and Class IV price formulas. The brief claimed that product yields by plants included in the cost surveys are significantly higher than the yield factors contained in the current product price formulas. Continental, et al., was of the opinion that changing make allowances without taking into account product yields could result in manufacturers receiving higher returns and further reduce producer revenue.

The Continental, et al., brief also opposed using an energy cost adjuster in the make allowances. The brief stated that adjusting make allowances by changes in energy costs was not a proposal noticed in the hearing notice. The brief also questioned the accuracy of the proposed method for adjustments on changes in energy costs. The brief noted that such adjustments would make it difficult for handlers and producers to minimize their price risk of monthly changing make allowances.

The Continental, et al., brief stated that supporters for increasing make allowances argued that they have been unable to recoup their higher processing costs from the marketplace because any increase to the price of their finished products is captured by the NASS price survey which, in turn, results in higher

raw milk costs. The brief argued that instead of changing the make allowances, proponents should seek to fix what Continental, et al. considers as the root of the problem—the NASS survey. The brief also claimed that over 75 percent of the cheese sold in the United States is not included in the NASS survey and therefore those plants can raise the price of their finished product prices to offset higher manufacturing costs without increasing the cost of raw milk.

The Continental, et al., brief asserted that increasing the make allowances to any of the levels proposed could, on average, reduce the blend price paid to dairy farmers by 19 cents to as much as 59 cents per cwt. The brief stressed that this would cost dairy farmers millions of dollars in lost revenue and would cause many family farms to go out of business. Increasing the make allowances, the brief concluded, would not provide manufacturing plants with an incentive to become more efficient because their higher costs are financed by lower prices paid to dairy farmers.

The Continental, et al., brief stated that after the past few years of high producer prices, milk prices are declining and predicted that this trend would continue for the next few years. The brief asserted that any further decline in prices paid to dairy farmers would only cause market instability and requested that the proceeding be terminated.

The Continental, et al., brief said that if the Department chose to increase the make allowances, the new make allowances should not apply to the minimum prices for the Southwest order because manufacturing plants regulated by that order are able to manufacture profitably under the current set of make allowances. The brief argued that producers pooled on the Southwest order should not have their revenue decreased because of inefficient plants located in other parts of the country.

A witness appearing on behalf of the National Farmers Union (NFU) testified in opposition to Proposal 1. The witness said that NFU has over 250,000 members nationwide. The witness was of the opinion that increasing make allowances would essentially guarantee manufacturers a profit. The witness was opposed to manufacturers having a guaranteed profit because dairy farmers are not assured of a profitable milk price under the Federal milk order system. The witness testified that the current milk pricing system does not include dairy farmers' costs of production and that the adoption of Proposal 1 would

only financially harm dairy farmers. The witness urged the Department to deny Proposal 1 and instead, adopt make allowances that would also take into account dairy farmer costs of production.

A witness appearing on behalf of Family Dairies USA (Family Dairies) testified in opposition to Proposal 1. According to the witness, Family Dairies is a Capper-Volstead cooperative located in Wisconsin with 3,700 dairy farmer-members. The witness testified that while manufacturing costs have increased, dairy farmers are similarly coping with increased production costs and cannot increase the price they receive for their milk.

A witness appearing on behalf of Southeast Milk, Inc. (SMI) testified in opposition to Proposal 1. According to the witness SMI is a Capper-Volstead cooperative that markets milk for approximately 300 dairy farmers located in Florida, Georgia, Alabama and Tennessee. The witness said that SMI sells most of its milk to Class I plants and insisted that if make allowances are increased, their producers' income will needlessly decline even though they sell little milk for manufacturing. According to the witness, SMI producers could collectively lose \$6.3 million to \$14 million of revenue in a single year if the make allowances are increased. SMI producers do receive over-order premiums but the witness claimed that SMI would be unable to recover any lost revenue through additional premiums. The witness insisted that the number of Southeast and Florida dairy producers has been declining rapidly and the remaining dairy farmers in these regions are already struggling to produce enough local milk just to meet fluid demands. The witness claimed that any reduction in the Class I price would only accelerate the loss of dairy farmers in these areas. The witness also insisted that dairy farmers who supply primarily Class I plants should not have their income reduced by subsidizing the manufacturing market by providing larger make allowances.

A post-hearing brief submitted on behalf of SMI reiterated their opposition increasing make allowances. The brief asserted that the competitive pay price in the Upper Midwest marketing area is above the announced blend price and claimed that if manufacturers are able to pay above the blend price for their raw milk, an increase in the make allowances is unwarranted. The brief also asserted that dairy farmers located in high Class I utilization markets would bear an inequitable loss in revenue if make allowances are increased.

A witness appearing on behalf of Dairy Farmers of America (DFA) and DairyLea Cooperative (DLC) testified in opposition to Proposal 1. The DFA/DLC witness stated that if the Department found it appropriate to update the make allowances, that an energy cost adjuster should be included to ensure that as energy prices change, that make allowance formula would also change.

A post-hearing brief submitted on behalf of DFA/DLC supported updating the make allowances contingent that any changes apply only to the Class III and Class IV price formulas. The brief argued that unlike Class III and Class IV processors, manufacturers of Class I and Class II products have the ability to recoup higher processing costs from the marketplace. The brief stated that if higher make allowances are used in setting Class I and Class II, then prices processors of those products will receive a financial windfall for costs that they do not incur. The brief stressed that this would cause extreme financial harm to dairy farmers nationwide.

A witness appearing on behalf of the Progressive Agriculture Organization, Faithpity Farms, Farm Wives United, Tioga Valley Milk Cooperative, Family Farm Defenders, American Raw Milk Producers Association, Pennsylvania Farmers Union, National Family Farm Coalition and the South Auburn Grange testified in opposition to raising make allowances. The witness testified that dairy farmer income should not be reduced to cover higher process costs of manufacturers of Class III and Class IV products. The witness stressed that dairy farmers have also experienced higher production costs and that dairy farmers cannot raise their price as a means to offset higher costs.

An independent dairy farmer witness appearing on behalf of the Progressive Agriculture Organization, Pennsylvania Farmers Union and the National Family Farm Coalition Dairy subcommittee, testified in opposition to Proposal 1. The witness was opposed to raising make allowances because it will result in lower dairy farmer income. The witness also emphasized that dairy farmers cannot raise their milk price when their costs of production increase. The witness stressed that instead of decreasing farmer income, manufacturers should strive to recoup their costs through the marketplace or by becoming more efficient.

An independent dairy farmer witness, whose milk is pooled on the Northeast order, testified in opposition to increasing make allowances. The witness stated that their farm is burdened with higher production costs and that any reduction in the blend

price they receive would injure their farming operation. According to the witness, if higher make allowances are adopted, their farm income would be reduced approximately \$3,000 to \$5,500 per year. The witness was of the opinion that manufacturers should recover their increased costs from the marketplace and not by reducing the income of dairy farmers who have no milk order provisions by which to recover higher costs.

A second independent dairy farmer whose milk is pooled on the Northeast order testified in opposition to increasing make allowances. The witness was of the opinion that dairy manufacturers should recoup their processing costs from the marketplace or become more efficient to lower their production costs. The witness said that dairy farmers have also faced higher production costs for items such as fuel and health insurance. The witness said that dairy farmers do not have the ability to pass their higher costs on to their customers. The witness estimated that if higher make allowances are adopted, their farm income would be reduced to between \$7,500 and \$13,000 per year.

A dairy farmer from Tennessee whose milk is pooled on the Southeast order testified in opposition to increasing make allowances. The witness was opposed to increasing the make allowances because it will lower producer revenue. The witness said that the Southeast marketing area has declining dairy farm numbers and any decrease in the revenue they receive would only serve to accelerate the decline.

A post-hearing brief submitted on behalf of the Kentucky Dairy Development Council (KDDC) expressed opposition to increasing the make allowances. According to the brief, KDDC represents approximately 300 dairy farmers located in the State of Kentucky. The brief claimed that if the make allowances are adopted at levels proposed by Agri-Mark, Kentucky dairy farmers would lose an estimated \$426,000 to \$1.28 million a month. The brief stated that Kentucky milk production has been declining and any decrease in producer revenue would only hasten that decline.

*b. The following summary of testimony and post-hearing briefs pertains to the second session of the public hearing held September 14–15, 2006, in Strongsville, Ohio.*

A professor from Cornell University testified regarding a research study conducted by the Cornell Program on Dairy Markets and Policy (CPDMP), to assess the cost of processing cheddar

cheese, dry whey, butter and nonfat dry milk. The witness did not testify in support of or in opposition to any proposal presented at the hearing. The witness offered a working paper of the CPDMP study that explained the methodology and results.

The CPDMP witness explained that the number of plants surveyed in the study were drawn from the AMS list of Dairy Plants Surveyed and Approved for Grading and a separate plant list maintained by CPDMP. The witness explained that plants eligible to participate in the survey were selected on the basis that they had to produce one of the four commodity products (cheddar cheese, dry whey, NFDM or butter) but the plant also had to produce their product(s) in one or more of the package sizes surveyed by NASS. The witness said that each plant surveyed was asked to provide cost data for a recent 12-month period including fiscal year data. The witness explained that the plants participating in the cost survey were geographically dispersed throughout the country, though none were located in the State of California.

The CPDMP witness testified that a sample of cheese plants was selected by size and represented both cooperatively owned and proprietary plants. Five plants were randomly selected from the largest ten percent of cheese plants by volume and all five plants opted to participate in the study, the witness said. The witness explained other cheese plants were selected randomly; however, only 11 of these cheese plants had submitted complete cost data. The other four plants had either submitted incomplete cost data or had problems with their data and therefore were not included in the study. The witness emphasized that the sample of cheese plants purposely over-represented large sized plants. The witness explained that large plants would have been underrepresented on a cost basis if the survey had relied on a purely random draw of cheese plants.

A total of 12 dry whey plants surveyed were a subset of the cheese plant sample and were all proprietary plants, said the witness. According to the witness, 8 NFDM plants and 10 butter plants were selected by a non-stratified random draw of the population. While all 8 of the NFDM plants selected opted to participate in the study, only 4 butter plants selected opted to participate, noted the witness.

The CPDMP witness described the cost accounting methodology used in the CPDMP study as very similar to the methodology used by CDEA's study of manufacturing costs. There are differences, the witness noted, in that

CPDMP did not have the authority to audit data collected from the plants, that CPDMP did not calculate a current value of assets from schedules of economic depreciation, and that the sample of plants used in the CPDMP study was a less than the total number of plants. The witness added that the

manufacturing costs contained in the CPDMP study contain a ROI allowance, but do not include marketing costs. The witness noted that the ROI factor used in the CPDMP study differs from that in the CDFA study. According to the witness, the CDFA data used detailed accounting records and depreciation

schedules for plant and equipment while the CPDMP study relied on plant estimates of fair market value for plant and equipment.

The witness concluded that the cost of processing, given in cost per pound of product, for the sample of plants in the CPDMP study was as follows:

	Cheese	Dry whey	NFDM	Butter
Simple Average .....	\$0.2065	\$0.2282	\$0.1484	\$0.1492
Weighted Average .....	0.1638	0.1941	0.1423	0.1108

The CPDMP witness noted that the study, as well as previous cost of processing studies conducted by CPDMP, indicated that economies of scale are evident across all dairy manufacturing plant types.

The CPDMP witness explained that the 16 cheese plants participating in the study enabled CPDMP to perform a nonlinear regression in a study addendum to make inferences of the cost of processing cheese for the entire survey population of 53 cheese plants. According to the witness, the CPDMP study estimates that the weighted average cost of processing cheese for the 53 cheese plants is \$0.2028 per pound. The witness estimated that if the cheese make allowance was set at this level, 82 percent of the volume of cheddar cheese made in the country and 33 percent of the cheese plants in the country would be able to cover their processing costs. The witness explained that the weighted average costs of processing for dry whey, NFDM and butter could not be made because of the small number of plants and not knowing the volume of production.

The CPDMP witness further explained that the nonlinear regression used the manufacturing cost data submitted by the 16 cheese plants to generate a cost curve and cost equation for the 53 plants that comprise the number of cheese plants for the study. According to the witness, the derived cost equation suggests that a plant producing an amount of cheese approaching an infinite number of pounds per year would have an estimated manufacturing cost per pound approaching \$0.170028 which represents the lowest calculated cost per pound of cheese produced. On the other hand, a plant producing approximately 683,000 pounds of cheese per year would have a manufacturing cost per pound approaching \$1.170028 and represents the highest calculated cost per pound of cheese produced. The witness reported that, based on the regression analysis, 87 percent of the variability observed in the cost of making cheese can be

explained by the volume of cheese production.

The CPDMP witness also testified from another study addendum that during the time period that manufacturing plants offered cost data, the cost of energy had increased significantly. The witness attempted to index the cost of energy using Producer Price Indexes for natural gas and industrial electric from the Bureau of Labor Statistics and from this adjust manufacturing cost information to capture energy cost increases. According to the witness, to index the costs of processing to 2005 energy costs, the following amounts would need to be added to the make allowances—\$0.0034 for cheese, \$0.0070 for NFDM, \$0.0076 for dry whey and \$0.0029 for butter.

A dairy farmer appearing on behalf of Select, et al., testified in opposition to changing the make allowances. According to the witness, Continental Milk Producers, Inc. and Dairy Producers of New Mexico endorsed the CPDMP witness's testimony. The witness asserted that the weighted average costs contained in the CPDMP study were very similar (with the exception of dry whey) to the make allowances used in the current Class III and Class IV product price formulas. From this, the witness concluded that the current make allowances for cheese, NFDM and butter should not be increased. In the witness's opinion, if the Department chooses to change the dry whey make allowance, it should be based on the NFDM make allowance plus an energy cost adjustment to account for the additional energy needed to produce dry whey.

The Select, et al., witness testified that there are four cheese plants located in the Southwest region of the country and asserted that all but one of those plants are able to operate profitably under the current make allowances. The witness testified that the cheese plants in the Southwest have taken many steps to lower their manufacturing costs. The witness was of the opinion that other cheese plants need to also take steps to

improve their efficiency instead of seeking to increase the make allowances to cover their costs. The witness asserted that some producers in the Southwest region are receiving \$1.50 below the Class III price for their milk because of the abundant supply of milk in the region and the higher cost of transporting milk to market. The witness estimated that if make allowances were increased such that the blend price to farmers was lowered by \$0.50 per cwt, dairy farmers in the Southwest region would lose between \$3 to \$5 million dollars per month.

A post-hearing brief submitted on behalf of Select, et al., reiterated their opposition to increasing make allowances and appealed to terminate the proceeding. Select, et al., was of the opinion that the CPDMP study is the only valid data that the Department should consider in whether or not make allowances should be changed. They asserted that the CPDMP study weighted average make allowances are so similar to the current make allowances that making any changes would be unjustified. If the Department determines that make allowances should be changed, Select, et al., proposed using the CPDMP study weighted average costs for butter, NFDM and cheese, but that the NFDM make allowance for dry whey be adjusted for additional energy costs. They also opposed the inclusion of an energy adjustor or the consideration of plant balancing costs in setting new make allowances.

Select, et al., wrote that the adjusted NFDM weighted average of \$0.1423 offered by the CPDMP witness is not reliable because all of the CDMP study data was not audited. Select, et al., also elaborated that the CPDMP weighted average cost for dry whey is not reliable because of the small number of plants represented in the study and because most industry participants testified that the dry whey make allowance should be set at the NFDM make allowance plus an adjustment for additional energy costs. Additionally, the brief argued that

the CPDMP cost estimate derived for the 53 cheese plants should not be used because the estimates for butter, NFDMP and dry whey could not also be derived. Select, et al., wrote that the data used to derive the cheese manufacturing cost estimate is not current because it does not contain 2 new large cheese plants in the southwest region that produce in excess of 10 percent of the cheese volume represented by the total 53 cheese plants of the study.

Select, et al., also argued that the Department should not make any changes to the make allowances without first considering changes to the other parts of the price formulas, specifically factors for shrinkage and product yields.

The Select, et al., brief characterized the underlying problem facing manufacturers is the "circularity" of price changes that are reflected in the NASS price survey. If manufacturers are able to recover their higher cost from the marketplace by increasing the price of the product, the NASS survey, in turn, reflects these higher prices and the formula, in turn, will result in a higher value for raw milk. They were of the opinion that if the circularity problem is addressed by the Department, manufacturers will be able to recoup their additional costs in the marketplace thus negating any need for raising the make allowances and lowering producer revenue.

The Select, et al., brief claimed that the cheese manufacturers seeking higher make allowances account for less than 20 percent of the producer milk pooled on the Federal Order system. The brief also stated that there is no evidence to establish a measure of efficiency for these manufacturers or if there are other factors affecting or inherent in their businesses which cause them to be unable to produce cheese at or below the current make allowance. The brief also stressed that although cheese manufacturers say they are unable to produce cheese at the current make allowances, one can not simultaneously conclude if a plant is not profitable because the hearing record has no data regarding product selling prices.

A witness appearing on behalf of NMPF testified in support of increasing the make allowances and incorporating a monthly energy cost adjustor. The NMPF witness reiterated testimony given at the first public hearing regarding that the volatility of energy costs make an energy adjustor necessary to ensure that energy cost swings are reflected in the make allowances. The witness stated that energy costs have fallen since January 2006 and surmised that if new fixed make allowances had been implemented in late 2005, they

would now be too high manufacturing costs have decreased due to lower energy prices. The witness warned that if the Department recommends a change in the make allowances without containing a monthly energy cost adjustor, the new make allowances could become outdated before they are implemented.

A post-hearing brief submitted on behalf of NMPF reiterated their proposal for the inclusion of a monthly energy cost adjustor in the updated make allowances. NMPF wrote that the inclusion of a monthly energy cost adjustor would be the only way to ensure that make allowances do not quickly become outdated due to fluctuating energy costs.

The Secretary of Agriculture for the Commonwealth of Pennsylvania (Secretary) testified in opposition to increasing the make allowances. The Secretary claimed that within the past 10 years Pennsylvania has lost over 2,000 dairy farms and 75,000 dairy cows because of low milk prices. The Secretary was of the opinion that any change in the make allowances that would result in a lower milk price would hurt dairy farmers in Pennsylvania and would further cause a decline in the number of dairy farmers and cows.

An associate professor from Penn State University (PSU) testified regarding a study conducted by the witness to estimate the impacts of changing make allowances on class prices, blend prices, and 2006 and 2007 Federal order pool values. The witness did not testify either in support of or in opposition to any proposal at the hearing and did not testify as a representative of PSU. The witness explained the study relied on the manufacturing cost estimates of the CPDMP study to analyze six different make allowance scenarios. According to the witness, the weighted average make allowances contained in the CPDMP study were very similar to the make allowances used in the current Class III and Class IV product price formulas with the exception of dry whey.

The witness testified that of the six different make allowance scenarios analyzed in the witness' study only the scenario relying on the weighted average manufacturing cost of the low cost plants from the CPDMP study resulted in higher estimated uniform prices to producers. The remaining five scenarios resulted in lower estimated uniform prices, ranging from \$1.26 per cwt lower (using the weighted average manufacturing costs of the high cost plants in the CPDMP study) to \$0.02 per cwt lower using weighted average

manufacturing costs of all plants in the CPDMP study for butter, cheese, NFDMP, and the dry whey weighted average manufacturing costs plus \$0.0256.

The witness was of the opinion that the current make allowances adequately cover manufacturing costs and allow processors to expand their plant capacities and production levels. The witness added that with current low prices, any increase in make allowances would financially harm dairy farmers.

A post-hearing brief submitted on behalf of NCI supported using the CPDMP study as a basis for calculating new make allowances. NCI was of the opinion that the CPDMP study is the only publicly available data that accurately represents costs of processing for manufacturing plants located outside California. NCI wrote that a marketing cost factor of \$0.0015 per pound and an adjustment for the higher energy cost observed in 2005 should be included in any new make allowances proposed by the Department.

NCI was also of the opinion that the cheese manufacturing cost estimate of \$0.2028 per pound for all 53 cheese plants should be used as the basis for determining the cheese make allowance. NCI asserted that the stratified cheese plant sample used in the CPDMP survey was weighted heavily towards large, low cost plants and as a result the weighted average manufacturing cost is not representative of the cost of making cheese throughout the country. Because CPDMP was unable to derive manufacturing cost estimates for butter, NDFM and dry whey, as CPDMP had for cheese, NCI wrote that relying on the manufacturing costs of the surveyed plants weighted average of those products as a basis for new make allowances. The NCI brief offered that make allowances be set no lower than the following: cheese—\$0.2077 per pound, dry whey—\$0.2032 per pound, butter—\$0.1152 per pound and NFDMP—\$0.1508 per pound.

Post-hearing briefs submitted separately by Lactalis, Kraft, Grande, Saputo and Glanbia also supported the use of the CPDMP study as the basis for setting new make allowances. Each company expressed the opinion that any make allowances proposed by the Department should include a marketing cost factor of \$0.0015 per pound and be adjusted for 2005 energy costs. They argued that the manufacturing cost estimate for the 53 cheese plants should be used as the basis for determining a new cheese make allowance because it accounts for the entire population of cheese plants and not solely the surveyed plants that are weighted towards large, low cost plants.

According to their briefs, the lack of plant data for butter, NFDM and dry whey, each of the companies supported the use of the CPDMP surveyed plant's weighted average manufacturing costs as the starting point for determining make allowances.

A post-hearing brief submitted on behalf of Leprino supported the use of the CPDMP study in determining make allowances for cheese and dry whey. Leprino was of the opinion that the CPDMP study accurately reflects the cheese manufacturing costs of both proprietary and cooperative-owned plants. Beginning with the CPDMP cheese manufacturing cost estimate of \$0.2028 per pound, adding a \$0.0034 per pound to adjust for 2005 energy costs, and a \$0.0015 marketing cost factor, Leprino proposed that the cheese make allowance be set no lower than \$0.2077 per pound. Leprino was of the opinion that the CPDMP cheese sample-weighted average manufacturing cost should not be used because it over-represents large, low-cost cheese manufacturing plants.

Leprino was of the opinion that the dry whey make allowance should be set no lower than \$0.2032 per pound. Leprino computed this make allowance by starting with the CPDMP dry whey sample weighted average cost of \$0.1941 per pound, adding a \$0.0076 to adjust for 2005 energy costs and a \$0.0015 marketing cost factor. Leprino further argued that the CPDMP dry whey weighted average manufacturing cost is most likely skewed in over representing large, low-cost plants because the dry whey plants surveyed is a subset of the cheese plant survey which is skewed towards large low-cost plants. Leprino asserted that the Department would be justified in setting the dry whey make allowance higher than \$0.2032 per pound because the CPDMP study does not provide dry whey cost estimates for all dry whey plants.

A post-hearing brief submitted on behalf of Agri-Mark, et al., offered varying combinations of the CDFA, RBCS and CPCMP study results to determine new make allowances. They emphasized that make allowances should be set at a level that would cover manufacturing costs for most plants. They are was of the opinion that the Department should consider the strengths and weaknesses of each manufacturing cost survey to determine what information should be relied upon in establishing new make allowances. They wrote that any new make allowances should be updated to reflect higher 2005 energy costs and that an adjustment factor of \$0.0015 per pound be added to reflect marketing costs.

Although the CPDMP cheese plant survey is weighted heavily towards large, low-cost plants, Agri-Mark, et al., wrote that this information can be relied upon to make inferences about all cheese plants and is the best data available. By relying on the CPDMP survey of the average annual plant volume by region, and the manufacturing cost equation generated to determine manufacturing costs of all plants, Agri-Mark, et al., inferred that the average manufacturing cost per pound of cheese in various regions of the country should be varied and be as follows: Eastern—\$0.2920, Upper Midwest—\$0.2100 and Western—\$0.1860. According to their brief, it was concluded that if the CPDMP surveyed plant's average manufacturing cost for cheese of \$0.1638 is adopted, all average cost and higher than average cost plants in these regions would not be able to recover their manufacturing costs. The brief expressed the opinion that the manufacturing cost estimate for all cheese plants should be a starting point for updating the cheese make allowance. After incorporating a \$0.0015 marketing cost factor and adjusting for 2005 energy costs, Agri-mark, et al., offered that the cheese make allowance be set no lower than \$0.2077 per pound.

Agri-mark, et al., was of the opinion that because the CPDMP dry whey plants surveyed are a subset of the cheese plants surveyed, it would be appropriate to use the CPDMP sample average dry whey manufacturing cost of surveyed plants as a starting point for setting a new dry whey make allowance because as with the cheese plants surveyed, the dry whey plant surveys are also heavily weighted toward large, low-cost plants. The brief claimed that many small cheese plants incur transportation and loading costs for delivering dry whey to other plants for processing. The brief estimated this cost at \$0.0249 per pound and that it be included in the manufacturing cost of producing dry whey. Including an adjustment factor to reflect higher energy costs, the brief offered that a new dry whey make allowance be set no lower than \$0.2281 per pound.

The Agri-Mark, et al., brief said that using the CPDMP study for determining a butter make allowance would not be appropriate because the sample of the 4 plants surveyed only represent approximately 13 percent of the butter volume surveyed by NASS. They wrote also that the surveyed butter plants manufacturing costs are skewed because the 4 plants surveyed account for 75 percent of California's butter production. Instead, the brief offered using the weighted average

manufacturing costs of the RBCS and CDFA study (after adjusting for inclusions of a marketing cost factor and a ROI factor to the RBCS study). After adjusting for higher 2005 energy costs, the brief offered that the butter make allowance be set no lower than \$0.1554 per pound.

The Agri-Mark, et al., brief also argued that the CPDMP study should not be relied upon for determining a new NFDM make allowance because it also over-represents large, low-cost plants. The brief explained that because NFDM is a byproduct of the butter making process, the same method for computing the butter make allowance also should be applied in determining a make allowance for NFDM. Specifically, the brief offered that the CDFA medium-cost NFDM sub-group should be weighted with the RBCS NFDM weighted average manufacturing cost. After including an adjustment for higher 2005 energy costs and a marketing cost factor, the brief offered that the NFDM make allowance be set no lower than \$0.1848 per pound.

The Agri-Mark, et al., brief maintained that lower producer prices resulting from higher make allowances should not be a factor in determining new make allowance levels. The brief expressed the opinion that if processing plants continue to close because they are unable to recoup their manufacturing costs, plants will cease operations and that lost market revenues would far outweigh producer revenue losses due to higher make allowances. In this regard, the brief stressed that the purpose of the Federal milk orders are to set minimum milk prices and other government programs such as the Price Support Program and the Milk Income Loss Program are designed to protect producer prices.

A brief submitted on behalf of O-AT-KA and Upstate Farms Cooperative, Inc. (O-AT-KA, et al.) expressed support for the brief submitted by Agri-Mark for the reconvened hearing. O-AT-KA, et al., was of the opinion that the CPDMP plants surveyed for butter and NFDM is too small and biased toward large, low-cost plants and do not accurately reflect the manufacturing costs of plants not surveyed throughout the country. The brief maintains that because not all surveyed plants had been given the opportunity to review their submitted data that cost errors, similar to those found by a NFDM plant that did review their submitted costs, could be contained in the study.

A post-hearing brief submitted on behalf of MMPA opposed the use of the CPDMP study in calculating new make allowances. MMPA was of the opinion



that some of the surveyed plants had difficulty accurately completing the survey because it was administered electronically and not by submission of cost information on paper. Therefore, MMPA offered that the study results may not accurately reflect current manufacturing costs. The brief said that new make allowances should be calculated relying on the RBCS and CDFA surveys and supported the specific make allowances offered by Agri-Mark. The brief expressed continued support to include a monthly energy cost adjustor as proposed by NMPF.

A post-hearing brief submitted on behalf of DFA proposed that only minimal adjustments be made to increase the current make allowances because of the impact higher make allowances have on reducing producer revenue. DFA wrote that because only a portion of manufactured dairy products are surveyed by NASS, those other plants producing products not surveyed by NASS have the ability to pass on higher processing costs to their customers. Their brief indicated support for a monthly energy cost adjustor.

A post-hearing brief submitted on behalf of Dairylea argued that instead of increasing make allowances, the Department should hold a hearing to address the price circularity issue inherent in the NASS price survey. In relating production cost increases for dairy farmers, Dairylea wrote that farm input costs are higher, but dairy farmers are not able to receive regulatory relief similar to what processors are seeking through higher make allowances. Dairylea estimated that the average cost of producing milk has increased by at least \$1.00 per cwt since 2002 and 2003 and that during the middle of 2006 prices to dairy farmers declined approximately \$2.00 per cwt.

Dairylea was of the opinion that the Federal milk order system was created to improve milk prices to farmers and to protect the viability of dairy farms. Dairylea argued that the law providing for milk orders does not support the lowering of blend prices to producers by the use of higher make allowances without simultaneously considering higher farm input costs borne by dairy farmers. Dairylea also was of the opinion that Class I and II prices should not be lowered due to higher make allowances for the Class III and Class IV product pricing formulas.

If the Department concludes that make allowances should be increased, Dairylea proposed that an increase should be reduced by 52 percent (to be reflective of the 2005 Federal order system average Class I and Class II

utilization); and an emergency hearing be held to consider if Class I and Class II prices should not change resulting from changes to the make allowances. Only after such implementation preventing changes to Class I and Class II prices, the new make allowances should be restored to 100 percent of recommended increases.

A post-hearing brief submitted on behalf of Family Dairies opposed increasing all current make allowances. They contended that dairy farmers also have higher production costs but do not have the ability to appeal to the Government for regulatory relief. They asserted that if make allowances are increased, dairy farmer income will be reduced by \$300 million in the first year. They also noted while manufacturers claim they have incurred extremely high energy costs, the cost of natural gas has declined significantly from its high in 2005.

#### *Discussion and Findings*

##### *Discussion*

At issue in this proceeding is whether the make allowance factors of the product price formulas used in setting Class III and Class IV milk prices should be changed and how they should be changed. In the context of this proceeding, make allowances reflect the cost that manufacturers incur in processing raw milk into cheese, butter, NFDM and dry whey. The Class III and Class IV milk prices are also used to compute component prices for butterfat, protein, nonfat solids, and other solids.<sup>4</sup>

As proposed by Agri-Mark, et al., revised make allowances would rely on the recent 2004 CDFA survey and the 2004 RBCS survey. The revised make allowances would be established by using the same methodology (a weighted average of the RBCS and CDFA manufacturing costs) used in establishing current make allowances (67 FR 67906, published November 7, 2002, and Final Rule, 68 FR 7063, published February 12, 2003). Agri-Mark, et al., contended that by substituting the original cost data with the most current data available from the 2004 RBCS and CDFA surveys, make allowances would reflect cost increases that manufacturers incur but cannot recover from the marketplace. Additionally, Agri-Mark, et al., proposed that a make allowance for dry whey would be based on the cost of manufacturing NFDM.

The Agri-Mark, et al., proposal was modified by NMPF to adjust Class III and Class IV pricing formulas by

<sup>4</sup> Other solids are defined as nonfat solids less protein.

including a monthly energy adjustment based on monthly changes in the prices of industrial electricity and industrial natural gas. The monthly energy adjustments would be calculated as percentage changes in current month prices for industrial electricity and natural gas components from the 2004 Producer Price Index (PPI) for natural gas and electricity. The PPIs for natural gas and electricity items are published monthly by the U.S. Department of Labor's Bureau of Labor Statistics ([www.bls.gov](http://www.bls.gov).) A separate modification offered by Agri-Mark, et al., would similarly account for changes in electricity and natural gas prices but do so on an annual basis. While the issues concerning how volatile input costs should be handled in the product price formulas have been raised in these modifications, the scope of this proceeding is limited to considering updating the costs associated with make allowances. In this regard, the broader consideration of using indices in accounting for energy price fluctuations would be more appropriately considered as part of a separate rulemaking to consider all aspects of the Class III and Class IV product price formulas.

Opponents to increasing make allowances include independent dairy farmers from the Northeast and Appalachian marketing areas, and cooperatives representing a significant volume of the milk marketed via Federal orders—DFA, Dairylea, SMI, Family Dairies, Select, Continental, Lone Star, and Zia. These cooperatives view increasing make allowances as a benefit for regulated handlers at the expense of dairy farmers and assert that there is no industry consensus to support increasing make allowances. It is notable that DFA is an owner and operator of manufacturing plants that produce cheese, dry whey, and NFDM. Select, a cooperative that is a part owner and supplier of two major cheese plants in the southwestern U.S., testified that their plants do not require increased make allowances to operate successfully. DFA, Dairylea, and SMI, also opposed increasing make allowances because doing so would result in lower Class I and Class II prices and lower dairy farmer income.

Independent dairy farmers who pool their milk on the Northeast and Appalachian orders oppose increasing make allowances under any circumstances. These dairy farmers who testified are of the opinion that increasing make allowances will lower milk prices received by dairy farmers who also are experiencing similar increases in their operating costs for

energy and other inputs. SMI similarly argues that dairy farmers who supply the high Class I utilization markets of the Southeast and Florida milk marketing areas will needlessly suffer reduced income. They argue that Class III and Class IV milk costs are essentially unrelated to their businesses as suppliers of milk for fluid uses.

Continental and Select oppose increasing make allowances without also considering potential changes in yield factors for cheese, NFD, and dry whey that are an important part of the Class III and Class IV product pricing formulas. They argue that failure to simultaneously consider higher yields and productivity changes would essentially be the same as overstating manufacturing costs and would result in a financial windfall for the most efficient manufacturing plants. They also argue that if manufacturers are able to pay premiums for producer milk, then existing make allowances should be considered adequate in accounting for all manufacturing costs. This argument is countered by proponents who note that paying premiums is necessary to compete with Class I handlers for a milk supply. Proponents argue that paying such premiums requires make allowances be increased to recover these additional milk costs.

The argument that higher yield factors will offset lower Class III and Class IV milk prices and producer blend prices resulting from increased make allowances may be important. However, this proceeding was limited to make allowance factors only and as a result the record evidence on yield factors is limited. Consequently, yield factors may need to be addressed in the broader, more inclusive Class III and Class IV product price formula proceeding. Likewise, consideration of farm-to-plant loss as a component of the product price formulas may need to be considered but only in a separate proceeding of broader scope that considers the Class III and Class IV price formulas in their entirety. Most importantly, the scope of this proceeding has been limited to consideration of the cost elements comprising make allowances.

Three manufacturing cost surveys were considered in this proceeding to determine if make allowances for cheese, dry whey, nonfat dry milk, and butter should be changed and by what amounts. The CDFA 2004 manufacturing cost survey collects and reports the costs of producing these commodities for nearly all plants located in California. The RBCS survey of dairy manufacturing costs collects and reports a summary of the plant costs for certain plants of participating

cooperatives located in areas regulated by the Federal milk order program. The CPDMP manufacturing cost study examines the processing costs of plants selectively sampled to be reflective of costs for plants of various sizes that are located in areas regulated by Federal milk marketing orders (FMMOs.)

The CDFA and RBCS surveys have been conducted for more than 20 years. The RBCS survey was designed and implemented to allow participating cooperatives to compare their operating costs to an average cost basis. It does not provide a comprehensive view of manufacturing costs across plants in the Federal order system nor exclusively relied upon to establish manufacturing allowances. The RBCS survey was used in combination with the CDFA cost survey results to establish current make allowances because at the time, no other cost information was available from which to assess manufacturing costs for FMMO plants.

The CPDMP study is based on a voluntary structured survey of participating manufacturing plants selected to represent a cross sectional view of manufacturing costs for cheese, dry whey, butter, and NFD outside of California. The CPDMP study is a first time survey and study of plant manufacturing costs designed to be relied upon in establishing make allowances.

The CDFA survey collects and reports plant manufacturing costs from audited financial records provided voluntarily to establish aggregated costs by commodity type for plants located in California. This survey is a continuation of annual surveys whose purpose and design includes setting of manufacturing allowances by the State of California for their manufactured dairy products. The CDFA methodology is comprehensive, representing manufacturing cost data for almost all plants located in California and organizing that data into the well-defined categories that include high and low (and in some cases medium) cost plants. Total plant manufacturing cost categories include: processing labor costs, processing non-labor costs, packaging costs, other ingredient costs, general and administrative costs, and a return on investment (ROI) cost element. It includes data for both cooperative-owned and proprietary plants.

A total cost for each industry category (e.g., cheese) in the CDFA survey is reported as a weighted average for each of these cost elements by high or low (and medium for NFD) cost plant sizes and a total weighted average for all plants. Where the collection and

reporting of plant manufacturing costs for CDFA are in commodity categories for which five or fewer plants are surveyed, separate defined high and low cost plant calculations are omitted with only a weighted average manufacturing cost reported. This was the case for dry whey in the January 12, 2006, CDFA publication of costs and make allowances that are based on 2004 cost survey data. Because the CDFA survey comprehensively reports manufacturing costs for nearly all plants located in California producing the four commodities, there is no need to estimate costs of all plants from the cost data of surveyed plants.

The CDFA data specifically establishes that economies of scale are evident for California processing plants for all four commodity types. The data demonstrate that plant size is a major determinant of plant costs, with larger plants having significantly lower per unit costs of processing than smaller plants. A major difference between the RBCS survey and both the CDFA survey and the CPDMP study is that the RBCS survey does not demonstrate that larger plants have lower per unit costs when compared with smaller plants.

Demonstrable economies of scale as shown in the CDFA survey for California manufacturing plants and by the CPDMP study for manufacturing plants located outside of California meet the expectations of economic theory and provide evidence that the CDFA and CPDMP survey results are reasonable and comparable. The fact that the RBCS survey does not reveal plant size as an important determinant of processing costs supports concluding that the RBCS survey does not reasonably reflect costs across the four commodity plant types for plants located outside California. This also provides a basis to conclude that the RBCS survey costs are not comparable to costs measured and reported by the CDFA survey and CPDMP study. In addition, the RBCS survey costs do not conform to reasonable expectations of economic theory that predicts declining average costs where production volume increases directly with plant size.

The CDFA plant cost data, considered in isolation, have somewhat limited utility for considering manufacturing costs for plants located in all FMMO areas because all of the plants are located in California. This comprehensive collection and reporting of manufacturing costs includes costs experienced by plants in California for processing non-labor, processing labor, and packaging categories that do not necessarily reflect costs experienced by manufacturing plants located beyond

California. Because of the comprehensiveness of CDFA's coverage and California's importance to national dairy markets and dairy product manufacturing, the CDFA survey of plant manufacturing costs provides an important reference for considering and calibrating the costs of similarly-sized and operated plants located outside of California. For example, record evidence shows that California's NFDM production can account for more than half of all U.S. NFDM production.

According to the record, the RBCS survey is based on data provided on a voluntary basis by participating cooperatives but not audited as are CDFA survey data. The RBCS survey does not include manufacturing cost information from proprietary plants. The RBCS survey released in 2006 contained manufacturing costs for producing condensed and dry whey for the first time in the 20-year presentation of the manufacturing cost survey.

Other cost comparability differences between the three surveys include data on handling costs associated with dry whey and methodology differences in defining and establishing appropriate manufacturing costs for dry whey. The differences in costs collected and allocated are so significant between the CDFA and RBCS surveys that the proponents for increasing make allowances concluded that the dry whey manufacturing costs from either survey should not be relied on to establish a make allowance. In the CDFA survey, dry whey drying costs may be unreasonably high because California has only three dry whey processing plants where high cost plants appear to skew the costs dramatically. Alternatively, the CPDMP study reports a relatively large sample of 12 plants that provides a more reasonable estimate of dry whey processing costs for plants outside California.

The record reveals that balancing functions and balancing costs differ between California and non-California butter and NFDM plants contained in the CPDMP study and the RBCS cost survey. Plants producing butter and NFDM products in California that perform balancing functions are not explicitly identified as having disparate costs due to balancing compared to other similarly situated plants in California that do not perform market balancing. The CPDMP study does not explicitly allocate balancing costs either but the RBCS survey is largely represented by balancing plants. The CPDMP study noted that seasonal fluctuations in utilizing plant capacity affects costs, but these costs are not allocated separately as "balancing cost"

line items. In addition, the cost of fuels (specifically natural gas and electricity) is not clearly represented in the RBCS survey compared with the CPDMP study or the CDFA survey. Record evidence reveals that an unknown portion of the RBCS fuels cost data is combined with water and sewer costs and not allocated separately. Accordingly, the record does not support concluding that the cost of fuels as reported in the RBCS survey reasonably represents the costs of fuels experienced by manufacturing plants.

The CPDMP study and the RBCS survey differ in how cost data was collected and verified. The CPDMP study for example, relied upon electronic data entry from a computerized data collection system that aggregated and produced reports detailing the cost information. RBCS collected plant costs through a mail-in survey form that was reviewed and aggregated by the RBCS coordinator. CPDMP followed its data collection with actual plant visits designed to give the researcher context within which to consider the reasonableness of data collected and cost allocations for each plant were surveyed. The CPDMP study, while not providing audited data, does provide improvement in data collection and data verification.

A comparison of the CPDMP study to the CDFA cost survey data does illustrate significant differences but the data are more similar than is a comparison of CDFA's survey data with the RBCS survey data. The CPDMP survey does not include dairy manufacturing plants located in California. It uses a cost accounting reporting format that is very similar to that used by CDFA. The record shows that the CPDMP survey differs from CDFA's in that CPDMP did not have audit authority to verify records and only a fraction of manufacturing plants outside of California participated in the survey. While CDFA's data represents the manufacturing costs of producing dairy products for almost all plants in California, the record indicates that the CPDMP study sampled the costs of 16 cheese plants, 12 dry whey plants, 8 NFDM plants, and 4 butter plants. However, unlike the RBCS survey, the CPDMP study data includes manufacturing costs of both proprietary and cooperative-owned plants for cheese and dry whey, demonstrates evidence of economies of scale, and better allocates fuel costs.

The CPDMP study presents the weighted average manufacturing costs for high and low cost plants in each of the four commodity product categories, as well as weighted average costs for high cost and low cost plants, in a

format very similar to CDFA. The CPDMP study of surveyed plants consists of eight high cost and eight low cost cheddar cheese plants, six low cost and six high cost dry whey processing plants, four high cost and four low cost NFDM plants, and four butter plants. High and low cost plant categories could not be reported for the small sample of butter plants without risking disclosure of confidential business information of individual plants.

The CPDMP study sample of cheese plants is not a random sample. It is a *stratified* random sample where randomness only applies to strata (size related groupings) of the surveyed plants. The sample universe for cheese plants include only plants that chose to participate in the survey and represent processing volumes that fit the cross-sectional sample design. For cheese, a sample of 20 plants was planned but only 16 plants participated, with 5 plants from the largest plant size, 6 plants from medium sized plants and 5 plants representing smaller cheese plants. This sample design was intentionally biased to over-represent large, lower cost plants. The record shows that large plant costs otherwise would have been seriously underrepresented if the survey had relied on a truly random selection of cheese plants. Random selection of plants from the total number of plants that produce cheddar cheese would have over-represented small plants and been "size-biased" downward because of the relatively large number of small scale plants producing cheddar cheese outside of California. While the plants selected for inclusion in the survey changes the applicability of statistical methods, the record supports concluding that this stratified selection of cheese plants, according to size, is reasonable for cost data collection because record evidence shows that 48 percent of all American cheese produced outside of California is produced by these large, low-cost plants. The CPDMP survey design sought an additional four plants from the smaller-plant category but plants of that size did not participate in a manner meeting the survey time requirements.

Importantly, 7 of 16 cheese plants that participated in the CPDMP survey were proprietary plants and these plants also have an accompanying dry whey processing plant represented in the survey. Thus, 7 of the 12 dry whey plants for which data is reported in the CPDMP study are proprietary plants. Unlike the RBCS survey, the inclusion of proprietary plants in the CPDMP study more accurately represents cheese and dry whey manufacturing costs for

plants outside of California because large proprietary plants represent a preponderance of cheese volumes produced in all locations.

The record reveals that the CDFA, CPDMP, and RBCS surveys do not include a marketing cost recovery factor. However, record evidence provided by proponents indicates that a marketing factor is appropriate to account for sales costs incurred as part of the manufacturing process. The record supports concluding that a marketing cost recovery factor, as contained in the existing make allowances, should be continued to account for sales costs at processing plants. A fixed factor of \$0.0015 will apply identically to the make allowances for cheese, dry whey, NFDM, and butter.

The methods and means used by CDFA and CPDMP cost data differ in accounting for ROI. CDFA uses detailed accounting records and depreciation schedules to compute a ROI cost factor for plants and equipment. The CPDMP study relies on plant estimates of the fair market value for plants and equipment used in product processing for its ROI estimate. From the record evidence it is reasonable to conclude that an ROI cost factor should be part of all make allowances even though the ROI value for each of the four commodity categories in the CPDMP study is different than the values included in the CDFA survey. The RBCS cost survey does not include a ROI cost category.

A reasonable conclusion finds that the CPDMP survey provides more comprehensive information on the cost of processing by manufacturing plants in the Federal milk order program than does the RBCS survey. The fact that economies of scale are evident in the CPDMP study is a marked improvement which can be used to support using these costs of processing dairy products over the RBCS survey costs. The inclusion of proprietary plant manufacturing costs, representing a preponderance of cheese processor volume outside of California, provides broader and improved information on the costs of processing because the RBCS survey is limited by design and purpose to survey costs of cooperative-owned plants. The CPDMP study was designed, in part, to consider the costs that should be relied upon in establishing make allowances used in Federal order product price formulas.

The format that the cost data is reported by the CPDMP study enables more direct comparisons with the CDFA survey than does the RBCS survey. The enhanced verification of plant manufacturing costs and cost allocations

in the CPDMP study represents a significant improvement to the RBCS cost survey. The costs attributable to ROI, despite differences between the CPDMP study and CDFA's survey, is another improvement because this factor is not included in the RBCS survey. The record therefore supports finding that the CPDMP study is preferred to the RBCS survey for the purpose of determining make allowances for cheese, dry whey, NFDM and butter.

While CPDMP's study provides improved manufacturing cost data for plants in the Federal milk order program, combining it with the additional information available in the CDFA survey establishes a superior set of data on which to determine revised make allowances. Specifically, this tentative final decision finds agreement with the proponents of Proposal 1 that combining the CDFA survey with costs representative of Federal order manufacturing costs for cheese, NFDM, and butter (except dry whey) is the most reasonable approach for determining changes to the make allowances. CDFA survey data should be combined with the CPDMP study results because California's production volumes of cheese, dry whey, NFDM and butter are of such national significance it would be unreasonable to ignore California plant's manufacturing costs in the Class III and Class IV product price formulas.

CPDMP's data gathering was designed to collect average manufacturing costs from groups of dairy manufacturing plants so that representative average cost estimates could be used in developing make allowances. Butter manufacturing costs were estimated from 4 plants. NFDM costs were estimated from 8 plants reporting average costs for 4 high cost and 4 low cost plants. In the case of cheese, CPDMP used regression techniques to derive an average manufacturing cost that could be used to estimate the costs of cheese plants that were not surveyed. The record does not support a finding for using the estimation results reported by CPDMP that proponents for increasing make allowances have based their arguments because the CPDMP results are based on the estimation of an equation which generates an estimated cost curve based on the cost survey of 16 cheese plants.

CPDMP's estimated equation coupled with cheese production volume estimates from 53 plants yields a low manufacturing cost of \$0.17 per pound and a high manufacturing cost of \$1.17 per pound. The estimated low cost of \$0.17 per pound is higher than the \$0.1459 per pound average of the 8 low

cost-plants of the study sample. Using the equation and the 53 plants' volumes yields a weighted average manufacturing cost of \$0.2028 per pound which is 94.7 percent of the \$0.2140 per pound average manufacturing cost of high cost cheese plants from the plant sample, and 23.8 percent higher than the weighted average cost of \$0.1638 per pound for the survey sample of plants. These comparisons raise questions about the representativeness of the results of this simple regression analysis. However, the 16 plant sample observations are sufficient for estimating a representative average manufacturing cost for plants in both the high cost and low cost strata, and for estimating a weighted average cost across all sampled plants.

It is useful to consider the sample weighted average cost of \$0.1638 per pound in terms of the 8 plant high-cost average of \$0.2140 per pound and 8 plant low-cost average of \$0.1459 per pound. The low-cost and high-cost production volume shares as provided in the record show about 74 percent of production volume is produced at the low average cost of \$0.1459 per pound and about 26 percent of the volume is produced at the higher average cost of \$0.2140 per pound. Based on the shape of the curve represented in the record, it appears that 74 percent is a conservative estimate of low-cost production volume.

In their post-hearing briefs proponents for raising the cheese make allowance seek to use this estimation as justification for increasing it to \$0.2028 per pound or higher. Based on the preceding analysis, increasing the cheese make allowance from the current \$0.1650 per pound to \$0.2028 per pound is not reasonable.

Even if the methodology used to calculate the estimated make allowance of \$0.2028 per pound of cheese was statistically acceptable, the Department would not use it as the new make allowance for cheese. The use of different methodologies to establish make allowances for different products likely would result in unintended consequences that could distort the competitive situation between cheese plants and butter-NFDM plants. CPDMP did not have similar population data available to do comparable regression analyses for butter, NFDM and dry whey. For cheese, the regression methodology resulted in a make allowance estimate that was \$0.039 per pound higher than the weighted average cost of the sample. It is possible that if the regression methodology could be used for butter, NFDM and dry whey that estimated average make allowances

for those products also would be higher than the weighted average costs from the plant samples. Therefore, if comparable increases in make allowances would result for the other products, the use of this different methodology only for cheese could give cheese plants a \$0.39 per cwt of milk advantage as it competes for a supply of milk.

The CPDMP study contains an addendum concerning the cost of natural gas and electricity in dairy manufacturing. This addendum uses a specific time period for estimating these costs for each of the four dairy commodity categories. The collection of cost data for manufacturing occurred during a 26 month period that does not correspond to the 12 month period for which these energy cost estimates were derived from data available from the Bureau of Labor Statistics. While proponents advance that this energy cost data should be included in the manufacturing costs of producing cheese, dry whey, NFDM, and butter, the periods for which the costs should be applied and whether these costs are already captured in the cost survey data of the CPDMP study are not clearly stated in the addendum. The volatility of energy costs, revealed by the record, is important in considering total manufacturing costs. As presented in the addendum to the CPDMP study, the energy cost information cannot be relied upon to consider changes to make allowances.

**Findings**

This tentative final decision finds that combining the weighted average

manufacturing costs of the CDFA survey and CPDMP study for cheese, nonfat dry milk and butter into a single weighted average is appropriate for updating make allowances for those three products. The CPDMP study weighted average manufacturing cost of dry whey (without California) should be used for the dry whey make allowance. All four adopted make allowances include an additional factor of \$0.0015 per pound to account for product marketing costs. The make allowances are weighted by the processing volumes reported in the 2005 NASS Dairy Product Summary and applied to the manufacturing costs of plants in California (for CDFA total average manufacturing costs) and those States outside of California (for CPDMP total average manufacturing costs), respectively.

This tentative final decision finds that the CPDMP survey of four butter plants is half of the survey size that would have been acceptable as representing the butter manufacturing costs for butter plants located outside of California. The eight butter plants appearing in the CDFA survey located in California provide a reasonable basis on which to reinforce and improve estimating the cost of manufacturing butter outside of California because no other better source of cost data is available on which such costs can be reasonably based. In this regard, there is merit that CDFA cost data accurately represents costs for butter plants outside of California and should be combined with CPDMP cost data on a weighted average basis to provide an updated make allowance for butter.

This tentative final decision finds agreement with proponents such as Kraft, Glanbia, Lactalis, Saputo, and Leprino, that the CPDMP study's weighted average manufacturing cost of dry whey plus a marketing cost factor of \$0.0015 per pound best represents the cost of dry whey for plants outside of California. Three of CDFA's dry whey plants have a manufacturing cost variance so large that it would be unreasonable to combine the total weighted CDFA value with the 12 plant CPDMP sample. The make allowance adopted for dry whey plus a marketing factor is \$0.1956 per pound.

This tentative final decision finds agreement with the Agri-Mark, et al., proponents' contention that medium-sized California NFDM plants are representative of Federal order NFDM plants. CDFA medium sized plant weighted total average manufacturing costs are combined with the CPDMP eight plant sample total weighted average manufacturing costs plus a marketing factor. The NFDM make allowance adopted is \$0.1570 per pound.

The CDFA weighted average cost for cheese of \$0.1769 is combined with the CPDMP total weighted average cost for cheese of \$0.1638 plus a marketing factor to compute a cheese make allowance. The make allowance for cheese is weighted by the California and non-California volumes of American cheese. The cheese make allowance adopted is \$0.1682 per pound.

The following table summarizes the proposed changes:

**SUMMARY OF MAKE ALLOWANCE CHANGES**

	Proposed	Current	Change
Cheese .....	\$0.1682	\$0.1650	\$0.0032
Dry whey .....	0.1956	0.1590	0.0366
NFDM .....	0.1570	0.1400	0.0170
Butter .....	0.1202	0.1150	0.0052

2. Determining whether emergency marketing conditions exist that would warrant omission of a Recommended Decision and opportunity to file written exceptions

Evidence presented at the hearing and in post-hearing briefs establishes that current manufacturing allowances contained in the product price formulas do not reflect the current costs of manufacturing milk into cheese, butter, NFDM and dry whey. Data presented at the hearing demonstrates that manufacturing costs have increased since manufacturing allowances were

last updated in 2003, relying upon 1998 manufacturing cost data. The record contains requests by numerous parties that the rule should be implemented on an emergency basis.

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

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

*Rulings on Proposed Findings and Conclusions*

Briefs and proposed findings and conclusions were filed on behalf of certain interested parties. These briefs, proposed findings and conclusions, and the evidence in the record were considered in making the findings and conclusions set forth above. To the

extent that the suggested findings and conclusions filed by interested parties are inconsistent with the findings and conclusions set forth herein, the requests to make such findings or reach such conclusions are denied for the reasons previously stated in this decision.

### General Findings

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

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

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

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

### *Interim Marketing Agreements and Interim Order Amending the Orders*

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

It is hereby ordered, that this entire tentative decision and the interim orders and the interim marketing agreements annexed hereto be published in the **Federal Register**.

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

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

The representative period for the conduct of such referenda is hereby determined to be July 2006.

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*

The month of July 2006 is hereby determined to be the representative period for the purpose of ascertaining whether the issuance of the order, 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 and Arizona marketing areas is approved or favored by producers, as defined under the terms of the orders as hereby proposed to be amended, who during such representative period were engaged in the production of milk for sale within the aforesaid marketing areas.

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

Milk marketing orders.

Dated: November 17, 2006.

**Lloyd C. Day,**

*Administrator, Agricultural Marketing Service.*

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

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

### Findings and Determinations

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

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

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

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

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

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

### Order Relative to Handling

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

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

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

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

1. Section 1000.50 is amended by:  
a. Revising paragraph (l);

- b. Revising paragraph (m);
  - c. Revising paragraph (n)(2);
  - d. Revising paragraph (n)(3)(i); and
  - e. Revising paragraph (o).
- The revisions read as follows:

*Section 1000.50 Class Prices, Component Prices, and Advanced Pricing Factors.*

\* \* \* \* \*

(l) *Butterfat price.* The butterfat price per pound, rounded to the nearest one-hundredth cent, shall be the U.S. average NASS AA Butter survey price reported by the Department for the month, less 12.02 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 15.70 and multiplying the result by 0.99.

(n) \* \* \*

(1) \* \* \*

(2) Subtract 16.82 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by 1.383;

(3) \* \* \*

(i) Subtract 16.82 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by 1.572; and

\* \* \*

(o) *Other solids price.* The other solids price per pound, rounded to the nearest one-hundredth cent, shall be the U.S. average NASS dry whey survey price reported by the Department for the month minus 19.56 cents, with the result multiplied by 1.03.

(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 12.02 cents from this average, and multiplying the result by 1.20.

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

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

I. The findings and determinations, order relative to handling, and the provisions of § \_\_\_\_\_ to \_\_\_\_\_<sup>5</sup> all inclusive, of the order regulating the handling of milk in the \_\_\_\_\_<sup>6</sup> marketing area (7 CFR Part \_\_\_\_\_<sup>7</sup>) which is annexed hereto; and

II. The following provisions: § \_\_\_\_\_<sup>8</sup> Record of milk handled and authorization to correct typographical errors.

(a) Record of milk handled. The undersigned certifies that he/she handled during the month of \_\_\_\_\_<sup>9</sup>, \_\_\_\_\_ hundredweight of milk covered by this marketing agreement.

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

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

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

Signature  
By (Name) \_\_\_\_\_  
(Title) \_\_\_\_\_  
(Address) \_\_\_\_\_  
(Seal)  
Attest \_\_\_\_\_

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<sup>5</sup> First and last section of order.

<sup>6</sup> Name of order.

<sup>7</sup> Appropriate Part number.

<sup>8</sup> Next consecutive section number.

<sup>9</sup> Appropriate representative period for the order.

**DEPARTMENT OF AGRICULTURE**

**Agricultural Marketing Service**

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

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

**Milk in the Northeast and Other Marketing Areas; Notice of Hearing on Proposed Amendments to Tentative Marketing Agreements and Orders**

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

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

**ACTION:** Proposed rule; Notice of public hearing on proposed rulemaking.

**SUMMARY:** A national public hearing is being held to consider and take evidence on a proposal seeking to amend the Class I and Class II milk price formulas applicable to all Federal milk marketing orders. Evidence also will be taken at the hearing to determine whether emergency marketing conditions exist that would warrant omission of a recommended decision under the rules of practice and procedure (7 CFR 900.12(d)).

**DATES:** The hearing will convene at 1 p.m., Monday, December 11, 2006.

**ADDRESSES:** The hearing will be held at the Sheraton Station Square Hotel, 300 West Station Square Drive, Pittsburgh, Pa. 15219. Telephone number: (412) 261-2000.

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

Persons requiring a sign language interpreter or other special accommodations should contact David Walker, Market Administrator, at (330) 225-4758; e-mail: [dwalker@fmmaclev.com](mailto:dwalker@fmmaclev.com) before the hearing begins.