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Request for Emergency Hearing	)
To Amend Marketing Orders	)
	)
(Class I and II Price Calculations)	)

Request by the National Milk Producers Federation
For an Emergency Hearing on Class I and Class II Prices

The National Milk Producers Federation (NMPF) hereby requests that the Secretary convene a hearing on an expedited basis to consider NMPF's proposal to amend the Federal milk marketing orders. The proceedings under Docket No. AO-14-A74, et al., addressed the certain outdated manufacturing costs, which are applied to all four classes and whose increase will reduce producer prices; they did not address outdated fluid supply costs, which are also part of the current Class I and II price formulas and whose analogous increase would be expected to raise producer prices. NMPF requests that the Secretary establish updated and simplified price formulas for Class I and Class II milk.

NMPF's proposed amendment would maintain a direct relationship between dairy product prices and Class I and II prices; would reestablish the appropriate relationship between the Class I and II prices and the Class III and IV prices; would complete the update of all cost considerations that define the current formulas, including both manufacturers' make allowances and fluid milk supply costs; and would impel future amendments of the Class I and II price formulas to be based on full consideration of these costs. NMPF's proposal is founded on well-established Federal order principles.

NMPF is an association that represents the interests of more than 50,000 of America's estimated 65,000 dairy farmers, and 33 cooperative associations that they own.

Basis for Emergency Consideration.

The issue of how to appropriately formulate Class I and Class II prices requires the Secretary's immediate consideration. The Department is in the process of concluding the proceedings in Docket No. AO-14-A74 involving a proposal by a cheese manufacturer to increase "make allowances" for Class III and IV dairy products. This change was proposed to remedy an emergency situation faced by manufacturers of cheddar cheese, dry whey, butter, and nonfat dry milk.[1] However, based on current language and the defined scope of that proceeding, any changes to Class III and Class IV make allowances will also result in lower Class I and Class II prices and lower income for producers. This is a result that is unnecessary: it does not provide economic relief for dairy product processors, and it does not consider offsetting increases in the fluid milk supply costs originally incorporated into the Class I and II milk price formulas. Unless adjustments are made to the Federal order Class I and Class II prices, dairy producers will be faced with unnecessary and unjustified economic hardships.

1. The Anticipated Decision will Impose an Undue Hardship upon Producers.

NMPF asserts that the same factors that have increased dairy product manufacturers' costs have also raised the costs to producers and cooperative associations of supplying

[1] As demonstrated by the hearing record in Docket No. AO-14-A74, the manufacturers of the four benchmark products (cheddar cheese, dry whey, nonfat dry milk, and butter) face higher costs than those upon which the current make allowances are based. At the same time, the margin between their average price and their minimum raw milk price are constrained by those make allowances. NMPF supported the proposed changes to the Class III and Class IV make allowances in that proceeding, but argued that Class I and Class II pricing should be held harmless from any changes, pending a full consideration of those prices. Unfortunately, both the "hold harmless" approach and the fuller consideration of Class I and II pricing were excluded from the scope of the hearing.

Class I and II milk. The potential reduction of Class I and II milk prices under Docket No. AO-14-A74 does not give proper consideration to these costs. By Federal order precedent, discussed below, these costs should be acknowledged and Class I and II prices raised accordingly. NMPF's current proposal stands alone on its own merits; but without it, the incomplete results of the hearing under Docket No. AO-14-A74 would unduly deny producers well-justified offsetting compensation in the Class I and II price formulas.

Fifty-two percent of milk pooled in the Federal orders in 2005 was Class I and II milk.[2] U.S. dairy producers are now experiencing an extended period of low milk prices, high production costs, and exceptionally low farm returns. Unnecessarily large reductions in Class I and II revenues will further stress farm income and, undoubtedly will be disastrous for many producers.

USDA marketing order officials testified that if the proposed make allowance changes were applied to the calculation of the prices producers receive for Class I and II milk, the negative impact on producer income would be nearly double that which would occur if the proposed changes were applied only in calculating the prices of Class III and Class IV milk. USDA program officials estimated the losses to producers from reduced Class I and Class II revenues to be potentially as high as $350 million over 5 years. [3]

USDA senior staff economist Howard McDowell presented his analysis of the impact on direct producer income of the proposed make allowance changes under several scenarios. In the scenario with the smallest impact, he estimated that the negative impact to producer revenue from changes in the Class I and Class II prices would be $155

[2] USDA/AMS *Dairy Market News*, February 10, 2006, p. 9.

[3] Docket No. AO-14-A74, et al., Exhibit 2, Table A-4, summing all impacts on Class I and II revenue.

million over five years (2006 through 2010), or 40% of the projected impact from all classes. In his scenario with the largest impact, producers would lose $340 million in Class I and II income over five years, representing 36% of the total. [4]

The table below presents NMPF's estimates of the impact of changing the make allowances. It does not account for dynamic changes in the market over time, as Dr. McDowell's does. Nevertheless, it can be read as a short-run analysis that provides an estimate of the relative impacts of applying or not applying the Class III and IV make allowances to Class I and II.

Estimated 2005 Class and All-Milk Prices
Using Alternate Make Allowance Calculations

	Current	RBS/ CDFA*	Change from Current	Cornell Wtd. Avg**	Change from Current	Cornell Alt. Wtd. Avg**	Change from Current
Make Allowances:			*($/lb.)*				
Cheese	0.1650	0.1794	0.0144	0.1653	0.0003	0.2028	0.0378
Butter	0.1150	0.1515	0.0365	0.1123	-0.0027	0.1123	-0.0027
Powder	0.1400	0.1652	0.0252	0.1425	0.0025	0.1425	0.0025
Whey	0.1590	0.1809	0.0219	0.1956	0.0366	0.1956	0.0366
Prices:			*($/cwt.)*				
Class I	16.86	16.57	-0.28	16.64	-0.21	16.32	-0.53
Class II	13.58	13.20	-0.37	13.56	-0.01	13.56	-0.01
Class III	14.05	13.76	-0.28	13.83	-0.22	13.47	-0.58
Class IV	12.88	12.50	-0.37	12.86	-0.01	12.86	-0.01
All-Milk (est.)	15.14	14.91	-0.23	15.03	-0.11	14.86	-0.28
Annual Prod. Revenue			*($ million)*				
Applied to All Prices	$25,738	$25,351	-$387	$25,554	-$184	$25,261	-$477
Applied to Cl III/IV Only	$25,738	$25,470	-$268	$25,616	-$122	$25,418	-$320
Difference			***$118***		***$63***		***$157***

* Combined using USDA methodology from 2003 final decision; offered at January 2006 hearing.
**Cornell weighted averages plus $0.0015 "marketing costs" added in 2003 final decision.
Note: All-milk impact based on 75% of FO Class price changes.
Sources: USDA/AMS; USDA/RBCS; CDFA; Mark Stephenson, Cornell University; NMPF

An expedited hearing and decision are necessary to provide a more complete consideration of the Class I and II price formulas. NMPF expects this fuller

[4] Docket No. AO-14-A74, et al., Exhibit 2, Tables A2 and A4.

consideration will produce offsetting compensation in these formulas, and thereby avoid unnecessary and excessive reductions in producer income.

2. The Inadequacy of Current Class I and II Pricing is Contributing to Disorderly Marketing in Federal Order Markets.

The Class I and II price formulas were defined during order reform, based on specific cost considerations, which are discussed in more detail below. These have not been updated since the proposed rule was issued in 1998 despite substantial changes in these costs. As a result, the Class I and II prices are inadequate to ensure orderly marketing, as evidenced by rising Class I over-order premiums in milk surplus regions, the growing difficulty of supplying deficit markets, and the increase in "de-pooling" associated with inadequate Class I and II pool revenue. An expedited hearing and decision can address these conditions.

NMPF Proposes New Class I and II Formulas.

NMPF proposes simplified and updated Class I and II formulas based directly upon dairy product prices. If these formulas were applied, Class I and Class II prices would move in concert with the Class III and IV prices, as they do now, but in a form that maintains a proper consideration for the fluid supply costs borne by producers and handlers. NMPF's proposed Class I and II formulas would better describe the appropriate relationship among class prices and dairy product prices, consistent with Federal order precedent and principles.

The last time the relationship between Class I and II and Classes III and IV was fully considered was at the time of order reform, in 1996 through 1999. The January 2006

national hearing considered the changes in Class III and IV manufacturing costs, and applied these changes directly to the Class I and II price calculations without also considering changes in the costs borne by producers and handlers of balancing and maintaining Grade A milk supplies for Class I and II use and the competitive pressures that must be addressed to achieve orderly marketing through the Federal orders. Suppliers of Class I and II milk face additional costs which vary, sometimes exactly, with Class III and IV manufacturing costs; but while costs are subtracted in Class III and IV formulas, they are added in Class I and II. A full consideration of these Class I and II costs is a necessary and analogous complement to the make allowances changes that are now in process.

1. Class I Skim Milk Formula

Expressed in its simplest form, the current Class I skim milk mover formula is equal, per hundredweight, to the higher of:

Nonfat dry milk price x 8.9 - $1.25

or

Cheese price x 10.0 + Dry whey price x 6.1 – Butter price x 3.9 – $2.17.

The butter-powder-based calculation incorporates the yield of nonfat dry milk per hundredweight of skim milk, minus a make allowance ($1.25/cwt.). The cheese-based calculation incorporates yields for cheese, whey, and whey butter, minus a skim milk-equivalent make allowance ($2.17/cwt.).[5]

[5] The make allowances in the current Class III calculation are only indirectly meaningful with respect to skim milk alone. However, for milk with a certain butterfat test, the butterfat elements of the Class III formula cancel each other out, and only cheese and whey values remain.

NMPF proposes the following replacement for the Class I skim milk price mover, equal to the higher of:

NDM price x 8.9 – .52

or

Cheese price x 10.0 + Dry whey price x 6.1 – Butter price x 3.9 - $1.44

NMPF's proposed formula incorporates the same commodity values and yield factors as the current Class I formula (including all Class III and IV make allowances and yield factors), minus a Class I adjuster which combines product conversion costs and corresponding changes (73¢) in the estimated per hundredweight costs of supplying Class I milk. That is, it is the current formula, simplified, plus 73¢.

At the time of order reform, certain costs of supplying Class I milk were explicitly incorporated into the minimum Class I differential. NMPF does not propose to change the Class I differentials at this time, but maintains that any change in these Class I supply costs can be applied just as effectively to the Class I skim milk and butterfat movers. Class I supply costs were applied to the Class I differential during order reform only because the Class I mover directly incorporated the Class III and IV formulas by reference. If the Class I mover is simplified according to the formula NMPF proposes, it is equally appropriate to apply adjustments in any fixed element of the Class I price to the mover calculation.

The Class I skim milk price and Class II price are currently calculated using the Class III and IV price formulas by reference, adding differentials that are designed to reflect their relationship to Class III and IV values.[6] These differentials are designed to compensate not processors, but rather the suppliers of Class I and II raw milk. In the

[6] *See* 7 CFR 1000.50.

Proposed Rule for Order Reform, USDA set the minimum Class I differential at $1.60 per hundredweight, based upon several enumerated costs, beginning with the costs of maintaining Grade A standards.

> There are several requirements for producers to meet to convert to a Grade A dairy farm and then maintain it. A Grade A farm requires an approved water system (typically one of the greatest conversion expenses), specific facility construction and plumbing requirements, certain specifications on the appearance of the facilities, and specific equipment. After achieving Grade A status, producers must maintain the required equipment and facilities, and adhere to certain management practices.[7] Often, this will require additional labor, resource, and utility expenses. It has been estimated that this value may be worth approximately $0.40 per hundredweight. [8]

The "labor, resource, and utility expenses" of dairy farmers rise, of course, along with those of milk processors. Non-feed costs in the production of milk have risen by 27% between 1998 and 2004, according to USDA estimates. Based on the above, and applying the same 27**%** to the 40¢ cost of maintaining Grade A supplies, NMPF conservatively estimates the present costs of maintaining Grade A standards at 51¢ per hundredweight, an increase of 11¢ from the status quo.

USDA's order reform decision also stated:

> Traditionally, the additional portion of the Class I differential reflects the marketing costs incurred in supplying the Class I market. These marketing costs include such things as seasonal and daily reserve balancing of milk supplies, transportation to more distant processing plants, shrinkage, administrative costs, and opportunity or 'give-up' charges at manufacturing milk plants that service the fluid Class I markets. This value has typically represented approximately $0.60 per hundredweight. [9]

Most of these are the same costs associated with operation of plants producing such products as cheese, dry whey, butter, and nonfat dry milk powder. The operators of balancing plants often sacrifice plant profitability of their manufacturing operations in

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[7] Management expenses include costs of hot water and steam for sanitation, additional bedding material, more frequent cleaning, and purchase of additional supplies and services necessary to maintain Grade A status. All these costs rise as processors' costs do.
[8] 63 FR 4908.
[9] 63 FR 4908.

order to provide Class I and II balancing services. The costs of this balancing rises as energy costs and per-pound processing costs rise, and these costs should be offset in the Class I price. Shipping milk from distant sources imposes an even larger cost of balancing Class I markets; transportation costs also rise with higher energy prices, as has been acknowledged in a recent tentative partial decision on the transportation credits in the Southeast and Appalachian markets.[10] The manufacturing costs estimated from the recent surveys tend to reflect costs of plants running near full capacity; processing costs of balancing plants are higher, and should be reflected in the Class I price. Very conservatively, though, the same percentage increase in the costs of butter and powder manufacture (the primary form of market balancing through manufacturing) that is applied to Class III and IV make allowances should also be applied to the 60¢ balancing cost. The data presented at the January hearing suggested a 22% increase the costs of converting milk into butter and powder. A 22% increase in the 60¢ balancing cost applied in the order reform decision would be 13¢ per hundredweight. In addition, shifts in milk production and manufacturing consolidation have lead to longer hauls to Class I plants. Based upon the record in the ongoing transportation credit proceeding and studies performed by the Seattle Milk Market Administrator's office,[11] we estimate at least an additional 10¢ per hundredweight increase in Class I assembly costs, for a total increase of 23¢ in this component of the original $1.60 Class I cost. This is a conservative estimate. NMPF anticipates that there will be additional data at hearing regarding increased costs.

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[10] *See* 71 FR 54118, et seq. Marketwide balancing assessments and credits may be ultimately be necessary to fully compensate balancing plants, as opposed to full-capacity manufacturers.

[11] 71 FR 45118, et seq.; "Analysis of Hauling Charges and Producer by Location and Size-Range of Production, Pacific Northwest Order, May 2005", Staff Paper 05-03, November 2005, and predecessor papers.

The last element of the minimum Class I price, per the proposed rule, was the "additional competitive factor", estimated at 60¢ per hundredweight based upon two price comparisons. The proposed rule reported that Grade A milk received an average premium above Class III in 1995 and 1996 of 86¢ in Minnesota and 89¢ in Wisconsin.[12] In 2004 and 2005, these average premiums were up to $1.33 in Minnesota and $1.53 in Wisconsin.[13] In addition, the proposed rule considered the substantial over-order premiums paid for Class I milk in Chicago, Milwaukee, and Minneapolis in 1996, ranging from $1.19 to $1.79. By 2005, the Class I differential had been increased, per the order reform decision, but the over-order premiums were now $2.10 in Minneapolis and $2.72 in Chicago and Milwaukee. These growing premiums are indication of the inadequacy of the current minimum Class I prices to draw milk to the pool to meet Class I needs, and of their failure to meet the objectives of the Act. In both cases, the competitive costs associated with Class I milk have risen by an average of about 65%. Applying this increase to the 60¢ "competitive factor" incorporated at order reform would produce a 39¢ increase in the minimum Class I price.

Altogether, these considerations conservatively justify at least a 73¢ increase in the Class I skim milk price mover.

2. Class I Butterfat Formula

In its simplest form, the current Class I butterfat price mover is calculated as:

(Butter price x 1.2) - $0.1380

[12] 63 FR 4908-4909.
[13] USDA/NASS data, available at www.nass.usda.gov.

This incorporates the butter yield (1.2 lbs. butter per lb. of butterfat) minus the make allowance ($0.138/lb. bf).

NMPF proposes the following replacement:

(Butter price x 1.2) – $0.1307

This would correspond exactly to the proposal for Class I skim milk, including a 0.73¢ increase in the price per pound associated with fluid supply costs.[14]

3. Class II Skim Milk Formula

In its simplest form, the current Class II Skim Price is calculated as:

(Nonfat dry milk price x 8.9) - $1.2474 + $0.70

= (Nonfat dry milk price x 8.9) - $0.5474

This contains the nonfat dry milk yield (8.9 lbs./cwt.) and the 70¢ Class II differential minus make allowance ($1.2474/cwt.)

NMPF proposes the following direct replacement for the Class II skim milk price:

(Nonfat dry milk price x 8.9) – $0.54

NMPF's proposed formula is equal to the full value of nonfat dry milk (NFDM) derived from a hundredweight of skim milk, minus condensing costs, plus the cost of rehydrating powder, and is similar to the current calculation, except that it avoids the redundant application of the cost of drying condensed skim milk. In the current formulas, this drying cost is deducted from powder values to arrive at a Class IV value, and then added back through application of the 70¢ differential.

[14] We propose only this modest adjustment, although experience in California's state program has shown the feasibility of a substantially larger premium on Class 1 butterfat, vis-à-vis manufacturing classes.

In the Order Reform Proposed Rule and in the Final Decision, the calculation of the Class II price was based on the Class IV calculation, plus 70¢.[15] "The $0.70 differential represents the cost of converting concentrated milk to dry solids, plus rehydration."[16] "Only a small portion of the $0.70 is intended to represent the cost of rehydration. The majority of the $0.70, $0.57, represents the cost to dry condensed milk…. It should be noted that the cost to purchase or manufacture NFDM for use in Class II products would include not only the cost of milk at the Class IV price, but the cost of making NFDM."[17] The final decision notes:

> Generally, the source of inputs alternative to product milk for the manufacture of Class II products is dry milk products and butterfat that otherwise would be used in butter. Basing the price of milk used to make Class II products on these alternative ingredients should help considerably to remedy a situation in which it is perceived that a separate product class for dry milk (Class III-A) has resulted in a competitive advantage over producer milk used to produce Class II products. [18]

In other words, the relationship between the nonfat dry milk price and the Class II price is the objective of the 70¢ Class II differential. This relationship depends upon make allowances established at that time; it is therefore out of date and inconsistent with current manufacturing costs. It is now appropriate to establish a direct relationship between the Class II skim milk price and the nonfat dry milk price, with only an allowance for condensing. NMPF's proposal follows the same logic as the current Class II skim milk price formula, but simplifies it by canceling redundant elements. [19]

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[15] 63 FR 4882, 64 FR 16104.
[16] 64 FR 16104.
[17] 64 FR 16104. This indicates a rehydration cost of 13¢ per hundredweight.
[18] 64 FR 16104.
[19] If condensing and rehydration costs are equal to $0.5474, this would be equivalent to the current formula. Here is a derivation of the proposed formula. To avoid giving Class II manufacturors a year-round incentive to dry and rewet milk for Class II uses, the price of Class II skim condensed milk should be set less than or equal to the price of Class IV milk dried and rewet:

Class II skim + condensing cost ≤ Class IV skim + condensing cost + drying cost + rewetting cost,

where drying cost is the cost of drying condensed milk. The Class IV formula is:

Class IV = powder value - condensing cost - drying cost

Much Class II skim milk is sold as skim condensed milk, which competes with nonfat dry milk as an ingredient. Substitution between Class II skim condensed and nonfat dry milk can help balance markets, but the margin should be such that otherwise uneconomic permanent year-round substitution of nonfat dry milk is not made for skim condensed. Therefore, this formula is equal to the value of an equivalent volume of nonfat dry milk, minus a condensing cost, plus the cost of rehydrating powder. Condensing costs are currently estimated by the industry at 6¢ to 7¢ per pound of solids, or 54¢ to 63¢ per cwt. of skim milk.

4. Class II Butterfat Formula

In its simplest form, the current Class II butterfat price is calculated as:

(Butter price x 1.2) - $0.138 + $0.007

= (Butter price x 1.2) - $0.131

This incorporates the butter yield (1.2 lbs./lb. of bf) minus the make allowance ($0.138/lb. bf), plus the Class II differential ($0.007/lb. bf).

NMPF proposes the following replacement:

(Butter price x 1.2) – $0.1147

This is equivalent to the proposed Class I butterfat mover, plus the minimum Class I differential of 1.6¢/lb. ($1.60 per cwt.) Class IV butterfat is used almost

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So,

$$Cl.\ IV\ skim + condense + dry + rewet = powder - condense - dry + condense + dry + rewet$$
$$= powder + rewet$$

From this and the first equation, we have:

$$Class\ II\ skim + condense \leq powder + rewet,$$

or

$$Class\ II\ skim \leq powder - condense + rewet.$$

exclusively to produce butter. Since butter is generally not a viable substitute for cream in Class II applications, Class II butterfat is not constrained by competition with a manufactured substitute. As such it should be set equivalent to the minimum Class I butterfat price, excluding only the location component of the overall Class I butterfat price. Class I and II supplies are complementary, with much Class II butterfat use coming from the surplus butterfat at Class I bottling plants. The average 2005 butterfat tests for Class I use and Class II use were 1.97% and 7.42%, respectively. Combined, however, their average butterfat test was 3.34%, close to the Federal order standard of 3.5%.

Proposed Class I and II Formulas Better Meet the Objectives of the Act.

NMPF proposes that the Secretary establish new Class I and II milk price formulas. These would better meet the object of the Agricultural Marketing Agreement Act in several ways.

1. Class I and Class II are not Constrained by, and so are Only Incidentally Related to, Make Allowances for Class III and IV milk.

The manufacturers of cheddar cheese, dry whey, butter, and nonfat dry milk who receive Federal order milk are collectively constrained by the orders to operate within a margin between the average product prices that they must report to the National Agricultural Statistics Service, and the Federal order minimum prices for Class III and IV milk. The make allowance hearing was about establishing a margin wide enough to provide a reasonable opportunity to cover costs.

By contrast, the processors of Class I and Class II products are able to pass on increased costs to the market; higher product prices are not part of their minimum Class price calculation. The relationship between the Class I and II prices, on one hand, and the Class III and IV make allowances, on the other, is incidental.[20] Changes to these make allowances should only be applied to the Class I and II prices after direct consideration of the Class I and II formulas.

2. The Costs of Supplying Raw Class I and II Milk Must Be Recognized in the Calculation of their Prices, in the Interests of Orderly Marketing.

Producer and cooperative suppliers of raw milk for Class I and II use face substantial costs, as has been discussed above. These costs are analogous to those faced by dairy manufacturers and have had increases analogous to increases faced by manufacturers.

Just as manufacturing costs are subtracted in Class III and IV price calculations, so are Class I and II supply costs have been added in Class I and II price calculations. In order to maintain the proper relationship between product prices and the Class I and II milk prices, both of these sets of costs must be considered and applied. Strict application of new Class III and IV make allowances to the Class I and Class II prices, without consideration of conditions specific to Class I and II milk, perverts the relationship among class prices.

Failure to address legitimate milk supply costs in establishing the Class I and II milk prices will undercut the ability of the pool to attract a stable supply of milk to these higher uses, and lead to increased de-pooling and more disorderly milk markets.

[20] This is why the record in the make allowance proceeding provided no record and no justification for the direct application of new make allowances to Class I and II prices.

Establishing these new Class I and II price formulas is clearly justified, and will as clearly further the objectives of the Act.

3. Class I and II Formula Provisions Should not Incorporate Class III and IV Price Formulas by Reference

While the elements of the Class III and IV milk price formulas may continue to be necessary bases for defining the Class I and II price formulas, their direct incorporation of Class III and IV price formulas can lead, and has led, to changes to Class I and II prices without due consideration for the independent conditions that pertain to Class I and II milk supplies. Establishing distinct and simplified Class I and II formulas will ensure that future changes in the Class I and II prices are based upon direct consideration of cost and processing considerations for both fluid milk (Class I and II) and manufacturing milk (Class III and IV). This would avoid unintended distortions in the relationships among Class prices that might lead to disorderly marketing conditions.

4. Substantial Producer Interest has been Expressed in NMPF's Proposal.

NMPF represents some 50,000 farmers through its 33 member cooperatives. As such, NMPF's serves as the voice of the majority of American milk producers. NMPF proffered testimony at the make allowance hearing[21] in support of an alternative to the strict application Class III and IV make allowance changes to Class I and II prices, and its views were supported by many producer groups to the extent that they were allowed to express that support. Consistent with the expedited nature of that hearing, the NMPF position argued that changes to the Class III and IV make allowances should not be

[21] Docket No. AO-14-A75, et al.

applied to the Class I and II price calculations, in anticipation of a future reconsideration of the costs borne by producers and handlers in supplying Class I and II milk. The witness for Dairy Farmers of America, Inc., and Dairylea Cooperative, Inc., initially testified, over the objections of opposing parties, that those cooperative associations fully supported NMPF's recommended modification.[22] NMPF's modification was also supported by the Association of Dairy Cooperatives in the Northeast (ADCNE)[23] -- an association which represents Agri-Mark, Inc. (the original proponent), Dairylea Cooperative, Inc., 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.) The ADCNE witness testified, despite objections of opposing parties, that their position was to support that of NMPF in establishing distinct Class I and II price provisions in the order language.[24] Counsel for O-AT-KA Milk Products Cooperative also argued forcefully in favor of this position.[25] Finally, the witness for Southeast Milk, Inc., attempted to testify in favor of distinct Class I and II price provisions, but his testimony to that effect was also excluded by the ALJ.[26]

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[22] Their witness testified that they had compelled by the administrative law judge's ruling excluding NMPF's testimony to adopt a position in opposition to a change in the make allowances. (Tr. IV-271-278)
[23] Tr.IV at 250-25.
[24] Tr. IV-257-258. He stated that, "While it is urgent to adjust the Class III and IV make allowances, and prices, it is not necessary, and would be positively detrimental to allow the changes to impact Class I and Class II prices."
[25] Tr. IV-58-61.
[26] Exhibit 61, p. 2; Tr. IV-72.

Conclusion

It now appears, as a result of the proceedings in Docket No. AO-14-A74, et al., that estimated increases in cheese, dry whey, butter, and nonfat dry milk production costs will be deducted from the calculation of all four milk classes. The analogous Class I and II milk supply costs, which are incorporated into the current Class I and II price formulas, will not be updated, and offsetting increases in those Class prices that would have resulted will not be realized by farmers. Excessive reductions in the Class I and II prices – and producer income – are neither a necessary nor a desirable consequence of make allowance changes intended to provide relief for manufacturers of benchmark Class III and Class IV products only. NMPF urges the Secretary to convene a new hearing, on an expedited basis, and to issue an amended rule that would establish simplified and updated Class I and II price formulas, in order to maintain the proper price relationship among the four classes and to the dairy product prices, and to avoid losses that could be as much as $350 million for America's dairy farmers.

NMPF's proposed Class I and II formulas would generally remain linked to the Class III and IV prices through dairy product prices and formulas based upon the same manufacturing costs and yields. However, placing the simplified Class I and II price formulas in distinct order provisions will assure that Class I and Class II revenue will be affected by future changes in make allowances only when Class I and II supply costs are fully considered.

America's dairy producers will face substantial economic hardship if, as anticipated, the decision in the make allowance proceeding results in reduction in Class I and Class II

prices. NMPF therefore requests the Secretary's immediate and expedited attention to the proper determination of Class I and Class II prices. NMPF asserts that an expedited proceeding on this issue will allow the Department to move forward in addressing the current inadequate make allowances for Class III and IV and in addressing substantial and analogous inadequacies in the Class I and II price calculations.

Respectfully submitted,

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National Milk Producers Federation

Order Language to Effect NMPF's Proposed Class I and II Price Formulas

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

Class prices per hundredweight of milk containing 3.5 percent butterfat, component prices, and advanced pricing factors shall be as follows. The prices and pricing factors described in paragraphs (a), (b), (c), (e), (f), and (q) of this section shall be based on a weighted average of the most recent 2 weekly prices announced by the National Agricultural Statistical Service (NASS) before the 24th day of the month. These prices shall be announced on or before the 23rd day of the month and shall apply to milk received during the following month. The prices described in paragraphs (g) through (p) of this section shall be based on a weighted average for the preceding month of weekly prices announced by NASS on or before the 5th day of the month and shall apply to milk received during the preceding month. The price described in paragraph (d) of this section shall be derived from the Class II skim milk price announced on or before the 23rd day of the month preceding the month to which it applies and the butterfat price announced on or before the 5th day of the month following the month to which it applies.

(a) Class I price. The Class I price per hundredweight, rounded to the nearest cent, shall be .965 times the Class I skim milk price plus 3.5 times the Class I butterfat price.

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

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

(d) The Class II price per hundredweight, rounded to the nearest cent, shall be .965 times the Class II skim milk price plus 3.5 times the Class II butterfat price.

(e) Class II skim milk price. The Class II skim milk price per hundredweight shall be the ~~**advanced Class IV skim milk price computed in paragraph (q)(2) of this section plus 70 cents**~~ **weighted average of the 2 most recent NASS U.S. average weekly survey nonfat dry milk prices announced before the 24th day of the month times 8.9, from which product is subtracted 54 cents**.

(f) Class II nonfat solids price. The Class II nonfat solids price per pound, rounded to the nearest one-hundredth cent, shall be the Class II skim milk price divided by 9.

(g) Class II butterfat price. The Class II 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, multiplied by 1.20, then subtracting from this product 11.47¢.** ~~**shall be the butterfat price plus $.007.**~~

(h) Class III price. The Class III price per hundred weight, rounded to the nearest cent, shall be .965 times the Class III skim milk price plus 3.5 times the butterfat price.

(i) Class III skim milk price. The Class III skim milk price per hundredweight, rounded to the nearest cent, shall be the protein price per pound times 3.1 plus the other solids price per pound times 5.9.

(j) Class IV price. The Class IV price per hundredweight, rounded to the nearest cent, shall be .965 times the Class IV skim milk price plus 3.5 times the butterfat price.

(k) Class IV skim milk price. The Class IV skim milk price per hundredweight, rounded to the nearest cent, shall be the nonfat solids price per pound times 9.

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

(m) Nonfat solids price. The nonfat solids price per pound, rounded to the nearest one-hundredth cent, shall the U.S. average NASS nonfat dry milk survey price reported by the Department for the month less 14 cents and multiplying the result by .99.

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

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

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

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

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

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

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

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

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

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

(p) Somatic cell adjustment. The somatic cell adjustment per hundredweight of milk shall be determined as follows:

(1) Multiply .0005 by the weighted average price computed pursuant to paragraph (n)(1) of this section and round to the 5th decimal place;

(2) Subtract the somatic cell count of the milk (reported in thousands) from 350; and

(3) Multiply the amount computed in paragraph (p)(1) of this section by the amount computed in paragraph (p)(2) of this section and round to the nearest full cent.

(q) Advanced pricing factors. For the purpose of computing the Class I skim milk price, the Class II skim milk price, the Class II nonfat solids price, and the Class I butterfat price for the following month, the following pricing factors shall be computed using the weighted average of the 2 most recent NASS U.S. average weekly survey prices announced before the 24th day of the month:

(1) An advanced ~~Class III~~ **cheese** skim milk price per hundredweight, rounded to the nearest cent, shall be computed as follows:

(i) Following the procedure set forth in paragraph~~s~~ (n)**(1)** ~~and (o)~~ of this section, but using the weighted average of the 2 most recent NASS U.S. average weekly survey prices announced before the 24th day of the month, **multiply the resulting cheese price times 10.0** ~~compute a protein price and an other solids price~~;

(ii) Multiply the **weighted average of the 2 most recent NASS U.S. average weekly survey dry whey prices announced before the 24th day of the month times 6.1** ~~protein price computed in paragraph (q)(1)(i) of this section by 3.1~~;

(iii) Multiply the **weighted average of the 2 most recent NASS U.S. average weekly survey butter prices announced before the 24th day of the month times 3.9** ~~other solids price per pound computed in paragraph (q)(1)(i) of this section by 5.9~~; and

(iv) Add the amounts computed in paragraphs (q)(1)**(i) and** (ii) ~~and (iii), subtract the amount in paragraph (q)1(iii), and subtract $1.44~~.

(2) An advanced ~~Class IV~~ **butter-powder** skim milk price per hundredweight, rounded to the nearest cent, shall be computed as follows:

(i) ~~Following the procedure set forth in paragraph (m) of this section, but using~~ **Multiply** the weighted average of the 2 most recent NASS U.S. average weekly survey prices **for nonfat dry milk** announced before the 24th day of the month **times 8.9**; and

(ii) **From the amount computed in paragraph (q)(2)(i) subtract 52¢.** ~~Multiply the nonfat solids price computed in paragraph (q)(2)(i) of this section by 9.~~

(3) An advanced butterfat price per pound, rounded to the nearest one-hundredth cent, shall be calculated by computing a weighted average of the 2 most recent U.S. average NASS AA Butter survey prices announced before the 24th day of the month, ~~subtracting 11.5 cents from this average, and~~ multiplying the result by 1.20**, then subtracting 13.07¢**.