UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

IN RE:	
MILK IN THE NORTHEAST AND OTHER MARKETING AREAS; Class III/IV MAKE ALLOWANCES 71 Fed. Reg. 67467 (Nov. 22, 2006)	**Dockets: AO-14-A74 DA-06-01**

COMMENTS AND EXCEPTIONS OF DAIRY FARM COOPERATIVE PROPONENTS, AGRI-MARK, Et Al.,[1] ON TENTATIVE FINAL DECISION

Proponent dairy farm cooperative associations ("Proponents" or "Agri-Mark, et al.") endorse USDA's treatment of the Class III/IV make allowance issue on an emergency basis. We hope that the timing of the published Decision less than eight weeks after close of briefing, and release of referendum results one month later, will serve as a model for emergency decision-making in the future. However, we do have serious concerns about inconsistencies within the decision, incorrect interpretations of the hearing record, and inconsistencies between the Tentative Final Decision and policies expressed in past decisions of USDA. We address the latter matter first.

I. INTRODUCTION AND GOVERNING STANDARDS OF LAW

The record evidence in this "make allowance" proceeding overwhelmingly establishes that manufacturers' costs to covert a hundredweight of raw milk into commodity dairy products (cheese, whey, butter and NFDM) have increased over the course of seven years since manufacturing cost surveys from 1998 were first employed in the federal milk order reform decision to determine the market clearing value of milk

[1] Proponent cooperatives are: Agri-Mark, Associated Milk Producers, Foremost Farms USA, Land O'Lakes, and Northwest Dairy Association. Land O'Lakes is submitting its separate Comments and Exceptions addressing in greater detail several particulars of the Tentative Final Decision.

used in Class III and IV products. For almost 40 years prior to that time, variable manufacturing costs were automatically captured in competitive manufacturing grade milk price surveys used to establish the minimum market clearing value of Class III milk that manufacturers could afford to pay. 60 Fed. Reg. 7290, 7299 (Feb. 7, 1995)(Final Basic Formula Price Decision); 64 Fed Reg. 16026, 16097 (April 2, 1999)(Final Federal Order Reform Decision).

The Tentative Decision of USDA addressing milk manufacturing costs, and the lawsuit filed on that decision just ten days ago,[2] reflect the competing economic, regulatory, and political pressures underlying this proceeding. Proponents seek to mitigate losses incurred in manufacturing certain dairy products, to reduce regulated cross-subsidies from proponent dairy farmers to other milk producers, to improve regulatory equity between proponent dairy farmers and farmers who do not operate milk manufacturing plants, and to maintain manufacturing plant capacity and markets for producer milk. Opponent producer groups, having received a windfall from inadequate make allowances embedded in regulatory concrete for several years, seek to convert the windfall to a regulatory entitlement. These pressures undoubtedly make it difficult for the Secretary to render an objective decision based on record evidence and consistent with decades of decisions relating to the market-clearing role of manufactured milk products in federal dairy policy.

Proponents do not intend herein to repeat analysis of record-supported facts and conclusions contained in their post-hearing briefs of February 17, 2006 ("Proponents'

[2] Bridgewater Dairy, et al. v. USDA, Civil Action No. 3:07-CV-104, U.S. District Court for the Northern District of Ohio, filed January 12, 2007. Plaintiffs' theory in the Bridgewater pleadings appears to be that Class III and IV prices are required to be income-enhancing, rather than market-clearing. This theory is contrary to six decades of legislative history and regulatory policy.

Feb 06 Brief") and October 2, 2006 ("Proponents' Oct 06 Brief"). We urge the Administrator, Dairy Programs' staff, and others on the Secretary's decision-making team carefully to re-examine those briefs, along with the evidentiary record, in light of further comments herein on the facts and conclusions supported by the record.

The tentative final decision, however, sharply departed from past policy in several respects, and did so without providing cogent reasons for those departures. USDA's policy precedents, upon which proponents relied in presenting evidence and in structuring their post-hearing briefs, are identified and summarized in Proponents' Feb 06 Brief at 4-5, and in Proponents' Oct 06 Brief at 3-4.

The Tentative Final Decision adopts make allowances based on "weighted average" (weighted by product volume produced) surveyed costs. 71 Fed. Reg. at 67486-87. The record also demonstrates that those survey costs are inadequate as a result of bias from: (i) lower costs of very large plants, (ii) survey sampling that was demonstrably not representative of plants of average size in the relevant federal order plant population, (iii) western region and non-federal market locations of low cost plants, and (iv) lower costs incurred by plants not performing balancing functions.

The best evidence of manufacturing costs for the population of cheese plants receiving federal order milk, for example, reveals that a make allowance of over $0.25 per pound of cheese, plus or minus 11.3% ($0.0285),[3] is required to cover the costs of "most plants" and meet historical policy objectives. Proponent cooperatives proposed an

[3] Based on costs reported by *surveyed* plants, Dr. Stephenson testified that 88.7% of cost variability among plants is explained by plant size or production volume. Ex. 75 p. 6. Applied to the population of 53 cheese plants, costs of about half of the plants would be covered by a make allowance of 25 cents. *Id*. p. 7.

allowance of only $0.2077 for this emergency hearing, representing estimated costs of about one-third of the population of 53 cheese plants. Proponents' Oct 06 Brief at 13-14.

The Tentative Final Decision does not find, nor does the record demonstrate, that the adopted cheese make allowance will: (1) cover the costs of "most" cheese plants that receive federal order milk,[4] or (2) allow most manufacturers of commodity cheddar cheese "clear the market *and make a profit*" after the recommended make allowance is applied in the Class III price formula. These are two of the most important policies heretofore applied by USDA in fixing make allowances and minimum pricing of surplus milk used to make commodity dairy products. Proponents' Feb 06 Brief at 4-5.

The CPDMP survey of manufacturing costs for cheddar cheese plants provided new analyses and insights, not developed during the course of federal order reform or post-reform hearings on make allowances, on the measurable differences of plant costs due to economies of scale – plant size and production volume – from which an allowance covering the costs of most plants (+/- 11.3%) can be reasonably estimated (fn. 3, *supra*). The Tentative Final Decision correctly observes that such evidence on cost variability due to economies of scale represent a "marked improvement" over previous surveys. 71 Fed. Reg. at 67486. It then proceeds to disregard reasonable conclusions from the "marked improvement" in methodology.

Dr. Stephenson's regression analysis of cost variability due to plant size was ***not rebutted*** by any opposing expert testimony or evidence. Yet the Tentative Final Decision, without benefit of testimony by any agency statistician or disclosure of

[4] The adopted cheese make allowance of 16.82 cents per pound will cover estimated costs for not more than 3 plants in the relevant population. *Id.*

statistical analysis employed,[5] speculates that there are "questions about the representativeness of the results of [Dr. Stephenson's] simple regression analysis," and implies that Dr. Stephenson's "methodology…[may not be] statistically acceptable." *Id.* Even if the unrebutted regression analysis of cheese plant make cost variability is sound (and would thereby be more consistent with past policy to cover costs of most plants), the Tentative Final Decision rejects its use for cheese because similar population data (available only to USDA, but undisclosed on the record) was not available to Dr. Stephenson for butter, NFDM, and dry whey plants, resulting in the 'possibility' that make allowances covering costs of only one-third of 53 cheese plants "could" give cheese plants an advantage over NFDM and butter plants in competition for supplies of raw milk. 71 Fed. Reg. at 67486-87.

Even if the speculation in the Tentative Final Decision has foundation, lack of USDA data in the administrative record for size and production volume distribution of butter, NFDM, and whey plants is not a rational reason for abandonment of the standard of cost plus reasonable return on investment for most plants in fixing a cheese allowance. Indeed, no interested dairy product manufacturer espoused the 'competitive advantage' theory upon which the Tentative Final Decision relied in its abandonment of efforts to estimate manufacturing costs of most plants for inclusion in regulated make allowances. Rather, the Tentative Decision's observation is reason to adopt a cheese make allowance

[5] Administrative expertise cannot be exercised in an evidentiary vacuum. "There is… no precedent which allows the Secretary to make a decision based solely on his administrative expertise and knowledge unless it has been introduced in evidence in a hearing record." *Abbotts Dairies v. Butz*, 389 F. Supp. 1, 8-9 (ED Pa. 1975). The application of cost surveys and related statistical methodology to make allowances is relatively new in federal milk order pricing, and the agency's expertise (like that of the industry) is still in development. That is all the more reason for presentation of affirmative testimony by agency experts if the agency anticipates the need to diverge from unrebutted testimony of statistical scholars engaged by the agency, or if it desires to proceed at variance with accepted norms of statistical science and survey standards.

of $0.21 to $0.25 per pound, and use best available evidence and reasonable inferences to extrapolate from the record make allowances that will cover the costs of most butter, NFDM, and whey plants, or of plants of average size.[6] This can be accomplished even though surveyed plant costs are biased by plant size, location, and balancing function or lack thereof.[7] That is precisely what proponents have already done in post-hearing briefs. Proponents' Oct 06 Brief (at 15-18 for whey, 18-22 for butter, and 22-27 for NFDM). In a Final Decision, issued as soon as possible, the Secretary should make a similar effort to capture estimated costs of most plants, of average size plants, or at least one-third of plants, in manufacturing allowances. In the absence of such an effort to conform to past policy, the Secretary should explain in detail why he is departing from past policy in this proceeding.

In *Motor Vehicle Mfgrs. v. State Farm Mutual*, 463 U.S. 29, 41-42 (1983), the U.S. Supreme Court reaffirmed the established law governing administrative agency decision-making when long-established policies are changed or not followed:

> A "settled course of behavior embodies the agency's informed judgment that, by pursuing that course, it will carry out the policies committed to it by Congress. There is, then, at least a presumption that those policies will be carried out best if the settled rule is adhered to." Atchison, T. & S. F. R. Co. v. Wichita Bd. of Trade, 412 U.S. 800, 807-808 (1973). Accordingly, an agency changing its course by rescinding a rule is obligated to supply a reasoned

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[6] Record evidence reveals the number of plants producing each product, the total pounds produced by all plants, and therefore the average plant size (smaller than average survey plants).

[7] The miserly make allowances proposed in the Tentative Final Decision would clearly eliminate any "balancing cost" component expressly incorporated as a matter of policy in prior product make allowances, and significantly influencing recent USDA decisions to deny balancing cost credits from local market-wide revenue pools under statutory market-wide service authority. 67 Fed. Reg. 67906, 67920-21 (Nov. 7, 2002); 70 Fed. Reg. 4931, 4951-52 (Jan. 31, 2005). A series of regional hearings would then be necessary to capture additional costs incurred by manufacturing plants in local balancing cost credits, further complicating the tangled web of milk regulations.

> analysis for the change beyond that which may be required when an agency does not act in the first instance.

This obligation to provide greater explanation for a change of course, whether or not the agency acknowledges a departure from its precedents, is applied vigorously by courts on review. *E.g., Yale-New Haven Hospital v. Leavitt*, 470 F.3d 71 (2d Cir. 2006)(unexplained departure from Medicare reimbursement practices); *AT&T Corporation v. Federal Communications Commission*, 236 F.3d 729, 236 F.3d 729 (D.C. Cir. 2001)(departure from standards and weight given to economic factors in telecommunication price regulation); *Citizens Awareness Network Inc. v. United States Nuclear Regulatory Commission,* 59 F.3D 284 (1st Cir. 1995)(departure from procedural standards); *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1971); II Kenneth Culp Davis & Richard J. Pierce, Jr., Administrative Law Treatise S11.5, at 204 (3d ed. 1994). We encourage the authors of a Final Decision on make allowances to seek and apply advice from the Office of the General Counsel on the requirements of the foregoing precedents in the course of their decision-making, rather than waiting for routine review for legal sufficiency after decision-drafting by program personnel has been completed.

Proponents now turn to more detailed analysis and comment on specific parts of the Tentative Final Decision.

II. ADDITIONAL COMMENTS ON COST SURVEYS

The level of the manufacturing allowance in relation to the costs of manufacturing is crucial to the orderly operations of all milk marketing orders and the viability of market-clearing manufacturing plants serving all federal order markets.

There are four manufacturing allowances under consideration in this hearing: cheese, whey powder, butter and nonfat dry milk. Cost information from three different surveys was entered into the hearing record. These three surveys included the RBCS-USDA survey conducted by Dr. K.Charles Ling, the Cornell manufacturing costs survey conducted by Dr. Mark Stephenson (Cornell survey) and the California Dairy Plant Manufacturing cost survey conducted by the California Department of Food and Agriculture (CDFA).

USDA has used the RBCS-USDA and CDFA surveys twice before to establish Federal Order manufacturing allowances – in 2000 and 2003. The updated version of the CDFA survey presented in this hearing record used more current information than in the past as well as the same methodology. The RBCS-USDA survey likewise used the same methodology as well as an updated and even larger survey base. The Cornell survey used a new methodology, similar to the CDFA procedure, but applied it across plants outside of California. Each survey had its strengths and weakness for purposes of setting Federal Order-wide manufacturing allowances.

In the decision, USDA dismissed the RBCS-USDA survey despite its status as an established survey and despite the Department having accepted its results two other times in the past several years. It reasoning for excluding such a large and previously accepted survey was: "The witness (Dr. Ling) said that the RBCS data did not support concluding that as plant size increased, costs of production decreased on a per unit basis." 71 Fed Reg. at 67470. The Decision then went on to incorrectly conclude that "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…The RBCS - costs do not conform to reasonable expectations of economic theory that predicts declining average costs where production volume increases directly with plant size" 71 Fed. Reg. at 67484.

However, the foregoing characterizations of the evidence are demonstrably incorrect. Dr. Ling never stated that there was no relationship between plant size and costs. The intent of his survey was to determine the average costs of manufacturing at dairy plants; it was not to analysis the relationship between size and costs. As a conscientious USDA employee, Dr. Ling was specifically trying to avoid discussing specific plant information beyond the aggregated data. The discussion on the record in regard to this issue went as follows (pp. 132-133 of the January 25, 2006 hearing record):

> Q. Jack Rower, AMS Dairy Programs. Good Morning, Dr. Ling.
> A. Good morning
> Q. In your plant costs analysis, did you notice that larger plants tend to have lower production costs than smaller plants in the population of plants you were looking at?
> A. Without looking at the data, I wouldn't be able to give you that general statement because there are so many factors going into, you know, price and cost.
> Q. So that is not just eminently apparent from looking at the data and from remembering this morning?
> A. No. I mean from my memory, I don't...
> Q. (Mr. Rower) Okay. Thank you very much Doctor. That's my questions. Thank you.

It is unclear how USDA can dismiss an entire detailed survey that it accepted twice in the past based upon inferences that are clearly not supported by the record. Dr. Ling never said that there was no relationship of costs to plant size, only that he did not recall and needed to review the data. As will be discussed further, the information relative to butter and nonfat dry milk costs in the RBCS surveys clearly confirm the cost and size relationship based upon the simple and weighted average costs provided by RBCS.

Agri-Mark, et al., believe that USDA should use the best cost survey data available to determine manufacturing allowances, as it committed itself to do in the Notice of Hearing. 71 Fed. Reg. 36751 (July 28) and 525000002 (Sept. 6, 2006). Although we initially had concerns about using California plant data since those plants receive no Federal Order regulated milk and tend to be thousands of miles away from most Federal order marketing areas, we are willing to accept their use since the data is at least audited. As will be further discussed however, we do not understand why USDA choice to use California data for only three of the allowances and exclude that CDFA data for the whey powder allowance. As will be also discussed further, the USDA reasoning for that action was not correct.

III. COMMENTS ON CHEESE MANUFACTURING COST ALLOWANCE

Agri-Mark, et al. believe that USDA should not have used the Cornell weighted average manufacturing costs to determine the manufacturing cost allowance when the author of the study clearly explained the problems in doing so and testified to a "better approximation of the cheddar cheese population". The Cornell survey intentionally used a disproportionate number of very large plants in its survey, thereby weighting the results heavily in favor of the lower cost levels of those plants. However when the survey results were tabulated, instead of 5 of the 20 plants being from the very large size plant sub-group and 15 from the bulk of the plant population, data from only 16 total plants were available. These 16 plants included the 5 very large plants but only 11 plants from the remaining plant population. This further weighted the results in favor of the very large plants.

Dr. Stephenson acknowledged the weighting distortions and used additional data available to correct for it by calculating a population weighted average costs based upon known plant sizes and size distribution. These population cost estimates better represent the plant costs incurred by plants throughout the Federal order system. In fact, Dr. Stephenson acknowledged that likely no cheese plant in the Northeast federal Order, for example, could cover its costs if the initial weighted average costs were implemented. Therefore, under the manufacturing cost allowance used in the interim decision every plant in the Northeast will continue to be unable to cover its costs. The plants which can cover their costs under the interim decision are located many hundreds and in most cases, thousands of miles from the Northeast. With over 22% of its producer milk (5 billion pounds annually) being used by cheese plants, it will clearly create disorderly marketing in the Northeast if those plants cannot cover their costs or any of them eventually go out of business. Under minimum pricing, cheese plants cannot pay less than the Class III price yet even when a clearly insufficient manufacturing allowance is used. Table 2 of Dr. Stephenson's testimony shows that more than 90% of cheese plants in the Federal Order system cannot cover their costs under the manufacturing allowance set by USDA![8]

USDA put so much emphasis of the relationship between plant size and manufacturing costs per pound that it erroneously excluded the RBCS survey, yet at the

[8] Unrebutted evidence that very large number (90%) of cheddar cheese plants in federal order markets will be unable to recover their cheese make costs under proposed make allowances, and that a very high percentage of butter/NFDM plants serving federal order markets will also be forced to operate these plants at a loss, mandates a careful review and new analysis of the proposed rules under the Regulatory Flexibility Act. It is plainly irrational to conclude that the recommended make allowances "will not have any different impact" on small manufacturing plants (and on producers that own or market milk to such plants), than on large ones (71 Fed. Reg. at 67468), where the revised allowances are large-plant biased by design, and their adoption threatens the continued viability of smaller plants.

same time, USDA failed to acknowledge the importance of plant size expressed by Dr. Stephenson. USDA clearly should use the population weighted average costs to determine the make allowance.

IV. COMMENTS ON WHEY POWDER MANUFACTURING COST ALLOWANCE

Agri-Mark, et al., agree with the use of the Cornell survey for determining the whey powder manufacturing cost allowance. However USDA erred in not including the California cost allowance as it did with the three other dairy products.

USDA said that it wanted consistency in the methods used to determine the allowances, and relied on that premise in an attempt to justify not using the population weighted average cheese cost recommended by Dr. Stephenson. In addition, USDA implied that consistency was also a reason to not use the RBCS-USDA survey.

However USDA disregarded its own standard for this proceeding by using the CDFA cost information for all products except dry whey. The decision states that "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." 71 Fed. Reg. at 67487. However, the conclusion of unreasonableness is incorrect and not supported by the record. The CDFA costs for all three plants averaged $.2673 per pound. Cornell reported a 95% confidence interval of whey make costs between $0.1328 to $.3237 (Ex. 75 p. 5), which clearly puts the CDFA-survey costs within the appropriate confidence level. In fact, the Cornell costs show that the half the plants in its own study had an average costs exceeding $.30 per pound, well above the CDFA plant cost level. CDFA's reported whey plant costs, in any event, are hard, audited numbers. The variability of those costs among California plants simply reflects

economic reality and the dangers of fixing a make allowance that is too low where plant costs are variable. USDA's reasoning to exclude CDFA costs was unreasonable, and those costs should be included in the whey make allowance adopted in the final decision.

USDA used a national weighted average production for California and non-California production to weigh the costs. While this cannot be done so easily for whey powder, the ratio of cheese and whey powder production in a hundredweight of milk is fixed in the Federal order formula, therefore USDA should use the same national weighting for dry whey costs as the department used for cheese. Even through there are only three California dry whey plants, USDA was willing to use just four butter plants in the Cornell survey to weigh the entire U.S. butter production outside of California.

The inclusion of dry whey powder values into the Class III price has added significant value to that price and assumes that all cheese makers using Federal order regulated milk can achieve the costs used in the manufacturing allowance. However this is clearly not true given the large size of the whey plants in the Cornell survey. In order to achieve those low cost levels, the vast majority of cheese plants must transport their whey to the larger facilities, if that option is even available. The whey powder make allowance must recognize those transportation costs or else recognize a much lower value of the whey by-product. As proposed by Agri-Mark, et al., and others, at least two cents per pound should be added to the whey manufacturing allowance to reflect those costs.

V. COMMENTS ON BUTTER MANUFACTURING COST ALLOWANCE

As testified to by Dr. Stephenson, the Cornell survey first focused on obtaining cheese and whey plant cost information, and did not begin its work on butter and nonfat dry milk costs until later. This is one of the reasons that the industry did not get to review

the butter and nonfat dry milk cost information prior to publishing. Clearly this is reflected in that information from only four butter plants was available for the Cornell results. Under cross-examination, Dr. Stephenson discussed the weaknesses inherent in using such a small and likely unrepresentative data set.

When Dr. Stephenson calculated a 95% confidence interval for surveyed butter costs, that calculation ranged from NEGATIVE $0.0921 to $0.3905. Dr. Stephenson noted that "the large range on butter costs reflects relatively few observations and a fair amount of variability in the data." Ex. 75, p. 5. His confidence range implies that the true costs of making butter could be as high as $.39 per pound and may be as low as NEGATIVE $.09 per pound. The negative number implies that there can be zero costs to make a pound of butter, and somehow there could be mysterious negative cost plant somewhere. Clearly this reflects that the CPDMP butter survey costs, while representative of the four plants, cannot confidently be adopted as representative of costs in 55 plants in the population for which the butter make allowance is adopted. The CPDMP butter plant survey costs should therefore not be used, or at least be given very little weight, in drawing conclusions about manufacturing costs for the average butter plant receiving federal order milk.

Fortunately there is an alternative cost survey from which representative butter manufacturing costs may be estimated with much greater confidence. This is the RBCS data. Combined with CDFA data, this group represents the majority of butter production in the country. Although the RBCS data is limited to cooperative information, when it comes to butter (and nonfat dry milk powder), cooperatives are the primary manufacturers of these products outside of California.

The RBCS butter survey shows a simple average cost of $0.18137 cents per pound and a weighted average cost of $0.16588 per pound. This difference implies that the survey data demonstrates for butter, like other products, cost variability due to economies of scale, with lower costs per pound for large volume plants. In addition, the RBCS survey included seven plants and about twice the butter production volume as the Cornell study. The Cornell survey for butter was the first such attempt by Cornell to do so and the results show serious problems in the applicability of survey results to the population of plants not surveyed. The RCBS survey for butter has been done many times n the past and has been used by USDA before.

The Cornell butter cost survey should not be used to calculate the manufacturing cost allowance for that product throughout the Federal order system. To do so results in a $0.12 per pound cost allowance that is unreasonably below the California level despite the fact that California has much larger and newer plants that are not used for balancing the way that most Federal order plants are.

VI. COMMENTS ON NFDM MANUFACTURING COST ALLOWANCE

Butter and nonfat dry milk are companion products at many plants. As such we believe that USDA should use the established RBCS survey in place of the new and untested Cornell survey for this product also.

The RBCS survey for nonfat dry milk also shows a similar plant size versus costs per pound relationship as butter production. The RBCS survey shows a simple average price of $0.21417 per pound and a weighted average price of $0.16816 per pound.

The RBCS survey includes data from a much larger number of plants (14 versus the 8 from the Cornell survey) and includes a greater distribution of plants by size.

Indeed, with 14 surveyed plants representing 38% of the population of 37 non-California NFDM plants (and producing 65% of non-California NFDM), the RBCS cost survey for NFDM captures a far greater share of the relevant plant population than any other manufacturing cost survey for plants outside of California. The average production volume of RBCS surveyed plants (31.4 million pounds NFDM) comes much closer to reflecting costs of average-sized non-California plants (17.8 million pounds) than the average size plant participating in the CPDMP survey (55 million pounds). Finally, the credibility of the RBCS survey results are reinforced by its comparability to CPDMP's survey of NFDM average make costs in plants of similar size:

	Av. Production Volume	Av. Make Costs per pound
RBCS	31,359,689	$0.1681 [9]/
CPDMP high cost group	39,681,700	$0.1659

From these data, and the uncontroverted evidence that manufacturing costs are releated to plant size, it is clear that an allowance based on weighted average costs of plants averaging 56.6 million pounds of production (as adopted by the Decision) is unreasonable to apply to federal order NFDM plants that produce an average of 17.8 million pounds of product per year.

The RBCS survey plants are also more representative of balancing plants that are crucial to the functioning of Class I markets.

VI. COMMENTS ON 2004 COSTS VERSUS 2005 COSTS.

Agri-Mark, et al., are concerned that USDA initially choose to only use 2004 cost information from the Cornell survey when the effective date for the implementation of these new costs is already 2007. Dr. Stephenson provided a simple energy adjustor to

[9] It should be remembered that the RBCS survey does not include any return on investment. None of the surveys include a marketing cost component.

update costs to the 2005 level and we believe that at the very least, such adjustment should be included for all costs. This will update the costs to 2005 levels.

VII. MINIMUM PRICES AND MANUFACTURING COSTS

Although the focus of this hearing was on "manufacturing costs" rather than on producer milk prices, its results will determine the proper level of market-clearing Class III and IV prices. By their very nature, market-clearing prices cannot be fixed for the purpose of producer income enhancement. That is the function of Class I and II differentials, and of market-driven premiums over regulated prices.

Federal Order Class prices, including Class III and IV prices, are minimum prices. As such regulated handlers must account for these price levels to each order pool. When minimum prices are too high, as is the current case for Class III and IV prices, handlers are forced to pay more for the milk than it is worth. In the case of the Northeast all dairy product manufacturers cannot cover their costs under the proposed make allowances. USDA did not address this concern in their interim decision, but must do so in the final decision. The best way to deal with this issue is to make the adjustments suggested by Proponents, Agri-mark., et al.

VIII. COMMENTS ON CALIFORNIA PRICES AND COMPETITION.

The Tentative Final Decision ignored the competitive relationship between California and the Federal order make allowances and market-clearing prices. That relationship has been weighed heavily in federal order market-clearing price decisions of the past. The decision would result in federal order Class III and IV prices that are dramatically lower than California regulated prices for the same uses of milk. This gives Class III and IV handlers a direct economic incentive to re-locate their production and/or

purchases from Federal Order marketing areas to California. This would exacerbate disorderly marketing flowing from the Tentative Decision's disregard of other established policy principles.

CONCLUSION

For the foregoing reasons, the Secretary should give careful review of the content of the record, these Comments and Exceptions, and prior briefs filed by Proponent Cooperatives. Upon such review, the proposals of Proponents, which would provide conservative but inadequate recovery of manufacturing costs on an emergency basis, should be adopted. If the recommendations of the Tentative Final Decision are nevertheless affirmed on review, the Secretary must provide a detailed and cogent explanation for his departure from, or rejection of, policies and principals that have guided administration of milk marketing order market-clearing prices for many decades.

Respectfully submitted,

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January 22, 2007