

APR 10 2015

April 9, 2015

**VIA FEDERAL EXPRESS, HAND DELIVERY
AND ELECTRONIC MAIL**Deputy Administrator
USDA/AMS/Dairy Programs
STOP 0231, Room 2971
1400 Independence Avenue, SW
Washington, DC 20250-0225Re: Response and Alternative Proposal with Respect to Proposal for a California Milk
Marketing Order**Introduction**

This submission is filed on behalf of the Dairy Institute of California in response to the Agricultural Marketing Service, Dairy Programs' February 6, 2015 request for additional proposals with respect to the Cooperatives' February 3, 2015 request for a California Milk Marketing Order. The Dairy Institute of California is a trade association founded in 1939 that represents 28 proprietary companies, including processors of fluid milk and manufacturers of cheese, cultured, and frozen dairy products. Member companies operate 38 dairy plants in California, which account for approximately 70% of the fluid milk products, 85% of the cultured and frozen products, and 90% of the cheese products processed and manufactured in the state.

The Dairy Institute concludes that there are no significant disorderly marketing conditions that would warrant either a hearing or, after any hearing, the promulgation of a California Federal Milk Marketing Order ("FMMO"). The Cooperatives' proposal fails to meet the minimum requirements set forth in 7 C.F.R. § 900.3(a). The Cooperatives' conclusion that there are disorderly marketing conditions is merely their assertion and rests squarely on the perceived inequity caused by differences between the regulated prices for milk used to produce cheese and whey under the FMMO and California Food & Agriculture ("CDFA") programs, respectively. Their failure to present any real evidence of disorderly marketing conditions is not surprising, given that no such evidence exists.

Moreover, to date the Secretary of the United States Department of Agriculture has never found this type of manufacturing class price difference (if it even exists once differences in the two systems' pooling provisions are accounted for) as evidence that disorderly marketing exists to an

extent necessary to impose an order on handlers. Such pricing conditions do not justify one now. *See, e.g., Zuber v. Allen*, 396 U.S. 168, 180-181 (1969) (holding that “[t]he plain thrust of the federal statute was to remove ruinous and self-defeating competition among the producers and permit all farmers to share the benefits of *fluid milk profits* according to the value of the goods produced and the services rendered”) (emphasis supplied).

Background

Unlike the facts underlying USDA promulgation order hearings in the past, the California dairy industry does not operate in a regulatory vacuum or face destructive unpriced milk competition from out-of-state fluid milk. California has a long-standing, robust minimum regulated classified price and pooling program administered by CDFA. CDFA’s classified pricing system, like its Federal Order counterparts, establishes Class I fluid milk as the highest price class and then shares the Class I value among all dairy farmers. As the Cooperatives’ proposal makes clear (especially on pages 5 – 10 of the Cooperatives’ cover letter), their primary concern is with perceived disparities in manufactured product prices as compared to federal order pricing.

The basis for the adoption of every Federal Milk Order has been that Class I fluid milk revenues are not being shared by the market’s dairy farmers who stand ready and willing to serve the fluid market. But that is quite clearly not the principal or principled basis for the Cooperatives’ proposal. Their February 3, 2015 cover letter plainly reveals their complaint to be over differences between the Federal Orders’ Class III and the CDFA Class 4b price for milk used in the manufacture of cheese. Because the Cooperatives’ proposal fails to provide any accepted basis for its claim that disorderly marketing exists in California, it is legally insufficient and incomplete. In short, their proposed marketing agreement will not tend to effectuate the declared policy of the Agricultural Marketing Agreement Act (“AMAA”), 7 U.S.C. § 601 *et seq.*; *see* 7 C.F.R. § 900.3(a).

Recognizing that the Secretary may nonetheless notice a promulgation hearing on this subject matter, we are concerned that the proposal submitted by the cooperatives would actually create disorderly marketing conditions where none now exist. Therefore, the Dairy Institute’s membership has voted unanimously to submit a complete alternative proposal for a California Federal Milk Order.¹ Unlike the Cooperatives’ proposal, which fundamentally alters Federal Milk Marketing Order policy and structure to accommodate a transfer of California’s state milk marketing order to Federal regulation, the Dairy Institute’s alternative proposal is modeled upon existing Federal Milk Orders, primarily Order 30 – Upper Midwest because that regulation has similar Class I utilization and significant cheese production. The Dairy Institute’s proposal also has added features to address some particular California milk marketing conditions and regulations, including accounting for the recent Farm Bill provision that “[t]he order covering California shall have the right to reblend and distribute order receipts to recognize quota value.”

¹ *See* Proposed Order language is attached as Attachment 1.

Thus, the Dairy Institute proposal considers particular California milk marketing conditions and regulations, but has the look and feel of a Federal Milk Order, rather than the other way around. This distinction is important because the Secretary has in the past concluded that the provisions of a traditional Federal Milk Order can effectuate the purposes of the AMAA (e.g., shipping percentages and inverse diversion limits for producer milk, designed to insure that milk sharing in pool revenues actually performs for the fluid market). In this order promulgation proceeding, if an order is recommended, the Secretary will necessarily be required to find on the basis of record evidence submitted not only that there are disorderly marketing conditions in California, but also that each provision of a proposed Federal Order is justified.

The Dairy Institute strongly disagrees with the factual assertions of the Cooperatives regarding perceived problems with, or short comings of, the California system. The Dairy Institute similarly disagrees about what Federal Milk Marketing Order provisions will both effectuate the purposes and meet the requirements of the AMAA.

First, Federal Milk Orders requiring pooling of producer returns are designed to share Class I proceeds with dairy farmers willing and able to serve the fluid market. For this reason, Class I handlers are subject to mandatory regulation, and the proceeds of the purchases of milk for those facilities is shared with all pool producers. However, stand-alone Class II, Class III and Class IV operations are not required to be pool plants. In this way, pooling of milk other than Class I is voluntary under Federal Milk Orders. The Secretary has routinely rejected “mandatory,” “automatic,” or “inclusive” pooling, and the reason is simple. The right to share in the Class I proceeds is directly linked to the volumes of milk that are able to and, when necessary, do serve the Class I market, plus a reasonable reserve supply. Thus, Federal Milk Orders, in addition to sharing Class I revenue, have as their quid-quo-pro actual performance requirements to serve the Class I market through shipping requirements and reciprocal diversion limits that cause milk to move to the Class I market when milk is needed for fluid use. The Cooperatives’ proposal for mandatory pooling undermines, indeed eliminates, the necessary incentives for serving the Class I market and would make marketing of milk to Class I processors much less orderly than under any other FMMO.

Second, Federal Milk Orders establish manufactured milk prices for the lowest use classifications that are designed to be market clearing. California’s state milk marketing order in effect today essentially extends minimum regulated prices to all California-produced Grade A milk. The complaint that California manufactured prices are too low compared to Federal Milk Order prices wholly ignores the economic implications of a mandatory regulated price for milk used to make manufactured dairy products versus a voluntary regulated price for such uses. In a Federal Milk Order with mandatory regulated prices for milk used in manufactured dairy products, Class III and Class IV processors could be forced to pay a higher price that is not market clearing, whereas with voluntary regulated prices for manufacturing uses, these same processors have the option to not pool the milk and avoid uncompetitive or unprofitable price levels. Under these different regulatory treatments, direct comparison of manufacturing class prices in the manner undertaken by the Cooperatives is not valid. Attempting to avoid this conclusion by establishing mandatory minimum regulated prices for milk used to make

manufactured products that exceed market clearing prices would create disorderly marketing conditions.

Third, the Dairy Institute maintains that market clearing prices for manufactured products produced in California are different from such prices in other parts of the country. As this is a promulgation hearing, Federal Milk Order formulas must be established based upon current evidence, not evidence discussed or submitted at hearings in which the Dairy Institute or its members did not have a direct, cognizable interest. Requiring 2015 evidence (as opposed to simply adopting a Federal Order with existing federal order regulated prices that are not independently justified) avoids the known problem that federal order regulated prices overstate the value to many western dairy product manufacturers of various products including, and especially, whey. Minimum regulated prices that are too high, when coupled with mandatory order pricing for milk used in manufacturing, will not be market clearing and will lead to disorderly marketing conditions.

Fourth, the Dairy Institute concludes that Congress' Farm Bill proviso - "[t]he order covering California shall have the right to reblend and distribute order receipts to recognize quota value" - can be fulfilled without impairing the rights of out-of-state milk to receive a traditional federal order blend price. Congress' pronouncement is not structured as an amendment to the AMAA; therefore all the provisions of the Act are still in force. The Farm Bill language does not mention price levels to be paid by handlers, and the language is limited to "recognize quota value" not quota prices or, especially, overbase prices. This provision cannot be relied upon, as the Cooperatives appear to do, for massive structural changes to the Federal Milk Order program in order to accommodate a California state order in Federal Milk Order guise.

Moreover, the Cooperatives' proposal discriminates against out-of-state milk in ways that constitute illegal trade barriers proscribed by 7 U.S.C. § 608c(5)(G). See *Hillside Dairy, Inc. v. Kawamura*, 317 F. Supp.2d 1194, 1198 (E.D. Cal. 2004); *Lehigh Valley Coop. Farmers, Inc. v. United States*, 370 U.S. 76 (1962). In effect, their proposal exports the California overbase price to producers in other states who have never had the opportunity to be given or to purchase quota, but who nonetheless would be pooled under a California Federal Order. Instead, the Dairy Institute proposes giving producers a choice. A traditional pool price can be calculated, announced and used for out-of-state milk as well as for California dairy farmers who affirmatively elect to be paid using the traditional Federal Order blend price model. The Secretary has found this system to be in keeping with USDA's legislative mandate in the past. 34 Fed. Reg. 17684 (October 31, 1969).

Last, but not least, the Dairy Institute again recognizes that this is an order promulgation hearing for which fresh and tested evidence will need to be introduced. Each and every feature of any proposed Federal Milk Order, including the need for, development of, and level of Class I differentials (including a proper Class I base price, if any) must be proven on the basis of current record evidence. In addition, real and meaningful shipping requirements, like those found in all other Federal Milk Orders, must be established. The Cooperatives' proposal lacks, except for out-of-state milk, any shipping requirements as those exist in all Federal Milk Orders today. The

Cooperatives' failure to include shipping percentages (and reciprocal diversion limits) would make marketing more, not less, disorderly.

Overview of Dairy Institute Submission²

In view of the foregoing, and in the unlikely event that the Secretary concludes that current marketing conditions warrant the establishment of a California Federal Milk Marketing Order, the Dairy Institute is proposing the following key provisions designed to eliminate the disorderly marketing conditions that the Cooperative proposal would engender:

1. The marketing area will be the State of California.
2. The California quota system will remain intact and will be administered by CDFA. The operation of the FMMO traditional pool and the California quota program will be jointly administered pursuant to a memorandum of understanding between USDA and CDFA and consistent with the authority of each under their respective programs.
3. Classified milk uses, if justified by the hearing, will be established using the same four class system of product classification found in all existing FMMOs.
4. Class prices for milk will be established for the California FMMO based upon evidence submitted at the hearing. While Class I differentials are for submission purposes the same as those established under 7 C.F.R. Part 1000, the final prices may be different based upon the hearing record and the need to justify in a promulgation order hearing the need for and level of any Class I differential, including the Class I price enhancement caused by establishing the Class I base price using the higher of the advance Class III and Class IV skim prices. Class II, III and IV prices will be established similarly to those under existing FMMOs, but using updated formulas and corrected information reflecting, in particular, western product values and manufacturing costs.
5. Handlers will pay classified use values, first as a traditional FMMO partial payment to producers directly, and the remainder of funds (Final Payment) will be paid to the Market Administrator. The Market Administrator will establish a traditional statistical uniform price and Producer Price Differential as in other Federal Milk Orders with multiple component pricing. The Market Administrator will pay out-of-state dairy farmers and those California dairy farmers who elect to receive a traditional federal order blend price, the statistical uniform price/producer price differential. All funds remaining will then be paid over to CDFA to be rebled and distributed in accordance with the California quota system. This approach will "recognize quota value" as permitted by the Farm Bill language.

² The materials being submitted include: (1) this letter; (2) proposed regulatory language should the Secretary conclude, contrary to the Dairy Institute, that disorderly marketing conditions exist; and (3) supplemental responses suggested by 7 C.F.R. § 900.22 (technically applicable to proposals seeking to amend a FMMO only). Four copies of each are provided pursuant to 7 C.F.R. § 900.3.

6. A system of transportation credits and allowances will facilitate the movement of milk from production areas and supply plants to qualifying Class I and II processing locations. The transportation credits and allowances will be established with payments made from the marketwide pool for the marketwide service of moving milk to Class I and II uses, taking account of the implicit transportation assistance provided by the Class I price surface and location differentials used in calculating the Producer Payment Differential at the producer's location.
7. All Class I plants, whether located inside or outside California that meet typical distributing plant requirements will be required to be pooled. All other plants, cooperative associations or proprietary bulk tank handlers, whether located inside or outside California will, if they wish to be pooled, be subject to uniform shipping requirements – for all milk such shipping requirements will be linked to the recent Class I utilization of the market. In addition, quota milk, in order to qualify for quota price, will be subject to additional shipping requirements. “Call provisions” on quota milk will be available to assist the Market Administrator in insuring that the Class I needs of the market are fulfilled; this recognizes the historical relationship between quota and the fluid market.
8. Producer-handler language is proposed that is substantially the same as the language for both the Arizona and Pacific-Northwest Federal Milk Orders. The history and experience of producer-handlers in western FMMO regions has been different from that of the Upper Midwest.
9. In order to address the issue of depooling, rather than adopting mandatory or “inclusive” pooling, the Dairy Institute proposal uses the producer milk definition from the Upper Midwest concept of limiting repooling in a subsequent month to 125% for most months and 135% for March of milk pooled in a prior month. The Secretary has found that this solution should lead to orderly marketing conditions.
10. Producer payment dates will provide for a partial and final check each month on dates which generally track those employed in other FMMOs.
11. All handlers and cooperatives will be required to file monthly reports of receipts and utilization to the Market Administrator of the California FMMO. Required submissions will include all information necessary for administration of the marketwide pool and the California quota program. All information necessary for continued operation of the California quota program will be made available to CDFA; CDFA will make necessary information available to the Market Administrator.
12. Verification of producer weights and tests will be provided for as is presently done in the FMMO system, allowing the continuation of any and all non-duplicative California state programs. Multiple component pricing will be applicable both to handlers and producers, following the traditional FMMO model, except for Class I which will

divide skim value into nonfat solids and the fluid carrier, which prices components to handlers of Class I (fat, skim, nonfat solids and fluid carrier); Classes II and IV (fat and nonfat solids); handlers of Class III (fat, protein, and other solids) and to producers (fat, protein, and other solids) on all milk.

13. Fortification of milk for Class I uses to meet the California fluid milk standards will be accommodated through a fortification allowance to Class I handlers.
14. Uniform classification and allocation of milk for pooling purposes will be provided for as in the FMMO system, except for a proposed modification to shrinkage allowance for extended shelf life milk.
15. Complete audit procedures will be prescribed and conducted by the FMMO Market Administrator with assistance from CDFA as necessary to audit the quota program.

Key differences between Cooperatives and Dairy Institute Proposed Order Language

The Dairy Institute's proposal includes a number of provisions that are identical to the Cooperatives' proposal – especially standard definitions, product classifications, and handler reports. There is no need to dwell on a discussion of these kinds of provisions over which there is no real debate (although all language must be supported by record evidence in any promulgation hearing). The following is a discussion of key differences between the Cooperatives' and the Dairy Institute's proposed order language. In most cases, the reason for the difference is that the Cooperatives' proposal would increase disorderly marketing while the Dairy Institute proposal will promote orderly marketing.

1. Quota Program

The Cooperatives' proposal for the treatment of quota would result in the quota value being extracted from the total pool, including out-of-state milk receipts, before calculating an order blend price. Out-of-state dairy farmers have never and will still never have the right to own California quota, but their minimum pool value will be based upon the remainder of pool dollars after many California dairy farmers (and *only* California dairy farmers), receive a special quota price. As a result, unlike their counterparts throughout the United States pooling milk on a Federal Milk Order that is shipped in from another state, these out-of-state dairy farmers will be uniquely disadvantaged. The AMAA requires uniform payments to producers, but these producers will not receive a uniform price as that term has been used by the Secretary for over 80 years.

While Congress did provide that “[t]he order covering California shall have the right to reblend and distribute order receipts to recognize quota value,” Congress did not otherwise expressly amend the AMAA. The AMAA and the Farm Bill language must be read in conjunction and seamlessly. Since California quota value today is “recognized” without subjecting out-of-state milk to this kind of differential treatment (and Congress is deemed to have known that fact when

it adopted the Farm Bill language), out-of-state milk must receive a minimum regulated price based upon a traditional order blend price. To the extent that such dairy farmers today receive, after *Hillside Dairy*, a plant blend price, they will already see their pay price reduced to the order blend. Reducing their pay prices further to a mere remainder, non-uniform price is not permitted under the AMAA.

The Dairy Institute's proposal recognizes quota value without violating the spirit or the language of the AMAA. A traditional federal order pool and blend price/producer price differential would be established and funded with the traditional final payment made for milk by all regulated handlers. Non-California dairy farmers and California dairy farmers who positively elect to do so would be paid based upon the traditional pool price (multiple component price with PPD). The proceeds of all milk for producers who choose to remain subject to the California quota program would be paid over to CDFA (treating CDFA as one producer in the same manner that a cooperative is deemed to be the producer for its members' milk) for reblending and distribution in order to recognize quota value. Because this would be a Federal Milk Order, and because USDA adopted a similar approach in 1969, the Dairy Institute's proposal also recognizes that California dairy farmers should be given the option, at their election, to receive the Federal Order blend price.

The Secretary has previously found this approach to meet the legal requirements of the AMAA. Therefore, the Dairy Institute's proposal would also lead to orderly marketing conditions as previously determined by the Secretary, and would avoid the disorderly marketing conditions that would be created by the Cooperatives' approach to quota and pooling.

2. Pooling

The Cooperatives' proposal provides that all California produced milk received at a California Grade A facility will be in the pool. The Cooperatives refer to this practice as "inclusive" pooling. The Secretary has in the past used the term "automatic" pooling. Industry uses the term "mandatory" pooling. The semantics do not matter as the terms refer to the same thing – the requirement that all Grade A milk be pooled. This is not a requirement of any past or present Federal Milk Order, except as it always has applied to Class I handlers or to temporary continued pooling of plants that have met regulatory requirements in the past. The Cooperatives rely in part on this mandatory pooling concept on the rationale that otherwise voluntarily pooling and depooling milk constitutes disorderly marketing.

The Secretary has certainly found in the past that this kind of opportunistic pooling is destabilizing and constitutes disorderly marketing. But the Secretary's solution to that problem has been to adopt limited repooling options in future months. The Dairy Institute agrees with this approach. The Cooperative proposal turns the problem on its head and creates new and significant disorderly marketing problems, especially for Class I handlers for whom no milk is actually delivered, not just because their proposal eliminates the economic incentives that make those Class I deliveries happen, but also because it limits the ability for manufactured products to clear the market when necessary.

Mandatory pooling eliminates the traditional, and necessary, performance requirement (shipping percentages in the pool handler definition and diversion limits in the producer milk definition). Under the Cooperatives' proposal, since all California milk received at a California Grade A plant is pool milk, not one drop of California milk ever has to move to a distributing plant in order to receive either the quota or the overbase price. Every existing Federal Milk Order has such shipping percentages and diversion limits in order to achieve the purposes of the AMAA. The lack of such standard and necessary order provisions makes the Cooperatives' proposal ineffective in meeting the declared purpose of the AMAA. Class I handlers must pay the highest regulated minimum price for their milk, but there is no reason for any dairy farmer to ship milk to a distributing plant if it will be pooled regardless.

For this reason, the Dairy Institute proposes traditional Federal Milk Order shipping percentages and division limits for quota and all milk wishing to be pooled. The Dairy Institute's proposal would establish brackets for shipping percentages and diversion limits based upon the actual Order's Class I utilization for the three prior months. There are also additional performance requirements for quota milk since quota was originally established by California based upon Class I usage and has had a historical connection with serving the Class I market in the state. These performance provisions are modeled after traditional Federal Milk Order provisions which the Secretary has found to effectuate the purposes of the AMAA and to lead to orderly marketing conditions.

In order to facilitate pooling of milk, especially quota milk, the Dairy Institute's proposal includes a provision for a proprietary bulk tank handler. The performance standards are identical for cooperative handlers, supply plants and proprietary bulk tank handlers. Permitting proprietary handlers to pool milk on a California Federal Milk Order using the proprietary bulk tank handler provision that has previously existed in other Federal Milk Orders would recognize quota value and performance standards. This would lead to orderly marketing conditions because it would limit inefficient movements of milk that might otherwise be required in order to meet performance standards.

Additionally, the Dairy Institute's proposal does not include automatic pooling for cooperative-owned plants in Churchill County, Nevada. Milk supplies from Nevada are not needed to provide a reserve supply for a marketing area that already has milk supplies greatly in excess of Class I needs. If plant operators in Nevada desire to pool milk on the California Federal Order they can do so by meeting the prescribed shipping percentages and diversion limits for supply plants.

The Dairy Institute's proposal expands upon the Cooperatives' provisions regarding pool prices calculated for producers (beyond multiple component pricing) to include a Producer Price Differential, a Statistical Uniform Price, location adjustments applied to producers, and a somatic cell adjustment. Inclusion of a somatic cell adjustment is designed to encourage the continued production of high quality milk.

3. Classified Pricing

A. Class I Pricing

The Dairy Institute is proposing the Class I price surface known as Modified Option 1A from the 1999 Federal Order Reform process. While this is identical to the Cooperatives' proposal, this promulgation proceeding evidentiary record will need to demonstrate the need for and level of any Class I differential. Moreover, significant problems are associated with the current base price, especially the use of the "higher of" Advanced Class III or IV price. Proponents of a Federal Milk Order for California must justify these provisions based upon present-day evidence. The Dairy Institute's proposal also includes a provision to split the Class I skim milk price into prices for Class I nonfat solids and Class I fluid carrier. The separation of skim component into these two constituents is currently done in the California state milk marketing orders and is necessary to ensure equal raw product cost to competing Class I handlers in light of California's unique fluid milk standards, which must be acknowledged as they will remain in force should a California FMMO be promulgated and adopted.

B. Shrinkage

The Dairy Institute proposes adding an additional provision for shrinkage for ultra-pasteurized or aseptically processed fluid milk at a 7(b) distributing plant. The Dairy Institute intends to submit evidence establishing that such additional shrinkage for these specific products is an unavoidable result of specialized processing.

C. Other price formulas (Classes II, III and IV)

Class II prices will be established using the same procedure employed in other FMMOs. The Class II skim milk price shall be the Advanced Class IV skim milk price plus a differential of 70 cents per hundredweight. The Class II butterfat price shall be the Class III/IV butterfat price for the month plus a differential of 0.7 cents per pound.

Class III and IV prices will be established using end product formulas that are similar to those under existing FMMOs, but will be adjusted to reflect western product values and current western manufacturing cost allowances for butter, nonfat dry milk, 40-pound blocks of cheddar cheese, and dry whey. The Dairy Institute has proposed using prices and costs for 40-pound cheddar blocks, rather than the block/modified barrel weighted average prices used on other FMMOs, because cheddar cheese produced in the proposed marketing area is predominantly in the block form. Modified barrel prices do not adequately represent the prices California cheddar plants receive for cheese and would lead to overvaluing milk used for cheddar cheesemaking in California on a more than occasional basis.

It is vital that the regulated milk prices under the order for Class III and Class IV be minimum prices that are market clearing. Therefore, the formulas employed in determining these prices

must not assign product prices that are higher than those received by California plants. Current NDPSR prices are, on average, higher than those received by California manufacturing plants for the products they sell. To address this problem, the Dairy Institute proposes that USDA collect and report weighted average prices from plants manufacturing cheddar blocks, butter, nonfat dry milk and dry whey. In the event that USDA is unable to collect and report this price due to confidentiality issues, the Dairy Institute proposes a default value for the product prices by making adjustments to the NDPSR product prices that are currently collected and reported. The adjustments are based on the recent history of the differences between the prices received by California plants in comparison to the NDPSR prices.

The Dairy Institute asserts that under a California FMMO, the manufacturing allowances contained in the end-product component priced formulas for Classes III and IV must be based on costs achievable by western plants. To that end, the Dairy Institute proposes that USDA conduct a cost study of butter, cheddar block, nonfat dry milk and dry whey manufacturing plants in selected western states, consistent with methods employed by CDFA in its manufacturing cost surveys. In the event that USDA is unable to conduct such cost studies, the Dairy Institute proposes default values for product manufacturing allowances based on most recent weighted average costs as determined by CDFA. In any end-product pricing formula, it is important for the proper valuing of milk that manufacturing cost allowances be as current as possible. Manufacturing cost allowances that are currently used in the end-product price formulas employed in other FMMOs are based on information that is nine years old.

With regard to the formula for the Class III other solids price, the use of dry whey to represent the underlying component value presents a host of problems. There is a rich body of evidence from California state milk order hearings that the use of dry whey in the formula for milk used in cheesemaking overvalues milk to plants that do not have any value-added whey processing capacity. The FMMO Class III other solids formula currently uses the NDPSR dry whey price to represent the other solids value. In constructing minimum regulated prices for milk used in cheesemaking, a better approach is to use the average price (on a solids basis) at which cheese plants sell concentrated liquid whey to other plants for further processing. Unfortunately, no publicly available data on such transactions exists. As a consequence, the Dairy Institute proposes using a dry whey based end-product formula like the one currently in use in other FMMOs, but modified to reflect western dry whey product values and updated whey drying costs.

Recognizing the value of encouraging dairy farmers to produce high quality milk, the Dairy Institute is proposing a somatic cell adjuster to the Class III price. The proposed adjuster is identical to the one used in the Upper Midwest order.

4. Other Order provisions

A. Transportation credits and allowances

The Dairy Institute's proposal provides for a system of transportation credits and allowances to provide for partial reimbursement for the cost of moving milk to qualifying plants in deficit

regions within the marketing area. California's current industry structure and organization has developed in the presence of these forms of transportation assistance, and it is appropriate that they be a part of any order promulgated under this proceeding. Omission of these provisions will likely increase procurement costs to Class I handlers and ultimately consumer prices, which will hasten the decline in fluid milk purchases to the detriment of producers. We have proposed using the current transportation allowance rates, which are based on recent actual hauling rates, to partially offset the cost of farm to plant milk movements after deducting the implicit transportation incentives supplied by the location adjustments to producer pay prices. These provisions are similar in concept to the assembly credits used in the Upper Midwest Order.

Transportation credits will apply to plant to plant milk shipments for milk, skim or condensed skim originating in designated supply areas and delivered to eligible plants in designated deficit areas. The transportation assistance provided by the transportation credits will partially offset the plant to plant shipping costs for eligible milk movements. Before any promulgation hearing is convened, CDFR will have published updated shipping rates for both farm to plant and plant to plant shipments. It is our intention that the most current transportation rate data be used in setting the transportation allowances and credits.

B. Fortification allowance

As previously noted, fortification of milk for Class I uses to meet the California fluid milk standards will be accommodated through a fortification allowance to Class I handlers. These provisions are included to offset some of the costs to Class I handlers of meeting California's unique fluid milk standards, which will remain in force should a California FMMO be promulgated and adopted. California's fluid milk standards, which require higher nonfat solids content than milk meeting federal standards, were put in place at the request of California's dairy farmers. It is appropriate, therefore, that producers bear some responsibility, through the pool, of the added cost fluid milk processors face in making products that meet these standards.

C. Market Administrator, Handler Responsibility and Obligations

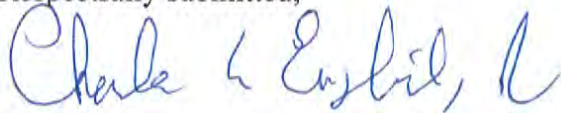
The Dairy Institute's proposal includes provisions establishing a Market Administrator, providing for ongoing and termination of obligations and handler responsibilities for maintaining records and facilities. These are standard FMMO provisions that were omitted from the Cooperatives' proposal.

Conclusion

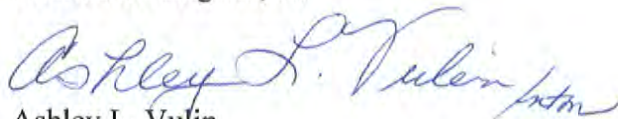
For all of the foregoing reasons, the Dairy Institute of California respectfully requests that the Secretary conclude pursuant to 7 C.F.R. § 900.3(a) that a hearing is not warranted because: (a) the California milk market is not subject to disorderly marketing conditions; and (b) the Cooperative proposal does not tend to effectuate the declared policy of the AMAA. In the alternative, the Dairy Institute submits the enclosed alternative proposed complete Federal Milk Order for consideration at a formal rulemaking proceeding at which substantial and current evidence will be required to justify adoption of any Federal Milk Order for California.

Deputy Administrator
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Respectfully submitted,



Charles M. English, Jr.



Ashley L. Vulin

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Attachments:

- 1: Alternative proposed regulatory language for a California Milk Marketing Order
- 2: Supplementary responses to topics addressed in 7 C.F.R. § 900.22.

cc: Anne Alonzo, Administrator, AMS (via e-mail)
Dana Coale, Deputy Administrator, AMS (via e-mail)
Marvin Beshore, Esq. (via e-mail)