NORTHEAST DAIRY COMPACT COMMISSION

7 CFR Part 1301

Compact Over-Order Price Regulation

AGENCY: Northeast Dairy Compact Commission.

ACTION: Final rule.

SUMMARY: This rule amends the current Compact Over-Order Price Regulation to exempt from the regulation any fluid milk sold in eight-ounce containers distributed by handlers under open competitive bid contracts and sold by School Food Authorities in New England during the 1998–1999 contract year, to the extent an increased cost of such milk is documented as attributable to operation of the price regulation. The Compact Commission will reimburse School Food Service Authorities for such documented increased costs.

EFFECTIVE DATE: April 1, 1998.

ADDRESSES: Northeast Dairy Compact Commission, 43 State Street, P.O. Box 1058, Montpelier, Vermont 05601.

FOR FURTHER INFORMATION CONTACT: Daniel Smith, Executive Director, Northeast Dairy Compact Commission at the above address or by telephone at (802) 229-1941 or by facsimile at (802) 229–2028.

SUPPLEMENTARY INFORMATION:

Background

The Compact Commission was established under authority of the Northeast Interstate Dairy Compact (''Compact''). The Compact was enacted into law by each of the six participating New England states as follows: Connecticut—Pub. L. 93–320; Maine—Pub. L. 89–437, as amended, Pub. L. 93–370; Massachusetts—Pub. L. 93–370; New Hampshire—Pub. L. 93–106; Vermont—Pub. L. 89–95, as amended, 93–57. Consistent with Article I, Section 10 of the United States Constitution, Congress consented to the Compact in Pub. L. 104–127 (FAIR ACT), Section 147, codified at 7 U.S.C. sec. 7256. Subsequently, the United States Secretary of Agriculture, pursuant to 7 U.S.C. sec. 7256(1) authorized implementation of the Compact.

Section 8 of the Compact empowers the Compact Commission to engage in a broad range of activities designed to ''promote regulatory uniformity, simplicity and interstate cooperation.'' For example, the Compact authorizes the Compact Commission to engage in a range of inquiries into the existing milk programs of both the participating states and the federal milk marketing system, to make recommendations to participating states, and to work to improve industry relations as a whole. See Compact, Art. IV, section 8.

In addition to the powers conferred by Section 8, the Compact also authorizes the Compact Commission to consider adopting a compact Over-order Price Regulation. See Compact, Art. IV, section 9. A *compact over-order price* is defined as:

> A minimum price required to be paid to producers for Class I milk established by the Commission in regulations adopted pursuant to sections nine and ten of this compact, which is above the price established in federal marketing orders or by state farm price regulation in the regulated area. Such price may apply throughout the region or in any part or parts thereof as defined in the regulations of the Commission.

Compact, Art. II, section 2(8).

The regulated price authorized by the Compact is actually an incremental amount above, or ''over-order'' the minimum price for the same milk established by Federal Milk Market Order #1. The price regulation establishes the minimum procurement price to be paid by fluid milk processors for milk that is ultimately utilized for fluid milk consumption in the New England region. Price regulation also provides for payment of a uniform ''over-order'' price, out of the proceeds of the price regulation, to dairy farmers making up the New England milkshed, regardless of the utilization of their milk. See Compact, Art. IV, section 9 (''The Commission is hereby empowered to establish the minimum price for milk to be paid by pool plants, partially regulated plants and all other handlers receiving milk from producers located in a regulated area.'')

Section 11 of the Compact delineates the administrative procedure the Compact Commission must follow in deciding whether to adopt or amend a price regulation:

> Before promulgation of any regulations establishing a compact over-order price or commission marketing order, including any provision with respect to milk supply under subsection 9(f), or amendment thereof, as provided in Article IV, the Commission shall conduct an informal rulemaking proceeding to provide interested persons with an opportunity to present data and views. Such rulemaking proceeding shall be governed by section four of the Federal Administrative Procedures Act, as amended (5 U.S.C. § 553). In addition, the Commission shall, to the extent practicable, publish notice of rulemaking proceedings in the official register of each participating state. Before the initial adoption of regulations establishing a compact over-order price or a commission marketing order and thereafter before any amendment with regard to prices or assessments, the Commission shall hold a public hearing. The Commission may commence a rulemaking proceeding on its own initiative or may in its sole discretion act upon the petition of any person including individual milk producers, any organization of milk producers or handlers, general farm organizations, consumer or public interest groups, and local, state or federal officials.

As part of any rulemaking procedure to establish or amend a price regulation, Section 12(a) of the Compact, directs the Commission to make four findings of fact with respect to:

> (1) Whether the public interest will be served by the establishment of minimum milk prices to dairy farmers under Article IV.
>
> (2) What level of prices will assure that producers receive a price sufficient to cover their costs of production and will elicit an adequate supply of milk for the inhabitants of the regulated area and for manufacturing purposes.
>
> (3) Whether the major provisions of the order, other than those fixing minimum milk prices, are in the public interest and are reasonably designed to achieve the purposes of the order.
>
> (4) Whether the terms of the proposed regional order or amendment are approved by producers as provided in section thirteen.

Compact, Art. V, Section 12.

Pursuant to Section 11 of the Compact, the Compact Commission initiated its first rulemaking procedure in December, 1996.[1] The rulemaking culminated on May 30, 1997 with the issuance of a final rule establishing a compact over-order price regulation for the period July 1, 1997–December 31, 1997.[2] On September 8, 1997, the Compact Commission issued notice of proposed rulemaking to consider whether to extend the price regulation beyond the present December 31, 1997 expiration date and whether to amend the regulation generally.[3] On November 25, 1997, a final rule was issued extending the price regulation through to sunset of the Compact enabling

[1] The Commission issued a notice of Hearing on December 13, 1996, 61 FR 65604, and held public hearings on December 17 and 19, 1996. The notice also invited the public to submit written comments through January 2, 1997. Following the close of this comment period, the Commission met on January 16, 1997 and established three working groups to consider the testimony and data submitted. The Commission issued a notice of Additional Comment Period on March 14, 1997, 62 FR 12252. This comment period closed on March 31, 1997; the reply comment period closed April 9, 1997. Based on the testimony and comment received, the Compact Commission issued a proposed rule on April 28, 1997 to adopt price regulation, 62 FR 23032. As part of the proposed rule, the Commission published for comment technical regulations to be codified at 7 CFR 1300, *et seq.* Minor corrections to the proposed rule were published May 8, 1997, 62 FR 25140, to provide clarification and to correct errors. The Compact Commission received additional comment in response to the proposed rule issued April 28, 1997.

[2] 62 FR 29627 (May 30, 1997).

[3] 62 FR 47156 (September 8, 1997)

legislation, and amending the technical regulation in certain instances.[4]

On December 11, 1997 (62 FR 65226), the Compact Commission issued a notice of proposed rulemaking[5] to exempt from the regulation fluid milk distributed by handlers under open and competitive bid contracts for the 1998–1999 contract year with New England School Food Authorities for child nutrition programs qualified for reimbursement under the National School Lunch Act and the Child Nutrition Act.[6] The Notice set a public hearing for December 29, 1997, as required by Section 11 of the Compact, and, pursuant to the Commission's bylaws, invited the public to submit written comments through January 12, 1998.

Based on the oral testimony and written comment received, and by reference to the reasoning set forth in its previous and final rules, the Compact Commission hereby amends the current Compact Over-order Price Regulation to exempt from the regulation fluid milk distributed by handlers under open and competitive bid contracts for the 1998–1999 contract year and sold by School Food Authorities, to the extent that an increased cost for such milk can be documented as attributable to operation of the price regulation.

The technical provisions of the Compact Over-order Price Regulation is codified at 7 CFR 1300 through 1308.1. The rule amends the regulation by adding a new paragraph (e) to 7 CFR 1301.13 *Exempt milk*.

Immediately following is a summary analysis and response to the comments received during the present rulemaking procedure. A more detailed review and response follows, organized around the finding analysis required by Section 12 of the Compact.

I. Summary Analysis of Comments Received in Response to the Proposed Rule and Compact Commission's Response

The Commission duly considered oral and written comment received at the December 29, 1997[7] hearing and the considered additional comments received by the Compact Commission's published deadline of January 12, 1998. The Compact Commission met on January 26, 1998 to consider and act on the comment received.[8]

Fifty-one separate comments were received during the hearing and written comment period. Of the total commenters, thirty-one expressed support for the regulation's amendment and fifteen expressed opposition to its amendment. The remaining five commenters took no apparent position on the proposal.

Ten of the fourteen commenters opposing the amendment were farmers. The remainder included representatives of farmer groups or organizations representing farmers. Five farmers spoke in support of the exemption.[9] Nine of the remainder of the thirty-two commenters supporting the amendment were directly employed in providing school lunches to schools, including representatives from Canton, Walpole, Pittsfield, Wakefield, Essex, and Quincy, Massachusetts. The remaining commenters in support of the exemption are a diverse group, including representatives of the region's departments of agriculture, officials of dairy farmer cooperatives and other farmer organizations, and a state legislative representative from Massachusetts.

Those farmers opposed to the amendment spoke of their strong support for the Compact and the need to keep the price regulation intact. Most of these commenters spoke in specific terms of the importance of the price regulation to the viability of their farming operations, but only in general terms with regard to its possible impact on school food service programs. The commenters who testified in favor of the exemption as food service program administrators provided specific evidence of the potential cost to their programs caused by the price regulation, and the importance of exemption from such cost. They described how food service programs are non-profit and predominantly self-supporting, and can absorb increased cost inputs only by price increases for meals or a la carte items. These commenters also emphasized the nutritional importance of milk. Many referred to the existing exemption in the price regulation for the Special Supplemental Nutrition Program for Women, Infants and Children (WIC) as a justification for treating school food service programs in a similar manner.

Other commenters who spoke in favor of establishing an exemption for school food service programs cautioned against making the exemption broader than necessary. Rather than exempting all milk sold to schools for the entire amount of the over-order price regulation, as in the WIC model, these commenters stressed the need for an exemption procedure by which only the actual, documented, amount of increased cost for milk sold in eight-ounce containers directly attributable to the price regulation would be reimbursed.[10]

The November 25, 1997 final rule establishing the present Compact over-order price regulation, as well as its predecessor promulgated May 30, 1997, defined as a governing principle the importance of assuring that the regulation does not adversely affect operation of child nutrition programs. Stemming in part from this governing principle, despite the Commission's overall determination that the end-consumer market would be positively affected by operation of the price regulation over time, the Commission established an exemption for the WIC program. This exemption was established in part because of the determination that the WIC program is unique as a capped entitlement program, but also out of an abundance of caution to assure that the program would be ''held harmless'' against any unanticipated short-term market distortions or other consequences attributable to the price regulation.

Following from this underlying, governing principle, the Commission is persuaded by the comment received in the present rulemaking procedure of the need to establish a limited exemption for school food service programs.[11] The Commission is responding, at bottom, to the universal understanding of the nutritional importance of milk for child nutrition, and the central role that school food service programs play in providing for child nutrition.

[4] 62 FR 62810 (November 25, 1997)

[5] The proposed rulemaking stemmed from the report of a Commission Ad Hoc Committee established pursuant to the final rule adopted on November 25, 1997. The rule charged the task force with assessing the impact of the Compact over-order price regulation on school food service programs and to ''make recommendations as to whether the region's school food service programs should receive reimbursement for some or all of any increased costs attributable to the price regulation and, if so, the method for reimbursing the appropriate authorities.'' 62 FR 62820.

[6] National School Lunch Act of 1946, Pub. L. 79–396; Child Nutrition Act of 1966, Pub.L. 89–642.

[7] December 11, 1997, 62 FR 65226.

[8] Public Notice of the January 26, 1998 meeting was published originally on January 9, 1998, 63 FR 1396. The meeting was rescheduled for January 26, 1998 (63 FR 3267, published January 22, 1998).

[9] One farmer, Bill Peracchio, initially testified against the exemption at the public hearing, but subsequently submitted written testimony in support of the exemption.

[10] These commenters included representatives from the Connecticut Farm Bureau, Agri-Mark, Inc., Massachusetts Cooperative Milk Producer's Federation, Independent Dairymen's Association, St. Albans Cooperative Creamery, Inc. and the Connecticut, Massachusetts and Vermont Departments of Agriculture.

[11] As explained below, the comment received makes clear that the exemption should apply to all milk served by school food service programs rather than only milk provided through government supplemental nutrition programs by schools, as set forth in the proposed rule.

Accordingly, the Commission hereby amends the price regulation to exempt milk sold in eight-ounce containers by school food service programs during the 1998–1999 school year, to the extent an increased cost attributable to operation of the price regulation is documented.

The comments received with regard to the significant concerns and relative positions on the critical issues invoked by the finding analysis mandated by Section 12(a) of the Compact are now addressed in detail.

II. Summary and Further Explanation of Findings Regarding Amendment

As noted above, Section 12(a) of the Compact directs the Commission to make four findings of fact before an amendment of the over-order price regulation can become effective.

The first finding considers whether the establishment of an exemption mechanism for milk sold in eight-ounce containers by school food service programs serves the public interest. The Compact Commission finds that the public interest will be served by a reimbursement process for the school year contract period for 1998–1999, or September, 1998–June, 1999.[12]

The second finding considers the level of producer price needed to cover costs of production and to assure an adequate local supply of milk. The Compact Commission finds that the exemption for milk sold in eight-ounce containers by school food service programs will reduce the net producer price established under the regulation by approximately three percent. Such a reduction will adversely affect to some degree the regulation's intended function as contemplated under this finding analysis. Nonetheless, the Commission concludes that this impact must be balanced within the overall context of the public interest contemplated under the first finding analysis, in which the paramount importance of child nutrition programs is overriding.

The fourth finding, requiring the determination of whether the amendment has been approved by producer referendum pursuant to Article IV, Section 12 of the Compact, is invoked in this instance given that the amendment will affect the level of the price regulation on the producer side. In this final rule, as in the previous final rules, the Compact Commission makes this finding premised upon certification of the referendum's results published separately in this **Federal Register**. The procedure for such certification is set forth infra in the section of this rule addressing the fourth finding.[13]

A. Whether an Amendment to the Price Regulation Establishing A Reimbursement Provision for Milk Sold in Eight-Ounce Containers by School Food Service Programs Will Serve the Public Interest

As one of the four underlying findings required for the establishment of price regulation, the Compact Commission must determine:

> (1) Whether the public interest will be served by the establishment of minimum milk prices to dairy farmers under Article IV.

Compact, Art. V., Section 12(a)(1).

In its prior rulemakings, as part of a broad ranging consideration of the public interest in price regulation, the Compact Commission directly addressed the anticipated impact of the price regulation on child supplemental nutrition programs. The Commission there determined that school food services programs operate essentially in accordance with the broad parameters of the competitive retail marketplace, whereby the price for school milk sold in eight-ounce containers is set through an open, competitive, bid process. Based on a direct reference to a General Accounting Office study's description of the programs, the Commission determined that:

> The National School Lunch Act of 1946 (Pub. L. 79–396) and the Child Nutrition Act of 1966 (Pub. L. 89–642) authorize USDA to reimburse state and local school authorities—under grant agreements—for some or all of the costs of these programs. Reimbursements are based on either the number of meals served or the number of half pints served. The schools use these funds, as well as state and local funds and moneys collected from students, to purchase food, including milk, for these programs. These purchases are made through either sealed bid or negotiated procurements. USDA's regulations require that these procurements be conducted in a manner that provides for the maximum amount of open and free competition.[14]

All commenters in the present rulemaking procedure, whether for or against an exemption, agree on the importance of school food service programs in ensuring that children have the opportunity to eat a nutritious and balanced meal at lunchtime during the school day (and at breakfast, where such meals are available). According to the comment received, milk provides 23–38 percent of the daily calcium requirement critical to bone development, depending on age, as well as other important nutrients and vitamins.[15]

One registered dietician explained why milk is such a valued and critical source of child nutrition:

> Now there are other sources of calcium. They include broccoli, kale, turnip and beet greens, canned fish, tofu, dried peas and beans. Frankly, none of these are really popular with children. So you can see that not only the most economical but the most acceptable source of calcium is milk or milk products.[16]

One farm couple, though opposed to an exemption, summed up the universal understanding of milk's importance as a nutritional source:

> Nutritionally, young children should consume their minimum daily requirements of calcium to avoid later skeletal problems. Calcium is stored as money in the bank for use in later life.[17]

The Commission received extensive, additional comment from directors of school food services programs about the operation and financing of these programs, and about the significance and relative cost of milk to the success of these programs.[18] The food service program directors described how their programs are for the most part self-funding, or without external funding from municipalities or state government, and receive only partial reimbursement from the federal government. The non-profit nature of the programs was also delineated. For example, the profit and loss statement for one program disclosed a total profit of $707.48 against total expenditures of $701,218.05, and it was explained that this surplus was intended as a carry-

[12] As developed further below, the Commission notes that the Compact sunsets by law no later than April, 1999, so that the actual term of the exemption is in reality from September, 1998–April, 1999.

[13] The third finding requires a determination of whether the provisions of the regulation other than those establishing minimum milk prices are in the public interest. The amendment serves only to establish a direct exemption from the price regulation itself. The matter of the public interest is thereby addressed under the first required finding and not under this finding. In any event, the Commission concludes that the price regulation, with operation of the amendment, remains in the public interest in the manner contemplated by this finding.

[14] GAO Report 13–239877 at p. 2 (October 16, 1992) submitted by Jim Jeffords as Additional Reply Comment, April 9, 1997; *see also* 62 FR 23050.

[15] Nancy E. Sandbach, Director of Nutrition Education, New England Dairy and Food Council, WC, January 5, 1998.

[16] Lois Black, Registered Dietician, Hamilton-Wenham Regional School District, December 29, 1997, Public Hearing at 43.

[17] Jacqueline and Dale Lewis, WC, January 12, 1998.

[18] Tina Lauersdorf, Food Service Director, Wakefield, MA Public Schools, December 29, 1997, Public Hearing at p. 25; Lois Black, Registered Dietician, Hamilton-Wenham, MA Regional School District, PH at p. 41; and Jaqueline Morgan, Food Services Director, Walpole, MA Public Schools, PH at p. 80. See also Allen Brown, Kenneth Leon and Marsha J. Maher, Canton, MA Public Schools, WC, December 22, 1997.

over to cover initial costs for the subsequent school year.[19]

Sales of milk by school food service programs, predominantly in eight-ounce containers, were described as occurring in two forms, either as part of a breakfast or lunch meal package or a la Carte. Lunch meal prices, including the milk container, are in the range of $1.00–$1.75.[20] A la Carte milk prices ranged from $0.35–$0.50 per container.

These commenters, as well as others,[21] described the milk procurement process for school food service programs. Supply contracts for a subsequent school year are put out to bid by individual districts or consortiums of districts, usually in April or May. After a review process, the contracts are let in July. By law, Massachusetts' school districts must accept the lowest bid received.

Bids and contracts take two forms, variable or fluctuating, and fixed. Fluctuating bids and contracts account for the variability in the vendor/processor's procurement cost, attributable to the monthly changes in federal milk market order pricing for fluid, or Class I milk. Fluctuating bids and contracts account for these changes by the establishment of a benchmark price as of a particular month, with allowance for subsequent changes in the market order price. Fixed bids and contracts do not allow for any such variability in the school program procurement price; the inherent variability in the processor's cost is built into the price upfront, and applies for the duration of the contract.[22]

According to statistics provided by the Massachusetts Department of Agriculture, approximately half each of all contracts are let by the fixed and variable methods. Also according to the Department's statistics, school food service program sales of milk amount to approximately three to four percent of all total fluid milk sales in the New England region.

All commenters associated with school food service programs were unanimous in expressing their concern that the programs are extremely sensitive to cost increases for milk. All expressed the concern that increases in milk costs could adversely affect their ability to provide milk to schoolchildren. These commenters all indicated that they understood the Compact price regulation as causing such a price increase, with the resulting adverse impact on their programs. For this reason, all commenters associated with school food service programs requested an exemption from the price regulation for their milk purchases.

As noted by many other commenters, however, the commenters associated with the school food service programs based their calculations of the potential or actual impact of the price regulation on a clearly inaccurate and incomplete understanding of the price regulation's operation.[23] Despite their apparent knowledge of the monthly variability in milk pricing, the food service program commenters expressed their opinions of the regulation's potential annual impact by reference to a letter from one vendor, describing the regulation's impact for only the one month of September, 1997. Even accounting for the well-understood arcane nature of milk market regulation, such incomplete analysis is by definition limited in terms of its benefit for understanding the dynamics between the price regulation and the region's school lunch programs.

The Commission further notes that the stated concerns expressed with regard to the potential impact of the price regulation come predominantly from food service programs in the state of Massachusetts. While comment in support of the exemption was received from a Food Service program provider in New Hampshire and in Vermont, all other commenters associated with food service programs were from Massachusetts. From the comment received, it is apparent that the concerns of many of these Massachusetts-based programs stemmed from the unsuccessful attempt by one vendor, West Lynn Creamery, Inc., to increase the fixed contract price to a number of school districts the vendor supplied, after the price regulation went into effect. Though unsuccessful, the attempt apparently served to bring operation of the price regulation to the attention of these commenters.[24]

Notwithstanding these vagaries in the testimony, the Compact Commission is persuaded that the comment received indicates that the price regulation may serve, at least in the short-term, to increase the cost of milk provided by school food service programs, and that such increase would have an adverse impact on the effectiveness of these vital child nutrition programs. Accordingly, the Commission hereby determines that the establishment of an exemption from the price regulation to preclude such an adverse impact best serves the public interest.

Many commenters other than representatives of school food service programs support this conclusion. For example, Leon Graves, Vermont Commissioner of Agriculture, testified that:

> The agricultural community understands the need to err on the side of caution regarding supplemental nutrition programs. As farmers are benefiting from the Compact Regulation, we recognize that the nutrition and well-being of children should not be at risk as a result of our efforts. If there is evidence in the record to demonstrate that increased milk contract prices are harming schools involved in child nutrition programs, then as was done with WIC, it would be prudent for the Commission to grant an exemption for milk in school meal programs as well.[25]

Frank Mattheson, a dairy farmer from Littleton, MA echoed the Commissioner's sentiment:

> I am concerned that even one child or school district is hurt by the Compact.[26]

The Commission accepts the approach of those commenters supporting an exemption premised on reimbursement of only higher costs that can be documented as attributable to the

[19] Jaqueline Morgan, Food Services Director, Walpole, MA Public Schools, WC, January 9, 1998.

[20] Lois Black, Registered Dietician, Hamilton-Wenham Regional School District, December 29, 1997, Public Hearing at 77; Jaqueline Morgan, Food Services Director, Walpole, MA Public Schools, December 29, 1997, Public Hearing at p. 129.

[21] See e.g. William J. Gillmeister, Economist, Massachusetts Department of Agriculture, WC, January 12, 1998.

[22] See Jaqueline Morgan, WC January 9, 1998, ''Cooperative Purchasing, Specifications for Milk and Milk Products, FY 1997–98''; see also William J. Gillmeister, WC, January 12, 1998.

[23] See e.g. Leon Berthiaume, WC, January 12, 1998; Bob Wellington, WC, January 9, 1998.

[24] ''When food service directors got this letter [from West Lynn Creamery announcing the intended price increase] the phone was ringing * * *'' Jaqueline Morgan, December 29, 1997, Public Hearing, p. 119.

The comment about this vendor's competitive conduct in the 1997–1998 bid process, and that of others, also may indicate that the price regulation could have created a downward pressure on milk prices in the manner contemplated by the Commission's analysis in the final rule adopting the price regulation. According to the testimony, West Lynn's attempt to increase the contract price for its milk after the price regulation went into effect may have ultimately been unsuccessful because ''* * * they would no longer be the lowest bidder so instead of going out to re-bid, West Lynn absorbed the cost into their price.'' Jaqueline Morgan, PH p. 119. This commenter subsequently qualified her statement by indicating that she was describing the experience of a program other than her own. While somewhat uncertain, the hearing testimony indicated further that more than the one vendor used this pricing strategy of not incorporating the price regulation into their bid price. ''We were informed by Nature's Best that they were not going to pass the price along to our collaborative.'' Jaqueline Morgan, PH at p. 109; see also Lois Black, PH at p. 47–48, indicating that Turner's Dairy did not include the price regulation in its bid. Such a pricing strategy of not incorporating anticipated price increases into a bid, whether based on the regulation's establishment of a flat procurement price or otherwise, could thus in fact have resulted in the positive, competitive-based, impact on prices anticipated by the rulemaking process.

[25] Leon Graves, PH at p.145.

[26] Frank Mattheson, WC, January 9, 1998.

price regulation.[27] Simple reference to the difference between the federal milk market order price structure and the compact ''over-order'' price regulation would, for most months at least, result by definition in the determination that the price regulation causes an increased procurement cost to the school food service programs. It is apparent from the comment received, however, that the bid process is in fact competitive and that, while changes in the federal milk market order price are used as a benchmark, the federal pricing structure is not the only component of the vendors' respective cost structures. Diverse costs associated with the particular circumstances of the multi-varied school food service programs,[28] as well as differing overheads, all can affect a vendor's particular bid. Given that some vendors apparently chose not to include it in their bids, incorporation of the price regulation's impact into the cost structure, itself, may also be a consideration, strategic or otherwise.

The Commission concludes that it is appropriate to establish the exemption in this format based on the further determination that such a requirement will not work undue hardship on the school food service programs. The programs currently document and report monthly milk sales for purposes of receiving federal reimbursement. Under this system of reimbursement, all food service programs in each state report to the respective state department of education.[29] The data and procedure for reporting sales currently in use can be relied upon and tailored for purposes of the compact price regulation exemption.

The procedure utilized will be modified to include a certification process from each school food service program vendor, establishing that the compact price regulation has been included in whole or in part in the contract price, and identifying the precise unit cost amount attributable to the price regulation. Vendors will be required to disclose in their bids the underlying cost components resulting in the identified unit price amount. These should include overhead and other standard cost components and the manner and degree to which the federal pricing structure has been incorporated. The Commission again concludes that such a requirement will not work a hardship, given that the vendors must currently make certain certifications as part of the current bid process, as well as account for the interplay between compact and federal price regulation in their composition of fixed and variable bids.[30]

To establish the precise mechanics of the reimbursement procedure, the Compact Commission will enter into a memorandum of understanding with the state departments of education, or other agency as appropriate, not later than May 1, 1998. The memorandum of understanding shall include provisions for certification by supplying vendor/processors that their bid and contract cost structures do in fact incorporate the over-order price obligation, in whole or in part, and provisions for defining the components of cost structure to be provided in support of such certification. The memorandum shall also establish the procedure for providing reimbursement to the school food service programs. This procedure shall provide for quarterly reimbursement, unless it is determined that a different reimbursement time frame would be more efficient and appropriate, and the appropriate amount to be escrowed by the Commission. The memorandum of understanding shall in addition contain provisions to ensure the confidentiality of the bid process.

The exemption is made applicable to all milk sold by school food service programs, rather than only milk qualified for reimbursement under federal child nutrition programs. According to the comment, the reimbursements are imbedded into the revenue structure for the school food service programs. The degree to which the reimbursements reduce program costs for milk, as opposed to the total food costs, cannot thereby be readily identified. As a result, to accomplish its purpose, all milk must be covered by the exemption.[31]

The exemption is limited with regard to its application in time and duration. Based on the comment received describing a competitive bidding process for the 1997–1998 contract year, it is apparent that the exemption must be made prospective, only. It would not be appropriate to interfere with or alter contractual arrangements already established. It is also apparent that the exemption must be limited to apply only to the 1998–1999 contract year, given the Compact's scheduled sunset of no later than April, 1999.

Some of the school food service program directors testifying at the December 29, 1997 Hearing suggested use of the WIC Program exemption procedure as the means to establish the exemption for school milk sales. The WIC Program exemption procedure is not applicable to the school food service programs. As noted, milk is provided in bulk deliveries by single vendors directly to the school food service programs. By contrast, there is no differentiation between or among the variety of fluid milk brands and products supplied to retailers for sale to WIC Program participants and that supplied for sale to all other consumers. On the other end of the transaction, school food service programs sell only program milk in a narrow readily definable transaction pattern, in contrast to the diverse pattern of retail sales to WIC Program participants.

Several commenters opposed establishment of the exemption based on the concern that petitions for additional exemptions would necessarily follow.[32] The Commission declines to rely on this stated concern as wholly speculative. A number of farmer commenters also expressed concern that the Commission was making its decision for political reasons.[33] The Commission responds by emphasizing that the decision arises only out of its assessment of the public interest as expressly required by the Compact, based on the record before it as developed through the regulatory hearing process, pursuant to Art. IV, section 12 of the Compact.

Some commenters indicated that the marginal cost to the school food service programs which may be attributed to the price regulation does not justify the exemption. The Commission responds

[27] Dan Stevens, President, Massachusetts Cooperative Milk Producer's Federation, WC, January 9, 1998; Sally Beach, General Manager, Independent Dairymen's Cooperative Association, December 29, 1997, Public Hearing at p. 12; Leon Berthiaume, General Manager, and Diane Bothfeld, St. Albans Cooperative Creamery, Inc., WC, January 12, 1998 and December 29, 1997, Public Hearing at p. 8; Gabe Moquin, Connecticut Department of Agriculture, WC, January 9, 1998; Leon Graves, Commissioner, Vermont Department of Agriculture, December 29, 1997, Public Hearing at p. 14; Bob Wellington, Senior Vice President, Agri-Mark, Inc., WC, January 9, 1998.

[28] Bids and contracts must expressly account for equipment use and even the provision of straws. (Provided free of charge by Nature's Best). Other considerations are frequency of delivery and the number of ''drops'' per territory. Jaqueline Morgan, December 29, 1997, Public Hearing at p. 103–104.

[29] Jaqueline Morgan, WC, January 9, 1998; William J. Gillmeister, WC, January 12, 1998.

[30] Jaqueline Morgan, WC, January 9 and 12, 1998.

[31] The exemption is limited to the sale of half-pint containers, the basic sales unit for the school food service programs. See Gabe Moquin, Connecticut Department of Agriculture, WC, January 9, 1998.

[32] See e.g. Doug Carlson, December 29, 1997, Public Hearing at p. 167.

[33] See e.g. Mathew Freund, PH at p. 154; and Dave Jacquier, PH at p. 159. In this regard, the Commission is responding particularly to the testimony of Mr. Jacquier, as well as that of Douglas P. Gillespie, Director of Governmental Relations, MA Farm Bureau Federation, Inc., WC, January 12, 1998.

by referring to the substantial and diverse comment highlighting the specific importance of school food service programs to the promotion of child nutrition. The Commission's decision to establish this exemption is in large part based on the determination that any adverse impact on these particular programs, so targeted for the promotion of child nutrition, is significant and must be avoided.

On the diametrically opposed end of the spectrum, two commenters expressing support for the exemption based their position on the view that the demonstrated need for the exemption should serve in effect as the basis for extinguishing the entire price regulation.[34] The Commission responds to these commenters by reference to the reasoning of the price regulation describing the expected positive impact on all segments of the marketplace, from farmgate to retail, including low-income consumers.

Finally, the Compact Commission notes that the public interest analysis of the rules establishing and extending the price regulation included a balancing of the interests of all persons affected by the price regulation. In this instance, the interests of farmers and processors must be balanced with the interests of the school food service programs, and their clients-children.

The Compact Commission determines that establishment of the instant exemption will not adversely affect the interests of processors. As described above, processor/vendors will retain the discretion to make strategic bid pricing decisions with regard to incorporation of the impact of the price regulation on their costing structures, including a simple pass through, should that be their strategic choice. As also described above, the Commission concludes that the certification and documentation procedure to be established by the memorandum of understanding will not cause undue hardship for processor/vendors.

With regard to the farmer interest, the Commission concludes that the exemption will have an adverse impact by reducing the net payment to producers. As explained in detail below, it is expected that the net payment will be reduced by approximately three percent for the ten-month period September 1998-June 1999. It is to be noted that the over-order price regulation will remain in effect for the summer months of July and August, when federally-established milk prices are traditionally at their low point, and the over-order price at the corresponding highest amounts. The Commission nonetheless concludes that this adverse impact on the farmer pay price must be balanced against the documented potential for harm to the school food service programs.

For all the reasons set forth above, the Commission concludes that the public interest will best be served by the establishment of an exemption from the price regulation and reimbursement procedure for fluid milk distributed by handlers under open competitive bid contracts and sold by School Food Authorities in New England during the 1998–1999 contract year, to the extent an increased cost of such milk is documented as attributable to operation of the over-order price regulation.

B. The Exemption's Impact on the Price Level Needed To Assure a Sufficient Price to Producers and an Adequate Local Supply of Milk

As one of the four underlying findings required for the establishment of price regulation, the Commission must determine:

> (2) What level of prices will assure that producers receive a price sufficient to cover their costs of production and will elicit an adequate supply of milk for the inhabitants of the regulated area and for manufacturing purposes.[35]

Compact Art. V, Section 12(a).

In the prior rulemakings, the Commission's deliberations regarding the level of price required to cover costs of production focused again on the variety of cost inputs identified in Section 9(e) of the Compact. With regard to the price needed to elicit an adequate local supply of milk, the Commission reviewed the nature of the balance of production and consumption in the region, as also called for by Section 9(e) of the Compact. This required review prompted the determination that farm prices have been insufficient to cover costs of production over time (''price insufficiency''), and the degree to which such insufficiency has affected the balance of production and consumption in the region. Assessment of this issue also required consideration of the wide swings over time in farmer pay prices under federal regulation, which have caused farm financial stress and made it difficult for farmers to plan financially (''price instability''), and the failure of farmer pay prices to keep up with inflation.

To determine the required benchmark cost of production, the Commission's analysis surveyed the various cost inputs as required under Section 9(e) of the Compact, including by reference to the numerous studies on the subject.[36] Based on data received from farmers and a comprehensive assessment of a number of these studies, the Commission concluded that the range of the costs of production for New England is somewhere between $14.06 and $16.46. By reference to prevailing federal milk market order prices, the Commission concluded that an over-order pay price in the range of $0.46–$1.90 was necessary to bring farmer pay prices up to the level necessary to cover cost of production.[37] Assuming Class I utilization of 50 percent, this means that price regulation in the amounts of $0.92–$3.80 would be necessary to achieve the necessary range of over-order payment.

In addition to the relatively discrete assessment of the level needed to cover cost of production, the required finding with regard to pay price accounts for the broader assessment of the price level needed to elicit an adequate supply of milk. In the prior rulemaking, the Compact Commission determined that the Compact, Section 9(e) scrutiny of the balance of production and consumption of fluid, or beverage, milk in the region is critical to this additional assessment.[38] The Commission determined that production and consumption are presently in balance, but in a state of balance of pronounced and unsustainable stress that must be alleviated.

Assessment of how to alleviate the stress on the region's supply of milk through price regulation required the Commission to consider how best to alleviate the stress under which producers operate. This inquiry naturally reverted back to the issue of the degree to which farmer pay prices are not sufficient to cover costs of production. In addition, as previously determined, the review led the Commission to conclude that the nature of the persistently unstable farmer pay prices and the degree to which farmer prices have failed to keep pace with inflation are also structural factors of stress.

[34] Arthur S. Jaeger, Executive Director, Public Voice for Food & Health Policy, WC, January 12, 1998; Joyce Campbell, Massachusetts ACORN, WC January 12, 1998.

[35] The Commission limited its assessment to issues relating to the fluid milk market, given the limitations on its authority to regulate the price of milk used for manufacturing purposes. *See* Compact, section 9(a); *see also* 7 U.S.C. Sec. 7256(2). At the same time, for purposes of this analysis, it must be recognized that the present supply needs for manufacturing purposes are not available for fluid usage.

[36] 62 FR 29632–33.

[37] See 62 FR 29633 (final rule); 62 FR 23040–41 (proposed rule)

[38] See 62 FR 29634–35.

Based on this combined analysis, the Commission determined that a compact over-order price of $16.94 would yield sufficient return to farmers to bring the producer price into the low range of that required to cover cost of production. The Commission further concluded that establishment of the over-order Class I obligation as a flat price would also serve to stabilize the producer price, yielding benefits to producers in this regard as well.

The following chart indicates that the price regulation is yielding the anticipated results with regard to producer prices. The current, average, producer price of $0.93 is at the low end of the range identified as required to bring producer prices up to a level sufficient to cover costs of production. Similarly, the current, average, regulated blend price of $14.07 is just over the low end of the identified threshold of $14.06 which defines the price needed to cover costs of production. The chart also indicates that the price regulation is providing stability to producer pay prices relative to what they would have been in its absence.

	Fed order #1 class I price (Zone 1)	Compact over-order obligation	Fed order #1 blend price (Zone 21)	Company producer price	Combined producer price
July	$13.94	$3.00	$11.97	$1.28	$13.25
Aug	13.98	2.96	12.26	1.31	13.57
Sept	14.10	2.84	12.54	1.36	14.17
Oct	15.31	1.63	13.60	0.81	14.44
Nov	16.03	0.91	14.10	0.44	14.54
Dec	16.07	0.87	14.06	0.40	14.46
Jan	16.20	0.74	.....	.....	.....
Feb	16.53	0.41	.....	.....	.....
Avg	15.27	1.67	13.09	0.93	14.07

It is estimated that the exemption and reimbursement for school food service programs will cause a 3 percent decrease in the producer pay price.[39] Based on the current average pay price of $0.93, this would result in a decrease in the pay price of approximately $0.03.

This decrease will bring the producer pay price still nearer to the bottom range of that identified as necessary to bring prices in relative alignment with costs. It is of course apparent that any reduction in the producer pay price will adversely affect the price regulation's intended function with regard to enhancement of producer income. Nonetheless, the amount of the decrease must be understood in view of the fact that the regulation will continue to provide significant stability to producer prices. Accordingly, the Commission concludes that the price regulation, as amended to include an exemption for milk sold by school food service programs will remain at a level sufficient to assure that producer costs of production are covered and to elicit an adequate supply of fluid milk for the region.

III. Required Findings of Fact

Pursuant to Compact Art. V, Sec. 12, the Compact Commission hereby finds:

(1) That the public interest will be served by the establishment [amendment] of minimum milk price [regulation] to dairy farmers under Article IV.

(2) That a level price of $16.94, [accounting for a school lunch exemption], will assure that producers receive a price sufficient to cover their costs of production and will elicit an adequate supply of milk for the inhabitants of the regulated area and for manufacturing purposes.

(3) That the terms of the proposed price regulation were approved by producers by referendum.[40]

[39] See William J. Gillmeister, WC, January 12, 1998.

[40] Section 13 of the Compact requires that the Commission conduct a referendum among producers and that, at least, two-thirds of the voting producers approved the regulation. A separate notice in the **Federal Register** certifies the results of the referendum pursuant to the following Referendum Approval Certification Procedure:

The Compact Commission resolves and adopts this procedure for certifying whether the price regulation adopted by this final rule has been duly approved by producer referendum in accordance with Compact Article V, section 12.

Mae Schmidle, Vice-Chair is hereby designated as ''Referendum Agent'' and authorized to administer this procedure.

The designated Referendum Agent shall:

1. Verify all ballots with respect to timeliness, producer eligibility, cooperative identification, authenticity and other steps taken to avoid duplication of ballots. Verification of ballots shall include those cast individually by block vote. Ballots determined by the Referendum Agent to be invalid shall be marked ''disqualified'' with a notation of the reason for disqualification. Disqualified ballots shall not be considered in determining approval or disapproval of the regulation.

2. Compute and certify the following:

A. The total number of ballots cast.

B. The total number of ballots disqualified.

C. The total number of verified ballots cast in favor of the price.

D. The total number of verified ballots cast in opposition to the price regulation.

E. Whether two-thirds of all verified ballots were cast in the affirmative.

3. Report to the Executive Director of the Compact Commission the certified computations and results of the referendum under Section 2.

4. At the completion of his or her work, seal all ballots, including the disqualified ballots, and shall submit a final report to the Executive Director stating all actions taken in connection with the referendum. The final report shall include all ballots cast and all other information furnished to or compiled by the Referendum Agent.

The ballots cast, the identity of any person or cooperative, or the manner in which any person or cooperative voted, and all information furnished to or compiled by the Referendum Agent shall be regarded as confidential.

The Executive Director shall publish the certified results of the referendum in the **Federal Register**.

List of Subjects in 7 CFR Part 1301

Milk.

Codification in Code of Federal Regulations

For the reasons set forth in the preamble, the Commission amends 7 CFR part 1301 as follows:

PART 1301—[AMENDED]

1. The authority for part 1301 continues to read as follows:

Authority: 7 U.S.C. 7256.

2. Section 1301.13 is amended by adding paragraph (e) to read as follows:

§ 1301.13 Exempt milk.

* * * * *

(e) Effective April 1, 1998, all fluid milk distributed by handlers in eight-ounce containers under open and competitive bid contracts for the 1998–1999 contract year with School Food Authorities in New England, as defined by 7 CFR 210.2, to the extent that the school authorities can demonstrate and document that the costs of such milk have been increased by operation of the Compact Over-order Price Regulation. In no event shall such increase exceed the amount of the Compact over-order obligation. Documentation of increased costs shall be in accordance with a memorandum of understanding entered into between the Compact Commission and the appropriate state agencies not

later than May 1, 1998. The memorandum of understanding shall include provisions for certification by supplying vendor/processors that their bid and contract cost structures do in fact incorporate the over-order price obligation, in whole or in part, and provisions for defining the components of cost structure to be provided in support of such certification. The memorandum shall also establish the procedure for providing reimbursement to the school food service programs, including the scheduling of payments and the amount to be escrowed by the Commission to account for such payments.

Daniel Smith,

Executive Director.

[FR Doc. 98–4140 Filed 2–26–98; 8:45 am]

BILLING CODE 1650–01–P

NORTHEAST DAIRY COMPACT COMMISSION

7 CFR Part 1301

Results of Producer Referendum on Compact Over-Order Price Regulation

AGENCY: Northeast Dairy Compact Commission.

ACTION: Notice of referendum results.

SUMMARY: The Northeast Dairy Compact Commission adopted an over-order price regulation by Final Rule on January 26, 1998, which is published elsewhere in this issue. To become effective the price regulation must be approved by at least two-thirds of all producers voting by referendum. A producer referendum was held during the period of February 10 through February 20, 1998. The Commission's price regulation was approved by more than two-thirds of all producers voting in the referendum.

ADDRESSES: Northeast Dairy Compact Commission, 43 State Street, P.O. Box 1058, Montpelier, Vermont 05601.

FOR FURTHER INFORMATION CONTACT: Daniel Smith, Executive Director, Northeast Dairy Compact Commission at the above address or by telephone at (802) 229–1941 or by facsimile at (802) 229–2028.

SUPPLEMENTARY INFORMATION: The Compact Commission was established under the authority of the Northeast Interstate Dairy Compact (''Compact''). The Compact was enacted into law by each of the six participating New England states as follows: Connecticut—Pub. L. 93–320; Maine—Pub. L. 89–437, as amended, Pub. L. 93–274; Massachusetts —Pub. L. 93–370; New Hampshire—Pub. L. 93–336; Rhode Island—Pub. L. 93–106; Vermont—Pub. L. 89–95, as amended, 93–57. Consistent with Article I, Section 10 of the United States Constitution, Congress consented to the Compact in Pub. L. 104–127 (FAIR ACT), Section 147, codified at 7 U.S.C. § 7256. Subsequently, the United States Secretary of Agriculture, pursuant to 7 U.S.C. § 7256(1), authorized implementation of the Compact.

Article V, Section 13(a) of the Compact provides that to ascertain whether a price regulation established by the Commission is approved by producers the Commission shall conduct a referendum among producers. Section 13(b) provides further that a price regulation shall be deemed approved by producers if the Commission determines that it is approved by at least two-thirds of the voting producers who, during a representative period, have been engaged in the production of milk subject to Commission price regulation. Section 13(c) directs the Commission to consider the approval or disapproval of any qualified cooperative association by block vote as the approval or disapproval of the producers who are members or stockholders in the cooperative association. Section 13 (c)(4) provides that producers who are members of cooperatives may express their approval or disapproval of the order by ballot, and the Commission shall remove their vote from the total certified by the Cooperative.

By Final Rule, published in this **Federal Register**, the Commission adopted an amendment to the over-order price regulation on January 26, 1998, which is published elsewhere in this issue. The Final Rule includes specific findings of fact required under Section 12(a)(1)–(4) of the Compact. The following notice provides certification of the finding required under Section 12(a)(4), specifically: ''Whether the terms of the proposed regional order or amendment are approved by producers as provided in section 13.''

The Commission adopted the following resolution for certifying a referendum vote at its January 26, 1998 meeting:

The Compact Commission resolves and adopts this procedure for certifying whether the price regulation adopted by this final rule has been duly approved by producer referendum in accordance with Compact Article V, section 12.

Mae Schmidle, Vice-Chair, is hereby designated as ''Referendum Agent'' and authorized to administer this procedure.

The designated Referendum Agent shall:

1. Verify all ballots with respect to timeliness, producer eligibility, cooperative identification, authenticity and other steps taken to avoid duplication of ballots. Verification of ballots shall include those cast individually by block vote. Ballots determined by the Referendum Agent to be invalid shall be marked ''disqualified'' with a notation of the reason for disqualification. Disqualified ballots shall not be considered in determining approval or disapproval of the regulation.

2. Compute and certify the following:

A. The total number of ballots cast.

B. The total number of ballots disqualified.

C. The total number of verified ballots cast in favor of the price.

D. The total number of verified ballots cast in opposition to the price regulation.

E. Whether two-thirds of all verified ballots were cast in the affirmative.

3. Report to the Executive Director of the Compact Commission the certified computations and results of the referendum under Section 2.

4. At the completion of his or her work, seal all ballots, including the disqualified ballots, and shall submit a final report to the Executive Director stating all actions taken in connection with the referendum. The final report shall include all ballots cast and all other information furnished to or compiled by the Referendum Agent.

The ballots cast, the identity of any person or cooperative, or the manner in which any person or cooperative voted, and all information furnished to or compiled by the Referendum Agent shall be regarded as confidential.

The Executive Director shall publish the certified results of the referendum in the **Federal Register**.

A referendum was held during the period of February 10 through February 20, 1998. All producers who were producing milk pooled in Federal Order #1 or for consumption in New England, during August of 1997, the representative period determined by the Commission were deemed eligible to vote. The mailing of ballots to eligible producers was completed on February 10, 1998 by the Federal Order #1 Market Administrator. The ballots included an official summary of the Commission's action. Producers were notified that, to be counted, their ballots had to be returned to the Commission offices by 5:00 pm on February 20, 1998.

Twelve Cooperative Associations were notified of the procedures necessary to block vote by letter dated February 4, 1998. Cooperatives were required to provide prior written notice of their intention to block vote to all members on a form provided by the Commission, and to certify to the Commission that (1) timely notice was provided, (2) the number of eligible producers for whom they claimed to be voting, and (3) that they were qualified under the Capper-Volstead Act. Cooperative Associations were further notified that Cooperative Association block vote reporting forms had to be