DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

7 CFR Part 1051

[Doc. No. AO–15–0071; AMS–DA–14–0095]

Milk in California; Recommended Decision and Opportunity To File Written Exceptions on Proposal To Establish a Federal Milk Marketing Order

AGENCY: Agricultural Marketing Service, USDA.

ACTION: Proposed rule and opportunity to file exceptions.

SUMMARY: This Recommended Decision proposes the issuance of a Federal Milk Marketing Order (FMMO) regulating the handling of milk in California. The proposed FMMO incorporates the entire state of California and would adopt the same dairy product classification and pricing provisions used throughout the current FMMO system. The proposed FMMO provides for the recognition of producer quota as administered by the California Department of Food and Agriculture. This proposed rule also announces the Agricultural Marketing Service's (AMS) intent to request approval by the Office of Management and Budget (OMB) of new information collection requirements to implement the order.

DATES: Written exceptions to this proposed rule must be submitted on or before May 15, 2017. Pursuant to the Paperwork Reduction Act, comments on the information collection burden must be received by April 17, 2017.

AMS will conduct a public meeting on February 22, 2017, to review the rulemaking process, explain and answer questions relating to how the proposed California FMMO would operate, and inform the public how they can submit public comments for consideration.

ADDRESSES: Comments should be submitted at the Federal eRulemaking portal: *http://www.regulations.gov.* Comments may also be filed with the Hearing Clerk, U.S. Department of Agriculture, Room 1031–S, Washington, DC 20250–9200, Facsimile number (202) 720–9976. All comments should reference the docket number and the date and page number of this issue of the **Federal Register**. All comments will be made available for public inspection in the Office of the Hearing Clerk during regular business hours, or can be viewed at: *http://www.regulations.gov.*

The public meeting will convene at 9:00 a.m. on Wednesday, February 22, 2017, at the Clovis Veterans Memorial District Building, 808 Fourth Street, Clovis, California 93612. Additional meeting information can be found at *www.ams.usda.gov/caorder.*

FOR FURTHER INFORMATION CONTACT: Erin Taylor, Acting Director, Order Formulation and Enforcement Division, USDA/AMS/Dairy Program, STOP 0231, Room 2969–S, 1400 Independence Ave. SW., Washington, DC 20250–0231, (202) 720–7311, email address: *erin.taylor@ams.usda.gov.*

SUPPLEMENTARY INFORMATION: This recommended decision finds that a FMMO for California would provide more orderly marketing conditions in the marketing area, and therefore promulgation of a California FMMO is warranted. The record is replete with discussion from most parties on whether disorderly marketing conditions exist, or are even needed, to warrant promulgation of a California FMMO. FMMOs are authorized by the Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601–674 and 7253) (AMAA). The declared policy of the AMAA makes no mention of ''disorder,'' and this recommended decision finds that disorderly marketing conditions are not a requirement for an order to be promulgated. The standard for FMMO promulgation is to ''. . . establish and maintain such orderly marketing conditions . . .,'' (7 U.S.C. 602(4) and this recommended decision finds that the California FMMO recommended decision meets that standard.

AMS has considered all record evidence presented at the hearing, as well as the arguments and proposed findings submitted in post-hearing briefs, to formulate this Recommended Decision. The package of provisions recommended in this decision reflect California marketing conditions, while still adhering to fundamental FMMO principles that have historically helped to maintain orderly marketing conditions, ensured a sufficient supply of pure and wholesome milk, and been in the public interest.

A FMMO is a regulation issued by the Secretary of Agriculture that places certain requirements on the handling of milk in the area it covers. Each FMMO is established under the authority of the AMAA. A FMMO requires handlers of milk for a marketing area pay minimum class prices according to how the milk is used. These prices are established under each FMMO after a public hearing where evidence is received on the supply and demand conditions for milk in the market. A FMMO requires that payments for milk be pooled and paid to individual farmers or cooperative associations of farmers on the basis of a uniform or average price. Thus, all eligible dairy farmers (producers) share in the marketwide use-values of milk by regulated handlers.

This decision recommends the establishment of a FMMO to regulate the handling of milk in California. Where appropriate, the recommended California FMMO proposes adoption of uniform provisions that are contained in the 10 current FMMOs. These uniform provisions include, but are not limited to, product classification, end-product price formulas, Class I differential structure, and producer-handler definition.[1] This decision recognizes the unique market structure of the California dairy industry through tailored performance-based standards to determine eligibility for pool participation.

As in all current FMMOs, California handlers regulated by a California FMMO would be responsible for accurate reporting of all milk movements and uses, and would be required to make timely payments to producers. The order would be administered by the United States Department of Agriculture (USDA) through a Market Administrator, who would provide essential marketing services, such as laboratory testing, account verification, information collection and publication, and producer payment enforcement.

A unique feature of the proposed order is a provision for the recognition of the California quota value specified in the California quota program currently administered by the California Department of Food and Agriculture (CDFA). This decision finds that the California quota program should remain a function of CDFA in whatever manner CDFA deems appropriate. Should CDFA continue to use producer monies to fund the quota program, this decision finds that the proper recognition of quota values within a California FMMO, as provided for in the Agriculture Act of 2014 (2014 Farm Bill) (Pub. L. 113–79, sec. 1410(d)), is to permit an authorized deduction from payment to producers, in an amount determined and announced by CDFA.

In conjunction with this Recommended Decision, AMS conducted a Regulatory Economic Impact Analysis to determine the potential impact of regulating California milk handlers under a FMMO on the milk supply, product demand and

[1] References to Class I, Class II, Class III and Class IV refer to products classified in those classes based on uniform FMMO provisions.

prices, and milk allocation in California and throughout the United States. As part of the analysis, a regional econometric model was used to project deviations from the USDA Agricultural Baseline Projections to 2025 [2] under the provisions of the proposed order. The full text of the Regulatory Economic Impact Analysis Report and accompanying documentation may be accessed at *www.regulations.gov* or *www.ams.usda.gov/caorder.*

Prior documents in this proceeding:

Notice of Hearing: Issued July 27, 2015; published August 6, 2015 (80 FR 47210);

Notice To Reconvene Hearing: Issued September 25, 2015; published September 30, 2015 (80 FR 58636).

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

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

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

The AMAA provides that administrative proceedings must be exhausted before parties may file suit in court. Under 7 U.S.C. 608c(15)(A) of the AMAA, any handler subject to an order may request modification or exemption from such order by filing with USDA a petition stating that the order, any provision of the order, or any obligation imposed in connection with the order is not in accordance with the law. A handler is afforded the opportunity for a hearing on the petition. After a hearing, USDA would rule on the petition. The AMAA provides that the district court of the United States in any district in which the handler is an inhabitant, or has its principal place of business, has jurisdiction in equity to review USDA's ruling on the petition, provided a bill in equity is filed not later than 20 days after the date of the entry of the ruling.

Civil Rights Impact Analysis

AMS has reviewed this rule in accordance with Departmental Regulation 4300–4—Civil Rights Impact Analysis, to identify and address potential impacts the proposal might have on any protected groups of people. After a careful review of the rule's intent and provisions, AMS has determined that this rule would not limit or reduce the ability of individuals in any protected classes to participate in the proposed FMMO, or to enjoy the anticipated benefits of the proposed program. Any impacts on dairy farmers and processors arising from implementation of this proposed rule are not expected to be disproportionate for members of any protected group on a prohibited basis.

Regulatory Flexibility Analysis

Pursuant to the requirements set forth in the Regulatory Flexibility Act (RFA) (5 U.S.C. 601–612), AMS has considered the economic impact of this action on small entities. Accordingly, AMS has prepared this initial regulatory flexibility analysis.

The purpose of the RFA is to fit regulatory actions to the scale of business subject to such actions so that small businesses will not be unduly or disproportionately burdened. Small dairy farm businesses have been defined by the Small Business Administration (SBA) (13 CFR 121.601) as those businesses having annual gross receipts of less than $750,000. SBA's definition of small agricultural service firms, which includes handlers that would be regulated under the proposed California FMMO, varies depending on the product manufactured. Small fluid milk and ice cream manufacturers are defined as having 1,000 or fewer employees. Small butter and dry or condensed dairy product manufacturers are defined as having 750 or fewer employees. Small cheese manufacturers are defined as having 1,250 or fewer employees.

For the purpose of determining which California dairy farms are ''small businesses,'' the $750,000 per year criterion was used to establish a production guideline that equates to approximately 315,000 pounds of milk per month. Although this guideline does not factor in additional monies that may be received by dairy farmers, it is a standard encompassing most ''small'' dairy farms. For the purpose of determining a handler's size, if the plant is part of a larger company operating multiple plants that collectively exceed the employee limit for that type of manufacturing, the plant is considered a large business even if the local plant has fewer than the defined number of employees.

Interested persons were invited to present evidence at the hearing on the probable regulatory and informational impact of the proposed California FMMO on small businesses. Specific evidence on the number of large and small dairy farms in California (above and below the threshold of $750,000 in annual sales) was not presented at the hearing. However, data compiled by CDFA [3] suggests that between 5 and 15 percent of California dairy farms would be considered small business entities. No comparable data for dairy product manufacturers was available.

Record evidence indicates that implementing the proposed California FMMO would not impose a disproportionate burden on small businesses. Currently, the California dairy industry is regulated by a California State Order (CSO) that is administered and enforced by CDFA. While the CSO and FMMOs have differences that will be discussed later in this decision, they both maintain similar classified pricing and marketwide pooling functions. Therefore, it is not expected that the proposed regulatory change will have a significant impact on California small businesses.

The record evidence does indicate that while the program is likely to impose some costs on the regulated parties, those costs would be outweighed by the benefits expected to accrue to the California dairy industry. AMS prepared a Regulatory Economic Impact Analysis to study the possible impacts of the proposed California FMMO. The analysis may be viewed in conjunction with this recommended decision (Docket No. AMS–DA–14–0095) at *www.regulations.gov.*

California Dairy Market Background

The record shows that the California dairy industry accounts for approximately 20 percent of the nation's milk supply. While its 39 million residents are concentrated in the state's coastal areas, the majority of California's dairy farms are located in the interior valleys, frequently at some distance from milk processing plants and consumer population centers.

CDFA has defined and established distinct regulations for Northern and Southern California dairy regions.[4]

[2] U.S. Department of Agriculture, Office of the Chief Economist, World Agricultural Outlook Board, Interagency Agricultural Projections Committee, 2016. Long-term Projections Report OCE–2016–1.

[3] CDFA, *California Dairy Review,* Volume 19, Issue 9, September 2015.

[4] CDFA, *Stabilization and Marketing Plan for Market Milk, as Amended, for the Northern California Marketing Area.*

According to data published by CDFA,[5] well over 90 percent of the state's approximately 41 billion pounds of milk for 2015 was produced in the Northern California region. The five leading milk production counties in 2015 were Tulare, Merced, Kings, Stanislaus, and Kern, together accounting for approximately 73 percent of the state's milk.

According to CDFA, there were 1,438 dairy farms in California in 2015. Of those, 1,338 were located in Northern California, and 100 were in Southern California. The statewide average number of cows per dairy was 1,215; in Northern California, the average herd size was 1,235 cows, and in Southern California, 952 cows. Average milk production for the state's 1.75 million cows was 23,382 pounds in 2015.

According to record evidence, 132 handlers reported milk receipts to CDFA for at least one month during 2015. A CDFA February 2015 list of California dairy product processing plants by type of product produced[6] shows that 35 California plants processed Class 1 products; 75 plants processed Class 2 and 3 products; 18 plants processed Class 4a products; and 64 plants processed Class 4b products.[7] Some plants processed products in more than one class.

CDFA reported[8] that approximately 99 percent of California's 2015 milk production was market grade (Grade A), and the rest was manufacturing grade (Grade B). Thirteen percent of the milk pooled under the CSO was utilized by California processors as Class 1 (fluid milk). Nine percent was utilized for Classes 2 and 3 (soft and frozen dairy products), 32 percent was utilized for Class 4a (butter and dried milk powders), and 46 percent was utilized for Class 4b (cheese).

According to CDFA, total Class 1 sales in California were approximately 662 million gallons in 2015. Record evidence shows that annual California Class 1 sales outside the state averaged 22 million gallons for the five years preceding 2015.

The record shows that for the five-year period from 2010 through 2014, an average of 230 million pounds of California bulk milk products were transferred to out-of-state plants for processing each year. During the same period, an average of 633 million pounds of milk from outside the state was received and reported by California pool plants each year.

Impact on Small Businesses

This rule proposes to establish a FMMO in California similar to the 10 existing FMMOs in the national system. The California dairy industry is currently regulated under the CSO, which is similar to the recommended FMMO in most respects. California handlers currently report milk receipts and utilization to CDFA, which calculates handler prices based on component values derived from finished product sales surveys. Likewise, FMMO handlers report milk receipts and utilization to the Market Administrators, who calculate handlers' pool obligations according to price formulas that incorporate component prices based on end product sales values. Under both programs, the value of handlers' milk is pooled, and pool revenues are shared by all the pooled producers. Thus, transitioning to the FMMO is expected to have only a minimal impact on the reporting and regulatory responsibilities for large or small handlers, who are already complying with similar CSO regulations.

Pricing

Under the recommended California FMMO, uniform FMMO end-product price formulas would replace the CDFA price formulas currently used to calculate handler milk prices. FMMO end-product price formulas incorporate component prices derived from national end-product sales surveys conducted by AMS. Use of price formulas based on national product sales would permit California farmers to receive prices for pooled milk reflective of the national market for commodity products for which their milk is utilized. Consistent with the current FMMOs, California FMMO Class I prices would be computed using the higher of the Class III or IV advance prices announced the previous month, and would be adjusted by the Class I differential for the county where the plant is located.[9]

Regulated minimum prices, especially for milk used in cheese manufacturing, are likely to be higher than what handlers would pay under the CSO. However, pooling regulations under the proposed FMMO would allow handlers to elect not to pool milk used in manufacturing. This option would be available to both large and small manufacturing handlers.

Dairy farmers whose milk is pooled on the order would receive a pro rata share of the pool revenues through the California FMMO uniform blend price. The FMMO would not provide for the quota and non-quota milk pricing tiers found under the CSO. Under the recommended FMMO, regulated handlers would be allowed to deduct monies, in an amount determined and announced by CDFA, from blend prices paid to California dairy farmers for pooled milk and send those monies to CDFA to administer the quota program.

These changes are expected to affect producers and handlers of all sizes, but are not expected to be disproportionate for small entities.

Producer-Handlers

The record shows that there are four producer-handlers[10] in California whose Class 1 milk production is all or partially exempt from CSO pricing and pooling by virtue of their ''exempt quota'' holdings, representing approximately 21 million pounds of milk each month. It is likely that these four entities would become fully regulated under the recommended FMMO and accountable to the marketwide pool for all of their Class I sales in the marketing area. By accounting to the pool for all their Class I sales in the marketing area, the value of the marketwide pool is expected to increase, benefiting most other large and small producers. The recommended California FMMO makes no provision for exempting large producer-handlers from pricing and pooling regulations under the order.

The evidentiary record shows that several smaller California producer-handlers, whose production volume exceeds the threshold to receive an exemption from the CSO's pricing and pooling regulations, would likely qualify as producer-handlers under the recommended FMMO.[11]

Interstate Commerce

The evidentiary record indicates that milk in interstate commerce, which the CSO does not have authority to regulate, would be regulated under the FMMO. Currently, California handlers who purchase milk produced outside the state do not account to the CSO marketwide pool for that milk. Record

[5] CDFA, *California Dairy Statistics Annual 2015.*

[6] CDFA, *Milk and Dairy Food Safety Branch (MDFS). https://www.cdfa.ca.gov/ahfss/Milk_and_Dairy_Food_Safety/index.html#Plants.*

[7] References to Class 1, Class 2, Class 3, Class 4a and Class 4b refer to products classified in those categories based on the CSO.

[8] CDFA, *California Dairy Statistics Annual 2015.*

[9] FMMOs have four classifications of milk: Class I—fluid milk products; Class II—fluid cream products, soft ''spoonable'' cheeses, ice cream, and yogurt; Class III—hard cheeses and spreadable cheese such as cream cheese; Class IV—butter and dried milk products.

[10] A producer-handler is a dairy farmer who processes and distributes their own-farm milk into dairy products.

[11] The CSO exempts producer-handlers with sales averaging less than 500 gallons of milk per day on an annual basis and who distribute 95 percent of their production to retail or wholesale outlets.

evidence shows approximately 425 million pounds of milk from outside the state was processed into Class 1 products at California processing plants during 2014.

Under the recommended FMMO, all Class I milk processed and distributed in the marketing area would be subject to FMMO pricing and pooling regulations, regardless of its origin. Revenues from Class 1 sales not currently regulated would accrue to the California FMMO pool and would be shared with all producers who are pooled on the California FMMO. If California handlers elect to continue processing out-of-state milk into Class I products under the FMMO, they would be required to pay the order's classified minimum price for that milk. Those additional revenues would be pooled and would benefit large and small producers who participate in the pool. Both large and small out-of-state producers who ship milk to pool plants in California would receive the California FMMO uniform blend price for their milk.

Classification and Fortification

Dairy product classification under the CSO and the recommended FMMO is similar, but not identical. The table below compares CSO and FMMO product classes.

CSO class	Equivalent FMMO class
Class 1	Class I.
Class 2 and 3	Class II.
Class 4b	Class III.
Class 4a	Class IV.

Under the proposed California FMMO, the classification of certain California products would change to align with standard FMMO classifications:

- Reassigning buttermilk from CSO Class 2 to FMMO Class I
- Reassigning half and half from CSO Class 1 to FMMO Class II
- Reassigning eggnog from CSO Class 2 to FMMO Class I
- There are numerous instances where the CSO classifies products based on product type and location of where the product is sold.[12] The proposed California FMMO would classify all products based solely on product type.

Under the recommended FMMO, California handlers would no longer receive credits for fluid milk fortification. Instead, accounting for fortification would be uniform with other FMMOs, as the classification of the fluid milk equivalent of the milk solids used to fortify fluid milk products would be classified as Class IV and the increased volume of Class I product due to fortification would be classified as Class I. The FMMO system accounts for fortification differently from the CSO, but the record does not indicate the net impact of this change. However, the impact is not expected to disproportionately affect small entities.

Transportation Credits

The recommended FMMO does not contain a transportation credit program to encourage shipments to Class 1, 2 and 3 plants as is currently provided for in the CSO. This decision recommends that producer payments be adjusted to reflect the applicable producer location adjustment for the handler location where their milk is received, thus providing the incentive to producers to supply Class I plants. As producers are responsible for finding a market for their milk and consequently bear the cost of transporting their milk to a plant, the record of this proceeding does not support reducing the producers' value of the marketwide pool through the payment of transportation credits to handlers. This change is not expected to disproportionately impact small business entities.

Summary

This decision finds that adoption of the recommended California FMMO would promote more orderly marketing of milk in interstate commerce. Classified milk prices under the recommended order would reflect national prices for manufactured products and local prices for fluid milk products, fostering greater equality for California producers and handlers in the markets where they compete. Under the recommended order, handlers would be assured a uniform cost for raw milk, and producers would receive uniform payments for raw milk, regardless of its use. Small dairy farmers and handlers are not expected to be disproportionately impacted by the transition from CSO to FMMO regulations.

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35) (Act), this notice announces AMS' intention to request approval from the Office of Management and Budget (OMB) for a new information collection totaling 2138.35 hours for the initial set-up and annual reporting and recordkeeping requirements contained in this proposed rule for the promulgation of a California FMMO.

OMB previously approved information collection requirements associated with all other FMMOs and assigned OMB control number 0581–0032. This proposed rule would change certain aspects of the information collection and recordkeeping requirements previously approved. Therefore, a NEW information collection is required to carry out the requirements of this proposed rule. AMS intends to merge this new information collection, upon OMB approval, into the approved OMB No. 0581–0032 collection.

Below, AMS has described and estimated the annual burden for entities to prepare and maintain information necessary to participate in this proposed California FMMO. As with all mandatory regulatory programs, reporting and recordkeeping burdens are periodically reviewed to reduce information requirements and duplication by industry and public sector agencies. The Act, as amended, provides authority for this action.

Title: Report Forms Under a California Federal Milk Marketing Order (From Milk Handlers and Milk Marketing Cooperatives).

OMB Number: 0581–NEW.

Expiration Date of Approval: Three years from date of approval.

Type of Request: This is a NEW collection.

Abstract: FMMO regulations (7 CFR parts 1000–1199) authorized under the AMAA require milk handlers to report in detail the receipts and utilization of milk and milk products handled at each of their plants that are regulated by a Federal order. The data are needed to administer the classified pricing system and related requirements of each Federal order.

A FMMO is a regulation issued by the Secretary of Agriculture that places certain requirements on the handling of milk in the area it covers. Each FMMO is established under the authority of the AMAA. The FMMO requires handlers of milk for a marketing area pay not less than certain minimum class prices according to how the milk is used. These prices are established under each FMMO after a public hearing where evidence is received on the supply and demand conditions for milk in the market. A FMMO requires payments for milk be pooled and paid to individual farmers or cooperative associations of farmers on the basis of a uniform or average price. Thus, all eligible dairy farmers (producers) share in the marketwide use-values of milk by regulated handlers.

[12] CDFA, *Classification of Dairy Products. https://www.cdfa.ca.gov/dairy/pdf/PRDCLASS.pdf.*

FMMOs help ensure adequate supplies of milk and minimum returns to producers. The FMMOs also provide for the public dissemination of market statistics and other information for the benefit of producers, handlers, and consumers.

Formal rulemaking amendments to the FMMOs must be approved in referenda conducted by the Secretary.

During 2015, 1,438 California dairy farmers produced over 40.9 billion pounds of milk. This volume represents approximately 20 percent of all milk marketed in the U.S. The value of this milk delivered to CSO regulated handlers at minimum CSO classified prices was over $3 billion. Producer deliveries of milk used in Class 1 products (mainly fluid milk products) totaled 13 percent of the State's market utilization.

Under the proposed California FMMO, an estimated 3.4 billion pounds of milk would be pooled, making it the largest FMMO pool. Class I volume pooled would approximate 438 million pounds each month, making it the third largest.

Each FMMO is administered by a Market Administrator. The Market Administrator is authorized to levy assessments on regulated handlers to carry out their duties and responsibilities under the FMMOs. Additional duties of the Market Administrator are to prescribe reports required of each handler, to assure handlers properly account for milk and milk products, and to assure such handlers pay producers and associations of producers according to the provisions of the FMMO. The Market Administrator employs a staff that verifies handlers' reports by examining their records to determine that required payments are made to producers. Most reports required from handlers are submitted monthly to the Market Administrator.

The forms used by the Market Administrators are required by the respective FMMOs authorized by the AMAA. The forms are used to establish the quantity of milk received by handlers, the pooling status of the handlers, the class use of milk by the handler, and the butterfat content and amounts of other components of the milk.

The forms covered under this information collection require the minimum information necessary to effectively carry out the requirements of the proposed California FMMO, and their use is necessary to fulfill the intent of the AMAA as expressed in the FMMO and in the rules and regulations proposed under the FMMO. The information collected will only be used by authorized employees of the Market Administrator and authorized representatives of the USDA, including AMS Dairy Program staff.

Some of the established forms under ''Report Forms under Federal Milk Orders (From Milk Handlers and Milk Marketing Cooperatives)'' OMB No. 0581–0032 will be used and modified for this proposed order. However, the burden shown in this section is for this collection only. Upon approval, USDA will request to merge this burden into the currently approved OMB No. 0581–0032. All separate burdens will become all inclusive.

Estimate of Burden: Public reporting burden for this collection of information is estimated to average 1.06 hours per response.

Respondents: Milk handlers and milk marketing cooperatives.

Estimated Number of Respondents: 55.

Estimated Total Annual Responses: 2,022.

Estimated Number of Responses per Respondent: 36.76.

Estimated Total Annual Burden on Respondents: 2138.35.

Comments are invited on: (1) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) the accuracy of the agency's estimate of the burden of the proposed collection of information including the validity of the methodology and assumptions used; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of the collection of information on those who are to respond, including the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology.

All responses to this notice will be summarized and included in the request for OMB approval. All comments will become a matter of public record. A 60-day period is provided to comment on the information collection burden.

Preliminary Statement

Notice is hereby given of the filing with the Hearing Clerk of this Recommended Decision with respect to the proposed marketing agreement and order regulating the handling of milk in California.

This Recommended Decision is issued pursuant to the provisions of the AMAA and the applicable rules of practice and procedure governing the formulation of marketing agreements and orders (7 CFR part 900). The proposed marketing agreement and order are authorized under 7 U.S.C. 608(c).

The proposed marketing agreement and order are based on the record of a public hearing held September 22 through November 18, 2015, in Clovis, California. The hearing was held to receive evidence on four proposals submitted by dairy farmers, handlers, and other interested parties. Notice of this hearing was published in the **Federal Register** on August 6, 2015.

Ninety-eight witnesses testified over the course of the 40-day hearing. Witnesses provided a broad overview of the history and complexity of the California dairy industry, and submitted 194 exhibits containing supporting data, analyses, and historical information.

The material issues presented on the record of hearing are as follows:

1. Whether the handling of milk in the proposed marketing area is in the current of interstate commerce, or directly burdens, obstructs, or affects interstate commerce in milk or its products;
2. Whether economic and marketing conditions in California show a need for a Federal marketing order that would tend to effectuate the declared policy of the Act;
3. If an order is issued, what its provisions should be with respect to:

a. Handlers to be regulated and milk to be priced and pooled under the order;
b. Classification of milk, and assignment of receipts to classes of utilization;
c. Pricing of milk;
d. Distribution of proceeds to producers; and
e. Administrative provisions.

Findings and Conclusions

The findings and conclusions on the material issues are based on the record of the hearing. Discussions are organized by topic, recognizing inevitable overlap in some areas. Topics are addressed in the following order:

1. Regulatory Comparison
2. Overview of Proposals
3. Justification for a California FMMO
4. California Quota Program Recognition
5. Definitions and Uniform Provisions
6. Classification
7. Pricing
8. Pooling
9. Transportation Credits
10. Miscellaneous and Administrative Provisions

1. Regulatory Comparison

The purpose of the following section is to provide a general description and comparison of the major features of the California state dairy regulatory framework and the FMMO system as provided in the evidentiary record. A more detailed discussion of each issue is provided in the appropriate section of this decision.

California State Order

Currently, milk marketing in California is regulated by the CDFA. The CSO is codified in the *Pooling Plan for Market Milk,* as amended, and in two *Stabilization and Marketing Plan(s) for Market Milk,* as amended, for the Northern and Southern California marketing areas.[13]

Quota

The California quota program is a state-administered producer program that entitles the quota holder to $0.195 per pound of solids-not-fat above the CSO base and overbase price of milk.[14] The quota premium is funded through a deduction from the CSO marketwide pool before the CSO overbase price is calculated. The quota program requires quota holders to deliver milk to a pool plant at least once every 60 days. Quota can be bought and sold, and according to record evidence, approximately 58 percent of California dairy farms owned some volume of quota in 2015.

Classification

The CSO provides for the pricing of five classified use values of milk. In general, Class 1 is milk used in fluid milk products; Class 2 is milk used in heavy cream, cottage cheese, yogurt, and sterilized products; Class 3 is milk used in ice cream and frozen products; Class 4a is milk used in butter and dry milk products, such as nonfat dry milk; and Class 4b is milk used in cheese—other than cottage cheese—and whey products.

Pricing

The CSO utilizes an end-product pricing system to determine classified prices for raw milk produced and manufactured in the State of California. Class 1, 4a, and 4b prices are announced monthly. Class 2 and 3 prices are announced bi-monthly. Prices for all five milk classes are component-based. Three components of milk are used to determine prices: Butterfat (fat); solids-not-fat (SNF), which includes protein and lactose; and a fluid carrier (used in only the Class 1 price).

The CSO determines milk component prices based on commodity market prices obtained from the Chicago Mercantile Exchange (CME), the AMS Dairy Market News Western Dry Whey—Mostly (WDW-Mostly) price series, and the announced nonfat dry milk (NFDM) California Weighted Average Price (CWAP), which is determined by CDFA through weekly surveys of California manufacturing plants.

The price for milk used in cheese manufacturing (CSO Class 4b) is a central issue in this proceeding. The Class 4b price is announced monthly and utilizes average commodity market prices for block Cheddar cheese, butter, and dry skim whey to determine the Class 4b component values. The average CME prices for butter and 40-pound Cheddar blocks are adjusted by f.o.b. price adjusters, which are designed to represent the difference between the CME price and the price California manufacturers actually receive. The CME butter price is also reduced by $0.10 per pound to derive the value of whey butter as it relates to cheese processing. The value of dry skim whey is determined through a sliding scale that provides a ''per hundredweight (cwt)'' value based on a series of announced WDW-Mostly per pound value ranges. The sliding scale determines dry whey's contribution to the Class 4b price, with a floor of $0.25 per cwt and a ceiling of $0.75 per cwt when the WDW-Mostly price equals or exceeds $0.60 per pound.

The CSO pricing system has a number of features worth highlighting. First, under the CSO, handlers must pay at least minimum classified prices for all Grade A milk purchased from California dairy farmers, regardless of whether the milk is pooled on the CSO. Additionally, Class 1 processors may claim credits against their pool obligations to offset the cost of fortifying fluid milk to meet the State-mandated solids content standards.

The classified use values of all the milk pooled on the CSO are aggregated, and producers are paid on the fat and SNF component levels in their raw milk. Producers are paid on the basis of their allocated quota (if applicable), base, and overbase production for the month. While the CSO pricing formulas have changed over time, in their current form, the base and overbase prices are the same. Generally, the quota price is the overbase price plus the $1.70 per cwt quota premium.

Pooling

Almost all California-produced milk received by California pool plants is pooled on the CSO, with some exceptions. Grade B milk is neither pooled nor subject to minimum prices. Manufacturing plants that do not make any Class 1 or 2 products can opt out of the pool, however, they are still required to pay announced CSO classified minimum prices for Grade A milk received. The requirement that quota holders must deliver milk to a pool plant at least once every 60 days tends to limit the amount of Grade A milk not pooled on the CSO. The decision not to pool milk in California carries with it a stipulation that the plant may not repool for 12 months after opting not to pool, and after repooling, a plant cannot opt out of pooling for 12 months.

Entities recognized as producer-handlers under the CSO may be exempt from pooling some or all of their milk. Producer-handlers are dairy farmers who also process and distribute their dairy products. Fully exempt (''Option 66'') producer-handlers have minimal production volumes and are exempt from the pricing and pooling provisions of the CSO. Producer-handlers who own exempt quota (''Option 70'') do not account to the CSO marketwide pool for the volume of Class 1 milk covered by their exempt quota.

The State of California cannot regulate interstate commerce, and therefore milk from out-of-state producers cannot be regulated by the CSO. While the record reflects that California handlers typically pay for out-of-state milk at a price reflective of the receiving plant's utilization, those prices are not regulated or enforced by the CSO.

Transportation Credits

The CSO provides transportation credits to producers for farm-to-plant Class 1, 2 and 3 milk movements between designated supply zones and plants with more than 50 percent Class 1, 2 and/or 3 utilization in designated demand zones. The CSO also provides for transportation allowances to handlers for plant-to-plant milk movements.

Classification

Whereas the CSO designates five classes of milk utilization, FMMOs provide for four classes of milk utilization. FMMO Class I is milk used in fluid milk products. Class II is milk used to produce fluid cream products, soft ''spoonable'' products like cottage cheese, ice cream, sour cream, and yogurt, and other products such as kefir, baking mixes, infant formula and meal replacements, certain prepared foods, and ingredients in other prepared food products. Class III is milk used to

[13] Chapter 2, Part 3, Division 21 and Chapter 3, Part 3, Division 21 of the California Food and Agriculture Code.

[14] The hearing record reveals that the $0.195 per pound solids-non-fat equates to a $1.70 per cwt of milk quota premium. Additionally, under current CSO provisions, base and overbase prices are equal.

produce spreadable cheeses like cream cheese, and hard cheeses, like Cheddar, that can be crumbled, grated, or shredded. Class IV is milk used to produce butter, evaporated or sweetened condensed milk in consumer-style packages, and dry milk products.

Federal Milk Marketing Orders

A FMMO is a regulation issued by the Secretary of Agriculture (Secretary) that places certain requirements on the handling of milk in a defined geographic marketing area. FMMOs are authorized by the AMAA. The declared policy of the AMAA is to ''. . . establish and maintain such orderly marketing conditions for agricultural commodities in interstate commerce . . .'' (7 U.S.C. 602(1)) . The principle means of meeting the objectives of the FMMO program are through the use of classified pricing of milk and the marketwide pooling of returns.

Pricing

Like the CSO, the FMMO program currently uses end-product price formulas based on the wholesale prices of finished products to determine the minimum classified prices handlers pay for raw milk in the four classes of utilization. However, the FMMO pricing system has some notable differences. While the CSO announces some classified prices on a bi-monthly basis, FMMOs announce prices for all four milk classes monthly. FMMOs use four components of milk to determine prices: Butterfat, protein, nonfat solids and other solids.

Like the CSO, the FMMO determines component prices based on commodity prices. However, AMS administers the Dairy Product Mandatory Reporting Program (DPMRP) to survey weekly wholesale prices of four manufactured dairy products (cheese, butter, NFDM and dry whey), and releases weekly average survey prices in the National Dairy Product Sales Report (NDPSR).[15] The FMMO product-price formulas use these surveyed prices to determine the component values in raw milk.

As referenced previously, a main feature of this proceeding is the pricing of milk used for cheese manufacturing (FMMO Class III). The FMMO pricing system determines the Class III value from DPMRP surveyed butter, cheese, and dry whey prices. The FMMO does not utilize a sliding scale to determine the value of whey that contributes to the Class III price.

Unlike the CSO, FMMOs do not provide for a tiered system of producer payments. A uniform blend price is computed for each FMMO reflecting the use of all milk in each marketwide pool. A blend price is paid for all milk that is pooled on the FMMO, adjusted for location. In six of the FMMOs, producers are paid for the pounds of butterfat, pounds of protein, pounds of other solids, and cwt of milk pooled. The cwt price is known as the producer price differential (PPD) and reflects the producer's pro rata share of the value of Class I, Class II, and Class IV uses in the pool relative to Class III value. In the other four FMMOs, producers are paid on a butterfat and skim basis.

Pooling

Inclusion in the FMMO marketwide pool carries with it an obligation to be available to serve the fluid market with necessary milk supplies throughout the year. In the FMMO system, participation in the pool is mandatory for distributing plants that process Grade A milk into Class I products sold in a FMMO marketing area. Handlers of manufacturing milk (Class II, III or IV) have the option of pooling, and pool eligibility is based on performance standards specific to each FMMO.

FMMOs recognize the unique business structures of producer-handlers, and exempt them from the pricing and pooling regulations of the orders based on size. Producer-handler exemptions under FMMOs are limited to those vertically-integrated entities that produce and distribute no more than three million pounds of packaged fluid milk products each month.

Unlike the CSO, FMMOs are authorized to regulate the interstate commerce connected with milk marketing. Thus, there is no differentiated regulatory treatment for milk produced outside of a FMMO marketing area boundary. All eligible milk is pooled and priced in the same manner, regardless of its source.

Transportation Credits

The Appalachian and Southeast FMMOs provide for transportation credits to offset a handler's cost of hauling supplemental milk to Class I markets. During deficit months, handlers can apply for transportation credits to offset the cost of supplemental milk deliveries from outside the marketing area to meet the Class I demand of FMMO handlers. The most significant difference from the CSO is that the FMMO transportation credits described are not paid from the marketwide pool. Instead, they are paid from separate funds obtained through monthly assessments on handlers' Class I producer milk. The exception is the Upper Midwest FMMO, which provides transportation credits on plant-to-plant milk movements paid from the marketwide pool.

2. Overview of Proposals

Four proposals were published in the Hearing Notice of this proceeding. Dairy Farmers of America, Inc., Land O'Lakes, Inc., and California Dairies, Inc., jointly submitted Proposal 1. Dairy Farmers of America, Inc. (DFA), is a national dairy-farmer owned cooperative with approximately 14,000 members and several processing facilities located throughout the United States, with products marketed both nationally and internationally. Within California, DFA represents 260 members and operates three processing facilities. Land O'Lakes (LOL) is a national farmer-owned cooperative with over 2,200 dairy-farmer members. LOL has processing facilities in the Upper Midwest, the eastern United States, and the State of California, with products marketed nationally and internationally. Within California, LOL represents 200 dairy-farmer members and operates three processing facilities. California Dairies, Inc. (CDI), is a California based dairy-farmer owned cooperative with 390 dairy-farmer members, six processing facilities in California, and national and international product sales. Combined, DFA, LOL, and CDI (Cooperatives) market approximately 75 percent of the milk produced in California.

Proposal 1 seeks to establish a California FMMO that incorporates the same dairy product classification and pricing provisions as those used throughout the FMMO system. Proposal 1 also includes unique pooling provisions, described as ''inclusive'' throughout the proceeding that would pool the majority of the milk produced in California each month, while also allowing for the pooling of milk produced outside of the marketing area, if it meets specific pooling provisions. The proposal includes fortification and transportation credits similar to those currently provided by the CSO. Lastly, Proposal 1 provides for payment of the California quota program quota values from the marketwide pool before the FMMO blend price is computed each month.

Proposal 2 was submitted on behalf of the Dairy Institute of California (Institute). The Institute is a California trade association representing proprietary fluid milk processors and cheese manufacturers, and cultured and

[15] Official Notice is taken of the Notice of Equivalent Price Series: 77 FR 22282. The National Dairy Product Sales Report was deemed as equivalent to the price series previously released by the National Agricultural Statistics Service.

frozen dairy products manufacturers in 38 plants throughout California. Institute plants process 70 percent of the fluid milk products, 85 percent of the cultured and frozen dairy products, and 90 percent of the cheese manufactured in the state. The Institute's first position is that a California FMMO should not be promulgated. However, should USDA find justification for promulgation, the Institute supports Proposal 2. Proposal 2 incorporates the same dairy product classification provisions used throughout the FMMO system, as well as pooling provisions that are consistent with those found in other FMMOs. The Proposal 2 pooling provisions require the pooling of Class I milk, but the pooling of milk used in manufactured products is optional. Proposal 2 includes fortification and transportation credits similar to those currently provided by the CSO. It also includes an additional shrinkage allowance for extended shelf life (ESL) products above that provided in the FMMO system. Lastly, Proposal 2 recognizes quota value by allowing producers to opt out of the quota program, thus receiving a FMMO blend price reflective of the market's utilization. Under Proposal 2, producers who remain in the quota program would have their blend price monies transferred to CDFA and redistributed according to their quota and non-quota holdings.

Proposal 3 was submitted on behalf of the California Producer Handlers Association (CPHA). CPHA is an association of four producer-handlers: Foster Farms Dairy, Inc. (Foster), Hollandia Dairy, Inc., Producers Dairy Foods, Inc. (Producers), and Rockview Dairies, Inc. (Rockview). CPHA members own their respective dairy farms and process that farm milk, as well as the milk of other dairy farms, for delivery to consumers. CPHA members own exempt quota, which entitles them to exemption from CSO pricing and pooling provisions for the volume of Class 1 milk covered by their exempt quota. Proposal 3 seeks recognition and continuation of CPHA members' exempt quota status under a California FMMO.

Proposal 4 was submitted on behalf of Ponderosa Dairy (Ponderosa). Ponderosa is a Nevada dairy farm that supplies raw milk to California fluid milk processing plants. Ponderosa contends that disorderly marketing conditions do not exist in California that would warrant promulgation of a FMMO. However, if USDA finds justification for a California FMMO, Proposal 4 seeks to allow California handlers to elect partially-regulated plant status with regard to milk they receive from out-of-state producers. Such allowance would enable handlers to not pool out-of-state milk, as long as they could demonstrate that they paid out-of-state producers an amount equal to or higher than the market blend price.

3. Justification For A California FMMO

This section reviews and highlights the testimony and evidence received regarding whether or not promulgation of a California FMMO is justified. This decision finds that the proposed California FMMO would provide for more orderly marketing conditions for the handling of milk in the State of California, as provided for and authorized by the AMAA.

A Cooperative witness testified regarding current California marketing conditions and the need for establishing a California FMMO. According to the witness, California is the largest milk-producing state, producing more than 20 percent of the nation's milk. The witness stated that the pooled volume of a California FMMO would be the largest of all FMMOs, averaging slightly below 3.4 billion pounds per month; the Class I volume would represent the third largest, following the Northeast and Mideast FMMOs.

The Cooperative witness testified that the primary reason California farmers are seeking the establishment of a FMMO is to receive prices reflective of the national commodity values for all milk uses. The witness opined that orderly marketing is no longer attainable through the CSO because the prices California dairy farmers receive do not reflect the full value of their raw milk. The witness estimated that this pricing difference has reduced California dairy farm income by $1.5 billion since 2010. The witness maintained that Proposal 1 allows California dairy farms to receive an equitable price for their milk, while also tailoring FMMO provisions to the California dairy industry. The Cooperatives' post-hearing brief reflected this position.

The Cooperative witness testified that there are significant differences in prices, depending on whether a producer's milk is regulated by the CSO or a FMMO. To illustrate this difference, the witness compared California farm milk prices to those received by producers in the states that comprise the Upper Midwest and Pacific Northwest marketing areas.[16] The witness selected these areas for comparison due to the similar milk utilization in the Upper Midwest FMMO and the geographic proximity of the Pacific Northwest FMMO. The witness estimated that between August 2012 and May 2015, California dairy farmers received on average $1.85 per cwt less (ranging from $0.43–$4.27 per cwt lower) than producers pooled on the Upper Midwest and Pacific Northwest FMMOs. The witness used the data to emphasize a wide difference in prices for farmers in similarly situated areas. The witness opined that a California FMMO, as advanced in Proposal 1, would ensure California dairy farmers receive equitable prices, more in line with those received by their FMMO counterparts.

The Cooperative witness emphasized that while both the CSO and the FMMOs use end-product pricing formulas to determine class prices, the two regulatory systems use different commodity series, effective dates, yield factors, and make allowances, which result in substantially different prices, as highlighted above. The witness explained that while the two regulatory systems have always had price differences, historically CSO and FMMO prices were relatively close. According to the witness, prices began to diverge significantly in 2007 when the CSO established a fixed whey factor in its formula for milk used to produce cheese. From that point forward, the witness said, price differences have become significant and have led to market disruptions both in the fluid and manufacturing markets.

The Cooperative witness summarized USDA's justification from the FMMO Order Reform decision for adopting a national Class I price surface that assigns a Class I differential for every county in the country, including counties in California. The witness said that the separate CSO Class 1 price surface undermines the integrity of the nationally coordinated Class I price surface and has become a source of disorder in California. To demonstrate the disorder, the witness compared FMMO Class I and CSO Class 1 prices for both in-state and out-of-state purchases. The witness said that because of the CSO and FMMO differences in both classified price formulas and Class I/1 price surfaces, the Class 1 price paid by California handlers is almost always lower than what it otherwise would be if FMMO Class I prices were applicable for those same purchases.

The Cooperative witness presented a similar comparison between CSO Class 1 prices and Class I prices in FMMO areas that were likely competitors. The witness said that under FMMO regulations, the difference in Class I prices between two FMMO areas is attributed to the difference in the Class I differential at the two locations. For

[16] Wisconsin, Minnesota, and Illinois; Oregon, Washington and Northern Idaho, respectively.

example, the witness explained, the Class I price difference between two plants, one located in a $2.10 zone and another in the $2.00 zone, would be $0.10 per cwt. However, when the witness compared Class 1 prices in California and a competing FMMO area, the price difference was always greater than the difference in differentials. For example, the FMMO differential in the Los Angeles/San Diego market is $2.10, while the differential in neighboring Phoenix is $2.35, a difference of $0.25. However, said the witness, when comparing the actual CSO Class 1 price in Los Angeles/San Diego with the FMMO Class I price in Phoenix from August 2012 to July 2015, the difference averaged $0.62. The witness concluded that these observed price differences undermine a nationally-coordinated pricing structure and contribute to disorderly marketing where fluid milk handlers pay different minimum prices depending on where they are regulated.

The Cooperative witness also provided testimony on the CSO and FMMO price disparities for manufacturing milk. The witness testified that FMMO Class II, III, and IV prices reflect national prices for products manufactured in these classes. If Proposal 1 is adopted, the witness said, California handlers would pay the same uniform prices as their FMMO competitors in the national marketplace. The witness noted past FMMO decisions that discussed the national supply and demand for manufactured dairy products and the need for national uniform manufacturing prices. The witness stressed that California producers should also receive these national prices like their FMMO counterparts.

The Cooperative witness elaborated on the differences between CSO and FMMO manufacturing class prices. When comparing FMMO Class II to CSO Class 2 and Class 3 prices, the witness cited differences in the commodity series used as price references, the time periods of data used, and the length of time prices are applicable to explain the sometimes large differences in prices under the two regulatory systems. As a result, the witness said, Class 2 products are sometimes sold on a spot basis to exploit short-term price differences.

The Cooperative witness presented a comparison of CSO Class 4a and FMMO Class IV prices from January 2000 to July 2015, revealing that over the entire time period the Class 4a price averaged $0.29 per cwt less than the Class IV price. The witness added that over this 15-year period, the CSO Class 4a price on an annual average basis was never above the FMMO Class IV price.

The Cooperative witness also provided testimony on the price disparity between CSO Class 4b and FMMO Class III price formulas. Data from January 2000 to July 2015 revealed that the CSO Class 4b price was lower than the Class III price in 161 of the 187 months examined. The witness computed the difference over that 15-year time period averaged $0.91 per cwt, with the largest difference of $3.24 per cwt occurring in November 2014. The witness attributed the observed price differences to differences in the valuation of dry whey between the CSO 4b and the FMMO Class III formulas. The witness said that in 2007, the whey factor in the CSO Class 4b formula became a tiered, bracketed system with a floor of $0.25 and a ceiling of $0.75 which is reached when the WDW-Mostly price is greater than or equal to $0.60 per pound. The witness added that the whey value contained in the FMMO Class III price comes from the AMS NDPSR, and reflects the mandatory reporting of dry whey sales throughout the country. The witness estimated that from August 2012 through July 2015, the DMN whey value contributed $0.68 per cwt to the CSO 4b price, while the NDPSR whey value contributed $2.39 per cwt to the FMMO Class III price. The witness concluded that the whey cap contained in the CSO 4b price results in lower contributions to the marketwide pool than what is observed in the national marketplace and reflected in FMMO prices.

The Cooperative witness reiterated the consequences of two different regulatory pricing schemes have led to severe differences between the regulated markets. The witness opined that the regulatory differences allow California handlers who purchase raw milk and manufacture products for sale on the national marketplace to pay substantially different regulated minimum prices than handlers regulated by the FMMO system. The witness estimated that because of the regulatory price differences, from August 2012 to July 2015, California farms received, on average, $1.89 per cwt less than similarly-situated FMMO farms. The witness concluded that this results in California farms being in a worse competitive position than other similarly situated FMMO farms. The witness labeled this as disorderly and said that this condition should be remedied through the adoption of Proposal 1.

The Cooperative witness also entered data estimating the value of regulating interstate commerce through the establishment of a California FMMO. The witness cited January 2009 through July 2015 CDFA data that indicated a monthly average of 54.5 million pounds of milk originating outside the state was processed by California processing plants and another monthly average 36 million pounds of milk was produced inside California and sold to plants located outside of the state. The witness explained that this milk is able to evade CSO minimum-price regulations because of the state's inability to regulate interstate commerce. Consequently, the witness said, out-of-state farms delivering milk to California plants can receive plant blend prices, which can be higher than the market's overbase price received by in-state producers delivering to the same plant. The witness elaborated that the problem is compounded because processors receiving these unregulated supplies are not required to pay minimum classified prices and can instead pay a lower price than their regulated competitors. By regulating these transactions through the establishment of a California FMMO, the witness stressed, the California market would be more orderly.

The Cooperatives' post-hearing brief also highlighted the CSO's inability to regulate out-of-area milk as a market dysfunction. The Cooperatives wrote that out-of-area sales financially harm California dairy farms because the Class 1 revenues from those sales does not contribute to the CSO marketwide pool that is shared with all the farms in the market.

A consultant witness, appearing on behalf of the Cooperatives, testified in support of Proposal 1. The witness was of the opinion that the primary purpose of FMMOs is to enhance producer prices, which is provided in the AMAA through its flexibility to regulate milk and/or milk products, not just fluid milk. As evidence of this flexibility, the witness discussed the Evaporated Milk Marketing Agreement, in existence until 1947, under which manufacturing milk was regulated. Therefore, the witness said, it is reasonable to conclude from this example that the regulation of all California plants that purchase milk from California farms, as contained in Proposal 1, would fall within the scope of the AMAA.

The consultant witness elaborated that extending minimum price regulation to all classes of milk in California is necessary to avoid the market-disrupting practice of handlers opting to not pool eligible milk because of price, often referred to as depooling. The witness said that many FMMOs have adopted provisions to reduce the instances of depooling. Currently, under the CSO, the witness said, while plants can choose to not participate in the marketwide pool, there is no price advantage, because they are still required to pay minimum classified prices. The witness was of the opinion that the impact of depooling would be greater in a California FMMO because of how California quota premiums are paid. The witness testified that uniform prices calculated after deducting quota premiums would be less than they otherwise would be, if large volumes of milk were not pooled. Additionally, the witness addressed the issue of uniform producer payments. The witness was of the opinion that once quota premiums were paid, as required by California law, remaining pool revenues would be distributed uniformly to producers for non-quota milk, as required by the AMAA.

The consultant witness addressed the issue of whether Proposal 1 would implement classified prices that were too high. The witness opined that the classified price formulas contained in Proposal 1 would not establish manufacturing milk prices that are too high because FMMO regulated handlers in other areas are already paying those prices. The witness entered data showing that cheese production has increased in the western states (not including California and Idaho) by 92 percent from 2000 to 2014, while California cheese production has increased only 64 percent. The witness concluded that minimum FMMO prices have not been detrimental to FMMO-regulated plants, and offered the fact that over-order premiums are currently paid to FMMO producers to support that claim. The witness stated that provisions providing for orderly marketing conditions should also provide stability (regulations should not alter market transactions) and efficiency (regulations should stimulate a competitive economic environment), and concluded that both are embodied in Proposal 1.

Twenty-seven California dairy farmers testified in support of Proposal 1. Sixteen belong to one of the three proponent Cooperatives: Nine LOL members, three DFA members, and four CDI members. An additional 11 dairy farmers not associated with the Cooperatives provided testimony supporting the adoption of Proposal 1.

Although each dairy farmer provided unique testimony, several difficulties challenging the California dairy industry were addressed repeatedly. Producer testimony described financial hardships due to the CSO producer prices they receive consistently being below the amount needed to cover the cost of production. One farmer witness cited CDFA cost of production data from the first quarter of 2015 for the North Valley of California, and estimated that 90 percent of surveyed farms had negative net incomes. Farmer witnesses stated that a FMMO would provide an opportunity for dairy farms to cover their cost of production and work toward reducing debts incurred from historically low mailbox prices.

A number of producers testified that historically they had many competitive advantages (low cost of land, grain, hay and water) enabling them to produce milk at a significantly lower cost than farms located in the rest of the county. All of the witnesses testified that the hardships of high land, feed, and/or water costs, as compared to those in other dairy states, have eroded their competitive advantage. Citing no competitive advantage, coupled with the difference between the FMMO and CSO pricing formulas, dairy farmers testified they are receiving a lower mailbox price than their FMMO counterparts. Testimony stressed that these realities are forcing many California dairy farms out of business.

Many producers were of the opinion that their inability to cover the cost of production is tied to how whey is valued in the CSO Class 4b formula. Thirteen of the 27 producers testified regarding the impact of the whey valuation on mailbox prices. The witnesses stressed that the CSO historically responded to producers' needs by encouraging manufacturing plant investment that would provide an outlet for milk to be processed at a regulated price considered fair. According to the witnesses, this regulatory balance shifted in 2007 because of a CDFA rulemaking that adopted a sliding scale that capped the value of the dry whey factor in the Class 4b formula. Testimony was provided that stated that the 2007 hearing marked the start of the widening discrepancy between mailbox prices for California dairy farmers and those received by other dairy farmers across the nation. Witnesses stated the reduced mailbox prices continue to undervalue milk throughout the State. The producers were of the opinion that a California FMMO would bring California's valuation of dry whey in line with the rest of the country. With comparable whey values, producers testified their mailbox price would become more representative of the true market value of their milk.

Three testifying producers owned farms in both California and FMMO regulated areas. These producers testified to the difference in production costs and mailbox prices received by their farms over the last decade or more. Their testimonies specifically highlighted the industry differences between California and Wisconsin. The producers said the production advantages California dairy farmers enjoyed (inexpensive land, feed, and a different regulatory environment) no longer exist, and as a result, California dairy farms are closing or moving out of state at an increasing rate.

Seven producers testified that the use of futures contracting and hedging as risk management tools are hindered by the differences in the CSO and FMMO price formulas. They explained that current risk management tools are based on FMMO prices, and the fact that CSO prices are different make those tools less effective for California producers.

Eight producers provided evidence about reductions in the California dairy industry since 2007. According to the witnesses, many farms have elected to reduce their herd size or cease dairy farming. A witness provided September 2014 to September 2015 data showing that the Cooperatives have experienced a 6.6 percent reduction in milk production volume. The witness stated that the reduction seen by the Cooperatives is supported by CDFA data showing a 3.5 percent reduction in California milk production. The witness noted that while milk production in California is decreasing, it is increasing in the rest of the country. The witnesses believed the discrepancy between California milk production and national production is due to the inability of California farms to compete on a level-playing field with farms in the FMMO system. Many also expressed concern with the impact on related businesses due to the closing of many California dairy farms.

According to six producer witnesses, many farms have opted to weather the milk price volatility by diversifying their operations and investing in tree-crop production. Several witnesses testified that lenders encourage tree-crop production over dairy farming, due to the reduction of risk and the large margins attainable in tree-crop farming. Producers expressed a belief that the adoption of a California FMMO would lead to a more stable dairy industry supported by lenders.

Overall, California producer witnesses stated they are currently subject to a regulatory system that does not provide producer milk prices representative of the full value of their raw milk in the market. The producers believe adoption of a California FMMO represents an opportunity to remedy this regulatory disadvantage and to compete on a level-playing field with the rest of the country.

A Western United Dairymen (WUD) representative testified in support of Proposal 1. WUD is a trade organization representing approximately 50 percent of California dairy farmers, whose farm sizes range from 17 to 10,000 cows. According to the WUD witness, the difference between CSO Class 4b and FMMO Class III prices demonstrates that the CSO is not providing California dairy farms with a milk price reflective of the national marketplace for manufactured dairy products. The witness attributed the pricing differences to how dry whey is accounted for in the two price formulas. The witness said the value difference has become increasingly larger since the CSO adopted a fixed whey factor in 2007, and then subsequently replaced it with a sliding scale whey factor in 2011. The witness said that from August 2014 to July 2015, the CSO Class 4b whey value averaged $1.50 per cwt less than the FMMO Class III whey value. As a result, the witness said, there are different regulated minimum milk prices for the milk products that compete in a national market. This milk price difference, the witness stressed, results in market decisions based on government regulations instead of market fundamentals. Furthermore, the witness said, the resulting lower CSO class prices put California dairy farmers at a competitive disadvantage compared to their FMMO counterparts. The witness concluded that this situation is disorderly and reiterated WUD's support for Proposal 1 as a more appropriate method to determine the value of whey.

A witness representing the California Dairy Campaign (CDC) testified in support of Proposal 1. CDC is a dairy producer organization with members located throughout California. The CDC witness said that over the last 10 years, more than 600 California dairy farms have permanently closed or moved to other states. The witness attributed this to milk prices that have been consistently lower than the cost of producing milk in California, and noted that water and feed availability due to the ongoing drought is the primary reason for increased production costs. The witness highlighted the consolidation and concentration of the California dairy manufacturing sector that causes dairy producers to be price takers in the market, thus making equitable minimum regulated prices vital to the long-term viability of California dairy farms.

The CDC witness testified that the failure of the CSO to align with FMMO prices, particularly between CSO Class 4b and FMMO Class III, has resulted in a more than $1.5 billion loss to California producers since 2010. The witness also said that risk-management tools, particularly the USDA Margin Production Program (MPP), are not as effective for California dairy farms because the national all-milk price used to determine MPP payments is significantly higher than California producer mailbox prices under CSO regulation.

The witness highlighted CDC's support of specific provisions contained in Proposal 1, including the adoption of FMMO end-product pricing formulas, unique pooling provisions that address the needs of the California market, regulation of out-of-state milk, uniform producer-handler provisions, fluid milk fortification allowances, and the continuation of the California quota program. The witness was of the opinion that Proposal 1 addresses California's unique market conditions and is the only path to restoring California producer price equity and the health of the California dairy industry.

CDC's post-hearing brief stated CDC has supported adoption of a California FMMO for over 20 years. The brief highlighted 2015 CDFA data showing California cost of production at $19.30 per cwt, while the average farm income was $15.94 per cwt. The brief stated the belief that minimum prices are put in place to ensure dairy farmers are able to share in some minimal level of profitability. CDC estimated that in 2015, a 1,000-cow California dairy farm was paid approximately $1.4 million less than equal-sized farms whose milk was pooled on a FMMO.

A witness representing Milk Producers Council (MPC) testified in support of Proposal 1. MPC is a nonprofit trade association with 120 California dairy-farmer members, accounting for approximately 10 percent of the California milking herd. The witness agreed with testimony given by the Cooperatives outlining California's disorderly marketing conditions. The witness said that California dairy farmers have repeatedly, though unsuccessfully, sought relief through CDFA to bring CSO classified prices more in line with FMMO classified prices. This is why California dairy farmers are now seeking to join the FMMO system, the witness added.

The MPC witness testified that Proposal 1 would establish orderly marketing conditions in California, resulting in a level-playing field for producers and processors. The witness stressed that not only would Proposal 1 provide price alignment between California and FMMOs, but a California FMMO would regulate interstate commerce—something the CSO cannot do. Proposal 1 would also maintain the current California quota program, a vital financial tool for many California dairy farmers, the witness stated. The witness said that while the quota program has no impact on the minimum prices handlers pay, it does aid in providing a local milk supply for some plants that would otherwise have to source milk from farther distances. The witness explained that in some instances, quota is an investment farms located in higher cost areas of the state make to remain financially viable and be able to provide a local milk supply to plants that would otherwise have to seek a supply from farther distances.

A witness representing the National Farmers Union (NFU) testified in support of Proposal 1. NFU is a national grassroots farmer organization with over 200,000 members across the nation, including dairy farmers located in California. The witness testified that NFU supports the inclusion of California in the FMMO system so California dairy farms could receive prices similar to those received by dairy farms located throughout the country. The witness testified that California's low-milk prices and high-feed costs have resulted in strained margins and ultimately the closure of over 400 dairy farms in the last five years.

The NFU witness testified the pay price differences between dairy farms whose milk is pooled under the CSO and FMMOs is primarily due to the difference in the Class 4b and Class III prices and has resulted in disorderly marketing conditions and a revenue loss to California dairy farms of more than $1.5 billion since 2010. The witness added that pay-price differences have reduced the ability of California dairy farms to utilize risk management tools, and puts them at a competitive disadvantage when competing for resources such as feed, land, cattle and labor.

A witness appearing on behalf of the Institute testified that while the Institute offered Proposal 2 as an alternative to the Cooperatives' proposal, their first position is that disorderly marketing conditions do not exist in California to warrant the promulgation of a FMMO. The witness stated that the California dairy industry is currently regulated by the CSO, whose purpose, much like a FMMO, is to provide for orderly marketing conditions. The witness emphasized their opinion that orderly marketing conditions are currently achieved through CSO classified pricing and marketwide pooling.

The Institute witness reviewed CSO history and regulatory evolution, and highlighted regulatory changes demonstrating how the CSO has consistently adapted to changing market conditions. Some, but not all, of these regulatory changes are highlighted below.

The Institute witness explained that California sought state solutions to disorderly marketing conditions through the Young Act of 1935. When FMMOs were authorized in 1937, California opted to remain under the purview of the CSO.

The Institute witness explained that the CSO adopted marketwide pooling through the Gonsalves Milk Pooling Act. Before that time, handlers operated individual handler pools, giving Class 1 handlers strong bargaining power as producers sought Class 1 contracts. According to the witness, this led to handler practices that eroded producer revenues. The witness testified that the California quota program, also authorized by the Gonsalves Milk Pooling Act, was a way for Southern California dairy farmers, who at the time had a higher percentage of Class 1 contracts, to preserve some of the Class 1 earnings they would otherwise be required to share with all producers through marketwide pooling. At the time, the witness said, producers were assigned a production base, and producer quota was allocated based on historical Class 1 sales. Milk marketed in excess of a producer's base and quota allocations was termed overbase milk. The witness explained that, during this time, the state's population was growing, and quota was deemed necessary to ensure the market's Class 1 needs would always be met.

The Institute witness said that when the quota program was established, there was a growing number of dairy farmers who also owned fluid milk bottling operations. They typically processed all the milk they produced, and were referred to as producer-handlers. These operations feared that the income benefits they gained from processing their own milk would disappear with the establishment of mandatory pooling. To relieve this concern, the witness said smaller producer-handlers were exempted from pooling in return for not receiving a quota allocation. The witness explained larger producer-handlers had the option of not receiving a quota premium, and deducting those quota pounds from their Class 1 obligations to the pool, an amount referred to as exempt quota.

The Institute witness testified that the CSO was modified numerous times in the late 1970's and early 1980's to ensure that Class 1 needs of the market would always be met. First, call provisions were established requiring manufacturing plants participating in the pool to maintain a percentage of quota milk available to Class 1 plants. Second, a system of transportation credits and allowances was established to cover part of the cost of moving milk from surplus areas to deficit areas for Class 1 use. According to the witness, CDFA regularly updates these milk movement incentives to reflect current costs.

In the early 1990's, CDFA amended how the quota premium was derived. At the time, quota funds were derived from Class 1, 2 and 3 prices, while overbase prices were derived from Class 4a and 4b prices. Consequently, the witness noted, the difference between quota and overbase prices varied greatly by month. The witness said the historic value of quota, in comparison to the overbase value, was evaluated to derive a fixed quota price of $0.195 per pound of quota solids nonfat.

The Institute witness also reviewed several instances since 2000 where CSO provisions were amended to reflect changing market conditions and changing FMMO regulations. These instances included adopting the ''higher of'' concept for pricing Class 1 milk, incorporating a dry whey factor in the price formulas, and changing the make allowances contained in the product price formulas—all changes the witness said were necessary to maintain orderly marketing conditions in California.

The Institute witness maintained that current California marketing conditions are orderly, and therefore the establishment of a FMMO is not justified. The witness stated the CSO program focuses on orderly marketing conditions to ensure Class 1 needs are met, while providing reasonable returns to those dairy farms who supply the Class 1 market. The witness stressed the regulated price differences between CSO Class 4a/4b prices and FMMO Class III/IV prices do not amount to disorder, and in fact, those differences are needed to maintain orderly marketing in the state.

The Institute witness testified that in the CSO-regulated environment, where all milk is subject to minimum price regulation, it is important that manufacturing prices are not set above market-clearing levels. The witness elaborated that the largest market, and therefore the highest value, for finished dairy products is in the eastern United States where most of the population resides. Therefore, the witness said, in order for California dairy products to be transported and compete in the eastern markets, they must have a lower value in the West. The witness was of the opinion that FMMO Class III and Class IV prices are not appropriate local, market-clearing prices for California.

The Institute witness also was of the opinion that current differences between CSO Class 2 and 3 prices and FMMO Class II prices are not disorderly. The witness explained that Class 2 and 3 prices are set relative to the Class 4a price, and it is important that these prices are not set so high as to encourage dairy ingredient substitution with Class 4a products. The witness argued the Cooperatives provided no evidence that the class price differences between the CSO and FMMO systems are disorderly.

The Institute witness also testified regarding the difference between CSO Class 1 and FMMO Class I prices. While CSO Class 1 prices are somewhat lower than those in neighboring FMMO areas, the witness said, they are not causing disorderly marketing conditions. The witness explained that if lower priced California milk is sold into FMMO areas, there are provisions for FMMO partial regulation to ensure the California Class 1 plants do not have a regulatory price advantage over the FMMO plants.

The Institute witness testified that recent declines in California milk production and increases in dairy farm consolidation are not evidence of disorderly marketing conditions. The witness elaborated that dairy-farm consolidation is a natural market evolution resulting from differences in producers' cost structure, risk tolerance, and access to capital. This is no different than consolidation trends that have happened in other regions of the country, added the witness. The witness also testified that, while dairy farmer margins have been volatile in recent years, California milk production costs have remained below the United States average. According to USDA Economic Research Service data, the witness said 2010–2014 California milk production costs were well below the national average, by a yearly average of $4.19 per cwt. Regardless of milk production and consolidation trends, the witness stated that California has adequate milk supplies to meet fluid demand, and milk movements to meet processing and manufacturing demands are largely efficient.

The Institute witness explained its members represent approximately 65 percent of the fluid milk processing in California, and none have expressed difficulty obtaining milk supplies or any type of disorderly marketing condition. The witness expressed concern that any changes in the regulatory environment would likely increase the cost of fluid milk. This cost would be passed onto consumers, thereby creating a barrier for fluid milk sales, said the witness.

The Institute witness opined the CSO has an effective pricing and pooling system that has evolved over time to address changing market conditions, and disorderly marketing conditions do not exist to warrant a California FMMO. However, should USDA recommend a California FMMO, the witness said the provisions outlined in Proposal 2 should be adopted.

The post-hearing brief submitted on behalf of the Institute reiterates its opinion that USDA must find disorderly marketing conditions to justify intervention. Disorderly marketing conditions under the AMAA, the Institute wrote, refers to the fluid milk supply and not the market for manufactured milk. The brief stated that California has, on average, an 11 to 12 percent Class 1 utilization and more than enough reserve milk to meet fluid demand.

The Institute's brief outlined a six-point test that it argued needs to be met in order to justify a California FMMO. The Institute stated the current CSO already meets all six of the requirements and thus Federal intervention is not justified.

The Institute's brief also addressed the 1996 and 2014 Farm Bills as they pertain to the consideration of a California FMMO. The Institute stressed that in neither case did Congress amend the AMAA, and therefore USDA is authorized, but not required, to incorporate the California quota program. According to the Institute, whatever decision USDA makes, it must uphold the AMAA's uniform payments and trade barrier provisions. The Institute stated that Proposal 1's incorporation of the California quota program does not uphold either of these provisions.

The Institute's post-hearing brief argued that the differences in Class III and Class 4b prices, highlighted by the Cooperatives, do not provide justification for a California FMMO. According to the brief, the AMAA requires marketing orders to have regional application that recognizes differences in production and market conditions.

A witness appearing on behalf of Hilmar Cheese Company (Hilmar) testified that USDA has consistently found that evidence of disorderly marketing conditions must exist in order to justify Federal intervention through the promulgation or amendment of a FMMO. Hilmar is a dairy manufacturer with facilities in California and Texas selling dairy products both domestically and internationally. According to the witness, Hilmar's California cheese and whey manufacturing facility is the largest cheese manufacturing facility in the State, processing 12 percent of the total California milk supply, which is purchased from 200 dairy farms, most of whom are not affiliated with any cooperative.

The Hilmar witness cited previous USDA decisions, including the 1981 Southwestern Idaho/Eastern Oregon and the 1990 Carolina promulgations, as examples of what market conditions should be present in order for USDA to act. The witness was of the opinion that the Cooperatives did not provide evidence of actual disorderly marketing conditions in California warranting Federal intervention.

In its post-hearing brief, Hilmar stated that FMMOs are designed to be a marketing tool to address problems associated with the inherent instability in milk marketing. Hilmar reiterated its opposition to a California FMMO, stating that USDA has consistently denied proposals seeking price enhancement, as they believe is the case in this proceeding. Hilmar stated the record does not support the notion that there is an inadequate supply of milk for fluid use in California, and therefore a California FMMO is not justified.

A witness appearing on behalf of HP Hood, LLC, a milk processor with facilities in California and other states, testified that disorderly marketing conditions are not present in California and therefore a FMMO is not warranted. The witness said the CSO is an efficient program that has been routinely updated to reflect changing market conditions. The witness stated that HP Hood has not had any difficulty securing an adequate supply of raw milk for its California processing plants, nor is HP Hood aware of instances where raw milk had to be transported long distances in order to meet California demand.

The HP Hood witness suggested USDA consider the potential adverse impacts of recommending a California FMMO on other FMMOs, as well as potential increases in milk costs to consumers that may stem from adoption of the higher uniform minimum milk prices included in Proposal 1. The witness specifically opposed the inclusive pooling portion of Proposal 1 and explained how the ability for milk handlers to pool or not pool is how orderly marketing has been maintained in the existing FMMOs. The witness urged the adoption of Proposal 2, should USDA find that a California FMMO is warranted.

A witness appeared on behalf of Saputo Cheese USA, Inc. (Saputo), a proprietary international dairy and grocery products manufacturer and marketer with seven dairy product-manufacturing facilities in California. Saputo opposes the promulgation of a California FMMO, but should USDA find a FMMO warranted, it supports adoption of Proposal 2. The witness testified that disorderly marketing conditions are not present in California to warrant FMMO promulgation. The witness explained how CDFA has been responsive to dairy industry concerns, has held many hearings in the past, and administers the CSO in a manner that facilitates orderly marketing as well as, or better than, the FMMO system.

The Saputo witness summarized many of the similarities and differences between the CSO and FMMO systems. The witness was of the opinion that the CSO mandatory pooling rules increased milk production to surplus levels and encouraged the construction of bulk, storable dairy product manufacturing facilities. In conjunction with these rules, the witness explained, CSO regulated minimum prices are set at levels that are not too high to encourage significant additional increases in supply.

The Saputo witness described the California cheese production landscape. The witness, relying on CDFA data, said that from January through March of 2015, 57 cheese plants processed 45 percent of California's milk. The witness noted that out of the 57 cheese plants, 3 of the plants processed more than 25 percent of the state's entire milk supply. The witness stated that if the increase in the hypothetical California FMMO Class III price included in the USDA Preliminary Economic Analysis of $1.84 per cwt occurred, under a system of mandatory pooling, the aforementioned 3 cheese plants would face combined increased annual raw milk costs of nearly $196.5 million. The witness testified that such raw milk cost increases would be disorderly and threaten the viability of California manufacturing facilities.

A witness appearing on behalf of Farmdale Creamery (Farmdale) testified in support of Proposal 2. Farmdale is a proprietary dairy processing company located in San Bernardino, CA, that manufactures cheese, sour cream, dried whey protein concentrate, and buttermilk. The witness was of the opinion that disorderly marketing conditions are not present in California, since there is no shortage of milk to meet fluid milk needs. The Farmdale witness was of the opinion that the CSO maintains an orderly market by responding to changing market conditions when warranted. Should USDA find a California FMMO justified, the witness supported adoption of Proposal 2 and opposed the mandatory pooling provisions contained in Proposal 1.

The witness also testified about financial losses incurred by Farmdale since 2005, when the CSO whey value was sometimes higher than what they could obtain from the market. The witness added that their on-again, off-again financial losses demonstrate the inability of current regulatory pricing systems to track and value the whey markets.

A witness appeared on behalf of Pacific Gold Creamery (Pacific Gold) in opposition to the adoption of a California FMMO, although the witness supported the provisions contained in Proposal 2 should a FMMO be recommended. Pacific Gold operates a dairy farmer owned specialty cheese plant in California. The witness testified that across existing FMMOs and unregulated areas, dairy product manufacturers regularly pay below FMMO minimum prices. The witness presented and explained USDA-prepared FMMO data regarding volumes of milk pooled and not pooled across existing FMMOs.

The Pacific Gold witness explained how their business produces ricotta from the whey stream of their cheese manufacturing, and how ricotta sales supplement the income of the cheese operation. The witness was of the opinion that the FMMO Class III price, and the accompanying higher whey value contained in Proposal 1, would be devastating to small and mid-size facilities. The witness also testified how an increase in California minimum-regulated prices would jeopardize exports, saying that U.S. domestic cheese prices are already relatively higher than global prices.

A post-hearing brief was submitted on behalf of Trihope Dairy Farms (Trihope). Trihope is a dairy farm located in, and pooled on, the Southeast FMMO. Trihope stated that disorderly marketing conditions do not exist in California to warrant promulgation of a FMMO. Trihope was of the opinion that California dairy farmers are seeking higher prices through a new regulatory body, which is not a justification for USDA to proceed. According to Trihope, the AMAA was designed to solve marketing problems in unregulated areas, not to address price disparities between Federal and State regulation.

Trihope expressed concern about the potential impact a California FMMO would have on the entire system. Trihope specifically noted the impacts to the southeastern marketing areas contained in the USDA Preliminary Economic Impact Analysis. According to their brief, Trihope estimates losses from 2017 to 2024 of approximately $313,091. Trihope wrote that California's marketing issues of high California milk production and limited plant capacity would not be solved by a FMMO.

A post-hearing brief submitted by Select Milk Producers, Inc. (Select), expressed support for the adoption of a California FMMO. Select is a national dairy-farmer cooperative that markets over 6.5 billion pounds of milk annually, and whose members' milk is regularly pooled on the Appalachian, Mideast, Southeast and Southwest FMMOs. Select also supplies plants located in many other FMMOs, but it does not supply any California plants. Select was of the opinion that having California's milk supply priced similarly to the rest of the FMMOs would remedy the competitive disadvantages faced by companies competing in the national marketplace, and would allow for more efficient milk movements. Select expressed support for maintaining a uniform national pricing system and opposed the Institute's alternative whey-pricing proposal. Select expressed support for the Cooperatives' inclusive pooling provisions on the basis that the provisions would apply only to California, due to its unique marketing conditions. Select stated the California quota program should be addressed outside of this rulemaking proceeding. Select was of the opinion that adoption of a California FMMO would lead to more orderly milk marketing throughout the entire FMMO system, and thus uphold the intent of the AMAA.

A post-hearing brief submitted on behalf of the Northwest Dairy Association (NDA) expressed support for Proposal 1. NDA is a dairy farmer-owned cooperative that markets the milk of its 460 members and operates numerous fluid milk and manufacturing plants located in Washington, Oregon, Idaho, and Montana. NDA was of the opinion that adoption of Proposal 1 would create more orderly marketing conditions and strengthen the entire FMMO system. As California represents the largest milk supply in the United States, NDA wrote, it is important for the integrity of the FMMO program to include the additional 20 percent of United States milk represented by California. NDA stated that California producers should not be disadvantaged with lower Class III and IV prices than what their western FMMO producer counterparts receive.

Findings

The record contains a voluminous amount of testimony, evidence and opinions as to whether or not a California FMMO is justified. The Cooperatives and their supporters argue that a California FMMO was authorized by Congress in the 2014 Farm Bill. They contend that this proceeding is not about whether or not a FMMO should be established, but rather to determine what the California FMMO provisions should be. The Cooperatives are of the opinion that the existence of disorderly marketing conditions is not required by the AMAA to justify order promulgation. They stressed in their post-hearing briefs that a FMMO needs to establish and maintain orderly marketing conditions, and that would be accomplished through the adoption of their proposal. However, should the Department find that disorderly marketing conditions must be present, the Cooperatives provided evidence of what they believe are ongoing disorderly marketing conditions in California.

In general, the record reflects that the California producer community supports joining the FMMO system. Producers are of the opinion that the prices they currently receive under the CSO do not reflect the appropriate value for their milk and its components. Particularly, producers believe that the price they receive for milk used for cheese manufacturing does not value the dry whey component at a level commensurate with what manufacturers receive for whey in the marketplace.

In contrast, the Institute and its members consistently argued throughout the hearing and in their post-hearing briefs that the existence of disorderly marketing conditions is required by the AMAA, and that such conditions do not exist in California. They provided testimony explaining how the CSO is a flexible system that is routinely evaluated through the CDFA hearing process and changes are made as market conditions warrant. The Institute and its members were united in the opinion the Cooperatives are solely seeking to receive higher prices for their milk, and that such higher prices are not justified for California.

As discussed earlier, the declared policy of the AMAA is to ''. . . establish and maintain such orderly marketing conditions for agricultural commodities in interstate commerce . . .'' FMMOs accomplish this through the classified pricing of milk products and marketwide pooling of those classified use values. Through these mechanisms, orderly marketing conditions are provided so that handlers are assured uniform minimum raw milk costs and producers receive minimum uniform payments for their raw milk, regardless of its use.

While in recent history FMMOs have been consolidated, amended and expanded, it has been decades since a new order has been promulgated. The records of those promulgation proceedings include descriptions of the market conditions at the time, and how a FMMO would provide order in the market. However, those decisions did not, nor does this decision find, that disorderly marketing conditions must exist to justify order promulgation. Order promulgation and amendatory proceedings have reiterated that a FMMO must adhere to the declared policy of the AMAA, where there is no mention of disorderly marketing conditions.

This decision finds that a FMMO for California would provide more orderly marketing conditions in the marketing area, and therefore promulgation of a California FMMO is warranted. The record is replete with discussion from most parties on whether disorderly marketing conditions exist, or are even needed, to warrant promulgation of a California FMMO. The declared policy of the AMAA makes no mention of ''disorder,'' and this decision finds that disorderly marketing conditions are not a requirement for an order to be promulgated. The standard for FMMO promulgation is to ''. . . establish and maintain such orderly marketing conditions . . .,'' and this decision finds that the California FMMO recommended meets that standard by providing uniform minimum raw milk costs to handlers and minimum uniform payments to producers for their raw milk, regardless of its use.

The record indicates that there are both handler and producer price differences between the CSO and the FMMO systems. The record contains data regarding the difference in classified use values paid by handlers regulated by the CSO and FMMOs. As discussed later, this decision recommends the adoption of the classified price formulas that currently exist in the FMMO system. A California FMMO, under the provisions recommended in this decision, will ensure that the prices handlers pay to purchase pooled California milk will be similar to prices paid for milk pooled on other FMMOs. As commodity dairy products compete in the national market, current FMMOs uniformly price the raw milk used in those products. This pricing system ensures that competing handlers have uniform minimum raw milk costs, and consequently none has a regulatory price advantage. The record demonstrates that California manufactured dairy products compete in the national market, however the CSO regulated prices paid by California manufacturers are different than those priced by FMMOs. This decision finds the proposed California FMMO would provide classified milk prices that would be more uniform with those paid by competing handlers, and more reflective of the national market for manufactured milk products and the local market for fluid milk products, as is the policy for the 10 current FMMOs. This decision finds that these prices would provide more orderly market conditions for California.

This decision also finds that the classified prices proposed for a California FMMO will provide producers with a minimum producer blend price more reflective of the national market for manufactured products and the utilization of the local California market. Taken together, handler and producer prices reflective of the national market, for which manufactured dairy products are sold, will ensure orderly marketing conditions in California.

While the current CSO provides classified pricing and marketwide pooling similar to a FMMO, the hearing record reflects that California dairy producers have been unsuccessful in obtaining a minimum regulated price they believe is reflective of the full value of their raw milk. Some parties argued on the record that because the CSO already provides classified pricing and marketwide pooling, disorderly marketing conditions do not exist and therefore there is no justification for promulgating a California FMMO. As discussed earlier, disorderly marketing conditions are not a requirement for order promulgation. Furthermore, this decision finds that it is not the intent of the AMAA to preclude a group of producers from petitioning for a FMMO because they are otherwise regulated by a state that provides classified pricing and marketwide pooling. Such a requirement would place an undue barrier on those producers as they would not have the opportunity to petition for FMMO regulation simply because they are currently regulated by a state.

Additionally, unlike the CSO, a California FMMO would have the authority to regulate interstate commerce. The record reveals that there is milk, both raw and packaged, being sold into and out of California over which the CSO has no regulatory jurisdiction. The revenues from those Class I sales are not shared with all the producers supplying the California market. A FMMO would ensure that those classified use values would be shared with all producers who supply the California market. The ability of a California FMMO to regulate these interstate sales, either through full or partial regulation, protects the integrity of the entire regulatory framework. Furthermore, out-of-state producers supplying that milk would be paid the order's blend price, which is reflective of the market's total classified use value.

In their post-hearing brief, the Institute made reference to a ''six-point test'' that must be met in order for a FMMO to be promulgated. While the Institute correctly lists various factors that have been used in some order promulgations, the articulated AMAA standard that must be met for order promulgation is that the order will ''. . . establish and maintain such orderly marketing conditions. . . .''

Other parties in post-hearing briefs contend that the 2014 Farm Bill mandated that a California FMMO be promulgated. The Farm Bill authorized a California FMMO that recognizes quota value as determined appropriate through a rulemaking proceeding. It is important to note that California producers could have petitioned for a FMMO at any time. However, Congress did not provide for the recognition of quota before the 1996 Farm Bill, and later, the 2014 Farm Bill. This decision finds that a California FMMO is justified, as it will meet the objective of the AMAA to ''. . . maintain such orderly marketing conditions . . ..'' The provisions recommended are tailored to the California market, adhere to the uniform handler and producer pricing provisions of the AMAA, and recognize quota as authorized by the 2014 Farm Bill and as deemed appropriate by an analysis of this hearing record.

Additionally, some hearing participants indicated that a goal of FMMOs, and therefore of a California FMMO, is to enhance producer prices. Other participants from outside of California, in testimony and post-hearing briefs, expressed the opinion that a California FMMO cannot be promulgated if it would have adverse impacts on other FMMOs, and that the Department must act to negate those adverse impacts before such promulgation.

FMMOs are a marketing tool that, among other things, establish a marketing framework and enforce market-based minimum prices to handlers and uniform payments to producers reflective of all classified use values in the market. The record reflects that California represents over 20 percent of the United States milk supply. If a California FMMO is established, over 80 percent of the United States milk supply would fall under the same regulatory framework. This decision finds that a California FMMO will provide more orderly marketing conditions in California. Through inclusion of California in the FMMO regulatory framework, the prices received by all producers participating in the FMMO system would be more reflective of the national marketplace for dairy products. This would send uniform market signals to producers that would allow them to make their own individual business decisions.

4. California Quota Program Recognition

This section reviews and highlights the testimony and evidence received regarding the appropriate recognition of the California quota program, including exempt quota, in a California FMMO. The California quota program is a state-administered program that entitles the quota holder to an additional $0.195 per pound of SNF over the CSO overbase price. The money to pay the quota premium is deducted from the CSO marketwide pool before the CSO overbase price is calculated. This decision finds that the quota program should remain entirely within the jurisdiction of CDFA, and that its proper recognition under the proposed California FMMO would be through an authorized deduction from payments due to producers.

Proposal 1

A Cooperative witness testified regarding the development of the California quota program and its continued significance to California dairy farmers. The witness explained the California quota system is a tiered pricing system, developed in the late 1960's, that pays producers on three price calculations referred to as quota, base, and overbase. In its current form, ownership of quota entitles producer-owners to a higher price for milk covered by quota, and a lower base/overbase price on their nonquota milk production. Approximately 58 percent of all California farmers own quota at varying levels, which in aggregate represents approximately 2.2 million pounds of SNF on a daily basis. The witness testified that, currently, quota premium payments are approximately $12.5 to $13 million per month, and this money is taken out of the CSO marketwide pool before the base/overbase price is calculated. The witness stressed that the quota program is an important revenue source for California dairy farms, and the value of quota should not be diminished with the adoption of a California FMMO.

The Cooperative witness reviewed the authorization of the California milk pooling and quota programs by the 1967 Gonsalves Milk Pooling Act (Gonsalves Act). Originally, the witness explained, producers were assigned quota holdings as they related to the producers' historical milk production and individual deliveries to the Class 1 market. The witness said that in the beginning, quota premiums were not a set value, but instead were determined by allocating quota holdings to the highest value milk (Class 1), then base and overbase production were allocated to the remaining classes in descending order of classified value. In essence, the witness explained, quota holders were paid the Class 1 price for their quota holdings, and then a separate lower value for their non-quota holdings. According to the witness, when CDFA sought to enhance producer prices, typically additional revenue was assigned to Class 1 and subsequently quota holders, and overbase prices were not impacted. As milk production grew without corresponding increases in quota holdings, the witness said that producers were faced with lower milk prices on their non-quota production. Therefore, the Gonsalves Act was amended, effective January 1, 1994, and set a quota premium at $0.195 per pound of SNF (equivalent to $1.70 per cwt). The result, said the witness, was that overbase production did not subsidize quota milk, and quota holders could receive a reasonable return on their quota holdings.

The witness also discussed adjustments made to the total CSO marketwide pool value in conjunction with the quota program. According to the witness, when pooling was originally established, the provisions contained producer location differentials designed to encourage quota milk to be delivered to Class 1 plants. However, as overbase milk production began to grow, location differentials applicable to only quota milk did not ensure that the market's Class 1 needs would always be met, the witness stated. Consequently, in 1983 transportation allowances (on milk movements from ranch-to-plants) were established in lieu of location differentials. At the same time, the witness said, regional quota adjusters (RQAs), while providing no direct incentive to move Class 1 milk, were established to address producer equity issues that arose with the elimination of location differentials. The witness described RQAs as reductions (ranging from $0.00 to $0.27 per cwt) to the producer's quota premium, depending on their farm location and plant of receipt. In essence, the witness said, quota premiums have a location value: The farther the dairy farm is located from the receiving plant, the lower the quota premium.

The Cooperative witness stated that quota can only be held on Grade A milk produced in California, and a quota holder must deliver milk to a pool handler at least every 60 days. The witness also noted the fact that quota is bought and sold on a monthly basis, which underscores its continued importance to California dairy farms. The witness estimated that at a price of $525 per pound of SNF, the California quota program has a value of $1.2 billion to California dairy farms.

The witness was of the opinion, which was reiterated in the Cooperatives' post-hearing briefs, that under current California and Federal statutory authorities, a California FMMO can be established and the California quota program maintained. The witness said that the main objective of Proposal 1 is to preserve the quota program to the maximum extent possible, and proponents believe this is consistent with the Congressional intent of the Agricultural Act of 2014 (2014 Farm Bill), which authorized a California FMMO that recognizes the quota program.

The witness concluded by outlining what the proponents believe is the necessary framework of a proposed working relationship between CDFA and USDA, and that the provisions contained in Proposal 1 are needed to effectively maintain the quota program. The witness explained that Proposal 1 allows the quota premium to be removed from the marketwide pool before a FMMO blend price is computed. Producers would then receive the blend price for their nonquota holdings and the FMMO blend price plus the quota premium (adjusted for RQAs) for their quota holdings. According to the witness, USDA would enforce all producer payments, including quota payments, and jurisdiction over quota administration, calculations, record keeping and regulatory changes would remain with CDFA.

In their post-hearing brief, the Cooperatives asserted that their proposal is the only one that properly recognizes the quota program as intended by Congress. The Cooperatives rebutted the Institute's claim that adoption of Proposal 1 would create a trade barrier to milk produced outside the state because that milk would be ineligible for the quota program. The Cooperatives offered a modification that would create an out-of-state adjustor to ensure out-of-state producers do not receive a lower price due to California quota premium payments.

The Cooperatives further argued that Proposal 1 upholds the AMAA's uniform pricing provisions, as all quota would be paid uniformly, all non-quota milk would be paid uniformly, and all milk located outside of the proposed marketing area would be unaffected by the quota program. The Cooperatives' brief stated that the ability of a FMMO to regulate interstate commerce would provide a more level playing field among all handlers with sales in California.

A consultant witness, appearing on behalf of the proponents of Proposal 1, testified regarding the economic importance of the California quota program, and provided a brief history of its evolution. At current market prices, the witness estimated the value of the California quota program at $1.164 billion—a significant economic asset for dairy farms and the communities they support, especially in counties where a high percentage of milk production is covered by quota. The witness noted that not only is quota a solid financial investment for dairy farms, but it is a tangible asset used by dairy farms to obtain additional financing from banks and lenders.

The witness utilized an economic impact analysis model to estimate the total economic impact of the California quota program. The witness estimated that total annual economic value of quota is associated with a $27.9 million increase in California GDP, creation of 1,269 jobs, an $11 million increase in local tax revenue, and a $16.7 million increase in Federal tax revenue. The witness clarified that the analysis did not consider the economic impact of the quota program on non-quota holders, but stressed any change to the quota program would create regulatory uncertainty and diminish the economic value of quota. The witness was of the opinion that Proposal 2 does not recognize the economic value of quota and would result in the devaluation of the asset, which would financially harm California quota holders. The witness concluded that Proposal 1 was the only proposal that would preserve and maintain the California quota program.

Twelve dairy farmers testified that a California FMMO must provide for the continuation of the California quota program. The farmers stressed the importance of the California quota program as an asset for dairy farms throughout the state. The witnesses explained that farms utilize quota not only for the monthly quota premium they receive, but also as an asset on farm balance sheets for lending purposes. The witnesses expressed concern that any devaluation of their quota asset would be financially harmful to their businesses. Of the 27 dairy farmers who testified, 8 said they owned quota, and both quota and non-quota holders expressed support for the quota program.

A witness testifying on behalf of WUD also elaborated on the importance of maintaining the quota program and the need for strict pooling provisions to ensure the quota premium could continue being paid. The witness said quota is considered an asset and if its value is diminished, it could create cash flow and lending difficulties for dairy farms. The witness was of the opinion that if a California order was adopted with pooling provisions similar to those found in other FMMOs, the quota value would likely be diminished, which would violate the California statute.

Proposal 2

A witness appearing on behalf of the Institute testified regarding Proposal 2's recognition of the California quota program. Like the Cooperative witness, the Institute witness provided a historical overview of the quota program's authorization and evolution. The witness stated that the quota program served as a way to compensate producers who shipped most of their milk to Class 1 plants through the contract system in place prior to marketwide pooling. At the time, the witness said, the industry believed prices to producers would become more uniform and quota allocation would be equalized among producers as Class 1 utilization grew.

The Institute witness outlined the problems they believe arise from Proposal 1's method for quota recognition. The witness was of the opinion, which also was stressed in the Institute's post-hearing briefs, that the Cooperatives have rendered an overly broad interpretation of the 2014 Farm Bill, and in doing so, proposed provisions that violate the AMAA. The witness said that before quota can be recognized, a California FMMO must first determine and pay a traditional FMMO blend price to out-of-state dairy farms who cannot own quota. The witness said that subtracting the quota value from the marketwide pool first, before computing a non-quota blend price, as suggested in Proposal 1, would result in non-uniform payments to producers and violate the AMAA.

The Institute witness explained the mechanics of quota recognition in Proposal 2, which were modeled after the former Oregon-Washington FMMO. The witness said that out-of-state producers would receive a traditional FMMO blend price for their milk pooled on the California FMMO. In-state producers would have the option to receive the CDFA calculated quota and non-quota prices, or they could irrevocably opt out of the quota program and receive the traditional FMMO blend price. The witness explained that producers opting to be paid on a quota/non quota basis would have their aggregate FMMO blend price monies transferred to CDFA for reblending and distribution to that producer subset. The witness was of the opinion that by giving in-state producers the payment choice, the uniform payment provision of the AMAA would be satisfied. The Institute witness said that Proposal 2 sought to recognize quota value as authorized by the 2014 Farm Bill while simultaneously upholding the purpose and provisions of the AMAA. These opinions were reiterated in the Institute's post-hearing brief.

The Institute witness highlighted California producer support for the quota program, and was of the opinion that USDA's Preliminary Economic Impact Analysis prediction that the program would quickly erode under Proposal 2 was overstated.

Proposal 3

Proposal 3, submitted by the CPHA, seeks to have exempt quota—as part of the California quota program—be recognized and preserved, should a California FMMO be recommended. CPHA also proposed that the terms of consanguinity, as currently applied to producer-handlers under CDFA regulations, be removed to allow indefinite perpetuation of exempt quota. CPHA withdrew the second part of their proposal at the hearing.

A consultant witness for CPHA provided testimony regarding the history of the Gonsalves Act and detailed how exempt quota was included as part of the State's milk marketing program from its inception. According to the witness, the CSO marketwide pooling system and quota program was developed as an alternative to a FMMO. The witness said the quota program was originally designed so that farmers who historically served fluid milk processors would continue to receive a higher price for the portion of their milk that had previously been under Class 1 contract; under the CSO marketwide pooling system, all of the Class 1 revenue would be shared with the market's producers. Over time, the witness said, it was thought that quota holdings would be equalized among dairy farmers. Those who had not previously held contracts with fluid milk processors were expected to be assigned rights to new quota created as the fluid milk market expanded.

The consultant witness explained that dairy farmers who processed their own milk into fluid milk products were issued exempt quota, rather than regular quota, under the new CSO system. The exempt quota was allotted to these vertically integrated entities, known as producer-handlers, in recognition of how their milk was marketed. The witness said that there were originally 49 exempt quota holders, but only 4 remain. The witness said that the amount of exempt quota was legislatively capped in 1995.

The consultant witness clarified that exempt quota was issued as certificates of ownership to the producer entity. The witness explained that the handler side of the business is still required to report all its milk receipts to the CSO, and in turn, the handler entity receives a credit against its financial obligation to the pool for the volume of exempt quota owned by the producer entity. The handler entity then accounts to the CSO marketwide pool for Class 1 sales in excess of the exempt quota volume, said the witness. The producer entity side receives the Class 1 price from the handler side for the exempt quota volume of milk they produce, and then they receive a combination of the quota and overbase prices from the marketwide pool, depending on their regular quota holdings.

A witness from Producers, testifying on behalf of CPHA, said that all four members of CPHA own exempt quota, are referred to as ''Option 70'' producer-handlers, are fully regulated, and report to the CSO marketwide pool for all their Class 1 sales. The witness contrasted this to ''Option 66'' producer-handlers, who are fully exempt from the CSO and do not participate in the quota program. Of the original 49 ''Option 70'' producer-handlers, the witness said only the 4 CPHA members remain, and all have maintained essentially the same business structures since the quota program was established.

According to the Producers witness, CPHA members hold both exempt quota and regular quota, but most of the milk produced by CPHA members is accounted for as overbase production. Using 2015 CDFA data, the Producers witness calculated that ''Option 70'' producer-handler milk represents approximately 0.6 percent of all California production. The witness estimated that exempt quota represents 17.4 percent of ''Option 70'' producer-handler production and 4.6 percent of all California Class 1 sales. The witness said that all of the milk produced and sold by CPHA members, including volumes covered by exempt quota, is reported to the CSO marketwide pool.

The Producers witness said that the Gonsalves Act primarily addressed industry problems that did not impact producer-handlers because all the milk from their dairy operations flowed to their own Class 1 plants and the markets they had developed. The witness was of the opinion that the exempt quota feature was included as part of the quota program to recognize the vertically integrated producer-handler's unique business structure.

Additional CPHA witnesses representing Foster and Rockview joined the Producers witness in describing their acquisition and maintenance of exempt quota over the years. Each mentioned they had to make strategic business decisions or sacrifices in order to preserve their exempt quota status.

The CPHA witnesses attempted to quantify the value of exempt quota, explaining that exempt quota is carried as an asset on their farms' books and can be sold as or converted to regular quota. The CPHA witnesses measured the value of exempt quota as the difference between the CSO Class 1 and the quota prices. Using historical CDFA data, the Producers and Rockview witnesses calculated the average exempt quota value over the previous 20 years to be approximately $1.14 and $1.20 per cwt, respectively.

Using CDFA data for the preceding five years, a second Foster witness calculated the value of exempt quota in terms of regular quota for both northern and southern California. The witness estimated that every pound of exempt quota in northern California and southern California is worth 1.96 pounds and 2.12 pounds of regular quota, respectively. Valuing regular quota at $525 per pound of SNF, but not adjusting for RQAs, the witness estimated the value of exempt quota as $1,029 per pound of SNF in northern California, and $1,113 per pound of SNF in southern California. Citing CDFA production data, the witness calculated the value of the collective 40,244.51 pounds of SNF exempt quota in northern California as $41,411,600 and the 17,669.59 pounds of SNF exempt quota in southern California as $19,666,253.

The Rockview witness added that converting exempt quota to regular quota would make those volumes eligible for CSO transportation credits that are not currently available for exempt quota milk.

A Cooperative witness also testified with regard to the evolution of exempt quota for ''Option 70'' producer-handlers. The witness estimated that the four CPHA members market approximately five percent of all California Class 1 sales. The witness explained that exempt quota entitles the producer-handler to waive any pool obligation on those holdings. The witness described the value of exempt quota as the difference between the Class 1 and quota prices. The witness estimated that from 1970 through 2014, the additional value of exempt quota was approximately $0.58 per cwt in southern California. The witness estimated the monthly impact to the marketwide pool of recognizing exempt quota in this manner at less than one-half of one cent per cwt. The witness testified that the Cooperatives did not oppose adoption of Proposal 3.

A witness representing the Institute was of the opinion that exempt quota was offered to large producer-handlers for political expediency. According to the witness, as the Gonsalves Act and the particulars of marketwide pooling were being developed in the 1960s, larger producer-handlers worried they would lose advantages enjoyed under the then-prevailing system. To head off producer-handler opposition to marketwide pooling, the witness contended concessions were made to smaller producer-handlers who were exempted entirely from pooling and received no quota allocation. Larger entities were given the option to forgo the quota premium and instead exempt those pounds from their Class 1 pool obligations.

The Institute witness testified that exempt quota holds no real market value, as it cannot be bought and sold. The witness acknowledged that determining an equivalency between exempt quota and regular quota might be one method to assign a value to exempt quota. The Institute witness was of the opinion that exempt quota holders have already recovered the cost of their exempt quota, which they were last able to purchase 20 years ago.

A witness from Dean Foods testified that the competitive advantage producer-handlers gain from their exempt quota can be spread out over their total volume of Class 1 sales. The witness argued that CPHA witnesses diluted the impact of exempt quota on Class 1 sales by comparing exempt quota volumes to total California milk production. The witness contended that it was more accurate to compare total ''Option 70'' producer-handler Class 1 production to total California Class 1 sales. The witness calculated that the total volume of the 4 producer-handlers, including their exempt quota volumes, accounted for 24 percent of total California Class 1 volume, including milk from out of state. The witness testified that 31 handlers process the other 76 percent of California Class 1 milk.

Additional fluid milk processor witnesses representing Clover Stornetta Farms and Farmdale Creamery, along with another Dean Foods witness, all testified that their companies face significant disadvantages compared to producer-handlers with exempt quota because, unlike exempt quota holders, their companies must account to the CSO pool at classified prices every month for all the milk they utilize. Some witnesses claimed they have lost sales to ''Option 70'' producer-handlers due to these regulatory disadvantages.

The Producers witness countered opposition testimony that exempt quota provides a competitive advantage enabling them to bid customers away from fully-regulated handlers. The witness said that Producers pays the Class 1 price to the farm side of the business for the exempt quota milk they use, and pays the quota or overbase price for the rest of the farm's milk it processes.

In its post-hearing brief, the Institute argued against recognition of exempt quota under a California FMMO. According to the Institute's brief, the recognition of exempt quota in a California FMMO would violate the AMAA's uniform pricing provisions. The Institute explained that by recognizing exempt quota, exempt-quota-holding-producer entities would not share the value of all their Class 1 sales with their fellow dairy farmers, and handler entities would not be required to pay uniform minimum prices for their raw milk supplies.

The Institute brief further argued that the 2014 Farm Bill language authorizing a California FMMO that recognizes quota value does not mean California's entire quota system should be preserved and maintained, nor that certain Class 1 handlers should be permitted to have a regulatory competitive advantage over other Class 1 handlers. The Institute brief also argued that permitting a differentiated status for only those few entities who currently own exempt quota would be inequitable to new market entrants.

In response, CPHA's reply brief asserted that CPHA handler entities currently pay Class 1 prices for all their raw milk, exempt quota provides no financial advantage over other fully-regulated handlers, and there are no market disruptions attributable to exempt quota. The reply brief stressed that CPHA producer entities, not their handler counterparts, hold exempt quota. Their reply brief also asserted the record contains no evidence that exempt quota holders enjoy raw milk price advantages. CPHA contended that all handlers pay the same classified price for raw milk in California despite misperceptions to the contrary. CPHA pointed out that competitors have won and lost accounts for milk sales for a variety of reasons not necessarily attributed to exempt quota ownership.

According to CPHA's reply brief, Congress's use of the term ''quota system,'' and its omission of specific reference to exempt quota in the 2014 Farm Bill language is consistent with its directive that the Secretary should hold a hearing to consider, and is authorized to recognize, all aspects of California's quota program under a California FMMO.

CPHA's reply brief clarified the intent of Proposal 3 to allow for the preservation of exempt quota status for those few producer-handlers who own it. CPHA argued its members are not seeking exemption from all pricing and pooling obligations under a California FMMO, but merely recognition of their ownership of exempt quota and the related volumes of production it represents.

A post hearing brief submitted by Trihope expressed concerns regarding the recognition of the California quota program within the FMMO framework. Trihope was of the opinion that any recognition of quota would violate the AMAA's uniform payments provision. Trihope also wrote that authorizing quota payments would give a revenue advantage to California dairy farms and create a trade barrier for out-of-state farms seeking to be pooled on the California FMMO.

Findings

The record contains detailed information about the establishment and evolution of the quota program administered by the State of California. The record reflects that the Gonsalves Act legislatively authorized both the California quota program and marketwide pooling within the structure of the CSO. Until that point, dairy farms were paid through individual handler pools that reflected a plant's use values for their milk—there was no marketwide pooling function that allowed all producers to share in the benefits from Class 1 sales and the burden of balancing the market to ensure an adequate supply of milk to meet Class 1 demand. Many witnesses spoke to the political compromise reached to compensate dairy farmers who held Class 1 supply contracts from the financial loss they would incur by pooling and sharing their Class 1 revenue with all dairy farmers in California. While the original quota allotment was based on existing Class 1 contracts, it was thought at the time that quota would equalize among producers as Class 1 utilization increased and future quota allotments were issued; however, this did not occur.

Many witnesses spoke of the importance they believe the California quota program has for the state's dairy industry. Producers spoke of the investments they made in purchasing quota allotments, and the continued financial benefit it provides through the monthly quota premium they receive. Even producers who own little or no quota spoke of the importance of continuing the program for their fellow dairy farmers.

The 2014 Farm Bill authorized the promulgation of a California FMMO, and specified that the order ''shall have the right to reblend and distribute order receipts to recognize quota value.'' The hearing record is replete with testimony on the proper interpretation of those final three words, ''recognize quota value.'' The Cooperatives conveyed, and stressed in their post-hearing brief submissions, that the 2014 Farm Bill mandates the quota program must be recognized, and only the method of recognition is to be decided through this rulemaking proceeding. The Cooperatives are of the opinion that the proper recognition of quota value is through the deduction of quota monies from the marketwide pool before a California blend price is calculated, as is current practice for the CSO.[17] The Cooperatives stressed repeatedly that should any conflict be found between the provisions of the 2014 Farm Bill and the AMAA, the 2014 Farm Bill language should be given more credence, as it is the most recent Congressional action.

Institute witnesses and post-hearing briefs stressed that quota recognition must be harmonized with the AMAA, in

[17] This position was slightly modified in their post-hearing brief to also adjust prices for out-of-state producers so that their price was not impacted by quota payments.

particular its uniform payments and trade-barrier provisions. Should any conflict arise, the Institute contends that because the Farm Bill did not amend the AMAA, the AMAA as the authorizing legislation should take precedent. The Institute's approach to recognizing quota value is to first allow producers the one-time decision to opt out of the quota program. Those producers who opt out of the quota program would be paid a FMMO blend price calculated without a deduction for quota. Those producers who remain in the quota program would have their FMMO blend price monies sent, in aggregate, to CDFA for reblending and redistribution according to their quota and nonquota milk marketings. The Institute is of the opinion that because dairy producers opting out of the quota program would not have their payments affected by quota, recognizing quota under a California FMMO would not violate the uniform pricing and trade-barrier provisions of the AMAA.

As discussed earlier, when promulgating or amending any FMMO, the Department must always evaluate whether the proposed action is authorized by the AMAA. The AMAA not only clearly defines its policy goal, which this decision has already discussed, but it also defines specific provisions that must be contained in the FMMO framework. The two most relevant to the discussion on quota recognition are the provision for uniform payments handlers make to producers, and the provision to prevent trade barriers. The uniform payment provisions require all handlers regulated by a FMMO to pay the same classified use value for their raw milk, and all producers whose milk is pooled on a FMMO to receive the same price for their milk regardless of how it is utilized. In this respect, similarly situated handlers are assured that they are paying the same raw milk costs as their competitors, and producers are indifferent as to where or how their milk is utilized, as they receive the same price regardless.

The trade barrier provision specifies that no FMMO may, in any manner, limit the marketing of milk or milk products within the marketing area. In this regard, FMMOs cannot adopt provisions that would create any economic barrier limiting the marketing of milk within marketing area boundaries.

To determine how to properly recognize quota value, Congress provided additional guidance to the 2014 Farm Bill language through the 2014 Conference Report.[18] In the report, Congress specified that the Department has discretion to determine how best to recognize quota value in whatever manner is appropriate on the basis of a rulemaking proceeding. Consistent with the Conference Report, this decision evaluated record evidence pertaining to how the current California quota program operates, how it can best be recognized within FMMO provisions tailored to the California market, and how all the FMMO provisions work in conjunction with each other to adhere to all AMAA provisions.

The California quota program, like the CSO, is administered by CDFA. The record reflects that 58 percent of California dairy farmers own quota. In its current form, the quota program entitles a quota holder to an additional $0.195 per pound SNF (equivalent to $1.70 per cwt) over the market's overbase price on the quota milk they market each month. Similar to their FMMO counterparts, California handlers pay classified use values for their milk, and those values make up the CSO marketwide pool. Each month, CDFA deducts quota monies from the CSO marketwide pool before a marketwide blend price, otherwise known as the overbase price, is calculated. CDFA then announces the quota and overbase prices[19] to be paid to California dairy farmers. As a result, in general, nonquota milk receives the market's overbase price, and quota milk receives the overbase price plus an additional $1.70 per cwt. CDFA enforces payments of both quota and overbase prices. Record data shows that the deduction from the CSO marketwide pool to pay quota premiums is approximately $12.5 to $13 million per month. Numerous witnesses estimated, at current quota market prices, the asset value of quota at $1.2 billion.

The record reflects that the California quota program is funded by California producers. All handlers regulated through the CSO pay minimum classified use values, and it is only once those values have been pooled that the quota value is deducted from the pool. Data on the record reflects all California dairy farmers, including quota holders, receive $0.37 per cwt less, on average, for all of their milk marketings in order to fund the $0.195 per pound of quota SNF payment to quota holders.

[18] Official Notice is taken of the Agricultural Agreement of 2014 Conference Report. *https://www.congress.gov/congressional-report/113th-congress/house-report/333/1.*

[19] The record reflects that CDFA also announces a base price which is equal to the overbase price. For simplicity, this decision will refer only to the overbase price.

This decision finds the California quota program could be maintained, administered, and enforced by CDFA and that a California FMMO should operate as a stand-alone program. As is currently done in all FMMOs, handlers would pay classified use values into the pool, and all producers, both in state and out of state, would receive a FMMO blend price reflective of the market's use values. It is through this structure that a California FMMO could ensure the uniform payment and trade barrier provisions of the AMAA are upheld.

Should CDFA determine it can continue to operate the California quota program through the use of producer monies, as is the current practice, the proposed California FMMO could recognize quota values through an authorized deduction by handlers from the payments due to producers for those dairy farmers determined by CDFA to be participants in the state-administered California quota program. The amount of the deduction would be determined and announced by CDFA.

Currently, FMMOs allow for authorized deductions, such as the Dairy Promotion and Research Program assessment, from a producer's milk check. The California FMMO similarly would authorize a deduction for the state-administered California quota program. The California FMMO would allow regulated handlers to deduct monies, in an amount determined and announced by CDFA, from blend prices paid to California dairy farmers for pooled milk, and send those monies to CDFA to administer the quota program. CDFA would in turn enforce quota payments to quota holders.

In essence, this decision proposes that the California quota program could continue to operate in essentially the same manner as it currently does. The record reflects that the California quota program already assesses California producers to pay quota values to quota holders. While producers may not see this as an itemized deduction on their milk checks, their overbase price is lower than it otherwise would be. This is a result of deducting the quota value from the pool prior to calculating the overbase price.

The California FMMO would authorize deductions from those California producers whose milk is pooled on the order. As this decision will later explain, the proposed California FMMO would have performance-based pooling standards that allow for milk to not be pooled. CDFA would be responsible for the collection of California producer monies for milk not pooled, because a California FMMO would only apply to producer milk as defined by the order. USDA and CDFA could cooperate by sharing data through a memorandum of understanding to ensure that, between the two regulatory bodies, all appropriate California producers are assessed an amount necessary to administer the quota program.

In regard to the treatment of exempt quota as addressed in Proposal 3, this decision finds that exempt quota is part of the California quota program and therefore its proper recognition should be determined by CDFA. The record demonstrates that exempt quota was initially granted when the California quota program was established, and like regular quota, the provisions have been adjusted numerous times through both California legislative and rulemaking actions. This decision finds the continuation of exempt quota, in whatever manner appropriate, should be determined by CDFA.

The record reflects that under the proposed FMMO, the four California producer-handlers who own exempt quota would likely become fully-regulated handlers because their sales exceed three-million pounds per month. These fully-regulated handlers would be required to account to the marketwide pool for all of their Class I utilization and pay uniform FMMO minimum classified prices for all milk they pool. The CPHA witnesses testified that exempt quota is held on the producer side of their businesses. CDFA could best determine how those producers holding exempt quota should be compensated. Such compensation cannot be made from reducing the minimum Class I obligation of FMMO fully-regulated handlers without undermining the uniform handler payment provision of the AMAA.

Throughout the hearing and in post-hearing briefs, dairy farmers and their Cooperative representatives stressed that while a California FMMO would provide them a more equitable price for their milk, entry into the FMMO system must not diminish or disturb, in any form, California quota values. This decision finds that the package of FMMO provisions recommended in this decision would create more orderly marketing of milk in California, adhere to all the provisions of the AMAA, and allow the California quota program to operate independently of the FMMO. In doing so, the California quota program will not be diminished or disturbed in any form by California's entry into the FMMO system.

5. Definitions and Uniform Provisions

This section outlines definitions and provisions of a California FMMO that describe the persons and dairy plants affected by the FMMO and specify the regulation of those entities.

The Cooperatives and the Institute both proposed regulatory language for an entire FMMO, including definitions and regulations specific to a California FMMO, as well as adoption of several of the uniform provisions common to other FMMOs. In many cases, hearing witnesses simply provided the list of uniform provisions for which they supported adoption, and in most cases, proponents for Proposals 1 and 2 agreed on the inclusion of these provisions.

The FMMO system currently provides for uniform definitions and provisions, which are found in Part 1000 under the General Provisions of Federal Milk Marketing Orders. Where applicable, those provisions are incorporated by reference into each FMMO. The uniform provisions were developed as part of FMMO Order Reform to prescribe certain provisions that needed to be contained in each FMMO to describe and define those entities affected by FMMO regulatory plans.

As outlined in the Order Reform Proposed Rule [20] and as implemented in the Final Rule,[21] the establishment of a set of uniform provisions provides for regulatory simplification and defines common terms used in the administration of all FMMOs, resulting in the uniform application of basic program principles throughout the system. Application of standardized terminology and administrative procedures enhances communication among regulated entities and supports effective administration of the individual FMMOs.

This decision finds that a set of uniform provisions should continue to be maintained throughout the FMMO system to ensure consistency between uses of terms. Therefore, this decision finds that a California FMMO should contain provisions consistent with those in the 10 current FMMOs.

Marketing conditions in each regulated marketing area do not lend themselves to completely identical provisions. Consequently, some provisions are tailored to the marketing conditions of the individual order, and provisions recommended for a California FMMO in this decision are similarly tailored to the California market where appropriate. This section provides a brief description of the uniform definitions and provisions recommended for a California FMMO.

[20] Official Notice is taken of Federal Order Reform Proposed Rule: 63 FR 4802.

[21] Official Notice is taken of Federal Order Reform Final Rule: 64 FR 47898.

Where a definition or provision does not lend itself to uniform application, it is discussed in greater detail here or in other sections of this document.

This decision recommends the following definitions for a California FMMO:

Marketing Area. The *Marketing Area* refers to the geographic area where handlers who have fluid milk sales would be regulated. In this case, the marketing area should include the entire state of California. The marketing area encompasses any wharves, piers, and docks connected to California and any craft moored there. It also includes all territory within California occupied by government reservations, installations, institutions, or other similar establishments.

Route Disposition. A *Route Disposition* should be a measure of fluid milk (Class I) sales in commercial channels. It should be defined as the amount of fluid milk products in consumer-type packages or dispenser units delivered by a distributing plant to a retail or wholesale outlet, either directly or through any distribution facility.

Plant. A *Plant* should be defined as what constitutes an operating entity for pricing and regulatory purposes. Plant should include the land, buildings, facilities, and equipment constituting a single operating unit or establishment where milk or milk products are received, processed, or packaged. The definition should include all departments, including where milk products are stored such as coolers, but not separate buildings used as reload points for milk transfers or used only as distribution points for storing fluid milk products in transit. On-farm facilities operated as part of a single dairy farm entity for cream separation or concentration should not be considered plants.

Distributing Plant. A *Distributing Plant* should be defined as a plant approved by a duly constituted regulatory agency to handle Grade A milk that processes or packages fluid milk products from which there is route disposition.

Supply Plant. A *Supply Plant* should mean a regular or reserve supplier of bulk milk for the fluid market that helps coordinate the market's milk supply and demand. A supply plant should be a plant, other than a distributing plant, that is approved to handle Grade A milk as defined by a duly constituted regulatory agency, and at which fluid milk products are received or from which fluid milk products are transferred or diverted.

Pool Plant. A *Pool Plant* should mean a plant serving the market to a degree that warrants their producers sharing in the added value that derived from the classified pricing of milk. The pool plant definition provides for pooling standards that are unique to each FMMO. The specifics of the pooling standards recommended for a California FMMO are discussed in detail in the Pooling section of this decision.

Nonpool Plant. A *Nonpool Plant* should be defined as plants that receive, process, or package milk, but do not satisfy the standards for being a pool plant. This provision provides additional clarity to define the extent of regulation applicable to plants. Nonpool plants should be further defined to include: *A Plant Fully Regulated under Another Federal Order,* which means a plant that is fully subject to the pricing and pooling provisions of another order; a *Producer-Handler Plant,* which means a plant operated by a producer-handler as defined under any Federal order; a *Partially Regulated Distributing Plant,* which means a plant from which there is route disposition in the marketing area during the month, but does not meet the provisions for full regulation; and an *Unregulated Supply Plant,* which is a supply plant that does not qualify as a pool supply plant.

Exempt Plant. An *Exempt Plant* also is a nonpool plant, and should be defined as a plant exempt from the pricing and pooling provisions of any order, although the exempt plant operator would still need to comply with certain reporting requirements regarding its route disposition and exempt status. Exempt plants should include plants operated by a governmental agency with no route disposition in commercial market channels, plants operated by duly accredited colleges or universities disposing of fluid milk products only through their own facilities and having no commercial route disposition, plants from which the total route disposition is for individuals or institutions for charitable purposes and without remuneration, and plants that have route disposition and sales of packaged fluid milk products to other plants of no more than 150,000 pounds during the month.

The exempt plant definition was standardized as part of Order Reform to provide a uniform definition of distributing plants which, because of their size, did not significantly impact competitive relationships among handlers in the market. The 150,000 pound limit on route disposition and sales of packaged fluid milk products was deemed appropriate because at the time it was the maximum amount of fluid milk products allowed by an exempt plant in any FMMO. Therefore, the uniform provisions ensured that exempt plants remained exempt from pricing and pooling provisions as part of Order Reform. This decision finds that to provide for regulatory consistency, the exempt plant definition in a California FMMO should be uniform with the 10 current FMMOs. This provision would allow for smaller California distributing plants that do not significantly impact the competitive relationship among handlers to be exempt from the pricing and pooling provisions of a California FMMO.

Both the Cooperatives and the Institute proposed adoption of the standard FMMO definition of exempt plants, and hearing witnesses were supportive of the proposals. However, in their post-hearing brief, the Cooperatives proposed two additional exempt plant categories to provide regulatory relief to small handlers under Proposal 1. The two additional exempt plant categories proposed include: (1) Plants that process 300,000 pounds or less of milk during the month into Class II, III, and IV products, and have no Class I production or distribution; and (2) plants that process, in total, 300,000 pounds or less of milk during the month, from which no more than 150,000 pounds is disposed of as route disposition or sales of packaged fluid milk products to other plants. Proposal 1, as originally drafted, would have fully regulated all handlers that received California milk, except for plants with 150,000 pounds or less of route disposition. Through the proposed modification, the Cooperatives sought to extend exempt plant status to smaller plants regardless of their use of milk. In essence, it would allow smaller plants with primarily manufacturing uses to be exempt from the pricing and pooling provisions. This decision finds the recommended performance-based pooling provisions make such additional exemptions unnecessary, as plants with manufacturing uses will have the option to elect not to pool their milk supply.

Handler. A *Handler* should be defined as a person who buys milk from dairy farmers. Handlers have a financial responsibility for payments to dairy farmers for milk in accordance with its classified use. Handlers must file reports with the Market Administrator detailing their receipts and utilization of milk.

The handler definition for a California FMMO should include the operator of a pool plant, a cooperative association that diverts milk to nonpool plants or delivers milk to pool plants for its account, and the operator of a nonpool plant.

The handler definition should also include intermediaries, such as brokers and wholesalers, who provide a service to the dairy industry, but are not required by the FMMO to make minimum payments to producers.

The Cooperatives proposed adoption of the uniform FMMO handler definition for a California FMMO. The Institute proposed adopting the uniform handler definition, modified to include proprietary bulk tank handlers (PBTH). A witness representing the Institute and Hilmar testified regarding the PBTH provision. The witness said a PBTH provision had been included in some former FMMOs to allow proprietary handlers to pool milk in a fashion similar to cooperative handlers, without needing to first deliver milk to a pool supply plant to meet the performance standards of the order. The witness explained that under Proposal 2, a PBTH would have to operate a plant—located in the marketing area—that does not process Class I milk and further, the PBTH would have to be recognized as the responsible handler for all milk pooled under that provision. The witness was of the opinion that the PBTH provision would promote efficient milk movements, reduce transportation costs, and eliminate unnecessary milk loading and unloading simply to meet the order's performance standards.

The witness said the flexibilities of a PBTH provision would offer operational efficiencies to Hilmar and allow them to meet criteria similar to the pool supply plant qualifications advanced in Proposal 2. The witness explained that Hilmar would be able to ship milk directly from a farm to a distributing plant, rather than shipping milk first to a pool supply plant and then on to a distributing plant.

In their post-hearing briefs, the Cooperatives opposed the PBTH provision, citing disorderly marketing conditions with its use in earlier marketing orders, and stating that the provision is unnecessary, prone to create disorder, and, as proposed, administratively unworkable.

The record supports adoption of the standard FMMO handler definition without the additional PBTH provision prescribed in Proposal 2. The Department has found in the past that PBTH provisions led to the pooling of milk that was not part of the legitimate reserve supply for distributing plants in the marketing area.[22] In California, with a relatively low Class I utilization, such a provision is unnecessary to ensure an adequate supply of milk for Class I use. Therefore, this decision finds that the uniform handler definition, without the inclusion of a PBTH provision, is appropriate for a California FMMO.

Producer-Handler. Under the 10 existing FMMOs, *Producer-Handlers* are defined as persons who operate, as their own enterprise and at their sole risk, both a dairy farm and a distributing plant from which there is route disposition within the marketing area, and have total Class I fluid milk sales of no more than three million pounds per month. Seven of the existing orders also allow producer-handlers to receive up to 150,000 pounds of fluid milk products per month from fully-regulated handlers in any order. Producer-handlers are exempt from the pricing and pooling provisions under each of the existing orders.

As a result of their exemption from the pricing and pooling provisions, producer-handlers, in their capacity as handlers, are not required to pay the minimum class prices established under the orders, nor are they, in their capacity as producers, granted minimum price protection for disposal of their surplus milk. Producer-handlers, in their capacity as handlers, are not obligated to equalize their use-value of milk through payment of the difference between their use-value of milk and the respective order's blend price into the producer-settlement fund. Thus, producer-handlers retain the full value of milk processed and disposed of as fluid milk products by their operation.

Entities defined as FMMO producer-handlers must adhere to strict criteria that limit certain business practices, including the purchase of supplemental milk. Given these limitations, producer-handlers bear the full burden of balancing their milk production between fluid and other uses. Milk production in excess of their Class I route disposition does not enjoy minimum price protection under the orders and may be sold at whatever price is obtainable in the market.

Producer-handlers are required to submit reports and provide access to their books, records and any other documentation as deemed necessary by the Market Administrator to ensure compliance with the requirements for their regulatory status as producer-handlers. Therefore, producer-handlers are regulated under the orders, but are not ''fully regulated'' like other handlers who are subject to an order's pricing and pooling provisions.

Under the CSO, two categories of producer-handlers are recognized. ''Option 66'' producer-handlers may request exemption from the CSO's pooling regulations if both their farm production and their sales average less than 500 gallons of milk per day on an annual basis, and if they ship 95 percent of their production to retail or wholesale outlets. ''Option 66'' producer-handlers are fully exempt from the pool for their entire production and may not own quota or production base. The record reflects that there were two ''Option 66'' producer-handlers in California at the time of the hearing. No production data was submitted at the hearing to quantify the volume of ''Option 66'' producer-handler milk exempt from the CSO pool.

The CSO's second producer-handler category pertains to ''Option 70'' producer-handlers—large scale entities that own exempt quota, which exempts them from pooling a portion of their Class 1 milk. The exempt quota held by ''Option 70'' producer-handlers was discussed earlier in this decision.

Proposals 1 and 2 both include definitions and provisions for producer-handlers consistent with the 10 FMMOs that currently exempt persons who operate both dairy farms and distributing plants, and process and distribute no more than three million pounds of fluid milk per month. The producer-handler regulations under Proposal 2 more closely resemble those in the Pacific Northwest and Arizona FMMOs in that they contain additional specificity about producer-handler qualifications.

A Cooperative witness supported adoption of the standard FMMO producer-handler definition for a California FMMO as contained in Proposal 1. Under the standard definition, producer-handlers who sell or deliver up to three million pounds of Class I milk or packaged fluid milk products monthly would be exempt from the pricing and pooling provisions. The witness added that under Proposal 1, producer-handlers could own regular quota and qualify for transportation credits.

Two producer witnesses who also operate processing facilities in California described their individual experiences related to running small dairy farms and fluid milk processing operations. Both witnesses testified that they supported Proposal 1 because, among other things, they thought the proposed FMMO producer-handler definition could provide them exemptions from the pooling requirements for their Class I production and sales, something that they do not currently enjoy from the CSO.

A witness from Organic Pastures Dairy Company, LLC (Organic Pastures) testified on behalf of Organic Pastures and three other small San Joaquin Valley ''producer-distributor'' entities. According to the witness, these entities produce and bottle their own Class 1 milk, but do not qualify as ''Option 66'' producer-handlers, and must therefore account to the CSO pool. The witness explained that these businesses have taken risks to develop their own brands and customer bases, but struggle to survive financially. The witness said that Organic Pastures' monthly pool obligation for December 2014 was $50,000 for the milk they bottled and sold in California. The witness contended that because they produce, process, and distribute their own products, they should be exempt from regulation.

The entities represented by the witness supported a California FMMO because they believe they would meet the FMMO producer-handler definition and thus be exempt from the pricing and pooling provisions. The witness testified that the standard three-million pound limit would allow them to grow their businesses, but remain exempt from pricing and pooling provisions.

A witness from Dean Foods testified in support of the producer-handler provision contained in Proposal 2. The witness described similarities and differences between the producer-handler definitions in Proposals 1 and 2. The witness added that proponents of Proposal 2 recommended adoption of the additional ownership requirements, which mirror the standards in the Pacific Northwest and Arizona FMMOs. The witness explained that the additional requirements would ensure that larger-size operations typical of the western Federal orders that meet the producer-handler definition would not be able to undermine the intent of the provision.

The witness testified that Dean Foods fully supported the Institute's proposal to cap producer-handler exemptions at three million pounds of monthly Class I route disposition. The witness cited USDA decisions that found producer-handlers with greater than three million pounds of route disposition per month impacted the market, and thus their exemption from pricing and pooling provisions was disorderly.

Support for the producer-handler provisions contained in Proposal 2 was

[22] Official Notice is taken of Pacific Northwest and Western Marketing Areas Tentative Final Decision: 68 FR 49375.

also expressed by two small California processors and by the Cooperatives in their post-hearing brief.

The FMMO system has historically exempted producer-handlers from the pricing and pooling provisions of FMMOs on the premise that the burden of disposal of their surplus milk was borne by them alone. Until 2005, there was no limit on the amount of Class I route disposition producer-handlers were allowed before they would be fully regulated. A Pacific Northwest and Arizona FMMO rulemaking established a three-million pound per month limit on Class I route disposition.[23] The record of that proceeding revealed large producer-handlers were able to market fluid milk at prices below those that could be offered by fully regulated handlers in such volumes that the practice was undermining the order's ability to establish uniform prices to handlers and producers. That proceeding found that producer-handlers with more than three million pounds of Class I route disposition significantly affected the blend prices received by producers and should therefore be fully regulated. The producer-handler provisions in all FMMOs were later amended in 2010.[24] In that proceeding, USDA found a three-million pound monthly limit on producer-handler total Class I route dispositions was appropriate to maintain orderly marketing conditions throughout the FMMO system.

This decision finds the regulatory treatment of producer-handlers should continue to be uniform throughout the FMMO system. The monthly three-million pound limit on Class I route disposition would ensure that California FMMO producer-handlers could not use their pricing and pooling exemption to undermine orderly marketing conditions. Therefore, the proposed California FMMO should contain the uniform FMMO producer-handler provision that limits monthly Class I route disposition to three million pounds.

The adoption of the standard FMMO producer-handler definition was supported by proponents of Proposals 1 and 2, as well as by entities that could meet the proposed producer-handler definition. The record does not contain data to indicate how many California entities would meet the proposed FMMO producer-handler definition, but it does indicate that only a small number would be impacted.

The additional qualification standards contained in the Pacific Northwest and Arizona FMMOs were explained in the Order Reform Proposed Rule.[25] The decision explained the larger than average herd size of dairy farms in the western United States lent itself to the existence of producer-handlers that were a significant factor in the market. Therefore, the Pacific Northwest and Arizona FMMOs adopted producer-handler provisions with additional qualification standards tailored to the larger dairy farm size typical of the western region of the United States.

The record reveals that herd sizes in California tend to be typical of the larger herd sizes found in the western FMMOs. According to CDFA data, in 2015 California's average herd size was 1,215. This decision finds it appropriate that the producer-handler provision in a California FMMO should include the additional qualification standards similar to those in the nearby Pacific Northwest and Arizona FMMOs.

In their post-hearing brief, the Cooperatives proposed modifying Proposal 1 to broaden the producer-handler definition to include utilization other than Class I. The modification would allow producer-handlers with Class II, Class III, or Class IV manufacturing, in conjunction with their Class I processing, to be granted producer-handler status, as long as their total production remained under the three million pound processing limit. The Cooperatives contend this would provide regulatory relief to smaller producer-handlers, who would otherwise become regulated under the inclusive pooling provisions of Proposal 1. This decision finds that extending the producer-handler definition to include manufacturing uses is not necessary because the package of pooling provisions recommended in this decision allows for optional pooling of milk used in manufacturing.

California Quota Program. The *California Quota Program* should be defined as the program outlined by the applicable provisions of the California Food and Agriculture Code and related provisions of the pooling plan administered by CDFA. Details about the proposals, hearing record, and this decision's findings regarding appropriate recognition of the California quota program were discussed earlier in this decision.

Producer. A *Producer* should be defined as a dairy farmer that supplies the market with Grade A milk for fluid use or who is at least capable of doing so if necessary. Producers would be eligible to share in the revenue that accrues from marketwide milk pooling. The producer definition in each FMMO order typically differs with respect to the degree of association that dairy farmers must demonstrate within a marketing area, as provided in the producer milk definition. The details of the proposals, hearing evidence, and this decision's findings regarding the producer milk definition are described later in the Pooling section of this decision.

Producer Milk. Producer Milk should be defined to identify the milk of producers that is eligible for inclusion in the marketwide pool. This definition is specific to the proposed California FMMO marketing order, reflecting California marketing conditions, and provides the parameters for the efficient movement of milk between dairy farms and processing plants. The details of the proposals, hearing evidence, and this decision's findings regarding the producer milk definition are described later in the Pooling section of this decision.

Other Source Milk. The order should include the uniform FMMO definition of *Other Source Milk* to include all the skim milk and butterfat in receipts of fluid milk products and bulk fluid cream products from sources other than producers, cooperative handlers, or pool plants. Other source milk should also include certain products from any source that are used to make other products and products for which a handler fails to make a disposition.

Fluid Milk Product. A California FMMO should include the standard FMMO definition of a Fluid Milk Product, which sets out the criteria for determining whether the use of producer milk and milk-derived ingredients in those products should be priced at the Class I price. Under the definition, *Fluid Milk Product* includes any milk products in fluid or frozen form that are intended to be used as beverages containing less than 9 percent butterfat, and containing 6.5 percent or more nonfat solids or 2.25 percent or more true milk protein. Fluid milk products would include, but not be limited to: Milk, eggnog, and cultured buttermilk; and those products could be flavored, cultured, modified with added or reduced nonfat solids, sterilized, concentrated, or reconstituted. Nonfat solid and protein sources include, but are not limited to, casein, whey protein concentrate, dry whey, and lactose, among others.

Products such as whey, evaporated milk, sweetened condensed milk, yogurt beverages containing 20 or more percent yogurt by weight, kefir, and certain

[23] Official Notice is taken of Pacific Northwest and Arizona Proposed Rule: 70 FR 19636.

[24] Official Notice is taken of FMMO Producer-Handler Final Rule: 75 FR 21157.

[25] *See infra.*

packaged infant formula and meal replacements, would not be considered fluid milk products for pricing purposes.

Fluid Cream Product. The order should include the standard FMMO definition of *Fluid Cream Product.* Fluid cream product includes cream or milk and cream mixtures containing at least 9 percent butterfat. Plastic cream and frozen cream would not be considered fluid cream products.

Cooperative Association. The order should include the uniform FMMO definition of *Cooperative Association* to facilitate administration of the order as it applies to dairy farmer cooperative associations. Under the uniform definition, a cooperative association means any cooperative marketing association of producers that the Secretary determines is qualified to be so recognized under the Capper-Volstead Act. Cooperative associations have full authority to engage in the sales and marketing of their members' milk and milk products. The definition also provides the recognition of cooperative association federations that function as cooperative associations for the purposes of determining milk payments and pooling.

Commercial Food Processing Establishment. The uniform FMMO definition for *Commercial Food Processing Establishment* should be included in a California FMMO to describe those facilities that use fluid milk and cream as ingredients in other food products. The definition helps identify, for classification purposes, whether disposition to such a facility should be considered anything but Class I, and clarifies that packaged fluid milk products could not be further disposed of by the facility other than those received in consumer-type containers of one gallon or smaller. Producer milk may be diverted to commercial food processing establishments, subject to the diversion and pricing provisions of a California FMMO.

Market Administrator. The record supports a provision for the administration of the order by a *Market Administrator,* who is selected by the Secretary and responsible for the oversight of FMMO activities. The market administrator receives and reviews handler reports, allocates handlers' milk receipts to their proper utilization and classification, publicizes monthly milk prices, provides monthly written account statements to handlers, and manages the producer settlement fund which serves as a clearing house for marketwide pool revenues. The market administrator is authorized to make adjustments to the order's shipping and diversion provisions, where justified, and to investigate noncompliance with the order. The market administrator manages the marketwide pool, conducts handler audits, provides laboratory testing of milk samples, and performs many other functions that support the regulation of milk marketing in the area. Market administrator activities are funded through an administrative assessment on handlers.

Continuity and Separability of Provisions. Each FMMO prescribes uniform rules governing the implementation and maintenance of the marketing order itself, and a California FMMO should likewise include these provisions. These rules state that the Secretary determines when the FMMO becomes effective and whether and when it should be terminated. The rules also provide for the fulfillment of any outstanding obligations arising under the order and liquidating any assets held by the Market Administrator, if the order is terminated or suspended. Finally, the rules provide that if, for some reason, one provision of the order—or its applicability to a person or circumstance—were to be held invalid, the applicability of that provision to other persons or circumstances and the remaining order provisions would otherwise continue in force.

Handler Responsibility for Records and Facilities. Provision should be made for the maintenance and retention by handlers of the records pertaining to their operations under a California FMMO. Records of the handler's milk purchases, sales, processing, packaging, and disposition should be included, along with records of the handler's milk utilization, producer payments, and other records required by the market administrator to verify the handler's compliance with order provisions. The market administrator should be able to review and audit each handler's records, and should have access to the handler's facilities, equipment and operations, as needed to verify the handler's obligation under the order. Handlers should be required to retain all pertinent records for three years, or longer if part of a compliance enforcement action, or as directed by the market administrator.

Termination of Obligations. Provision should be made under a California FMMO for notification to any handler who fails to meet financial obligations under the order, including payments to producers, other handlers, and to the market administrator. Such provision is contained in the uniform provisions of all FMMOs, and specifies that the market administrator has two years after the receipt of the handler's report of receipts and utilization to notify the handler of any unmet financial obligation. Provisions are included for the enforcement of the handler's payment requirement and for the handler's opportunity to file a petition for relief as provided under the AMAA.

6. Classification

The AMAA authorizes FMMOs to regulate milk in interstate commerce, and its provisions require that milk be classified according to the form in which or purpose for which it is used. Therefore, the classification of milk is uniform in all FMMOs to maintain orderly marketing conditions within and between FMMOs and to ensure that handlers competing in the national market for manufactured products have similar raw milk costs.

This decision finds that because California would be joining the FMMO system it should contain the uniform classification provisions included in the 10 existing FMMOs. Adoption of standard FMMO product classification provisions in the proposed California FMMO is appropriate to maintain uniform pricing for similar products both within the California FMMO and throughout the FMMO system. This section provides a summary of the hearing evidence and post-hearing arguments regarding milk classification under a California FMMO.

Proposals 1 and 2 both offer standard FMMO product classifications for their respective California FMMO provisions. Proposal 2 also provides an additional shrinkage allowance for ESL production at qualified ESL pool distributing plants.

A Cooperative witness testified regarding the proposed classification provisions contained in Proposal 1. The witness reviewed the evolution of the FMMO classification provisions and noted that the CSO uses a similar classification system, with limited differences. The witness was of the opinion that the FMMO classification provisions should be adopted in a California FMMO to ensure uniform classification of milk and milk products throughout the entire FMMO system.

A Cooperative witness contended that ESL products are value-added products and should not be granted additional shrinkage allowances under a California FMMO. The Cooperatives further argued that ESL shrinkage allowances should be evaluated at a national hearing because ESL products are manufactured in other FMMO marketing areas, as well as in California.

A consultant witness, appearing on behalf of the Institute, testified in support of the portion of Proposal 2 that establishes an additional shrinkage allowance for the manufacture of ESL and ultra-high temperature (UHT) milk products. The witness explained that the shrinkage allowance recognizes the inherent loss of milk from farm to plant and within the plant. The FMMO system currently allows for up to a 2 percent shrinkage allowance for pool distributing plants, depending on how the milk was received at the plant. The witness contended that the standard 2 percent allowance was developed before extensive use of ESL technology became common-place, and was based on typical shrinkage experienced in traditional high temperature, short time pasteurization (HTST) processing. The witness explained that under current FMMO classification provisions, a portion of the milk accounted for as shrinkage is classified at the lowest priced class for the month and shrinkage losses beyond 2 percent are considered excess shrinkage and classified as Class I.

The consultant witness testified that Proposal 2 provides an additional shrinkage allowance of 3 percent on ESL production at plants qualified as ESL pool distributing plants. Under the proposed provisions, the plants eligible for the additional shrinkage allowance would be distributing plants located in the marketing area that process 15 percent of the respective plant's total receipts of fluid milk products physically received at the plant into ultra-pasteurized or aseptically-processed fluid milk products.

The intent of Proposal 2, explained the witness, is for an eligible plant to have a maximum shrinkage allowance of up to 5 percent on milk used in its ESL production, not on all milk used in the plant. Data from the witness' ESL processing clients, all located outside of California, showed their total product pound shrinkage averaged above 5 percent. The witness also estimated based on 2013 to 2014 USDA record data, excess shrink in ESL and UHT plants throughout the country averaged 2.09 percent.

Another Institute consultant witness testified regarding a 19-plant shrinkage study of ESL plants; three of the plants in the study were located in California. The study showed a weighted average product pound shrinkage of 2.73 percent.

Two additional Institute consultant witnesses and a witness from HP Hood testified in support of the ESL shrinkage allowance provided in Proposal 2. The witnesses presented historical shrinkage data for ESL and UHT manufacturing facilities and offered extensive technical explanations for why shrinkage levels are higher in those systems than in HTST systems. The witnesses explained that shrinkage refers to milk lost in the manufacturing process due primarily to the fact it sticks to the equipment pipes and is lost in the cleaning process. The witnesses stressed that ESL equipment has longer piping, and noted numerous operational differences which inherently lead to higher losses of milk when compared to HTST processing.

The HP Hood witness provided a similar explanation of ESL processing and why it lends itself to higher product losses. The witness said that even though fluid milk sales across the United States are declining, HP Hood ESL product sales have grown. The witness was of the opinion that because increases in ESL fluid milk sales benefit the entire dairy industry, dairy producers should share the burden of producing these products through greater shrinkage allowances, as reflected in the classification provisions provided in Proposal 2.

HP Hood, in its post-hearing brief, reiterated its position that the heavy investment in the development of ESL technology and market expansion for those products should be shared by dairy farmers. The Institute, in its post-hearing brief, concurred with HP Hood's brief and argued the shrinkage allowances provided in Proposal 2 would assure ESL processors, like conventional fluid milk processors, would only be charged Class I prices for milk contained in fluid milk products and not for milk lost during processing. The Institute also stated that a promulgation proceeding for a new FMMO was an appropriate place to consider ESL shrinkage allowances.

The Cooperatives' reply brief reiterated that ESL products are value-added products and handlers already receive a premium in the market. As well, the Cooperatives claimed that the manufacturing costs cited by HP Hood in its brief were not significant enough to warrant the proposed change to the uniform classification rules.

Findings

As discussed earlier in this decision, the primary objective of FMMOs is to establish and maintain orderly marketing conditions. FMMOs achieve this goal through the classified pricing and the marketwide pooling of the proceeds of milk associated with a marketing area. To that end, the AMAA specifies that a FMMO should classify milk "in accordance with the form in which or the purpose for which it is used." The classification of milk ensures competing handlers have the same minimum regulated price for milk used in a particular product category. Thus, FMMOs have found it is reasonable and appropriate that milk used in identical or nearly identical products should be placed in the same class of use. This reduces the incidence of disorderly marketing that could arise from regulated price differences between competing handlers.

Currently, the provisions providing the classification of milk pooled on the existing FMMOs are identical.[26] Uniform classification provisions are particularly important in assuring orderly marketing because markets are no longer isolated, and handlers often sell products outside of their local marketing area. The current FMMO classification provisions provide four classes of milk use, and specify provisions for the classification of milk transfers and diversions, plant shrinkages and overages, allocation of handler receipts to handler utilization, and Market Administrator reporting and announcements concerning classification.

Under the current FMMO uniform provisions, Class I consists of milk used to produce fluid milk products (whole milk, lowfat milk, skim milk, flavored milk such as chocolate milk). Class II milk includes milk used to make a variety of soft products, including cottage cheese, ice cream, yogurt and yogurt beverages, sour cream, baking mixes, puddings, meal replacements, and prepared foods. Class III includes milk used to make hard cheeses that may be sliced, grated, shredded, or crumbled, cream cheese, and other spreadable cheeses. Class IV milk includes milk used to produce butter, evaporated or condensed milk in consumer-type packages, and dried milk products. Other milk dispositions, including milk that is dumped, fed to animals, or accidentally lost or destroyed, is generally assigned to the lowest priced class for the month.

The record reflects that current product classification provisions under the CSO are comparable to those under FMMOs. While the CSO has five classes of milk (1, 2, 3, 4a and 4b), the record reflects that under the uniform FMMO classification provisions, products currently classified by the CSO as Class 2 and 3 would be classified by the California FMMO as Class II; CSO Class 4b products would be classified as California FMMO Class III; and CSO Class 4a products would be classified as California FMMO Class IV products.

Both the Cooperatives and the Institute supported the product classification provisions already

[26] 7 CFR 1000.40 through 1000.45.

provided in the current FMMOs. Neither group was of the opinion that the proposed FMMO classification provisions would disadvantage any handler currently regulated by the CSO.

This decision finds that a California FMMO should contain, to the maximum extent possible, provisions that are uniform with the FMMO system California producers are seeking to enter. To that end, the proposed California FMMO should include the same classification provisions as currently provided in existing FMMOs to allow for consistency of regulation between FMMOs. Adoption of these provisions would ensure that milk pooled on the California FMMO is classified uniformly with the rest of the FMMO system, and consequently, competing handlers will incur the same regulated minimum prices.

Therefore, this decision finds a California FMMO should provide the following product classifications used in existing FMMOs: Class I milk should be defined as milk used to produce fluid milk products; Class II milk should be defined as milk used to make a variety of soft products, including cream products, high-moisture cheeses like cottage cheese, ice cream, yogurt and yogurt beverages, sour cream, baking mixes, puddings, meal replacements, and prepared foods; Class III milk should be defined as milk used to make spreadable cheeses like cream cheese, and hard cheeses that may be sliced, grated, shredded, or crumbled; Class IV milk should be defined as milk used to make butter, evaporated or condensed milk in consumer-type packages, and dried milk products. Other uses for milk, including milk that is dumped, fed to animals, or accidentally lost or destroyed, should be assigned to the lowest-priced class for the month.

This decision also finds that the California FMMO should adopt the same provisions as the existing FMMOs regarding the classification of milk transfers and diversions, plant shrinkage and overages, and allocation of handler receipts to handler utilization.

The existing FMMOs also contain uniform provisions recognizing that some milk loss is inevitable in milk processing. This is referred to as shrinkage and is calculated as the difference between the plant's total receipts and total utilization. Pool handlers must account for all receipts and all utilization. Shrinkage provisions assign a value to milk losses at a plant. There is, however, a limit on the quantity of shrinkage that may be allocated to the lowest priced class. The limit depends on how the milk is received. For instance, milk physically received at the plant directly from producers based on farm weights and tests is limited to 2 percent, whereas, milk received directly from producers on a basis other than farm weights and tests is limited to 1.5 percent. Similar limits are placed on other types of bulk receipts. Quantities of milk in excess of the shrinkage limit are considered "excess shrinkage." Excess shrinkage is assigned to the highest class of utilization at the plant to arrive at gross utilization, from which the allocation process begins.

The CSO provides a shrinkage allowance of up to 3 percent of the plant's total receipts, which is allocated on the basis of the plant's utilization. Similar to the FMMOs, excess shrinkage in the CSO is assigned as Class 1.

This decision does not find justification for an additional shrinkage allowance for ESL production at ESL pool distributing plants. While the record contains some ESL plant shrinkage data, data pertaining to ESL production at California plants is limited. The record does indicate that ESL production occurs throughout the country. Therefore, amending provisions that are uniform throughout the FMMO system to allow an additional shrinkage allowance on ESL production should be evaluated on the basis of a separate national rulemaking proceeding.

7. Pricing

The two main proposals in this proceeding offered end-product price formulas as the appropriate method for pricing producer milk pooled on a California FMMO, although the factors in the formulas differed. This section reviews arguments presented in testimony and post-hearing briefs regarding the appropriate way to value producer milk. This section further explains the finding that the recommended California FMMO should adopt the same end-product price formulas as contained in the 10 existing FMMOs.

Summary of Testimony

A LOL witness, appearing on behalf of the Cooperatives, testified in support of the classified price provisions contained in Proposal 1. The witness testified that under Proposal 1, California would adopt the classified prices (including the commodity price series, product yields, and make allowances), the component prices, and the advanced pricing factors presently used in the FMMO system. The witness stated that 65 percent of the United States milk production is currently priced under these common provisions, and the same should apply to the 20 percent of the national milk supply produced in California.

The witness provided testimony regarding the evolution of a national manufacturing price, starting with the Minnesota-Wisconsin price series in the 1960's, and ending with the national classified end-product price formulas adopted in 2000. The witness discussed the national pricing system that resulted from FMMO Order Reform (Order Reform), including the multiple component pricing (MCP) system used in 6 of the 10 current FMMOs. The witness explained that the MCP system met the criteria set forth by Congress to make pricing simple, transparent, and based on sound economic theory. Under the MCP system, the witness said, prices are derived from actual, observed market transactions for wholesale commodity milk products, and utilize yield factors and make allowances to determine the value of raw milk in each class. The witness explained that through the Dairy Product Mandatory Reporting Program (DPMRP), manufacturers of the four commodity dairy products (cheese, butter, NFDM, and dry whey) are required to submit sales information on current market transactions. The witness said that information is aggregated, released in the National Dairy Product Sales Report (NDPSR), and utilized in the FMMO price formulas. The witness stated that because many large-scale California dairy plants are part of the DPMRP, California commodity prices are reflected in the prices paid by FMMO handlers and received by producers in the rest of the country, and the same prices should be applicable to milk pooled under a California FMMO.

The witness also testified regarding the influence of California dairy manufacturing costs on the current FMMO make allowances. The witness noted that a USDA Rural Cooperative Business Service (RCBS) study, a Cornell University study of processing costs, and a CDFA cost-of-processing survey were relied upon by USDA to determine appropriate make allowance levels for cheese, butter, NFDM, and dry whey. In the witness's opinion, the inclusion of CDFA manufacturing cost data in the formulation of FMMO manufacturing allowances would justify the use of the same manufacturing allowances (butter: $0.1715 per pound; NFDM: $0.1678 per pound; cheese: $0.2003 per pound; and dry whey: $0.1991 per pound) in a California FMMO. The witness also reviewed the rulemaking history on the derivation of the product yields contained in the current FMMO price formulas, and was of the opinion they are similar to product yields attainable by California manufacturing plants. The witness stated that the FMMO make allowances and product yields remained relevant, as they had been reaffirmed by USDA through a 2013 Final Rule.[27]

The witness also testified regarding the FMMO national Class I price surface. The witness said that Order Reform resulted in the adoption of a national pricing surface, which assigned a value to milk for every county in the United States based on milk supply and demand at those locations. The witness was of the opinion that since California was factored into USDA's Order Reform analysis to derive the price surface, it would be appropriate for the price surface to be adopted in a California FMMO. The witness noted the price surface identifies five pricing zones covering California, ranging from $1.60 to $2.10 per cwt. The witness explained that in the FMMO system, the Class I differential is added to the higher of the Class III or Class IV price to determine the Class I price for a distributing plant at its location. The witness elaborated that since Class I processors compete with Class III and IV manufacturers for a milk supply, Class I prices are linked to manufacturing prices in the FMMO system, and this concept should likewise apply to a California FMMO.

The witness also explained how the base Class I differential, $1.60 per cwt, was derived during Order Reform. The witness said that the $1.60 base differential assumes a cost per cwt of $0.40 to maintain a Grade A facility, $0.60 for marketing, and $0.60 for securing a milk supply in competition with manufacturers. The witness noted these values were established in 2000, and although still relevant, the actual costs are higher in the current marketplace. The Cooperatives provided additional information in their post-hearing brief, contending that current costs support a base Class I differential of $2.40, a 50 percent increase over the base listed above.

The witness concluded by saying that California dairy farmers should receive prices reflecting the current national market and that are comparable to what producers receive from FMMO regulated plants in the rest of the country. This position was reiterated in the Cooperatives' post-hearing brief.

Another Cooperative witness provided testimony on the handler's value of milk and related provisions. The witness proposed that handlers regulated by a California FMMO pay classified prices based on the components in the raw milk they receive (otherwise known as "multiple component pricing"): Butterfat, protein, and other solids. Under Proposal 1, the witness said, regulated handlers would pay for milk on the following components:

- *Class I:* Butterfat and skim
- *Class II:* Butterfat and solids nonfat
- *Class III:* Butterfat, protein and other solids
- *Class IV:* Butterfat and solids nonfat

The witness reiterated the Federal Order Reform Recommended Decision justification for implementing a national pricing structure and contended the same reasons apply to extending national pricing to a California FMMO. The witness added that while California handlers would be paying the same national prices for milk components, there would be no need to adjust price formulas for regional product yields because handlers only pay for the components they receive. The witness also explained that Proposal 1 did not prescribe location adjustments in the price formulas because California plants are included in the price surveys that determine the national commodity prices used in the FMMO formulas.

The witness also testified that Proposal 1 provides for a fortification allowance on milk solids used to fortify Class I products to meet California's fluid milk standards, as is currently provided in the CSO. The witness noted that Proposal 1 does not propose a somatic cell adjustment or producer location differentials since both features are not currently contained in the CSO.

The witness said Proposal 1 seeks to have producers paid on the basis of butterfat, protein and other solids, and does not include a producer price differential (PPD) adjustment per se. The witness said that the PPD is typically viewed as the benefit to FMMO producers for participating in the marketwide pool since the PPD reflects the additional revenue shared from the higher value class utilizations. Instead, the witness explained that under Proposal 1, the California FMMO would calculate a monthly PPD, but the value of the PPD would be paid to producers according to each component's annual contribution to the Class III price. For example, said the witness, if on an annual basis butterfat accounted for 32 percent of the total value of the Class III price, then 32 percent of the monthly PPD value would be paid out through an adjustment to the butterfat price. This same adjustment, the witness said, would apply to the producer protein and other solids prices. The witness explained that FMMO producers typically find the monthly PPD concept confusing and complicated, especially in months when it is a negative value. The witness said that California producers, who do not receive a PPD adjustment under the CSO, might find Proposal 1's method of distributing the PPD value simpler to understand.

The witness also clarified that the Cooperatives were amending the proposal regarding announcement of producer prices contained in Proposal 1 from "on or before the 11th" to "on or before the 14th day after the end of the month."

Support for a national uniform pricing system was reiterated in the Cooperatives' post-hearing brief. The Cooperatives argued that the hearing record demonstrates California cheese competes in the national market. Having California milk priced uniformly in the FMMO system would not disadvantage California processors, reiterated the Cooperatives, but it would diminish the current pricing advantage they have under the CSO. The brief noted record evidence that many FMMO cheese processors paid higher than FMMO minimum prices for milk as proof that FMMO minimum prices are not too high.

The Cooperatives' brief also discussed California whey processing. The brief stated that 85.8 percent of cheese manufactured nationally is produced in plants that also process whey. In California, the Cooperatives wrote, the percentage is closer to 90 percent. Based on these comparable percentages, the Cooperatives stated whey pricing in California should be no different from the rest of the country.

The Cooperatives also stressed opposition to any adjustment to the price formulas to reflect a lower location value in California. The Cooperatives stated milk prices should not be California centric because manufactured products are sold nationally. If California classified prices were to be based solely on California product sales, the Cooperatives were of the opinion that California handlers would receive a raw milk cost advantage over other FMMO regulated handlers. The brief noted that the Cooperatives manufacture a majority of the butter and NFDM produced in California, and they did not believe the proposed California FMMO prices associated with those Class IV products would be too high. The Cooperatives stressed that any changes to the FMMO pricing system should be considered at a national hearing and not in this single-market proceeding.

[27] Official Notice is taken of FMMO Class III and IV Price Formula Final Rule 78 FR 24334.

An Institute witness testified regarding the pricing provisions included in Proposal 2. The witness explained that Class I products have the highest use value in order to encourage adequate milk production to meet Class I needs, and to attract milk to Class I rather than manufacturing uses. As manufacturing class uses balance the supply and demand needs of the marketing area, the witness said it would be important that those classified use values not be set above market-clearing levels.

The Institute witness testified that historically, as milk began to travel greater distances for processing, FMMO pricing policy became more coordinated to promote orderly marketing conditions both within and between FMMOs. The witness said that the Minnesota-Wisconsin price series served as the basis for FMMO pricing because the area surveyed represented the largest reserve supply of milk in the country, and therefore generated an appropriate market-clearing price for manufacturing milk. The witness stated that California is now the region with the largest reserve supply and because California products must compete for sales in the East, the value of raw milk in California is lower than in eastern parts of the country. Therefore, emphasized the witness, minimum prices for a California FMMO should not be set above market-clearing levels in California. This opinion was reiterated in the Institute's post-hearing brief.

The Institute witness cautioned against setting minimum prices too high because it could lead to the inability of dairy farmers to find a willing buyer for their milk. Alternatively, the witness said, if minimum prices are set too low, dairy farmers could be compensated by the market through over-order premiums. The witness said Class III and IV prices for a California FMMO need to be reflective of commodity prices received by California plants, and reflective of current California manufacturing costs. The witness was of the opinion that the national values used in the current FMMO Class III and IV formulas are not appropriate for California.

The Institute witness explained their preference would be to use western commodity prices in the Class III and IV formulas. However, the witness said that, due to data confidentiality issues, USDA is unable to report these prices. As an alternative, the witness said, Proposal 2 contains default commodity values that would adjust the NDPSR prices based on the historical difference between the NDPSR prices and California or western based prices as reported by either CDFA or Dairy Market News. This western adjustment, the witness said, would result in commodity prices in the price formulas more representative of the prices received by California handlers. The witness noted the only exception to how the adjustors are calculated is the default adjustor proposed for the Class III protein price. The Class III protein price adjustor utilized CME 40-pound block Cheddar cheese prices, because CDFA stopped reporting California 40-pound block Cheddar prices after August 2011.

The Institute witness also reviewed the manufacturing allowances contained in Proposal 2. Except for the dry whey manufacturing allowance, explained the witness, all are based on the most recent CDFA manufacturing cost survey for 2013.[28] The witness explained that CDFA no longer reports the dry whey cost data. Therefore, Proposal 2 provides for a dry whey manufacturing allowance that adds the difference between the FMMO manufacturing allowances for nonfat dry milk and dry whey to the most recent CDFA weighted average manufacturing cost for nonfat dry milk. The witness was of the opinion that the yields contained in the FMMO price formulas would be appropriate for California, and are therefore also prescribed in Proposal 2.

The Institute witness testified that many California cheese plants manufacture products other than dry whey that often do not generate revenues to match the dry whey value in the regulated formulas. Other plants, according to the witness, do not have the capability to process the whey by-product from their cheese making operations. Therefore, the witness offered an alternative Class III other solids price formula that would be based on whey protein concentrate (WPC), and would cap the whey value to recognize that not all plants are able to capture value from their whey stream. The witness testified that a more appropriate reference commodity for whey products, one that would be more applicable to most California cheesemakers' operations, would be WPC. The witness explained that over the previous eight years, the production of dry whey declined 3.3 percent, while the production of various WPC and Whey Protein Isolate (WPI) products has seen increases ranging from 1.1 percent to 9.5 percent.

The Institute witness testified that cheese and whey markets are vastly different, and not all cheese plants find it profitable to invest in whey processing. According to the witness, when cheese plants do invest, it is usually in the limited processing of whey into concentrate solids for transportation savings. The witness said that only one plant in California consistently dries whey, and of the 57 California cheese plants, only 13 process whey in any fashion. The witness explained that the alternative other solids price formula offered by the Institute incorporates the value of liquid WPC–34 sold to a plant that would then process the product further into a dry product. While there are a variety of liquid whey products marketed, the witness said using WPC–34 prices as a reference price for other solids would be most appropriate because WPC–34 is the predominant form of liquid whey sold. The witness explained how Proposal 2 would convert the WPC–34 reference price to a dry whey equivalent basis so that the other parts of the other solids price formula could be retained. The witness added that the dry whey make allowance would need to be increased to include the cost of cooling and delivering the liquid whey to a processing facility. To provide some protection to small cheesemakers when the price is very high, and to dairy producers when the price is very low, the witness proposed another solids price floor of $0.25 per pound and a ceiling of $1.50 per pound.

The Institute's post-hearing brief discussed several of the unique aspects of the California dairy industry. The brief stated that from 1995 to 2014, while the state's population grew 23 percent, California milk production increased 82 percent, which in turn fueled the expansion of cheese processing in the state. The brief stated that three processing facilities account for 25 percent of California's cheese manufacturing, and much of that production is marketed east of the Mississippi River. The brief cautioned that increasing minimum prices would create an economic trade barrier where California processors would no longer have the ability to compete in eastern markets due to higher minimum regulated prices.

The Institute's post-hearing brief also addressed the need for a national FMMO pricing hearing. The Institute reiterated hearing testimony that current pricing formulas are based on data from the 1990s, making the prices out of alignment with current market realities. The brief stated that pricing formulas need to be updated in order to be representative of current marketing conditions. The FMMO pricing system, the Institute stressed, needs all pricing

[28] Proposed manufacturing allowances were later amended to incorporate a marketing cost.

formulas to be set at market clearing levels that enable over-order premiums to be paid when appropriate.

A witness appearing on behalf of Leprino Foods, a mozzarella cheese and whey products manufacturer in Denver, Colorado, testified regarding the Class III price formula contained in Proposal 2. Leprino operates nine plants in the U.S., three of which are based in California. Leprino is a member of the Institute and supports adoption of Proposal 2 if USDA recommends a California FMMO.

The Leprino witness stressed the importance of minimizing the impacts of minimum regulated pricing on the dairy marketplace. The witness testified that the United States dairy industry is increasingly integrated with global dairy markets since more than 15 percent of United States milk solids are exported, and that many manufacturers, including Leprino, have made significant investments in developing export markets to increase demand for United States dairy products. The witness said it is important that any future California FMMO facilitate rather than inhibit the dairy industry's ability to leverage this export opportunity.

The Leprino witness testified about the importance of setting minimum regulated milk prices at market clearing levels that would allow for reasonable returns achievable under good management practices by California manufacturers. The witness testified that 80 percent of California milk production is utilized in Class III and IV products, a large percentage of which are marketed outside of California. Therefore, the witness said, California FMMO minimum prices should reflect values of California-manufactured products, f.o.b. the manufacturing plant. The witness added that because price formulas could only be changed through a hearing process, it would be important to set the regulated price formulas at minimum levels that allow market forces to function outside of the regulated system. The witness said regulated prices that are too high would lead to over-production of milk and disorderly marketing conditions. This concept was reiterated in the post-hearing briefs submitted by the Institute and Leprino.

The Leprino witness summarized findings from the Order Reform Final Decision that explained how manufacturing plant operators who find make-allowances inadequate to cover their actual costs are free to not participate in the order. The witness noted this option would not be available under Proposal 1, which underscores the importance of setting appropriate market clearing prices.

The Leprino witness testified that a California FMMO would require a Class III formula that is set in relation to achievable returns in California using the most recent data. The witness explained Leprino's preference that USDA suspend the California FMMO hearing to defer implementation until after a national hearing could be held to review and revise the existing Class III formula. The witness added that USDA should hold a national Class III and IV price formula hearing after this rulemaking to utilize more current data and account for the impacts of a California FMMO, if necessary.

The Leprino witness testified in support of establishing a DPMRP western price survey to determine minimum milk prices under a California FMMO. The witness explained how USDA might rely on surveyed commodity prices from other western states, if necessary, to overcome any data confidentiality issues. In brief, Leprino encouraged USDA to establish a definition for the Western Area, and recommended it include California, Oregon and Washington. In addition to these three states, the witness said that other areas should be considered in order to eliminate confidentiality constraints. However, the witness said that in the event confidentiality concerns continue to arise, Proposal 2 contained alternative default equations.

The Leprino witness discussed the justification for pricing western produced products differently than those in the rest of the country. The witness stressed that the location value of California manufactured products is lower because of the additional transportation costs required to deliver products to the population centers in the East. This opinion was reiterated in Leprino's post-hearing brief. The witness noted that nearly half of Leprino's cheese production sold domestically is shipped to markets east of the Mississippi, and they incur transportation costs ranging from $0.10 to $0.15 per pound.

The Leprino witness was of the opinion that bulk Cheddar cheese remains the most appropriate product from which to derive the FMMO Class III price, but California Class III price formulas should rely on 40-pound block Cheddar prices because all California Cheddar production is in blocks. The adoption of 40-pound block cheddar prices was reiterated in Leprino's post-hearing brief.

The witness testified in support of modifying the make allowances in Proposal 2 to incorporate a sales and administrative cost of $0.0015 per pound. Therefore, the new proposed make allowances per pound of product would be as follows: $0.2306 for cheese, $0.1739 for butter, $0.2310 for whey, and $0.2012 for NFDM.

The Leprino witness provided extensive testimony on the appropriate valuation of whey in FMMO Class III minimum pricing. The witness explained how the explicit whey factor had been a problem for cheesemakers and led the Institute to propose an alternative valuation. Proposal 2 would value the whey portion of the Class III price formula relative to its concentrated liquid whey value, which the witness said was the most generic whey product produced. The witness stated that the WPC–34 price index is the most common reference used for the sale of liquid whey by cheese plants selling concentrated whey in California. The witness added that the prices received for liquid whey are discounted to reflect additional processing required to produce a full-value whey product. Accordingly, said the witness, California FMMO minimum prices should rely on WPC–34 survey prices to approximate a whey value in the Class III price.

The Leprino witness testified in opposition to the Class III and IV formulas contained in Proposal 1. The formulas, the witness said, do not reflect California market conditions. The witness warned that higher regulated prices in California would lead to disorderly marketing conditions. In its post-hearing brief, Leprino stated the pricing formulas in Proposal 1 used old manufacturing cost data and the national weighted average prices for the four products exceeded the prices received in California. Leprino noted that there was no evidence provided by the Cooperatives related to the relevance of the Proposal 1 formulas to California.

A witness testifying on behalf of Hilmar spoke to how the current FMMO Class III and IV pricing formulas, if applied to a California FMMO incorporating inclusive pooling, would lead to disorderly marketing conditions. In its brief, Hilmar stated that disorderly marketing conditions would negate the competitive equilibrium present between eastern and western markets and lead to a trade barrier that would hinder the California dairy industry.

The witness testified that Hilmar had not experienced difficulties in sourcing raw milk supplies, and that there was currently no disorder in California to warrant promulgation of a California FMMO. The witness described several scenarios in the past where CSO whey pricing methodology over valued whey and led to disorderly marketing conditions for Hilmar, its independent producer suppliers, and other California dairy farmers, which CDFA was able to remedy through an adjustment to the whey factor.

The Hilmar witness testified that if milk used in California cheese production was subject to the whey factor used in the current FMMO Class III price, the whey product stream in California would be overvalued. Use of that whey factor, along with the inclusive pooling provisions in Proposal 1, would give rise to disorderly marketing conditions.

The Hilmar witness was of the opinion that 2015 California milk production decreased for reasons not relevant to the differences in CSO 4b versus FMMO Class III pricing. Instead, the witness said, production was influenced by low milk powder prices related to global oversupply of milk powder, as well as drought, environmental regulations, and competition for land from other crops.

The Hilmar witness testified that CSO milk prices are minimums, and cooperatives have the ability to negotiate for higher milk prices from their proprietary plant customers. The witness said that Hilmar paid premiums of approximately $120 million for milk above the CSO 4b price over the last several years. The witness explained that these premiums were paid for milk characteristics such as component content and other market-based factors. The witness added that when CSO 4b prices were temporarily increased through CDFA's adjustment to the sliding scale whey factor, the premiums Hilmar paid for milk decreased.

The Hilmar witness testified that the make-allowances in the FMMO Class III and IV formulas are outdated, and new manufacturing cost studies are necessary. The witness stated that Hilmar's manufacturing costs for cheese and milk powders are higher than those provided for in the FMMO Class III and IV formulas. The witness said that if a California FMMO was adopted with inclusive pooling, it would be impossible for Hilmar to clear the market, unlike in existing FMMOs where manufacturing milk is not required to be pooled.

The Hilmar witness explained that California FMMO minimum milk prices need to reflect local supply and demand conditions. The witness entered Hilmar data showing that prices received for the sale of Hilmar cheese averaged $0.04 per pound lower than the announced NDPSR weighted average cheese price from 2010 to 2013. This price difference, the witness explained, is a function of the additional transportation cost incurred by Hilmar to transport product to eastern markets. The witness made similar price comparisons for NFDM and butter.

The Hilmar witness stressed that if California FMMO prices are not reflective of the California market, the California dairy industry will be less competitive in the global marketplace. The witness noted that in 2014, Hilmar exported 10 percent of its cheese, 50 percent of its WPC, and 95 percent of its lactose; and they planned to export all of the skim milk powder to be produced at a manufacturing facility nearing completion in Turlock, California. Inclusive pooling and U.S.-centric milk pricing in California, said the witness, would lead to competitive disadvantages for California manufacturers in international and domestic markets.

The Hilmar witness testified that they produce several types of whey products, but not dry whey. The witness was of the opinion that dry whey is a poor indicator of the value of Hilmar's WPC products. The witness said the potential minimum regulated cost under inclusive pooling provisions in a California FMMO would make production of Hilmar's whey products unprofitable.

In the post-hearing brief submitted by Hilmar, concerns regarding an adequate return on investment were raised. Hilmar was of the opinion that Proposal 1 does not provide an adequate level of return on investment to allow for processors to remain viable. The brief stated that adoption of provisions allowing for handlers to opt not to pool manufacturing milk could alleviate those concerns.

In its post-hearing brief, Hilmar sought to counter the Cooperatives' claim that California manufacturers have a competitive advantage over their FMMO counterparts and thus should be able to pay FMMO minimum prices. Hilmar countered that California handlers have a long-term competitive disadvantage when compared to their FMMO counterparts because of the CSO's mandatory pricing and pooling provisions. Hilmar maintained that the value of milk in California is lower than in the eastern part of the country, and California FMMO price formulas should reflect this reality.

A witness testified in support of Proposal 2 on behalf of Marquez Brothers International (Marquez), a Hispanic cheese manufacturer located in Hanford, California. The witness explained how their company invested in a processing facility in 2004 to address challenges with whey disposal. The witness explained that of the total milk solids they receive, approximately 48 percent is used in cheese, and 52 percent ends up in the whey stream. The formulation of Marquez's whey stream, the witness noted, is approximately 5.11 percent whey cream, 9.45 percent WPC–80, and 85.44 percent lactose permeate.

The Marquez witness testified that out of 57 California cheese plants, 49 plants (19.1 percent of California cheese production) have limited or no ability to process whey. The witness testified that whey disposal had been a burden for their business in the past, costing $1.5 million per year with no revenue offset and no recognition in the CSO 4b price of whey disposal costs. The witness added that the same problems existed in the FMMO Class III formula price contained in Proposal 1. The witness testified that the reliance on dry whey to price the other solids component of the FMMO Class III price would be inappropriate since cheesemakers must pay producers for the value of whey that can be generated from their milk, regardless of whether that price is actually obtained from the market.

The Marquez witness testified that adoption of Proposal 1 would discourage investment in cheese processing technologies. The witness said that a system of inclusive pooling coupled with other increases in operating costs would lead to competitive difficulties for California cheese plants.

A witness appeared on behalf of BESTWHEY, LLC (BESTWHEY), in opposition to adoption of Proposal 1. BESTWHEY provides consulting services to cheese manufacturing facilities, with a focus on specialty cheeses and whey handling and disposal. According to the witness, Proposal 1 would restrict the growth of California's cheese industry and eliminate most of the small cheese businesses in the state, and Proposal 1's inclusive pricing and pooling would lead to an over-supply of California milk. The witness highlighted the limited number of California plants with whey processing capabilities. The witness supported adoption of Proposal 2 because, according to the witness, it would provide a more realistic value for whey in the other solids price calculation, based on the actual value of liquid whey sold by cheese plants.

A witness appeared on behalf of Klondike Cheese (Klondike), a Wisconsin-based cheese manufacturer. The witness said that Klondike cools its liquid whey by-product and sells it to a larger whey processing facility. The witness provided detailed descriptions of whey processing methodology and the associated costs. The witness testified that basing the other solids price on dry whey markets is inappropriate and does not accurately reflect the revenues from whey at their operation. The witness entered Klondike 2014 data showing an average loss on its whey production of $0.6516 per cwt of milk.

A witness testified on behalf of Decatur Dairy (Decatur), a cooperative-owned, Wisconsin-based cheese manufacturer, in regards to using dry whey as the basis for the other solids price. The witness provided detailed descriptions of whey processing methodology and the associated costs. The witness said that Decatur sells warm wet whey to a nearby plant for further processing. The witness said that dry whey prices contained in the FMMO product-price formulas did not reflect the revenue they receive from their liquid whey sales, and it is not feasible for them to invest in drying equipment. The witness entered Decatur data for 2012 to 2015 showing average annual losses on its whey production ranging from $0.0627 to $0.7114 per cwt of milk.

A consultant witness appeared on behalf Joseph Gallo Farms (Gallo Farms). The witness explained that Gallo Farms owns two dairy farms, as well as cheese and whey processing facilities in California, and supports adoption of Proposal 2. Gallo Farms processes WPC from their own cheese operation and from other cheese facilities.

The Gallo Farms witness testified that if they had been required to pay the FMMO Class III price for milk, they would not have been able to make updates or improvements to their facilities. The witness estimated their cheese costs would have increased by $0.2237 per pound if Proposal 1 had been in effect from January 2014 through September 2015. The witness was of the opinion that California dairy farmers should not compare the prices received in California to prices received in the Midwest or East Coast, where significant population centers are serviced. The witness characterized the California market as significantly different from eastern markets, as it includes not only the West Coast population centers, but also Mexico and other export markets. The witness was of the opinion that a California FMMO, as provided for in Proposal 1, could lead to the closure of small and medium sized manufacturing plants.

The Gallo Farms witness supported the portion of Proposal 2 that relies on WPC to determine the other solids price, as most whey pricing is related to the WPC market rather than dry whey.

An Institute witness testified regarding Class I pricing. The witness was of the opinion that the policy of assigning Class I milk the highest classified value should be reevaluated, given current market realities. The witness said that Proposal 1 relied on the current Class I price surface and fluid milk pricing system incorporated in the existing FMMOs, while other potential fluid milk pricing options have not been thoroughly investigated. The witness argued that although the ''higher of'' pricing mechanisms dampens Class I sales and limits the ability of fluid milk processors to hedge their Class I milk volumes, the Institute still supported the Class I milk pricing mechanism advanced in Proposal 2.

The Institute witness also testified regarding a technical modification to Proposal 2 that would affect how handlers pay for the milk components used in Class I products and how handler credits for fortifying fluid milk products would be determined. The witness explained that milk standards set by the State of California require a higher nonfat solids content than the Food and Drug Administration standard used elsewhere in the country. California fluid milk processors fortify raw milk with either condensed or nonfat dry milk to meet these higher standards.

The Institute witness described the differences between CSO and FMMO accounting for fluid milk fortification. Under FMMOs, the witness said, handlers account to the pool at the Class IV price for the solids used to fortify milk, but then are charged the two-factor (butterfat and skim) Class I price for the volumetric increase in fluid milk realized through fortification. Under the CSO, handlers account to the pool using a three-factor (butterfat, nonfat solids, and fluid carrier) Class 1 price for all solids used in Class 1 products, but then receive a credit for the solids used to fortify milk to meet the state standards. The Institute witness was of the opinion that the CSO three-factor system, coupled with its fortification credits, is superior to the FMMO system because it encourages orderly milk movements by making fluid milk handlers indifferent to the solids content of milk they receive, and it ensures that Class 1 handlers do not have a regulated milk price advantage over one another. The witness explained that plants receiving milk with a higher solids content might pay a higher Class 1 price for the raw milk, but less for fortification, while plants receiving milk with a lower solids content might pay a lower Class 1 price for the milk, but more for fortification, making both plants competitive with each other. The witness emphasized that in the absence of a fortification credit for meeting the California milk solids requirement, handlers under a California FMMO might make milk sourcing decisions solely to take advantage of a two-factor Class I price formula.

A witness appeared on behalf of Hilmar to outline the history of FMMO surplus milk pricing policies. The witness, referring to decisions from previous FMMO rulemakings and reports, stated that FMMO minimum pricing should be set at levels aligning with net revenues received by manufacturers in the local marketing area in order for milk to ''clear'' the market. Therefore, the witness concluded, USDA must examine the local California market situation when determining appropriate minimum prices in a California FMMO.

A Cooperative witness addressed the alternative Other Solids price formula that was offered by the Institute. The witness stressed that there was not then available a verifiable price series for WPC–34, nor had the Institute presented any third-party WPC–34 manufacturing cost studies. The witness estimated that 86 percent of the Class 4b milk was processed at plants that had whey drying capabilities. In addition, the witness said that the Cooperatives' modified exempt plant provision would exempt as many as 25 of the 57 cheese plants from FMMO minimum price regulation.

Findings

Handler's Value of Milk

The FMMO program currently uses product price formulas relying on the wholesale price of finished products to determine the minimum classified prices handlers pay for raw milk in the four classes of products. Class III and Class IV prices are announced on or before the 5th day of the month following the month to which they apply. The Class III and Class IV price formulas form the base from which Class I and Class II prices are determined. The Class I price is announced in advance of the applicable month. It is determined by adding a Class I differential assigned to the plant's location to the higher of an advanced Class III or Class IV price computed by using the most recent two weeks' DPMRP data released on or before the 23rd of the preceding month. The Class II skim milk price is announced at the same time as the Class I price, and is determined by adding

$0.70 to the advanced Class IV skim milk price. The Class II butterfat price is announced at the end of the month, at the same time as the Class III and Class IV prices, by adding $0.70 to the Class IV butterfat price.

AMS administers the DPMRP to survey weekly wholesale prices of four manufactured dairy products (cheese, butter, NFDM and dry whey), and releases weekly average survey prices in the NDPSR. The FMMO product price formulas use these surveyed products to determine the component values in raw milk. The pricing system determines butterfat prices for milk used in products in each of the four classes from surveyed butter prices; protein and other solids prices for milk used in Class III products from surveyed cheese and dry whey prices, respectively; and a nonfat solids price for milk used in Class II and Class IV products from surveyed NFDM product prices. The skim milk portion of the Class I price is the higher of either the protein and other solids prices of the advanced Class III skim milk price or the NFDM price of the advanced Class IV skim milk price.

The butterfat, protein, other solids, and nonfat solids prices are derived through the average monthly NDPSR survey price, minus a manufacturing (make) allowance, multiplied by a yield factor. The make allowance factor represents the cost manufacturers incur in making raw milk into one pound of product. The yield factor is an approximation of the product quantity that can be made from a hundredweight of milk received at the plant. The milk received at the plant is adjusted to reflect farm-to-plant shrinkage when using farm weights and tests. This end-product pricing system was implemented as a part of Order Reform on January 1, 2000,[29] and last amended on July 1, 2013.[30]

The pricing methodology described above were proposed by the Cooperatives to apply in a California FMMO and are contained in Proposal 1. The Cooperatives maintain USDA has for many years held that the market for manufactured dairy products is national in scope and that the price of milk used to manufacture those products should therefore be the same across the nation. Proponents of Proposal 1 explained that the commodity prices used in the formulas are based on a survey of prices for manufactured dairy products from plants across the country, including California. They went on to point out that the surveyed manufacturing costs were from plants in California, as well as in other states. These surveyed costs have been used to determine FMMO make allowances in the product-price formulas since their inception.

The Cooperatives, through witness testimony and post-hearing briefs, stressed that prices used to determine California handlers' value of milk should be based on the same national average factors as those used in the FMMOs. They repeatedly stressed that manufactured products compete in a national market, and therefore California dairy farmers should receive a milk price reflective of those commodity values. The Cooperatives' primary justification for a California FMMO is that the CSO does not provide dairy farmers a milk price reflective of these national values, and they are now seeking to be included in the FMMO system so California dairy farmers can receive prices similar to their counterparts in the rest of the country.

The Institute, through witness testimony and post-hearing briefs, argued that classified prices in a California FMMO must be reflective of the current market conditions in California. They were of the opinion that not only has data used in the formulas become outdated, but that the value of California milk is inherently lower because of California's geographic location in the West and the additional cost of transporting finished product to population centers in the East. They argued that these conditions make it hard for the Institute's dairy manufacturing member companies to remain competitive in the market.

In Proposal 2, the Institute proposed several changes to the current FMMO pricing formulas that would be applicable in California. First, the Institute proposed a western states price series for each commodity surveyed by the DPMRP. If a western price could not be used because of data confidentiality issues, the Institute proposed that a fixed value for each commodity be subtracted from the current NDPSR prices to represent the lower value of products in the West. Second, the Institute suggested that a Western states manufacturing cost survey be conducted to determine relevant California make allowances for each commodity, and if this was not feasible, they proposed specific make allowance levels that they asserted are representative of manufacturing costs in California. Third, they proposed that the NDPSR Cheddar cheese price used in the FMMO protein price formula for California only consider 40-pound block prices. They proposed that 500-pound barrel Cheddar cheese prices should not be included as they are in current FMMOs.

Class III and Class IV Pricing. This decision recommends that the classified and component price formulas used in the 10 current FMMOs[31] be utilized without change in the proposed California FMMO. These formulas were adopted nationally as part of Federal Order Reform and were described at the beginning of this section. The Order Reform Final Decision[32] found that because commodity dairy products compete in the national market, it was appropriate that the raw milk used in those products be priced uniformly across the FMMO system. This hearing record contains testimony explaining the FMMO evolution toward national uniform pricing for manufactured products. Such explanation was also outlined in the Order Reform Final Decision.

In the early 1960s, FMMOs used a Minnesota-Wisconsin (M–W) manufacturing grade milk price series to determine a price for milk used in manufactured products based on the supply and demand for Grade B milk. As Grade B milk production and the number of plants purchasing Grade B milk declined, FMMOs moved to a Basic Formula Price (BFP). The BFP price incorporated an updating formula with the base M–W price to account for the month-to-month changes in the prices paid for butter, NFDM, and cheese. The Order Reform decision recognized that Grade B milk would only continue to decline and that the FMMO system needed a new way of determining the value of producer milk.

As outlined in the Order Reform Final Decision, the goals for replacing the BFP price were: (1) To meet the supply and demand criteria set forth in the AMAA; (2) not to deviate greatly from the general level of the current BFP; and (3) to demonstrate the ability to change in reaction to changes in supply and demand. The product-price and component formulas currently used in the FMMO system were found to be the appropriate market-oriented alternative to the BFP. Additionally, that final decision specifically addressed the national market for commodity dairy products:

". . . the current BFP may have a greater tendency to reflect supply and demand conditions in Minnesota and Wisconsin rather than national supply/demand conditions. The formulas in this decision use national commodity price series, thereby reflecting the

[29] *See infra.*

[30] *See infra.*

[31] 7 CFR 1000.50 and 1000.52.

[32] Official Notice is taken of FMMO Reform Final Decision: 64 FR 16026.

national supply and demand for dairy products and the national demand for milk.'' [33]

The Department subsequently reiterated the necessity for FMMO classified prices to reflect national markets in a later final decision on Class III and IV pricing when it specifically addressed public comments pertaining to the relationship of the CSO and FMMOs:

''Class III and Class IV dairy products compete in a national market. Because of this, Class III and Class IV milk prices established for all Federal milk marketing order areas are the same.'' [34]

This decision finds the prices used in the California FMMO should also reflect the national marketplace for cheese, butter, NFDM and dry whey. The record reflects that commodity products produced in California compete in the same national market as products produced throughout the country. Uniform FMMO price formulas ensure similarly situated handlers have equal minimum raw milk costs regardless of where the handler is regulated. As California is seeking to join the FMMO system, it is appropriate that the milk pooled on the California FMMO be priced under the same uniform price provisions found in all current FMMOs. Additionally, this decision finds that by pricing California milk under these uniform pricing provisions, prices received by farmers whose milk is pooled on the California FMMO would be more reflective of the national market for commodity products for which their milk is utilized. Therefore, adopting a western adjusted price series, a 40-pound only Cheddar cheese price, and California-specific make allowances is not appropriate. As explained below, FMMO price formulas already account for California market conditions; therefore, it is reasonable to use these price formulas in a California FMMO. This decision finds that the national FMMO pricing policy continues to reflect the marketing conditions of the entire FMMO system and is appropriate for adoption in California.

FMMO product-price formulas generally consist of three factors: Commodity price, manufacturing allowance, and yield factor. Product yields contained in the formulas reflect standard industry norms. The yields were last updated in 2013,[35] and the record shows that these values continue to reflect current market conditions, as there was no dispute as to their continued relevancy.

Commodity prices used in the FMMO formulas are announced by AMS in the NDPSR every month and reflect current commodity prices received for products over the previous four or five weeks. While surveyed plant names and locations are not released by USDA, several witnesses testified that California dairy product sales meeting the reporting specifications [36] are included in the NDPSR. These California sales are part of the NDPSR prices used by the FMMOs in the same way that sales from plants located in other areas of the United States are currently included.

FMMO pricing formulas currently contain the following per-pound make allowances: Cheese—$0.2003, butter—$0.1715, NFDM—$0.1678, and dry whey—$0.1991. These make allowances were last updated in 2013.[37] They were determined on the basis of a 2006 CDFA survey (plants located inside of California) and a 2006 Cornell Program on Dairy Markets and Policy (CPDMP) survey (plants located outside of California) of manufacturing costs. The butter and NDFM make allowances were computed by taking a weighted average of the CDFA and CPDMP surveys, weighted by national commodity production volumes, and adjusting for marketing costs. The cheese make allowance was computed by relying solely on the CDFA survey and adjusting for marketing costs. The dry whey make allowance was computed by relying solely on the CPDMP survey and adjusting for marketing costs. California dry whey data was not considered because at the time, it was restricted and therefore not available.

As the record demonstrates, most of the manufacturing allowances already account for California manufacturing costs. In regard to the Institute's position that data used to determine make allowance levels is not current, this decision recognizes 2006 data was used to determine current make allowance levels. Since that time, USDA has not received a hearing request to amend the levels. It may be appropriate to amend these levels in the future, and USDA would evaluate any changes to those levels on the basis of a formal rulemaking record.

Institute witnesses stressed that California manufacturers would be competitively harmed should California FMMO minimum classified prices not reflect a solely western location value. This decision finds that California manufacturers would not face competitive harm with the adoption of the uniform FMMO prices. Western manufacturing handlers who purchase milk pooled on the Pacific Northwest and Arizona FMMOs already routinely pay these prices. The record reflects that the Institute's primary concern was the adoption of the current FMMO price formulas for California, coupled with the adoption of the inclusive pooling provisions contained in Proposal 1. The provisions recommended by this decision allow handlers to elect not to pool milk used in manufacturing as determined appropriate for their individual business operations. The proposed California FMMO provisions would not prohibit handlers and producers from utilizing the Dairy Forward Pricing Program [38] to forward contract for pooled manufacturing milk.

Other Solids Price. Currently, the FMMO system determines the other solids price using the same basic formula used to determine the other component prices: (Commodity price less make allowance) times yield, using dry whey as the NDPSR-referenced commodity price. As the market price for dry whey moves and is reflected in the NDPSR price, it moves the other solids price accordingly.

At the hearing, the Institute proposed an alternative method for computing the whey value in the other solids formula. The Institute argued, in testimony and post-hearing brief, that dry whey is not an appropriate reference commodity for California because little dry whey is produced in the state. Instead, they testified that prices from the more commonly produced WPC–34 should be used. The Institute provided evidence regarding WPC–34 production in California. The record contains testimony explaining how WPC–34 and dry whey production practices and manufacturing costs differ.

This decision finds that prices adopted in the California FMMO should be uniform with all current FMMOs and be reflective of the dry whey market. Therefore, it is not appropriate on the basis of this hearing record to adopt a change in other solids pricing for only one FMMO. The data and testimony presented by the Institute could warrant further consideration, but to consider such a change for only one FMMO is inappropriate. While an academic expert did provide testimony on the record about a WPC–34 manufacturing cost survey, results of the survey, which would be of interest if such a proposal was being evaluated, were not available.

[33] *See infra.*

[34] Official Notice is taken of FMMO Class III and IV Final Decision: 67 FR 67937.

[35] *See infra.*

[36] 7 CFR 1170.8.

[37] *See infra.*

[38] *See* 7 CFR part 1145.

Class II Pricing. The FMMO system currently prices milk used in Class II products uniformly. The Class II skim milk price is computed as the advanced Class IV skim price plus $0.70 per cwt. The Class II butterfat price is the Class III butterfat price for the month, plus $0.007 cents per pound. The $0.70 differential between the Class IV and Class II skim milk prices adopted in the Order Reform Final Decision was an estimate of the cost of drying condensed milk and re-wetting the solids for use in Class II products.

The record reflects—and this decision finds—that milk pricing in the FMMO system should be as uniform as possible. Therefore, this decision finds that Class II pricing in the California FMMO should be the same as in current FMMOs. Class II pricing in the California FMMO would result in forward pricing the skim portion of Class II while pricing butterfat on a current basis. Butterfat used in Class II products competes on a current-month basis with butterfat used in cheese and butter, and its price should be determined on the basis of the same month's value.

Class I Pricing. Currently, FMMOs determine Class I prices as the higher of the advanced Class III or Class IV price, plus a location-specific differential referred to as a Class I differential. Class I differentials have been determined for every county in the continental United States, including California.[39] Class I prices paid in all current FMMO's are on a skim/butterfat basis. Handlers who fortify their Class I products have the NFDM or condensed skim used to fortify classified as a Class IV use, and pay the Class I price for the volumetric increase attributed to fortification.

The Cooperatives have proposed that the California FMMO adopt the same Class I pricing structure: The higher of the advanced Class III or Class IV price plus a Class I differential based on the plant location. They argued that the Class I price surface was designed as a nationally coordinated structure and already includes differential levels for all California counties. According to the Cooperatives, any change to the Class I differential surface should be done through a national rulemaking hearing where all interested parties can participate.

The Institute argued, in testimony and post-hearing brief, that the Class I differential surface adopted as part of Order Reform did not consider California in its inception, and is inappropriate for adoption here. The Institute did not offer an alternative.

This decision finds that the Class I price formula contained in Proposal 1, and as currently used in all current FMMOs, is appropriate for the proposed California FMMO. This decision finds that prices for milk pooled on the California FMMO and used in Class I products should be location-specific, since Class I products generally compete on a more local market. Therefore, the Class I differential surface that applies in all current FMMOs is recommended for the California FMMO. As such, Class I prices for milk pooled on the California FMMO would be determined by the higher of the advanced Class III or Class IV milk price announced on or before the 23rd day of the preceding month, plus the Class I differential at a plant's location.

This decision recommends for a California FMMO the same Class I differential surface used in the current FMMOs. Contrary to Institute testimony, this differential surface was determined through a United States Dairy Sector Simulator (USDSS) model that included California supply and demand factors. An academic expert testifying in this proceeding was one of the lead authors of the model and stated that California was included when the model was constructed. This price surface was designed to facilitate the movement of milk to Class I markets without causing disorderly marketing conditions within or across markets. Therefore, it is inappropriate on the basis of this hearing record to make a change to this nationally coordinated Class I price surface.

The Institute repeatedly argued that the Department did not consider California when determining the nationally coordinated Class I price surface. Prior to January 1, 2000, there were 31 FMMOs. As part of the 1996 Farm Bill, the Department was instructed by Congress to consolidate the existing orders into as few as 10, and no more than 14, FMMOs, reserving one place for California. Since California stakeholders did not express a desire to enter the FMMO system at that time, the Order Reform process only considered the FMMO marketing areas in existence at the time for consolidation. In the Order Reform Final Decision, the reference to "not including the State of California" [40] pertained to determining appropriate consolidated marketing areas, not the analysis pertaining to Class I pricing, which included California.

Three-Factor FMMO Class I Pricing and Fortification. The Institute proposed that California Class I prices be paid on a 3-factor basis: Butterfat, nonfat solids and fluid carrier, as well as incorporate a fortification credit similar to what is currently provided for in the CSO. The fortification credit offered in Proposal 2 provides a credit to a Class I handler's pool obligation for the NFDM or condensed skim milk a handler uses to fortify Class I products to meet the State's higher nonfat solids content requirement. The proposed fortification credit would be paid out of the California FMMO marketwide pool funds.

The Institute explained these two features are currently provided for in the CSO and work together to financially assist Class 1 handlers in meeting the State-mandated higher nonfat solids content for Class 1 products. The Institute explained that handlers receiving high solids milk pay a higher Class 1 price, but use less solids to fortify Class 1 products, and thus incur less cost to meet the state's nonfat solids standards for fluid milk products. Conversely, handlers purchasing low solids content milk pay a lower Class 1 price, but then incur a higher cost to fortify their Class 1 products. The Cooperatives supported this concept in their post-hearing brief.

The current FMMO system prices all Class I skim milk at the same price regardless of the solids content. The record does not contain enough justification to deviate from the uniform treatment of Class I pricing. Therefore Class I milk pooled on the California FMMO will be paid on a skim and butterfat basis. This uniform treatment will avoid disorderly marketing with adjacent or other Federal orders, as handlers could seek to engage in inefficient milk movements solely for the purpose of seeking a Class I price advantage.

Current FMMOs do not provide credits to a handler's pool obligation for fortification of Class I products. Instead, NFDM or condensed skim used to fortify Class I products is classified as a Class IV product on a skim equivalent basis. The volumetric increase due to fortification is classified and priced as Class I. Proposal 2 contains this same system of credits to a handler's pool obligation for fortification.

The record reflects that the CSO fortification credit system is also included in Proposal 2. The record indicates the CSO fortification credit system was designed in response to California's legislatively mandated higher nonfat solids standard for Class 1 products. The record does not address how incorporation of the CSO fortification credit system would operate in the context of the existing

[39] 7 CFR 1000.52.

[40] *See infra.*

FMMO fortification classification provisions without resulting in a double credit for fortification.

This decision does not find justification for incorporating into the California FMMO a modification to how the FMMO system uniformly addresses fortification of Class I products. As described above, and as contained in the proposed classification structure in both Proposals 1 and 2, the California FMMO would provide a lower classification for products used to fortify Class I products. Handlers would only be charged the Class I price on the volumetric increase in Class I products resulting from fortification.

In its post-hearing brief, the Institute filed a Negative Inference Motion asserting that because the Cooperatives did not enter into the record of this proceeding a study they commissioned evaluating their proposed milk pricing provisions, USDA should conclude that the study results contradict the Cooperatives' justification for adopting the price formulas contained in Proposal 1.

It is left to the discretion of the trier of fact to determine whether or not a negative inference will be drawn from the failure to present any specific piece of evidence under one party's exclusive control. The USDA finds that the recommended pricing provisions are properly based on testimony of those witnesses who appeared and the evidence that has been presented by all parties on the record.

Producer's Value of Milk

Currently, 6 of the 10 FMMOs utilize multiple component pricing to determine both the handler's and producer's value of milk. In the six orders, producers are paid for the pounds of butterfat, pounds of protein, pounds of other solids of milk pooled, as well as a per hundredweight (cwt) price known as the producer price differential (PPD). The PPD reflects the producer's pro rata share of the value of Class I, Class II, and Class IV use in the market relative to Class III use. The Class III butterfat, protein, and other solids prices are the same component prices charged to handlers based on the value of the use of milk in Class III. In four of these six FMMOs, there is an adjustment to the producer's payment for the somatic cell count (SCC) of the producers' milk.

Proposal 1 and Proposal 2 seek to pay producers on a multiple component basis for the milk they produce. As will be discussed below, the proposals differ on how they would apply a PPD to producer payments. Unlike Proposal 2, Proposal 1 does not specify a somatic cell adjustment to the producer's value of milk.

The record reflects that milk use in California is concentrated in manufactured dairy products. In 2015, California Class 1 utilization was 13 percent, Class 2 and Class 3 utilization combined was 8.6 percent, while 78.4 percent was used in Class 4a and Class 4b products (cheese, butter and dried milk powders). As California is clearly a manufacturing market, it is appropriate for producers to be paid for the components they produce that are valued by the manufacturers. Therefore, this decision recommends producer payments on a multiple component basis. Producers would be paid for the butterfat, protein, and other solids components in their producer milk and for the cwt of milk pooled.

This decision recommends that producers be paid a PPD calculated in the same manner as six current FMMOs. The PPD represents to the producer the value from the Class I, Class II, and Class IV uses in the pool that they are entitled to share because they participate in the FMMO pool. In general, the PPD is computed by deducting the Class III component values from the total value of milk in the pool, and then dividing the result by the total pounds of producer milk in the pool. The PPD paid to producers participating in the California FMMO pool would be adjusted to reflect the applicable producer location adjustment for the handler location where their milk is received.

Therefore, under the proposed California FMMO, the minimum payment to producers would be determined by summing the result of: Multiplying the hundredweight of a producer's milk pooled by the PPD adjusted for handler location; multiplying the pounds of butterfat in the producer's milk by the butterfat price; multiplying the pounds of protein in a producer's milk by the protein price; and multiplying the pounds of other solids in a producer's milk by the other solids price.

Proponents of Proposal 1 proposed distributing the PPD value across the butterfat, protein and other solids components, based on the average value each component contributed to the Class III price during the previous year. The Cooperatives purported that the PPD is confusing to producers, particularly when it is negative, and spreading the value of the PPD across the components would be a simpler method of distribution.

The PPD is the difference between value associated with all the milk pooled during the month and the producers' value for the butterfat, protein, and other solids priced at the Class III component prices for the month. In general, if the marketwide utilization value of all milk in the pool, on a per cwt basis, is greater than the marketwide utilization value of the producer's components priced at Class III component values, dairy farmers receive a positive PPD.

A negative PPD occurs when the value of the priced producer components in the pool exceeds the total value generated by all classes of milk. This is possible since all producer components are priced at the Class III components values, but pooled milk is utilized in all four classes, each with its own separately derived value.

Specifically, negative PPDs can happen when large increases occur in NDPSR survey prices from one month to the next resulting in the Class III price (announced at the close of the month) exceeding, or in a close relationship to, the Class I price (announced in advance of the month). Negative PPDs can also occur in markets with a large Class IV use when the Class IV price is significantly lower than the Class III price. A negative PPD does not mean that there is less total revenue available to producers. It often means the Class III component values are high relative to Class I prices. Because component values are the biggest portion of a producer's total revenue, high component prices coupled with negative PPDs often result in higher *overall* revenue to producers than when component prices are lower and PPDs are large and positive.

This decision does not find justification for distributing the PPD through the component prices as offered in Proposal 1. Current FMMO producers receive and understand that the PPD represents the additional value from the higher classified markets that they are able to share because they participate in the FMMO. This includes times when the PPD is negative.

While the proponents claim a negative PPD is confusing, this decision finds that distributing the PPD through the component prices would distort market signals to producers. As in the current FMMOs, a negative PPD in the California FMMO would inform producers that component values are rising rapidly. Regulated FMMO prices should not block those market signals. Producers in other FMMOs have been able to adapt to a multiple component pricing system that incorporates an announced PPD. This decision finds that California producers can do the same.

Four of the current FMMOs provide for a SCC adjustment on producer milk values. The CSO does not include any such adjustment. Proposal 1 did not include a provision for a SCC adjuster, and a Cooperative witness specifically testified against its inclusion. Proposal 2 included a SCC adjuster, but no Proposal 2 witnesses testified regarding this aspect of their proposal. This decision does not recommend a SCC adjuster for the California FMMO, as the record does not contain evidence to support its inclusion.

This decision proposes that handlers regulated by the California FMMO should be allowed to make various deductions from a producer's milk check, identical to what is allowed in the current FMMOs. These deductions include such things as hauling expenses and National Dairy Promotion charges, as well as other authorized deductions such as insurance payments, feed bills, equipment expenses, and other dairy related expenses. Authorized deductions from the producer's check must be authorized in writing by the producer. For the California FMMO, authorized deductions would include any assessment identified by CDFA for the payment of California quota values. A quota assessment would be authorized upon announcement by CDFA; it would not have to be authorized in writing by the producer.

Some hearing witnesses suggested that changes to the FMMO pricing system need to be considered in a separate rulemaking proceeding before California producers vote on a FMMO. This decision finds no justification for California producers to wait for a decision on a California FMMO until after what would most likely be a lengthy proceeding on national FMMO pricing. California producers should have the opportunity to vote on whether to join the FMMO system and adopt the provisions recommended in this decision with the full awareness that prices can be re-evaluated at a future hearing.

8. Pooling

This section addresses the pooling provisions of the recommended California FMMO. A summary of testimony for the pooling provisions contained in Proposals 1 and 2 is provided below. Additionally, Proposal 4 is addressed in this section as it seeks to allow handlers the ability to elect partially regulated distributing plant status with respect to milk received from farmers located outside of the marketing area. Proposal 4 would continue the practice of handlers paying the plant blend price for milk produced from outside of the state, instead of the market's blend price, since such interstate transactions cannot be regulated by the State. Essentially, Proposal 4 pertains to whether or not out-of-state milk would be incorporated into the proposed California FMMO marketwide pool and therefore it is addressed in this section.

This decision recommends pooling provisions for a California FMMO that are conceptually similar to the current 10 FMMOs, but tailored for the California market. The recommended pooling provisions are performance based and designed to determine those producers who consistently supply the Class I market, and therefore should share in the revenues from the market. There would be no regulatory producer payment difference given to milk based on the location of the dairy farm where it was produced.

Summary of Proposals

A Cooperative witness testified regarding the pooling provisions contained in Proposal 1. The witness said the Proposal 1 pooling provisions are designed to address the wide disparity in producer and handlers prices that currently exists in California when compared to the FMMO system. The witness stated that in order to design adequate California pooling standards, the Cooperatives evaluated historical producer blend prices using both CSO classified prices and the proposed California FMMO classified prices, from January 2000 through July 2015. The witness estimated that producer blend prices would have averaged $14.65 per cwt using CSO classified prices and $15.22 per cwt using the proposed California FMMO classified prices, an average difference of $0.57 per cwt. The witness' analysis showed that in every month, the estimated CSO blend price was less than the FMMO blend price, and that in using the most recent data (January 2015 through July 2015) the average difference was $0.86 per cwt. The witness stressed that to bring California producer blend prices in closer alignment with FMMO producer blend prices, the pooling provisions of a California FMMO must require the pooling of all classified use values.

The witness was of the opinion that California's combination of low utilization in the higher valued classes (Class 1, 2, and 3) and a state-administered quota program requires strict pooling provisions to prevent handlers from electing not to pool a significant portion of California milk each month. The witness was of the opinion that when the California overbase price is below Class 4a or 4b prices, there is an incentive to not pool milk in those classes because the handler can avoid a payment into the marketwide pool. The witness stated that from January 2000 through July 2015, the California overbase price was below either the Class 4a or 4b price 91 percent of the time. Thus, in those months, if not all milk was pooled, producers would receive different minimum prices—those producers whose milk was pooled would receive the minimum FMMO blend price, and those producers whose milk was not pooled had the potential to receive a higher price because the handler avoided sharing the additional revenue with all the producers in the market through the marketwide pool. This concern regarding producer price disparity was reiterated in the Cooperatives' post-hearing brief.

The Cooperative witness added that even after adjusting producer blend prices to account for quota payments (−$0.37), transportation credits (−$0.09), and RQAs ($0.03), there would be a financial incentive to not pool a significant portion of California milk in most months. Using the pricing provisions contained in Proposal 1, the witness estimated that from August 2012 through July 2015, handlers would have chosen not to pool Class III or Class IV milk 94 percent of the time. The consequence, the witness emphasized, would not only be unstable producer prices, but the inability of the FMMO to achieve uniform producer prices. The witness stressed that to accumulate the revenue needed to provide adequate, uniform producer blend prices and facilitate orderly marketing, all the milk delivered to California plants must be pooled. While provisions requiring all milk to be pooled cannot be found in another FMMO, the witness explained that FMMO pooling provisions have always been tailored to the market and the pooling provisions contained in Proposal 1 are no different. The Cooperatives' post-hearing brief stressed California's need to have tailored pooling provisions that are different from other FMMOs. The Cooperatives' brief reiterated that allowing for milk to not be pooled would inhibit a California producer's ability to receive the national FMMO prices they are seeking.

The witness proceeded to describe the proposed pooling provisions contained in Proposal 1. The witness explained that under Proposal 1, any California plant receiving milk from California farms would be qualified as a pool plant, and all California milk delivered to that plant would be qualified as producer milk. The witness said Proposal 1 also contains provisions for plants located outside of the marketing area that demonstrate adequate service to the California Class I market to qualify as pool plants on the order. The witness highlighted an additional provision that would regulate all plants located in Churchill County, Nevada, and receiving milk from farms located in Churchill County or California. According to the witness, producers in the Churchill County milkshed have historically supplied milk to the California Class 1 market and this provision would ensure they could remain affiliated. The witness proposed the partially regulated distributing plant (PRDP) provision should be the same as in other FMMOs; a plant qualifies as a PRDP if the plant does not have more than 25 percent of the plant's total disposition within the marketing area.

The Cooperative witness defined a producer as any dairy farmer producing Grade A milk received by a pool plant or a cooperative handler. This provision allows for dairy farmers located inside or outside of the marketing area to qualify as producers under the order, the witness added. The witness said a majority of the producer milk pooled on a California FMMO would be milk received by a pool plant directly from qualified producers or cooperative handlers. Proposal 1 also contains a provision to allow producer milk to be pooled in the order if it was received by a cooperative handler, the witness noted.

The Cooperative witness explained that Proposal 1 prohibits milk from being diverted to nonpool plants outside of the marketing area and remaining qualified for pooling on a California FMMO until five days' production is delivered to a pool plant, and subsequently diversions are limited by the amount the plant delivers to distributing plants. The witness said the California market appears to have an adequate reserve supply of Class I milk, so strict diversion limit standards are needed to ensure that additional milk being pooled is needed in the market.

The Cooperative witness provided examples of previous FMMO changes that the witness described as significant policy shifts, including the elimination of individual handler pools in favor of marketwide pools, the regulation of large producer-handlers, adoption of multiple component pricing, and the establishment of transportation credit programs. The witness said that in these examples the Department found it appropriate to significantly deviate from historical precedent because market conditions justified such changes. The witness stated that Federal Order Reform provided a FMMO foundation that was national in scope, while also allowing for some provisions to be tailored to meet the marketing conditions of individual orders. The witness concluded that the AMAA provides the Department the flexibility to tailor pooling provisions, and Proposal 1 recognizes the unique needs of the California market.

Another Cooperative witness offered testimony modifying Proposal 1 to include call provisions. The witness explained that call provisions are currently contained in the CSO, and while not often utilized, their existence alone encourages milk to be supplied to fluid processing plants when needed. As proposed, the witness said, call provisions should only be used on a temporary basis when the market's milk supply cannot meet distributing plant demand, not when an individual distributing plant is short on milk.

The Cooperatives' post-hearing brief reiterated the justification for the inclusive pooling provisions contained in Proposal 1. The brief stressed that the AMAA authorizes the pooling of milk, irrespective of use.

The Cooperatives' post-hearing brief also offered a modification to extend exempt plant status to small plants that process products other than, or in addition to, fluid milk products. The modification would increase the exempt plant production limit from route sales under 150,000 pounds of fluid milk product to sales under 300,000 pounds of milk in Class I, II, III or IV products during the month. The brief explained that this would allow for small fluid and manufacturing plants to be exempt from the pricing and pooling provisions of the order that would otherwise be required to participate in the marketwide pool.

A witness testifying on behalf of Western United Dairymen said that without inclusive pooling provisions, as outlined in Proposal 1, handlers could opt not to pool large amounts of milk. The witness said this would have a substantial impact on the pool value and consequently lower blend prices to those producers who remain pooled.

An Institute witness testified regarding the pooling provisions contained in Proposal 2. The witness explained how current FMMO provisions work together to assure an adequate milk supply for fluid use. First, said the witness, higher Class I revenues attract producers and producer milk to participate in the pool, then pooling provisions direct the producer milk to fluid plants. Class I plants, which by regulation are required to be pooled and pay the higher Class I price, receive in exchange the assurance that the regulations provide them an adequate supply of milk, the witness explained. The witness summarized a previous USDA decision finding that performance-based pooling provisions are the appropriate method for determining those producers who are eligible to share in the marketwide pool. The witness stressed that performance-based pooling provisions are essential in maintaining orderly milk movements to Class I.

The Institute witness objected to the Cooperatives' assertion that Class I premiums would be sufficient to move milk to Class I use. The witness was of the opinion that Class I plants already pay a high regulated Class I price and they should not have to pay additional over-order Class I premiums to attract milk to their plant. The witness questioned the purpose of Class I differentials if the use of premiums would be the primary way to attract milk for fluid uses in a California FMMO.

The Institute witness also spoke to Proposal 1's dependence on transportation credits to ensure that the Class I market is served. The witness was of the opinion that transportation credits are not an appropriate substitute for performance-based pooling standards.

The Institute witness testified that Proposal 1 provides no incentive for plants to serve the Class I market in order to qualify its producers to share in the market's Class I revenues. Instead, said the witness, Proposal 1 would allow plants to gain access to Class I revenues for their producers without bearing any burden in servicing the Class I market, thus making pooling provisions ineffective.

Another issue the Institute witness highlighted was inclusive pooling provisions in combination with regulated classified prices that are not market-clearing. If regulated classified prices are set above what a plant can pay for that milk, the witness stressed that many of those plants would exit the industry and available market plant capacity would shrink. According to the witness, this would lead to uneconomic milk movements as excess milk would need to find willing processing capacity.

The Institute witness opposed Proposal 1's provision to automatically grant pooling status to any dairy manufacturing plant located in Churchill County, Nevada. The witness said that all plants, whether located in state or out of state should qualify for pooling by meeting appropriate performance-based pooling standards.

The Institute witness concluded that pooling standards play a pivotal role in ensuring consumers an adequate supply of fluid milk. Inclusive pooling challenges the usefulness of pooling standards by allowing producers and handlers to benefit from the pool without actually being required to serve the Class I market, the witness said. The witness urged the Department to adopt the performance-based pooling standards contained in Proposal 2.

The Institute's post-hearing brief reiterated its position that the Department's policy has consistently ensured marketwide pool proceeds are distributed to those that demonstrate service to the Class I market. The brief maintained this standard should be upheld through performance-based pooling standards in a California FMMO. The Institute stressed that the inclusion of provisions to recognize the California quota program is not an adequate justification to exclude performance-based pooling standards.

The Institute also raised the issue in its post-hearing brief that adoption of mandatory pooling in California would result in trade barriers that are prohibited by the AMAA. With no way to avoid minimum regulatory pricing, the brief stressed that California handlers would be at a disadvantage since handlers regulated by other FMMOs can elect not to pool milk and avoid minimum regulated prices. With the inability to elect not to pool, the Institute was of the opinion that California plants would be discouraged from expanding plant capacity to handle surplus milk because they would be required to pay prices above market-clearing values.

Lastly, as it pertains to the proposed pooling provisions, the Institute expressed the opinion that inclusive pooling would de facto regulate farmers, something that is expressly prohibited by the AMAA.

A Dean Foods witness, on behalf of the Institute, testified regarding specific pooling provisions contained in Proposal 2. The witness revised Proposal 2 and expressed support for the distributing plant in-area route disposition standard of 25 percent offered by the Cooperatives. The witness explained the Class I route disposition levels that determine a plant's pool status is set by each of the individual orders, depending on the Class I utilization of the market, among other factors. The witness was of the opinion that a 25 percent in-area route disposition standard is appropriate for a California FMMO with a low Class I utilization.

The Dean Foods witness also supported the unit pooling provision provided in Proposal 2. The witness testified that the unit pooling provision allows two or more plants, operated by the same handler and located in the marketing area, to qualify for pooling as a unit by meeting the total and in-area route disposition standards as an individual distributing plant. Proposal 2 requires one of the plants to qualify as a distributing plant and other plant(s) in the unit to process at least 50 percent or more of the total milk processed or diverted by the plant into Class I or II products.

The witness expressed concern that the pooling provisions contained in Proposal 1 would not ensure Dean Foods an adequate milk supply to meet their needs because it provides no incentive to supply Class I plants.

A Hilmar consultant testified on behalf of the Institute regarding the pool supply plant performance standards contained in Proposal 2. The witness explained that the proposed supply plant performance standards and diversion limits would establish the volume of milk that could be associated with the California marketwide pool. The witness said that 10 percent is an appropriate base shipping standard for supply plants seeking to be pooled on a California FMMO. The witness explained this standard is similar to that in the Upper Midwest FMMO, which has a similar Class I utilization. The witness described Proposal 2's sliding scale system that would automatically change the supply plant shipping standard based on market Class I utilization over the previous three months. The witness was of the opinion that the sliding scale system would ensure the Class I market is adequately served by automatically adjusting should there be a change in the market's Class I utilization.

The Hilmar consultant witness also described different performance standards proposed for pool supply plants that receive quota milk. Proposal 2 would require 60 percent, or a volume equivalent, of a pool supply plant's quota receipts to be delivered to pool distributing plants, the witness said. The witness was of the opinion this additional requirement on quota milk would ensure that Class I needs would always be met. However, if additional milk is needed, that responsibility would fall first on quota milk as the Market Administrator would have the ability to adjust the quota milk shipping standard up to 85 percent if warranted. The witness added that this additional standard on quota milk is similar to provisions in the CSO.

The Hilmar consultant witness also testified that servicing the fluid milk needs of the market, the responsibility of quota milk to service the fluid market, and flexibility and supply chain efficiency should guide the Department in its decision making. The witness highlighted additional proposed provisions that would provide regulatory flexibility such as allowing for split-plants, the pooling of supply plant systems, and a provision to allow the Market Administrator to investigate market conditions and adjust shipping percentages if warranted by current market conditions.

The Hilmar consultant witness also addressed what Hilmar believes are appropriate producer milk provisions for a California FMMO, namely provisions modeled after the Upper Midwest FMMO. The witness was of the opinion that an appropriate producer touch-base standard would be the lesser of one-day's production or 48,000 pounds of milk, delivered to a pool plant during the first month the dairy farmer is a producer. In the following months, explained the witness, the producer's milk would be eligible for diversion to nonpool plants and still be pooled and priced under the terms of a California FMMO. The witness testified that handlers should not be allowed to pool more than 125 percent of the volume they pooled during the previous month, except during March when the appropriate limit should be 135 percent, due to the fewer number of days in February. The witness testified that the Institute relied on justification and methodology provided in Upper Midwest FMMO rulemaking decisions to determine appropriate repooling standards for a California FMMO.

In addition, the Hilmar consultant witness said that a California FMMO should not allow milk to be simultaneously pooled on a FMMO and a State order with marketwide pooling. Handlers, or a group of handlers, should be penalized if they attempt to not pool large volumes of Class III or Class IV milk to avoid pooling standards, the witness added.

A Leprino witness expressed opposition to mandatory-regulated minimum prices as advanced in Proposal 1. The witness characterized the inclusive pooling provisions of Proposal 1 as actually being mandatory minimum pricing provisions because they would cause all California milk to be pooled and priced under the terms of the FMMO. The witness explained how the CSO has applied minimum regulated pricing to all Grade A milk produced and processed in the state for decades, which the witness believed has led to negative market impacts. For example, the witness described how mandatory pricing and pooling has reduced competition across manufactured product classes and lessened incentives for milk to move to higher-valued uses.

The Leprino witness did not characterize the CSO as disorderly, but rather explained how there had been periods of dysfunction when CDFA set minimum-regulated prices that exceeded market-clearing levels, leading to overproduction of milk. The witness added that when there have been periods of large milk surpluses, milk has been shipped and sold outside of the state at discounted rates. The witness said this led to losses for California producers that could have been reduced under a more flexible regulatory scheme.

The Leprino witness stressed that a California FMMO should have voluntary pricing and pooling for manufactured milk, as is the case in all other FMMOs. The witness was of the opinion this promotes market efficiency, allowing milk to move to its highest valued use. In its brief, Leprino stated that the inclusive pooling provisions are over-reaching by regulating all milk and are inconsistent with the goals of the AMAA. Leprino stated that inclusive pooling standards combined with overvalued pricing formulas would result in a disorderly California market.

Another witness appeared on behalf of HP Hood in support of adoption of Proposal 2. HP Hood operates fluid milk processing facilities in California and in existing FMMOs, and is a member of the Institute. The witness testified that if a California FMMO were adopted that included inclusive pooling, there would be an oversupply of California milk, leading to decreased investment in dairy product manufacturing facilities. The witness supported a California FMMO that allows for optional milk pooling for non-fluid milk uses.

A Gallo Farms consultant witness testified that unlike other FMMOs, Proposal 1 would not allow handlers to elect not to pool manufacturing milk, which would lead to disorderly marketing conditions and increased operational costs for cheese plants. The witness supported the ability of cheese plants to elect not to pool milk as provided in Proposal 2.

A witness spoke on behalf of Nestle S.A. (Nestle) in support of Proposal 2. Nestle is the world's largest food company, headquartered in Switzerland. Its U.S. operations include Nestle USA, Nestle Nutrition, Nestle Purina Pet Care Company, and Nestle Waters North America.

The Nestle witness was of the opinion that milk marketing in California is orderly. However, if a California FMMO is adopted, Nestle supports Proposal 2 that would allow for optional pooling of manufactured milk. The witness stated that in all current FMMOs, handlers have the option to pool manufacturing milk. Inclusive pooling as contained in Proposal 1, according to the witness, would place Nestle at a competitive disadvantage with competitors in other FMMOs that can avoid minimum-regulated prices. Should mandatory pooling standards, in conjunction with the higher-regulated prices contained in Proposal 1 be adopted, the witness asserted that Nestle would seek to move more of its manufacturing outside of the state.

The Nestle witness added that the vast majority of its purchased California manufactured dairy powder products is utilized in its international plants. If California regulated prices increase and pooling becomes mandatory, the witness said that Nestle would look elsewhere globally to replace those products. The witness concluded that Nestle would like to see a consistent approach to regulations in all FMMOs so that its business continues to be competitive and grow.

Proposal 4 was submitted by Ponderosa Dairy (Ponderosa) in response to the Cooperatives' original Proposal 1. Proposal 4 would amend the provisions that regulate payments by a handler operating a partially-regulated distributing plant—under either Proposal 1 or 2—to allow handlers to elect partially regulated distributing plant status with respect to milk received from out-of-state farms.

A consultant witness on behalf of Ponderosa testified in support of Proposal 4. The witness described past judicial decisions regarding the treatment of out-of-state milk delivered to California handlers. According to the witness, out-of-state producers cannot currently obtain quota, are not eligible for transportation benefits under the CSO, and do not participate in the CSO marketwide pool. Instead, the witness said, they negotiate separate prices with the California handlers who buy their milk. The witness speculated that out-of-state producers receive the plant's blend price, although that is not enforced or verified by CDFA.

The Ponderosa consultant witness outlined the provisions of Proposal 4, which would modify the standard payment provisions for partially-regulated plants under a California FMMO. Proposal 4 would allow California handlers to elect partially-regulated status with respect to milk from out-of-state producers, and out-of-state milk would be classified according to the plant's overall utilization and receive the plant blend price. Since the milk would not be pooled under the FMMO, it would not receive the marketwide blend price. The witness clarified that although the out-of-state milk would be isolated for payment purposes, the handler's status as a fully regulated pool plant should not be lost if it otherwise meets the definition of a pool plant.

The Ponderosa consultant witness said that features of Proposal 4 are similar to those of individual handler pools that are no longer provided in the FMMO system. Such accommodation is needed, the witness said, to counter the inherent inequalities of California's unique quota system, which would otherwise disadvantage out-of-state producers. In the witness's opinion, the provisions of Proposal 4 should be contained in any California FMMO recommended by the Department, as it would establish a regulated and audited pricing mechanism to ensure out-of-state producers receive at least the price they would have if they shipped to an otherwise fully-regulated plant—something that is not provided in the CSO.

A witness representing Ponderosa explained that Ponderosa Dairy was founded in southern Nevada to supply raw milk to the Rockview plant in southern California with the expectation of receiving the plant blend price reflective of Rockview's plant utilization even though the plant was regulated by the CSO. With a Class 1 utilization of approximately 85 percent, the witness said that the plant blend price compensates Ponderosa for its inability to participate in the California quota program and for its higher transportation expenses to haul its milk 280 miles to Rockview.

Another Nevada producer, representing Desert Hills Dairy (Desert Hills), a dairy farm with 4,000 cows that delivers 50 percent of its production to California processing plants, testified in opposition to any California FMMO. However, the witness said that should a FMMO be adopted, Proposal 4 should be included as it most closely resembles the current CSO provisions for out-of-state milk. The witness testified that Desert Hills receives the plant blend price for the milk shipped to California, and that the dairy farm pays all transportation costs. The Desert Hills witness said that should Proposal 4 not be adopted, it would be financially harmful because Desert Hills would be pooled on a California FMMO and receive more than $1.00 per cwt less for the milk they ship to California.

Without addressing Ponderosa's concern that out-of-state producers are unable to own quota, the Cooperatives modified Proposal 1 in their post-hearing brief. Modified Proposal 1 would provide for the payment of a blend price adjuster to out-of-state producers so that those producers' total receipts would not be diminished by the deduction of quota premium payments from the marketwide pool.

The Cooperatives' brief argued that out-of-state producers have taken advantage of the fact that the CSO cannot regulate out-of-state milk and have sold milk to California Class 1 handlers for prices higher than the CSO regulated blend price but lower than the CSO classified use value. According to the Cooperatives, modified Proposal 1 does not erect trade barriers as it provides for uniform payment to California producers in similar circumstances by establishing uniform quota premium payments for milk covered by quota, and establishing a uniform blend price for production not covered by quota.

An Institute witness explained that under Proposal 2, out-of-state producers would receive the traditional FMMO blend price for their milk pooled on a California FMMO. That blend price, the witness said, would be determined before the value of quota is deducted from total marketwide pool revenues. According to the witness, out-of-state producers, who could never own quota under California's current laws, and in-state producers should be paid uniformly through a traditional FMMO blend price calculation.

The Institute witness explained they originally considered proposing the establishment of two marketwide pools or blend price calculations. The first would pay out-of-state producers, and then the second would recalculate and apportion all the remaining funds to California producers in the pool, on the basis of quota/non-quota prices and whether handlers elected to pool their milk. But the witness said that upon further consideration they realized that this solution would present additional problems.

The Institute witness provided examples where two producers shipping into the same California plant received different prices by virtue of their farms' locations. The witness was of the opinion that this treatment erects a trade barrier, provides non-uniform payments to producers, and violates the AMAA.

The Institute witness said Proposal 2 addresses these issues by providing that out-of-state producers receive the traditional FMMO blend price for their milk pooled on a California FMMO. According to the witness, by paying the traditional blend to out-of-state producers, rather than the non-quota price, no trade barrier is erected with respect to out-of-state milk.

A consultant witness representing Hilmar supported the Institute's position regarding the treatment of out-of-state milk.

Ponderosa's reply brief argued that the Cooperatives' proposed remedy—the out-of-state adjustment rate—would not resolve the discriminatory trade barrier issue raised in Ponderosa's initial brief. Ponderosa asserted the mechanics of the Cooperatives' proposal are unclear, but they seemed to add complication to the pooling process without fairly compensating out-of-state producers for their inability to participate in the quota program. According to Ponderosa, out-of-state producers can never realize the historic and ongoing benefits of quota ownership and can only avoid discriminatory treatment by being allowed to receive the plant blend price.

Findings

Two fundamentally different pooling philosophies have been proposed in this proceeding. The first, contained in Proposal 1, has been termed ''inclusive pooling'' and would automatically pool all California produced milk delivered to California plants, similar to how milk currently becomes pooled by the CSO. The Cooperatives are of the opinion that any change that would allow handlers to opt not to pool milk would be disorderly in an industry where all of the milk has historically been regulated. The Cooperatives testified that because California has a high percentage of both Class III and Class IV milk, in any given month handlers would elect to not pool one of those classes of milk because of price. The Cooperatives estimated the incentive to not pool one or both classes of manufacturing milk could occur 94 percent of the time. The resulting fluctuation in uniform producer prices, they claim, would be disorderly.

The second pooling philosophy, offered by the Institute, is performance-based pooling standards that are more typical of what exists in the current 10 FMMOs. These standards require the pooling of plants with predominantly Class I milk sales. Handlers have the option of pooling Class II, III and IV milk diverted to nonpool plants. The provisions set out standards for what plants, producers, and producer milk are eligible to be pooled and priced by the FMMO. The Institute testified that the inclusive pooling standards offered in Proposal 1 are not authorized by the AMAA, and performance-based pooling standards are the only means to ensure that Class I demand is always met.

The pooling standards of all current FMMOs are contained in the *Pool Plant, Producer* and *Producer Milk* provisions of an order. Taken together, these provisions are intended to ensure an adequate supply of milk is available to meet the Class I needs of the market, and provide the criteria for determining the producers that have demonstrated a reasonable measure of service to the Class I market, and thereby should share in the marketwide distribution of pool proceeds.

While the Cooperatives have put forth the argument that inclusive pooling is authorized by the AMAA, the analysis of the record of this proceeding finds that performance-based pooling standards remain the appropriate method for identifying the producers and producer milk that serves the Class I market. Therefore, performance-based pooling provisions, tailored to the local market, are recommended for the proposed California FMMO.

Pooling standards that are performance based provide a viable method for determining those eligible to share in the marketwide pool. It is primarily the additional revenue generated from the higher-valued Class I use of milk that adds additional revenue, and it is reasonable to expect that only producers who consistently bear the costs of supplying the market's fluid needs should be the ones to share in the returns arising from higher-valued Class I sales. Therefore, FMMOs require the pooling of milk received at pool distributing plants, which is predominately Class I milk. Handlers of Class II, III and IV uses of milk qualify their milk to be pooled by meeting the pooling and performance standards of an order. Pooling of Class II, III and IV milk is optional. By delivering a portion of their milk receipts to Class I distributing plants, handlers benefit from the marketwide pool by receiving the difference between their use-value of milk and the order's blend price in order to pay their producer suppliers the uniform producer blend price. This decision finds that the following performance-based pooling provisions are appropriate for the proposed California FMMO.

Pool Plant. The *Pool Plant* definition of each order provides the standards to identify plants engaged in serving the fluid needs of the marketing area and that receive milk eligible to share in the marketwide pool. The *Pool Plant* provisions recommended in this decision are a combination of those offered in both Proposal 1 and Proposal

2. Both proposals recommend similar distributing plant and supply plant provisions. However, Proposal 1 would automatically regulate any plant located in California that receives milk from a producer located in the marketing area, and the remaining proposed pool plant provisions (both distributing plant and supply plant provisions) would apply to only plants located outside of the marketing area. As discussed earlier, this decision finds that pooling provisions should be performance based, and therefore it is not appropriate to recommend provisions that would regulate plants based solely on location.

There are two performance standards applicable to distributing plants. First, this decision finds that a pool distributing plant should have a minimum of 25 percent of the total quantity of fluid milk products physically received at the plant (excluding concentrated milk received from another plant by agreement for other than Class I use) that are disposed of as route disposition or are transferred in the form of packaged fluid milk products to other distributing plants. This decision finds that a 25 percent route disposition standard for the proposed California FMMO is adequate to determine those plants that are sufficiently associated with the fluid market. The second criteria is an ''in-area'' standard and is designed to recognize plants that have an adequate association with the fluid market in the California marketing area. The record supports the adoption of the same in-area standard of 25 percent of total route disposition that is found in the current 10 FMMOs.

The *Pool Plant* provision also provides for regulation of distributing plants that distribute ultra-pasteurized or aseptically-processed fluid milk products. The record evidence shows that plants specializing in these types of products tend to have irregular distribution patterns that could cause the plant to shift its regulatory status. This shifting can be considered disorderly to the producers and cooperatives who supply those plants. Therefore regulating those plants based on location, as is done in other FMMOs, provides regulatory stability. Current FMMOs allow these plants to be regulated in the marketing area where they are located, as long as they process a minimum percent of their milk receipts into ultra-pasteurized or aseptically-processed fluid milk products during the month.

The record reveals that both the Cooperatives and the Institute used the Upper Midwest FMMO, which contains a 15 percent standard for distributing plants producing ultra-pasteurized or aseptically-processed products, as a template for pooling provisions. However, as explained in the Federal Order Reform Final Decision,[41] this standard was set equal to the total route disposition standard required for pool distributing plants in the respective FMMO. In this decision, the pool distributing plant standard is proposed to be 25 percent. Accordingly, this decision recommends that plants located in the marketing area that process at least 25 percent of their total quantity of fluid milk products into ultra-pasteurized or aseptically-processed fluid milk products would be fully regulated by the proposed California FMMO.

Performance standards for pool supply plants are designed to attract an adequate supply of milk to meet the demands of the fluid milk market by encouraging pool supply plants to move milk to pool distributing plants that service the marketing area. The record reveals that California has significant volumes of manufacturing milk, and the California Class 1 utilization in 2015 was only 13 percent. This decision recommends that a pool supply plant should deliver at least 10 percent of the plant's total milk receipts from producers, including milk diverted by the handler, to plants (qualified as pool distributing plants, plants in a distributing plant unit, producer-handlers, partially regulated distributing plants, or distributing plants fully regulated by another order) each month in order to qualify all of the milk associated with the supply plant for pricing and pooling under a California FMMO. This shipping provision is reasonable given that it mirrors the approximate Class I utilization of the market and is low enough to avoid uneconomic shipments of milk.

To prevent uneconomic shipments of milk solely for the purpose of pool qualification, this decision finds it appropriate to recommend two additional pooling provisions. First, this decision recommends a unit pooling provision that allows for two or more plants located in the marketing area and operated by the same handler to qualify for pooling as one unit. This applies as long as one or more of the plants in the unit qualifies as a pool distributing plant and the other plant(s) processes at least 50 percent of its bulk fluid milk products into Class I or II products. This unit pooling provision is designed to provide regulatory flexibility and avoid uneconomic milk movements in markets, like California, where there is often specialization in plant operations.

Second, this decision recommends a system pooling provision that allows for two or more supply plants, located in the marketing area and operated by one or more handlers, to qualify for pooling as a system by meeting the supply plant shipping requirements as a single plant. This system pooling provision recognizes the benefits supply plants provide by balancing the market's fluid needs, while ensuring that the plant is a consistent supplier to the market and therefore eligible to benefit from participation in the marketwide pool. Both unit and system pooling provisions are provided in other FMMOs.

The Cooperative and Institute witnesses testified in support of authorizing the Market Administrator to adjust shipping percentages if warranted by changing market conditions. This decision finds it appropriate to adopt such provisions should the Market Administrator conclude, after conducting an investigation, that justification for adjusting shipping standards for supply plants, and systems of supply plants to encourage shipments of milk to meet Class I demand, or to prevent uneconomic shipments of milk is warranted. This provision will ensure that California FMMO provisions can quickly respond to changing market conditions and that orderly marketing can be maintained. This provision negates the need to add call provisions, as advanced by the Cooperatives, to ensure that fluid milk demand is always met.

Like other FMMOs, the proposed California FMMO allows a plant, qualifying as a pool plant in the immediately preceding three months, to be granted relief from performance standards for no more than two consecutive months if it is determined by the market administrator that it cannot meet the performance standards because of circumstances beyond the control of the handler operating the plant. Examples of such circumstances include natural disaster, breakdown of equipment, or work stoppage.

In their post-hearing brief, the Cooperatives offered a modification to the exempt plant definition that would expand exempt plant status to plants with less than 150,000 pounds of Class I route disposition, and less than 300,000 pounds of total Class I, II, III or IV milk usage during the month. This modification was offered to exempt smaller plants that would otherwise be regulated under the inclusive pooling provisions of Proposal 1. This decision puts forth a package of performance-based pooling provisions; therefore,

[41] *See infra.*

there is no need to alter the standard exempt plant definition, as plants with manufacturing uses can elect to not participate in a California FMMO.

Proposal 2 offered a sliding scale supply plant shipping standard that would automatically adjust if the average Class I utilization percentage over the prior three months changed. Justification provided for this provision centered on administrative ease and flexibility of the regulations to change in order to reflect market conditions, without necessitating a formal rulemaking hearing. This decision recommends provisions allowing the market administrator to adjust supply plant shipping standards if warranted by changing market conditions. Therefore, it is not necessary to incorporate automatic adjustments to the standards, as that is provided with the flexibilities granted to the market administrator.

This decision does not recommend separate pooling standards for plants receiving California quota milk, as offered in Proposal 2. As discussed previously, this decision finds that proper recognition of the California quota program could be through an authorized deduction to payments to producers if deemed appropriate by CDFA. Therefore, it is not appropriate for the supply plant shipping standards to differ on the basis of whether or not they receive quota milk.

Proposal 1 contained a provision that would regulate a plant located in Churchill County, Nevada, receiving milk from producers within the county or in the California marketing area. The Cooperatives argued that currently a plant located in Churchill County has a long standing association with the California market, and this provision would ensure the plant would remain associated within the FMMO framework. This decision does not find it appropriate to regulate a supply plant based on its location and not in combination with some form of performance standard. If the Churchill County plant meets the pool plant provisions of the recommended California FMMO, and thus demonstrates an adequate association to the market, then that plant would become regulated and enjoy the benefits of participating in a California FMMO marketwide pool.

Lastly, this decision incorporates provisions contained in all other FMMOs implementing the provisions of the Milk Regulatory Equity Act of 2005 (MREA). The MREA amended the AMAA to ensure regulatory equity between and among dairy farmers and handlers for sales of packaged fluid milk in FMMO areas and into certain non-Federally regulated milk marketing areas from Federal milk marketing areas. Incorporation of these provisions is required to ensure that the proposed California FMMO does not violate the MREA.

Producer. The *Producer* definition identifies those dairy farmers supplying the market with milk for fluid use, or who are at least capable of doing so if necessary. Producers are eligible to share in the revenue that accrues from the marketwide pooling of milk. The *Producer* provisions proposed in Proposals 1 and 2 were virtually identical. This decision finds that the proposed California FMMO will recognize producers as any person who produces Grade A milk that is received at a pool plant directly from the producer or diverted from the plant, or received by a cooperative in its capacity as a handler. A dairy farmer would not be considered a producer under more than one FMMO with respect to the same milk. Additionally, the proposed California FMMO exempts producer-handlers and exempt plants from the pricing provisions, so the term producer would not apply to a producer-handler, or any dairy farmer whose milk is delivered to an exempt plant, excluding producer milk diverted to such exempt plant. Finally, the term producer would not apply to a dairy farmer whose milk is received at a nonpool plant as other than producer milk. Such a provision is commonly referred to as a dairy farmer for other markets provision.

The Cooperatives proposed an additional provision that would identify those dairy farmers who had lost their Grade A permit for more than 30 consecutive days as dairy farmers for other markets, and therefore would lose their ability to qualify as a producer on a California FMMO for 12 consecutive months. The Cooperatives explained that this provision was part of the inclusive pooling provisions and was designed to prevent producers from voluntarily giving up their Grade A status to avoid regulation. This decision is recommending a package of pooling provisions that are performance based and only those dairy farmers who meet the producer definition would be entitled to share in the marketwide pool. Therefore, any dairy farmer who delivers Grade A milk to a pool plant will be considered a producer.

Producer milk. The *Producer Milk* definition identifies the milk of producers that is eligible for inclusion in the marketwide pool. The recommended provisions are a combination of the provisions contained in Proposals 1 and 2, and uphold the performance-based pooling philosophy advanced in this decision.

This decision finds that for the proposed California FMMO, producer milk is defined as the milk of a producer that is received at a pool plant, or received by a cooperative association in its capacity as a handler.

The proposed California FMMO must also provide for the diversion of producer milk to facilitate its orderly and efficient disposition when not needed for fluid use. Diversion provisions are needed to ensure that milk pooled on the order but not used for Class I purposes is part of the legitimate reserve supply of Class I handlers. Providing for the diversion of milk is a desirable and needed feature of a FMMO because it facilitates the orderly and efficient disposition of milk when not needed for fluid use.

Accordingly, the recommended California FMMO would allow a pool plant to divert milk to another pool plant, and pool plants and cooperatives in their capacity as handlers could also divert milk to nonpool plants located in California, or in the surrounding states of Arizona, Nevada and Oregon. Milk would not be eligible to be diverted to a nonpool plant and remain priced and pooled under the terms of a California FMMO, unless at least one day of the dairy farmer's production is physically received as producer milk at a pool plant during the first month the dairy farmer is qualifying as a producer on the order. Given the large supply of milk for manufactured use in California, the record supports that a one-day ''touch base'' provision during the first month would be adequate to define the producer milk that should be included in a California marketwide pool. Proposal 2 offered an alternative touch base standard of the lesser of one-day's production or 48,000 pounds. This decision finds that a one-day touch base standard is an adequate demonstration of a dairy farmer's ability to service the market. Conversely, a higher standard, such as the five-day standard contained in Proposal 1, could lead to uneconomic milk movements for the sole purpose of meeting regulatory standards.

It is equally appropriate to safeguard against excessive milk supplies becoming associated with the market as the recommended California FMMO one-day touch base standard could lead to milk from far distances associating with a California marketwide pool without actually being available to service the market's fluid needs. Therefore, this decision recommends diversions be limited to 100 percent minus the supply plant shipping percentage (or 90 percent of all milk being pooled by the handler). Diversions would further be limited to nonpool plants within California and its surrounding states. This limit should allow the economic movement of milk to balance the fluid needs of the market, while simultaneously preventing the milk of producers located in areas distant from the marketing area from being delivered to a pool plant once, and then all the milk of that producer being diverted to a distant plant and still pooled on and receiving the recommended California FMMO blend price.

The recommended California FMMO also contains repooling standards of 125 percent for the months of April through February, and 135 percent for the month of March of the producer milk receipts pooled by the handler in the previous month. The record contains evidence that other FMMOs have experienced large swings in the volume of milk pooled on the order. This volatility was attributed to manufacturing handlers having opted to not pool all their eligible milk received in a month in order to avoid payment to the marketwide pool. The unrestricted ability of manufacturing handlers and cooperatives to elect not to pool milk and avoid payment into the marketwide pool is inequitable and contrary to the intent of the FMMO system.[42] Repooling standards have been found to be an appropriate remedy to safeguard marketwide pooling and deter the disorderly conditions that occur when milk is not pooled. These standards would not prevent manufacturing handlers or cooperatives from electing to not pool milk. However, they should serve to maintain and enhance orderly marketing by encouraging participation in the marketwide pooling of all classified uses of milk.

Therefore, this decision finds that repooling standards are justified for the proposed California FMMO to avoid known disorderly marketing conditions that have occurred in numerous FMMOs. As California is currently regulated by the CSO, there is no data on the record from which to discern how much milk plants that will qualify as pool plants on the recommended California FMMO will seek to pool. Therefore, the 125 and 135 percent repooling standards serve as a reasonable starting point for determining a handler's consistent supply of milk available to service the market's fluid needs. Any milk delivered to a pool distributing plant in excess of the previous month's pooled volume would not be subject to the repooling standards. The recommended California FMMO also contains a provision that allows the market administrator to waive these provisions for new handlers, or existing handlers with a significant change in their milk supply due to unusual circumstances.

Lastly, milk that is subject to inclusion and participation in a State-authorized marketwide equalization pool and classification system would not be considered producer milk. Without such exclusion, milk could be simultaneously pooled on a California FMMO and on a marketwide equalization pool administered by another government entity, resulting in a double payment on the same milk and giving rise to competitive equity issues between producers.

The record reflects that under the CSO, milk serving the California Class I market but produced from outside the state is not priced and pooled, and out-of-state producers commonly receive the plant blend price. Proposal 4 seeks to allow plants that otherwise qualify as fully regulated distributing plants to elect partially regulated distributing plant status with respect to milk received from out-of-state farms. If Proposal 4 were adopted, the recommended California FMMO would enforce payment to out-of-state producers of at least the plant blend price on the out-of-state milk and thus the out-of-state producers would receive the same price as they currently do by being exempt from CSO regulation.

Throughout the hearing, California producers extolled the virtues of joining the FMMO system and enjoying system-wide uniform product classification and pricing, which they believed would put them on a level-playing field with their producer counterparts across the country. In an effort to fairly compensate out-of-state producers while accommodating the California quota program under the proposed FMMO, proponents offered various payment alternatives. Under the modified provisions of Proposal 1, out-of-state producers would be entitled to a uniform blend price adjusted for quota. Under Proposal 2, out-of-state producers would be entitled to the traditional FMMO blend price calculated before quota premiums are paid.

Proponents of Proposal 4 argued that out-of-state producers should be allowed to continue receiving the plant blend price for milk shipped to plants regulated under a California FMMO to compensate for the fact that they have not historically been entitled to own and benefit from California quota and cannot expect to in the future. Under Proposal 4, otherwise fully regulated handlers could elect partially regulated distributing plant status with respect to out-of-state milk, for which they would pay the plant's blend price, based on classified use.

The record reflects that out-of-state milk is not priced and pooled by the CSO because the State of California is prohibited from regulating interstate commerce. One benefit of Federal regulation is the ability to regulate the interstate marketing of milk, something that states are expressly prohibited from doing. FMMO provisions ensure that all milk servicing a market's Class I needs is appropriately classified and priced, and the producers who supply that milk share in the marketwide revenues from all Class I sales in the market.

A key feature of FMMOs is that producer milk is classified and priced at the plant where it is utilized, regardless of its source. Similarly situated handlers pay at least the class prices under each order, and producers are paid at least the order's minimum uniform blend price, determined through marketwide pooling. This allows producers to share equally in the classified use value of milk in the market, while minimizing uneconomic milk movements.

As explained earlier, this decision recommends that a California FMMO operate independent of the State's quota program. Under the recommended provisions, no quota premium would be subtracted from the FMMO pool, and all producers delivering to regulated pool plants under the order would be paid at least the same minimum producer blend price, less authorized deductions. Therefore, all producers are paid uniformly, as is allowed by the uniform payments provision of the AMAA.

Accordingly, this decision finds no justification for differential producer treatment for milk servicing California's Class I needs and produced outside the marketing area. If an out-of-state dairy farmer qualifies as a producer on the recommended California FMMO, then their milk will be priced and pooled uniformly with all other producers serving the Class I market.

9. Transportation Credits

Transportation credits were contained in both Proposals 1 and 2 to reimburse handlers for part of the cost of transporting milk to Class I and/or Class II use. This decision does not recommend transportation credit provisions for a California FMMO.

A witness appearing on behalf of the Cooperatives testified in support of the transportation credit provisions

[42] Official Notice is taken of Upper Midwest Final Decision (71 FR 54136), Central Final Decision (71 FR 54152), and Mideast Final Decision (71 FR 54172).

contained in Proposal 1. The witness said that transportation credits are needed because Class I differentials are not high enough to cover the cost of moving milk from the Central Valley where most of the milk is produced, to Class I distributing plants which are primarily located on the coast where most of the population resides.

The Cooperative witness utilized April 2013 to October 2014 CDFA hauling cost data of milk deliveries to plants with Class 1, 2 and/or 3 utilization, and compared it to the proposed California FMMO Class I differentials that would be applicable for comparable hauls. The witness said the average cost to haul a load of milk from a supply region to a demand region was $0.75 per cwt, with a range of $0.35 to $1.82 per cwt. According to the witness, in all instances, the difference in FMMO Class I differentials between the two locations was much less than the actual haul cost, therefore an additional cost recovery mechanism is needed to assure orderly movements of milk to Class I plants.

The witness explained that Proposal 1 contains transportation credit provisions similar to the current CSO where marketwide pool monies are used to provide a credit for farm-to-plant milk movements within designated transportation zones to handlers with greater than 50 percent Class 1, 2 and/or 3 utilization. The witness said that the transportation credit zones represent current market procurement patterns where transportation credit assistance is necessary, and a similar credit system should be incorporated into a California FMMO. The witness stressed that the proposed credits would be mileage and transaction based, with a reimbursement rate cap of 175 miles,[43] and a fuel cost adjustor. The witness noted that the transportation credit rate would be calculated on a per-farm basis. So one haul route could have more than one farm stop and each farm stop would be eligible individually for a transportation credit. In their post-hearing brief, the Cooperatives modified their proposal to allow for milk outside the marketing area to be eligible for transportation credits.

The Cooperative witness explained that their proposed reimbursement equations were a result of Cooperative members' transportation cost data analyzed by the Pacific Northwest FMMO office. The Cooperatives requested that the FMMO office analyze the data and determine cost equations based on actual observed costs, minus $0.30 per cwt which represents the a producer's responsibility for a local haul. The witness said that the resulting equations are valid because they calculated a $5.205 million payment which was close to the actual observed costs of $5.261 million. The witness explained that because diesel prices are a key variable cost to transportation, a monthly fuel cost adjustor is needed to ensure that the transportation credit provisions maintain an accurate reflection of costs. The witness noted that Proposal 1 does not contain transportation credit reimbursement for plant-to-plant milk movements.

The Cooperative witness elaborated that Proposal 1 seeks to pay all producers the same FMMO blend price, unadjusted for location. Therefore the incentive to supply milk to Class I plants is borne solely through their proposed transportation credit provisions. The witness said that because all producers share in the higher valued class uses, it is appropriate that they share in the cost of supplying and balancing those markets by using marketwide pool monies to provide a handler credit on those milk movements.

The Institute, in its post-hearing brief, expressed support for the transportation credit provisions contained in Proposal 1, subject to the transportation credits being adjusted for the difference in location differentials.

A witness representing Ponderosa testified that any proposed California FMMO should allow for transportation credits of out-of-state milk that serves the California Class I and/or Class II market. The witness explained that Ponderosa experiences high-transportation costs because they haul their milk approximately 280 miles to a southern California Class I plant. The witness was of the opinion that this milk should be eligible for transportation credits if it is serving the California fluid market.

Findings

The record of this proceeding reflects that the California fluid market is structured such that some handlers and cooperative associations rely on the current CSO transportation credit system to assist them in making an adequate milk supply available for fluid use. The record reveals that Los Angeles, San Francisco, San Diego and Sacramento metropolitan areas contain an overwhelming majority of the state's population as well as the Class I plants that service those areas. However, these plants must often source milk from milk production regions of the state located farther away. The record reveals that this supply/demand imbalance, coupled with flat producer pricing necessitated the development of the CSO transportation credits for milk deliveries from designated supply regions to Class 1, 2 and/or 3 handlers located in demand regions where a majority of the population resides. The Cooperatives designed their transportation credit proposal to replicate the transportation credits currently paid by the CSO on farm-to-plant milk shipments, but attempted to make the proposed system more transaction based.

As previously discussed, this decision does not recommend flat producer pricing. The record of this proceeding supports the finding that producer payments should be adjusted to reflect the applicable producer location adjustment for the handler location where their milk is received. Therefore, the incentive to producers to supply Class I plants is embodied within the proposed producer payment provisions. As in all FMMOs, producers are responsible for finding a market for their milk, and consequently bear the cost of transporting their milk to a plant. Therefore the record of this proceeding does not support reducing the producers' value of the marketwide pool through the payment of transportation credits to handlers. The proposed Class I differential structure provides for higher differentials in the major metropolitan areas of Los Angeles, San Diego, San Francisco, and Sacramento to incentivize movements of Class I milk. If additional monies are needed above minimum classified prices to supply Class I plants, marketplace principles should dictate the source and amount of those additional funds.

10. Miscellaneous and Administrative Provisions

This section discusses the various miscellaneous and administrative provisions that would be necessary to administer the proposed California FMMO. All current FMMOs contain administrative provisions that provide for the handler reporting dates, announcements by the Market Administrator, and payment dates that are necessary to administer the provisions of the FMMOs. A California FMMO likewise needs similar administrative provisions to ensure its proper administration. The provisions outlined below generally conform to provisions contained in the 10 current FMMOs with reporting and payment dates tailored to the California dairy market.

Handler Reports. Handlers subject to a California FMMO would be required to submit monthly reports detailing the

[43] The mileage rate cap was modified at the hearing to 175 miles.

sources and uses of milk and milk products so that market average use values, or uniform prices, could be determined and administered. Under a California FMMO, handler reports of receipts and utilization would be due by the 9th day following the end of the month. To ensure the minimum payments to producers are made in accordance with the terms of a California FMMO, handlers would need to report producer payroll by the 20th day following the end of the month to the Market Administrator.

Announcements by the Market Administrator. In the course of administering a California FMMO, the Market Administrator would be required to make several announcements each month with respect to classification, class prices and component prices, an ''equivalent price'' when necessary, and various producer prices. Under a California FMMO, the Market Administrator would make these announcements on or before the 14th day following the end of the month.

Producer-Settlement Fund. Handlers regulated by a California FMMO would be required to pay minimum class prices for the milk received from producers. These minimum values would be aggregated in a California FMMO marketwide pool so that producers could receive a uniform price, or blend price for their milk. The equalization of a handler's use value of milk and the uniform value would occur through the producer-settlement fund that would be established and administered by the Market Administrator.

The producer-settlement fund ensures that all handlers would be able to return the market blend price to producers whose milk was pooled under the order. Payments into the producer-settlement fund would be made each month by handlers whose total classified use value of milk exceeds the values of such milk calculated at the announced producer prices. In a California FMMO, handlers would be required to pay into the producer-settlement fund by the 16th day following the end of the month.

Payments out of the producer-settlement fund would be made each month to any handler whose use value is below the value of their milk at producer prices. Under a California FMMO, the Market Administrator would distribute payments from the producer-settlement fund by the 18th day following the end of the month. This transfer of funds would enable handlers with a classified use value of milk below the average for the market to pay their producers the same uniform price as handlers whose classified use value of milk exceeds the market average.

In view of the need to make timely payments to handlers from the producer-settlement fund, it is essential that money due to the fund is received by the due date. Accordingly, payment to the producer-settlement fund is considered made upon receipt of funds by the Market Administrator. Payment cannot be received on a non-business day. Therefore, if the due date for a payment, including a payment to or from the producer-settlement fund, falls on a Saturday, Sunday, or national holiday, the payment would not be due until the next business day.

Payments to Producers and Cooperative Associations. The AMAA states that handlers must pay the uniform price to all producers and producer associations. As under other FMMOs, a California FMMO would provide for proper deductions authorized by the producer in writing. Such authorized deductions would be those that are unrelated to the minimum value of milk in the transaction between the producer and handler. The proposed California FMMO would also allow a deduction for any assessment announced by CDFA for the administration of the California quota program. The producer would not need to authorize this deduction in writing.

As in other FMMOs, producer associations would be allowed to ''reblend'' their payments to their producer members. The Capper Volstead Act and the AMAA make it clear that cooperative associations are unique in this regard.

A California FMMO would require handlers to make at least one partial payment to producers in advance of the announcement of the applicable uniform prices. The partial payment rate for milk received during the first 15 days of the month could not be less than the lowest announced class price for the preceding month, and would be paid to producers by the last day of the month. The final payment for milk under a California FMMO would be required to be made so that it is received by producers no later than the 19th day after the end of the month.

Handlers would pay Cooperatives for bulk milk and skim milk, and for bulk milk received by transfer from a cooperative's pool plant, on the terms described for individual producers, with the exception that payment would be due one day earlier. An earlier payment date for cooperative associations is warranted because it would then give cooperative associations the time they need to distribute payments to individual producer members.

All payment dates specified in the proposed California FMMO are receipt dates. Since payment cannot be received on a non-business day, payment dates that fall on a Saturday, Sunday, or national holiday would be delayed until the next business day. While this has the effect of delaying payments to cooperatives and producers, the delay is offset by the shift from ''date of payment'' to ''date of payment receipt.''

Payment Obligation of a Partially Regulated Distributing Plant. All FMMOs provide a method for determining the payment obligations due to producers by handlers that operate plants not fully regulated under any Federal order. These unregulated handlers are not required to account to dairy farmers for their milk at classified prices or to return a minimum uniform price to producers who have supplied the handler with milk. However, such handlers may sell fluid milk products on routes in a regulated area in competition with handlers who are fully regulated. To address this, FMMOs provide a minimum degree of regulation to all handlers who have route sales in a regulated marketing area. Partial regulation preserves the integrity of the FMMO classified pricing and pooling provisions and assures that orderly marketing conditions can be maintained. Without these provisions, milk prices under an order would not be uniform among handlers competing for sales in the marketing area, a milk pricing requirement of the AMAA. Like the other FMMOs, a California FMMO would partially regulate handlers who have route sales into the marketing area, but do not meet the threshold to be fully regulated.

The proposed California FMMO would provide regulatory options for a partially regulated plant handler. All partially regulated plant handlers would account to the California FMMO producer-settlement fund on the volume of packaged Class I sales in the California marketing area that exceeds receipts previously priced as Class I under a FMMO. Under the first option, a payment could be made by the partially regulated plant handler into the producer-settlement fund of the California FMMO at a rate equal to the difference between the Class I price and the California FMMO uniform price. Under the second option, the operator of a partially regulated plant handler could pay any positive difference between the gross obligation of the plant, had it been fully regulated, and the actual payments made for its milk supply. This is commonly referred to as the Wichita

Option. The third option applies to a partially regulated plant handler that is subject to a marketwide pool operated under the authority of a State. In this last case, the partially regulated plant handler would account to the producer settlement fund at the difference between the Federal order Class I value and the value at which the handler accounts to the State order pool on such route sales, but not less than zero.

Adjustment of Accounts. Current FMMOs provide for the audit of handler reports by the Market Administrator. The Market Administrator may adjust, based on verification of handler records, any amount due to or from the Market Administrator, or to a producer or cooperative association. Adjustments can affect the Producer-Settlement Fund, the Administrative Fund, and/or the Marketing Service Fund. A California FMMO would likewise provide for the adjustment of handler accounts based on audits of handler reports and records. The Market Administrator would promptly notify the handler of any necessary adjustments so that payments could be made on or before the next date for the payment related to the adjustment.

Charges for Overdue Accounts. The proposed California FMMO provisions require handlers to make payments to producers and cooperatives by the dates described earlier in this section. Payments not made by the specified due dates would be subject to a late payment charge of 1 percent per month by the Market Administrator and would accrue to the administrative fund. Additional late payment charges would accrue on any amounts that continue to be late on the corresponding due dates each succeeding month.

Assessment of Order Administration. The AMAA provides that the cost of order administration be financed by an assessment on handlers. Under the proposed California FMMO, a maximum rate of $0.08 per cwt would apply to all of a handler's receipts pooled under the order. The specific rate would be announced by the Market Administrator. Partially-regulated handlers would be assessed the same administrative rate on their volume of Class I route disposition inside of the marketing area. The money paid to the administrative fund is each handler's proportionate share of the cost of administering the FMMO.

Deduction for Marketing Services. The proposed California FMMO would provide marketing services to producers for whom cooperative associations do not perform services. Such services include providing market information and establishing or verifying weights, samples, and tests of milk received from such producers. In accordance with the AMAA, these marketing services are intended to benefit all nonmember producers under a California FMMO. Accordingly, as is uniform in the current FMMOs, each handler regulated by a California FMMO would be allowed to deduct a maximum of $0.07 per cwt from amounts due each producer for whom a cooperative association does not provide such services. The specific allowable rate would be announced by the Market Administrator and would be subtracted from the handler's obligation.

Rulings on Proposed Findings and Conclusions. In accordance with the Administrative Procedure Act, 5 U.S.C. 557(c), USDA has analyzed and reached a conclusion on all material issues of facts, law, and discretion presented on the record. Briefs, proposed findings and conclusions, and the evidence in the record were considered in making the findings and conclusions set forth in this recommended decision. To the extent that the suggested findings and conclusions filed by interested persons are inconsistent with the findings and conclusions of this recommended decision, the requests to make such findings or reach such conclusions are denied for the reasons stated in this decision.

General Findings

(a) The proposed marketing agreement and order, and all of the terms and conditions thereof, will tend to effectuate the declared policy of the Act;

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

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

(d) All milk and milk products handled by handlers covered by the proposed marketing agreement and order are in the current of interstate commerce or directly burden, obstruct, or affect interstate commerce in milk or its products; and

(e) It is hereby found that the necessary expense of the market administrator for the maintenance and functioning of such agency will require the payment by each handler, as their pro rata share of such expense, 8 cents per hundredweight or such lesser amount as the Secretary may prescribe with respect to the milk specified in § 1051.85 of the aforesaid tentative marketing agreement and the order.

Recommended Marketing Agreement and Order

The recommended marketing agreement is not included in this decision because the regulatory provisions thereof would be the same as those contained in the order, as hereby proposed to be established. The following order regulating the handling of milk in California marketing area is recommended as the detailed and appropriate means by which the foregoing conclusions maybe carried out.

List of Subjects in 7 CFR Part 1051

Milk marketing orders.

The Agricultural Marketing Service proposes to add 7 CFR part 1051 to read as follows:

PART 1051—MILK IN THE CALIFORNIA MARKETING AREA

Subpart A—Order Regulating Handling

General Provisions

Sec.

Definitions

Market Administrator, Continuing Obligations, and Handler Responsibilities

Authority: 7 U.S.C. 601–608.

Subpart A—Order Regulating Handling

General Provisions

§ 1051.1 General provisions.

The terms, definitions, and provisions in part 1000 of this chapter apply to this part unless otherwise specified. In this part, all references to sections in part 1000 refer to part 1000 of this chapter.

Definitions

§ 1051.2 California marketing area.

The marketing area means all territory within the bounds of the following states and political subdivisions, including all piers, docks, and wharves connected therewith and all craft moored thereat, and all territory occupied by government (municipal, State, or Federal) reservations, installations, institutions, or other similar establishments if any part thereof is within any of the listed states or political subdivisions:

California

All of the State of California.

§ 1051.3 Route disposition.

See § 1000.3.

§ 1051.4 Plant.

See § 1000.4.

§ 1051.5 Distributing plant.

See § 1000.5.

§ 1051.6 Supply plant.

See § 1000.6.

§ 1051.7 Pool plant.

Pool plant means a plant, unit of plants, or system of plants as specified in paragraphs (a) through (f) of this section, but excluding a plant specified in paragraph (h) of this section. The pooling standards described in paragraphs (c) and (f) of this section are subject to modification pursuant to paragraph (g) of this section:

(a) A distributing plant, other than a plant qualified as a pool plant pursuant to paragraph (b) of this section or § ______.7(b) of any other Federal milk order, from which during the month 25 percent or more of the total quantity of fluid milk products physically received at the plant (excluding concentrated milk received from another plant by agreement for other than Class I use) are disposed of as route disposition or are transferred in the form of packaged fluid milk products to other distributing plants. At least 25 percent of such route disposition and transfers must be to outlets in the marketing area.

(b) Any distributing plant located in the marketing area which during the month processed at least 25 percent of the total quantity of fluid milk products physically received at the plant (excluding concentrated milk received from another plant by agreement for other than Class I use) into ultra-pasteurized or aseptically-processed fluid milk products.

(c) A supply plant from which the quantity of bulk fluid milk products shipped to (and physically unloaded into) plants described in paragraph (c)(1) of this section is not less than 10 percent of the Grade A milk received from dairy farmers (except dairy farmers described in § 1051.12(b)) and handlers described in § 1000.9(c), including milk diverted pursuant to § 1051.13, subject to the following conditions:

(1) Qualifying shipments may be made to plants described in paragraphs (c)(1)(i) through (iv) of this section, except that whenever shipping requirements are increased pursuant to paragraph (g) of this section, only shipments to pool plants described in paragraphs (a), (b), and (d) of this section shall count as qualifying shipments for the purpose of meeting the increased shipments:

(i) Pool plants described in § 1051.7(a), (b), and (d);

(ii) Plants of producer-handlers;

(iii) Partially regulated distributing plants, except that credit for such shipments shall be limited to the amount of such milk classified as Class I at the transferee plant; and

(iv) Distributing plants fully regulated under other Federal orders, except that credit for shipments to such plants shall be limited to the quantity shipped to (and physically unloaded into) pool distributing plants during the month and credits for shipments to other order plants shall not include any such shipments made on the basis of agreed-upon Class II, Class III, or Class IV utilization.

(2) Concentrated milk transferred from the supply plant to a distributing plant for an agreed-upon use other than Class I shall be excluded from the supply plant's shipments in computing the supply plant's shipping percentage.

(d) Two or more plants operated by the same handler and located in the marketing area may qualify for pool status as a unit by meeting the total and in-area route disposition requirements of a pool distributing plant specified in paragraph (a) of this section and subject to the following additional requirements:

(1) At least one of the plants in the unit must qualify as a pool plant pursuant to paragraph (a) of this section;

(2) Other plants in the unit must process Class I or Class II products, using 50 percent or more of the total Grade A fluid milk products received in bulk form at such plant or diverted therefrom by the plant operator in Class I or Class II products; and

(3) The operator of the unit has filed a written request with the market administrator prior to the first day of the month for which such status is desired to be effective. The unit shall continue from month-to-month thereafter without

further notification. The handler shall notify the market administrator in writing prior to the first day of any month for which termination or any change of the unit is desired.

(e) A system of two or more supply plants operated by one or more handlers may qualify for pooling by meeting the shipping requirements of paragraph (c) of this section in the same manner as a single plant subject to the following additional requirements:

(1) Each plant in the system is located within the marketing area. Cooperative associations or other handlers may not use shipments pursuant to § 1000.9(c) to qualify supply plants located outside the marketing area;

(2) The handler(s) establishing the system submits a written request to the market administrator on or before July 15 requesting that such plants qualify as a system for the period of August through July of the following year. Such request will contain a list of the plants participating in the system in the order, beginning with the last plant, in which the plants will be dropped from the system if the system fails to qualify. Each plant that qualifies as a pool plant within a system shall continue each month as a plant in the system through the following July unless the handler(s) establishing the system submits a written request to the market administrator that the plant be deleted from the system or that the system be discontinued. Any plant that has been so deleted from a system, or that has failed to qualify in any month, will not be part of any system for the remaining months through July. The handler(s) that have established a system may add a plant operated by such handler(s) to a system if such plant has been a pool plant each of the 6 prior months and would otherwise be eligible to be in a system, upon written request to the market administrator no later than the 15th day of the prior month. In the event of an ownership change or the business failure of a handler who is a participant in a system, the system may be reorganized to reflect such changes if a written request to file a new marketing agreement is submitted to the market administrator; and

(3) If a system fails to qualify under the requirements of this paragraph (e), the handler responsible for qualifying the system shall notify the market administrator which plant or plants will be deleted from the system so that the remaining plants may be pooled as a system. If the handler fails to do so, the market administrator shall exclude one or more plants, beginning at the bottom of the list of plants in the system and continuing up the list as necessary until the deliveries are sufficient to qualify the remaining plants in the system.

(f) Any distributing plant, located within the marketing area as described in § 1051.2:

(1) From which there is route disposition and/or transfers of packaged fluid milk products in any non-federally regulated marketing area(s) located within one or more States that require handlers to pay minimum prices for raw milk, provided that 25 percent or more of the total quantity of fluid milk products physically received at such plant (excluding concentrated milk received from another plant by agreement for other than Class 1 use) is disposed of as route disposition and/or is transferred in the form of packaged fluid milk products to other plants. At least 25 percent of such route disposition and/or transfers, in aggregate, are in any non-federally regulated marketing area(s) located within one or more States that require handlers to pay minimum prices for raw milk. Subject to the following exclusions:

(i) The plant is described in § 1051.7(a), (b), or (e);

(ii) The plant is subject to the pricing provisions of a State-operated milk pricing plan which provides for the payment of minimum class prices for raw milk;

(iii) The plant is described in § 1000.8(a) or (e); or

(iv) A producer-handler described in § 1051.10 with less than three million pounds during the month of route disposition and/or transfers of packaged fluid milk products to other plants.

(2) [Reserved]

(g) The applicable shipping percentages of paragraphs (c) and (e) of this section and § 1051.13(d)(2) and (3) may be increased or decreased, for all or part of the marketing area, by the market administrator if the market administrator finds that such adjustment is necessary to encourage needed shipments or to prevent uneconomic shipments. Before making such a finding, the market administrator shall investigate the need for adjustment either on the market administrator's own initiative or at the request of interested parties if the request is made in writing at least 15 days prior to the month for which the requested revision is desired effective. If the investigation shows that an adjustment of the shipping percentages might be appropriate, the market administrator shall issue a notice stating that an adjustment is being considered and invite data, views, and arguments. Any decision to revise an applicable shipping or diversion percentage must be issued in writing at least one day before the effective date.

(h) The term pool plant shall not apply to the following plants:

(1) A producer-handler as defined under any Federal order;

(2) An exempt plant as defined in § 1000.8(e);

(3) A plant located within the marketing area and qualified pursuant to paragraph (a) of this section which meets the pooling requirements of another Federal order, and from which more than 50 percent of its route disposition has been in the other Federal order marketing area for 3 consecutive months;

(4) A plant located outside any Federal order marketing area and qualified pursuant to paragraph (a) of this section that meets the pooling requirements of another Federal order and has had greater route disposition in such other Federal order's marketing area for 3 consecutive months;

(5) A plant located in another Federal order marketing area and qualified pursuant to paragraph (a) of this section that meets the pooling requirements of such other Federal order and does not have a majority of its route disposition in this marketing area for 3 consecutive months, or if the plant is required to be regulated under such other Federal order without regard to its route disposition in any other Federal order marketing area;

(6) A plant qualified pursuant to paragraph (c) of this section which also meets the pooling requirements of another Federal order and from which greater qualifying shipments are made to plants regulated under the other Federal order than are made to plants regulated under the order in this part, or the plant has automatic pooling status under the other Federal order; and

(7) That portion of a regulated plant designated as a nonpool plant that is physically separate and operated separately from the pool portion of such plant. The designation of a portion of a regulated plant as a nonpool plant must be requested in advance and in writing by the handler and must be approved by the market administrator.

(i) Any plant that qualifies as a pool plant in each of the immediately preceding 3 months pursuant to paragraph (a) of this section or the shipping percentages in paragraph (c) of this section that is unable to meet such performance standards for the current month because of unavoidable circumstances determined by the market administrator to be beyond the control of the handler operating the plant, such as a natural disaster (ice storm, wind storm, flood, fire, earthquake, breakdown of equipment, or work stoppage, shall be considered to have met the minimum performance standards during the period of such unavoidable circumstances, but such relief shall not be granted for more than 2 consecutive months.

§ 1051.8 Nonpool plant.

See § 1000.8.

§ 1051.9 Handler.

See § 1000.9.

§ 1051.10 Producer-handler.

Producer-handler means a person who operates a dairy farm and a distributing plant from which there is route disposition in the marketing area, from which total route disposition and packaged sales of fluid milk products to other plants during the month does not exceed 3 million pounds, and who the market administrator has designated a producer-handler after determining that all of the requirements of this section have been met.

(a) *Requirements for designation.* Designation of any person as a producer-handler by the market administrator shall be contingent upon meeting the conditions set forth in paragraphs (a)(1) through (5) of this section. Following the cancellation of a previous producer-handler designation, a person seeking to have their producer-handler designation reinstated must demonstrate that these conditions have been met for the preceding month:

(1) The care and management of the dairy animals and the other resources and facilities designated in paragraph (b)(1) of this section necessary to produce all Class I milk handled (excluding receipts from handlers fully regulated under any Federal order) are under the complete and exclusive control, ownership, and management of the producer-handler and are operated as the producer-handler's own enterprise and at its sole risk.

(2) The plant operation designated in paragraph (b)(2) of this section at which the producer-handler processes and packages, and from which it distributes, its own milk production is under the complete and exclusive control, ownership, and management of the producer-handler and is operated as the producer-handler's own enterprise and at its sole risk.

(3) The producer-handler neither receives at its designated milk production resources and facilities nor receives, handles, processes, or distributes at or through any of its designated milk handling, processing, or distributing resources and facilities other source milk products for reconstitution into fluid milk products or fluid milk products derived from any source other than:

(i) Its designated milk production resources and facilities (own farm production);

(ii) Pool handlers and plants regulated under any Federal order within the limitation specified in paragraph (c)(2) of this section; or

(iii) Nonfat milk solids which are used to fortify fluid milk products.

(4) The producer-handler is neither directly nor indirectly associated with the business control or management of, nor has a financial interest in, another handler's operation; nor is any other handler so associated with the producer-handler's operation.

(5) No milk produced by the herd(s) or on the farm(s) that supplies milk to the producer-handler's plant operation is:

(i) Subject to inclusion and participation in a marketwide equalization pool under a milk classification and pricing program under the authority of a State government maintaining marketwide pooling of returns; or

(ii) Marketed in any part as Class I milk to the non-pool distributing plant of any other handler.

(b) *Designation of resources and facilities.* Designation of a person as a producer-handler shall include the determination of what shall constitute milk production, handling, processing, and distribution resources and facilities, all of which shall be considered an integrated operation, under the sole and exclusive ownership of the producer-handler.

(1) Milk production resources and facilities shall include all resources and facilities (milking herd(s), buildings housing such herd(s), and the land on which such buildings are located) used for the production of milk which are solely owned, operated, and which the producer-handler has designated as a source of milk supply for the producer-handler's plant operation. However, for purposes of this paragraph (b)(1), any such milk production resources and facilities which do not constitute an actual or potential source of milk supply for the producer-handler's operation shall not be considered a part of the producer-handler's milk production resources and facilities.

(2) Milk handling, processing, and distribution resources and facilities shall include all resources and facilities (including store outlets) used for handling, processing, and distributing fluid milk products which are solely owned by, and directly operated or controlled by the producer-handler or in which the producer-handler in any way has an interest, including any contractual arrangement, or over which the producer-handler directly or indirectly exercises any degree of management control.

(3) All designations shall remain in effect until canceled pursuant to paragraph (c) of this section.

(c) *Cancellation.* The designation as a producer-handler shall be canceled upon determination by the market administrator that any of the requirements of paragraph (a)(1) through (5) of this section are not continuing to be met, or under any of the conditions described in paragraph (c)(1), (2), or (3) of this section. Cancellation of a producer-handler's status pursuant to this paragraph (c) shall be effective on the first day of the month following the month in which the requirements were not met or the conditions for cancellation occurred.

(1) Milk from the milk production resources and facilities of the producer-handler, designated in paragraph (b)(1) of this section, is delivered in the name of another person as producer milk to another handler.

(2) The producer-handler handles fluid milk products derived from sources other than the milk production facilities and resources designated in paragraph (b)(1) of this section, except that it may receive at its plant, or acquire for route disposition, fluid milk products from fully regulated plants and handlers under any Federal order if such receipts do not exceed 150,000 pounds monthly. This limitation shall not apply if the producer-handler's own-farm production is less than 150,000 pounds during the month.

(3) Milk from the milk production resources and facilities of the producer-handler is subject to inclusion and participation in a marketwide equalization pool under a milk classification and pricing plan operating under the authority of a State government.

(d) *Public announcement.* The market administrator shall publicly announce:

(1) The name, plant location(s), and farm location(s) of persons designated as producer-handlers;

(2) The names of those persons whose designations have been cancelled; and

(3) The effective dates of producer-handler status or loss of producer-handler status for each. Such announcements shall be controlling with respect to the accounting at plants of other handlers for fluid milk products received from any producer-handler.

(e) *Burden of establishing and maintaining producer-handler status.* The burden rests upon the handler who is designated as a producer-handler to establish through records required pursuant to § 1000.27 that the requirements set forth in paragraph (a) of this section have been and are continuing to be met, and that the conditions set forth in paragraph (c) of this section for cancellation of the designation do not exist.

(f) Any producer-handler with Class I route dispositions and/or transfers of packaged fluid milk products in the marketing area described in § 1131.2 of this chapter shall be subject to payments into the Order 1131 producer settlement fund on such dispositions pursuant to § 1000.76(a) and payments into the Order 1131 administrative fund, provided such dispositions are less than three million pounds in the current month and such producer-handler had total Class I route dispositions and/or transfers of packaged fluid milk products from own farm production of three million pounds or more the previous month. If the producer-handler has Class I route dispositions and/or transfers of packaged fluid milk products into the marketing area described in § 1131.2 of this chapter of three million pounds or more during the current month, such producer-handler shall be subject to the provisions described in § 1131.7 of this chapter or § 1000.76(a).

§ 1051.11 California quota program.

California Quota Program means the applicable provisions of the California Food and Agriculture Code, and related provisions of the pooling plan administered by the California Department of Food and Agriculture (CDFA).

§ 1051.12 Producer.

(a) Except as provided in paragraph (b) of this section, *producer* means any person who produces milk approved by a duly constituted regulatory agency for fluid consumption as Grade A milk and whose milk is:

(1) Received at a pool plant directly from the producer or diverted by the plant operator in accordance with § 1051.13; or

(2) Received by a handler described in § 1000.9(c).

(b) Producer shall not include:

(1) A producer-handler as defined in any Federal order;

(2) A dairy farmer whose milk is received at an exempt plant, excluding producer milk diverted to the exempt plant pursuant to § 1051.13(d);

(3) A dairy farmer whose milk is received by diversion at a pool plant from a handler regulated under another Federal order if the other Federal order designates the dairy farmer as a producer under that order and that milk is allocated by request to a utilization other than Class I; and

(4) A dairy farmer whose milk is reported as diverted to a plant fully regulated under another Federal order with respect to that portion of the milk so diverted that is assigned to Class I under the provisions of such other order.

§ 1051.13 Producer milk.

Except as provided for in paragraph (e) of this section, *producer milk* means the skim milk (or the skim equivalent of components of skim milk), including nonfat components, and butterfat in milk of a producer that is:

(a) Received by the operator of a pool plant directly from a producer or a handler described in § 1000.9(c). All milk received pursuant to this paragraph (a) shall be priced at the location of the plant where it is first physically received;

(b) Received by a handler described in § 1000.9(c) in excess of the quantity delivered to pool plants;

(c) Diverted by a pool plant operator to another pool plant. Milk so diverted shall be priced at the location of the plant to which diverted; or

(d) Diverted by the operator of a pool plant or a cooperative association described in § 1000.9(c) to a nonpool plant located in the States of California, Arizona, Nevada, or Oregon, subject to the following conditions:

(1) Milk of a dairy farmer shall not be eligible for diversion unless at least one day's production of such dairy farmer is physically received as producer milk at a pool plant during the first month the dairy farmer is a producer. If a dairy farmer loses producer status under the order in this part (except as a result of a temporary loss of Grade A approval or as a result of the handler of the dairy farmer's milk failing to pool the milk under any order), the dairy farmer's milk shall not be eligible for diversion unless at least one day's production of the dairy farmer has been physically received as producer milk at a pool plant during the first month the dairy farmer is re-associated with the market;

(2) The quantity of milk diverted by a handler described in § 1000.9(c) may not exceed 90 percent of the producer milk receipts reported by the handler pursuant to § 1051.30(c) provided that not less than 10 percent of such receipts are delivered to plants described in § 1051.7(c)(1)(i) through (iii). These percentages are subject to any adjustments that may be made pursuant to § 1051.7(g); and

(3) The quantity of milk diverted to nonpool plants by the operator of a pool plant described in § 1051.7(a), (b) or (d) may not exceed 90 percent of the Grade A milk received from dairy farmers (except dairy farmers described in § 1051.12(b)) including milk diverted pursuant to this section. These percentages are subject to any adjustments that may be made pursuant to § 1051.7(g).

(4) Diverted milk shall be priced at the location of the plant to which diverted.

(e) Producer milk shall not include milk of a producer that is subject to inclusion and participation in a marketwide equalization pool under a milk classification and pricing program imposed under the authority of a State government maintaining marketwide pooling of returns.

(f) The quantity of milk reported by a handler pursuant to either § 1051.30(a)(1) or (c)(1) for April through February may not exceed 125 percent, and for March may not exceed 135 percent, of the producer milk receipts pooled by the handler during the prior month. Milk diverted to nonpool plants reported in excess of this limit shall be removed from the pool. Milk in excess of this limit received at pool plants, other than pool distributing plants, shall be classified pursuant to § 1000.44(a)(3)(v) and (b). The handler must designate, by producer pick-up, which milk is to be removed from the pool. If the handler fails to provide this information, the market administrator will make the determination. The following provisions apply:

(1) Milk shipped to and physically received at pool distributing plants in excess of the previous month's pooled volume shall not be subject to the 125 or 135 percent limitation;

(2) Producer milk qualified pursuant to § ______.13 of any other Federal Order and continuously pooled in any Federal Order for the previous six months shall not be included in the computation of the 125 or 135 percent limitation;

(3) The market administrator may waive the 125 or 135 percent limitation:

(i) For a new handler on the order, subject to the provisions of paragraph (f)(4) of this section; or

(ii) For an existing handler with significantly changed milk supply conditions due to unusual circumstances; and

(4) A bloc of milk may be considered ineligible for pooling if the market administrator determines that handlers altered the reporting of such milk for the

purpose of evading the provisions of this paragraph (f).

§ 1051.14 Other source milk.

See § 1000.14.

§ 1051.15 Fluid milk products.

See § 1000.15.

§ 1051.16 Fluid cream product.

See § 1000.16.

§ 1051.17 [Reserved]

§ 1051.18 Cooperative association.

See § 1000.18.

§ 1051.19 Commercial food processing establishment.

See § 1000.19.

Market Administrator, Continuing Obligations, and Handler Responsibilities

§ 1051.25 Market administrator.

See § 1000.25.

§ 1051.26 Continuity and separability of provisions.

See § 1000.26.

§ 1051.27 Handler responsibility for records and facilities.

See § 1000.27.

§ 1051.28 Termination of obligations.

See § 1000.28.

Handler Reports

§ 1051.30 Reports of receipts and utilization.

Each handler shall report monthly so that the market administrator's office receives the report on or before the 9th day after the end of the month, in the detail and on the prescribed forms, as follows:

(a) Each handler that operates a pool plant shall report for each of its operations the following information:

(1) Product pounds, pounds of butterfat, pounds of protein, pounds of solids-not-fat other than protein (other solids) contained in or represented by:

(i) Receipts of producer milk, including producer milk diverted by the reporting handler, from sources other than handlers described in § 1000.9(c); and

(ii) Receipts of milk from handlers described in § 1000.9(c);

(2) Product pounds and pounds of butterfat contained in:

(i) Receipts of fluid milk products and bulk fluid cream products from other pool plants;

(ii) Receipts of other source milk; and

(iii) Inventories at the beginning and end of the month of fluid milk products and bulk fluid cream products;

(3) The utilization or disposition of all milk and milk products required to be reported pursuant to this paragraph (a); and

(4) Such other information with respect to the receipts and utilization of skim milk, butterfat, milk protein, and other nonfat solids as the market administrator may prescribe.

(b) Each handler operating a partially regulated distributing plant shall report with respect to such plant in the same manner as prescribed for reports required by paragraph (a) of this section. Receipts of milk that would have been producer milk if the plant had been fully regulated shall be reported in lieu of producer milk. The report shall show also the quantity of any reconstituted skim milk in route disposition in the marketing area.

(c) Each handler described in § 1000.9(c) shall report:

(1) The product pounds, pounds of butterfat, pounds of protein, pounds of solids-not-fat other than protein (other solids) contained in receipts of milk from producers; and

(2) The utilization or disposition of such receipts.

(d) Each handler not specified in paragraphs (a) through (c) of this section shall report with respect to its receipts and utilization of milk and milk products in such manner as the market administrator may prescribe.

§ 1051.31 Payroll reports.

(a) On or before the 20th day after the end of each month, each handler that operates a pool plant pursuant to § 1051.7 and each handler described in § 1000.9(c) shall report to the market administrator its producer payroll for the month, in the detail prescribed by the market administrator, showing for each producer the information described in § 1051.73(f).

(b) Each handler operating a partially regulated distributing plant who elects to make payment pursuant to § 1000.76(b) shall report for each dairy farmer who would have been a producer if the plant had been fully regulated in the same manner as prescribed for reports required by paragraph (a) of this section.

§ 1051.32 Other reports.

In addition to the reports required pursuant to §§ 1051.30 and 1051.31, each handler shall report any information the market administrator deems necessary to verify or establish each handler's obligation under the order.

Subpart B—Milk Pricing

Classification of Milk

§ 1051.40 Classes of utilization.

See § 1000.40.

§ 1051.41 [Reserved]

§ 1051.42 Classification of transfers and diversions.

See § 1000.42.

§ 1051.43 General classification rules.

See § 1000.43.

§ 1051.44 Classification of producer milk.

See § 1000.44.

§ 1051.45 Market administrator's reports and announcements concerning classification.

See § 1000.45.

Class Prices

§ 1051.50 Class prices, component prices, and advanced pricing factors.

See § 1000.50.

§ 1051.51 Class I differential and price.

The Class I differential shall be the differential established for Los Angeles County, California, which is reported in § 1000.52. The Class I price shall be the price computed pursuant to § 1000.50(a) for Los Angeles County, California.

§ 1051.52 Adjusted Class I differentials.

See § 1000.52.

§ 1051.53 Announcement of class prices, component prices, and advanced pricing factors.

See § 1000.53.

§ 1051.54 Equivalent price.

See § 1000.54.

Producer Price Differential

§ 1051.60 Handler's value of milk.

For the purpose of computing a handler's obligation for producer milk, the market administrator shall determine for each month the value of milk of each handler with respect to each of the handler's pool plants and of each handler described in § 1000.9(c) with respect to milk that was not received at a pool plant by adding the amounts computed in paragraphs (a) through (h) of this section and subtracting from that total amount the values computed in paragraphs (i) and (j) of this section. Unless otherwise specified, the skim milk, butterfat, and the combined pounds of skim milk and butterfat referred to in this section shall result from the steps set forth in § 1000.44(a), (b), and (c), respectively, and the nonfat components of producer milk in each class shall be based upon the proportion of such components in producer skim milk. Receipts of nonfluid milk products that are distributed as labeled reconstituted milk for which payments are made to the producer-settlement fund of another Federal order under § 1000.76(a)(4) or (d) shall be excluded from pricing under this section.

(a) Class I value.

(1) Multiply the hundredweight of skim milk in Class I by the Class I skim milk price; and

(2) Add an amount obtained by multiplying the pounds of butterfat in Class I by the Class I butterfat price; and

(b) Class II value.

(1) Multiply the pounds of nonfat solids in Class II skim milk by the Class II nonfat solids price; and

(2) Add an amount obtained by multiplying the pounds of butterfat in Class II times the Class II butterfat price.

(c) Class III value.

(1) Multiply the pounds of protein in Class III skim milk by the protein price;

(2) Add an amount obtained by multiplying the pounds of other solids in Class III skim milk by the other solids price; and

(3) Add an amount obtained by multiplying the pounds of butterfat in Class III by the butterfat price.

(d) Class IV value.

(1) Multiply the pounds of nonfat solids in Class IV skim milk by the nonfat solids price; and

(2) Add an amount obtained by multiplying the pounds of butterfat in Class IV by the butterfat price.

(e) Multiply the pounds of skim milk and butterfat overage assigned to each class pursuant to § 1000.44(a)(11) and the corresponding step of § 1000.44(b) by the skim milk prices and butterfat prices applicable to each class.

(f) Multiply the difference between the current month's Class I, II, or III price, as the case may be, and the Class IV price for the preceding month and by the hundredweight of skim milk and butterfat subtracted from Class I, II, or III, respectively, pursuant to § 1000.44(a)(7) and the corresponding step of § 1000.44(b).

(g) Multiply the difference between the Class I price applicable at the location of the pool plant and the Class IV price by the hundredweight of skim milk and butterfat assigned to Class I pursuant to § 1000.43(d) and the hundredweight of skim milk and butterfat subtracted from Class I pursuant to § 1000.44(a)(3)(i) through (vi) and the corresponding step of § 1000.44(b), excluding receipts of bulk fluid cream products from plants regulated under other Federal orders and bulk concentrated fluid milk products from pool plants, plants regulated under other Federal orders, and unregulated supply plants.

(h) Multiply the difference between the Class I price applicable at the location of the nearest unregulated supply plants from which an equivalent volume was received and the Class III price by the pounds of skim milk and butterfat in receipts of concentrated fluid milk products assigned to Class I pursuant to §§ 1000.43(d) and 1000.44(a)(3)(i) and the corresponding step of § 1000.44(b) and the pounds of skim milk and butterfat subtracted from Class I pursuant to § 1000.44(a)(8) and the corresponding step of § 1000.44(b), excluding such skim milk and butterfat in receipts of fluid milk products from an unregulated supply plant to the extent that an equivalent amount of skim milk or butterfat disposed of to such plant by handlers fully regulated under any Federal milk order is classified and priced as Class I milk and is not used as an offset for any other payment obligation under any order.

(i) For reconstituted milk made from receipts of nonfluid milk products, multiply $1.00 (but not more than the difference between the Class I price applicable at the location of the pool plant and the Class IV price) by the hundredweight of skim milk and butterfat contained in receipts of nonfluid milk products that are allocated to Class I use pursuant to § 1000.43(d).

§ 1051.61 Computation of producer price differential.

For each month the market administrator shall compute a producer price differential per hundredweight. The report of any handler who has not made payments required pursuant to § 1051.71 for the preceding month shall not be included in the computation of the producer price differential, and such handler's report shall not be included in the computation for succeeding months until the handler has made full payment of outstanding monthly obligations. Subject to the conditions of this introductory paragraph, the market administrator shall compute the producer price differential in the following manner:

(a) Combine into one total the values computed pursuant to § 1051.60 for all handlers required to file reports prescribed in § 1051.30;

(b) Subtract the total values obtained by multiplying each handler's total pounds of protein, other solids, and butterfat contained in the milk for which an obligation was computed pursuant to § 1051.60 by the protein price, other solids price, and the butterfat price, respectively;

(c) Add an amount equal to the minus location adjustments and subtract an amount equal to the plus location adjustments computed pursuant to § 1051.75;

(d) Add an amount equal to not less than one-half of the unobligated balance in the producer-settlement fund;

(e) Divide the resulting amount by the sum of the following for all handlers included in these computations:

(1) The total hundredweight of producer milk; and

(2) The total hundredweight for which a value is computed pursuant to § 1051.60(i); and

(f) Subtract not less than 4 cents nor more than 5 cents from the price computed pursuant to paragraph (e) of this section. The result shall be known as the producer price differential for the month.

§ 1051.62 Announcement of producer prices.

On or before the 14th day after the end of each month, the market administrator shall announce publicly the following prices and information:

(a) The producer price differential;

(b) The protein price;

(c) The nonfat solids price;

(d) The other solids price;

(e) The butterfat price;

(f) The average butterfat, nonfat solids, protein and other solids content of producer milk; and

(g) The statistical uniform price for milk containing 3.5 percent butterfat, computed by combining the Class III price and the producer price differential.

Subpart C—Payments for Milk

Producer Payments

§ 1051.70 Producer-settlement fund.

See § 1000.70.

§ 1051.71 Payments to the producer-settlement fund.

Each handler shall make payment to the producer-settlement fund in a manner that provides receipt of the funds by the market administrator no later than the 16th day after the end of the month (except as provided in § 1000.90). Payment shall be the amount, if any, by which the amount specified in paragraph (a) of this section exceeds the amount specified in paragraph (b) of this section:

(a) The total value of milk to the handler for the month as determined pursuant to § 1051.60.

(b) The sum of:

(1) An amount obtained by multiplying the total hundredweight of

producer milk as determined pursuant to § 1000.44(c) by the producer price differential as adjusted pursuant to § 1051.75;

(2) An amount obtained by multiplying the total pounds of protein, other solids, and butterfat contained in producer milk by the protein, other solids, and butterfat prices respectively; and

(3) An amount obtained by multiplying the pounds of skim milk and butterfat for which a value was computed pursuant to § 1051.60(i) by the producer price differential as adjusted pursuant to § 1051.75 for the location of the plant from which received.

§ 1051.72 Payments from the producer-settlement fund.

No later than the 18th day after the end of each month (except as provided in § 1000.90), the market administrator shall pay to each handler the amount, if any, by which the amount computed pursuant to § 1051.71(b) exceeds the amount computed pursuant to § 1051.71(a). If, at such time, the balance in the producer-settlement fund is insufficient to make all payments pursuant to this section, the market administrator shall reduce uniformly such payments and shall complete the payments as soon as the funds are available.

§ 1051.73 Payments to producers and to cooperative associations.

(a) Each handler shall pay each producer for producer milk for which payment is not made to a cooperative association pursuant to paragraph (b) of this section, as follows:

(1) *Partial payment.* For each producer who has not discontinued shipments as of the date of this partial payment, payment shall be made so that it is received by each producer on or before the last day of the month (except as provided in § 1000.90) for milk received during the first 15 days of the month from the producer at not less than the lowest announced class price for the preceding month, less proper deductions authorized in writing by the producer.

(2) *Final payment.* For milk received during the month, payment shall be made so that it is received by each producer no later than the 19th day after the end of the month (except as provided in § 1000.90) in an amount not less than the sum of:

(i) The hundredweight of producer milk received times the producer price differential for the month as adjusted pursuant to § 1051.75;

(ii) The pounds of butterfat received times the butterfat price for the month;

(iii) The pounds of protein received times the protein price for the month;

(iv) The pounds of other solids received times the other solids price for the month;

(v) Less any payment made pursuant to paragraph (a)(1) of this section;

(vi) Less proper deductions authorized in writing by such producer, and plus or minus adjustments for errors in previous payments to such producer subject to approval by the market administrator;

(vii) Less deductions for marketing services pursuant to § 1000.86; and

(viii) Less deductions authorized by CDFA for the California Quota Program pursuant to § 1051.11.

(b) *Payments for milk received from cooperative association members.* On or before the day prior to the dates specified in paragraphs (a)(1) and (2) of this section (except as provided in § 1000.90), each handler shall pay to a cooperative association for milk from producers who market their milk through the cooperative association and who have authorized the cooperative to collect such payments on their behalf an amount equal to the sum of the individual payments otherwise payable for such producer milk pursuant to paragraphs (a)(1) and (2) of this section.

(c) *Payment for milk received from cooperative association pool plants or from cooperatives as handlers pursuant to § 1000.9(c).* On or before the day prior to the dates specified in paragraphs (a)(1) and (2) of this section (except as provided in § 1000.90), each handler who receives fluid milk products at its plant from a cooperative association in its capacity as the operator of a pool plant or who receives milk from a cooperative association in its capacity as a handler pursuant to § 1000.9(c), including the milk of producers who are not members of such association and who the market administrator determines have authorized the cooperative association to collect payment for their milk, shall pay the cooperative for such milk as follows:

(1) For bulk fluid milk products and bulk fluid cream products received from a cooperative association in its capacity as the operator of a pool plant and for milk received from a cooperative association in its capacity as a handler pursuant to § 1000.9(c) during the first 15 days of the month, at not less than the lowest announced class prices per hundredweight for the preceding month;

(2) For the total quantity of bulk fluid milk products and bulk fluid cream products received from a cooperative association in its capacity as the operator of a pool plant, at not less than the total value of such products received from the association's pool plants, as determined by multiplying the respective quantities assigned to each class under § 1000.44, as follows:

(i) The hundredweight of Class I skim milk times the Class I skim milk price for the month plus the pounds of Class I butterfat times the Class I butterfat price for the month. The Class I price to be used shall be that price effective at the location of the receiving plant;

(ii) The pounds of nonfat solids in Class II skim milk by the Class II nonfat solids price;

(iii) The pounds of butterfat in Class II times the Class II butterfat price;

(iv) The pounds of nonfat solids in Class IV times the nonfat solids price;

(v) The pounds of butterfat in Class III and Class IV milk times the butterfat price;

(vi) The pounds of protein in Class III milk times the protein price;

(vii) The pounds of other solids in Class III milk times the other solids price; and

(vii) Add together the amounts computed in paragraphs (c)(2)(i) through (vii) of this section and from that sum deduct any payment made pursuant to paragraph (c)(1) of this section; and

(3) For the total quantity of milk received during the month from a cooperative association in its capacity as a handler under § 1000.9(c) as follows:

(i) The hundredweight of producer milk received times the producer price differential as adjusted pursuant to § 1051.75;

(ii) The pounds of butterfat received times the butterfat price for the month;

(iii) The pounds of protein received times the protein price for the month;

(iv) The pounds of other solids received times the other solids price for the month; and

(v) Add together the amounts computed in paragraphs (c)(3)(i) through (v) of this section and from that sum deduct any payment made pursuant to paragraph (c)(1) of this section.

(d) If a handler has not received full payment from the market administrator pursuant to § 1051.72 by the payment date specified in paragraph (a), (b), or (c) of this section, the handler may reduce pro rata its payments to producers or to the cooperative association (with respect to receipts described in paragraph (b) of this section, prorating the underpayment to the volume of milk received from the cooperative association in proportion to the total milk received from producers by the handler), but not by more than the amount of the underpayment. The payments shall be completed on the next scheduled payment date after receipt of the balance due from the market administrator.

(e) If a handler claims that a required payment to a producer cannot be made because the producer is deceased or cannot be located, or because the cooperative association or its lawful successor or assignee is no longer in existence, the payment shall be made to the producer-settlement fund, and in the event that the handler subsequently locates and pays the producer or a lawful claimant, or in the event that the handler no longer exists and a lawful claim is later established, the market administrator shall make the required payment from the producer-settlement fund to the handler or to the lawful claimant, as the case may be.

(f) In making payments to producers pursuant to this section, each handler shall furnish each producer, except a producer whose milk was received from a cooperative association handler described in § 1000.9(a) or (c), a supporting statement in a form that may be retained by the recipient which shall show:

(1) The name, address, Grade A identifier assigned by a duly constituted regulatory agency, and payroll number of the producer;

(2) The daily and total pounds, and the month and dates such milk was received from that producer;

(3) The total pounds of butterfat, protein, and other solids contained in the producer's milk;

(4) The minimum rate or rates at which payment to the producer is required pursuant to the order in this part;

(5) The rate used in making payment if the rate is other than the applicable minimum rate;

(6) The amount, or rate per hundredweight, or rate per pound of component, and the nature of each deduction claimed by the handler; and

(7) The net amount of payment to the producer or cooperative association.

§ 1051.74 [Reserved]

§ 1051.75 Plant location adjustments for producer milk and nonpool milk.

For purposes of making payments for producer milk and nonpool milk, a plant location adjustment shall be determined by subtracting the Class I price specified in § 1051.51 from the Class I price at the plant's location. The difference, plus or minus as the case may be, shall be used to adjust the payments required pursuant to §§ 1051.73 and 1000.76.

§ 1051.76 Payments by a handler operating a partially regulated distributing plant.

See § 1000.76.

§ 1051.77 Adjustment of accounts.

See § 1000.77.

§ 1051.78 Charges on overdue accounts.

See § 1000.78.

Administrative Assessment and Marketing Service Deduction

§ 1051.85 Assessment for order administration.

On or before the payment receipt date specified under § 1051.71, each handler shall pay to the market administrator its pro rata share of the expense of administration of the order at a rate specified by the market administrator that is no more than 8 cents per hundredweight with respect to:

(a) Receipts of producer milk (including the handler's own production) other than such receipts by a handler described in § 1000.9(c) that were delivered to pool plants of other handlers;

(b) Receipts from a handler described in § 1000.9(c);

(c) Receipts of concentrated fluid milk products from unregulated supply plants and receipts of nonfluid milk products assigned to Class I use pursuant to § 1000.43(d) and other source milk allocated to Class I pursuant to § 1000.44(a)(3) and (8) and the corresponding steps of § 1000.44(b), except other source milk that is excluded from the computations pursuant to § 1051.60 (h) and (i); and

(d) Route disposition in the marketing area from a partially regulated distributing plant that exceeds the skim milk and butterfat subtracted pursuant to § 1000.76(a)(1)(i) and (ii).

§ 1051.86 Deduction for marketing services.

See § 1000.86.

Subpart D—Miscellaneous Provisions

§ 1051.90 Dates.

See § 1000.90.

Dated: February 6, 2017.

Bruce Summers,

Acting Administrator.

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