BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE

In the Matter of:	:	
MILK IN THE NORTHEAST AND	:	**DOCKET NO. AMS-DA-07-0026;**
	:	**AO-14- 77, et al.; DA-07-02**
OTHER MARKETING AREAS	:	

COMMENTS ON TENTATIVE PARTIAL FINAL DECISION
SUBMITTED BY
SELECT MILK PRODUCERS, INC.,
CONTINENTAL DAIRY PRODUCTS, INC., AND
DAIRY PRODUCERS OF NEW MEXICO

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PROPOSED RULE; TENTATIVE PARTIAL FINAL DECISION BY
SELECT MILK PRODUCERS, INC., AND
CONTINENTAL DAIRY PRODUCTS, INC.

I. Introduction

A. Summary of Argument

Select Milk Producers, Inc., Continental Dairy Products, Inc., and Dairy Producers of New Mexico (Dairy Producers) comment on the Proposed Rule; Tentative Partial Final Decision as published in the Federal Register on June 20, 2008. In summary, the Dairy Producers agree with the decision to adopt Proposal 6 which corrected the error in the butterfat yield. However, the Dairy Producers strenously oppose the unsubstantiated increases in the make allowances in the Final Decision. Further, the Dairy Producers continue to urge the Department to issue correct yields as proposed by proposals 3, 7, 8, and 15 as modified by the testimony at the hearing. Specifically, these producer organizations request that the formulas for the component prices be as follows (changes are in ***bold italics)***:

Butterfat = (Butter price - ***0.115***)*****1.22***

Protein = (Cheese Price - ***0.1638***)*****1.405*** + ((Cheese Price -***.1638***)*****1.653*** - ***0.94****(BF Price))*****1.214***. SNF = (NFDM - ***0.1410***)*1.02

Other Solids = (Dry Whey - ***0.1590***)

In addition to comments on the proposal, the Dairy Producers also note that the Department must comply with the Farm Bill changes to the Federal order marketing system. [1] That act, which applied as of May 22, 2008, provides as relevant here that in considering make allowances, the Department must determine the average costs of feed and fuel incurred by producers, using the most recent data available, and consider that data in whether or not to change make allowances. Since this was a "tentative decision" merely keeping those allowances is not appropriate. The Department must consider the entire hearing and come up with a decision in compliance with the law. That it did not comply in issuing the Interim Rule cannot excuse non compliance at this stage.

Two other hearings involving product prices remain open for consideration by the Department. The Department issued an Interim Order in the Class III/IV make allowance hearing, but a final decision has not been issued.[2] Again, in accordance with the Farm Bill, that hearing must be considered in terms of the criteria of the statute and the make allowances created in that decision must be reconsidered. No decision has been reached in the Class I/II hearing on decoupling.[3] Those two hearings and this hearing are inextricably linked. When making a recommended decision in any one of these proceedings, the Department should be mindful of the impact that decision will have on the remaining open proceedings, and to the extent possible, leave comments open so that the effects of each decision can be weighed in light of changes in the other proceedings.

B. Standing

Dairy Producers of New Mexico (DPNM) is a not-for-profit trade association of producers in New Mexico and Texas. It advocates the interests of its producer members in legislative, judicial

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[1]Food, Conservation and Energy Act §1504(G) (FCEA), Pub. L. 110-246, 122 Stat 1651, 1721 (June 18, 2008)

[2]71 Fed. Reg. 52502 (September 6, 2006).

[3]71 Fed. Reg. 67489, 67495 (November 22, 2006).

and agency proceedings. DPNM is an "interested party" in these proceedings as that term is used in 7 C.F.R. §900.8(b).

Select Milk Producers, Inc. (Select) supports the proposals of DPNM and is a milk marketing cooperative association of producers which markets milk on behalf of its members into Orders 126, 5 and 7, and other orders. Select is an "interested party" in these proceedings as that term is used in 7 C.F.R. §900.8(b). Select is a proponent of Proposals 3, 6, 7, 8, and 15.

Continental Dairy Products, Inc. (Continental) also supports the proposals of DPNM and is a milk marketing cooperative association of producers which markets milk on behalf of its members into Orders 33, 5, and 7, and other orders. Continental is an "interested party" in these proceedings as that term is used in 7 C.F.R. §900.8(b). Continental is a proponent of Proposals 3, 6, 7, 8, and 15.

II. The law has changed and USDA is compelled to consider producer costs of feed and fuel.

Since the submission of proposed findings and conclusions, Congress has changed the law regarding criteria and decisions must be reached in making decisions on make allowances.[4] From now on, the Department must determine the average monthly costs of fuel and feed within each of the marketing areas and consider those in making changes to make allowances. As shown in the hearing record, changes to energy costs impact producers because it increases the cost of their water, the operation of their farm, the harvesting of crops, the hauling of feed, and the hauling of milk.[5] The Interim Rule which taxes dairy producers for the higher energy costs of plants doubles the

[4]Food, Conservation and Energy Act §1504(G) (FCEA), Pub. L. 110-246, 122 Stat 1651, 1721 (June 18, 2008)

[5]Squire 536-541, Genske, *passim.*

impact of such changes. Congress has now said that the Department no longer lower minimum prices without considering those impacts of those decisions on dairy farmers.

The hearing at issue is one to adjust make allowances. It commenced prior to September 30, 2012. Once those preliminary requirements are met, the AMAA now mandates that USDA (1)"determine the average monthly prices of feed and fuel incurred by dairy producers in the relevant marketing area"; (2) "consider the most recent monthly feed and fuel price data available;" and (3) consider those prices in determining whether or not to adjust make allowances.[6] By its own admission, USDA failed to complete any of these three mandatory tasks, in violation of its statutory obligations, "These [arguments that feed costs are too high] are not valid arguments for opposing how make allowances should be determined or what levels make allowances need to be in the Class III and Class IV product-pricing formulas."[7] But USDA's stated belief that these factors are not relevant is supplanted by Congress's mandatory directive that these factors be determined and considered.

1. USDA failed to consider separate factors enumerated in the AMAA and their impact on the various milk marketing areas. Instead, USDA engaged in a single national analysis of its proposed changes.

In addition to mandating the consideration of feed and fuel costs,, the AMAA also mandates consideration be given to "the marketing area to which the contemplated marketing agreement, order, or amendment relates." The econometric model in the Economic Analysis does not take into account the regional economic conditions which affect market supply and demand for milk or its products in the marketing area to which the contemplated marketing agreement, order, or

[6]7 U.S.C. 608c(17) as amended by FCEA §1504(G).

[7]73 Fed. Reg. 35306, 35324.

amendment relates. During the evidentiary part of the hearing process during the Make Allowance Hearing which is still pending a final decision, USDA's economist was questioned about whether the economic model can take into account the economic conditions and effect of the proposed changes "on a region-by region or order-by-order or geographic basis." In response, he stated unequivocally, "Not at this time." Dr. McDowell was also asked about whether the model forecasted the all-milk price impacts on a marketing order basis. Once again, he stated that the model did not compute region-specific data.[8]

In this hearing, Dr. McDowell confirmed that USDA's economic analysis does not include any regional analysis of the proposed minimum price amendments. On cross-examination, he agreed that disparate regional impacts are not captured in USDA's econometric model.[9] In light of this total failure, even if the Court were to conclude that USDA met its obligation to consider feed costs and availability, the Formula Rule must still be enjoined for failure to consider regional economic factors.

USDA ignores marketing area regions, and, instead treats pricing as if it occurred in a "national market." For example, it states, "Additionally, the Class III and Class IV product-price formulas establish derived classified prices for producer milk that are used nationally in all Federal milk orders."[10] That is not a true statement. The Federal milk marketing orders collectively do not constitute the "national market" but instead are ten regional markets that account for only two-thirds of the milk produced in the nation. Changes in the federal order prices under the Formula Decision

[8]McDowell, January 24, 2006, p. 260-1.

[9]McDowell, February 27, 2007, p. 190-92.

[10]73 Fed. Reg. 35306, 35324.

do not affect the national milk supply. Furthermore, Dr. McDowell testified that the specific regional impacts vary from marketing area to marketing area.

In fact, USDA determined that while federal milk market order receipts would decline by $165 million dollars on average over nine years, producer revenue over the entire nation would only go down $156 million, suggesting that producer revenue outside of the federal system will benefit by $9 million per year.[11] If this was truly a "national" market as represented by USDA in the Formula Decision, distribution of the economic impact of USDA's decision should be borne more approximate to two-thirds by the federal order system and one-third by those participants operating outside of the federal order system.

The USDA goes further afar with the make allowances when it says:

> It is important to Federal order classified pricing that Class III and Class IV prices be derived, as much as possible, from *national* estimates of manufacturing cost information and because NASS survey prices include California. Accordingly, it is reasonable to conclude that appropriately combining this cost data with cost survey data of manufacturing plants not located in California will tend to produce a measure of *national* manufacturing costs.[12]

The argument fails because the make allowances are not national at all. Their distribution is weighted in favor of areas outside of the federal marketing areas, especially California. Based on the Formula Decision, the entire make allowance for cheese comes from California.[13] According to the economic analysis that accompanied the Make Allowance Decision, only 854 million pounds of American style cheese of the U.S. total of 3.812 billion came from California.[14] The California

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[11] *Id.*

[12] *Id* (emphasis added).

[13] *Id* at 35326.

[14] USDA Agricultural Marketing Service (AMS) Economic Analysis Class III and IV Make Allowances Tentative Final Decision, November 2006, Table 1, p. 2.

cost survey of cheese shows a range of costs from $0.1862 to $0.2186 based on efficiency of plants.[15] USDA chose California's *weighted* average. Implicitly it found, without evidence, that the distribution of cheese production among more and less efficient plants in California is the same "nationally" and within the marketing areas. This is not supported by evidence.

In line with the requirements under subsections (17) and (18) that determinations be made on a market by market basis, the AMAA requires that the orders are to be created and amended based on regional, not national factors.

> All orders issued under this section which are applicable to the same commodity or product thereof shall, so far as practicable, prescribe such different terms, applicable to different production areas and marketing areas, as the Secretary finds necessary to give due recognition to the differences in production and marketing of such commodity or product in such areas.[16]

In 1973, when Congress added language to Subsection (18) regarding the productive capacity, it reaffirmed that the purpose of Subsection (18) was to assure a farm income adequate to maintain production. "Although the need for establishing price levels that assure maintenance of adequate productive capacity to meet future needs is probably already embodied in the existing standard, the amendment is intended to make clear that adequate farm income is an important consideration in setting prices under milk marketing orders."[17]

Congress has demanded that USDA assess supply and demand considerations within each marketing area, not nationally, when defining marketing order regulations. A perusal of the Formula Decision as well as the hearing record establishes both that USDA has failed to comply with the AMAA in this regard, and this lack of evidence prohibited a change in the minimum prices. The

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[15]Manufacturing Costs Exhibit - 2006, CDFA http://www.cdfa.ca.gov/dairy/pdf/ManufCostExhibit2006.pdf.

[16]7 U.S.C. §608c(11)(C).

[17]H.R. Rpt. 93-337, at p. 1762 (June 27, 1973).

Supreme Court in has held that "the agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[18] In this case the relevant data includes at a minimum the average monthly costs of feed and fuel incurred by dairy farmers with the marketing area. There is no evidence of such examination.

III. Use of Official Notice to incorporate the CDFA make allowance data without either a hearing or opportunity to respond violated the longstanding rules of decisions based on the hearing record.

The Dairy Producers object to the Department's use of the CDFA data without an opportunity to cross examine the material or provide evidence that places that material into context. The fact that in the case of cheese, it was the make allowance (twelve days of hearings and all of the witnesses and exhibits rejected) is additional grounds for this being an unfair apparatus. It undermines the integrity of the system and makes the oft state view that the decisions are based on the hearing record untrue.

The last day of the hearing was July 11, 2007. Comments were filed and the ALJ certified the transcript on October 11, 2007. On November 27, 2007, one of the proponents for higher make allowances sought to supplement the record by official notice with data from California Department of Food and Agriculture. It was a report on plant costs, yields, and prices for California for 2006 and was issued October 3, 2007. USDA did not reopen the hearing to take any additional evidence.

The APA provides, "Before a recommended, initial, or tentative decision, or a decision on agency review of the decision of subordinate employees, the parties are entitled to a reasonable opportunity to submit for the consideration of the employees participating in the decisions (1)

[18] *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43 (1983).

proposed findings and conclusions; or (2) exceptions to the decisions or recommended decisions of subordinate employees or to tentative agency decisions; and (3) supporting reasons for the exceptions or proposed findings or conclusions."[19]

Though there may be a "national market" for dairy commodities, the cost to produce those commodities is not national. No businessman would consider the cost of energy in California to be the cost for Ohio, or the labor costs in California to be the costs in West Texas. Taking California costs, which vary widely between plants, is not a supportable position. Except for the fact it is the government that is doing it, it would be a position rejected out of hand.

The reason it was unfair to the Dairy Producers is that the data was taken out of context. The Report by CDFA shows the average costs of labor by different sizes of plants. According to the report, they ranged from 4.1 cents to 6.2 cents per pound.[20] The high cost plants had non-labor costs nearly a cent lower.[21] The range in costs was even wider than the weighted average, ranging as high as 3.5 cents per pound in labor.[22]

The problem with USDA's use of this data is that it took the *California weighted* average without any consideration as to how that would weigh in the rest of the country. That is CDFA has 3 low cost plants and 4 high cost. How many are in the nation that are high cost or low cost? There is nothing in the record to give that number, but USDA's own researcher says that the large, low cost

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[19]5 U.S.C. §557.

[20]California Manufacturing Cost Annual 2006, Compiled and Published in 2007, p. 8; http://www.cdfa.ca.gov/dairy/pdf/annual/2006/manufacturingcost2006annual.pdf (August 18, 2008).

[21]*Id.*

[22]*Id.* at 9.

plants are doing it for less than a dime. In short, USDA has no facts by which it either can use the CDFA data in total or in part.

IV. USDA is denying milk producers substantive Due Process because they cannot participate in the rulemaking or pricing program.

USDA has effectively shut producers out of the pricing program. The following is a list which, in the aggregate, effectively removes producers from the rulemaking program.

- USDA insists on using the NASS pricing series. The ability of plants to choose to participate in the survey or not is absolute–all they have to do is produce product not on the list or enter into contracts not included. Elsewhere in this brief, explanations of how the NFDM survey prices can be manipulated is explained.

- The use of end-product-pricing puts all of the elements of the pricing in the control and knowledge of plants, and outside of producers' knowledge.

- Related to that, but separate, is that USDA has failed to provide any kind of comprehensive and trustworthy research in all three of the legs to the pricing formula–sales, yields, and make allowances– and made that research transparent.

- When producers do bring errors to the attention of USDA it takes years to correct the simplest of errors (the butterfat yield error now corrected) and refuse to give any redress (NASS reporting errors costing producers tens of millions of dollars).

- In the surveys of plants, the plants themselves get to negotiate with the researcher to change numbers in their favor but have no obligation to change numbers that are not in their favor and producers have no way of knowing which is which.

- USDA insists on ignoring the effects on individual marketing orders. By treating the nation, including one third of the milk not subject to FMMO, as part of the "national" marketing area, producers who support the FMMOs are diluted in their own market conditions.

- Holding a national hearing without addressing individual markets puts producers in different markets at a disadvantage. They are required to address problems in other markets. The recent reduction of producer income of $1.4 billion could have purchased the failing plants in the Mideast and Northeast many times.

- USDA uses without question data from a regulatory system to which the producers have no political or legal standing to participate in or challenge.

- USDA changes the formulas and what it will rely upon to set make allowances hearing-to-hearing without advance notice.

- USDA changes its position on how formulas will be used and then imposes them before comments or testimony can be heard on the issue.

- USDA adds to the hearing record after it has been closed.

- USDA refuses to address comments when made. In the Make Allowance hearing the USDA issued a Tentative Decision, called for comments, but never addressed the comments. That decision is years old and the current one has intervened. Those who did submit comments were not treated fairly and never had USDA address their exceptions and comments.

- USDA makes decisions without facts and contrary to facts, fails to research facts, and then chides producers because they cannot disprove the unproven facts. For example, USDA has decided that when water is added to solid material, the total mass goes down. In other words if one adds one pound of SNF to water so that the solution is 3% moisture by weight, it only produces 0.99 pounds of product. Because that is not supported by physical or chemical laws, let alone facts, to expect producers to have evidence of equal unreliability is asking too much.

- USDA remains sensitive to the interests of plant witnesses who bemoan their economic stress. At the same time USDA, administering a program that was designed for producers, tells them their financial woes are immaterial and permits the ALJ to deny producers the opportunity to testify.

V. Specific Challenges to Statements made by the Department.

The Department states: "In the aggregate, the costs of producing milk are reflected in the supply and demand conditions for the dairy products."[23] That is not true. Ask any dairy farmer. Reread the testimony of the farmers who testified. Who said such a thing? The truth is the costs of producing milk are reflected in the supply and demand conditions for feed and fuel as Congress has now required the Department to document and consider. It is also reflected in the cost of farm labor and capital costs and animal acquisition costs. The costs of environmental compliance, too, are no longer insignificant and having nothing to do with the price of dairy products. The evidence at the hearing showed that there is no correlation between feed costs and milk prices.[24] No contrary facts were admitted. The Department is dependent upon the hearing record and cannot substitute opinions it holds for facts in the record or supply facts to fill in support for positions it wants to take.

This concept that the value of milk at the farm is the value of dairy products is only half of the story. In a market where there is truly an arms length negotiation by equals, the value of milk to the buyer is one factor, but the cost of the seller to produce it is one as well. If the buyer's value is less than a farmer can produce, the farmer will not produce it. The Economic Analysis accompanying the decision shows that is what will happen, by reducing the price of milk, less milk is produced. That is not because the value of the finished product went down, but because producer costs for some producers exceed the value of milk as set by USDA.

The Department states, "The record demonstrates that current make allowance levels are not reflective of the costs manufacturers incur in processing raw milk into the finished products of

[23]73 Fed. Reg. at 35324

[24]Genske, 803-04.

cheese, butter, NFDM and dry whey."[25] Based on this record the Department has no reliable evidence as to what it costs to produce these products in an average, or any, plant in the Federal marketing order system. Sure, costs may have gone up. But what about yields and efficiencies? Have they not also gone up to offset those costs? What about the sales price for products? Have they not also gone up to cover the costs? Is it not true that plants can produce other than commodity products and avoid circularity in pricing?

The point is, even though costs may have increased (there is no evidence to show what they were or where they are) that does not mean that plant margins have gone down. Evidence suggests otherwise. During this period of time when, according to this statement, make allowances have been too low, USDA statistics show that the total number of cheese plants in the US in 2006 was 427 compared to 434 in 2007, or an increase in seven plants during the "emergency conditions." The production of cheese in 2006 rose 4.1% over 2005 and 2007 was 1.8% over 2006.[26] Similarly, the number of butter plants increased by three and producers of non fat dry milk increased by five.[27] Contrast that with the reduction of farms 2006 to 2007 from 74,980 to 71,510 and USDA's own expectation that the rule will result in even more farms going out of operation.[28]

The Department says,

> Opponents of increasing make allowances argue a number of points—that they are already set at too high a level, that dairy farmer production costs also have increased significantly due to higher energy and feed costs, that processors should look beyond

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[25]73 Fed. Reg. at 35324.

[26]USDA National Agricultural Statistics Service, Dairy Products 2007 Summary, April 2008, pp. 2, 4, 5, and 7. http://usda.mannlib.cornell.edu/usda/current/DairProdSu/DairProdSu-04-25-2008.pdf.

[27]*Id*.

[28]USDA Agricultural Statistics Board, NASS, Farms, Land in Farms, and Livestock Operations 2007 Summary, February 2008, p. 23.

> asking dairy farmers to receive less for their milk by charging more for manufactured products, and that make allowance increases should be made only when all dairy farmer production costs are captured in their milk pay price.[29]

This greatly misstates the argument. No one, least not the Dairy Producers have said "that make allowance increases should be made only when ***all*** dairy farmer production costs are captured in their milk pay price." Rather the position has to be that the Department, as now required by the law, must consider what it does cost producers. It would be inappropriate for the Department to set minimum prices below what the weighted average of producers can make milk. There will be those which cannot produce milk at a price which is cost effective. There are no guarantees. Same goes for plants.

The Department says,

> Accordingly, the accuracy of deriving the minimum value of raw milk is dependent on the accuracy of the commodity sale prices reported and in large part the accuracy of the manufacturing costs factors, or make allowance factors, that are used in the pricing formulas.[30]

Dairy Producers certainly agree about accuracy though for make allowances. As the Department says elsewhere in the Proposed Rule, "Improving the accuracy of the formulas upon which all classified milk prices are set in all orders is critical in providing processors with adequate revenue to maintain operations and in providing producers with market-based pricing signals from which they base production and marketing decisions."[31] If, as the Department correctly states, accuracy is important, why has the Department not only failed, but refused, to find information on the yields to make them accurate?

During the Make Allowance hearing in 2006, Dr. Stephenson testified as follows:

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[29]73 Fed. Reg. at 35324.

[30]73 Fed. Reg. at 35324.

[31]73 Fed. Reg. at 35330.

Q. That end product pricing starts with some product price in the NASS survey and we subtract costs for manufacturing which may be yours or somebody else's; right?

A. Yes.

Q. Then that's multiplied times the yield; right ?

A. Yes.

Q. None of your studies show any yields at these plants ; right?

A. That's correct.

Q. As I recall the testimony you gave in September 2006, that part of this study was at the request of the Department of Agriculture or not?

A. Yes. We have done a number of these studies over the years and they have been of general interest to the dairy industry and of specific interest to plants , but until we had product price formulas probably not too much to USDA , but at that time USDA had more interest in it and we were ready to redo a couple of the products that hadn't been done in some period of time, most notably cheese and whey, so it was a good timing . We were ready to do it and USDA wanted to see it done.

Q. Was there any discussion in determin ing what the yields would be at these plants ?

A. No.[32]

As to the importance of an accurate yield the following was said:

[32]Stephenson, Tr. 2812-2813.

Q. I'm going to give a hypothetical . For the moment this is purely hypothetical . The number is not an evidentiary issue one way or the other , but assume for the moment that cheese is produced. A hundredweight of milk produces ten pounds of cheese at test and you have done this make allowance , whatever the cost is, 15 cents or whatever you propose with your stratificational analysis , but USDA uses a formula that says that we are going to assume that there is 12 pounds of cheese that comes out of the hundred pound of milk. In that formula these make allowance s would probably be inaccurate or insufficient to truly reflect what the value of milk is in the end on end product pricing.

A. We have the value of a product, the price of the end product that you are producing and we are trying to impute the value of the milk?

Q. Right.

A. There are two primary parameters in those formulas that are important . One of these is the make allowance and one is the yield factor . They don't necessarily influence one another and wouldn 't have to in the formulas . The important thing I think is to do your best to replicate what you think the industry is doing in both the cost of processing and in the yield of products that they are making from these formulas . If you are going to have a formula it should probably be as close to those industry numbers as you can get with one exception , and that is that I do think if you are going to err you should err on the side of slightly smaller make allowance s -- excuse

> me, slight ly larger make allowance s. I will repeat that . A slightly larger make allowance . That would give you a somewhat smaller price, room for the market to pick up any of the errors in our trying to determine values.[33]

Yields are more important because they magnify the or minimize the accuracy or inaccuracy depending on what side one is on. Accuracy of yields is even more important. The reason is that when yields are inaccurate low, as is the case now and explained later, those lower yields actually compensate plants in the formula. For example, the Department takes the position that by adding water to completely dry solids-not-fact so that the result is moisture in the range of 3 to 5% of weight means the yield is is less than one (the NFDM formula). Besides being a physical and chemical novelty, the gross inaccuracy costs producers dearly. When NFDM prices are reported by NASS at, for instance, $1.20 per pound, the loss of three points in yield (the difference between proposed 1.02 and .99) reduces the value of milk.

1.20 * 0.03 = $0.036 per pound

$0.036/pound * 9 pounds of product/cwt = $0.324 per cwt.

In point of fact, USDA is giving the plants the make allowance twice again! As prices of NFDM go up, the gift goes up. The idea that adding water reduces total weight gives processors an effective allowance of almost fifty cents. The following chart illustrates the extent of this unwarranted discrepancy.

Product Price	Make Allowance	Yield Error	Effective Make Allowance
0.90	0.1678	0.24	0.41
0.95	0.1678	0.26	0.42

[33]Stephenson, Tr. 2813-2814

1.00	0.1678	0.27	0.44
1.05	0.1678	0.28	0.45
1.10	0.1678	0.30	0.46
1.15	0.1678	0.31	0.48
1.20	0.1678	0.32	0.49
1.25	0.1678	0.34	0.51
1.30	0.1678	0.35	0.52
1.35	0.1678	0.36	0.53
1.40	0.1678	0.38	0.55
1.45	0.1678	0.39	0.56
1.50	0.1678	0.41	0.57
1.55	0.1678	0.42	0.59
1.60	0.1678	0.43	0.60
1.65	0.1678	0.45	0.61
1.70	0.1678	0.46	0.63
1.75	0.1678	0.47	0.64
1.80	0.1678	0.49	0.65
1.85	0.1678	0.50	0.67
1.90	0.1678	0.51	0.68
1.95	0.1678	0.53	0.69
2.00	0.1678	0.54	0.71

Thus when the Department repeatedly states that plants need a higher make allowance, it should look at the price levels of commodities and see how much additional money plants are making under the current formula. Effectively as prices of commodities go up, the make allowance climbs as well.

The yield in cheese is particularly inaccurate. CDFA, whose make allowances USDA uses, has a yield of 10.2 in its formula.[34] One must assume that with its auditing it knows that such a yield is not overstated. The effective yield for the USDA formula effectively says that out of one hundred pounds of producer milk at standard test, the yield is about 9.8. The .4 pounds of cheese for which producers pay the make allowance but receive nothing in the price effectively inflate the make allowance greatly. For example, assume $1.50 per pound NASS survey cheese price. The 0.4

[34]CDFA, Detailed Instructions Used to Calculate Class Prices (as of December 2007) Last Updated: December 06, 2007 http://www.cdfa.ca.gov/dairy/pdf/classprice_inst.pdf (August 16, 2008).

pounds equals sixty cents per hundredweight. This is because the USDA formula assumes a lower yield.

$1.50/pound * 0.4 pounds/cwt = $0.60/cwt.

Divided by the yield used in the formula, 9.8 pounds, this is an offset of $0.062 cents per pound of cheese which increases the Interim Rule make allowance to $0.265 cents per pound. Differences in the prices of cheese change the equation as the following table shows.

	Make Allowance	Yield Error	Effective Make Allowance
0.90	0.2003	0.04	0.24
0.95	0.2003	0.04	0.24
1.00	0.2003	0.04	0.24
1.05	0.2003	0.04	0.24
1.10	0.2003	0.04	0.25
1.15	0.2003	0.05	0.25
1.20	0.2003	0.05	0.25
1.25	0.2003	0.05	0.25
1.30	0.2003	0.05	0.25
1.35	0.2003	0.06	0.26
1.40	0.2003	0.06	0.26
1.45	0.2003	0.06	0.26
1.50	0.2003	0.06	0.26
1.55	0.2003	0.06	0.26
1.60	0.2003	0.07	0.27
1.65	0.2003	0.07	0.27
1.70	0.2003	0.07	0.27
1.75	0.2003	0.07	0.27
1.80	0.2003	0.07	0.27
1.85	0.2003	0.08	0.28
1.90	0.2003	0.08	0.28
1.95	0.2003	0.08	0.28
2.00	0.2003	0.08	0.28

All of this undermines contentions that make allowances are too low.

Considering the need for accuracy, the absence of studies regarding yields is troubling. There was a request to the Department to obtain this information in collecting the NASS data.

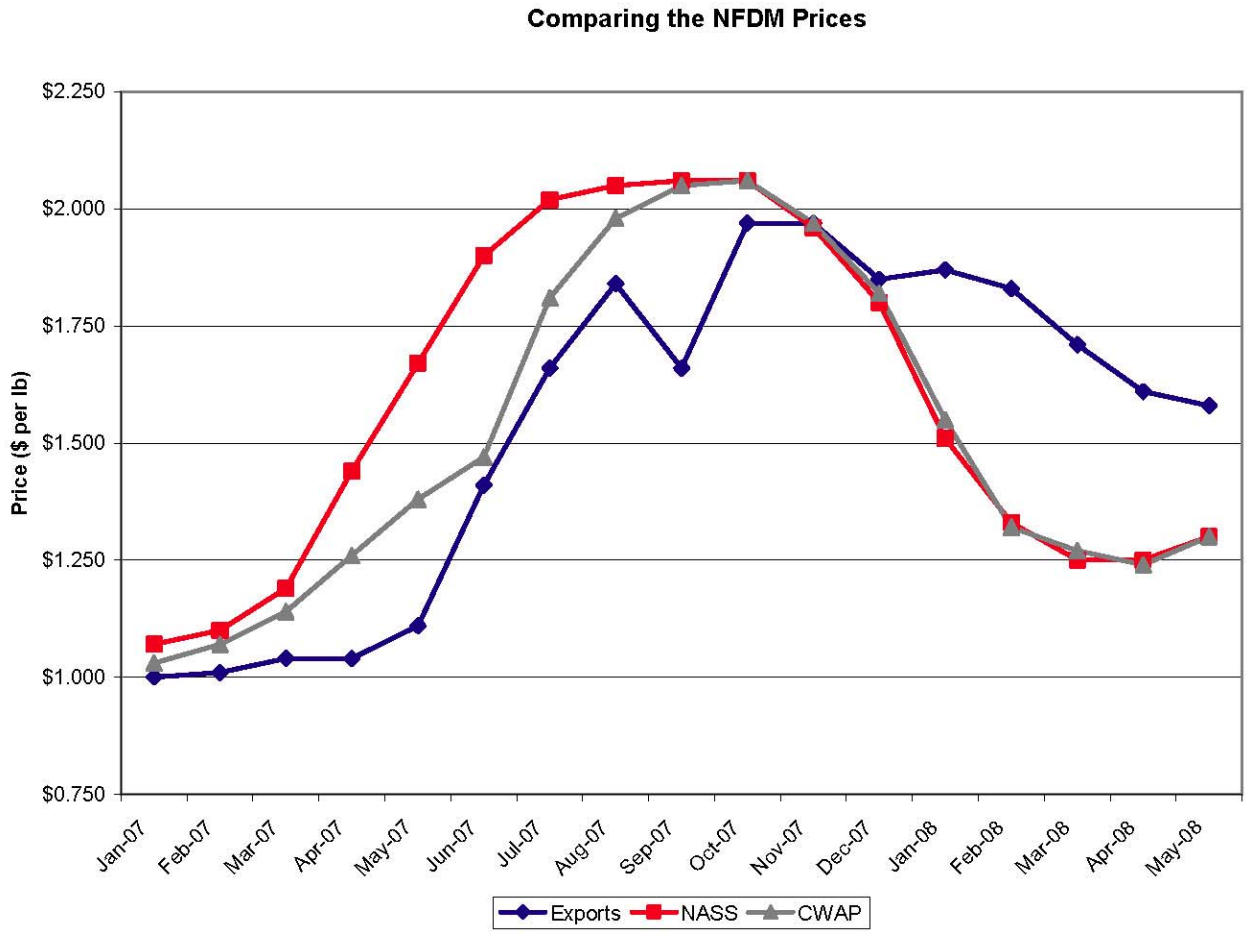
USDA refused.[35] USDA has otherwise shown an unwillingness to know the truth about this important leg in the tripod holding up end-product pricing.

Similarly, the accuracy of the product prices is an issue. This is not an argument that says NASS numbers are wrong, but that the NASS survey is incomplete. It allows and encourages plants to sell products at higher prices to avoid the reporting of the true value.

The following statements and analyses, while lengthy, were presented in the newsletter of the Milk Producers Council the Western Average Producer price reported by CDFA illuminate the issue. The explanation and descriptions encapsulate and explain how the California and Federal regulatory systems continually leave producers holding the short end while permitting shenanigans to be played with the regulatory formulas:

> Since last October, the monthly average prices for sales of nonfat dry milk reported by California plants (CWAP) to CDFA and by all U.S. plants reported to the National Agricultural Statistics Service (NASS) have been very close to each other. In one sense that is good because California producers would not want a repeat of what happened last year when the NASS prices rose far above California's prices, which caused milk prices in federal order areas affected by nonfat dry milk prices to be at times more than $3.00 per cwt higher than comparable prices in California. Those differences over a six month period resulted in a net loss of revenue to California producers of more than $195 million dollars.
>
> The differences were caused by California plants reporting sales made under long-term fixed price contracts to CDFA, but were not permitted to include them in their reports to NASS. (Since at least the middle of 2006 California plants have been handling more than half of all export sales.) CWAP prices for the nine months since September 2007 have been virtually identical to those in federal order areas. And therein lies a puzzle. California producers were assured a number of times last year that when prices started downward (and if the reporting differences between CDFA and NASS continued), CWAP would be above the NASS prices and last year's losses would turn into this year's gains. The graph below shows that isn't happening.

[35] Dairy Product Mandatory Reporting, Final Rule, 73 Fed. Reg. 34175, 34180-34180 (June 17, 2008).



The graph covers prices over a seventeen month period, ending this May which is the latest month export prices are available. A major reason given to explain why California prices lagged the NASS prices last year was the "old" fixed priced sales being reported by California plants were set well before the spot market prices began to rise in response to rising demand for product. On average, that looks like a net two month lag effect (which would reflect a combination of old and new prices under old and new contracts), and can be seen if you picture the line for the CWAP prices in this graph moved about two months to the left. That visual transformation of the graph would show the CWAP and NASS prices almost overlapping from January 2007 through September 2007. It would also show NASS prices to be much lower than the California prices for the period from October 2007 through May 2008 – which they should be just as California producers were assured last year would happen because of the price/sell time lag.

The graph also shows the national average prices for exports over the seventeen month period. Because of the large percentage of exports of nonfat dry milk made by California plants, the CWAP line was and should still be fairly close to the average price for exports. It was through December 2007, but has since fallen far below the export price average, along with the NASS prices. Not shown on this graph is the fact that the recent prices shown for U.S. exports are very close to what USDA reports being charged for skim milk powder in Western Europe and New Zealand.

* * *How can we reconcile the fact that more than one-half of U.S. production of nonfat dry milk this year is exported at prices that have been averaging $.37 to $.50 per lb higher than domestic prices, and yet domestic prices have been reflecting spot prices reported by Dairy Market News? It just doesn't compute. Could non-reporting of higher priced export sales be happening? Could the first sale be made to a broker at prices reflective of the recent NASS and CWAP and then resold for export after a significant markup? Could the fact that almost one-half of all exports of nonfat powders from the U.S. are now skim milk powder whose prices are not reported to NASS or CDFA have an effect on average export prices?***[36]

The possible reasons given included non-reporting of higher priced sales (unlikely under NASS' elevated oversight program), sales to a broker at or below prices reflective of current market prices and then resold for export after a significant markup, or a possible effect of the higher volumes of exported skim milk powder on average export prices. The graph that was part of the report showed that the CWAP and NASS prices ranged from about $.50 per lb below export prices in February to $.27 per lb below in May, which is the latest available month for export data. Data for June should be published next week.

The graph also clearly showed a different pricing pattern since September 2007 than for earlier periods with respect to the closeness of CWAP prices and NASS prices, and since December to their relationship to nonfat dry products sold for export. Since December, export prices have been consistently and significantly higher than the two market price series. A discussion this week with the Chief Economist for USDA/AMS/Dairy Programs about specific rules for reporting sales by companies who are members of a federation of cooperatives (or by any company to anyone other than a final user), clarified an understanding that the rule about first sales being the only sale that is to be reported can be used to establish a sale price that is used in milk price formulas, with all later sales of the same product not recordable until the product shows up at a "port" where it leaves the country. A further clarification of remaining questions on this issue is being sought. If that is happening, it means that an immense amount of money is being withheld from milk producers around the country and the resulting net profits are going to the proverbial middleman.

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[36]John Kaczor, QUESTIONS ABOUT NONFAT DRY MILK PRICES, Milk Producers Council, MPC FRIDAY MARKET UPDATE, August 1, 2008. http://www.milkproducerscouncil.org/updates/080108.pdf.

> However, in discussing the matter this week with a number of people with different industry interests, it was suggested to me that the large amount of skim milk powder that is being produced and exported in conjunction with fixed-priced long term contracts, may explain at least part of the reason for the troubling price differences. June's export report next week could shed some light on that interesting idea.[37]
>
> * * *The report for June's exports was published this week. The average price was $1.54 per lb, 4 cents per lb lower than May, 7 cents lower than April, 17 cents lower than March, and 29 cents lower than February. It looks like a trend, and it doesn't look good. The volume, for a second month in a row, exceeded 100 millions lbs, an estimated 40% of which was skim milk powder (SMP), the product reportedly designed for export exclusively and whose sales are not reportable by anyone.
>
> * * *The weighted average nonfat dry milk price for June, reported by California plants (CWAP) to CDFA, was $1.34 per lb. The CWAP price is considered to be the price most representative of all nfdm sales because CDFA permits the reporting of sales whose prices were set as much as 6 months before the sale is made, and California plants have been handling the majority of powder exports. [Note: prices for exported dairy products include the cost for transporting the product from the place of first sale to the place where it leaves the country. If transportation costs 3 cents per lb, the price received by the first seller in June would have been $1.51 per lb.]
>
> Last week's article on this subject closed with a comment that at least part of the troubling price difference between export prices and domestic prices could be caused by the fact that exports of nonfat powders include substantial volumes of SMP which is said to be sold at a price higher than NFDM. In order to check that out, we assumed that all SMP that is produced is exported within weeks of production, and that the CWAP was representative of all exports of NFDM, for the reasons stated above. Using those assumptions, it's concluded that 42% of nonfat powder exports during the January to June period consisted of SMP, sold at a price that averaged $2.14 per lb. The average price for NFDM exported during that period averaged 1.29 per lb.* * *[38]

These articles reflect not only what is happening in NFDM, but in general in the other commodities–locking producers out of the higher product prices and higher yields

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[37]John Kaczor, MORE ON NONFAT DRY MILK PRICES, Milk Producers Council, MPC FRIDAY MARKET UPDATE, August 8, 2008. http://www.milkproducerscouncil.org/updates/080808.pdf.

[38]John Kaczor, PICKING APART PRICES FOR NONFAT POWDER SALES, Milk Producers Council, MPC FRIDAY MARKET UPDATE, August 15, 2008. http://www.milkproducerscouncil.org/updates/081508.pdf.

The Department says,

> It is reasonable to conclude that the make allowances used in the Class III and Class IV product-price formulas should be updated to reflect changes in the costs manufacturers incur in producing cheese, butter, dry whey, and NFDM. It is necessary to reflect changes in manufacturing costs so that with the prevailing market prices for manufactured products, minimum Federal order classified prices can be set.[39]

The proffered conclusion is not reasonable. First it assumes that the then existing make allowances were accurate. They were not after adjustments for inaccurate yields and understated product prices. Second, as explained elsewhere, the costs the USDA is using to compare are illusory.

VI. Comments on USDA's Decisions on the various proposals

A. **Changes to the Cheese Protein Price Yield and Nonfat Solids Yield Factors**.

The Department was wrong to adopt increases in the make allowances and not adopt proposals 7 and 8 would change the protein price yield factor and the nonfat solids yield factors to account for (1) 94 % butterfat recovery; (2) the presence of 83.25% casein in true protein at average producer test; and (3) the fact that plants yield more than 0.99 pounds of nonfat dry milk from one pound of solids-not-fat. Utilizing these adjustments the formula should be as follows:

Protein = (Cheese Price - 0.1682)****1.405*** + ((Cheese Price -0.1682)****1.653 - 0.94****(BF Price))****1.214***

Nonfat Solids = (Nonfat Dry Milk Price - 0.14) * ***1.02***

USDA misunderstands the importance and use of the CDFA data on yields. The use is to determine the butterfat recovery, not the yield of cheese from producer milk. For this analysis it is immaterial whether the fat and milk solids come directly from the farm or all supplemental. As was testified at the hearing, there is a narrow window in the relationship between the percent of casein and butterfat, ratio of 0.65 to 0.7. By taking CDFA's data showing a butterfat test, for example in

[39]73 Fed. Reg. at 35324.

the 2006 data, 4.69% or 4.69 pounds per hundred pounds in the vat, it can reasonably be assumed that the amount of casein is between 3.04 and 3.28. By plugging in the resulting yield, moisture, and casein percent, the butterfat recovery can be determined. Leprino's witness agreed. Thus the Department's refusal to see this is an error that needs to be corrected.

1. Cheese Formula Analysis

The parts of this formula which are at issue in Proposals 6, 7 and 8 are the percent of casein in protein and the butterfat recovery rate. In addition, because of the single manufacturing class butterfat price, the ratio of fat to protein ratio is also a necessary part of the cheese to protein formula even though it is not part of the Van Slyke formula itself.

The current formula assumes that a plant recovers 90% of the butterfat when making cheese. The butterfat recovery percentage should be increased to 94% to reflect modern efficiencies and to eliminate farm-to-plant shrink. The use of a higher butterfat recovery is supported by (1) A statement by IDFA's expert witness that her cheese plants use 100% of the butterfat delivered to the plant; (2) CDFA and RBCS studies reporting butterfat yields in excess of 94%; (3) Empirical studies using a recovery of 93% and published articles relying on a 92% recovery; (4) Opponent testimony that whey cream can and is used again; (5) Sales literature promising vat recoveries in excess of 94%; and (6) Academic reports advising cheddar cheese makers how to utilize whey cream in cheese vats.

Second, the current formula assumes that casein represents 82.2% of the true protein in milk. At statistical standards, the actual percentage of casein in true protein is 83.25%. At average producer tests, the actual percentage of casein in true protein is 83.10%. DPNM proposes to change the percentage of casein in the formula to reflect the more accurate percentage of casein either at the statistical standards or the weighted average producer's test as supported by the following: (1) Evidence showing that the average weighted test of producer milk for true protein is 3.04% and for

butterfat is 3.69%; (2) By applying 78% casein in total protein and adjusting total protein 0.19% for non-protein nitrogen, the percent of casein in true protein at the standardized test is 83.25% and at the weighted average producer test the true protein is 83.10%; and (3) the current rate of 82.2% is consistent with true protein of 3.56% or a rate significantly higher than the standard or average milk marketed through the FMMO system.

Finally, the fat to protein ratio in the cheese to protein formula used to adjust protein to compensate for the difference between Class III and IV butterfat should be changed to 1.214 to reflect average producer tests of butterfat and true protein. This is based upon evidence that shows that the average weighted test of producer milk for true protein is 3.04 and for butterfat is 3.69 and, therefore, the ratio of fat to protein of average producer milk is 1.214, not 1.17.

The nonfat dry milk (NDM) to solids not fat (SNF) yield should be 1.02, not 0.99. The implication in the current formula is that by taking 100% solids of SNF and adding 3 to 4% moisture there is less NDM than SNF. But reports by Cornell show yields in excess of 103% plus the value of dry buttermilk. A yield of 1.02 is consistent with facts and fairness.

a. The butterfat recovery factor in the cheese to protein formula should be increased to 94%.

The Department premised its selection of a 90% butterfat recovery on testimony from Kraft, Leprino, and cheese vat technology from the late 1970's and early 1980's.[40] The stated grounds to support a 90% butterfat recovery in the 2002 Final Decision are unreasonable and unsupportable today.[41] First, Kraft does not make the commodity cheddar cheese reported in the NASS survey but makes a higher quality cheese that has a different value and is produced in a manner different than

[40]67 Fed. Reg. 67907, 67929 (November 7, 2002).

[41]*Id*.

commodity cheddar cheese.[42] Similarly, Leprino does not make any commodity cheese (but recovers all of its butterfat in the cheese it does make).[43] Regardless, basing the value of milk produced by farmers in 2007 using plant efficiency information for cheese vats now more than twenty years old is simply wrong.

The statement in the 2002 decision, "The preponderance of the record indicates that most cheese manufacturers should be able to obtain a 90 percent butterfat recovery," is true but only because it is too low. Not a single plant has complained about the yield. If 90% represented average butterfat recovery in cheese plants, then there would be someone on the short side. The only parties on the short side of this factor are producers.

Record evidence shows that Leprino, the largest manufacturer of Italian cheeses, utilizes **all** of its purchased butterfat, "So, ultimately all of our fat, all of our whey fat is reincorporated into the cheese."[44] Italian cheese makers account for approximately a third of the cheese produced in the U.S.[45] Assuming the rest of the cheese manufactured recovers only 90% of their butterfat, the record evidence demonstrates that as much as 93.3% of all butterfat is recovered in all of the cheeses made from Class III milk.

In addition to the inapplicability of the previous rationale for a 90% butterfat recovery, the surveys and studies relied upon to set make allowances show that plants are, in fact, realizing yields significantly higher than those implied in the current price formulas.

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[42]McCully 1116-18.

[43]Taylor 2951.

[44]Taylor 2951.

[45]Taylor 2950-51.

In response to those who say that the CDFA yields on cheese cannot be used to approximate the butterfat recovery, IDFA/Leprino's expert witness was asked if she were given the cheese yield, moisture percentage, percentage of fat, and percentage of casein, the butterfat recovery can be calculated.[46] She was given specific data for each of these. The amount of casein in a cheddar cheese plant can be approximated because the ratio of casein to butterfat in the vat is very close, generally around 70%.[47] Thus the missing factor, casein, can be computed from the data as can the butterfat recovery. CDFA reports all of the data except percentage of casein annually. Reports for 2002,[48] 2003,[49] 2004,[50] and 2005[51] have been admitted into the record.

The information needed to calculate a butterfat recovery is all contained in CDFA's reports, with the exception of casein. Testimony at the hearing showed that a casein to fat ratio of approximately 70% was a proper vat mix.[52] With a reported 4.02% butterfat for 2004, the amount of casein can be calculated at 2.814%. With that figure, the butterfat recovery for 2004 is 95.51%. Testimony at the hearing reported casein to fat ratios of 64% to 68%.[53] Such ratios if used to approximate the amount of casein in CDFA data would result in even higher butterfat recovery to obtain the yields reported.

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[46]Taylor 2991-92.

[47]Yale 2255.

[48]Ex. 33, FFF CDFA Cheese Processing Costs Released November 2003.

[49]Ex. 33, GGG CDFA Cheese Processing Costs Released November 2004.

[50]Ex. 33, HHH CDFA Cheese Processing Costs Released November 2005.

[51]Ex. 33, III Cheese Manufacturing Costs, Current Study Period: January through December 2005 with Comparison to the same time Period Prior Year (2004).

[52]Yale 2255.

[53]Brown 2916.

These are single vat recoveries and do not reflect the totality of butterfat recovery in the entire operation. Because all witnesses agreed that whey cream (that is the butterfat not recovered in the first pass) can be and is returned to subsequent vats, it is immaterial whether or not all cheese plants use it on all of the cheese they produce, the value is there if they wish to use it and producers should not be denied the value of butterfat because of plant choices. This is especially true when a third of cheese produced from Class III uses all of the butterfat in the cheese.

The mathematics of multiple passes with reuse of whey cream only increases the recovery rate. For example if the recovery is only 90% and the whey cream is reused, 95% of the first vat's butterfat ends up in finished cheese even when 75% of the whey cream is recoverable.[54] Whey cream cannot be recycled indefinitely, but in the mean time the amount of butterfat ending up in finished product sold as cheese is much higher than current formulas acknowledge. When the plant's vat recovery is 92% such as Foremost Farms[55] the total butterfat recovery only increases proportionately.[56] When the butterfat recovery shown by the CDFA data is used, use of the whey cream raises the amount of butterfat ending up into cheese to near total. (95% + .75 x 5% = 98.375%).

In this way, the arguments of proponents for whey cream adjustment are unfounded. First there is very little whey cream actually produced (IDFA presented no data). More importantly when whey cream is sold it is the lesser valued whey cream that results from repeated recycling and, as a result, demands a lower multiple.

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[54]Brown 2651.

[55]Ex. 38.

[56]Taylor 2975-76.

A cheese plant in California paid producers based on the Van Slyke formula, and utilized 78% of casein to crude protein and a 94% butterfat recovery.[57] Similar analysis for producers selling milk to plants in other states where modern plants pay on a cheese yield formula, the implied yields reflect butterfat recovery in the same or higher range.[58]

In addition, the RBCS study supports a higher butterfat recovery. The RBCS study introduced at the 2006 hearing on make allowances reported a cheese yield of 10.4 pounds per hundredweight on all cheeses and 10.7 pounds per hundredweight on 40-pound blocks.[59] Applying FMMO average tests of butterfat and true protein, 3.69% and 3.04% respectively, the results show a butterfat recovery of 95.25% for all cheeses.[60]

Other academic papers and published studies support a butterfat recovery greater than 90%. Dr. Barbano's testimony from the 2000 hearing, introduced by IDFA, documents a 93% butterfat recovery.[61] In his text on cheese manufacturing, Vikram Mistry, a Professor of Dairy Science at South Dakota State University demonstrates the Van Slyke formula with a butterfat recovery of 93%.[62] Prior to the use of end product pricing, the USDA price support for cheese presumed 10.1 pounds of cheese for 100 pounds of milk at 3.67% butterfat which reflects a 92% butterfat recovery,

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[57]Yale 1337.

[58]*Id.*

[59]Ex. 33, OOO, Charles Ling Testimony Ex. 18 in 2006 Make Allowance Hearing.

[60]Ex. 33, PPP, Estimating Butterfat Recovery on RBCS Report.

[61]Ex. 59, p. 6.

[62] Kosikowski and Mistry, *Cheese and Fermented Milk Foods*, Vol. 1, Third Ed. 1997, pp. 623-24, *See* Yale 1338-39.

and that was based on technology more than twenty years old. An advisory paper from the University of Wisconsin assumes a 93% recovery.[63]

Finally, manufacturers of cheese making equipment recognize and, in fact, promote butterfat recoveries significantly higher than 90%. In a proposal for a plant to purchase new vats, Scherping estimated butterfat recoveries in excess of 94%.[64]

The Class III price for milk applies to all cheeses, not just American style. Discounting the protein price by use of 90% butterfat recovery rate provides a windfall for those, approximately one third, of the plants that use virtually all of the butterfat and an unwarranted bonus to the remaining plants. The Department, based on this evidence, should adopt a 94% butterfat recovery. Adopting a 94% butterfat recovery results in the following changes to the Class III pricing formulas. (1) The coefficient for the butterfat reducer rises from 0.90 to 0.94; and (2) The yield of cheese per pound of butterfat rises from 1.582 to 1.653.[65] As a result of these changes only, the formula would be: Protein = (Cheese Price - .1682)*1.383 + ((Cheese Price -.1682)****1.653*** - ***0.94****(BF Price))*1.17.

b. The percentage of casein in true protein should be based on average producer tests.

In the Final Decision from 2002,USDA stated that the percent of casein in crude protein was 78%.[66] The assumption was that one can compute the amount of casein in crude protein by simple multiplication. This is not true.

The traditional Van Slyke formula uses 78% of crude, or total, protein to determine the amount of casein in milk. The Department, beginning in 2000, began to use "true" protein as the

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[63]Ex. 77, p.3.

[64]Ex. 33, SSS, Scherping Proposal.

[65]The derivation of these calculations can be referenced at Yale 1345, Ex. 33, TTT.

[66]67 Fed. Reg. at 67928.

value of the protein component. True protein is the difference between total protein and non-protein nitrogen (NPN).

Calculating the casein in milk beginning with crude protein is accomplished as follows: find the percent casein is of true protein at the average producer test by deriving it from the Van Slyke formula. There is the known factor that casein is 78% of true protein.[67] That percentage times the total protein test determines the amount of casein. The amount of casein in milk of a given remains the same regardless of whether it is measured as a function of true protein or total protein. Evidence at the hearing showed that the 82.2% represents milk with true protein in excess of 3.56%.[68] At standard test 2.9915% true protein, the value would be 83.25%.

Evidence at the hearing establishes that the amount of NPN is 0.19%.[69] The amount of NPN as a percent of true protein varies, but NPN is a fairly static value irrespective of the value of total protein. Personnel at USDA AMS and Cornell determined that a fair factor for NPN is a relatively unchanging 0.19%.[70] The issue is at what level of true protein is the percentage determined.

The current formula implies 82.2% of true protein of all milk is casein. This is incorrect for producer milk at the average weighted tests in the market. Producers with less than 3.56% true protein are penalized by the inaccurate implied percentage in the current formulas.[71] (That is the point when 82.2% of true protein equals 78% of crude protein.) That is a full half a point of protein higher than the average true protein value in milk marketed in the FMMOs.

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[67]67 Fed. Reg. At 67928, Ex. 59, 6; Yale 1311.

[68]Ex. 33, DDD.

[69]Metzger 1674, Yale 1310, Taylor 2995, Ex. 61.

[70]Ex. 33, CCC, David M. Barbano and Joanna M. Lynch, "FAQ: Changing from Crude Protein to True Protein," May 14, 1999.

[71]Ex. 33, CCC.

Basing the ratio of casein to true protein on the *weighted average* producer test is consistent with the USDA's use of the weighted average sales price reported by NASS. Further, the make allowances surveyed by Stephenson and CDFA were extrapolated and merged on a weighted average basis. Finally, the use of a proxy that is on the weighted average insures that on the whole plants pay for all of the casein and producers receive no more than all of the casein though individual plant and producer results may vary.

With that in mind, the appropriate ratio of casein to total protein is 83.25% for milk at 2.9915% true protein and 83.10% for milk at the weighted average true protein test within the federal milk marketing orders. Applying this casein percent to the Van Slyke formula results in increasing the casein factor in the cheese yield formulas from 1.383 to 1.405.[72]

c. The Fat to Protein Ratio in the butterfat adjustment to the protein component price should also be based on average producer tests.

The Department was wrong when it refused to adjust the fat to protein ratio in the formula. It is mathematically driven. Following the goal that in fixing values, where ever practical, the weighted average should be used, the weighted average of the FMMO system of fat to protein is 1.214 and thus that should be the number for the formula protein adjustment, not the current 1.17.

The current cheese to protein formula adjusts the simple protein component price to act as a residual to the difference between the Class IV butterfat and the value of butter used in cheese. In simple terms, the difference between the two different butterfat values will be carried by the protein so that the overall value of Class III at test will not change as a result of changing the butterfat value. Since the adjustment is being stated per pound of protein and there is less protein

[72]The derivation of this factor can be found at Yale 1313-15, Ex. 33, EEE.

than butterfat, the rate of adjustment, first computed as per pound of butterfat, has to be increased so that on the fewer pounds of protein the same total value is adjusted.

The current formula uses the ratio of 1.17. This represents the ratio of standardized tests of 3.5% butterfat and 2.9915% true protein. The problem with that ratio is that average tests for butterfat and protein are 3.69% and 3.04% respectively.[73] This represents a ratio of 1.214, not 1.17.[74] Having the ratio incorrectly set at the standardized tests effectively undervalues milk at test for more than one half of the producer milk marketed in the FMMO system.

d. Summary of changes to the cheese to protein formula

Dairy Producers reiterate their proposal that the following findings and conclusions be adopted:

1. The standard for determining yields is the Van Slyke formula.

2. The Van Slyke formula for cheddar cheese is as follows:

Pounds of Cheese = ((BR% x BF lbs) + (CS% x PR lbs) -0.1) x 1.09)/(1 - Moisture%)

Pounds of Cheese from Butterfat = (BR% x BF lbs) x 1.09)/(1 - Moisture%)

Pounds of Cheese from Protein = ((CS% x PR lbs) -0.1) x 1.09)/(1 - Moisture%)

3. NASS survey prices are based upon the weighted average price.

4. Make allowances are based upon a weighted average of surveyed plant data.

5. The casein percent of true protein factor in the cheese to protein component formula should be based on the weighted average protein tests of producers.

6. The Van Slyke formula is based upon the amount of casein in crude or total protein and uses 78% of total protein for the amount of casein.

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[73]Ex. 33, OO and Ex.33, P.

[74]Ex. 33, UUU Ratio of Butterfat to True Protein at Various Tests.

7. The difference between total protein and true protein is non-protein nitrogen or NPN.

8. The amount of NPN in total protein cannot be expressed in terms of a percentage.

9. The amount of NPN is fairly narrow and varies little as total protein goes up or down and is best expressed as 0.19%.

10. The average true protein test for all orders was 3.05% and for milk used in Class III was 3.04%.

11. The only time in which 82.2% of true protein equals 78% of crude protein is when the true protein test is 3.56%.

12. The Department should adopt a protein formula that uses 83.25% of the true protein.

13. The factor for yield of cheese from a pound of protein should be 1.405.

14. The weighted average of butterfat and true protein in the FMMO system is 3.69% and 3.04% respectively or a ratio of 1.214 to 1, not 1.17.

15. The multiplier of the butterfat adjuster for the protein price should be 1.214.

16. The butterfat recovery in cheese is higher than the implied 89.4% now being used in the formula.

17. The actual higher butterfat recovery in plants means that plants are not paying for all of the protein used to make cheese.

18. The 90% butterfat recovery implied in the current cheese to protein formula is too low to represent current industry practices, reported yields, and academic reports.

19. Leprino recovers all of the butterfat in its cheese plants.

20. Italian style cheeses represent about one third of the cheese produced from Class III milk.

21. Assuming that all other cheese makers recover 90% of the butterfat, that means, at a minimum, that on the average users of Class III milk use 93.3% of the butterfat in cheese.

22. The butterfat recovery of plants reported by CDFA can be approximated by calculating the amount of casein in the vat as a percentage of the butterfat.

23. The butterfat recovery of plants reported by CDFA approximates 95.51%.

24. Cheese plants paying producers on end product pricing use formulas with implied butterfat rates of 94%.

25. The RBCS study gave yields of cheese that suggested butterfat recovery rates on average FMMO milk at 95.25%

26. Dr. Barbano testified in 2000 that 93% recovery was at least recoverable today.

27. Manufacturers of cheese vats promote butterfat recovery in excess of 94%.

28. Subsequent use of whey cream in the vat substantially increases overall butterfat recovery and reduce unused whey cream.

29. The yield of cheese per pound of butterfat should be 1.653 instead of 1.582 and the adjustment for the Class III to IV butterfat should be .94.

30. The cheese to protein formula should be

Protein = (Cheese Price - .1682)*1.405 + ((Cheese Price - .1682)*1.653 -.94*(BF Price))*1.214

B. The yield for nonfat dry milk should be corrected.

The Department's continued refusal to even follow CDFA who uses 1.02 as a factor for NFDM by saying the addition of water reduces the yield in NFDM. The Department should correct

the NFDM to SNF yield to reflect actual yields. Currently the multiplier is 0.99. This states an impossibility. NFDM is the product of removing water from pasteurized skim milk. The resulting powder may not "contain more than 5 percent by weight of moisture".[75] Because of the cost of drying as well as the fact that the moisture is less valuable than the powder, the expectation is that NFDM will be sold at nearly 95% dry matter. In the case of Extra Grade the moisture is lower, 4.5%. The solids not fat (SNF) component price for the FMMO pricing system is based upon dry matter with no moisture. But the current formula implies that NFDM is *drier* than the SNF. According to the standards of identity, one pound of SNF will produce as much as 1.05 pounds of NFDM. It is impossible to produce less than a pound as the current formula contends. NFDM is approximately 3.2% moisture. Thus the Final Rule represents a loss of 5.2 pounds of nonfat milk solids in every 100 pounds of NFDM or a 5% loss.

Prior to the Final Decision effective 2003, the formula was a multiplier of 1. USDA in setting the NFDM yield to the current 0.99 stated:

> This final decision also changes the divisor from 1 to 0.99 in order to account for farm-to-plant losses of nonfat solids and to simplify and provide consistency to price formulas. Nonfat milk solids in buttermilk are removed from the computation of the Class IV nonfat solids price.[76]

The farm-to-plant losses are addressed elsewhere in this brief. In any event a 0.15% loss of solids as alleged but not proved would reduce the yield from 1.05 to 1.048, not 0.99. As for the simplification and consistency, any number can act as the numerator and maintain the consistency and simplification of multiplying the yields rather than using a divisor.

The removal of buttermilk solids from the formula is also unwarranted. Such provide marketable powder for which plants receive money that offsets their costs. The output from such

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[75]Ex. 33, UU Std of Identity for NFDM, 21 C.F.R. §131.125.

[76]67 Fed. Reg. 67906, 67921.

a plant, output paid for by the make allowances included in the formula, is not only powder and butter, but condense and buttermilk both bulk and powder.[77] Studies of powder plant operations show buttermilk as an output. [78]

CDFA examined actual yields in butter powder plants. It found the yields of NFDM, not including buttermilk to average 1.025.[79] It would indeed be ironic for the Department to pick and chose the CDFA make allowances for powder plants but turn a blind eye to CDFA's study of plant yields.

Plants today certainly are not less efficient. All of these studies show a combined NFDM and buttermilk powder yield in excess of 1.025 pounds of product from each pound of solids non fat. However, buttermilk powder is slightly less valuable than NFDM and so we are proposing a yield of 1.02 pounds of SNF in each pound of finished product.

Thus the formula for NFDM before adjusting for the make allowance should be:

SNF = (NFDM - 0.1570)***1.02**

III. Proposals dealing with farm-to-plant shrink.

USDA was wrong in refusing to correct the shrink. All of the plants it noted were in other marketing areas. Making the southern order producers who have developed efficiencies take less for their milk because other areas have refused to do so is simply wrong.

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[77]Ex. 9.

[78]Ex 33, XXX Excerpts from Stephenson and Novakovic, Determination of Butter/Powder Plan Manufacturing Costs Utilizing an Economic Engineering Approach, June 1990, A.E. Res. 90-6 and excerpts from Stephenson and Novakovic, Manufacturing Costs in Ten Butter/Powder Processing Plants, September 1989, A.E. Res. 89-12.

[79]Ex. 33, YYY CDFA Butter and Powder Yields, 1998.

The Department refused to remove the farm to plant shrink.[80] It gives as its reason that some coops continue to report farm to plant shrink. None of them were from the Southwest, Arizona, Southeast, Florida or Appalachian orders. That such shrink continues is wrong. That USDA rewards the inefficient by lowering standards to the past is not good. The Department must recognize that the future of dairy production, and milk marketing orders, will be with those who are showing they can manage the shrink. They have invested capital, technology and desire to do a better job. USDA should reward this. The future of the milk marketing orders depends upon USDA embracing the future and not the past.

A. Farm-to-plant shrink should be eliminated from the pricing formulas.

Proposal seven would eliminate the farm to plant shrink adjustments from the pricing formulas for the following reasons: (1) eliminating farm to plant shrink will result in a minimum pay price premised on the modern reality that true farm weights are equivalent to plant weights; (2) eliminating farm to plant shrink from the formulas will end the subsidization of those producers whose farm weights and tests are inaccurate and erroneous; and (3) eliminating farm to plant shrink will put an end to prices that are reduced unnecessarily because the manufacturing formulas are the basis for the Class I and II pricing formulas.

Historically, inclusion of a farm to plant shrink was considered reasonable because tankers were making many stops before arriving at the plants and there was inconsistency between farm weights and plant weights. But today, over half the milk in the country is produced on farms that have more than 500 cattle and, therefore, can deliver a full tanker of milk. This leads to greater specificity and accuracy in the observation of the milk picked up at the farm. Although DPNM recognizes that in some instances, milk haulers still have several stops on their route, but this is

[80]73 Fed. Reg. at 35327

increasingly the exception and not the rule. And, the net of all overages and underages between farm weights and tests and plant weights and tests is a wash today. In almost all instances, the difference between the farm weights and tests and the plant weights and tests is significantly less than the 0.25% assumed by the federal milk marketing order presumptions. If there is a consistent error, steps are taken to identify the source of the difference and to correct it.

To maintain its relevance, the federal order system needs to recognize the changing technologies and efficiencies in milk production and marketing. Producers should be fairly compensated for increasing their efficiencies. Maintaining a farm to plant shrink adjustment in the pricing formula penalizes those producers who have become more efficient and caters to those who could become more efficient, but decline to do so.

A basis for the 2002 Final Decision was that "the shrinkage provision allows assigning a value to milk losses at the lowest priced class, providing explicit recognition that some milk loss is inevitable in farm-to-plant movement."[81] But in the modern dairy industry, milk loss is not "inevitable" and those who are inefficient should not be rewarded by subsidies from those who have solved the problem.

The Department also said in the Final Decision, "The loss allowances in the Class III and IV formulas are intended to reflect actual losses that are beyond the processing handler's ability to control."[82] But these losses are within the processing handler's control. A handler can refuse to accept milk from shippers that demonstrate unacceptable farm to plant losses. The handler can request assistance from the market administrator to check the tanks and the testing methods. The

[81]67 Fed. Reg. at 67917 (November 7, 2002).

[82]*Id.*

handler can contract for milk based on farm tests without shrink, and adjust their payments accordingly.

Additionally, the Department stated,

> Prior to Federal order reform, milk pricing for all Federal milk marketing orders relied on the Grade B Minnesota-Wisconsin (M-W) price series and later the Basic Formula Price (BFP). These prices were determined by manufacture milk plant survey reports of Grade B milk purchases free of government price regulation and represented a competitive pay price for milk. The competitive pay price factored the entire cost of processing milk purchased from farms into finished dairy products. In contrast to the competitive pay prices, federal order reform could no longer rely on a competitive pay price and purposefully chose NASS surveys of end-product prices and sales to establish Class III and IV prices with product price formulas. Many of the plants reporting to NASS purchase large quantities of milk from individual producer cooperatives. The end-product pricing formulas developed under reform were based in part upon the cost to process raw milk into finished dairy products.[83]

The basic contractual relationship described in the Final Decision has not changed. Cooperatives can still negotiate with their members and pay them on actual milk deliveries. Proprietary handlers can refuse to accept milk from producers with excessive losses.

The elimination of farm-to-plant shrink is implicit in the formula proposals by DPNM.

B. A mathematical error in the calculation of the butterfat yield was properly corrected.

The Department properly corrected the butterfat error. Thank you. In support of that decision the Dairy Producers present the following:

Proposals 6 corrects a mathematical error in the computation of the butterfat factor by proposing an increase in the yield factor for butterfat to butter from 1.20 to 1.211. This proposal corrects for a mathematical error in the Department's calculation of "shrinkage." In the Final Decision establishing the Class III and IV pricing formulas from November 2002,[84] the Department

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[83] *Id*.

[84] *Id*. at 67906.

made substantial reductions from the yields in the Recommended Decision of October 2001[85] by including, for the first time, adjustments for "shrinkage." Because these changes were included in the Final Decision but not in the Recommended Decision, interested parties were not provided an opportunity to respond to the changes.

Assuming for the moment that shrinkage should be accounted for in the formula, the assumed shrinkage was improperly calculated The error is explained by the following: Assuming that overall milk volume at the farm is reduced by 0.25% in transportation and fat is further reduced by 0.015 pounds per 100 pounds of milk received at the plant, the milk at the plant is the farm volume adjusted for shrink in accordance with this formula: (3.5 * 0.9975) - 0.015 = 3.47625.

But the Department assumed that the plant lost 0.015 pounds of fat per pound of fat, not per hundredweight. The formula used by the Department was, as a result, (3.5 * (0.9975 - 0.015)) or (3.5 * (0.9825)) = 3.43875. A comparison of the correct formula with the Department's formula demonstrates that the Department has incorrectly placed the second set of parenthesis in its formula.

Correct Computation ((3.5 * 0.9975) – 0.015) = 3.47625

Department Computation (3.5 * (0.9975 – 0.015)) = 3.43875

By placing the parenthesis in the wrong place, USDA assumed that the plant received less butterfat that is actually does. When the Department then calculated the yield of butterfat from one pound of butter, it arrived at 1.2 instead of the correct yield of 1.211.[86] IDFA agrees that there is an error in the application of shrink to the butterfat formula but wants no change.[87]

DPNM proposes the following findings and conclusions:

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[85]66 Fed. Reg. 54064 (October 25, 2001).

[86]The derivation of these figures can be found at Yale 1345, Ex. 33, TTT.

[87]Taylor 2490-92.

1. The Department made a mathematical error when it applied shrink to the yield of butterfat in butter in the 2002 Final Decision.

2. The Department calculated a yield of 1.20 pounds of butter from a pound of butterfat when it should have calculated a yield of 1.211.

IV. Make Allowances Should be Set Using Data from the September 2006 Cornell Survey Only.

There is no good data on make allowances. Certainly not enough to justify changing the existing allowances.

Dairy Producers of New Mexico have offered proposal three to set make allowances at the following levels: butter 11.08 cents per pound, nonfat dry milk 14.10 cents per pound, cheese 16.38 cents per pound, and dry whey 14.98 cents per pound. The rationale behind proposal three is to set make allowances at levels consistent with the weighted average make allowances surveyed by Cornell University and reported at the last make allowance hearing in September 2006. The only exception is the make allowance for dry whey, which would be set at the observed weighted average price for dry whey, plus 0.9 cents to account for the additional energy needed to dry whey.

DPNM opposes all other noticed proposals related to make allowances. Based on the following principles:

- The data used to determine the appropriate level of manufacturing allowances for establishing federal order prices should be drawn from plants operating within the federal order system.
- Adjustments to federal order pricing regulations should always be subject to formal rulemaking.
- Make allowances should be set at a level deemed appropriate by the Secretary, after taking into consideration all statutorily required factors and the then-current milk

marketing conditions, rather then prescribed geographic or volumetric factors.

DPNM has offered proposal three so that make allowances can be set at levels that are known to exist in federally regulated plants, without influence from plants regulated by the California system. The current make allowances incorporate make allowance data compiled by the California Department of Food and Agriculture. DPNM does not take issue with the methodology employed by CDFA. In fact, in light of the testimony offered in this proceeding, the CDFA data and methodology is clearly more complete and accurate than any of the data compiled and presented by Cornell relevant to plants located in other areas of the nation.

V. Proposals one, two, and 17 should not be adopted.

Because DPNM opposes the use of data from plants not regulated by the federal milk marketing orders, DPNM opposes the adoption of proposals that would incorporate additional data from the California Department of Food and Agriculture, as it is our long-standing position that data from plants in California is not appropriate for inclusion in formulas setting minimum prices in the federal milk marketing orders. For this reason we oppose Agri-Mark's proposal one.

DPNM argued in its proposed findings and comments the last time that the Department examined make allowances that data from CDFA is not relevant to costs at federally regulated plants. Our brief in October 2006 stated:

> The California study, a virtual census of manufacturing costs for plants in California, cannot be used because it only reflects costs in California and those costs are admittedly higher than in the rest of the country. The California data also reflects a different mix of plants than in the FMMO system both in terms of products, but also markets, location of milk to plants, and costs. To the extent that California's industry has an impact on national pricing, that is captured in the NASS survey which properly incorporates by implication the California cost data. Finally, CDFA uses these audits along with audits of producer costs to establish policy on level of producer pricing. USDA does not have this data.

The Department first included CDFA cost data to counterbalance the RBCS survey data that the Department has since abandoned in establishing make allowances. With the Department's policy

decision to move away from RBCS, the need to maintain California data in the make allowance calculation has also passed.

In addition to including updated data from California, Agri-Mark seeks to update make allowances using the most recent data from Cornell's plant survey. When first presented in September 2006, the Cornell survey could be described as a thoughtful, though not perfect, attempt to arrive at reasonable approximations of manufacturing costs outside of California. But the version cobbled together and rushed to Pittsburgh at the behest of its product-manufacturing commissioners amounts to a regulatory Rorschach test. This data is so muddled and susceptible to selection and interpretation that regardless of the use to which the Department puts the numbers, they are bound to be wrong.

Here is a brief summary of what the 2007 version of the Cornell study included and how it differs dramatically from the 2006 survey.

- Some plants that did not submit data for the 2006 study submitted data from the 2007 study and some plants that participated in 2006 did not submit data in this survey.[88]
- Three plants not included in the 2006 study were high-volume, low-cost plants, and that when those plants were included, the make allowance for cheese actually declined.[89]
- Of the sixteen cheese plants that participated in the Cornell study reported in 2006, their costs increased by 1.7 cents.[90] For all plants participating in 2007, the cheese plant costs fell by approximately one-half cent.[91]

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[88]Stephenson 2748.

[89]Ex. 72, Stephenson 2750.

[90]Ex. 72, p. 6, Stephenson 2793.

[91]Ex. 72, p.5.

- 54% of the NFDM in the 2006 Cornell study came from NDA's plant.[92]

- USDA requested and paid for the 2006 study. The 2007 study was requested by and paid for by Agri-Mark and others.[93]

In 2006, Dr. Stephenson statistically modeled and extrapolated a make allowance for cheese. He advocated that USDA premise make allowance on this model, rather than his survey, because large plants were over sampled in 2006. The following exchange between Dr. Stephenson and counsel for IDFA is from the presentation of the 2006 Cornell study:

> Q. By the methodology you chose, and the result is that if one calculates a weighted average cost of producing cheddar cheese, the focus is only on the 16 sample plants, you are coming up with a weighted average cost based upon a sample population that is substantially over represented by larger plants, correct?
>
> A. That's correct.
>
> Q. And if one assumes that the larger plants are the most efficient, then the result would be that a weighted average cost of producing, based solely on the 16 sample plants, will substantially underestimate the weighted average cost of producing for the total population of all cheddar cheese plants located outside of California is that correct?
>
> A. That's a correct statement.[94]

Thankfully, the Department rejected his statistical extrapolation. Because, in Pittsburgh, Dr. Stephenson took exactly the opposite position about the exact same survey:

> Q. Is it still your view that that kind of refitting produces the best number?
>
> A. I think that it probably does because the last time [2006] we had an over sampling of smaller plant[s] in the survey. This time [2007] I think we have an over sampling of larger plants in the survey."[95]

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[92]Brown 2933-34.

[93]Stephenson 2748-49.

[94]Stephenson Testimony from 2006 Hearing, September 14, 2006, 80-81(appended hereto).

[95]Stephenson 2779.

This inexplicable about face was accompanied by the revelation that the testimony from Dr. Stephenson about the number of large plants in the survey in Strongsville in 2006 was erroneous. There, Dr. Stephenson led the hearing participants to believe that of the 16 cheese plants that submitted surveys, five were large plants, "We had full participation from the largest plants, the 5 largest plants that were polled, and we had less than full participation or final participation from the other 15. . . "[96] But in Pittsburgh, he testified that only one plant in the 2006 survey was "large."[97] Somewhere along the line, Dr. Stephenson reported mistaken testimony on the plants included in the survey, and the results are not harmless. If the author of the study cannot even provide reliable testimony about the stratification of the participants, how can the Department rely on the statistical extrapolation of that data?

But we must wonder, what would be the result if the three plants that did not participate in 2006 but participated in 2007 were reported in the 2006 Strongsville hearing. The record evidence demonstrated that the larger cheese plants, only one of which was included in the 2006 survey, had plant costs of approximately ten cents per pound. The smart money would bet that the make allowance for cheese would have been lower had these larger, more efficient plants been included.

Now, Dr. Stephenson, prompted by the very participants who have retained Cornell to update the survey for them, suggests that his new survey, which contains fewer observations is better than the 2006 survey. But nothing has changed, except that now we know that the survey is far less precise and accurate as we thought it was last year. What we have is not useful and reliable information about plant costs, but make-what-you-want-out-of-it data rushed to presentation to

[96]Stephenson Testimony from 2006 Hearing, September 14, 2006, 46 (appended hereto).

[97]Stephenson 2791-92.

satisfy those who commissioned the study. The Department should reject the requests to incorporate this poor data into the make allowances.

DPNM opposes the adoption of any proposal that would adjust make allowances, or any element of the make allowance component, automatically or without hearing. We oppose the adoption of proposal two or any other like regulations that would automatically update make allowances specify a defined quantity of milk production, plant capacity, or a geographical snubber that must be adhered to.

We understand the concern of some in the industry that the hearing process takes too long. But the longevity of the federal milk marketing order system, in our opinion, can be attributed to the participation of interested parties in the presentation of evidence, cross-examination of witnesses, and opportunity for the industry to present data for the Department's consideration. Absent a survey methodology that is more comprehensive than the current Cornell model, provides for a clear and comprehensible statistical method for extrapolating the survey results, guarantees appropriate representation across geographic areas and plant sizes, and compels the participation of the plants drawn to participate, the Department should decline to entrench it in the federal orders.

In any event, the testimony of Dr. Stephenson in Pittsburgh establishes that the methodology of the Cornell study is terribly nebulous. As we have explained, the Cornell study does not provide the Department a sufficiently sound methodology to obtain complete, accurate, and reliable information about make allowances. This survey should not be incorporated into any automatic update until it is further fine-tuned and demonstrated to be complete and accurate, which it is not now.

DPNM opposes the adoption and incorporation of an energy adjustor, as proposed by National Milk Producers Federation. There is little reason to segregate a single cost element from

the myriad of factors involved in the make allowance formula. Testimony from several witnesses expressed a desire that the price formulas not be made any more complex because, among other reasons, purchasers of dairy products needed to have predictability about their product costs.[98] Injection of monthly adjustments to the energy component of the make allowance formulas will only add to this complexity and should not be adopted.

VII. Price Data from the CME should be utilized instead of NASS surveyed prices for cheese, butter, and NFDM.

In 1999, DPNM advocated the utilization of Chicago Mercantile Exchange sales data instead of NASS surveyed data to establish the pricing series used to set component and minimum prices. Our proposal 15 would replace the use of the NASS survey to determine the sales prices of butter, nonfat dry milk. And cheddar cheese with data compiled from the daily prices on the CME. Proposal 15 would maintain the use of NASS survey prices to establish sales prices for dry whey.

Earlier this year, the concerns about market manipulation of the NASS survey prices by those handlers reporting prices became an expensive reality for dairy producers. It is obvious that if prices for nonfat dry milk sales were taken from the CME rather than the NASS survey, this error would have been prevented. There would be no question about what sales needed to be included. There would be no guessing about whether prices were submitted forthrightly or whether shenanigans were taking place. There would be no need to audit the umbers. The CME is transparent.

The General Accountability Office has now endorsed our argument in favor of CME data.[99] The GAO concluded that the CME prices establish the prices for cheese sales contracts in the United

[98]Yonkers 978, 987, McCully 1147, Carlson 2408, Latta 2420-21.

[99]Ex. 77.

States.[100] GAO observed that the NASS survey is not audited, covers the same sales as the CME, and is not timely.[101]

GAO concluded that:

> To improve the timeliness of reported cheese prices and reduce redundancy that exists in the NASS survey of cheddar cheese, we recommend that the Secretary of USDA direct the Administrator, Agricultural Marketing Service to give serious consideration to all proposals, in consultation with the industry, including the industry proposal to use the CME spot cheese market prices instead of the NASS survey of cheese prices in the minimum federal milk pricing formula.[102]

GAO also addressed the potential problems associated with the use of CME, such as the thinness of the cheese market and the possible manipulation of CME cheese prices. The GAO report properly points out that because the NASS survey captures the same price transactions as the CME, maintaining use of the NASS survey does nothing to addresses any potential manipulation.[103] In addition, CFTC and CME provide oversight over CME transactions.[104] That is, use of the CME can make things no worse that we have now. In fact, the transparency and lack of need for audit make the use of CME clearly preferable to the continued use of the NASS survey.

VIII. Use of CME price data for sales of cheddar blocks can obviate the need for a block-barrel spread.

While our proposal 15 was noticed to survey the CME prices for both 40-pound cheddar blocks and 500 pound cheddar barrels, our intent was the use of only 40-pound block prices from the CME. If the Department adopts the proposal as intended, then there would be no need to have

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[100]Ex. 77, p. 3.

[101]Ex. 77, p. 4.

[102]Ex. 77, p. 28.

[103]Ex. 77, p. 5.

[104]Ex. 77, p. 13-21.

additional debate over the existence or amount of a "block-barrel spread." But assuming that the Secretary elects to maintain the use of the NASS cheese survey, the current block barrel price spread should be maintained.

When the Department adopted the current price formulas, it explained that the purpose of the three-cent barrel price adjustment approximates the historical difference in cost of "manufacturing and packaging the two sizes of cheese" and that in the 22 month period before the Department's hearing on pricing formulas in 2000, the price spread averaged 4.4 cents.[105] As presented in testimony from Agri-Mark, the spread observed by the Department has narrowed. But the spread is not consistently less than three cents.

The argument offered by IDFA and its members in this proceeding is that current conditions do not support the maintenance of the barrel price add-on. It is true that the evidence presented demonstrates that the spread between block prices and barrel prices has moved since the spread has been implemented.[106] Since the start of 2006 through July 2007, the NASS surveyed block price has exceeded the barrel price in 38 of 83 weeks, with a spread as great as 3.85 cents and with block prices exceeding barrels for each week in July 2007.[107] Given the variability in block and barrel prices and the unpredictability of prices from week to week and month to month, the *status quo* should be maintained if the Department elects to include survey prices from both commodities.

IX. The competitive pricing proposal from the Maine Dairy Industry Association deserves serious consideration and further development.

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[105]65 Fed. Reg. 76832, 76845 (December 7, 2000).

[106]Wellington 856.

[107]Source: AMS Milk Marketing Order Statistics Public Database: <http://apps.ams.usda.gov/USDAMIB/PreparedReports/DisplayReport.aspx?ReportName=NASS%20Weekly%20Product%20Prices%20Final&Log=True>.

Competitive prices have always been preferred by DPNM over end product pricing. The MDIA proposal is an excellent start toward a framework that might just be the last, best hope for the future of the FMMO. Given the context of this hearing, and the timing of the MDIA presentation, however, the full implications of moving to this, or any other, competitive pricing system has not been developed in the record.

DPNM requests that the Secretary, regardless of the decision resulting from this hearing, take steps to take further comment and proposals regarding a competitive pricing model and notice a hearing to replace end product pricing with a competitive price system. DPNM believes that there is ample evidence in the record to conclude that the end-product pricing experiment is fraught with the need for constant hearings to set make allowances, product yields, and pricing series and that a new start is needed.

X. There should not be a reduction for whey butter.

DPNM opposes proposals nine and 16 and any changes to the pricing formulas that would incorporate a reduction for whey butter. When the Department adopted the end-product pricing formulas in 2002, it declined to adjust for whey cream values. Undoubtedly, whey cream commands a lower value than sweet cream. But at the Department recognized in 2002, and the record evidence in this hearing establishes, a significant percentage of whey cream is returned to the vat and incorporated into cheeses–both cheddar and mozzarella. Whey cream can also be used to produce ricotta cheese, and Agri-Mark utilizes some whey cream in their butter to enhance flavor.

There is no national or published data that indicates the volume of whey cream sold or the price it is sold for. Anecdotal evidence from one or two plants benefitting from the proposal is insufficient to reduce producer value in protein.

XI. The National All-Jersey Proposals on Whey should not be adopted.

DPNM supports National All-Jersey's proposal that USDA begin collecting data on the prices, manufacturing costs, and volumes of whey protein products and lactose. But we do not support the proposal as an amendment to proposal two that would be automatically incorporated into any aspect of the minimum pricing formulas.

DPNM appreciates National All-Jersey's proposal 16, which would value dry whey on a protein basis rather than on an other solids basis. But as the NAJ witness testified, pricing of dry milk products, including whey products has undergone a significant increase since this hearing began. The industry cannot know whether these increased prices, and the product processing decisions that result are a temporary market blip or a radical change in prices driven by demand. Accordingly, DPNM cannot support proposal sixteen at this time. Although, it may be appropriate to revisit this isue in the future. DPNM notes that the exploration and adoption of a competitive pricing system would render this discussion, and many of the other discussions in this hearing moot, and DPNM would prefer a sound competitive pricing system over additional revisions to the end-product pricing formulas.

XII. Conclusion.

If no other conclusion can be drawn from this record, it is that end product pricing is an experiment that has failed. The pricing formulas have grown increasingly complex. Both producers and handlers have legitimate concerns about the accuracy of the formulas. There is general disagreement as to what pricing series should be used. There is vast disagreement on the appropriate level of make allowances. There is disagreement over whether yields should be adjusted. There are proposals to add more data to NASS collection. There is a suggestion to begin incorporating whey protein concentrate and lactose prices in the pricing formulas. And there are proposals to allow cost add-ons to avoid circularity and price reporting. For the most part, data available to set the factors

in the pricing formulas is unavailable, incomplete, or unreliable. And in all likelihood, we will be back to have another hearing like this in three to five years

Regardless of the decision that results from this hearing, the Department is certain to leave someone with the short end of the stick. And those on the short end will have a legitimate grievance against the Department.

Obviously, Dairy Producers of New Mexico, Select Milk Producers and Continental Dairy Products support and urge the Department to adopt their proposals. There is ample reliable evidence in the record to adopt each and every one of their proposals. And since the industry will be dealing with end product pricing formulas for the foreseeable future, the adoption of proposals 3, 6, 7, 8, and 15 is in the best interest of the federal orders.

But what the industry really needs is a commitment to establishing an entirely new pricing structure. The proposal from the Maine Dairy Industry Association to establish a competitive pricing system may be exactly what the industry needs to move away from product pricing. The evidence in support of the Maine proposal, however, is insufficient for the Department to adopt it at this time. The industry would be well served if the Department called for additional proposals and comments on the Maine Dairy Industry Association proposal and subsequently called a hearing to address the narrow issue of moving to a competitive price system.

Respectfully submitted,

/s/ Benjamin F. Yale

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