Leprino Brief Mideast

# UNITED STATES DEPARTMENT OF AGRICULTURE

## AGRICULTURAL MARKETING SERVICE

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| **IN RE:** | ) | |
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| **MILK IN THE MIDEAST** | ) | |
| **MARKETING AREA;** | ) | **Docket Nos** |
| **PROPOSED AMENDMENTS TO** | ) | **AO-168-A68;** |
| **TENTATIVE MARKETING** | ) | **DA-01-04** |
| **AGREEMENT AND ORDER** | ) | |

## LEPRINO FOODS COMPANY'S BRIEF IN REGARDS TO TO PROPOSALS THAT WOULD AMEND CERTAIN POOLING AND RELATED PROVISIONS OF THE MIDEAST ORDER

There is pending before the United States Department of Agriculture ("Department") a proposal to modify the partial payment rate to producers and cooperative associations for milk received. A hearing was held October 23 and 24 in Wadsworth, Ohio ("Hearing") to consider this proposal, and others, that would amend certain pooling and related provisions of the Mideast Order. Leprino Foods Company ("Leprino") operates two mozzarella manufacturing facilities that receive milk regulated by the Mideast Milk Marketing Order ("Order") to be amended by the rulemaking proceedings. These facilities are located in Allendale and Remus, Michigan. Therefore, Leprino has a vested interest in the outcome of these proceedings. Leprino is submitting this Brief to assist the Department in its analysis of the testimony provided at the Hearing related specifically to Proposal 4.

With regard to Proposal 4, Hearing evidence supports the following conclusions:

A. The proposed change in the partial payment rate neither results in an advance payment that more closely resembles the actual uniform price, nor provides a more consistent cash flow than the current system, two objectives outlined by the proponents (Hollon (DFA), Tr. 1-411).

   1. Had proposal 4 been in place, the monthly differences between the partial payment and the uniform price would have ranged from an "underpayment" of \$4.60 to an "overpayment" of \$1.59 over the 4.75 year period analyzed (January 1997 - September 2001), a clear indication that the proposed partial payment <u>does not</u> emulate the final payment (Taylor (Leprino), Tr. 1-453). In fact, the

total range between the largest underpayment and the largest overpayment increases from $5.74 under the current partial payment to $6.09 under proposal 4 for the period analyzed.

2. The standard deviation of the differences between the partial payment and the uniform price is increased from $1.09 under the current system to $1.17 per cwt. under proposal 4 (Taylor (Leprino), Tr. 1-453). This also contradicts the proponents' suggestion that proposal 4 improves the consistency of producer cash flow and creates a partial payment that more closely resembles the uniform price.

B. The proponent's conclusion that the measures implemented as part of Order Reform in January 2000 fundamentally changed the relationship between the partial payment and the uniform price is erroneously based upon a period that is not representative of future price relationships.

1. The generally upward market trend during the post-reform period analyzed by proponents contributed to a larger difference between the partial payment and the uniform price than during the base period. The difference between the partial payment and the uniform price is greater in an upward market than in a downward market due to the use of the prior month manufacturing value to set the partial payment. Specifically, the partial payment price and uniform price converge in declining markets (that is, the partial payment price as a percent of the uniform prices increases) and conversely, these prices move away from each other in upward moving markets. In 15 of the 21 months (about 71%) since Order Reform, the statistical uniform price increased from the prior month, whereas in the previous three years, the statistical uniform price increased from the prior month in 23 of the 36 months (about 64%). There is no reason to believe that Order Reform will result over the long term in a higher frequency of upward markets than was experienced prior to reform. Therefore, the post-Reform period analyzed can not be considered representative of long term price relationships.

2. An additional factor contributing to the increased spread between the partial payment and the uniform price during the post-reform period is the comparatively high Class IV price relative to the Class III price. This, too, is not likely to be sustained. The Class IV price was higher than the Class III price in 19 of 21 months since Order Reform. This was the result of cheese prices being extraordinarily depressed throughout 2000 (driving down Class III prices) and nonfat dry milk prices being supported at above market clearing levels by the dairy price support program (driving up Class IV prices). The cheese values of 2000 can clearly be viewed as an anomaly, and the support program influence on Class IV prices was reduced in mid-2001 by an adjustment in the nonfat and

butter support prices. The return of cheese values to their historic range and the reduction in the artificial enhancement of nonfat dry milk prices by the support program will reduce the difference between the partial payment and the uniform price relative to the difference experienced during the period referenced by the proponents.

C. The proposal violates two basic tenets of pricing for milk manufactured into Class III and IV products. These are that Federal Milk Marketing Orders establish <u>minimum</u> pricing, and that since manufactured products are marketed nationally, the minimum regulated price level for Classes III and IV are consistent across all Orders. Adoption of proposal 4 would result in manufacturers of products in the lowest Class, and in many months in the lowest two Classes, paying more than the classified value of their milk in the partial payment. The existence Orders that currently require a prepayment rate in excess of a processor's minimum Class obligation does not validate the practice.

In response to the question regarding receipt of payment for finished products, Leprino receives payment for cheese and whey 57 days, on average, after the raw milk is received that is used to produce those finished products.

Respectfully submitted,

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