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September 29, 2005

Ms. Dana Coale, Deputy Administrator
USDA - AMS - Dairy Programs
1400 Independence Avenue, SW
Washington, D.C. 20250-0225

Re: Request for an emergency hearing on changes in the Class III and IV price formulas

Dear Deputy Administrator Coale,

The following three changes in the Federal Order provisions for Section 1001.50 are being proposed on an emergency basis on behalf of Agri-Mark Dairy Cooperative and its 1272 dairy farmer members who are all regulated under the Northeast Federal Milk Marketing Order.

PROPOSAL 1

Agri-Mark's primary proposal is to update the manufacturing allowances for cheese, whey powder, butter and nonfat dry milk powder. The current allowances were fixed based upon now antiquated cost data from 1998-2000, yet are still used to establish minimum prices for milk under all Federal Milk Orders. Actual manufacturing and other costs have risen dramatically during the past five to seven years but Federal Order provisions have effectively stopped manufacturers from covering those higher costs through higher general sales prices or other means.

In order to simplify and hopefully quicken the time and efforts needed to update manufacturing allowances, Agri-Mark is proposing that the amended allowances be based upon the same two surveys from California and the USDA Cooperative Service that USDA has already used twice to set those allowances.

The California state manufacturing cost survey is conducted annually and the latest one is expected to be available this fall. Dr. Charles Ling of the USDA Cooperative Service has agreed to update his survey using recent data from past participants. The following cooperatives have agreed to participate: Land O' Lakes, Foremost Farms, Michigan Milk Producers, Associated Milk Producers, Northwest Milk Producers and Agri-Mark. This information would be used to update the manufacturing allowances as follows in Section 1000.50 class prices:

Sub sections:

(l) butterfat price, current butter manufacturing allowances of 11.5 cents per pound,

(m) nonfat solids price, current nonfat dry milk manufacturing allowances of 14 cents per pound,

(n)(2) and (n)(3)(i) protein price, current cheese manufacturing allowances of 16.5 cents per pound,

(o) other solids price, current whey powder manufacturing allowances of 15.9 cents per pound, and

(q)(3) advanced butterfat pricing factor, current butter manufacturing allowances of 11.5 cents per pound.

JUSTIFICATION FOR PROPOSAL 1

On January 1, 2000, the basis for determining class prices for milk regulated under Federal Milk Marketing Orders was changed dramatically. Prior to that date, most class prices were determined using the competitively set M-W and Basic Formula Prices (BFP) that were paid for milk by dairy product manufacturers in the Upper Midwest. Those prices moved up or down as cheese and other dairy product prices moved. Those prices also moved if manufacturing costs changed and plants had more or less net income available to pay farmers for their milk.

When the Federal Orders were amended under major reform provisions in January 2000, the basis for determining class prices was shifted to an end-product pricing system. Rather than surveying competitively set farm milk prices, under this revised system, USDA surveys competitively set nationwide cheese, whey powder, butter and nonfat dry milk commodity wholesale prices. USDA then inserts those dairy product prices into formulas which, in turn, are used with administratively set product yields and manufacturing cost allowances in Order to determine the class prices to be paid by handlers for farm milk.

For the Class III milk price for example, the system functions by obtaining the cheese and whey products prices, and then subtracting fixed manufacturing allowances in order to end up with the net farm milk value. Appropriate yield factors are also used to convert dairy product pounds to pounds of raw farm milk components (and eventually, hundredweights of farm milk).

When USDA seeks the appropriate current dairy product prices to use in its class price calculations, it conducts weekly surveys of hundreds of plants so a reasonable monthly average price can be determined. The Department then automatically uses those prices to determine the appropriate class and component prices. Rightfully so, USDA wants the

price of milk to be responsive to any changes in the prices of the corresponding dairy products. However, similar care is not taken with the manufacturing cost allowances used in the same formulas. The fixed manufacturing cost allowances, currently in place throughout the Federal Order system, are completely unresponsive to any changes in actual costs until a Federal Order hearing is held and a USDA decision is determined to amend the appropriate provisions of the Federal Order regulations.

The manufacturing cost allowances currently in place throughout the Federal Order system for cheese, butter and nonfat dry milk as of January 1, 2001 are based upon cost data from a USDA Cooperative Service survey of costs at cooperative manufacturing plants in 1998 and 1999 and from a California state survey of instate manufacturing costs in 2000. Earlier versions of these same two surveys were used to determine the original Federal Order allowances effective on January 1, 2000.

Manufacturing costs for all dairy products have changed greatly from the 1998 to 2000 period. Energy costs have increased dramatically in the five to seven year period while medical related labor costs and insurance costs have increased substantially also. It would be incorrect, and in fact unreasonable, to assume that somehow technology or other efficiency improvements at existing plants have somehow entirely offset these escalating costs.

Dairy product manufacturers under Federal Milk Orders are trapped into a fixed make allowance with no opportunity to cover their higher costs no matter what the price of their dairy products are. If manufacturers raise their product prices to cover higher costs, those higher prices automatically lead to higher milk prices, leaving no additional net income to apply to the higher costs.

Dairy America, a cooperative federation of dairy cooperatives that manufacture and jointly market nonfat dry milk (of which Agri-Mark is a member), recently put a surcharge on nonfat dry milk powder to cover higher energy and other costs. However, they did not report that surcharge as part of the weekly USDA-NASS survey price. When USDA learned that, they automatically incorporated the higher price into the NASS survey, the Class IV price then rose and manufacturers ended up receiving nothing toward their higher costs.

This is a major problem for dairy product manufacturers like Agri-Mark who operate plants receiving milk under Federal Orders. Agri-Mark operates two cheese plants in Vermont, one cheese plant in New York and a butter/powder market balancing plant in Massachusetts. Agri-Mark's manufacturing costs are up over five cents per pound from 1998 to 2004 at our largest cheese/whey facility in Middlebury, Vermont. Energy, labor (particularly medical benefits) and plant/lab supplies are all up substantially. Butter manufacturing costs are up about two cents per pound during that same period and nonfat dry milk manufacturing costs are up over three cents per pound. We also provide over a billion pounds of milk to the Class I market, which represents about 40% of our total member milk production. Our competitors, who manufacture dairy products in California and Federally unregulated areas, do not have this same problem.

California has an end-product pricing system similar to Federal Orders. However, that state conducts annual manufacturing cost surveys and adjusts their manufacturing allowances accordingly. Currently, California has higher allowances for all dairy products and much higher allowances to manufacture whey powder, nonfat dry milk and butter. California is the largest milk producing state in the nation and, according to USDA statistics, produced 22% of the cheese, 31% of the butter and 52% of the nonfat dry milk produced in the nation last year (please see Table 1).

In order to help understand the scope of the problem faced by Agri-Mark and other manufacturers (and balancers) of Federal Order milk, the following table shows the current Federal Order manufacturing allowances as well as those in California. While California is important as a major competitor for all dairy products and their lower milk prices gives them a competitive price advantage in most common sales areas, the important issues about their following make allowances is that they are based upon audited financial information representing actual recent costs at California plants.

<u>Product</u>	<u>Manufacturing Allowances (\$/pound)</u>		
	<u>Federal Order</u>	<u>California</u>	<u>Difference</u>
Cheese	\$.1650	\$.1706	+.0056
Butter	\$.1150	\$.1299	+.0149
NFDM	\$.1400	\$.1560	+.0160
Whey	\$.1590	\$.2000	+.0410

California make allowances are higher than those used by the Federal Order for all products. While the cheese allowance is only about half a cent per pound higher, the whey powder allowance is over four cents per pound higher. Since the Federal Order Class III price formulas assume almost six pounds of whey powder in each hundredweight of milk, that lower Federal allowance alone unduly enhances Federal Order Class III prices by \$.24 per cwt.

Attached Table 1 shows the average volume of products manufactured at California plants versus the remainder of the country. On average, California cheddar cheese plants manufacture about 2 ½ times as much cheese as those in the rest of the nation. California butter plants average twice the production volume and the state's nonfat dry milk plants average four times the production volume. Most California manufacturing plants also are not as old as those in most other areas of the country. Due to economies of size and newer facilities, one would expect California plants to have lower manufacturing costs than those in the Federal Order.

Cheese makers and other dairy product manufacturers that serve as nearby outlets for local producer milk and as balancers of billions of pounds of Federal Order pool milk can no longer cover their costs under current Order provisions. The Northeast has seen a number of manufacturing plants close and watched as the region's annual Class III milk volume have fallen from 703 million pounds in 2001 to 454 pounds in the past 12 months. That's a 35% decline in only four years. The decline in Northeast cheese production would have been even greater had Agri-Mark not stepped forward in 2001

and kept the McCadam cheese plant in New York open after its owners decided to close it. On the other hand, as already noted, California cheese and dairy product manufacturing costs are surveyed annually and their class formulas have been adjusted accordingly.

California cheese plants usually pay about \$.30 to \$.60 less for their milk despite their newer and larger cheese operations. In 2004 the California announced minimum milk price paid by cheese manufacturers was \$.52 per cwt. less than the similarly announced minimum price under Federal Milk Orders. The most recent prices for August 2005 show Federal Order Class III milk users paid \$13.60 for their milk while California cheese makers paid \$12.99 for theirs. Class IV Federal Order plants also incurred a substantial difference when their Class IV price was \$13.44 in August compared to \$13.06 in California. It should come as no surprise that California cheese production has risen 42% in the last five years compared to a decline in the Federal Orders.

Upwards adjustments in the manufacturing allowances will initially result in lower class prices for milk under the Orders and a reduction in the farm blend price. As a farmer cooperative, Agri-Mark is always very concerned about anything that lowers the milk price to dairy farmers. However, dairy farmers in the Northeast are already bearing a financial burden due to the results of the insufficient make allowances. Several large cheese plants have already closed in the Northeast and that has forced farmers and their cooperatives to move milk to more distant plants at a greater cost that is passed onto farmers. In addition, competitive premiums paid to farmers are also under pressure as the local demand for milk falls.

In the Northeast, more milk has had to move to lower valued Class IV (butter/nonfat dry milk) balancing plants, increasing the Class IV utilization of milk. Had the Northeast Order had the same Class III utilization percentage in the past 12 months (August 2004 to July 2005) as it did in calendar year 2001, farm blend prices would have been \$.15 per hundredweight higher than they were. This problem will get worse as more manufacturing plants buy less milk or close entirely. In addition, Class IV balancing plants also are losing large sums of money due to the below costs fixed make allowances for butter and nonfat dry milk that are also set based on 1998/2000 costs.

Agri-Mark members have literally invested tens of millions of dollars into local plants in the Northeast while other dairy product companies have closed their facilities and sought cheaper manufacturing milk elsewhere. When manufacturing allowances are kept at a level below the costs of producing dairy products, farmers who have taken on the responsibility of balancing the milk and providing local homes for local milk end up receiving a lower net price than their neighbors. That is unfair to say the least.

We are aware that the Dairy Division of USDA's Agricultural Marketing Service has already begun looking at this problem by asking Cornell University researchers to create a methodology to measure manufacturing costs while also conducting a survey of those costs. We believe that conducting such a survey and updating manufacturing allowances

up or down on an annual basis is the correct long-term solution to this problem. However, this work is just beginning.

It will likely take at least a year or so before results for all dairy products are available and another year or two (or longer) for the industry to review the results, debate them during the hearing process and see them codified into the Federal Orders. As a long term approach intended to be in place for many years, the Cornell work would certainly generate much controversy within the industry. Once Cornell has completed its work and before the hearing stage is begun, all segments of the industry should have the time and opportunity to understand and comment on the method used. Following that, a lengthy and complex hearing process and hearing record would likely occur. However, the dairy manufacturing industry can not wait that extended period of time as it is already suffering losses each day as a result of the obsolete cost structure. These antiquated manufacturing allowances need to be updated immediately by the best available means.

PROPOSAL 2

Adjust the protein price to accommodate the reduced value of whey butter in the Class III price formula.

Amend Section 1000.50(n) by including the following additional paragraph:

(4) Subtract \$.017 from the price computed pursuant to paragraphs (n) (2) and (n) (3) of this section.

JUSTIFICATION FOR PROPOSAL 2

Under current Federal Order provisions, both the butterfat and protein prices use the Grade AA butter price as the value for all types of butter production resulting from the use of Class III and Class IV milk. While that may be an appropriate value for Class IV component value calculations, it is not so for Class III values.

The Class III yield calculation, for milk testing 3.5% butterfat and 2.99% true protein, assumes a 90% butterfat retention in cheese with the remaining fat being used to produce whey butter. However, the butterfat and protein formulas further dictate that the resulting 0.42 pounds of whey butter be priced as if it were sold as Grade AA butter.

It is illegal under USDA's own regulations for whey butter to be labeled as Grade AA butter and it therefore does not have that Grade AA value in the marketplace. Agri-Mark's whey butter selling prices average more than \$.12 per pound below that of Grade AA butter. That \$.12 difference multiplied by the 0.42 pounds of whey butter equals \$.0504 cent per hundredweight of milk. Using USDA's standard of 2.99 pounds of protein in that same hundredweight of milk, the value per pound of protein should be reduced by \$.017 (\$.0504 divided by 2.99).

PROPOSAL 3

Reduce the 3 cent addition to the NASS survey price for barrel cheddar cheese to 1.5 cents with the following amendment to section 1000.50:

(n) (1) (ii) ...reported by the department for the month plus 1.5 cents.

JUSTIFICATION FOR PROPOSAL 3

Under current Federal Order provisions, the average of the NASS survey prices for 40-lb. block and 500-pound barrel cheese, weighted by the volume surveyed of each, is used in determination of the protein price for milk. However, before the average cheese price is determined, three cents is added to the 500 pound barrel price. According to USDA's original decision, these three cents represented the historical difference in prices (prior to 2000) between block and barrel cheese prices and somehow was a proxy for production costs differences.

Since the 38% moisture factor was included along with protein pricing in January 1, 2000, the historical difference between the block and barrel prices, has averaged 1.8 cents per pound. The appropriate Order provisions relating to protein pricing were last amended on April 1, 2003. Since April 1, 2003, that block/barrel difference has averaged less than \$.015 per pound.

Agri-Mark believes the barrel price should be excluded from the protein price calculation since the make allowances are specifically for block cheese production. Clearly an artificial three cents surcharge primarily based on historical statistics no longer applies and has unduly enhanced the cheese price beyond what the market price for block cheese has been. However, if USDA believes it should maintain the use of the already established barrel price series, the surcharge should be reduced to \$.015 cents until such time that the Cornell survey has determined the true costs of block and barrel cheddar cheese production.

EMERGENCY DECISION STATUS

Manufacturing costs have increased substantially since the 1998-2000 period used to determine the current manufacturing allowances, yet those allowances provided for under Federal Orders have remained fixed. The problem has further escalated since 2004 when energy prices have skyrocketed. Both the production of whey powder (Class III) and nonfat dry milk powder (Class IV) involve removing moisture and therefore are particularly energy intensive. However, rising energy costs have also impacted all aspects of the production of dairy products, as have increases in other costs.

Current manufacturing allowances are well below the actual costs involved in manufacturing cheese, whey powder, butter and nonfat dry milk powder. Every day that goes by means losses on the part of manufacturers who provide outlets for billions of pounds of Federal Order milk production as well as balancing services to their respective

Orders. In the case of Agri-Mark, these losses are directly incurred by member-farmers, who end up receiving a lower net price than other farmers who have shown no such commitment to the marketplace.

Both the whey butter and barrel cheese addition issues are on-going problems that have both unduly enhanced the Class III price for the past several years and have put cheese manufacturers using Federal Order milk at a competitive disadvantage with manufacturers not so regulated.

We clearly need these three proposals considered on an emergency basis to address these serious economic problems!

Agri-Mark and its members/owners appreciate your consideration of these proposals.

Sincerely,



Robert D. Wellington
Sr. Vice President for Economics, Communications and Legislative Affairs
Agri-Mark Dairy Cooperative

cc: Mr. Erik Rasmussen, Market Administrator
Northeast Milk Marketing Area

**TABLE 1: CHEESE, BUTTER, NONFAT DRY MILK AND WHEY POWDER PRODUCTION
FOR CALIFORNIA AND THE UNITED STATES, 2004**

	<u>CHEDDAR CHEESE</u>			<u>ALL CHEESE*</u>			<u>BUTTER</u>			<u>NONFAT DRY MILK</u>			<u>WHEY POWDER**</u>		
	<u>Volume</u> (mil.lbs.)	<u>Plants</u> number	<u>Vol/Plant</u> (mil.lbs.)	<u>Volume</u> (mil.lbs.)	<u>Plants</u> number	<u>Vol/Plant</u> (mil.lbs.)	<u>Volume</u> (mil.lbs.)	<u>Plants</u> number	<u>Vol/Plant</u> (mil.lbs.)	<u>Volume</u> (mil.lbs.)	<u>Plants</u> number	<u>Vol/Plant</u> (mil.lbs.)	<u>Volume</u> (mil.lbs.)	<u>Plants</u> number	<u>Vol/Plant</u> (mil.lbs.)
CALIFORNIA	538	14	38	1,996	63	32	389	13	30	737	10	73.7	118	5	23.6
as % of U.S	19%	9%		22%	16%		31%	19%		52%	21%		12%	14%	
as % Other			247%			156%			198%			408%			91%
Other***	2,225	143	16	6,881	338	20	861	57	15	669	37	18.1	831	32	26.0
U.S.	2,763	157	18	8,877	401	22	1,250	70	18	1,406	47	29.9	949	37	25.6

*except cottage cheese

** for human consumption only

*** all states outside of California



International Dairy Foods Association
Milk Industry Foundation
National Cheese Institute
International Ice Cream Association

November 10, 2005

Ms. Dana Coale, Deputy Administrator
USDA - AMS - Dairy Programs
1400 Independence Avenue, SW
Washington, D.C. 20250-0225

Re: Petition of the National Cheese Institute (NCI) For an Expedited Hearing To Amend Federal Milk Marketing Orders

Dear Deputy Administrator Coale,

The National Cheese Institute (NCI) hereby petitions the Secretary of Agriculture to institute a proceeding to amend all current Federal Milk Market Orders (FMMOs), 7 C.F.R. Parts 1000 – 1135, on an expedited basis, to relieve the economic hardships on cheese manufacturers due to dramatically higher costs of manufacturing cheese since USDA last established manufacturing cost factors (make allowances) based on industry cost data from 1998 – 1999.

1. Introduction and Summary

The current make allowances were established by USDA based on evidence presented at a FMMO hearing held in May 2000. The evidence presented was based on industry cost data from the period 1998 – 1999, the most recent available at that time. Actual cheese plant manufacturing and related costs have risen significantly in the six years since. However, FMMO regulations strictly prevent cheese manufacturers from in any way recovering any portion of those higher costs through higher sales prices or other means.

When USDA implemented the 1996 Farm Bill's directive to reform FMMOs, it fundamentally altered the formulas for establishing the minimum prices which regulated dairy processing plants must pay dairy producers and milk marketing cooperatives for milk used in all dairy products. In doing so, USDA established a fixed relationship between the wholesale price of dairy products used in those formulas and the minimum class prices, with that fixed relationship based on the cost of producing cheese and other manufactured products ("the "make allowances"). However, USDA provided no mechanism to adjust that fixed relationship short of conducting a formal rule-making process.

Neither Congress nor USDA intended to threaten the economic viability of the U.S. cheese industry by forcing manufacturers to lose money on every pound of cheese produced, or potentially injure dairy producers by eliminating this important outlet for farm milk. However, the current system of FMMO regulated price formulas, unlike its predecessor, fixes the difference between the value cheese manufacturers obtain in the marketplace for their products and the minimum price they must pay for the milk used to make those products based on the industry costs as they existed at or before the May 2000 hearing at which the make allowances were established. Without any mechanism to adjust the make allowances in response to changes in industry costs, manufacturers are trapped into either losing money on every pound of product produced or stopping production entirely.

The method employed following the May 2000 hearing to establish make allowances used a weighted (by volume of dairy product production) average of two sources of industry cost data. The first is the annual published summary of the industry cost audit conducted by the California Department of Food and Agriculture (CDFA). The second was based on the results of a survey of dairy cooperative manufacturing plant costs conducted by the Rural Business Cooperative Service of USDA.

The cheese manufacturing industry urgently needs immediate relief from the highly injurious fixed relationship between output prices and minimum regulated milk prices that do not reflect current industry costs. Specifically, NCI seeks immediate consideration of the following proposed change in FMMO regulations:

Update the make allowances used in all FMMO minimum class price formulas using the same methodology used to establish the current make allowances, but with the most recently available industry cost data from both the California Department of Food and Agriculture and USDA's Rural Business Cooperative Service.

NCI requests that USDA promptly issue an expedited Notice of Hearing on the requested changes in the FMMO class price formulas. The Notice of Hearing should include the request that USDA omit a recommended decision so that a prompt final decision may be implemented immediately.

2. Explanation of the Problem

Prior to January 1, 2000, the minimum class prices for milk regulated by FMMOs were established based on the actual competitive market prices paid for unregulated (Grade B) milk in the upper Midwest. The Basic Formula Price (BFP) under FMMOs was based on the Minnesota – Wisconsin price series, a survey of the prices paid for Grade B milk in the second preceding month, updated by the changes in the weighted average of the wholesale prices for cheese, butter and nonfat dry milk between the second prior month and the immediately preceding month. While the minimum class prices moved up or down with changes in wholesale dairy product prices, the underlying market conditions for unregulated milk in the upper Midwest were the driving force in the level

of FMMO minimum class prices. Those competitive pay prices could, and did often, change in response to changes in industry manufacturing costs.

When the 1996 Farm Bill-directed reforms of FMMOs were first implemented in January 2000, the basis for determining class prices was shifted to an end-product pricing system. Rather than surveying competitive farm milk prices, USDA began to use surveys of actual market transaction prices for cheese, dry whey, butter and nonfat dry milk across the entire United States. USDA then uses those dairy product prices in conjunction with product yield factors and manufacturing cost allowances ("make allowances") in formulas which establish the value of the milk components; protein, other solids and butterfat or nonfat solids and butterfat. These component values, in turn, determine the minimum class prices to be paid by regulated processors for all farm milk.

The make allowances currently used throughout the FMMO system for cheese, dry whey, butter and nonfat dry milk were established following a hearing in May 2000. At that time, industry cost data were available for the years 1998 – 1999, and this formed the basis of testimony by a number of industry participants. In a decision based on that hearing, USDA fixed the make allowances for cheese, butter and nonfat dry milk by using data from two sources presented at the hearing. The first source was based on actual plant cost audits conducted by the California Department of Food and Agriculture (CDFA). The second source was a summary of a survey of dairy cooperative manufacturing plant costs conducted by the USDA's Rural Business Cooperative Service (RBCS). In both cases, the data came from actual industry costs during the period 1998 – 1999. The method adopted by USDA was to weight these two data sources by the volume of cheese, butter and nonfat dry milk represented by each data source.

At that time, neither of these two data sources included industry cost data for dry whey, and USDA relied on testimony at the hearing regarding the relationship in industry costs between nonfat dry milk and dry whey manufacturing to establish the dry whey make allowance.

USDA's National Agricultural Statistics Service (NASS) conducts weekly surveys of dairy product transaction prices (cheddar cheese, dry whey, butter and nonfat dry milk) from manufacturing plants across the entire United States. These weekly averages are used to calculate monthly, weighted average prices for these four products. The Department then uses those monthly average prices to determine the minimum component and class prices. In this manner, the FMMO minimum price of farm milk changes in conformity with changes in the wholesale prices of the manufactured dairy products in the market.

The fixed make allowances currently in place in all FMMOs are completely unresponsive to any changes in the actual costs incurred by manufacturing plants. Under the FMMO system, the FMMO minimum price for farm milk is the wholesale prices of the manufactured dairy products in the market as surveyed by NASS minus

the make allowance set forth in the FMMOs. Dairy product manufacturers under FMMOs are trapped into a fixed make allowance with no opportunity to cover their higher costs. If manufacturers raise their product prices to cover higher costs, those higher prices automatically lead to higher minimum component and class prices.

Industry manufacturing costs have changed substantially since the 1998 – 1999 period used to establish the current make allowances. One example is the data provided by CDFA, one of the two sources of industry cost data used by USDA to establish the current make allowances. At the May 2000 hearing, data published by CDFA in February 2000 was used. The most recent data published by CDFA is from December 2004. These data are presented in the following table:

Table 1: Cost to manufacture one pound of product, dollars per pound.

	Butter	Nonfat dry milk	Cheese	Whey
February 2000	\$0.0930	\$0.1277	\$0.1759	(1)
December 2004	\$0.1321	\$0.1551	\$0.1734	\$0.2675 (2)
Difference	+\$0.0361	+\$0.0277	-\$0.0025	

(1) CDFA did not collect whey costs prior to the December 2004 release.

(2) Survey period January 2002 through October 2003.

Source: CDFA

Due to the time necessary to conduct audits under the CDFA system, manufacturing cost data is already 6 to 12 months old at the time of publication. Therefore, even the data published in December 2004 represents the data period January 2003 through December 2003, with updates to some cost categories based on changes in price indexes through September 2004. CDFA expects to publish new data by early December 2005, which will reflect at least some of the recent period in which energy prices have been higher.

Even the data in Table 1 fails to fully describe the situation facing NCI members and other dairy product manufacturing plants regulated by FMMOs. The dairy products manufactured at FMMO plants compete directly with products manufactured at plants located in California and regulated by that state's regulations. For all manufactured dairy product make allowances used in FMMO and CA regulated minimum farm milk prices, the CA make allowances are higher, as seen in Table 2.

Table 2: Make allowances under both FMMO and California regulations.

Product	California	FMMO	Difference
NFDM	\$0.1560	\$0.1400	\$0.0160
Butter	\$0.1299	\$0.1150	\$0.0149
Cheese	\$0.1706	\$0.1650	\$0.0056
Dry Whey	\$0.2000	\$0.1590	\$0.0410

Source: AMS and CDFA

The second source of industry manufacturing cost data used by USDA as a result of the

May 2000 hearing was a survey conducted by USDA's Rural Business Cooperative Service (RBCS), the results of which were presented during that hearing by Dr. Charles Ling. Dr. Ling is in the process of conducting a new survey of cooperative dairy manufacturing plants and has expressed a willingness to again testify at a FMMO hearing regarding the results of this new survey. These results are expected to be available by mid-December 2005. Unlike data available from both CDFA and RBCS in May 2000, both sources plan to have data on dry whey costs.

In addition to the tables above containing CDFA data and make allowances, other secondary data clearly demonstrates the higher costs facing dairy product manufacturers. A recent study by researchers at the University of Wisconsin-Madison also looks at the impact of higher energy costs on dairy product manufacturers (Federal Order Product Price Formulas and Cheesemaker Margins: A Closer Look, by Ed Jesse and Brian W. Gould, Marketing and Policy Briefing Paper No. 90, October 2005). They conclude that changes in energy costs between January 2004 and September 2005 have increased the cost to take a hundredweight of milk and manufacture cheese, whey butter, and dry whey by 13.26 cents. The authors conclude that "In particular, competition would dictate that cheesemakers' gross margins rise and fall in response to changing costs. Formulas hold margins to a fixed amount that can only be changed through a laborious hearing process." They also state that "fixed margins can be a serious problem if they consistently yield sub-par returns and cause disinvestment in cheesemaking. Farmers and cheesemakers are partners – both must be profitable over the long run to sustain a healthy dairy industry."

In 2002, the last year without significant depooling, 55.7 billion pounds of FMMO milk was utilized to make cheese. Using the Jesse and Gould estimate of 13.26 cents per hundredweight, this calculates to an additional \$74 million cost incurred by cheese plants in the Federal Order system for energy cost increases since January 2004 alone. Other costs have also increased, as evidenced by data published by the U.S. Department of Labor's Bureau of Labor Statistics. Between the fourth quarter of 1999 and the third quarter of 2005, the employment cost index for wages and salaries in the manufacturing-non-durable-goods sector increased by nearly 18 percent (from 141.1 to 166.2). The increase in the employment cost index for benefits in the manufacturing sector was an even greater 42 percent (from 148.4 to 210.8). The increase in the industrial natural gas index was 165 percent (from 106.0 in December 1999 to 280.8 in September 2005; industrial electrical power increased 21 percent (from 129.5 in December 1999 to 156.6 in September 2005); and refined petroleum products increased 157 percent (from 75.6 in December 1999 to 194.6 in September 2005).

NCI member companies and other dairy product manufacturers can no longer cover their costs under current FMMO provisions. We are aware that Dairy Programs of USDA's Agricultural Marketing Service has already begun looking at this problem by asking Cornell University researchers to create a methodology to measure manufacturing costs while also conducting a survey of those costs. However, interim action is urgently needed to provide more rapid relief for the dairy manufacturing industry. The work being conducted by Cornell University researchers is unlikely to be

completed for all products used in the FMMO price formulas in time to address this enormous industry problem. The dairy manufacturing industry cannot wait for that data to become available, be debated by the industry, and initiate a lengthy hearing and decision process which considers all aspects of the Class III and IV FMMO price formulas. The last time USDA initiated such an undertaking with a hearing in May 2000, the final decision was not implemented until 35 months later in April 2003.

3. USDA can hold a hearing on short notice and render a final decision promptly without first publishing a recommended decision

USDA has been granted explicit legal authority to call hearings to consider FMMO amendments on as little as three days notice. 7 U.S.C. § 608c(17); see *also* 7 C.F.R. § 900.4(a). Furthermore, USDA is authorized to omit a recommended decision when necessary. The Administrative Procedure Act authorizes omission of a recommended decision "in a case in which the agency finds on the record that due and timely execution of its functions imperatively and unavoidably so requires." 5 U.S.C. § 557(b)(2). The Department's rules are to the same effect. 7 C.F.R. § 900.12(d).

Taking action here in an expeditious manner would be fully consistent with USDA's prior practice:

1) On September 30, 2004, USDA published in the Federal Register notice of a hearing to be held seven days later, on October 7, 2004, to consider the adoption of temporary transportation credits as a result of disruptions caused by hurricanes in the Southeastern United States. 69 Fed. Reg. 58368. Finding that emergency action was needed, USDA issued a final decision without first issuing a recommended decision. See 69 Federal Register 67670, 67677 (2004). The final decision was published on November 19, 2004, less than two months after the hearing was noticed.

2) In 1966, USDA held three regional hearings, which collectively covered all federal milk orders, for the purpose of substantially changing the Class I differentials then in existence. Notice of these hearings was published on March 5, 1966, with hearings commencing on March 9 and 10. See 31 Federal Register 3465, 3466 (1966). Based upon his finding that emergency action was needed, the Secretary issued a final decision without first issuing a recommended decision. See 31 Federal Register 5365, 5371, 5378 (1966). The final decision was published on April 5, 1966, a mere thirty days after the hearing was noticed, and the new Class I differentials were made effective as of April 10, 1966. See 31 Federal Register 5360, 5368, 5375, 5609, 5612, 5616 (1966).

3) USDA in 1974 promulgated emergency amendments changing the formula for setting minimum milk prices for manufactured products. The emergency decision was published on March 29, 1974, see 39 Fed. Reg. 11,567 (1974), only 45 days after the notice of hearing had been published on February 14, 1974. See 39 Fed. Reg. 5642 (1974). The hearing itself was held six days after publication of the notice of hearing. *Id.*

4) In 1982, USDA held emergency hearings to establish transportation credits. The notice of hearing was published on March 10, 1982, and the hearing

commenced six days later, on March 16, 1982. See 47 Fed. Reg. 10,230 (1982). The Emergency Decision was published on April 23, 1982 -- a mere 44 days after the notice of hearing. See 47 Fed. Reg. 17,530 (1982).

5) On January 26, 1998, USDA published notice of a hearing to commence less than one month later, on February 17, 1998, to consider proposals to floor the Class I and II prices. (63 Fed. Reg. 3667).

USDA is under no obligation to solicit additional proposals from other interested parties before holding a hearing for the purpose of updating the current make allowances. Neither the Agricultural Marketing Agreement Act of 1937 nor applicable USDA regulations impose any such requirement. The regulations simply provide that a person may file with USDA a proposed federal order amendment, and that USDA will serve a notice of hearing if deemed appropriate. 7 C.F.R. § 900.3.

Moreover, USDA historically has not solicited such proposals where, as here, the proponents of a specific proposal have demonstrated the need for prompt action. For example, available documentation indicates that no additional proposals were solicited in connection with the hearings discussed above in paragraphs 1, 2, 4 and 5.

NCI member companies and other dairy product manufacturers regulated by FMMOs are trapped by a fixed make allowance in combination with a surveyed commodity price, leaving no opportunity to cover their higher costs. If manufacturers raise their product prices to cover higher costs, those higher prices automatically lead to higher minimum component and class prices. NCI's proposal is very straightforward and can be accommodated through a very short hearing. The proposed method for determining make allowances is identical to that supported by most dairy producer groups during the May 2000 hearing; NCI is not proposing to reconsider or change the methodology used to set minimum prices, or the FMMO formulas, or the data sources used in those formulas. NCI only proposes to update the formulas by using the most currently available make allowance data from the same sources previously utilized.

NCI urges that USDA hold a hearing as soon as the updated CDFA and RBCS data is available and move expeditiously to a decision.

Respectively Submitted,

Robert D. Yonkers, Ph.D
Chief Economist
International Dairy Foods Association
1250 H Street NW, Suite 900
Washington, DC 20005
202-737-4332

Gino



Associated Milk Producers Inc.

315 N. Broadway, P.O. Box 455, New Ulm, MN 56073
Phone: (507) 354-8295 Fax: (507) 359-8651

October 12, 2005

Ms. Dana Coale, Deputy Administrator
USDA-AMS-Dairy Programs
1400 Independence Avenue, SW
Washington, D.C. 20250-0225

Dear Deputy Administrator Coale:

Associated Milk Producers Inc. (AMPI) is aware of Agri-Mark Dairy Cooperative's request for an emergency hearing on changes in the Class III and IV price formulas used for classified pricing in Federal Milk Marketing Orders.

The plant processing cost data (make allowances) currently used, which began on January 1, 2000, are out-dated and certainly inadequate compared to today. Costs, particularly energy, have gone up dramatically. This is causing larger and larger discrepancies between the Class III and IV prices resulting from current formula pricing and the returns actually received from the sale of the commodities used in these formulas.

We realize that Cornell University is in the process of developing processing cost data, but that the results could be a year or better away. The problems discussed above need to be addressed as soon as possible with whatever current cost data is available. Cornell data could possibly be used at another future hearing, when available.

AMPI supports the Agri-Mark request for an emergency hearing on changes in the Class III and IV price formulas.

Sincerely,

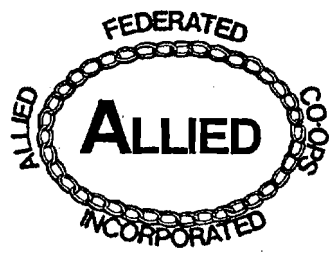
Neil S. Gulden
Director, Fluid Marketing
Associated Milk Producers Inc.

Cc: Mr. Paul Kyburz
Market Administrator
Upper Midwest Marketing Area

Mr. Robert Vander Linden
Market Administrator
Central Marketing Area

6100

Address:
49 Jameson Road
Canton, New York 13617



Phone: 315-386-8116
Fax: 315-379-0213
www.alliedcoop.com

September 23, 2005

Ms. Dana Coale, Deputy Administrator
USDA - AMS - Dairy Programs
1400 Independence Avenue, SW
Washington, D.C. 20250-0225

Mr. Erik F. Rasmussen, Market Administrator
Federal Milk Order No. 1
P.O. Box 51478
Boston, MA 02205-51478

Dear Ms. Coale and Mr. Rasmussen:

Allied Federated Cooperatives is a marketing cooperative representing 27 cooperatives and their 870 members regulated under the Northeast Federal Order. We are very concerned about the closing of a number of local manufacturing plants in our region.

The plant closings, as well as the reluctance of many cheese and dairy product plants to accept additional milk at current Class III and IV prices, have burdened our members with higher hauling costs as their milk is shipped longer distances in search of markets, as well as lower milk prices as fewer buyers compete for their milk. We have been forced to support the capitalization of our hauler's equipment besides paying the additional hauling to reach more distant markets. These problems are further compounded by the rapidly escalating fuel costs.

We understand there is a significant problem with Class III and IV pricing formulas that are effectively forcing local dairy product manufacturers, who receive Federal Order milk, to receive manufacturing allowances that are based upon obsolete costs from more than five years ago. This problem will jeopardize even more plants in our region and further exacerbate milk market outlet problems if not corrected as soon as possible.

We have reviewed Agri-Mark's proposal to update Federal Order manufacturing allowances based upon more current cost information and respectfully submit this correspondence in support of Agri-Mark's petition for an emergency hearing. Furthermore, we would ask the Department to review Class I differentials in light of the dramatically higher costs of moving milk to plants and consider raising those differentials accordingly.

Sincerely yours,

Mike Barnes, Chairman of the Board
Allied Federated Cooperatives, Inc.



October 11, 2005

Ms. Dana Coale, Deputy Administrator
USDA – AMS – Dairy Programs
1400 Independence Avenue, SW
Washington, D.C. 20250-0225

Dear Deputy Administrator Coale,

Foremost Farms USA is a dairy cooperative owned by 3,500 dairy farmers located in the states of Michigan, Indiana, Ohio, Illinois, Wisconsin, Iowa and Minnesota.. Our primary business is in the manufacturing of dairy products from our member-owners milk.

I am writing to you to support Agri-Mark Dairy Cooperative's request for an emergency hearing on changes in the Class III and IV formulas. We have incurred substantial increases in manufacturing costs since 2000. Natural gas costs have gone up by almost 20% and are expected to continue to climb even higher. Labor costs including wages, health insurance and retirement benefits continue to rise significantly compared to costs that were used to calculate the manufacturing cost allowances in the current Class III and IV formulas. The dairy products manufacturing industry is under a great deal of financial stress by not being able to recover these costs because of Class price formulas not accurately reflecting actual costs.

We urge you to proceed with an emergency hearing on this matter.

Sincerely

A handwritten signature in cursive script that reads 'David E. Fuhrmann'.

David Fuhrmann
President

DF:plr



Great Lakes Cheese of New York, Inc.

23 Phelps Street Adams, New York 13605 315-232-4511 Fax 315-232-4055

November 7, 2005

Ms. Dana Coyle, Deputy Administrator
USDA - AMS - Dairy Programs
1400 Independence Avenue, SW
Washington, D.C. 20250-0225
Fax: 202-690-3410

Re: Support for an emergency hearing on changes in the Class III and IV price formulas

Dear Deputy Administrator Coyle,

This letter is being submitted on behalf of Great Lakes Cheese Company in support for the request for an emergency hearing on changes in the Class III and IV price formulas recently submitted by Agri-Mark Dairy Cooperative.

We use milk regulated by Federal Orders in our facilities located in Adams and Cuba, New York.

The manufacturing allowances provided for under Federal orders were last updated based upon manufacturing cost data from 1998 to 2000. The Agri-Mark proposals merely asks that USDA again use the same two surveys that the Department used previously to update their make allowances to reflect actual current costs (proposal one), along with correcting two obvious problems with whey butter pricing (proposal 2) and the barrel/block cheese price spread (proposal 3).

Great Lakes Cheese has many options of where to manufacture and/or purchase its cheese; however, we have been and remain committed to our current suppliers of milk in the Northeast. The local farmers who ship their quality milk to our facilities are a major factor in our national reputation for consistently high quality cheese products. We would like this mutually beneficial relationship to continue and expand. However that can only happen if the Federal Order can provide make allowances that reflect the actual costs of manufacturing cheese and other dairy products.

Thank you for your consideration of this important issue. We look forward to the hearing process which will address an issue that is important for manufacturers and dairy farmers alike.

Sincerely yours,

John Jennings
Great Lakes Cheese Company

cc: Mr. Erik Rasmussen, Market Administrator
Northeast Milk Marketing Area
Fax: 617-737-8002

Land O'Lakes, Inc.



405 Park Drive, Carlisle, PA 17013
Tel: (717) 486-7000
Fax: (717) 486-3730

Dairy Foods

September 27, 2005

MS. Dana Coale, Deputy Administrator
USDA – AMS – Dairy Programs
1400 Independence Avenue, SW
Washington, DC 20250-0225

Re: Request for Emergency Hearing on Class III and IV Make Allowances

Dear Ms Coale,

Land O'Lakes joins Agri-Mark and other parties in requesting a Federal Order hearing to update the cost calculations that determine the Class III and IV make allowances.

Land O'Lakes is a Capper-Volstead cooperative with a national membership base of 3,500 dairy-farmers, pooled on six federal orders. Land O'Lakes operates numerous dairy manufacturing plants throughout the United States and is very aware of the differences in current processing costs from those cited in the hearing record of the May 2000 hearing. That hearing record established the current make allowances. Land O'Lakes is prepared to testify regarding current costs at its cheese and butter/powder plants and we believe the difference in processing costs justify an emergency hearing.

The May 2000 Hearing record included 1998 and 1999 costs from federal order and California manufacturing plants. Current processing costs are not reflective of those base surveys. For example, the U.S. Energy Information Administration reports that the national average price of commercial natural gas was \$5.48 per mcf in 1998, compared to an average price of \$9.26 in 2004, representing an increase of almost 70-percent for a critical processing input. Other processing inputs have also increased during the six-year period. The California Department of Food and Agriculture (CDFA) annually collect and audit processing costs from the state's manufacturing plants. The weighted average processing costs for butter, powder and cheese in 1999 were \$0.096; \$0.136 and \$0.169, respectively. The most recent (2003) CDFA weighted average processing costs were \$0.1299; \$0.1560 and \$0.1706 for the same commodities. Land O'Lakes believes these changes in processing costs adequately justify an emergency hearing.

Specifically Land O'Lakes requests that the make allowances contained in Section 1000.50 (l), (m), (n), (o) and (q) be updated to reflect current processing costs. These sections

define the butterfat, non-fat solids, protein, other solids and advance butterfat prices under the federal orders. In order to expedite a decision on this hearing, Land O'Lakes proposes that the Hearing Call specifically limit testimony to processing costs and leave yield and product pricing issues for another hearing.

In the Federal Order Reform Final Rule and the Final Decision of the May 2000 Hearing [Docket No. AO-14-A69, et al.: DA-00-03] the Secretary outlined a process of collecting information from various cost surveys to determine manufacturing and processing make allowances. In the Final Decision of the May 2000 Hearing the Secretary relied on the cost data contained Rural Cooperative Business Survey (RCBS) and the CDFA Manufacturing Cost Survey to determine the current make allowances. Currently the RCBS is collecting 2004 processing cost data from cooperatives that operate manufacturing plants and a CDFA is expected to release its 2004 Manufacturing Cost Survey before year's end. At the Hearing, processing costs were submitted by other parties, but they were found defective for various reasons. Land O'Lakes proposes that the Department be open to all manufacturing costs surveys submitted by interested parties engaged in operating cheddar cheese and butter/powder plants.

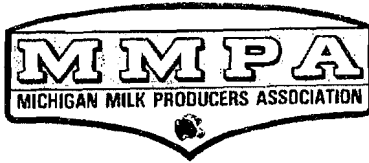
Through Federal Order Reform and other Decisions, the Secretary has repeatedly stated that the Class III and Class IV prices are meant to represent market clearing prices. To that end, the Secretary has adjusted the relative weighting of the cost surveys so that balancing costs are reflected in the make allowances. When the make allowance formulae no longer represent current processing costs, those handlers who provide a market balancing function suffer the greatest pain. As already stated, Land O'Lakes operates a multiple manufacturing plants with in the federal order system.

Land O'Lakes respectfully requests that the Secretary convene an emergency hearing to address manufacturing make allowances for federal order class prices. If you have any questions, please feel free to contact me at (717) 486-2276.

Sincerely,



Dennis J. Schad
Land O'Lakes
Director of Regulatory Affairs



Michigan Milk Producers Association

41310 BRIDGE STREET • P.O. BOX 8002 • NOVI, MI 48376-8002
PHONE: (248) 474-6672 FAX: (248) 474-0924

November 7, 2005

Ms. Dana Coale, Deputy Administrator
USDA – AMS – Dairy Programs
1400 Independence Avenue, SW
Washington, D.C. 20250-0225

Re: Request for an emergency hearing on changes in the Class III and IV price formulas

Dear Deputy Administrator Coale:

Michigan Milk Producers Association (MMPA) has reviewed the emergency hearing request submitted by Agri-Mark Dairy Cooperative in a letter dated September 28, 2005 regarding changes needed in the make allowance provisions of the Class III and IV pricing formulas and we would like to submit the following comments in support of their proposal:

MMPA has two manufacturing plants that produce Grade A nonfat dry milk and Grade AA bulk butter. MMPA's manufacturing plants participated in the USDA Cooperative Service survey of costs at cooperative manufacturing plants performed in 1998 and 1999. The data from those surveys were combined with the results of a similar survey of California instate manufactures and used as the basis for determining the make allowances for Class III and IV product formulas.

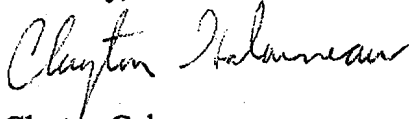
Our manufacturing costs have risen dramatically since those cost surveys were completed. Our gas costs for the fiscal year ending September 30, 2005 were 33% higher per pound of solids nonfat than the gas costs experienced in fiscal year 2004. Based on the most recent gas futures, it looks like we will be in for an additional 48% increase for our fiscal 2006. Most of the cost increases for 2005 had to be absorbed by our company. Any increases we have been able to tack on to our butter and powder prices are reported to NASS and then serve to increase the raw material cost for the milk used to make butter and powder.

Our gas costs for our manufacturing operations in 2005 were nearly \$2.7 million. If gas costs continue as projected, we anticipate that our gas costs are likely to increase by nearly \$1.3 million dollars for the year. For our size of organization, that will represent a significant hit to our bottom line and unfortunately the dairy pricing mechanisms do not allow us to recover these costs.

Agri-Mark Dairy Cooperative provided several examples of the necessity to adjust the make allowances for Class III and IV product pricing formulas. MMPA has two plants that when combined process over a billion pounds of milk per year and we have considerable experience in the production of nonfat dry milk and butter. We agree that the make allowances should be adjusted to take into consideration the increased costs manufacturers are experiencing. Due to the significant impact these increased costs have inflicted upon our industry, we agree with the need to consider changing the make allowance on an emergency basis in order to provide needed relief as soon as possible.

These comments are submitted on behalf of the Michigan Milk Producers Association which is a member owned and operated dairy cooperative serving over 2,400 dairy farmers in Michigan, Ohio, Indiana and Wisconsin. Thank you for considering our comments.

Sincerely,

A handwritten signature in cursive script that reads "Clayton Galarneau".

Clayton Galarneau

Director, Manufactured Sales and Operations



Upstate Farms Cooperative, Inc.

7115 West Main Road, LeRoy, New York 14482-9352
Phone: (585) 768-2247 (800) 724-MILK Fax: (585) 768-8367

October 26, 2005

Ms. Dana Coale, Deputy Administrator
USDA – AMS – Dairy Programs
1400 Independence Avenue, SW
Washington, D.C. 20250-0225

Re: Upstate Farms supports emergency hearing to update the manufacturing cost allowances.

Dear Ms. Coale:

Upstate Farms (a New York dairy cooperative that markets 1 billion pounds of milk annually) supports holding an emergency hearing to update the manufacturing cost allowances used in Federal Order pricing for cheese, whey powder, butter and nonfat dry milk powder.

As set forth in Agri-mark's request for an emergency hearing on changes in the Class III and Class IV price formulas, "[t]he current allowances were fixed based upon now antiquated cost data from 1998-2000, yet are still used to establish minimum prices for milk under all Federal Milk Orders." **With the dramatic surge in the price of energy since 2000, the need to update the make allowances has become urgent.**

We understand that some dairy industry stakeholders desire a far-reaching, comprehensive re-examination of the methodology and/or use of make allowances in Federal Order pricing. However, such a thorough review of make allowances may take years. We cannot wait that long for relief.

Therefore, the prudent course is to hold an emergency hearing to update the data in the make allowances. Holding such a focused emergency hearing does not prevent holding a subsequent hearing that conducts a far-reaching, comprehensive re-examination of the methodology and/or use of make allowances in Federal Order pricing.

Thank you for your prompt attention to this important, urgent matter.

Very truly yours,

Timothy R. Harner
General Counsel

Cc: Mr. Erik Rasmussen, Market Administrator
Federal Milk Order No. 1
P.O. Box 51478
Boston, Massachusetts 02205-51478