Prepared Testimony of
Daniel S. McBride,
Northwest Dairy Association

Re: Proposal No.1

Federal Milk Market Order Hearing
Docket No. AO-14-A74, DA-06-01

My name is Daniel S. McBride. I am testifying today on behalf of Northwest Dairy Association, which is usually referred to as "NDA". My title is Director, Milk Pricing & Producer Programs for NDA. I am responsible for coordinating all types of matters pertaining to Federal Orders, and have done so since leaving the Market Administrator's office to join the NDA staff in 1986.

Northwest Dairy Association is a cooperative marketing the milk of approximately 640 dairy farmers in Oregon, Washington, Idaho and California. Approximately 520 of our producer members are part of the Pacific Northwest Federal Milk Marketing Order (Order 124). Approximately 120 producers are located in the unregulated area of Eastern Oregon and Southwest Idaho.

Northwest Dairy Association conducts all processing and marketing operations through a subsidiary, known as WestFarm Foods. WestFarm Foods is a fluid milk processor in the Northwest region. WestFarm Foods operates three Class I processing plants in Order 124 (Seattle, Washington; and Portland, and Medford, in Oregon) and one in Boise, Idaho. WestFarm Foods operates four dried milk product plants located at Lynden and Chehalis, Washington, and Caldwell and Jerome, Idaho. WestFarm Foods also operates a cheese/whey plant in Sunnyside, Washington, and a butter plant in Issaquah, Washington.

NDA would like to thank USDA for their timely response to the hearing request of Agri-Mark and others. We appreciate the opportunity to address the important issue of updating Federal Order manufacturing allowances at this hearing.

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I am testifying on behalf of NDA in support of Agri-Mark's proposal to update the manufacturing costs surveys used to determine the Federal Order Manufacturing Allowances. These cost updates are needed in order to allow Class III and IV manufacturing plants to effectively operate under the current market conditions. Both Agri-Mark and Land O'Lakes have provided a thorough background on how Class prices are determined and have outlined a specific proposal to address these concerns. NDA is in agreement with both of them.

NDA also supports the Agri-Mark proposal because of the simple, logical approach it provides to updating processing costs. No changes are being made to the manufacturing formulas other than adjustments for changes in costs. By completing new surveys, all cost changes are captured, including any improved efficiencies within the plants.

As other supporters of the Agri-Mark proposal have noted, the "circular" impact of NASS price reporting allows manufacturers of nonfat dry milk, fresh cheddar cheese, and whey few if any options to increase margins through higher product prices. As described by both the Agri-Mark and Land O'Lakes testimony, the NASS survey collects product price adjustments for energy and includes that information in the published NASS price survey. But since the manufacturing allowances have not been adjusted for the increased costs of such inputs as energy, labor and packaging, processors of these products have been left with the tab for increased production costs. Adjusting manufacturing allowances to reflect more current costs provides a logical way to assure plant margins are not so severely impacted by dramatic short term or even longer-term changes in production costs.

We find the results of the RCBS and CDFA surveys to be consistent with our own. While NDA provided data on six plants for the 2004 survey, we did not participate in the 1998 survey. There have been fairly significant changes in the product mix in many of our plants since that time and it is difficult to provide direct comparisons. However, we believe our cost increases are in line with the changes noted in the CDFA and the RCBS surveys.

NDA agrees that balancing costs need to be considered when determining make costs, particularly in Class IV plants. We believe the proposal details outlined by Agri-Mark and Land O'Lakes helps address that need. We also agree with the Land O'Lakes testimony outlining the challenges with balancing, and we support their recommendations. Our results from the 2004 RCBS survey show our nonfat dry milk processing costs are from 2-5 cents higher per pound of nonfat dry milk in plants we used to balance the market, compared to our Class IV plant with the highest capacity utilization rate. And even that plant is far from 100% utilization.

The WestFarm Foods Director of Manufacturing for the Ingredients Division, Scott Burleson provided testimony on the different costs involved in processing whey and nonfat dry milk. I would like to discuss a different aspect of the whey costing issue related to our whey processing costs. When we calculated our whey costs for the RCBS survey of our Sunnyside plant, we did not adjust our costs to reflect the purchase of a significant amount of condensed whey from another cheese manufacturer. Those costs are significant, and we would like to outline them now. In our Sunnyside cheese/whey plant, about 22.5% of our processed whey is received as condensed whey from another plant. That whey is condensed off-site to about 20% solids and transported to Sunnyside where it is further condensed and dried. Of course, those costs are part of the total whey drying cost, and should have been included in our whey costing. That cost is outlined in the table below.

Impact of Outside Whey on Total WFF Whey Processing Costs

	Per 73,000 Pound Truck	Per Cwt. Condensed 20% Whey	Per # Whey Solids
Estimated Condensing Costs (RCBS Average)	**$981.12**	**$1.3440**	**6.720 Cents**
Loading Costs	**$30.00**	**$0.0411**	**0.205 Cents**
Transport Costs	**$266.45**	**$0.3650**	**1.825 Cents**
Total Unaccounted Costs on Outside Whey (22.5% of Total Whey Processed)	**$1,277.57**	**$1.7501**	**8.750 Cents**
Total Weighted Cost Increase on All Whey	**$287.45**	**$0.3938**	**1.969 Cents**

The table outlines the additional whey drying costs on our operation that result from this outside whey source, based on the RCBS average condensing costs, and our known transportation costs. While the plant that condenses this whey is part of the RCBS survey, we do not know their condensing cost, so we are using the average cost of 6.72 cents per pound solids for a proxy in this example. The load rate is based on a cost of $1 per minute while loading. The haul rate is the actual movement cost between the two plants. The additional processing cost on this whey totals 8.75 cents. When this cost incurred on 22.5 percent of our whey intake is spread across all of the whey processed in our Sunnyside plant, the cost increase equals an additional 1.969 cents per pound of all whey processed.

NDA supports adjustment of the 2004 survey costs to reflect 2005 energy costs, and also supports the use of indexed energy costs to adjust manufacturing allowances, based on changes in the cost of natural gas and electricity. The National Milk Producers Federation (NMPF) will be providing testimony that outlines an indexing system for fuel costs that will allow manufacturing costs to be adjusted, depending on changes in these costs. We have reviewed the NMPF proposal and support the energy adjusters as a good way to keep manufacturing cost estimates up to date. We believe adopting such a program now will both protect processors from future price spikes, and producers from drops in energy costs.

While we support the NMPF proposal on using energy adjusters, we must emphasize that the current plant cost situation requires immediate relief. There are simply no ways at this time to manage the higher energy costs we are now experiencing in our plants. We support the request of Agri-Mark and others for the Secretary to release an interim final decision using the most recent survey data, adjusted for 2005 energy costs, and, if deemed necessary, provide for a more thorough comment and review period on the energy adjusters proposed by NMPF.

The issue of increasing make allowances is not an easy one for NDA or any farmer-owned cooperative to address. Updating allowances to reflect current costs has significant impacts on producer prices. USDA's analysis shows those net impacts to be significant to producers, but less than the actual change in regulated milk prices. This issue has been discussed at both the

NDA Board of Directors Meetings and at our producer meetings for some time, our Board of Directors are producers. Our January producer newsletter announced our participation in this specific hearing to our membership. Our members understand the importance of having make allowances that allow for our cooperative to cover our costs and protect their huge investment in our manufacturing plants.

NDA supports the adoption of Agri-Mark's proposal on an emergency basis, without a recommended decision, in order to protect the solvency of the manufacturing base that participates in the Federal Order System. The tight world fuel supply/demand situation and other steadily increasing costs have left most industries exposed to higher costs. The "circular" effect of the NASS product price surveys provides little, if any, opportunity to address increased costs through product price adjustments. Issuance of a tentative final decision in a timely fashion is necessary to protect the assets of our Federal Order manufacturing plants.

NDA again would like to thank USDA for their rapid response to industry requests for this hearing. We look forward to a timely decision that addresses the needs of our industry.