

BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE

In the Matter of:

MILK IN THE NORTHEAST AND

OTHER MARKETING AREAS

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**DOCKET NO. AO-14-A74, et al.
DA-06-01**

**PROPOSED FINDINGS OF FACT AND ARGUMENTS
IN OPPOSITION TO CHANGES TO MANUFACTURING MILK PRICES
FOLLOWING THE SEPTEMBER 14-15, 2006 HEARING
ON BEHALF OF
SELECT MILK PRODUCERS, INC.,
CONTINENTAL DAIRY PRODUCTS, INC.,
LONE STAR MILK PRODUCERS, INC.,
ZIA MILK PRODUCERS, INC. AND
DAIRY PRODUCERS OF NEW MEXICO**

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**BRIEF IN OPPOSITION TO CHANGES TO CLASS III AND CLASS IV MILK PRICE
FORMULAS SUBMITTED BY SELECT MILK PRODUCERS, INC., CONTINENTAL
DAIRY PRODUCTS, INC., LONE STAR MILK PRODUCERS, INC., ZIA MILK
PRODUCER’S, INC., AND DAIRY PRODUCERS OF NEW MEXICO**

I. Introduction

A. Summary of position

The position of Select Milk Producers, Inc., Continental Dairy Products, Inc. Lone Star Milk Producers, Inc., Zia Milk Producer’s Inc., and Dairy Producers of New Mexico remains the same as that following the January hearing. Comments filed by these parties in opposition to changes in make allowances are incorporated in this brief. As the result of testimony at the hearing in September 2006, additional comments are required. A summary of the position of these milk producers is:

1. Holding a hearing on only one of three interrelated and indivisible variables in margin is a denial of an opportunity to fully explore all the facts necessary to properly and lawfully arrive at consideration of any changes to the manufacturing price formulas. The margin is a function of not only manufacturing costs, but also product prices, and yields.
2. The hearing record from both sessions does not provide evidence sufficient to justify a change in make allowances only at this time.
3. The Cornell study on make allowances shows that the weighted averages for

commodity manufacturing are so near current formulas so as not to justify a change.

4. If the Department pursues changes to make allowances without looking at other factors, it must limit those changes to the Cornell Weighted Averages as submitted by Dr. Stephenson in the preliminary study with the costs to manufacture dry whey adjusted to be the cost to manufacture NFDM plus the extra energy costs found by Dr. Stephenson. These are as follows: Butter - 11.08 cents per pound, Cheese - 16.38 cents per pound, NFDM - 14.1 cents per pound, and Dry Whey - 14.99 cents per pound.
5. There should be no automatic adjustment for energy costs in the make allowances.

B. Parties submitting these comments

Select Milk Producers, Inc. (Select) is a milk marketing cooperative association of producers which markets milk on behalf of its members into Orders 126, 5 and 7, among other orders. Select is an “interested party” in these proceedings as that term is used in 7 C.F.R. §900.8(b).

Lone Star Milk Producers, Inc. (Lone Star) is a milk marketing cooperative association of producers which markets milk on behalf of its members into Orders 126, 5, and 7, among other orders. Lone Star is an “interested party” in these proceedings as that term is used in 7 C.F.R. §900.8(b).

Zia Milk Producers, Inc. (Zia) is a milk marketing cooperative association of producers which markets milk on behalf of its members into Orders 126, 5, and 7, among other orders. Zia is an “interested party” in these proceedings as that term is used in 7 C.F.R. §900.8(b).

Collectively Select, Lone Star and Zia represent approximately 40% of the milk and the producers in the Southwest Milk Marketing Area, Order 126.

Continental Dairy Products, Inc. (Continental) is a milk marketing cooperative association of producers which markets milk on behalf of its members into Orders 33, 5, and 7, among other orders. Continental is an “interested party” in these proceedings as that term is used in 7 C.F.R. §900.8(b).

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 before legislative, judicial and agency proceedings. DPNM is an “interested party” in these proceedings as that term is used in 7 C.F.R. §900.8(b).

C. Applicable law

The Secretary has authority to set minimum prices under 7 U.S.C.A. §608c. When setting minimum prices the AMAA provides a requirement that producer costs including the cost of feeds be “reflected” in the calculation.

Under the Act that gives the Secretary power to set prices, such setting must meet the following standard:

(18) Milk prices

The Secretary of Agriculture, * * * prior to modifying the price fixed in any such term, shall ascertain the parity prices of such commodities. The prices which it is declared to be the policy of Congress to establish in section 602 of this title shall, for the purposes of such . . . order, or amendment, be adjusted to reflect the price of feeds, the available supplies of feeds, and other 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 amendment relates. Whenever the Secretary finds, upon the basis of the evidence adduced at the hearing required by section 608b of this title or this section, as the case may be, that the parity prices of such commodities are not reasonable in view of the price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk and its products in the marketing area to which the contemplated agreement, order, or amendment relates, he shall fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk to meet current needs and further to assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs, and be in the public

interest.¹

The District Court for the District of Vermont considered this very issue in *St. Albans Co-op Creamery v. Glickman*, 68 F. Supp. 2d 380, 390 (D. Vt. 1999). The Court explained:

The record shows no direct consideration of regional costs in feed, feed availability, or other region specific economic factors. Defendant's counsel conceded in oral argument that the only consideration of such factors prior to the announcement of the final order was indirect. Record at 44-47. Had such indirect consideration been sufficient, Congress would not have gone to such lengths in drafting §608c(18)'s explicit requirements that feed costs and other regional economic considerations be accounted for in the setting of milk prices. Given that the consolidation of the orders creates a concrete and direct effect on milk prices, and that indirect consideration of regional economic factors is imprecise, direct consideration of these factors is required by the AMAA. Since the Secretary failed to adequately consider such factors, the final order violates the AMAA.

Id.

In short, the AMAA requires that the Secretary's establishment of minimum prices for Class III and Class IV reflect the cost of feeds and the regional issues.

Further, although this is a "national hearing" in that the notice applied to all of the marketing areas, the law specifically requires the Secretary make determinations as regards the marketing area of the order. Thus, for example, evidence of milk prices for milk used in manufacturing in New England cannot be applied to the Southwest Milk Marketing Area.

II. Proposed Findings and Conclusions of Law.

A. The Secretary should make no changes in the Make Allowances.

As explained below, all variables in product formulation must be considered. Further, Dr. Stephenson testified that current make allowances are statistically within the range of those found in the study.

B. The only data on make allowances that can be considered is that of the Cornell Study.

¹7 U.S.C.A. §608c(18)

The Secretary wisely determined that there was insufficient evidence presented in January of this year to justify any changes in the manufacturing make allowances. The testimony presented by the study by Mark Stephenson showed that the values sought in January were excessive. Now that we have data, it is clear that the current make allowances are justified by research.

At the January session of this hearing, evidence was taken from CDFA as well as a 2004 study by Dr. Ling for the Rural Business Cooperative Service (RBCS Study). Neither of these should be considered for purposes of establishing make allowances in the FMMO system.

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 RBCS study is worthless for setting make allowances for the FMMO system. This is more fully explained in comments filed by these parties after the initial hearing in January. It only included cooperative plants and only those who volunteered to participate. This gave plants who had a vested interest in the result to decide to their advantage whether to participate or not. It was intended for another purpose.

We request that the Department make the following findings regarding significant differences between the California study and the RBCS study.

1. The RBCS study is not the result of any audit. Ling, Tr. 119 (Day 1).
2. Cornell study looked at only commodity cheddar cheese as reported in the

NASS price survey. Stephenson 148. CDFA includes Monterey Jack and Cheddar cheeses in its survey while RBCS uses Cheddar and Other cheeses. *Cf. Ex. 18 with Ex. 23.*

3. Cornell study represented about 44% of the commodity cheese produced outside of California. RBCS only examined plants making approximately 12% of cheddar cheese produced. 2004 Dairy Products Summary; Ling, Tr. 94 (Day 1).
4. The Cornell study looked at proprietary and cooperative plants and sought a cross section of size. Stephenson Tr. (Day 5) . RBCS only examined coop plants. Ling, Tr. 99 (Day 1).
5. Dr. Stephenson visited each of the plants to make sure he understood the data. Stephenson Tr. (Day 5). RBCS made no plant inspections. Reed, Tr. 159 (Day 1).
6. CDFA plants had a yield of 11.08 pounds of cheese per hundred pounds of milk. RBCS showed a yield of 10.4 or 10.7 depending on the cheeses. Ex. 23, Ex. 18. The Cornell study had no yields stated. Stephenson Tr.197-98.
7. CDFA pricing included the cost of 640 pound blocks. Cornell did not use 640s and those are not part of the NASS price survey. *Id.*
8. RBCS does its survey only as often as requested by cooperatives. Cornell Study was done at the request of USDA as well as Cornell's own desire to update its studies on costs.
9. The RBCS study is superceded entirely by the Cornell Study.
10. CDFA does not cover any plants that participate in the FMMO system.
11. The methodologies and the scope of the data (CDFA is a virtual census of

California while Cornell Study is a sample outside of California) makes blending the two for costs only outside of California impermissible.

- C. If the Secretary determines that make allowance changes should be made they should be limited to using the Cornell Weighted Average Prices with the dry whey being set at the NFDM cost adjusted for added energy costs.**

Although these comments support no change to make allowances, as explained elsewhere, should the Secretary decide to make changes in the make allowances then it must reply only on the Cornell Study and none of the others.

Commodity	Current Make Allowance	Cornell Weighted Average Adjusted for Dry Whey
Butter	11.5 cents	11.08 cents
Cheese	16.50 cents	16.38 cents
NFDM	14.0 cents	14.1 cents
Dry Whey	15.9 cents	15.0 cents

The Cornell Study weighted average is the appropriate measure.

1. This is primarily because this make allowance is subtracted from the weighted average of product prices sold. Matching weighted average to weighted average avoids improper results.
2. For the same reason it would be improper to use the weighted average of the largest or smallest plants because we do not have matching sales data. The result would be the lower sales price but the higher costs if, for example, the smaller plants were used.
3. There is nothing in the data that permits extrapolating costs beyond the weighted average for butter, powder or dry whey. Such would be a guess.

4. There is no evidence in the record, for example, as to the price for butter at 60% of the plants or 80% of the plants to permit the Secretary to match plant costs as such a level.
5. At the hearing Stephenson testified that the NFDM costs should be increased to 14.24 to reflect changes in data suggested by one person who has a vested interest in the result. Although we all have interests in accuracy, it is troubling that a few people have access to the data and those who can gain by adjustments have the sole access to the reporter of the data. No change should be made to the preliminary study until it has been audited and reviewed by USDA.

Dry whey presents a particular problem. It has a wide range in reported costs— unlike the other commodities. CDFA has so found. Ex. 24 shows a range of 22.69 to 34.55 cents per pound. Dr. Ling had a weighted average of 11.409 cents per pound. Ex. 18. The Cornell Study had a range of 14.66 to 30.07 cents per pound or the higher cost plants' costs exceeded the lower costs by over 100%! Ex. 76, p.8. This is an extreme range.

There are two reasons for this. The first is the lack of observable data— 3 plants with CDFA, 6 with RBCS and 12 with Cornell.

The second reason, and one that sampling cannot correct, is that all whey produced at a plant is not dried and the rise in costs reflects lack of utilization as the result of more economical choices by the processor. In the production of cheese, out the vat comes a whey stream. It is liquid and about 6 percent solids. The lowest tech, and lowest priced product, is to dry it and sell as dry whey. Another option is to take the suspended solids and pass the liquid whey through a number of filtrations to produce whey protein concentrates of different concentrations or whey protein isolates. These processes have additional costs, but the products are immensely more valuable than dry

whey. Unlike NFDM to MPC there is no arbitrage, because WPC and WPI have specific uses for which the dry whey is completely incompatible.

When the whey comes off of the vat, the operator has to make a business decision— either dry the whey or further process it. When it further processes the whey the "costs" of the dry whey operation climb because of lack of utilization. But overall it is more economical for the processor to bypass and absorb this cost because the WPC or WPI is more valuable after even absorbing the higher drying costs. This is why costs to process dry whey vary so wildly. The plants that make the higher value WPC and WPI probably have the highest dry whey costs because they use them the least. That also correlates that these are the most profitable plants. So to adopt the higher costs of a study, producers are being denied the full value of end product pricing. At the same time, the averages are skewed.

6. The Secretary has from the beginning of end product pricing has not been satisfied with the data on dry whey processing. ²As a result it has taken the NFDM costs and added the additional energy.
7. Virtually all of the makers of dry whey have agreed. Burleson testified that the energy is the primary additional costs. Tr III, 140-72, Exs. 47-48.
8. In its brief after the January hearing, Agrimark commented:

In the absence of reliable and complete data for whey manufacturing costs, it is reasonable to follow USDA's past practice for estimating whey manufacturing costs by (1) starting with representative NFDM make costs, and (2) adding to NFDM costs the additional costs incurred to

²2002 Class II/IV Decision, – Fed. Reg. at 67930-31

convert skim whey to whey powder.³

Dr. Bailey found this to be a proper proposal.⁴

9. Dr. Stephenson identified the additional energy as 4.27 cents per pound for dry whey versus 3.39 for NDFM. Thus taking the 14.1 for NDFM and adding the .88 cents for 14.99 for dry whey.

D. The proposed extrapolation to population for cheese cannot be used

At the hearing, Dr. Stephenson proposed taking the sample data he had and extrapolating it to the population of cheese plants. He could not do it for the other three. It should not be considered for the cheese. Proposed findings are:

1. It is only on one of the four commodities. It would require mix standards for setting manufacturing prices.
2. Use of population extrapolation for cheese and not for other commodities adjusts the relationship between Class III and IV. The price of cheese is so reduced that Bailey predicts within the next twelve months Class IV would be the Class I mover. Bailey Tr. 18-19 (Day 6).
3. There is no corresponding extrapolation to the population for the prices the cheese is sold. The NASS Price Survey shows that substantial volumes of cheese is sold in the Upper Midwest by as much as seven cents a pound above the national average price.
4. The proposed formula for the linear regression cannot predict accurate half of the cheese produced in the observable data. The observable data for 960

³Agrimark Brief, p. 12, Proposed Finding 23.

⁴Bailey Tr. 13 (Day 6).

million pounds of 2.2 billion of total pounds (or 44% of the cheese manufactured outside of California) is not even reflected in the formula used to define the line. Stephenson Tr. 290 (Day 5) With a weighted average of 16.35 cents per pound, using a cost function that begins at 17.1 cents plus a factor based on size *never* describes the weighted average of half of the milk! Based upon the sampling method, the concept of size correlating to costs, and the observable data, it is reasonable to expect that much more than half of the cheese produced in the US would yield a weighted average less than the formula permits. To get to the projected 18.9 cents, the remaining 6 percent would have to cost over 35 cents per pound to bring up average— a number outside the range of possible values.

5. There is no transparency to this representation. No one but Dr. Stephenson has the data, no one can run and test his formula for accuracy, no one can truly review the methodology to insure it is done correctly. Most importantly, the ability to cross examine the witness or truly participate in an open hearing is denied. There were admissions of errors. For example, Dr. Stephenson said he erred regarding distribution of costs in a powder plant that allegedly changed the weighted average of NFDM by about 0.15 cents per pound. Stephenson, Tr. 109 (Day 5). He also acknowledged that the total volume in the cheese population was about 2.2 billion pounds per year, not 1.2 billion pounds because of an error in the spread sheet. Stephenson, Tr. 289-290 (Day 5) it was not part of the study that USDA commissioned. Dr. Stephenson was providing a means to take the report and apply it to the population. The purpose of the rulemaking hearing is to provide transparency

to the facts leading to the rules, not provide a “black box”.

6. The population data is already out of date. It does not consider the plant in Clovis, NM which now represents 10% of the cheese of the 53 plants. It produces 140 loads of milk per day or 7 million pounds. Nor does it consider the addition of the Dalhart plant by Hilmar. By the time these prices will be in effect these plants will be producing a third of the volume used in the population model and, even by the premise of the model, at larger, more efficient and much lower cost plants.

E. The Department should not make any changes to the pricing formulas unless it addresses the issue of shrink.

In 2002, when the Department issued the Final Decision of the Manufacturing Price Hearing the Department held that overall milk volume at the farm is reduced by 0.25% in transportation to the plant and fat is further reduced by 0.015 pounds per 100 pounds of milk. 67 Fed. Reg. 67906, 67917 (November 7, 2002). As this was a final decision, the industry could not respond to it.

The result is that the butterfat which the plant pays for is the farm volume adjusted for shrink in accordance with this formula: $(3.5 \times 0.9975) - 0.015$ or 3.47625. The yield from this reduced butterfat volume is divided by the farm weight to obtain the yield from farm weight to product. Furthermore, the calculation performed by the department is incorrect. The Final Decision on butterfat uses a formula of $(3.5 \times (.9975 - .015))$ or $(3.5 \times (.9825))$ or 3.43875. This is a difference of 0.0375 pounds from the correct calculation. Elementary math tells us that the use of a second set of parentheses resulted in a miscalculation.

This mathematical error effectively increases the “make allowance” by approximately 1.1 cents. Overall, the correction would increase producer blend prices by two cents.

The quarter percent farm-to-plant shrink that is embedded in the formulas has no basis in fact

today. As was testified to at the January hearing, the plants and producers agree on the weights and tests. Talsma, Tr. 212 (Day 3). There is no shrink, and, in some cases, even overages.

Implied in the “update” of make allowances is that the underlying formulas are accurate and do not need to be updated. That simply is not true. The Department can certainly recognize that the plants purchasing the milk are receiving an enhancement of the stated make allowance in this farm-to-plant transfer reduction. In any event an obvious error must be corrected.

Based upon the record and simple math, the absence of the farm-to-plant shrink and its implications can be accounted for. On the issue of shrink, we propose the following findings and conclusions:

1. As a result of incorporation of farm-to-plant shrink in the pricing formulas producers pay twice – once to eliminate shrink and once and for shrink that is not there. Talsma, Tr. 210-19 (Day 3).
2. There is a mathematical error in the farm-to-plant shrink that should be corrected.
3. The formulas for the other components, too, are reduced for this shrink. It pervades the entire scheme.
4. The impact of shrink as it increases the implied yields offsets any small adjustment under the Cornell Model.

F. The Department must consider the yields as well as the make allowances because both the CDFA and the RBCS cost surveys are derived from plants that realize yields that far exceed those implied in the FMMO formula.

The theory of end-product pricing is that by taking the volume of product produced from milk components times the sales price of those products less an allowance for manufacturing margin leaves what is available for the milk components or the producer milk. The three variables in the

formulas—product price, product yield, and manufacturing allowance are not independent variables. The manufacturing allowance alone can not predict profitability of the plant.⁵ The other factors of yield and price sold can radically change the result.

In 2000, when end-product pricing was first adopted, the Department implied a yield for cheese that approximated 9.74 pounds of cheese per hundred pounds of milk at 3.5% butterfat and 2.9915% true protein. The Cornell study on make allowances provides no yields for the make allowances. The 1998 RBCS study showed a yield on cheese of 10.3 pounds of cheese per hundred pounds of milk. Though the milk content was not stated, the average component values could be imputed. Using 3.66% butterfat and 3.03% true protein and a butterfat recovery of 94% the yield approximates 10.3 pounds. After adjusting to the standard components, the cheese yield is 9.98 pounds per hundred pounds of milk which approximates that used in the formula.

The updated RBCS study suggests that cheese plants already enjoy a true allowance for margin of as much as 23 cents per pound. This should not surprise the Department. After all, CDFA stated that 62% of the cheese in California is produced at prices less than the average make allowance which already has a built in return on investment. Reed, Tr. 188 (Day 1). The Cornell Study showed that nearly half of the cheese is produced at 16.38 cents without consideration of sales or yields.

In summary, the hearing does not have record evidence that products made at the yields and make allowances now employed by the Department are in need of being updated. We propose the following findings and conclusions:

1. Exhibit 16 of the January hearing shows the formulas used to set FMMO prices. Relevant to this hearing are the formulas to establish the component

⁵Stephenson Tr. 59.

prices used to determine minimum prices.

2. A change in any of the price series, the yield factors, or the make allowances would result in a change in the component prices. Rourke, Tr. 50 (Day 1).
3. The formula for cheese is a modification of the Van Slyke formula. It is used to create the formulas used in the FMMO program. 67 Fed. Reg. 67906, 67928 (November 7, 2002).
4. That formula is stated as: $\text{Yield} = \{[(\text{BR} \times \text{BF}) + (\text{CS} \times \text{PR}) - .1] \times 1.09\} \div (1 - \text{M}\%)$

Where BF = butterfat lbs

BR = butterfat recovery as a percent

PR = true protein pounds, and

CS = percentage of casein in true protein

5. From this formula, one can determine not only the yield but the amount of butterfat in a pound of cheese or the amount of protein in a pound of cheese.
6. The pounds of butterfat in a pound of cheese can be determined as follows:
 $\text{Butterfat per Lb of Cheese} = \{[(\text{BF} \times \text{BR}) \times 1.09] \div (1 - \text{M}\%)\} \div \text{BFLbs}$
7. The implied Butterfat Recovery in a formula can be derived as follows: $\text{BR} = \{\text{Yield} \div [(1 - \text{M}\%) \times 1.09] - (\text{CS} \times \text{PR} + .1)\} \div \text{BF}$
8. The Protein per pound of cheese can be calculated as follows: $\text{Protein Yield} = \{[(\text{CS} \times \text{PR} - .1) \times 1.09]\} \div (1 - \text{M}\%) \div \text{PR}$
9. Based upon butterfat at 3.5% and protein at 2.9915%, the pounds of cheese per hundred pounds of milk according to the formula used in FMMO is 9.59 pounds per one hundred pounds of cheese.
10. While the FMMO has a cheese yield of 9.63, the use of make allowances

from studies that have significantly higher yields. These significant contributions to margins that should be considered by the Department.

11. The Cornell Study provides no yield data.

G. The underlying problem facing manufacturers was the circularity in the NASS pricing.

The Proponents' have argued that if a plant puts its costs into the reported price, then NASS captures it and makes the plant pay producers for those costs. If that is in fact the case, then the record evidence of the hearing has established what must be done to correct the problem. The solution is not changing make allowances, but changing the use or operation of the NASS pricing survey. Changing allowances without considering NASS circularity remains the wrong way to address the concerns of manufacturing plants.

III. The effect of an increase in make allowance is a transfer of value of dairy products from producer to processors.

The purpose of changing the make allowances was to raise them and to transfer money from producers to processors. Though a few, certainly not all, cooperatives from some marketing orders, less than half of them, have claimed a need for relief for their commodity cheese and powder plants from the make allowances so that they can remain competitive in the market place, the vast majority of the impact of these make allowances will be to transfer potentially staggering figures from rural America, dairy farmers, to proprietary plants who take producer milk and convert it into higher value bottled milk, creams, and specialty cheeses—products that have no need for relief. Even of that which is produced as a commodity by cooperatives, that represents a small amount of the product.

Assuming that a make allowance is an appropriate remedy for these few cooperative plants in some of the marketing areas, those purchases represent less than 20 percent of the milk purchased from producers. The impact of increasing make allowances is a reduction of producer prices on 100

percent of the milk in all of the areas. Said another way, the result would be producers throughout the country paying 80 cents of each reduced dollar to plants that do not need it under any circumstances so that 20 cents can be transferred to those who allege the need. The inefficiency of this taxing of producers and its cruelty at this time is not only staggering but nonsensical. Now that we have a record that shows the current amounts are supportable, such change is illegal.

The Secretary obtains the power to set prices from the AMAA. That requires the Secretary consider costs to farmers, not plants.⁶ There is nothing in the record that shows that raising make allowances improves producer income.

A review of Dairy Products 2004 Annual Summary shows that even without an “update” of the make allowances, capacity and production of dairy products continues to climb. The number of plants reported in 2003 was 2247 and was 2248 in 2004. Total pounds of dairy products increased from 33.6 billion pounds of product in 2003 to 34.5 billion pounds in 2004. Dairy Products 2004 Summary, p. 2-7. Further, the addition of new plants in the Southwest illustrates increasing capacity. Talsma, Tr. 214 (Day 3) and Stroup, Tr. 397 (Day 2).

California is able to say that 62% of its cheese and 75% of its butter was processed at costs less than the weighted averages. Ex. 23, p. 3 n.6, p. 5 n.7. On the other hand, there is nothing in the record that shows whether the weighted average price will allow all or what percent of processing to be done at those prices. Stated another way, there is nothing in the record that shows that the proposed make allowances cover a majority but not all of the production of that product.

This is particularly the case because as mentioned above, the RBCS 2004 study differs from the 1998 study in the plants and volumes under consideration. The study does not consider profitability. Ling, Tr. 145 (Day 1). The absence of this information is very important because it

⁶7 U.S.C.A. §608c(18).

would show (1) whether the make allowances claimed by the plants in conjunction with the sales prices are too generous or not and (2) whether or not plants are sustainable at current make allowances.

Although some of the proponents suggest their plants are in financial distress there is nothing that indicates whether those plants are the most efficient, average efficient, or least efficient plants or even if there are factors other than make allowances contributing to the problems of these facilities. *See e.g.* Wellington, McBride.

The Proponents' arguments that the Department should consider balancing costs or consider the costs of smaller powder plants rather than the CDFA average is really a request that the Department ignore efficiency altogether and permit all plants to be profitable without regard to size or other factors bearing on efficiency. Additionally, the profitability of individual plants is an issue relevant to particular marketing areas, not a basis for setting national pricing formulas.

As indicated in the analysis of the impact of the proposals, the USDA has identified that there will be substantial losses at the farm level and reduction in the number of cows. The number of operations that will be lost is not known, but it is known that small farms as well as others will be stressed by this decision. The statement by the Department that it must not set too low a make allowance coupled with the AMAA's requirements to ensure an adequate supply of milk, allowing any change that will reduce milk supply without knowing whether there is a true need for the change, what plants are troubled, and the amount of production affected is simply wrong.

1. Hilmar Cheese has announced the construction of a new cheese manufacturing facility in Texas which will process approximately 9.5 million pounds of cheese. Stroup, Tr. 397 (Day 2).
2. There have been other plants that have opened throughout the country over the last five years. Yonkers, Tr. 337 (Day 4). There is no data concerning

plant capacity in the United States. Yonkers, Tr. 336 (Day 4). The absence of this data works against the record evidence in support of the proponents requested change.

3. A "partial budgeting approach" that looks at the average costs of a survey of plants is not a correct methodology for setting make allowances when (1) energy costs may have peaked; (2) producers are experiencing the same higher costs that plants are experiencing; (3) milk prices will be falling dramatically due to other market forces; and (4) there are other areas of the pricing formula that should be simultaneously considered. Weaver, Tr. 278-81 (Day 3).
4. If a large percentage of cheese is produced by producer-owned cooperatives, and making cheese is not profitable, then the correct course of action for producers and cooperatives is to evaluate what the optimum thing they should be doing with their milk is and how much milk they should be producing. Increasing make allowances sends a signal to the co-op, that running a "profitable" plant is preferable to re-blending producer income. Weaver, Tr. 287-88 (Day 3). DeJong Tr. 262.
5. The full examination of issues should include cheese yields and efficiencies. Weaver, Tr. 290 (Day 3).
6. The capital demands on dairy producers differs from the capital demands on producers during the first make allowance hearing in 2000. Specifically, the cost of production has increased because the environmental compliance demands on producers have increased dramatically. Weaver, Tr. 291-95 (Day 3).

7. The impact on blend prices was estimated by Bailey as follows:

	95% Confidence			Weighted	Mod. Weighted	Population	Population
	Baseline	Low	High	Average	Average	Average	Avg. w/ Energy
	\$/cwt			–change from baseline, mil \$--			
Northeast	3,173	53	-259	-30	-5	-67	-83
Appalachian	879	13	-62	-9	-2	-17	-21
Southeast	1,097	18	-91	-12	-2	-25	-30
Florida	473	7	-34	-5	-1	-10	-12
Mideast	2,230	43	-240	-26	-5	-64	-76
Upper Midwest	3,129	71	-460	-46	-8	-125	-144
Central	2,048	40	-223	-23	-4	-58	-70
Southwest	1,426	25	-125	-14	-2	-32	-40
Arizona	392	7	-39	-4	-1	-10	-12
Pacific Northwest	938	18	-84	-8	-1	-20	-26
Sum	15,784	295	-1,619	-177	-30	-428	-514

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he impact on producer income was estimated by Bailey as follows:

	95% Confidence			Weighted	Mod. Weighted	Population	Population
	Baseline	Low	High	Average	Average	Average	Avg. w/ Energy
	\$/cwt			–change from baseline, \$/cwt--			
Northeast	13.45	0.22	-1.1	-0.13	-0.02	-0.28	-0.35
Appalachian	13.9	0.21	-0.99	-0.14	-0.03	-0.27	-0.33
Southeast	13.8	0.22	-1.15	-0.15	-0.03	-0.32	-0.38
Florida	15.12	0.21	-1.08	-0.17	-0.03	-0.32	-0.38
Mideast	12.42	0.24	-1.34	-0.15	-0.03	-0.36	-0.43
Upper Midwest	12.05	0.27	-1.77	-0.18	-0.03	-0.48	-0.56
Central	12.3	0.24	-1.34	-0.14	-0.02	-0.35	-0.42
Southwest	13.09	0.23	-1.14	-0.13	-0.02	-0.29	-0.36
Arizona	12.37	0.24	-1.25	-0.13	-0.02	-0.33	-0.4
Pacific Northwest	11.98	0.23	-1.07	-0.11	-0.02	-0.26	-0.33
Average of 10 orders	13.05	0.23	-1.22	-0.14	-0.02	-0.32	-0.39

	95% Confidence			Weighted	Mod. Weighted	Population	Population
	Baseline	Low	High	Average	Average	Average	Avg. w/ Energy
	\$/cwt			–change from baseline, \$/cwt--			
Northeast	13.75	0.22	-1.21	-0.13	-0.02	-0.28	-0.35
Appalachian	14.09	0.21	-1.12	-0.13	-0.02	-0.26	-0.32
Southeast	14	0.22	-1.26	-0.15	-0.02	-0.3	-0.37
Florida	15.34	0.21	-1.26	-0.17	-0.03	-0.31	-0.37
Mideast	12.65	0.23	-1.39	-0.14	-0.02	-0.34	-0.41
Upper Midwest	12.38	0.26	-1.77	-0.17	-0.03	-0.47	-0.54
Central	12.52	0.23	-1.37	-0.13	-0.02	-0.34	-0.4
Southwest	13.26	0.22	-1.21	-0.12	-0.02	-0.28	-0.35
Arizona	12.57	0.23	-1.3	-0.13	-0.02	-0.31	-0.38
Pacific Northwest	12.08	0.22	-1.11	-0.1	-0.02	-0.25	-0.32
Average of 10 orders	13.27	0.23	-1.3	-0.14	-0.02	-0.31	-0.38

Table 7. Federal Order Pool Values for 2007 – Changes from the Baseline							
		95% Confidence		Weighted	Mod. Weighted	Population	Population
	Baseline	Low	High	Average	Average	Average	Avg. w/ Energy
	\$/cwt			–change from baseline, mil \$--			
Northeast	3,290	55	-295	-31	-5	-68	-85
Appalachian	901	14	-74	-9	-1	-17	-21
Southeast	1,124	18	-104	-12	-2	-25	-30
Florida	485	7	-41	-5	-1	-10	-12
Mideast	2,303	43	-258	-26	-4	-64	-76
Upper Midwest	3,256	71	-472	-45	-7	-125	-144
Central	2,107	41	-235	-22	-3	-58	-70
Southwest	1,463	25	-137	-14	-2	-32	-40
Arizona	402	7	-42	-4	-1	-10	-12
Pacific Northwest	960	18	-90	-8	-1	-20	-26
Sum	16,291	298	-1,748	-176	-28	-429	-516

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In his testimony and the preliminary report, Dr. Stephenson said that some plants' costs exceeded the make allowances that were stated. This does not mean they were not profitable. Unknown is the price at which product was sold and what kind of yields were obtained.

Q. All right. That is not intended to indicate whether or not a plant is profitable, right?

A. No. We've collected no information on the actual cost of the dairy inputs, such as the milk or nonfat dry milk or cream that might have been purchased by these plants. And we've collected no information on the price the product was sold for. **So we can't impute profitability on these operations.**

Stephenson, Tr. 60 (Day 5) (emphasis added), *See also* Bailey Tr. 41-43 (Day 6)

V. Do not consider regional balancing issues

There was the assertion through questioning that the Secretary should consider “balancing costs” and “market clearing values” in setting these make allowances. Wrong. This is a hearing establishing the price of milk that applies to all orders, not just some. The balancing costs vary from market-to-market within orders and from order-to-order. There is absolutely nothing in the hearing record for the Secretary to make such a determination to adjust the make allowances. It would be purely speculation and that is not permitted under the law.

Those areas where the cooperatives believe that they are carrying an undue burden in balancing costs have several options— one they can organize all of the milk as the Southwest and permanently and completely deal with the issue, they can refuse to carry those costs and let the market adjust, or they can seek market service payments under the order that address those costs in

those markets.

It is absurd to consider that producers in the Southeast, or Florida or the Southwest or Arizona must take reduced income from plants in those markets because some coops in some regions want some money to cover their balancing costs in those regions. It makes no economic sense whatsoever.

VI. The energy adjustor should not be adopted

The proposal that the Federal Milk Marketing Orders become the risk absorber for plant energy costs should not be adopted. The Milk Producers also oppose the energy adjustor. It is simply illegal. Under Section 8c(18) of the AMAA, the Secretary is to make changes that reflect producer costs. At a time of rising energy costs, producers have rising costs as well. To shift the risk of energy onto producers when plants should be moving that to their customers or find additional efficiencies, creates a double whammy on producer income. The law does not permit it.

It is not provided for in the Act. The Secretary has authority to adjust prices and determine means to set those prices but that is limited under subsection (8) which requires that it be producer costs, not processor costs that drive the equation. If energy costs rise, they will rise on both producers and processors. Under the Act, if adjusting for energy is important, then it must be to raise producer prices by lowering make allowances or other factors, not lowering producer prices to protect plant margins.

It is economically inefficient to protect plants from rising energy costs. They should either pass them on to their customers, find more efficient energy uses, take actions to reduce their energy risk such as the futures market, change the energy sources, or make other adjustments in their operations to absorb the costs. This is what producers have to do, the Act does not give the Secretary authority to give plants any higher value.

There is not enough information in this record to make the change. In particular energy costs

are local in nature. Spikes and reductions occur regionally and locally, not equally on a national basis.

VII. There is no need for an emergency decision.

The proposed decision should not be omitted. No Final Decision should issue until the Secretary makes a proposed decision and participants have an opportunity to comment on it.

First, the current make allowances do not differ in a significant way from the Cornell Study weighted averages.

Second, plants receive relief in the form of lower yields and, in particular, the error on the butterfat shrink. Such offsets any difference in make allowances by a several times.

Third, there should be no change until all factors have been considered, not just make allowances.

Fourth, the evidence shows that current levels are sufficient as plant capacity in the United States continues to grow and producers continue to produce more milk.

VIII. Conclusion

The Secretary should not change the make allowances. If he chooses to do so, then he must use the weighted averages from the Cornell Study with the dry whey costs adjusted off of the NFDM prices.

The Department should terminate the proceeding.

Respectfully Submitted,

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