

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**

**BRIEF IN OPPOSITION TO CHANGES TO MANUFACTURING MILK PRICES
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 Argument

This hearing was called to consider a proposal which “seeks to amend § 1000.50 milk price formulas by revising the existing manufacturing allowances for butter, nonfat dry milk, cheese, and whey powder based upon evidence obtained from the hearing record.” Ex. 1., 71 Fed. Reg. 551-52 (January 5, 2006). The “evidence” reflects something else altogether. The proposal described evidence including, a recently **updated** survey of manufacturing costs conducted by the USDA Rural Business Cooperative Service. *Id.* (emphasis added). Instead what was presented was a radically different study that included a whole new group of plants, and a division of products that was not in the first report. Most importantly, this “updated survey” resulted from a lobbying effort to participate in the survey by those who stood to gain by reducing producer prices.

Though the Department has called the hearing, it is not obligated, and in fact is prohibited by law, from adopting changes if the evidence is faulty, contrived, too narrowly focused, or deliberately avoids and ignores critical evidence that supports no change. All of those problems apply to this hearing.

When the anecdotal stories and superfluous testimony is stripped, the picture revealed demonstrates that plants throughout the country are paying more than the minimum prices for milk. This suggests that most plants are profitably marketing their products at prices in excess of what must be paid. If the plants were not profitable paying these premium prices, then the answer is to reduce their premiums rather than reduce income to all. The evidence suggests that a few cooperatives with a few plants are struggling, but the solution is not to rob all dairy producers of a third of a billion dollars in the first year and over a billion dollars for five years to cover up other economic problems in those regions— especially when those complaining pay more than they are legally obligated to pay.

The purpose of the AMAA is, after all, to benefit producers, not penalize them. Nowhere does the Act state that the Department is to consider plant profitability as an element of pricing. Rather it speaks in terms of dairy farmer viability. 7 U.S.C. § 608c. Buyers of milk will always claim the price is too high. The AMAA was created to provide a voice for producers and to arm them with the force of the federal law to protect and defend their economic position. To use the Act as a basis to reduce producer income, as this proposal is expressly and openly designed to do, so as to reduce the cost of milk to buyers of that milk would be to turn the Federal Milk Order program on its head.

All of the plants and companies seeking lower milk costs certainly face economic challenges in operating their businesses. So, too, do dairy farmers. Increased costs of energy, health care, and other costs of operation have hit them as well. To impose on dairy farmers the additional risk of cost increases at the processor level without considering the level of farm income needed to maintain viable milk supplies constitutes an unnecessary and illegal double hit.

From the mouth of virtually every proponent witness came the statement that the NASS survey price and its use in the formulas deprived plants the ability to pass extra costs on to their buyers and

thus they were compelled to take it from producers. If that is true, then the overwhelming evidence demonstrates that it is the very pricing system that is broke and needs to be fixed, the answer is not tweaking a formula that is flawed in a different aspect. Changing make allowances to rectify a problem in the price series is as fruitful as replacing the brakes on a car that won't start.

In light of the fact that at least one order has all of its producers on record in opposition to these changes and at least four other orders have little to no support (if not full opposition) it is incumbent upon the Department to reject this proposal rather than risk the termination of the order system altogether.

This post hearing brief and proposed findings and conclusions will identify key areas of the testimony that must be considered, provide summary of why the evidence does not support reducing producer income, and then recount the facts in the record that support our conclusions.

In summary, the argument presented is as follows:

1. The narrow focus of the hearing only on “make allowances” for the purpose of reducing producer income without consideration of the complete pricing formulas is itself arbitrary and capricious, and no lawful regulation can be derived from such a proceeding.
2. There is no emergency situation demanding that the Department drastically reduce producer prices. Rather, there is evidence that with falling commodity prices, supply and demand will result in market responses sufficient to address the concerns presented by proponent witnesses. Arbitrary reductions to producer income will exacerbate supply reductions and crush producers in all regions and of all sizes.
3. The record evidence does not support changes to milk prices in any Class.

4. The reduction in producer prices through make allowance adjustments does not have the support of sufficient producers to ensure approval and places the Federal Order program at risk.
5. The hearing record does not contain sufficient evidence for the Department to consider all factors required by 7 U.S.C. § 608c(18).

B. Standing of those making 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).

II. Proposed Findings and Conclusions

A. The 2004 RCBS Study is a completely different study from the one conducted in 1998.

In the hearing notice, the Department stated as follows:

Proposal No. 1

This proposal seeks to amend the manufacturing allowances for Class III and Class IV product formulas, as enumerated in §1000.50 based on record evidence that may include the most current California State dairy products manufacturing cost survey and a **recently updated survey of manufacturing costs** conducted by the USDA Rural Business and Cooperatives Service (RBCS). Specifically, this proposal seeks to amend § 1000.50 milk price formulas by revising the existing manufacturing allowances for butter, nonfat dry milk, cheese, and whey powder based upon evidence obtained from the hearing record. Amendments to these manufacturing allowances would directly affect the milk component values used in Federal order milk price formulas for all classes of milk.

Ex. 1. p. 551-52 (emphasis added).

The assumption from that statement is that the Agri-Mark proposal would simply plug in updated numbers into the existing pricing formulas using the same methodology as before. By excluding from the hearing any yields and the pricing series, the Department implied that the focus of the hearing was to simply update old data with new data and leave the formulas alone. Aside from the appropriateness of that which is discussed later, that is certainly the position of the proponents.

The problem with that is that the 2004 RCBS study radically differs from the 1998 study. The 2004 study includes twice as many plants than before. The 2004 study was conducted with a completely different focus than the 1998 study. (In 1998, the study was conducted for cooperative management, the 2004 study was engineered for the purpose of raising milk allowances in the FMMO system). Finally, the 2004 study reports on widely different commodities and definitions of commodities than the 1998 study.

Using the 2004 RCBS data to set make allowances would replace apples with oranges. The 2004 RCBS study does not reflect changes in costs from one period to the next, but instead reflects differences in the studies themselves.

The proponents argue that the Department's decision to utilize the 1998 RCBS study in 2000 to set make allowances permits the 2004 RCBS study to be substituted in the formula, but the 2004 study is so different from its predecessor that the 2004 must be analyzed on its own.

The most glaring difference between the two studies is that the 2004 study was requested by those with a vested interest in increasing make allowances. Wellington, Tr. 310 (Day 2); Gulden, Tr. 24-25 (Day 3). Participation was wholly voluntary (Ling, Tr. 91 (Day 1)) and cooperatives could choose which of their plants would be included. A powerful incentive existed for the more efficient operations to opt out or not participate. Whether it was "oversight" or an actual intent is not at issue, that they could and did is. See Scheuerman, Tr. 333-34 (Day 2). The study is not complete.

We propose the following findings and conclusions:

1. The 1998 RCBS study was not designed to be used for setting make allowances, nor was the methodology of the 2004 study altered to make the study suitable for setting make allowances. Ling, Tr. 138 (Day1).
2. Participation in the RCBS study is voluntary. Ling, Tr. 91 (Day 1).
3. The 2004 RCBS study was subject to the following caveats:
 - Cost analysis does not consider differences in product quality. Products of higher quality conceivably would require higher quality ingredients and more effort by labor.
 - Cost allocation procedure for multi-product plant may not be uniform among participating cooperatives; therefore, plants having exactly the same operations same total costs may show different unit product manufacturing costs.
 - The nature of a plant might affect cost. A plant used strictly for manufacturing purposes tends to have a relatively constant milk volume and is operated at a

high rate of capacity. It is likely to have a lower cost than a plant for balancing milk supply.

- There are regional differences in input costs such as wages, electricity and fuel rates. It is possible that an efficiently operated plant in one region might have a higher per unit manufacturing cost than a less efficient in another region.
- The proportion of butter in bulk and print forms may affect a butter plant's cost.
- When categorizing various in-plant expenses into cost items for this study, different plants may have grouped them differently. Although this should not affect the total cost, care should be used in reading the individual cost items.

Ling, Tr. 97-98 (Day 1).

4. No proprietary plants participated in the program. Ling, Tr. 99-100 (Day 1).
5. The current study was done at the urging of the proponents. Wellington, Tr. 310 (Day 2).
6. Twelve cheese plants participated in the 1998 study, 17 cheese plants participated in 2004. Of the 17 cheese plants in the 2004 study only six were also in the 1998 study. Ex. 35.
7. Proponents could choose to participate or not based upon their interests in the study, their own determination of whether their data would be “relevant” to the study, or for any other reason.
8. The costs for cheese include both the cost of processing and the costs prior to shipping of the intermediate product including cream, skim, condensed skim or condensed whey. Ling, Tr. 94 (Day 1).
9. Only nine cooperatives participated in the 2004 study. Ling, Tr. 94 (Day 1). The nine cooperatives that participated are Agri-Mark, Inc., Associated Milk Producers, Inc. (AMPI), Dairy Farmers of America (DFA), Foremost Farms USA (Foremost), Land O’Lakes (LOL), Michigan Milk Producers Association (MMPA), Northwest Dairy

Association (NDA), Tillamook County Creamery (Tillamook), and United Dairymen of Arizona (UDA). Ling, Tr. 100 (Day 1), Ex. 35.

10. Of the nine cooperatives participating in the program, seven supported changes to the make allowances. Ultimately DFA withdrew its support when the proposal to decouple class prices was denied consideration at the hearing. Hollon, Tr. 277 (Day 4). UDA and Tillamook did not testify at the hearing.
11. Three cooperatives participated in the 1998 study but did not participate in the 2004 study (Alto Dairy Cooperative, Farmers Co-op Creamery and Bongards Creameries). Ex. 35
12. In 2004, three new cooperatives participated in the study which had not participated previously (AMPI, NDA, and UDA). Ex. 35.
13. Half of the plants that participated in the 1998 cheese cost study did not participate in the 2004 study. These plants are Alto Dairy cooperative plants in Alto and Black Creek, WI; Bongards' plant in Bongards, MN; DFA's plants in Smithfield, UT; Foremost Farms USA's plant in Marshfield, WI; and Land O'Lakes' plant in Perham, MN. Ex. 35
14. Alto claimed that it did not realize that it had to expressly volunteer to participate. Scheuerman, Tr. 334 (Day 2).
15. Of the seventeen plants in the 2004 study on cheese costs, eleven or almost two-thirds were not in the 1998 study. Ex. 35.
16. Some of the proponents changed the plants that they reported in the study. Agri-Mark added Chateaugay, NY. AMPI added six plants. DFA dropped the Smithfield, UT

plant and added the Lovington, NM plant. Foremost switched the Marshfield, WI plant for the Lancaster, WI plant. Tillamook added Boardman, OR.

17. The increase of one plant in the butter cost study from 1998 to 2004 comes from dropping the McMinnville, OR plant and the two California plants and adding plants in Goshen, IN, Winnsboro, TX, Issaquah, WA and Tempe, AZ. Ex. 35.
18. Of the eight butter plants in the 2004 study, three were not in the 1998 study. Ex. 35.
19. The number of powder plants participating jumped from five in 1998 to fourteen in 2004. Ten of the fourteen plants in the 2004 study were not surveyed in 1998. Ex. 35.
20. The 2004 RCBS study was not prepared by USDA for use in an FMMO hearing. Ling, Tr. 95 (Day 1).
21. The study was prepared “for the sole use of” the participating cooperatives so that they could compare their costs with average of all plants making the same product. Ling, Tr. 95 (Day 1).
22. The RCBS study was never used to set make allowances nor was the study constructed to determine make allowances. Ling, Tr. 138 (Day 1).
23. The 1998 and 2004 reports for weighted costs can be summarized as follows:

	1998 (Ex. 20)	2004 (Ex. 18)
All Cheeses	12.916	13.295
40# Block Cheddar	None	15.136
Condensed Whey Solids	None	6.549
Dried Whey	None	11.409
Butter	11.271	16.588
Non-fat dry milk	14.457	16.816

24. The 1998 costs for cheese plants was for “mostly Cheddar cheese in 40-pound, 640-pound, or 500-pound packages; some Italian and other cheeses.” Ex. 20.
25. The 2004 costs for the cheese plants was for “Predominantly Cheddar cheese in 40-pound, 640-pound, or 500-pound packages; may contain some other cheeses.” Ex. 18.
26. The 2004 report reported separate costs for “40-lbs block cheese” which was defined as “predominately Cheddar cheese in 40-pound blocks; may contain some other cheeses.” This separate cost for 40- pound block cheddar was not reported in the 1998 report. Ex. 18.
27. For the “Powder” costs, the 1998 report described the product as “Mostly nonfat dry milk; *some* dry whole milk, dry buttermilk and powder for animal feed.” Ex. 20. (emphasis added).
28. For the “Nonfat dry milk” costs in the 2004 report, the product is described as “Predominantly non fat dry milk; *contain small amounts* of buttermilk powder, whole milk powder, animal feed *and others*. Ex. 18 (emphasis added).
29. The “Nonfat dry milk” costs in the 2004 report also include “both condensing and drying costs.” Ex 18, fn 3.
30. The 1998 report without California shows average cheese yields at 10.3 pounds per hundred pounds of milk. Ex. 20.
31. The 2004 report for all cheeses shows an average cheese yield of 10.4 pounds and an average cheese yield of 10.7 pounds for 40-pound blocks.
32. There is no evidence as to whether any of the products produced at the RCBS surveyed plants also reported sales to NASS. Ling, Tr. 115 (Day 1).

33. Income at the plants is not considered in the computation of costs. For example, payments to operate balancing plants is not factored in. Ling, Tr. 115 (Day 1).
34. According to Dairy Products 2004 Annual Summary produced by USDA and of which official notice was taken at the hearing, there are 157 plants producing cheddar cheese in the US. Combined they produce 2.76 billion pounds per year. Dairy Products 2004 Summary, page 22.
35. The study does not address the profitability of the plants. Ling, Tr. 145 (Day 1).
36. USDA does not send letters out to plants or cooperatives, the cooperatives themselves have to request to participate. Ling, Tr. 147 (Day 1).
37. The cheese plants in the RCBS study are approximately the same size as the California high cost plants and there are no 200 million pound cheese plants like those in the CDFA study. Reed, Tr. 220 (Day 1).

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

The various pricing formulas can be simply stated as commodity price less make allowance times yield. Holding commodity prices constant, a change in the yield correspondingly changes the make allowance. Not adjusting allowances to yields or yields to allowances distorts the entire data.

In 2000, when the methodology of using the RCBS was first adopted, the Department had 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 1998 RCBS 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.

In the meantime, the Department has significantly altered the yields for cheese in the formulas by reducing the amount of casein in true protein to 82.2% and imposing shrink on the fat and milk (which is addressed elsewhere in this brief). The result is an implied yield of 9.57 pounds of cheese per one hundred pounds of milk. Further, the RCBS study shows that for the same cheese in the 1998 study, the 2004 yield was 10.4 pounds with a derived 96.5% butterfat recovery. Adjusted to standard milk, a yield of 9.98 pounds is computed, which is fully one half of a pound more than the Department's implied yield.

Further, in the 40# Cheddar production costs that the proponents want the Department to use in setting the make allowances, the reported yield of 10.7 pounds represents a superior butterfat recovery and an implied yield of 10.13 pounds which is a pound more than in the FMMO formula. In short, the Department has to consider these yields that plants are realizing in evaluating the make allowances even if the Department chooses not to address the yields themselves in the formulas.

The impact can be shown in this simple example: Assume a cheese price of \$1.50. With a make allowance of \$0.165/pound, the gross margin on the cheese sale is \$1.335 per pound. At 9.57 pounds of cheese per hundredweight, milk would cost \$12.78 per hundredweight. But if the plant is actually yielding 10.17 pounds per hundredweight (as the surveyed RCBS plants are), the plant grosses \$13.52 for each hundredweight of milk it purchases. The difference between the gross income and the FMMO minimum price is \$0.74 per hundredweight. Divided over the 10.17 pounds this is an additional 7.3 cents per pound of margin on top of the stated make allowance. No wonder these plants can pay a Class III premium!

Thus, the updated RCBS study shows that the proponents already enjoy a make allowance of 23 cents per pound which exceeds their own admitted costs. 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).

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 shows the formulas used to set FMMO prices. Relevant to this hearing are the formulas to establish the component prices used to determine minimum prices. These are found at the Class III and Class IV formulas.
2. The Class III formula is derived from three components – protein, other solids and butterfat. Rourke, Tr. 43-44 (Day 1).
3. The protein component price is: $((\text{Cheese Price} - 0.165) \times 1.383) + (((\text{Cheese Price} - 0.165) \times 1.572) - \text{Butterfat Price} \times 0.9) \times 1.17)$. Where,
 - a. The Cheese Price is a weighted average price of weekly reported prices for 40-pound block cheddar and 500-pound barrel cheddar. Rourke, Tr. 45 (Day 1). The make allowance for cheese is 0.16541 lb. Rourke, Tr. 46 (Day 1).
 - b. The yield factor for protein in cheese is 1.383. Rourke, Tr. 46, 47 (Day 1).
 - c. The yield factor for butter in cheese is 1.572. Rourke, Tr. 47 (Day 1).
 - d. The Department has historically changed the yield factors. The protein yield factor has been changed from 1.405 to 1.383 and the yield factor for butter has been changed from 1.572 to 1.582. Rourke, Tr. 52-54 (Day 1).

- e. The butterfat recovery in cheese is 90% (0.9). Rourke, Tr. 48 (Day 1).
 - f. The ratio of butterfat to protein in cheese is 1.17. 67 Fed. Reg. 67906, 67928 (Nov. 7, 2002).
4. A change in any of the cheese price, the yield factors, or the make allowance would result in a change in the protein price. Rourke, Tr. 50 (Day 1).
5. The formula for setting the other solids component price is: $(\text{Dry Whey} - 0.159) \times 1.03$. Where,
- a. The dry whey price is a weighted average price of weekly reported sales for dry whey by the National Agricultural Statistical Service (NASS). Rourke, Tr. 48 (Day 1).
 - b. The make allowance for dry whey is \$0.159/lb. *Id.*
 - c. The yield factor is 1.03. *Id.*
Ex. 16, Rourke, Tr. 48 (Day 1).
6. A change in any of the dry whey price, the yield factor, or the make allowance would result in a change in the other solids price. Rourke, Tr. 50 (Day 1).
7. The formula for pricing butterfat is $(\text{Butter Price} - 0.115) \times 1.20$. Where,
- a. The butter price is a weighted average price of weekly reported sales for dry whey by NASS. *Id.*
 - b. The make allowance for butter is \$0.115/lb. *Id.*
 - c. The yield factor is 1.20. *Id.*
Ex. 16, Rourke, Tr. 49 (Day 1).
8. A change in any of the butter price, the yield factor, or the make allowance would result in a change in the butterfat price. Rourke, Tr. 50 (Day 1).
9. The formula for pricing Solids Not Fat is: $(\text{Non Fat Dry Milk Price} - 0.14) \times 0.99$

Where,

- a. The butter price is a weighted average price of weekly reported sales for commodity butter by National Agricultural Statistical Service. *Id.*
- b. The make allowance for butter is \$0.14/lb. *Id.*
- c. The yield factor is 0.99. *Id.*

Ex. 16, Rourke, Tr. 51-52 (Day 1).

10. 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).
11. 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

12. 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.
13. The pounds of butterfat in a pound of cheese can be determined as follows: Butterfat per Lb of Cheese = $\{[(\text{BF} \times \text{BR}) \times 1.09] \div (1 - \text{M}\%)\} \div \text{BFLbs}$
14. The implied Butterfat Recovery in a formula can be derived as follows: $\text{BR} = \{\text{Yield} \div [(1 - \text{M}\%) \times 1.09] - (\text{CS} \times \text{PR} + .1)\} \div \text{BF}$
15. The Protein per pound of cheese can be calculated as follows: $\text{Protein Yield} = \{[(\text{CS} \times \text{PR} - .1) \times 1.09]\} \div (1 - \text{M}\%) \div \text{PR}$

16. 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.
17. The cheese plants which made up the CDFA make allowance study had a yield of 11.08 lbs of cheese per hundredweight of milk with moisture of 37.84%, and tests of 4.02% butterfat and 9.05% solids-not-fat. Ex. 25.
18. A yield of 11.08 pounds of cheese equates to no allowance for shrink and a butterfat recovery of 94% .
19. If the FMMO used the same butterfat recovery as the CDFA, the implied yield would be 10.05 pounds per hundred pounds of milk at standardized tests.
20. The average yield for the plants in the 2004 RCBS study was 10.7 pounds per hundred pounds of milk for 40-pound blocks and 10.4 pounds for all cheeses. Ex. 18, p.4.
21. Assuming that the milk purchased by plants in the RCBS study contained 3.66% butterfat and 3.03% true protein (as the average all market test was reported for the FMMOs in the 2005 Annual Summary), the yield for all cheese effectively uses a butterfat recovery of 94%.
22. With that butterfat recovery rate, milk at 3.5% butterfat and 2.9915% true protein would have yields of 10.13 pounds per hundredweight of milk.
23. Assuming that the milk was at the average of 3.66% butterfat and 3.03% true protein (as the average all market test was report for the FMMOs in the 2005 Annual Summary), the yield for 40 pound block cheddar cheese effectively uses a butterfat recovery of 98.5%.

24. With that butterfat recovery rate, milk at 3.5% butterfat and 2.9915% true protein would have yields of 10.21 pounds per hundredweight of milk.
25. In summary, while the FMMO has a cheese yield of 9.63, the Proponents are urging the use of make allowances from studies that have significantly higher yields. By not adjusting the yield or the make allowance, the Proponents are hiding significant contributions to margins that should be considered by the Department.

C. 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 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.

D. The notice of hearing did not contemplate a change in pricing formulation to allow for an automatic fuel adjustment.

NMPF has proposed an energy adjuster which will change each month depending on the energy prices for the current month and the previous month. This automatic change is premised on several assumptions. First, it assumes that the devised adjuster itself is accurate enough to change the formula. As explained elsewhere, there is no such evidence. Second, the announced proposal anticipated updating the RCBS and California price studies, not some other index of pricing.

As it stands now, the number of factors leading to producer prices are myriad and complex. Managing price risk is nearly impossible for both plants and producers. Adding energy as a variable component will only make the situation worse.

Changes in energy will cause month to month changes in the pricing. A calculation of the December 2005 make allowances is provided below based on the testimony from NMPF. For December, the fluctuation in energy costs would have had a two cent impact on producer prices.

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National Milk Data (From Cryan Testimony: Ex. 58/60)				
2004 Make Costs (\$/lb)				
	Cheese	Butter	Powder	Whey
Electricity	0.00714	0.00912	0.01511	0.01493
Gas	0.00772	0.00492	0.02951	0.02266
Other Make Costs	0.16454	0.13746	0.12056	0.14336
Totals	0.17940	0.15150	0.16518	0.18095
BLS PPI Price Series				
	2004	November	December	January
Electricity	147.20000	161.50000	161.80000	
Gas	201.70000	315.60000	292.50000	
Energy Indices (Per NMPF Formula)				
	November	December		
Electricity	1.09715	1.09918		
Gas	1.56470	1.45017		
November 2005 Make Costs (per NMPF Formula with Energy Adjuster)				
	Cheese	Butter	Powder	Whey
Electricity	0.00783	0.01001	0.01658	0.01638
Gas	0.01208	0.00770	0.04617	0.03546
Other Make Costs	0.16454	0.13746	0.12056	0.14336
Totals	0.18445	0.15516	0.18331	0.19520
December 2005 Make Costs (per NMPF Formula with Energy Adjuster)				
	Cheese	Butter	Powder	Whey
Electricity	0.00785	0.01002	0.01661	0.01641
Gas	0.01120	0.00713	0.04279	0.03286
Other Make Costs	0.16454	0.13746	0.12056	0.14336
Totals	0.18358	0.15462	0.17996	0.19263

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

The Proponents' argument is 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.

The same proponents that now want changed make allowances requested the use of NASS survey prices in 2000 and argued that the survey did not have a circular impact. The Department agreed:

According to the testimony in the record and a number of the briefs, cheese and butter sellers and buyers look to the CME to identify the most current price levels. As a result, prices move in response to supply and demand conditions in the marketplace as reflected at the CME. Since the transaction prices of commodities are based off of the CME, it is difficult to see how the NASS survey can cause, or result in, circularity.

67 Fed. Reg. at 67913. Proponents cannot have it both ways. If the NASS survey is interfering with their ability to get their value out of the market place, then the survey needs to be fixed, not the make allowances.

There is additional evidence that the NASS survey is not as inflexible as the Proponents claim. NASS reports an Upper Midwest cheese price as well as a national price. This Upper Midwest price has been higher than the national price for 40# blocks. This proves that at least the Upper Midwest plants are getting sufficient added value out of the marketplace.

Further, plants can and do sell products that are not reported to NASS. For example almost $\frac{3}{4}$ of the cheeses sold in the United States are not cheddars and not subject to NASS pricing. Also, cheddar cheeses that do not meet the commodity criteria are not surveyed by NASS. There are ways that plants can, and do, get money out of the market without increasing producer prices. We request that the Department make the following findings:

1. Agri-Mark's economist admitted that there is more than one way to address Agri-Mark's cost issues, and that adjusting the price survey would also take care of the problem. Wellington, Tr. 174 (Day 2).

2. The Lactalis witness acknowledged that they have the ability to change the Class IV basis to reflect manufacturing costs, but he also agreed that they can't recoup it out of the market because of the circularity of NASS. Carlson, Tr. 321-23 (Day 2).
3. Dairy America believed that NASS would not capture an energy surcharge for NFDM, but it did. Consequently, that money could not be kept for the manufacturers. The problem was the NASS survey not the price formula. Schad, Tr. 367 (Day 2).
4. When asked if changing NASS reporting to exclude an energy surcharge would be a solution to its problem, the LOL witness said "No," not because that was an unworkable fix, but because he "like[s] the simplicity" of the current system that doesn't permit his cooperative to obtain the full value of its powder sales. Schad, Tr. 408 (Day 2).
5. Foremost Farms USA testified that we have tried to increase prices to offset increasing costs but to the extent that this gets reflected in NASS, the result is higher minimum classified prices for milk which offsets the higher prices received for the finished products. Weis, Tr. 48, 64 (Day 3).
6. MMPA's witness agreed with the other proponents that any increases in costs cannot effectively be passed on because of NASS reporting which results in paying higher costs for milk. Galarneau, Tr. 112 (Day 3).
7. O-AT-KA testified that increasing product selling prices is no solution because the increased prices get reported to NASS and are fed back into the pricing formulas and result in higher milk purchase prices. Alexander, Tr. 176 (Day 3).
8. NDA stated that the circular impact of NASS pricing leaves manufacturers few options to increase margins through higher product prices. McBride, Tr. 343 (Day 3).

9. But he acknowledged that market conditions dictate what NDA can sell cream for. McBride, Tr. 359-61 (Day 3).
10. The dairy industry can move product at prices that are not subject to NASS. For example McBride stated that cream is routinely sold as a multiple of the butter price and the price changes depending on the market.

Q. I want to follow up on some of Mr. Schad's questions here. I think maybe that would be a good place to start. We talked about the cream, and cream is bought and sold as a multiplier of the butter price, right?

A. Yes.

Q. And that's the CME price, right?

A. I believe we have got contracts do -- you know, CME or other market prices.

Q. What are some of those other market prices?

A. They could be based on NASS, also.

Q. And that multiplier is negotiated, is it not?

A. Yes.

Q. And if cream is tight, the multiplier goes up. And if cream is long, the multiplier goes down, right?

A. Yes.

Q. Sometimes pretty close to one if it's really long. It hasn't happened for a while, but it can happen, right?

A. It could.

Q. So if there is a cost or a value that cream or a cost, it reflects market conditions for cream in that particular market, right?

A. Yes.

Q. And the terms of the sales of that cream, are they traditionally FOB the selling plant or the buying plant or is that also negotiated?

A. That's negotiated.

Q. And as an operator of a butter plant, the opportunity sometimes exists to sell the cream at a price higher than you can obtain than if you processed the cream into butter yourself, right?

A. At times.

McBride, Tr. 358-361 (Day 3).

F. The hearing record is devoid of any evidence that the make allowances of the RCBS study represent plants that are profitable, unprofitable, efficient or ineffecient.

The numbers presented by RCBS and used by the proponents are given without any context.

The Department stated in the Final Decision of the 2000 hearing:

Both the marketing allowance and return on investment factors should be included in the manufacturing allowances provided in the component price formulas at the rates supported by the CDFA data. If processors are not provided enough of a manufacturing allowance to market the product they process, or to earn any return on investment, they will not continue to provide processing capacity for producers' milk. At the same time, the manufacturing allowances incorporated in the formulas will not provide enough of an allowance to assure that every processor, no matter how inefficient or high-cost, will earn a profit. Allowances set at such a level certainly could result in the situation warned of by producer groups in which processors manufacture greater volumes of product than the market demands because they are guaranteed a profit on all their production. As a result, the only way to market all of the product would be to reduce prices, with a profit to processors still locked in through the make allowance, which would result in decreasing prices paid to producers. In addition, manufacturers who are assured a profit on all of their output would have a lesser incentive to make a sufficient quantity of milk available for fluid use—a basic goal of the Federal milk order program.

67 Fed. Reg. at 67916-17.

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 RCBS 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 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.

We propose that the Department make the following findings and conclusions:

1. CDFA reports that its average make allowance for butter exceeds the actual costs to make 75% of the butter produced in its surveyed plants. Ex. 24, p. 2.
2. CDFA reports that its average make allowance for cheese exceeds the actual costs to make 62% of the cheese produced in its surveyed plants. Ex. 24, p. 4.
3. CDFA reports that its average make allowance for NFDM exceeds the actual costs to make 63% of the NFDM produced in its surveyed plants. Ex. 24, p. 3.
4. The RCBS study does not report such a number. *Cf.* Ex. 18 *with* Ex. 24.
5. The RCBS study does not determine whether a plant is profitable or not. Ling, Tr.145 (Day 1).
6. 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).
7. There have been other plants that have opened throughout the country over the last five years. Yonkers, Tr. 337 (Day 4).
8. The Lovington, NM plant reported a make allowance three cents less than the simple average reported by RCBS and two cents less than the weighted average reported by RCBS. Ex. 65.

9. The Lovington plant plus the requested ROI, Administration, and Marketing costs was operating *at* the stated FMMO make allowance for cheese. *Id.*
10. Agri-Mark's testimony shows a cheese make allowance at \$0.203/lb. that exceeds what it is asking for, but more importantly exceeds the Lovington plant by six cents. This range of reported costs, coupled with the discussion of other enhancements of actual make allowances elsewhere in this brief, make it clear that there is no way of knowing where the line is between efficient and inefficient.
11. 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.
12. 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).
13. 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 reblending producer income. Weaver, Tr. 287-88 (Day 3).

14. The full examination of issues should include cheese yields and efficiencies. Weaver, Tr. 290 (Day 3).
15. 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).

G. Combining the California and RCBS numbers is an illegitimate method to measure manufacturing costs for purposes of this hearing.

The 2004 RCBS study is not the federal equivalent of the California cost study. It is a poor substitute. The best evidence that its use is unreliable and skews results is to compare the 2000 Federal Order hearing results with what proponents are now arguing for. The proponents proposed a weighted average between the RCBS and California data.

In 2000 the California prices were higher than the RCBS and the use of the California data plus the addition of ROI and administration resulted in FMMO make allowances lower than California prices. Now the reverse is true. The California prices are now lower than the RCBS study and moderate any price increase. What this shows is that the RCBS study is flawed because its wide swings at a time when California's prices have been more moderate are the result of the methodology, not changes in economic conditions.

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

1. CDFA audits the plants, RCBS does not. Ling, Tr. 119 (Day 1).
2. CDFA includes Monterey Jack and Cheddar cheeses in its survey while RCBS uses Cheddar and Other cheeses. *Cf.* Ex. 18 with Ex. 23.

3. CDFA audits the costs of all plants. RCBS only examined 17 plants or 10.8% of plants making cheddar and approximately 12% of cheese produced. 2004 Dairy Products Summary; Ling, Tr. 94 (Day 1).
4. CDFA audits proprietary plants and coop plants. Reed, Tr. 179 (Day 1). RCBS only examined coop plants. Ling, Tr. 99 (Day 1).
5. CDFA does a plant inspection to make sure that the numbers reported reflect what is happening in the plant. RCBS made no plant inspections. Reed, Tr. 159 (Day 1).
6. CDFA also audits and checks cost of production of milk. Krug, Tr. 183 (Day 1). USDA does not.
7. CDFA has a mandate to promote the expansion of the California dairy industry, USDA only to insure stability.
8. CDFA requires all plants to purchase milk at minimum prices. Krug, Tr. 182 (Day 1). In the federal system, manufacturing plants can choose to participate in the pool or not and are not required to pay minimum prices.
9. CDFA plants had a yield of 11.08 pounds of cheese per hundred pounds of milk. RCBS showed a yield of 10.4 or 10.7 depending on the cheeses. Ex. 23, Ex. 18.
10. CDFA pricing included the cost of 640 pound blocks. RCBS did not. *Id.*
11. CDFA uses a straight line method of depreciation. Reed, Tr. 160 (Day 1). RCBS uses what the plant provides with no instruction. Ex. 18.
12. CDFA reconciles its numbers. Reed, Tr. 175 (Day 1). RCBS does so only informally. Ling, Tr. 143-44 (Day 1).

13. The average volume of cheese plants in the CDFA study was 116.7 million pounds; RCBS looked at cheese plants with an average volume of 62.3 million pounds. Ex. 25, Ex. 18.
 14. CDFA does the study every year as part of a consistent practice. RCBS does its survey only as often as requested by cooperatives. Reed, Tr. 157 (Day 1).
 15. CDFA hired a private accounting firm to review the work of CDFA's dairy manufacturing cost unit. Krug, Tr. 155 (Day 1).
 16. 99.9% of the butter is covered by the CDFA audit. Reed, Tr. 157 (Day 1). Not all butter in the United States is included in the RCBS study. *Cf.* Ex. 18 *with* 2004 Dairy Products Summary.
 17. 98.5 % of Cheddar and Monterey Jack cheese production is covered by the CDFA audit, Reed, Tr. 157 (Day 1). Not all cheddar cheese is covered by the RCBS study. *Cf.* Ex. 18 *with* 2004 Dairy Products Summary.
 18. 99.17% of NFDM is covered by the CDFA audit. Reed, Tr. 157 (Day 1). Not all NFDM is covered by the RCBS study. *Cf.* Ex. 18 *with* 2004 Dairy Products Summary.
- H. USDA has not taken testimony sufficient to meaningfully consider the factors enumerated in the AMAA. Producer income under the various proposals will be insufficient to maintain viable operations.**

The AMAA clearly requires that the Secretary consider the impact of the decision on producer economics:

(18) Milk prices The Secretary of Agriculture, prior to prescribing any term in any marketing agreement or order, or amendment thereto, relating to milk or its products, if such term is to fix minimum prices to be paid to producers or associations of producers, or 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

agreement, 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. Thereafter, as the Secretary finds necessary on account of changed circumstances, he shall, after due notice and opportunity for hearing, make adjustments in such prices.

7 U.S.C. §608c(18).

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.

Since virtually all witnesses testified that they were currently purchasing milk at prices higher than the minimum prices, the supply and demand considerations required under section (18) mandates that no reduction be made in the pricing formulas.

In the Final Decision of the 2000 Hearing, the Department stated that it did not have to comply with §608c(18) and consider the costs of feed directly. In doing so it stated:

The product price formulas adopted in the recommended decision would reflect accurately the market values of the products made from producer milk used in manufacturing. As supply costs increase with a resulting decline in production, commodity prices would increase as manufacturers secure additional milk to meet their needs. Such increases in commodity prices would mean higher prices for milk. The opposite would be true if supply costs were declining. Additionally, since Federal order prices are minimum prices, handlers may increase their pay prices in response to changing supply/demand conditions even when Federal order prices do not increase.

67 Fed. Reg. at 67911-12.

As indicated above, the courts have rejected this indirect consideration of feed prices as the avoidance of the Secretary's obligation to consider farm income in the determination of minimum prices. The underlying purpose of the AMAA was to cease letting producers be "price takers" and instead permit producers to fairly force their costs into the economic system and enjoy the cost of their production including the ROI, health insurance for them and their families and their employees, coverage for their increased energy costs and the other things that the Proponents want only plants to have.

Critically, however, the econometric analysis done by Dr. McDowell shows that this argument fails. The implication was made that dairy producer income will ultimately improve because the lower prices brought on by these changes will decrease supply and increased demand will drive prices back up. Aside from the hundreds of dairy farmers that will be bankrupted during the shakeout, the econometric model shows that producers do not gain but are net losers. Under Scenario 3, which approximates the impact of the NMPF proposal, the *net losses* are a billion dollars over five years, a third of a billion the first year alone. McDowell, Tr. 265-66 (Day 1), Ex. 2.

The Department then went on to say that “The formulas are used to establish minimum prices for milk used in making particular dairy products, not for determining payments to dairy farmers.” 67 Fed. Reg. at 67912. That is simply not true. The prices these formulas establish are used to determine the minimum class prices which are blended to determine the prices plants pay to producers by law. *See, e.g.*, 7 C.F.R. §§1126.70-76. If the Department is right in this regard, then there is no need for producers to support the FMMO program for it provides nothing to them. This hearing process more than any in the history of the FMMOs will be a test as to whether the FMMO program is a tool for the economic stability of dairy farmers or a mechanism to provide risk offset for manufacturers of dairy products.

We request that the Department make the following findings and conclusions:

1. The various proposals can be summarized as follows:

	Cheese Make	NFDM Make	Butter Make	Dry Whey Make
Current Formula	0.1650	0.1400	0.1150	0.1590
NMPF With Energy Adjustment Nov 2005	0.1844	0.1833	0.1552	0.1952
NMPF With No Energy Adjustment	0.1794	0.1652	0.1515	0.1809
NMPF 2004 adjusted for 1998 Energy Costs	0.1748	0.1491	0.1480	0.1682
Agrimark 2004 Survey Data Only +.019	0.1790	0.1870	0.1510	0.2060
Agrimark 2004 Survey Data Only +.019	0.1790	0.1870	0.1510	0.2120
Agrimark 2004 Survey Data, 2005 Energy Only +.019	0.1810	0.1970	0.1540	0.2160
Agrimark 2004 Survey Data and 2005 Energy +.025	0.1810	0.1970	0.1540	0.2220
California	0.1706	0.1560	0.1299	0.2000

Table 1. Summary of Proposed Changes to Make Allowances

Source: Exs. 24, 29 Table 7, 58 Table 1.

2. The USDA did an econometric analysis of three scenarios to approximate what an ultimate proposal might be. Ex. 1 p. 547, Ex. 2 and Ex. 27.

3. The impact on the All Milk price shown in Exhibit 2 reflects the impact of three scenarios on all milk marketed regardless of whether or not it is in the FMMO system. A comparison of the F.O. Cash Receipts to the Total F.O. Marketings shows a much greater impact per hundredweight on producers. This can be determined by first determining the Total F.O. Marketings for each scenario by adding the Baseline to the change from the Baseline for the scenario. Dividing the change in receipts by this adjusted baseline will yield the per hundredweight change. It is as follows:

	First Year Change in F.O. Receipts \$Million	First Year Total F.O. Marketings Million #s	\$ Per CWT Change to Producer Prices
Scenario 1	-155	119306	-0.12992
Scenario 2	-222	119283	-0.18611
Scenario 3	-277	119262	-0.23226

Table 2. Changes to F.O. Blend Prices Based Upon USDA Econometric Model
First Year

4. Using the same methodology, the amounts can be done for the five year average.

	First Year Change in F.O. Receipts \$Million	First Year Total F.O. Marketings Million #S	\$ Per CWT Change to Producer Prices
Scenario 1	-77	121661	-0.0633
Scenario 2	-135	121593	-0.111
Scenario 3	-191	121527	-0.157

Table 3. Changes to F.O. Blend Prices Based Upon USDA Econometric Model
Average 2005-2010

5. The impact of the proposed changes can be shown both in terms of a change in blend pricing or an econometric model.

6. The following table shows the impact of each of the proposals as well as that of using only California. The impacts are in terms of changes to blend prices using the same methodology as Rourke with the various scenarios. The impact on F.O. Receipts and U.S. Receipts uses the report prepared by McDowell and extrapolates by a simple ratio of blend price change against the dollars reported for the closest scenario. Although this is not as accurate it clearly shows the magnitude of producer price impact these changes will have. Exs. 1, 2, 13, 27

	CWT Change To Blend Prices	Est. \$ Impact First Year F.O. Receipts	Est. \$ Impact Five Year F.O. Receipts	Est. \$ Impact First Year U.S. Receipts	Est. \$ Impact Five Year U.S. Receipts
Current Formula	0.00				
NMPF With Energy Adjustment Nov 2005	-0.47	(273)	(942)	(314)	(1,021)
NMPF With No Energy Adjustment	-0.32	(206)	(626)	(225)	(649)
NMPF 2004 adjusted for 1998 Energy Costs	-0.19	(140)	(349)	(143)	(326)
Agrimark 2004 Survey Data Only +.019	-0.48	(279)	(962)	(320)	(1,042)
Agrimark 2004 Survey Data Only +.019	-0.51	(291)	(1,005)	(335)	(1,089)
Agrimark 2004 Survey Data 2005 Energy Only +.019	-0.57	(329)	(1,135)	(378)	(1,231)
Agrimark 2004 Survey Data and 2005 Energy +.025	-0.59	(342)	(1,178)	(392)	(1,277)
California	-0.26	(194)	(482)	(198)	(451)

Table 4. Estimated Impact on Producer Revenue. \$ Represents Million Dollars.

7. The changes to these make allowances change all classes of milk. Ex. 1.
8. This is a real impact on real families and real farms. Family businesses will be forced out of the business taking on any one of these proposals.
9. Arden Tewksbury, of Berwick, PA testified on behalf of Progressive Agriculture Organization; Faithopity Farms; Farm Wives United of North Java, NY; Tioga Valley Milk Co-op of Tioga PA; Family Farm Defenders of

Madison, WI; American Raw Milk Association of Wauna Key, WI; Pennsylvania Farmers Union; National Family Farm Coalition; and South Auburn Grange of Susquehenna County, PA. Mr. Tewksbury testified that increasing make allowances is inherently unfair to farmers who must absorb all of their own cost increases. He proposed that a new pricing formula should be considered that fairly treats farmers, processors, and consumers. Tewksbury, Tr. 14 (Day 2).

10. Mr. Tewksbury states that losses of the magnitude reflected in Exhibit 13 for Federal Order 1 (26-45 cents) would be a substantial loss to Faithpity Farms because the dairy is their sole source of income. Tewksbury, Tr. 31 (Day 2).
11. Faithpity Farms is a small business under the Regulatory Flexibility Act.
12. Donna Hall, of Lycoming County, PA testified in her capacity as a dairy farmer and member of Pro Ag, Pennsylvania Farmers Union and National Family Farm Coalition.
13. Mrs. Hall also testified that processors should offset their increased costs from the marketplace. Hall, Tr. 37 (Day 2).
14. Hall testified that farmers should be entitled to milk prices that reflect the cost of production plus a reasonable profit. Increases in the make allowances will erode the profit on her dairy farm. Hall, Tr. 40-41 (Day 2).
15. Mrs. Hall testified that a decrease of 10 to 25 cents per hundredweight in her milk check would mean paying electric bills late or decreasing the income to the four family members that operate their 68 cow dairy. Hall, Tr. 52-53 (Day 2).

16. Gerald Carlin, of Susquehenna County, PA is a dairy farmer with 60 cows and testified in opposition to the proposals.
17. The proposal from NMPF and Agri-Mark will cause a loss to his small farm of \$3,000 to \$5,000 per year, and the average farmer will see losses of \$6,500 to \$12,000 per year. Carlin, Tr. 62 (Day 2).
18. USDA must abide by 7 U.S.C. §608c(18) “to assure a level of income adequate to maintain productive capacity sufficient to meet anticipated future needs, and be in the public interest.” Carlin, Tr. 66 (Day 2).
19. The real world impact of increased make allowances on the Carlin farm “means a lot of worn-out equipment continues to be worn out and dangerous and not being able to update like I should and, of course, the additional stress of maybe getting further behind on bills.” Carlin, Tr. 72 (Day 2).
20. On the Carlin farm, electric (10%), fertilizer (25%), and diesel (80%) costs are up year over year. Carlin, Tr. 73-74 (Day 2).
21. Brenda Cochran, a 200 cow dairy farmer from Tioga County, PA also testified in opposition to the make allowance changes.
22. Dairy product manufacturers should secure cost increases from their customers rather than their raw product suppliers. Cochran, Tr. 79 (Day 2).
23. The dairy cooperatives who allege to represent their farmers' best interests are, in fact, masquerading as advocates for the farmers, and are actually working to bankrupt their membership. Cochran, Tr. 80 (Day 2).
24. There is little or no incentive for the coop plants to become more efficient as farmers have been forced to do. Cochran, Tr. 81 (Day 2).

25. Increased costs of fuel and health care have been absorbed by dairy farmers, as have the costs of advertising the processor's finished products.
26. “Until dairy farmers receive consideration for their rising production costs, any increase in profits or make allowances will unfairly negatively impact on dairy farmers' income, seriously affecting our ability to pay creditors, plant and harvest crops, care for our cattle and for our families. This insolvency will have an inevitable ripple effect in our rural communities, pulling down our agribusiness providers who are already struggling with open accounts from too many years of low milk prices and bad weather. My farm alone, using figures provided by Penn State's dairy economist, Ken Bailey, is projected to lose annually from \$7,500 to over \$13,000 if this larcenous scheme is approved. That financial loss will severely handicap our family's farm.” Cochran, Tr. 83-84.
27. Klaas Talsma, of Hico, TX on behalf of Select, Lone Star, and Zia testified that dairy farmers' production costs have increased due to increases in the price for electricity, fertilizer, fuels, and hauling. Dairy farmers have been forced to become more efficient to make up for these changes, and processors should have to do the same. Talsma, Tr. 207 (Day 3).
28. These cooperatives have in conjunction with the agency in common in place in the Southwest, worked to eliminate inefficiencies in the Southwest Marketing Area. Some examples include renovation of underperforming coop/agency plants; eliminating duplicative hauling routes; mandating full trailer loads of milk; utilizing technology like reverse osmosis; and weighing

milk at the farm and plant to eliminate shrinkage. Talsma, Tr. 210-19 (Day 3).

29. These producers through the agency, invested \$230 million in a new cheese plant that was carefully designed and located to operate efficiently within the constraints of the current FMMO regulations. The milk price paid by the plant to the members of the agency is pegged to the Class III price. Therefore, any reductions to the Class III price by increasing make allowance will be a direct hit to the producers of the southwest. Talsma, Tr. 214-17 (Day 3).
30. Reductions such as those contemplated in the hearing will mean a loss of income in the range of \$300,000 to \$400,000 per year to his three farms, which are representative of the size of farms located in West Texas and New Mexico. Talsma, Tr. 224 (Day 3).
31. Fertilizer costs have increased 250% over the past couple of years. Feed costs are up 10-15% due to increased hauling costs, and electricity is also up in price. Costs of irrigation have more than doubled because the price of the natural gas used to irrigate the fields has increased. Talsma, Tr. 224-26 (Day 3).
32. Leon Weaver, Montpelier, Ohio on behalf of Continental Dairy Products testified that market forces already in play and independent of any make allowance adjustments in this hearing will drive the milk price down in excess of a dollar per hundredweight. With changes of that magnitude, the

accuracy of the economic model needs to be carefully considered. Weaver, Tr. 275-77 (Day 3).

33. Because milk prices are already falling, adding another price decrease will exacerbate the number of cows and farmers leaving the market and could lead to an over-correction in the supply of milk available to the market. Weaver, Tr. 282-86 (Day 3).
34. Mike Sumners, Paris, TN testifying on behalf of his dairy, Tri-Hope Dairy Farms stated that there is an inconsistency within the Federal Order program. In early January, a hearing was held to change transportation credits to assure a milk supply for the Southeast region of the country. This hearing now proposes to lower producer income which will likely drive producers in the Southeast out of business and exacerbate the problems of obtaining a close-in supply for the Southeast. Sumners, Tr. 301-03 (Day 3).
35. Using a fluctuating make allowance will lead to increased risk of movement in the Class III price, thereby making it more difficult to assess risk in the futures market, which dairy farmers use as a tool to hedge prices. Sumners, Tr. 302-03 (Day 3).
36. The regional impacts of make allowance adjustments in its effect on the milk supply differ and need to be taken into account. Sumners, Tr. 303 (Day 3).
37. The USDA assembles and prepares mailbox prices for the various regions serviced by the FMMO system. Rourke, Tr. 37-38 (Day 1), Ex. 14 and 15.
38. The Mailbox Price is the “Net pay price received by dairy farmers for milk. Includes all payments received for milk sold and all costs associated with

marketing the milk. Price is a weighted average for the reporting area and is reported at the average butterfat test.” Ex. 14, fn. 1, Rourke, Tr. 39 (Day 1).

39. This is evidence that payments to producers are in fact a function of these minimum prices.
40. When asked whether many plants are paying a blend price or higher, Bob Wellington of Agri-Mark testified that the Class I plants certainly were and the manufacturing plants had to be competitive with them to keep their milk supply. Wellington, Tr. 169-70 (Day 2).
41. Neil Gulden of AMPI testified that producer prices in the Upper Midwest are currently slightly higher than or right at blend prices. Gulden, Tr. 30-31 (Day 3).
42. Joseph Weis of Foremost Farms USA testified that it was necessary for them to pay above blend prices in order to remain competitive and attract milk. Weis, Tr. 59 (Day 3). He further testified that Foremost has not had to allocate any losses during this period of time when they have been able to pay prices that were above blend. *Id.* at 69-70 (Day 3).
43. Clayton Galarneau of Michigan Milk Producers Association testified that they were currently paying prices at or above the blend price. Galarneau, Tr. 127-28 (Day 3).
44. For November 2005 and December 2005, the NMPF make allowance adjustments fall between those in USDA Scenarios 2 and 3. For the first fiscal year, this would mean reductions of about 15 cents per hundredweight in the Class I price and corresponding increases in MILC payments.

45. Producers are entitled to receive on the first 2.4 million pounds of milk produced on their farms 34% of the difference between the Class I price at Boston and \$16.94.
46. At an average payment rate of \$0.50 per cwt for MILC, the additional 5.1 cents represents about a ten percent increase in the program cost – or \$50 million per year.

I. There is no evidence of a need to change make allowances in the Southwest.

The AMAA requires that decisions on changing prices be based upon the economic conditions in the marketing area of the marketing order being amended, not nationally. It reads in relevant part:

(18) Milk prices ... The prices ...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. Thereafter, as the Secretary finds necessary on account of changed circumstances, he shall, after due notice and opportunity for hearing, make adjustments in such prices.

7 U.S.C. 608c(18) (emphasis added).

Applying that standard there is nothing in this record that supports changes of prices in the Southwest order. The only plant with data shows that its make is at the level now used in the formulas. All cooperatives in the Southwest Agency have voiced opposition to the proposals.

Market conditions in the Pacific Northwest, balancing plant issues in the Northeast, plant capacity in other regions are not reflective of market conditions in the Southwest which has one large plant now coming on line and a second one announced.

A look at the USDA Dairy Programs Website for Hearings has this beside the Southwest Order: “No hearings have occurred.” Since the inception of the FAIR Act reforms, for six years, that order has not asked for a single hearing. Why? Because it has found a way for producers to cooperate among themselves and collaborate with the industry to self maintain and manage their industry. It has come at a cost to producers, it has benefitted producers.

Other regions, for whatever reason, good or bad, intentional or imposed, have not been able to put that together. Some of the players in some of those regions have asked for the present hearing to address their specific problems. That by itself is fine. What is not appropriate is for them to impose on the Southwest and other marketing orders to solve their local problems and that is what this hearing is all about.

1. The Lovington plant has make allowances consistent with the current formulas being used. Ex. 65.
2. Hilmar is beginning to build a new plant in Texas which will produce up to 9.5 million pounds of cheese. Stroup, Tr. 397 (Day 2).
3. Southwest Cheese is now on line to produce cheese.
4. Producers in the Southwest have pegged their contracts to the FMMO Class III price. Any change in the FMMO price results in a penny for penny change

in their income. They cannot renegotiate to correct it. Talsma, Tr. 214-17 (Day 3).

5. The econometric analysis by the Department is not regional, but national in scope. McDowell, Tr. 260 (Day 1). There is no way to know what the impact would be based upon that model.
6. The impact on blend prices based upon a recalculation of the Southwest blend using the various proposals would be significant. The following table estimates the average monthly impact on the Order 126 pool alone.

	Order 126		No
	CWT	Avg Mo Pool	Producers 743
Current Formula	0.00	\$0	
NMPF With Energy Adjustment Nov 2005	-0.48	\$(3,638,968)	\$(4,898)
NMPF With No Energy Adjustment	-0.33	\$(2,490,881)	\$(3,352)
NMPF 2004 adjusted for 1998 Energy Costs	-0.19	\$(1,457,225)	\$(1,961)
Agrimark 2004 Survey Data Only +.019	-0.49	\$(3,718,977)	\$(5,005)
Agrimark 2004 Survey Data Only +.019	-0.51	\$(3,862,791)	\$(5,199)
Agrimark 2004 Survey Data 2005 Enrgey Only +.019	-0.58	\$(4,389,426)	\$(5,908)
Agrimark 2004 Survey Data 2005 Energy +.025	-0.60	\$(4,533,256)	\$(6,101)
California	-0.26	\$(1,929,265)	\$(2,597)

7. The average loss per producer for the approximately 750 producers on the order ranges to as much as \$6 thousand per farm per month. That is a significant loss.

J. There are no emergency conditions that require the reduction of producer prices.

On February 17, 2006, the USDA announced that the Class I price for March 2006 would be eighty-nine cents less than the February price. Based on current commodity trading, there is no end to the price decline in sight. Adding a jolt of an additional 20 to 50 cent reduction will create

instability in the market place. The evidence shows that plants due to economic conditions of supply and demand are now paying producers more than the blend prices. This shows that (1) there is more profit in making product than proponents would lead us to believe, (2) that the proposal would only reduce prices. Had the purchases been consistently below class, then that would be evidence that the milk is not worth that.

We are keenly aware of the pressure on the Department to get out a decision quickly. We have assisted in that by agreeing to an expedited briefing schedule. But a quick decision does not mean the Department has to reduce prices quickly. A quick termination of the proceedings would answer the call to quick decision making. The Department should keep in mind that plants and cheese editorials do not vote on order amendments, producers do. Congress designed it that way for a reason – to protect producers from unwarranted reductions in their incomes.

K. Other comments made by the proponents do not carry their argument.

In the midst of this four day hearing there were lots of witnesses who groused about rising medical insurance, energy costs, labor costs, and other costs. This is what business men do. Weis, Tr. 56-57 (Day 3). The role of the FMMO is not to place the risk of those costs on producers. Producers have the same costs hitting them. Talsma, Tr. 224-25 (Day 3). Producer income should not be reduced to cover those costs of plants.

Some witnesses testified that it is important to producers to have plants available to purchase milk and thus producers should be willing to sell at a lower price. See, Generally, Ooms, Tr. 193-228 (Day 4). This is an individual producer choice. Producers who have made that choice should not ask other producers to take price cuts because of their choice. The opposite is more true—reducing producer prices by as much as proponents are asking the Department to do will cause the exodus of more producers and production. This is shown by the Econometric Analysis. Exs. 1,

2, and 63. These statistics show fewer cows and fewer pounds of milk which translates into fewer producers. The coops now asking for help have many of the most vulnerable producers in their membership. Reducing their income will reduce the coops ability to attract milk to their plants and reduce the resources of capital to operate. None of these proposals will help that.

The problem the Proponent Cooperatives have is that their margins are being squeezed because there is a large volume of cheese and other products being produced by plants that can make it for less. A comparison of Agri-Mark's costs (Ex. 29) to CDFA (Ex. 23 and 24) for example show a significant spread between what Agri-Mark says it needs and what CDFA provides in its formulas. The salient point is that 62% of the cheese, 75% of the butter, and 63% of the NFDM are produced in California *at costs less than CDFA has listed*. Ex. 22. That means that a huge amount of product is already being made at prices that Agri-Mark is saying it cannot match. Reducing the milk cost for all plants, Agri-Mark and its competitors alike, will not change that relative margin. Agrimark will continue to be at a cost disadvantage. This is unfortunate for it and its members, but it is not a problem the FMMO can help, certainly not this hearing and it is not one for which producers in other marketing areas should take such a loss in income chasing this fruitless goal.

III. Conclusion: Options the Department may take based upon this hearing record.

The Department has several options which it may consider based upon the hearing record. As explained above, there is not sufficient credible, reliable and relevant evidence to support reducing producer pay prices under any of them. First and foremost there is no economic analysis done on each area as required by statute. Thus any change at this point is fatally flawed as a matter of law. Second, the misuse of the RCBS study and the "pick and choose" method of using numbers coupled with its merger with a state survey of costs lacks any meaningful connection with reality.

As a result, as a matter of law, the only options available to the Department are to terminate the proceeding or reopen it for additional evidence.

The Department is at a crossroads. This hearing was purely a manufacturer's proposal and hearing. It was held with the intent of benefitting manufacturer's, not producers. Even in the theory that reducing producer prices now raises them later fails based upon the Department's own model. In the first year alone a third of a billion dollars in producer income disappears, is gone and not to be replaced. How does that benefit producers? It does not. As one witness asked at the hearing, "Will the real Federal Order stand up?" It is time for the Department to stand up and show that its cause is not to protect some cooperative manufacturing plants in some regions of the country, but to provide stability in pricing *for producers*. If it decides to yield to buyers of milk who see an opportunity to drain capital from rural America by reduced milk prices, then, for a significant number of producers (significant enough to risk voting out one or more orders and put the legality of the remaining ones in question) the need for FMMOs has passed. Producers can reduce prices on their own, they do not need the government to do that.

If the Department persists and wishes to make changes to the FMMO pricing then it should consider calling for hearings to consider the real problem according to the proponent witnesses—circularity in the use of NASS in the formula. It should also call for a hearing to discuss only the methodology to determine formulas and make allowances. Do not consider any evidence that would result directly in a change in prices, but only the methodology. How will cost data be obtained? What level of plant efficiency will be considered? These need to be decided in advance not decided ad hoc at each hearing.

The Department should terminate the proceeding.

Respectfully Submitted

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