



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

September 28, 2006

Gino Tosi, Associate Deputy Administrator
USDA/AMS/Dairy Programs
Order Formulation and Enforcement Branch
Stop 0231-Room 2971
1400 Independence Avenue, SW
Washington, DC 20250-0231

RE: Comments and Proposals to Amend Federal Milk Marketing Orders

On June 28, 2006, USDA's Agricultural Marketing Service announced a notice of intent to reconvene the national hearing held January 24-27, 2006 in Alexandria, Virginia in order to obtain additional evidence with respect to proposals to change the make allowances used in Federal milk marketing orders. USDA at the same time also solicited proposals for other changes to federal order product price formulas. USDA subsequently determined to proceed with a reconvened hearing limited to make allowance issues, which took place on September 14-15, 2006, and to deal separately with other product price formula issues. The International Dairy Foods Association submits the following comments and proposals in response to USDA's request.

The International Dairy Foods Association (IDFA), Washington, DC, represents the nation's dairy manufacturing and marketing industries and their suppliers, with a membership of 530 companies representing a \$90-billion retail value industry. IDFA is composed of three constituent organizations: the Milk Industry Foundation (MIF), the National Cheese Institute (NCI) and the International Ice Cream Association (IICA). IDFA's 220 dairy processing members run more than 600 plant operations, and range from large multi-national organizations to single-plant companies. Together they represent more than 85% of the milk, cultured products, cheese and frozen desserts produced and marketed in the United States.

IDFA urges USDA to consider the following proposals:

1. Adjust the protein price formula used to establish the Class III milk price to reflect the lower value and reduced volume of butterfat recoverable as whey cream. The current Class III price formula is built on the premise that all of the butterfat in raw milk used to make cheese appears in the finished products; in other words, it assumes that none is lost in the manufacturing process. The formula further assumes that 90% of the butterfat in that raw milk should be priced based on the value of Cheddar cheese, and the remaining 10% should be

priced based on the value of Grade AA butter. Both of these assumptions are inconsistent with government regulations, production technology and the reality of the marketplace.

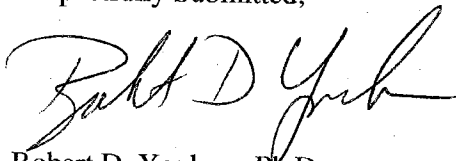
- a. The butterfat in raw milk that does not appear in Cheddar cheese is recovered from the liquid whey stream and is referred to as whey fat. Upon separation from liquid whey, this whey fat is contained in a product referred to as whey cream. USDA's quality standards prohibit whey cream from being used to produce USDA Grade AA butter; rather, it can only be used to produce Grade B butter. Not surprisingly, given this legal limitation as well as the flavor defects due to the cheesemaking process, the value of whey cream in the marketplace is at a severe discount to sweet cream (which is the source of butterfat for Grade AA butter). Therefore, the federal orders are improperly pricing the value of butterfat in whey cream by pricing it based on the value of Grade AA butter. An adjustment accordingly must be made in the Class III protein formula to reflect the significantly lower value of butterfat in whey cream relative to the value of butterfat in Grade AA butter.
 - b. The product price formulas are designed to require that the manufacturer pay a minimum price for raw milk based on the difference between what it receives for its end products minus the cost of transforming the raw milk into these end products. In carrying out this function, the existing formula assumes that all butterfat not captured in Cheddar cheese is recovered in a marketable by-product. In other words, the formula assumes that the manufacturer has been able to convert 100% of the raw milk it receives into a saleable product for which it has received that product's market value. The formula thus requires that the regulated minimum price be paid on all of the butterfat in the raw milk received at the plant. The assumption underlying this formula is inconsistent with both industry production processes and regulatory constraints. Inherent in the cheese manufacturing process associated with the conversion of raw milk into Cheddar cheese is the loss of butterfat and other milk components. These in-plant losses occur during receiving, separation and pasteurization, during movement of milk through piping, in other temporary storage vessels throughout the cheese production and finishing process, and throughout the whey and whey cream recovery and finishing process. Cleaning protocols required in human food manufacturing environments also contribute to significant in-plant losses. The manufacturer obviously receives no income from the raw milk lost due to these in-house losses, yet the current formulas require the manufacturer to pay for its milk as if it did. The product formulas must be adjusted to reflect actual manufacturing realities.
2. Eliminate the three-cent per pound adjustment made to the NASS monthly average price for Cheddar cheese in 500 pound barrels. The current three cent adjustment was adopted as part of the Final Rule under Federal Order Reform, which stated: "Since the make allowance of \$0.1702 is for block cheese, the

barrel cheese price must be adjusted to account for the difference in cost for making block versus barrel cheese. The three cents that is added to the barrel cheese price is generally considered to be the industry standard cost difference between processing barrel cheese and processing block cheese." Fed. Reg. Vol. 64 No. 63 Page 16098.

Subsequent to the adoption of this three-cent adjustment, two significant facts have arisen. First, the underlying cost data from RBCS upon which USDA relied in the May 2000 hearing included costs for both 40 pounds block and 500-pound barrel production. Additionally, the cost data presented by Dr. Mark Stephenson of Cornell University at the September 2006 hearing included both blocks and barrels. Therefore, these cost studies already reflect any cost difference that may exist between 40 pound blocks and 500 pound barrels.

Second, the three-cent addition was not based upon any study of actual industry cost differences; rather, it was based upon what was generally considered to be the industry standard cost difference between processing barrel cheese and processing block cheese. This three-cent rule of thumb had in fact been accepted by the industry, but only because it had been manifested in the marketplace as the long-term difference between the price of 40# blocks **with no adjustment to a standard moisture content** and price of 500# barrels **adjusted to a standard 39% moisture content**. However, subsequent to the implementation under Federal Order Reform, USDA adopted in the Tentative Rule implemented January 2001 a change in the pricing reference used for barrel cheese from the 39% moisture price --which as noted above had set the framework for the three cent adjustment --to a 38% moisture adjusted price. This change in the moisture level at which barrel prices are quoted has increased the barrel cheese price by 2.2 cents per pound during the period from its implementation in January 2001 through July 2006. Thus, the three-cent adjustment, and the adjustment of the barrel price to a 38% price reference are entirely duplicative, in that each accounts for the difference between 40# blocks and 500# barrels. The three cent adjustment should therefore be eliminated.

Respectfully Submitted,



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