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December 3, 2007

John R. Mengel, Chief Economist
USDA/AMS/Dairy Programs
Office of the Chief Economist
Stop 0229 - Room 2753
1400 Independence Ave., SW
Washington, DC 20250-0229

Re: Dairy Product Mandatory Reporting Program
Docket # AMS-07-0047; DA 07-07

Dear Mr. Mengel:

These comments are submitted by Dairy Producers of New Mexico (DPNM), a voluntary trade association of dairy producers in New Mexico and West Texas, regarding the Dairy Product Mandatory Reporting Program (Program). These comments supplement Dairy Producers of New Mexico's initial comments filed earlier this year.

DPNM requests that the Program be expanded to include the following information:

- The volume of milk and milk components acquired by the plant
- The prices paid for milk and milk components acquired by the plant
- The volume of milk products produced at the plant.
- The value of the milk products produced at the plant.
- Alternatively, the costs and yields associated with making reported products.

The information sought is essential for the FMMO pricing formulas to be understood and trusted by the market participants.

The purpose of the statute requires the Secretary broaden the information sought in order to provide "information that can be readily understood by producers and other market participants". The stated purposes of the Dairy Product Mandatory Reporting statute, 7 U.S.C. § 1637, (Act) are to:

(1) provide[] information that can be readily understood by producers and other market participants, including information with respect to prices, quantities sold, and inventories of dairy products;



Page 2

December 3, 2007

John R. Mengel, Chief Economist

Re: Dairy Product Mandatory Reporting Program

Docket # AMS-07-0047; DA 07-07

- (2) improve[] the price and supply reporting services of the Department of Agriculture; and
- (3) encourage[] competition in the marketplace for dairy products.

Currently, market participants, particularly producers, do not have sufficient information which is readily understood about the production of dairy products used to establish minimum milk prices. In particular there is no public information regarding product yields or cost of production of surveyed products. The information that is available is there is very incomplete and unreliable.

The current Class III and IV pricing formulas are “end product pricing” formulas. The pricing formulas, simply stated, are the product yield times the difference of the product price less a manufacturing allowance. Of these three factors, only the product price, is derived from surveyed data. As such, the Program has and continues to fail producers and frustrates market participants by not providing all the necessary information to compute an appropriate minimum price. The Program fails to provide market participants the means to understand “information ..actually used to establish minimum prices for Class III or Class IV milk.”

This failure became even more evident during the recent USDA hearings to revise the manufacturing price formulas. The information now collected under the Dairy Product Mandatory Reporting Program provided information to that hearing with regard to end product prices. But the absence of complete and clear data regarding product yields, make allowances, and comparative data regarding prices denies the Department the ability to arrive at a fair and transparent formula.

With regard to the yield, there is a complete absence of any data on that aspect of the minimum price formulas. Because it is the multiplier in the formulas, yields of cheese, butter, NFDM, dry whey, and other by-products are essential.

With regard to the product surveys, the Program should survey the prices of other products which concern those prices, quantities and moisture of those directly used the formulas. For example, a butter-powder plant produces, in addition to NFDM and butter, buttermilk, condensed skim, skim, and other similar products. It is important that correct information about these other related products be surveyed so that the Department has a complete picture of plant operations and pricing. There are several reasons for this request. First, it will provide an



Page 3

December 3, 2007

John R. Mengel, Chief Economist

Re: Dairy Product Mandatory Reporting Program

Docket # AMS-07-0047; DA 07-07

important audit function to insure that there are not things happening in the market that undermine the veracity of reported NFDM prices. For example earlier this year, when the Class IV price was low in response to low (illegally so) NFDM prices, plants who benefitted from the lower price were selling condensed skim milk instead of NFDM. This provided the buyer the solids it wanted but allowed the seller to obtain premiums and not have to report them as part of the pricing. Second, it will identify the real value coming out the plants to insure that the pricing formulas are understood and provide the necessary transparency to earn trust. Third, it will either confirm or deny that NFDM truly provides a “market clearing function” or whether other products do.

In the case of cheese, it is important that the amount of whey butter sold (as butter or as part of a whey stream) is reported. There was a great deal of discussion in the Class III and IV hearings regarding whey butterfat yields, again, without the broad statistical support as provided by the NASS product prices. During the hearing, Sue Taylor of Leprino testified regarding proposals to reduce the amount of whey butterfat being considered in the formula for Class III. Though she testified in favor of an adjustment that responded to claims of less whey butter production, she, herself testified that her company used all of its butterfat.¹ Mandatory reporting of what happens to products such as whey butter provides greater understanding to market participants as to how the Class III and IV formulas work. Since whey butter is implicit in the current formula and overt in proposed formula changes, the volume of whey butter out of cheese plants is certainly relevant to the Class III formula.

Another product that should be surveyed is Mozzarella cheese. This category has become one of the largest volumes of cheese produced in the country, rivaling Cheddar. The assumption under the FMMOs was that Mozzarella prices were tied to cheddar block prices. Mandatory reporting of these sales will either verify the correlation and thus concerns the pricing of the Class III or it will show that the Class III formula must account for that. This information will provide information to update the pricing value of the products used in the Class III formula. If it truly tracks Cheddar, incorporation of Mozzarella will increase the volume, and thus the veracity of the prices.

The information available regarding manufacturing allowances is worse than incomplete; it is simply wrong. Over the last several years, multiple hearings have been held regarding the

¹Taylor, Tr. 2951, Class III/IV Formula Hearing



Page 4

December 3, 2007

John R. Mengel, Chief Economist

Re: Dairy Product Mandatory Reporting Program

Docket # AMS-07-0047; DA 07-07

pricing formulas for Class III and IV milk.² What was presented as a scholarly, independent and accurate study of make allowances for use in the Class III and IV formulas was everything but that. Dr. Mark Stephenson of Cornell University conducted this study of make allowances of plants that made butter, cheese, NFDM, and dry whey. His intent was to mimic outside of California what CDFR did for California plants with its audited surveys of plant operating costs. It was not a census, but a survey and participants could, and some did, elect not to participate. Though the information was interesting, it was not nearly as accurate as was hoped—in large part because it was not a mandatory government program.

Here is a brief summary of some of the problems with that study and how mandatory pricing can correct them.

- Some plants that did not submit data for the 2006 study submitted data from the 2007 study, and some plants that participated in 2006 did not submit data in the 2007 survey.³ This contrasts with the price reporting which consistently receives information each week from the same plants making comparisons period-to-period reasonable. Mandatory reporting would correct this.
- Three plants not included in the 2006 study were high-volume, low-cost plants, and when those plants were included in the subsequent report, the make allowance for cheese actually declined.⁴ Of the sixteen cheese plants that participated in the study reported in 2006, their costs increased by 1.7 cents.⁵ For all plants participating in 2007, the cheese plant costs fell by approximately one-half cent.⁶ By having mandatory reporting from all relevant plants, errors resulting from some plants being in and others being out would be corrected. Further the

²In Re: Milk in the Northeast and Other Marketing Areas Class III/IV Formulas, Docket No. AO-14-A77, DA-07-02 and In Re: Milk in the Northeast and Other Marketing Areas Class III/IV Make Allowances, Docket No. AO-14-A74, et al.; DA-06-01,

³Stephenson Tr. 2748, Class III/IV Formula Hearing.

⁴Ex. 72, Stephenson Tr. 2750, Class III/IV Formula Hearing.

⁵Ex. 72, p. 6, Stephenson Tr. 2793, Class III/IV Hearing.

⁶Ex. 72, p.5, Class III/IV Hearing.



Page 5

December 3, 2007

John R. Mengel, Chief Economist

Re: Dairy Product Mandatory Reporting Program

Docket # AMS-07-0047; DA 07-07

reporting of aggregated data would allow market participants to audit the material and notify USDA if something extraordinary should occur.

- The study on NFDM manufacturing costs was skewed because 54% of the NFDM in the 2006 study came from only one powder plant-- Northwest Dairy Association's plant.⁷ Mandatory reporting from all plants would give a better understanding of market conditions.
- The study was done by one person and was not subject to any auditing, review, or supervision. Mandatory collection of data would correct that.

Market participants should not wonder, extrapolate, hypothecate or approximate, they should know. Thus, to meet the obligation of the Act, the Program must provide for mandatory reporting of manufacturing costs.

By having in aggregate form the volume of dairy products received at plants and the volume of dairy products that leave the plant, more accurate yields for products can be determined. As a point of fact by collecting the information regularly, the yields can be market driven.

Similarly, aggregated data on what plants sell products for less what they pay for milk will provide a dynamic market driven manufacturing allowance that obviates the need for erroneous studies of costs.

Further, one possible solution presented during the hearing was the return to a competitive price for dairy producers. Dairy Producers of New Mexico continues to support a competitive pricing system as a desirable alternative to the current end-product pricing system. The information collected could be used directly.

The Act gives the Secretary authority to collect the information on yields, make allowances, producer milk price, and other products. The language is "information *concerning* the price, quantity, and moisture content of dairy products". Note that the language *is not* merely "the price, quantity, and moisture content of dairy products". That Congress gives the Secretary discretion to broaden this to "information concerning", is clarified in subsection (b)(2) where Congress refers to "the information". Such information is limited only by package size and actually used "to establish minimum prices for Class III or Class IV milk under a Federal milk

⁷Brown Tr. 2933-34, Class II/IV Formula Hearing.



Page 6

December 3, 2007

John R. Mengel, Chief Economist

Re: Dairy Product Mandatory Reporting Program

Docket # AMS-07-0047; DA 07-07

marketing order.” It is noteworthy that the Congress chose not to limit under (b)(2)(A) the *products* but package sizes. Even that is ambiguous in that it can refer to wholesale product prices as contrasted with retail prices.

How “the information is actually used to establish minimum prices for Class III or Class IV milk under a Federal milk marketing order” is left to the discretion of the Secretary. There is nothing in this clause that requires that the information monthly be plugged into a formula to generate a price, but could be “used” to establish the formula itself. Instances in which information collected under this Act for purposes of use within the establishment of formulas as opposed to data include, without exclusion, obtaining yield, costs of manufacturing, and costs of milk which “concern[...] the price quantity, and moisture content of dairy products.”

Finally, the Secretary is ordered to promulgate “such regulations as are necessary to ensure compliance with, and otherwise carry out, this subchapter.” (c)(2). The Secretary is not constrained by law in terms of what he can do to establish minimum prices.

Obviously, the actual formulas employed by USDA is beyond the scope of the direct issue in this rulemaking. Nevertheless, we request that USDA implement as part of the Dairy Product Mandatory Reporting Program regulations that require all reporting handlers to provide all information which concerns the pricing of the products including yields, costs of make, prices paid to producers and the volumes of milk and milk products acquired and processed at the plants.

As we make this request, we are aware, that there may be cost considerations both for plants and the USDA. With regard to quantities of milk and milk products produced as well as products made and the data associated with costs, these would only need to be reported monthly, not weekly. There is no need to report retail sales or highly processed products, either. All of these products are fundamental commodities. As it stands now, pooled plants are all ready reporting the raw product coming in and the product going out. Those reports go to AMS, not NASS. Broadening that reporting to the entire nation and having one or the other aggregate and summarize the material would make it available for purposes of setting Class III and IV plants.

The desired end would be to have sufficient information to determine the price paid for milk coming into the plant and also to determine the price and quantity of product being sold. USDA and market participants could then derive the price paid for milk by marketing area (or such



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Page 7

December 3, 2007

John R. Mengel, Chief Economist

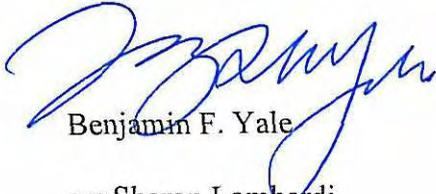
Re: Dairy Product Mandatory Reporting Program

Docket # AMS-07-0047; DA 07-07

other geographic area consistent with USDA's confidentiality policies. All data reported by USDA would be aggregated data and never plant specific.

As always, we appreciate your consideration of our position.

Very truly yours,
YALE LAW OFFICE, LP

A handwritten signature in blue ink, appearing to read 'Benjamin F. Yale'.

Benjamin F. Yale

cc: Sharon Lombardi