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**STATEMENT OF SUE M. TAYLOR  
LEPRINO FOODS COMPANY  
at the  
UNITED STATES DEPARTMENT OF AGRICULTURE PUBLIC HEARING**

**Alexandria, Virginia  
January 27, 2006**

**Introduction**

I am Sue Taylor, Vice President of Dairy Policy and Procurement for Leprino Foods Company (Leprino), headquartered in Denver, Colorado. Our business address is 1830 West 38th Avenue, Denver, Colorado 80211-2200. Leprino operates nine plants in the United States, manufacturing mozzarella cheese and whey products domestically and marketing our products both domestically and internationally. Six of the nine plants that Leprino operates in the United States receive milk pooled in the Federal Milk Marketing Orders. We produce sweet whey in our plants located in Waverly, New York and Allendale, Michigan. The six plants that receive milk pooled in the Federal Orders will be directly impacted by the outcome of this hearing. Therefore, Leprino has a strong interest in the decision by USDA ("Department") as a result of this hearing.

**Expertise**

In my role as Vice President of Dairy Policy and Procurement at Leprino Foods, I am responsible for developing the company's policy positions and advocating those positions in appropriate forums, such as today's hearing. Additionally, I am responsible for market analysis and forecasting, and raw milk procurement among other things. I have represented the company at all Federal Order and California Order hearings that have related to cheese milk pricing over the last eleven years.

In addition to my current responsibilities at Leprino, I chair the Legislative and Economic Policy Committee for National Cheese Institute and chair the Producer Relations Committee for the Dairy Institute of California. Both committees formulate the respective organization's positions as they relate to milk pricing policy.

My professional responsibilities have focused on dairy markets and policies since 1989, when I joined Sorrento Cheese as a dairy economist / production analyst. From 1992 through 1994, I was a principal in a dairy economics and management consulting business, Dairy Management Concepts, which provided consulting services to a broad spectrum of dairy companies, most of whom operated plants. I have been at Leprino leading the dairy policy and procurement efforts since January 1995. My educational background includes both Bachelor and Masters degrees from Cornell University in agricultural education with a heavy emphasis on agricultural economics.

## **Position**

My testimony is in support of adoption of proposal number 1 on an emergency basis. This proposal updates the make allowances in the current formula using an approach that is generally consistent with the decision from the May 2000 Class III / IV Hearing that defined the formulas that are operative today.

Although there are several other aspects of the Class III / IV formula that we believe warrant review and correction, the urgent need for relief supercedes our interest in reviewing these other items at this time. We have anxiously awaited the completion of the cost study commissioned by AMS for the purposes of updating the Class III / IV formulas and had planned to seek a comprehensive hearing to consider the make allowance and other formula factors upon the data release. We continue to support the call of such a hearing in the future. However, given the delay in the completion of the AMS-commissioned study and the urgent need for relief, we believe that it is critical to move forward with an update of the make allowances in the milk price formulas on an emergency basis at this time.

## **Need for Relief**

The need for relief for cheese makers is urgent. Costs have increased significantly from the base period of 1997 – 1999 that was used to establish the current make allowances. The fixed relationship between finished product prices and the Class III and IV formula milk prices limits the marketplace's ability to adjust for these changes. To the extent that some manufacturers have successfully implementing energy surcharges, those surcharges are being captured in the price surveys and flow through to the milk price.

The margin problem resulting from the understated Class III make allowances is not isolated to manufacturers of cheddar that is eligible for National Agricultural Statistics Service ("NASS") reporting. The vast majority of cheese produced in the United States would be considered commodity cheese. I would place American cheese, mozzarella, brick and Muenster in that category. Data from the NASS publication "Dairy Products" indicates that these cheeses comprised 75% of total U.S. natural cheese production in 2004. These cheeses are all priced relative to the CME and the milk used to produce these cheeses is priced as Class III under the Federal Milk Marketing Order System. Market forces drive the net economics of these cheeses to equilibrate with cheddar over time. This is because much of the equipment required to produce these cheeses is interchangeable. Several plants have gained the capability of producing both cheddar and mozzarella in recent years. Land O'Lakes' joint venture mozzarella plants in both Lake Norden, South Dakota and Tulare, California have added the capability of producing cheddar within the last year. It is illogical to believe that this additional capital investment was motivated by a desire to achieve lower margins. Regardless of the motivation, with dual capacity, milk can easily be shifted to the higher margin product. As that additional production seeks a market, downward pressure is applied to the pricing of the product with greater margins and the margins equilibrate.

Estimating manufacturing margins on non-cheddar varieties of cheese by using prices

that distributors are charging for 1,000 to 5,000 pound mixed lots to their customers is wholly inappropriate. The distributor level prices quoted typically on page 3 of Dairy Market News that have been used in this hearing to suggest that non-cheddar manufacturers enjoy very large margins are not reflective of prices received by mozzarella manufacturers. These prices are received at a different level in the marketing chain and reflect many other factors beyond the price paid to the manufacturer for the cheese. I am aware that mozzarella sold into the food service and food manufacturing segments by manufacturers is very competitively priced at a slight premium or discount to the CME. I am not aware of any energy surcharges being charged to address increased costs of manufacturing for by mozzarella manufacturers for mozzarella being sold. Although I cannot comment on the pricing of branded product to grocery chains, mozzarella sold to converters who market cheese into the retail segment is similarly priced.

The increased costs reflected in the cost studies are not regional issues. The combined cost studies and the individual company data submitted for the record at this hearing cover a broad geography. Energy, health care and packaging costs have all risen substantially since the late 1990s throughout the country. The health of the manufacturing sector and maintenance of adequate willing plant capacity for orderly marketing of milk is contingent upon timely relief in the form of updated make allowances as a result of this proceeding.

#### **Manufacturing Allowance Update**

We support the use of the combined California Department of Food and Agriculture ("CDFA") and Rural Business Cooperative Service ("RBCS") survey results as a benchmark for setting the make allowances as a result of this hearing.

The CDFA cost studies are completed by a staff of accountants whose primary responsibility is collecting and analyzing cost information. The resulting cost studies are based on audited data compiled according to a consistent methodology. CDFA's cost studies have been fine-tuned through many years of data collection and use to support policy decision-making. Although the methodology used in the CDFA studies results in the most accurate cost studies currently available, these costs are representative of California plants only and, therefore, may not be representative of the broader geography regulated under the FMMOs.

To establish a benchmark for costs in the broader geography outside California, the RBCS survey should be used. Although the RBCS survey is narrow in its composition (i.e., cooperative plants only) and was intended only as a benchmarking study, it does provide important information regarding trends in costs. The RBCS survey was used in establishing the current make allowances and it should continue to be used until such time as a more comprehensive study can be completed.

Bob Yonkers of IDFA has testified to the mechanics of the specific adjustments made to both the CDFA study and the RBCS survey results to develop the weighted average

cost, inclusive of a marketing adjustment, ROI, G & A, and energy update to 2005. We support his testimony and I will not retread that water. However, I would like to further elaborate on the approach to the whey cost studies.

Whey Cost Studies

Both the RBCS and CDFA dry whey cost studies have been criticized by other witnesses at this hearing. I, too, am critical of the RBCS study, but believe the CDFA cost study is sound.

Several characteristics of the RBCS dry whey cost study cause concern. First, the participating plants are much larger on average than typical sweet whey plants. The average whey plant included in the RBCS survey is more than double the size of the average whey plant as characterized by the *Dairy Products 2004 Summary*, published in April 2005 (available at [usda.mannlib.cornell.edu/reports/nassr/dairy/pdp-bban/daryan05.pdf](http://usda.mannlib.cornell.edu/reports/nassr/dairy/pdp-bban/daryan05.pdf)). The following table summarizes that data and shows that the average US whey plant size in 2004 produced 25.6 million pounds, less than half the 59.5 million pound average volume per plant in the RBCS survey. The average plant size fall within a reasonably tight range across the regions, spanning from a low of 24 million pounds whey to a high of 28 million pounds whey. Economies of scale are very important in whey because of the significant capital costs associated with whey processing. The significantly larger plant size in the RBCS study is likely contributing to a lowering of the survey results below the levels achievable by many sweet whey plants.

	2004 Total Sweet Whey Production (1,000 pounds)	Plants	Production Per Plant (1,000 pounds)
Atlantic	215,133	8	26,892
Central	455,587	19	23,978
West	278,195	10	27,820
US Total	948,915	37	25,646
RBCS Whey Survey	357,114	6	59,519

The second area of concern regarding the RBCS dry whey cost study is the omission of certain relevant costs in the reporting by the participating cooperatives. The Northwest Dairy Association witness indicated that his company omitted the costs associated with condensing whey in other plants and transporting the condensed to their drying facility. Most of the plants in the whey survey did receive outside condensed whey and none of them incorporated transportation costs incurred in order to accumulate the large quantities of whey that allowed their plants to run more efficiently and at a larger capacity than they otherwise would. These omissions result in a serious understatement of actual whey processing costs.

In contrast, the CDFA cost study was completed under the same rigorous process as the CDFA cost studies for cheddar, nonfat and butter. CDFA has conducted the whey cost survey two consecutive years. The data from the first survey was thoroughly reviewed during the February 1 and 2, 2005 Class 2, 3, 4a and 4b hearing.

The CDFA Hearing Panel Report concluded that:

*“After reviewing the information, the Panel believes the Department’s cost studies on dry skim whey are accurate, reliable, and consistent with the parameters of the Cornell study. “*

Ultimately, the panel recommended that the whey factor be eliminated from the Class 4b pricing formula. The decision to retain a whey factor and set the make allowance at \$0.20 was made at levels above the Dairy Marketing Branch within CDFA. The decision to set the make allowance at a level below the cost study was not recommended by the Hearing Panel and should not be taken as a sign that the CDFA data is invalid. The entire Hearing Panel report can be found at the CDFA website ([www.cdfa.ca.gov/dairy/pdf/hearings/FinalPanelReport022005.pdf](http://www.cdfa.ca.gov/dairy/pdf/hearings/FinalPanelReport022005.pdf)).

The CDFA whey cost study submitted for the record in this hearing covers three plants with average output of 31 million pounds, consistent with the average whey plant sizes nationally.

#### Whey make allowance

Leprino supports the increase in the whey make allowance to \$0.2215 as proposed by Agrimark and supported by IDFA. In the absence of an RBCS whey cost that reflects fully the costs to achieve the capacity utilization reflected in the study and more representative plant sizes, I endorse the general approach advocated by Agrimark and IDFA to determine the whey cost by adding the incremental cost of drying whey to the nonfat dry milk cost. I have reviewed the update submitted by Scott Burleson of WestFarm Foods of the Verikat analysis from the 2000 hearing and agree with his conclusions.

#### Consistency with changes in Leprino costs

The proposed whey make allowance of \$0.2215 is consistent with the cost that would be determined by adding the change in Leprino’s sweet whey processing cost since the survey period that was used to establish the current whey make allowances. The current formula make allowance of 15.9 cents was based upon the average costs of drying whey determined by a study commissioned by National Cheese Institute. The study primarily relied on data from 1998 and 1999. We produce sweet whey in Waverly, New York and Allendale, Michigan and participated in that study. Since 1999, our costs have increased by 5.4 cents per pound sweet whey in these two plants. When added to the 15.9 cent make allowance (the average NCI survey whey cost from the time), the new make allowance would be \$0.213, just slightly less than that proposed by Agrimark.

**Conclusion**

Setting regulated manufacturing prices above the manufacturing value of that milk results in disorderly marketing by encouraging additional milk production that the market does not have a ready outlet for, while decreasing demand for that milk from processors. Clearly, costs have increased significantly since the existing make allowances in the manufacturing classes were set and it is necessary to update the make allowances consistent with those changes. The magnitude of the issue warrants an expedited decision and we urge the Department to adopt the Agrimark proposal to adopt make allowances reflective of 2004 cost data updated for changes in 2005 energy costs.