

**UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE**

USDA
OALJ/HCO

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In re:)
Milk in the Northeast and)
Other Marketing Areas)
)

Docket Nos. AO 14-A69, *et al.*; DA-00-03

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**COMMENTS ON THE TENTATIVE FINAL DECISION SUBMITTED BY THE
INTERNATIONAL DAIRY FOODS ASSOCIATION**

These comments are submitted on behalf of the International Dairy Foods Association ("IDFA"), its constituent groups, and their members, with respect to the Tentative Decision regarding changes in the Class III and Class IV pricing formulas, published at 65 Fed. Reg. 76831 *et seq.* (December 7, 2000) ("Tentative Decision"). IDFA is a trade association representing processors, manufacturers, marketers, distributors, and suppliers of dairy foods, including milk, cultured dairy products, cheese, ice cream and frozen desserts.

These comments demonstrate that the following changes should be made to the provisions of the milk marketing orders contained in the Tentative Decision:

1. USDA should base the Class III butterfat price on the price of butter, and use the same formula to determine the butterfat price for Class III and Class IV products.
2. USDA should reduce from 3-cents to 1-cent the adjustment added to the barrel price for purposes of computing the weighted average cheese price.
3. The dry whey make allowance should be changed to no lower than 15.92 cents.

4. The nonfat dry milk yield factor should be changed to no lower than 1.01.

5. USDA should not utilize the RBCS survey for purposes of determining make allowances for cheese and dry whey, but should substitute the NCI surveys, together with the CDFA surveys.

6. All of the yield factors should incorporate shrinkage of components between the farm bulk tank and the finished dairy products.

7. USDA should include 640-lb blocks in the NASS weighted average cheese price.

8. The other solids price snubber should be eliminated.

9. The NASS butter price used in the butterfat price calculation should be reduced by six cents for all classes.

10. The butterfat to protein relationship factor of 1.28 in the protein price formula should be reduced to reflect the ratio of butterfat to protein in average producer raw milk, which is 1.22.

11. In no case should the Class III price be enhanced relative to that resulting from Federal order reform (as implemented on January 1, 2000).

Finally, the hearing should not be reopened.

1. USDA should base the Class III butterfat price on the price of butter, and use the same formula to determine the butterfat price for Class III and Class IV products.

The Tentative Decision's adoption of a new Class III butterfat price, based upon the market price for cheese, suffers from both procedural and substantive flaws,

and should be eliminated. While implementation of the new Class III butterfat price has been preliminarily enjoined, USDA should put a final end to this dispute by issuing a Final Decision that eliminates this contemplated regulatory change.

As required by the AMAA and the Administrative Procedure Act, USDA on April 14, 2000 had published in the Federal Register the 32 proposals to be considered during the May hearings, see 65 Fed. Reg. 20094 *et seq.* Not a single one of these proposals had called for the creation of a separate Class III butterfat price. Furthermore, an effort to interject such a proposal at the hearing itself, through the testimony of Dr. Barbano, was explicitly rejected by presiding Administrative Law Judge Hunt because it had not been adequately noticed: "I'm going to rule that Dr. Barbano's pricing formula is not one of the proposals being considered at this hearing. Although there is a lot of testimony and comments on it, this is not a proposal being considered..." (Tr. 790). Yet Dr. Barbano was the only witness who presented evidence relating to the creation of a separate Class III butterfat price, and that price as set forth in the Tentative Decision reflects in all material respects the very proposal by Dr. Barbano that the Administrative Law Judge had rejected on procedural grounds.

The Tentative Decision nowhere indicates the testimony on which the decision to make this change is based, see 65 Fed. Reg. 76846. The Tentative Decision merely states that "The reasons for using the same butterfat price in Class III and Class IV under Federal order reform have been outweighed by the outcome of that decision." Yet other than the testimony of Dr. Barbano, which was explicitly rejected, no testimony was presented which suggested that the value of butterfat in Class III should be based on a cheese product price formula.

In fact, the hearing record rejects the notion that there can be a separate butterfat price for Class III or Class IV. Numerous hearing witnesses presented detailed testimony regarding the market for butterfat, and the competition for the excess butterfat that Class I handlers must dispose due to the fact that the raw milk they buy has a higher butterfat content than the finished product they sell. A Class I handler regulated by a federal order selling cream is not just concerned with the price received for that cream, but rather the difference between that price and its federal minimum price obligation. (Yates (Suiza Foods) p. 799-802). Class I handlers account to the pool for the excess butterfat that they sell at the class price of the handler to whom they sell it.

Class II, III and IV handlers are all purchasers of that excess butterfat from Class I handlers. Many Class II and III handlers testified regarding the need for such handlers to have the same ability to compete for fat as Class IV handlers. Blaise (Wells Dairy) pp. 1375-76, Galloway (Galloway) pp. 1426-31, M. Schanback (Friendship Dairies) pp. 1632-34, and Throne (Hershey) pp. 1673-79. As explained by W. Schanback (Friendship Dairy), pp. 1637-41, under current regulations, a Class I handler is indifferent whether it sells its excess butterfat to a Class II, III or IV handler, because the price at which the Class I handler must account to the pool is virtually the same. That essential "neutrality" is destroyed by the Tentative Decision's Class III butterfat formula.

Moreover, a failure to adjust the butterfat price equally for all classes raises the real prospect of an increase in the substitution of lower priced Class IV products for higher class fluid milk and cream. Even under Federal order reform provisions, if butter prices rise sufficiently over a short period of time, a strong economic

incentive exists to advance purchase butterfat in the form of Class IV products such as butter or anhydrous milkfat. This occurs if butter prices rise more than the cost of converting butterfat to butter (the Tentative Decision make allowance suggests this cost is 11.5 cents per lb.) or anhydrous milkfat and then back to a form for use in further manufacturing. Of course, the costs of storing butter or anhydrous milkfat for those few months must also be taken into account. (Yonkers (IDFA), Exh. 14 at p. 51). Numerous witnesses-- Blaise (Wells Dairy), pp. 1375-76; Galloway (Galloway), pp. 1426-31; M. Schanback (Friendship Dairies), pp. 1632-34; Throne (Hershey) pp. 1673-79 -- all testified to the fact that their companies all regularly look at the cost of alternative sources of butterfat such as anhydrous milkfat.

These same substitution arguments apply to the substitution of Class IV products for Class III butterfat. In fact, the Tentative Decision reclassifies products like anhydrous milkfat, butteroil and plastic cream from Class III to Class IV. For Class III products without specific standards of identity, any of these now-Class IV products can be substituted for Class III butterfat. This decision increases the Class III butterfat price by nearly 50 cents per pound, more than enough to compensate for the 11.5 cent make allowance in Class IV used in valuing Class IV butterfat.

2. USDA should reduce from 3-cents to 1-cent the adjustment added to the barrel price for purposes of computing the weighted average cheese price.

The Tentative Decision failed to change from 3-cents to 1-cent the adjustment that is added to the barrel price for computing the weighted average cheese price, as advocated by NCI and others at the hearing. However, USDA did determine that it is appropriate to use cheese prices that reflect cheese containing 38 percent

moisture. As a result, the Tentative Decision will use barrel cheese prices adjusted to 38 percent moisture. These two decisions, first to continue to use the 3-cent adjustment to the barrel price, and second to use barrel cheese prices adjusted to 38 percent moisture, are inherently inconsistent, and must be rectified.

The Tentative Decision argues that the actual difference between the barrel cheese and block cheese prices for the period September 1998 through June 2000 was 4.4 cents (76845). First of all, this time period represented considerable volatility in the difference between the block and barrel prices (see following paragraph). In addition, this difference was based on comparing barrel cheese prices adjusted to 39 percent moisture, and the Tentative Decision recognizes that it is appropriate instead to using barrel cheese prices adjusted to 38 percent moisture. For the period October 1998 through December 2000, the average difference between the block cheese price and the price of barrel cheese adjusted to 38 percent moisture is 2.1 cents less than the average difference between the block cheese price and the price of barrel cheese adjusted to 39 percent moisture. Thus, once the adjustment to 38 percent moisture is made (and the Tentative Decision makes that adjustment), it necessarily follows that the adjustment to the barrel price should be 1 cent, not 3 cents.

Moreover, in comparing the differences between barrel and block cheese prices, USDA should not rely on the period when only the block cheese price was used in determining Class III minimum prices (*i.e.*, the period from May 1995 through December 1999 when the basic formula price included a product price update based on dairy product wholesale price changes that included only 40-lb blocks). An analysis of the price for cheese in blocks and barrels in a more analytically appropriate time--the

year 2000-- shows that the average price difference between block and barrels adjusted to 38 percent moisture was 1.5 cents (1.8 cents less than the average difference between the price of blocks and barrels adjusted to 39 percent moisture). During 2000, the block price exceeded the barrel price adjusted to 38 percent moisture by more than 3 cents only 11 weeks (21 percent of the time). In fact, the barrel price adjusted to 38 percent moisture without any adjustment exceeded the block price 18 weeks in 2000 (35 percent of the time). Further analysis of the period prior to May 1995 (when the basic formula price began using the block cheese price only) shows that from May 1990 through April 1995 the average difference between the price of blocks and barrels adjusted to 39 percent moisture was 3.1 cents, while the average difference between the price of blocks and barrels adjusted to 38 percent moisture was 1.1 cents (again, 2 cents less).

Regardless of the time period analyzed, USDA should compare cheese prices adjusted for moisture consistent with the moisture adjusted price used to calculate the weighted average cheese price. As the foregoing analysis clearly shows, the difference between the price of cheese in blocks and barrels adjusted to 38 percent moisture historically is 2 cents less than the difference in price between cheese in blocks and barrels adjusted to 39 percent moisture. The adjustment added to the barrel cheese price adjusted to 38 percent moisture should be 1 cent, not the 3 cents contained in the Tentative Decision.

3. The dry whey make allowance should be changed to not less than 15.92 cents.

The Tentative Decision cites no testimony whatsoever that supported its decision to leave the dry whey make allowance equal to the make allowance used for nonfat dry milk. It is baffling how the Tentative Decision could simply ignore entirely uncontested testimony by multiple witnesses explaining that the cost of drying whey significantly exceeds that of drying nonfat dry milk and that the make allowance for dry whey simply has to be higher.

Extensive and exhaustive expert testimony, supplemented with specific data, confirmed that it is inappropriate to continue to utilize the cost of manufacturing nonfat dry milk as a surrogate for the cost of manufacturing dry whey. (Venkatachalam (Leprino) pp. 1386-99 and Exh. 41). That expert established, without contradiction, that it costs a full 2.559 cents more to manufacture a pound of dry whey than a pound of nonfat dry milk. This is true for two basic reasons. First, raw liquid whey is approximately 94 percent water, compared to liquid skim milk, which is approximately 91 percent water. The cost of removing the water from liquid whey is therefore greater than that for skim milk, because there is more to remove. Second, the manufacturing process for dry whey requires a crystallization process that is more costly than the drying process used for nonfat dry milk, which is not crystallized.

The Tentative Decision's observation that this expert testimony did not provide an absolute figure for the cost of drying whey is completely misplaced. If one assumes that USDA has accurately determined the make allowance for nonfat dry milk

--and we assume that USDA believes it has done so-- then it is entirely appropriate to set a make allowance for dry whey that starts with the make allowance for nonfat dry milk and then makes the necessary adjustments based upon the added costs of drying whey.

In fact testimony was presented at the hearing regarding the total cost of manufacturing dry whey. This data, from the NCI survey, indeed was the only data presented at the hearing on the total cost of manufacturing dry whey. USDA even noted in the Tentative Decision that it used the NCI survey as a "check against" the results of using the weighted average of the RBCS and CDFA surveys cost of manufacturing cheddar cheese. It would be inconsistent of USDA not to use this data as at least reflecting the fact that the total cost of manufacturing dry whey exceeds that of nonfat dry milk by at least 1.92 cents. Based on this, the dry whey make allowance should be increased to not less than 15.92 cents.

4. The nonfat dry milk yield factor should be changed back to no less than 1.01.

The Tentative Decision's conclusion that "It is apparent from the information contained in the record of this proceeding that the 1.02 factor, as a divisor, is excessive" bears reconsideration. The analytical exercise which appears on p. 76844 of the Tentative Decision itself demonstrates why this is so. First, the Tentative Decision itself notes that the price of buttermilk powder (BMP) has at times averaged less than 70 percent of nonfat dry milk (NFDM) prices. However, in trying to mathematically justify the new NFDM yield factor, USDA chose to use an average value of 80 percent. In fact, it is far more appropriate that USDA use no higher than the 70 percent figure for purposes of this calculation, given that the formula is one that sets minimum prices all of

the time, and not average prices. For the same reason, USDA should add 3 cents to the NFDM make allowance for the BMP make allowance.

Moreover, the final result of the Tentative Decision's calculations is dependent on the NFDM price assumed. For instance, assuming that the BMP price is 70 percent of the price of NFDM and that the BMP make allowance is 17 cents, the appropriate divisor for the nonfat solids price formula would be 1.0103 if the NFDM price was \$1.03, but would be 1.0098 if the NFDM price was \$1.13 and 1.0107 if the NFDM price was \$0.93. The effect of the finished product price assumption upon the formula further supports the need to revert to a divisor that reflects minimum values rather than the average.

In addition, the yield factor for nonfat dry milk should also account for the loss of components between the farm and plant receiving station (see Number 6 below). For all these reasons, the divisor should be changed back to not less than 1.01.

5. USDA should not utilize the RBCS survey for purposes of determining make allowances for cheese and dry whey, but should substitute the NCI surveys, together with the CDFA surveys.

The Tentative Decision errs in suggesting the use of the RBCS survey for purposes of determining make allowances. As pointed out by Ling (USDA) pp. 73-81, the RBCS survey was never intended to be used as for setting make allowances in federal order product price formulas. The purpose was only to serve as benchmarks of in-plant costs of manufacturing.

The notion that the RBCS surveys are prepared for a neutral purpose, as compared to the NCI surveys commissioned for purposes of the hearings, is completely

misplaced. Ling testified that at the November 1999 annual meeting of the National Milk Producers Federation, NMPF urged members to submit data to the RBCS so that it could be used in the upcoming hearing on Class III and IV product price formulas.

Moreover, the RBCS survey is seriously flawed. It excludes some in-plant costs that were thought to be difficult to allocate correctly in multi-product plants. But witnesses from cooperatives participating in the RBCS survey confirmed that such cost of manufacturing, while excluded in their survey response, were actual, legitimate expenses incurred during the process of turning milk and dairy ingredients into manufactured dairy products. (Hollon (DFA) 1594-96; Olson (AFBF) pp. 842-845; Wellington (Agrimark) pp. 1507-08).

Furthermore, the Tentative Decision wholly ignores unimpeachable evidence that the RBCS data is inherently suspicious and unreliable. The results of the most recent RBCS survey purport to demonstrate that the larger the cheese plant, the higher the costs of operations (Ling (USDA) pp. 142), which is simply not true, because larger plants are more efficient and therefore have lower costs of manufacturing. (Ling (USDA) pp. 140-41), (Yonkers (IDFA), pp. 335-36). In addition, Wellington (Agrimark), pp. 1481-86 specifically described the lack of attention paid to the RBCS survey by one respondent, which resulted in under-reporting of the costs of manufacturing in this survey. This directly contradicts USDA's conclusion in the Tentative Decision that "there is every reason to believe that the costs provided are as accurate as possible."

The Tentative Decision erred in failing to utilize the data from the NCI surveys. The purported lack of expertise in the company that compiled the data is wholly misplaced, given that this company was working under the direction of IDFA's

agricultural economist, and its task was limited to the compilation of data supplied by numerous cheese and other manufacturers. Accordingly, the RBCS survey should be replaced with the NCI survey.

On several make allowance issues, IDFA supports the conclusions of the Tentative Decision. IDFA supports the conclusion that "the make allowances incorporated in the component price formulas under the Federal milk orders should cover the costs of most of the processing plants that receive milk pooled under the orders." This is true because pooled handlers must be able to compete with processors whose milk receipts are not priced in regulated markets, and because this approach helps to assure that the market is cleared of reserve milk supplies.

IDFA also supports the Tentative Decision's inclusion of both marketing allowances and return on investment factors in the manufacturing allowances provided in the component price formulas. However, while relying on CDFA as the primary source of this data may be appropriate, make allowances must be sufficiently flexible so as to allow for changes over time in the actual costs that make up these as well as other cost categories. For instance, strictly basing a federal order make allowance on data covering a calendar year which is now two years old does not allow for the fact that the cost of inputs may have increased since then. One specific example is the cost of energy; the U.S. Department of Labor reports that the producer price index for fuels and related products and power in 2000 was 36.9 percent higher than the annual average for 1998, the year for which most of the data was reported in the RBCS data.

These kinds of substantial cost increases further support the need for a make allowance that errs on the side of being too high rather than too low, and

demonstrates why the 17.02 cent make allowance advocated by NCI should be adopted in lieu of the lower make allowance set forth in the Tentative Decision. In no case should the cheese make allowance be set less than the weighted average of 16.87 cents calculated from the NCI survey and CDFA data.

6. All of the yield factors should incorporate shrinkage of components between the farm bulk tank and the finished dairy products.

The testimony of IDFA and other witnesses at the hearing conclusively demonstrate why the product pricing formulas now being used to set minimum milk prices to farmers must err on the side of overestimating make allowances and yield factors if a viable dairy industry is to be maintained in federal order areas. One example is the need to have yield factors that are sufficiently flexible as to account for shrinkage (loss of milk) between the farm bulk tank, where the milk is measured and priced, and the plant receiving silo.

A handler that is required to pay the minimum price for this milk obviously cannot recover that cost through the corresponding sale of finished product, since by definition no such finished product can be made. Yet the formulas provide that the amount of milk and components be measured and paid for at the farm in the farm bulk tank, while the make allowances, yield factors, and product prices are based only on the amount of product produced in the manufacturing plant.

In fact, the Tentative Decision acknowledges that several hearing participants testified regarding the loss of milk components during the manufacturing process. The Tentative Decision suggests that this problem is addressed by the fact that the orders allow for shrinkage. However, Federal order shrinkage provisions only

apply to designated pool plants, and the vast majority of plants manufacturing Class III and IV dairy products are not pool plants. In addition, any shrinkage allowance barely scratches the surface of the problem, because it simply provides that pool plants need only pay the lowest class price for the amount of components considered to be allowable shrinkage. But the mere fact that the lowest class price be paid in no way accounts for the fact that no moneys are collected by the handler through finished product sales that can pay for any cost associated with this milk. Thus, the yield factors themselves must be adjusted to account for these losses.

The Tentative Decision suggests that this is unnecessary because both the CDFA and RBCS cost surveys purportedly use a "process which should take shrinkage into account." But in fact, those surveys reflect the cost of manufacturing based on the pounds of end product produced, and do not account for the cost of manufacturing based on the pounds of components entering the process at the farm bulk tank. Considerable testimony clearly outlined that there is considerable shrinkage at several stages in the process, including between the farm bulk tank and the plant receiving silo, between the receiving silo and the vat, churn or dryer, and finally between the vat, churn or dryer and the pounds of actual components captured in the final product. Dr. Barbano prepared a graphic illustration of the many steps along the way where the handler experiences shrinkage. (Exh. 19).

In fact, it appears that USDA explicitly accounted for at least some shrinkage in its detailed calculations used to determine the yield factor for nonfat dry milk in the Tentative Decision (76843-44). However, as discussed later, USDA only accounted for shrinkage "...in the manufacture of butter and powdered products," and

not in any loss (shrinkage) between the farm bulk tank and the start of the manufacturing process.

IDFA therefore strongly urges USDA to account for shrinkage by using more liberal yield factors. This further supports the arguments already advanced for using divisor of no lower than 1.01 in the formula for nonfat dry milk, and the reasons why there can be no adverse changes in the formulas respecting butterfat recovery in cheese, or the butter or dry whey yield factors.

7. USDA should include 640-lb blocks in the NASS weighted average cheese price.

The Tentative Decision errs in its failure to include 640-pound blocks in calculating the weighted average cheese price used in setting the Class III minimum price. While no publicly available data on total production of 640-lb block cheddar cheese production exists, industry estimates suggest that 640-lb blocks represent as much as 27 percent of total cheddar cheese production. Reinke (Kraft) p. 1043. This was supported by Eastham (Great Lakes Cheese) p. 1279, who stated that 640-lb blocks are playing an ever-increasing role in the cheese market, and Gulden (AMPI) p. 1187, who stated that AMPI has 7 cheddar cheese plants, and that 80 to 85 percent of this cooperative's cheddar cheese production is in the form of 640-lb blocks. Intentionally excluding such a large percentage of cheddar production dramatically limits the NASS survey's ability to represent the true wholesale value of cheddar cheese. (Yonkers (IDFA), Exh. 14 at p. 45).

While the Tentative Decision recites some shortcomings in its past efforts to collect data or establish a spot market for this package type, this history is not

reflective of current reality, which as noted above demonstrates the increasingly important role played by these package size cheeses. Moreover, whatever problems USDA previously encountered in the collection of voluntary data on these cheeses is irrelevant given that all participation in NASS surveys regarding data used to calculate federal order minimum prices is now mandatory.

The Tentative Decision states that opponents to inclusion of 640-lb blocks in the cheese price computation contended that the vast majority of such products are made on a custom basis to customers' specifications (76845). However, no testimony was presented by these opponents regarding how specifications differed across customers, or why these differences would make the prices reported inappropriate for inclusion in the calculation of cheese prices. Indeed, moisture specifications also differ across customers for 500-lb barrel cheese, but this is easily accounted for by adjusting prices to a consistent moisture content.

USDA should include cheddar cheese in 640-lb blocks in both the NASS survey and the Class III minimum price calculations.

8. The other solids price snubber should be eliminated.

Substantial testimony from participants in the hearing repeated a consistent theme—all factors in the price formulas must reflect actual market conditions. In dairy markets, there may at times be a wholesale price for dry whey that does not fully cover the cost of manufacturing that product. By including the other solids snubber, USDA is insuring that manufacturers of dry whey will not be able to cover all the costs of manufacturing, should such a market situation occur. This decision by USDA essentially means that the make allowance is fixed as the wholesale price of dry

whey exceeds the make allowance used in the dry whey product price formula, but that the make allowance shrinks as the wholesale price of dry whey falls below that make allowance. As testified to by Yonkers, without an adequate level of make allowance, a manufacturing plant can not continue to operate, as it would have insufficient funds available to pay the vital costs necessary for operating the plant (Exh.14 at p. 7).

The component pricing system adopted by USDA in the Federal order reform process insures that milk producers receive the rewards of any positive revenues generated by manufacturing dairy products by absolutely limiting the revenue a manufacturer is able to generate. This limit is the make allowance; any value in excess of the make allowance obtained from the wholesale dairy product markets is returned to milk producers. The use of a snubber in any component price formula removes any market risk from milk producers.

Lastly, the concept of a snubber was not a noticed proposal for this hearing, nor was any direct testimony presented regarding the use of a snubber in the other solids price formula. The Tentative Decision snubber discussion references a post-hearing brief submitted by MMPA advocating that in no situation should a negative other solids market return be reflected in the milk price. The MMPA brief references a portion of an answer from a DFA witness in which the witness comments that it is difficult to explain why a regulated price is negative. Absent from the brief (and the Tentative Decision discussion) is the DFA witness's elaboration that he prefers that any negative value be shifted in the pooling process to the producer price differential.

Simplification for communication is not a good policy justification for economically disadvantaging manufacturers of dry whey. If a negative component price

in producer payments is problematic, it can be addressed, as inferred by the DFA witness, by allowing the component price to go negative and pooling the negative value as part of the producer price differential. Alternatively, the other solids price could be snubbed at zero while at the same time crediting the negative value to the protein price, as was the practice in many of the Federal orders with component pricing prior to reform.

9. The NASS butter price used in the butterfat price calculation should be reduced by six cents for all classes.

In rejecting proposals to reduce the NASS grade AA butter price when used in the milk order price formulas, the Tentative Decision states that "[c]ontrary to the belief stated by some witnesses, whether qualified experts or not, the use of the Grade AA butter price for computing the butterfat price under Federal order reform was not an oversight." The Tentative Decision supports that assertion by the observation that "[t]rading of Grade A butter on the CME was ended" at the time the proposed final rule had in January 1998 adopted the use of a NASS grade AA butter price.

But this observation is simply incorrect. When USDA had proposed in January 1998 to use a NASS Grade AA butter price, the CME in fact was still trading grade A butter, and would continue to do so until June 1998. In fact, USDA clearly chose to use in the basic formula price a butter price designed to reflect the grade A butter price when the CME did discontinue trading grade AA butter in June 1998.

IDFA therefore urges that USDA adjust the butter price used in the product price formulas by subtracting six cents, to correct for the fact that the NASS dairy products prices survey is only of grade AA butter. This would base the value of

butter used to determine the minimum price of butterfat on an equivalent to the grade A butter price. (Yonkers (IDFA), Exh. 14 at p. 50).

This change to the butterfat value should apply to all classes of milk, including Class II. In the final rule, USDA noted that "Butterfat used in Class II products competes on a current-month basis with butterfat used in cheese and butter, and its price should be determined on the basis of the same month's values." This is sound economics, for the reasons already explained. (Yonkers (IDFA), Exh. 14 at p. 50).

Proponents of a change for only Class IV butterfat did not succeed in making their case. The data presented by Schad (Land O'Lakes), pp. 1201-02, on the added costs of using cream in other dairy products clearly applied to cream used in all classes of milk, and by his own calculations only applied to at most 65.8% of the butterfat used to make Class IV products. In fact, Schad stated that users of cream in all classes of milk face the same costs (p. 1221). Moreover, Agrimark makes only 60% of its butter from cream, a figure expected to fall to 50%. (Wellington (Agrimark), pp. 1491-92). Similar testimony was received from Hollon (DFA), p. 1544. This data further supports the need for a uniform change across all classes, since these costs apply to handling cream, not to making only a Class IV product like butter.

In fact, the testimony from cooperative representatives establishes a different point--these unrecovered costs of handling cream should be reflected in the butter product price formula. The Tentative Decision states that "If there are additional costs involved in making butter, they would more appropriately be included in the make allowance for butter." (76842). IDFA agrees, and would urge that USDA take this step with respect to these costs. IDFA notes that while both Land O'Lakes and DFA testified

to the fact that these costs are not currently accounted for in the federal order butter product price formula, both supported reducing the make allowance used in that formula. These positions are at best inconsistent, and appear simply to be focused on the goal of reducing a key ingredient cost for the butter manufacturing operations of the two cooperative associations relative to other uses of butterfat in the marketplace.

10. The butterfat to protein relationship factor of 1.28 in the protein price formula should be reduced to reflect the ratio of butterfat to protein in average producer raw milk, which is 1.22.

The butterfat to protein relationship factor of 1.28 in the Class III protein price equation should be reduced to reflect the ratio in average producer milk, which is approximately 1.22. The concerns articulated by Dr. Barbano, and reflected in the Tentative Decision adoption of a cheese-based butterfat price, related to fluctuations in the Class III price when the wholesale price of butter changes while holding the wholesale price of cheese constant. Specifically, Dr. Barbano noted that as the butter price increases, the protein price decreases at a faster rate than the rate at which the butterfat price increases. (Barbano Testimony, Tr. 519). This concern can be addressed by correcting the 1.28 fat to protein ratio in the current formula to be representative of average producer milk composition.

The logic that led to adoption of the 1.28 factor in the Federal order reform process (that is, looking at the pounds of fat that can be associated with a pound of protein) was faulty. It is clearly inappropriate to incorporate a factor in the raw milk pricing system that inherently reflects a component ratio beyond that found in average raw milk. The 1.28 factor infers that cheddar cheese manufacturers must purchase

cream routinely to achieve a desired butterfat to protein ratio. The use of a factor that exceeds the ratio found in average raw milk transfers the incremental value that is derived from the purchase of additional butterfat into the raw milk price.

A review of FMMO data from 2000 for those Federal order marketing areas that have component pricing indicates that producer raw milk on average has a 1.22 ratio of butterfat to protein. Therefore, USDA should replace the 1.28 factor in the protein price equation with 1.22.

11. In no case should the Class III price be enhanced relative to that resulting from Federal order reform (as implemented on January 1, 2000).

In both the Federal order reform decision and the Tentative Decision, USDA performed a regulatory impact analysis. In both cases, USDA concluded that, while overall producer income would be slightly enhanced as result of these decisions, the market impacts of the decisions would actually lead to lower wholesale prices for the dairy products used in the component price formulas. This in turn led to the conclusion that the average Class III and IV prices under these decisions would be lower than had the previous pricing regulations remained in effect.

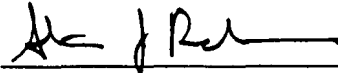
In other words, raising the Class III or IV price can actually result in less money in farmers' pockets due to the negative impact that higher milk prices can have on sales of finished product. USDA should bear this principle in mind and take care to ensure that Class III and IV minimum prices resulting from any changes to the Tentative Decision should be in line with those in effect as a result of both the Tentative Decision as published on December 7, 2000 and the provisions in effect under Federal order reform during all of 2000.

In particular, it should be noted that, as a result of the Preliminary Injunction granted by the U.S. District Court for the District of Columbia on January 31, 2001, the Tentative Decision now in effect (including the effect of the court ruling) provides for a higher Class III price than would have been the case under the Tentative Decision without the court ruling. We therefore urge USDA to act quickly to conclude this entire rulemaking process and make such additional changes in the Tentative Decision as these or other comments show are warranted.

There is no reason whatsoever for USDA to reopen the hearing. USDA has fully met the mandate set forth by Congress to review the Class III and IV pricing formulas contained in the Federal order reform final decision. As part of its process to comply with the mandate of Congress, USDA solicited industry proposals, which were included in a notice of hearing, and then conducted a week long hearing to receive testimony from any interested party. The hearing record created provided a more than ample basis for decision making. USDA then implemented a Tentative Decision by the Congress's deadline of January 1, 2001. Any interested party has now also had the opportunity to comment on the Tentative Decision by the comment deadline.

Should USDA, or any interested industry party believe that additional issues should be addressed, such issues should be addressed in a new proceeding initiated by a new hearing process, not by extending this one.

Respectfully submitted,



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