BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE

In the Matter of

MILK IN THE NORTHEAST AND OTHER MARKETING AREAS

DOCKET NO. AO-14-A69, et al.
DA-00-03

COMMENTS BY
SELECT MILK PRODUCERS, INC. and
CONTINENTAL DAIRY PRODUCTS, INC.
IN RESPONSE TO THE RECOMMENDED DECISION

I. Introduction and Standing

Select Milk Producers, Inc. and Continental Dairy Products submit these comments to the Recommended Decision on component formulas other than the Butterfat Adjustment to Protein. Select and Continental adopt the comments made in the Consolidated Producer Comments on that issue. Attached to these comments is a table that identifies the recommended changes in the formula.

Referring to that table, Select and Continental will comment in support of the values found at lines 1, 2, 13, 17, and 19, comment in opposition or changes to 6, 16, and 21. Predicated upon no further changes to the pricing surveys, yield formulas, or make allowances unless otherwise argued by Select and Continental, these cooperatives otherwise support the remaining elements as they are.

II. Comments

Select and Continental support the changes to the protein formula that properly account for the Butterfat Adjustment. They oppose the increase in make allowances for other solids because there is absolutely no testimony supporting the increase. They otherwise are in support or will not oppose the remaining portions of the component formulas.

Though the Secretary repeated during the process of the FAIR Act reformation of the federal milk marketing orders (FMMO) that a primary goal of the replacements to the BFP, (ultimately the
class III and IV prices in the Final Rule), “is that it [the BFP replacement] should not deviate greatly from the price level of the current BFP.” 64 Fed. Reg. 16096 (April 2, 1999) [emphasis added], the actual prices for Class III and IV fell short of that goal. The Secretary’s own evaluation of the BFP replacement in the Final Rule found that the replacement class III price was 3.5 percent below the BFP and the class IV price was 3.7 percent below the current BFP. Id. *Experience so far in 2000 and 2001 has shown that the class III price itself has provided producers almost fifty cents less of the cheese market prices than the BFP and M/W had provided earlier.* [Hearing Transcript Vanden Heuvel 870-871].

During these last two years, seven of the 24 months’ Class III prices did not even meet the meager Dairy Price Support Program’s cheese support price. *In fact, the simple average of Class III prices for the entire year of 2000 fell short of the support level of 9.80 at 3.5% test.*

7 U.S.C. 608c(18) is captioned “Milk Prices” and requires that:

> 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.

Neither the FAIR Act nor the Consolidated Appropriations, 2000, changed this underlying requirement of the AMAA. The pricing differentials must reflect the price of feeds and the available supply of feeds as well as other economic factors. Those who spoke of “too-high” or “too low” missed this legally required point entirely.

However, the Final Rule that went into effect January 2000 did reduced producer prices by 40 to 50 cents in the manufacturing side. To correct that producers sought Congressional assistance which required the Secretary to commence the hearing process of which this brief is a part. Correcting this 40 to 50 cent loss is the role of this hearing. In short, *producers deserve a fair share of the price paid for dairy products,* even if this means that in the eyes of some, the prices are “too high”.

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The shortfall is clearly shown in the Recommended Decision. The Secretary computed gross margins including make allowances for cheese milk. The estimate was $3.00 gross margin. This is similar to the “implied margin” that Select and others testified to at the hearing. Using the same methodology, the gross margin comes in at approximately 2.50 for the period prior to 2000. The fifty cents difference is right where the Secretary predicted it in 1999.

The Secretary now uses the formulas for FMMO to set support prices. However, during the last two years we have seen FMMO prices for Class III lower than support prices. Since January, 2000, the NASS price for cheese has hovered at support price levels with a range from 1.1144 per pound in January to 1.1665 in June. Rather than a producer price of 9.90, the class III price averaged below the support price for 2000. In the past, the BFP was generally higher than the support price. Unless the Recommended Decision is adopted and the other solids corrected, producers risk not only a reduction in the value of the FMMO minimum prices, but the price support program as well.

The Recommended Decision does, in part restore much of that lost producer value by correcting the Butterfat Adjustment to the protein formula. Select and Continental have joined with other producer groups in support of that change. However, at the same time the Secretary corrected a serious problem, it has further reduced producer prices by increasing the make allowances for other solids without record support for that change. This arbitrary increase effectively reduces the Class III price by 9 cents per hundredweight. Depending upon the “higher of” values, that increase in make allowance will reduce producer income in the Federal orders by almost 50 million dollars per year. When they started short, any further reduction is unwarranted.
A. **Other Solids**

1. **Class III should continue to use other solids in the Class III formula.**

   One of the dynamics of cheese manufacturing of the last ten years has been the growing value of whey products. What was once a disposal cost, has become an income generator. According to the weekly NASS Dairy Prices, dry whey has averaged almost a dime more in 2001 than in 2000.

   Other solids should continue to be used in class III. There was no real proposal to remove them, but Select, WSDPTA and other organizations in the abundance of caution continue to argue the need to keep them. Cropp explains the importance of these. Cropp 1457-58, Exhibit 43. National All Jersey supports the use of other solids. Brown 1651.

   Dr. Cropp did an extensive study of the role of other solids in the prices plants paid in the Upper Midwest under the BFP. The result of his study, found at Exhibit 43, is that other solids contribute as much as forty cents to the BFP. Under the Final Rule the other solids represent 5.9 of the 9.0 pounds of solids in class III skim. The formula takes the dry whey price less the make allowance and divides by .968 which represents the amount of other solids in a pound of dry whey.

2. **The Other Solids Make Allowance should not be increased.**

   *Producers never had a chance to cross examine a single witness from NCI or IDFA or its membership who could, and did testify, to the total cost to dry whey.* There was no presentation of any evidence on total dry whey manufacturing costs. Its incompleteness was misleading. It is unfair to producers. If plants have a genuine need for additional make allowances for dry whey, they are entitled to have that, but not as a gift based on speculation and incomplete evidence, but on real costs. Let them present what those costs are.

   Neither the Secretary nor other participants are blind. The formulas are not elephants. We should not be reduced to being shown only a portion of the whole and asked to speculate what that whole is. The Secretary has the intelligence and capacity to see the whole picture and make a decision. Giving only bits and pieces insults the process.
The testimony in support of increases was circuitous. If asked how much NFDM costs, they would say 2.6 cents less than dry whey! Is the total cost 12.6 cents or 16 cents? The record does not tell us that and it is grossly improper to speculate.

Put differently, if the true costs of manufacturing dry whey exceeded 13.7 cents, the plants had every incentive to present that complete evidence. The failure by those proposing to reduce producer prices higher costs to state the total costs of drying whey on the record is evidence that such costs are not higher than the current 13.7 cents.

The Secretary agrees there is no evidence. In December of 2000, in the Tentative Final Decision the Secretary stated as follows:

Most witnesses who testified about the cost of drying whey expressed the belief that drying whey costs more than drying nonfat dry milk. Two cooperative association witnesses testified that their Although a number of witnesses testified that the cost of drying whey is greater than that of drying nonfat milk, the record does not provide clear support for any particular differential over the NFDM make allowance. The differential costs of manufacturing whey powder over those of nonfat dry milk do not provide close enough agreement with the NCI-sponsored survey to use either means of determining a make allowance with any confidence. **Neither of the witnesses who testified that the extra costs of drying whey are 2.6 cents greater than the costs of drying nonfat dry milk testified about the total costs of the operations they were describing.** Therefore, the make allowance used to calculate the other solids price should continue to be the same as that used in the total nonfat solids component price formula. The other solids price will be computed by subtracting the make allowance of $0.14 from the NASS dry whey survey price and dividing the result by .968.

65 Fed. Reg. 76847. [Emphasis added] Elsewhere in that same Tentative Decision, it was held “The cost of manufacturing nonfat dry milk continues to be used as the cost of making whey powder due to the nature of the information in the hearing record about the actual costs of drying whey.”

Since the issuance of the Tentative Final Decision and the Recommended Decision there has been no more hearings and no more record evidence. Thus the following statement in the Recommended Decision cannot be:

Since information regarding the costs of drying whey was not available from the sources used for determining the other make allowances in product price formulas, the tentative final decision determined that the dry whey make allowance should remain the same as that for nonfat dry milk. However, that determination should be changed to reflect testimony and other evidence in the hearing record that the cost of drying whey is greater than that of drying nonfat dry milk.

66 Fed. Reg. 54085. Nothing has changed in the record to change the Tentative Final Decisions finding that “Neither of the witnesses who testified that the extra costs of drying whey are 2.6 cents greater than the costs of drying nonfat dry milk testified about the total costs of the operations they were describing.”

It is pure speculation to compute the make allowance by adding the “extra” to the NFDM milk costs. Adding the NFDM plant costs to extra drying costs will not give the whey drying costs in a cheese plant. The costs associated with drying whey occur in a cheese plant not a NFDM plant. **Though there may be evidence that the cost of drying is higher for dry whey than NFDM, there is no evidence as to total costs to make dry whey.** There is certainly no evidence as to what NFDM make allowance the “higher than” applies to.

Dry whey that is part of the other solids component of the Class III price is made in a cheese plant not a powder plant. When one says it costs “more” the logical question is: More than what? Though there is testimony that it costs more to dry than powder, there is no testimony that producing whey in a cheese plant is more than powder in a powder plant. The only direct testimony on the issue comes from DFA which stated that its plant in Smithfield Utah costs .1478 per pound.
Lepriono’s testimony should be rejected outright because it does not make NASS cheddar cheese and thus does not have the costs associated with the dry whey that is part of the Class III price. The use of this testimony is what makes the hearing process so unfair to producers. Anecdotal stories from cheese plants that do not make NASS cheese, incomplete stories that do not disclose the full cost, misleading studies which the Secretary rejected, cannot be used as a basis to take out of the pockets of producers almost 9 cents ($0.09 = 9 cents hundredweight). If plants want to take money from producers with higher make allowances then they have to prove it. They have to show that it costs “x” to take raw milk from the farm, process it into cheese, take the whey and process it by drying and this is the cost. No one did that but DFA.

Though Kraft said it cost more to dry whey than making non fat dry milk, it never answered the question: More than what? How can the Secretary or producers these unstated numbers? What integrity do they have? If we could trust cheese plants to pay producers the correct price, what is the purpose of the AMAA? For example, if Kraft’s NFDM costs only 10 cents, then its cost to make dry whey was 12.6 cents, not even 14 cents? The record does not tell us the base and it is improper for the Secretary to speculate that the costs to dry whey in a cheese plant are those in a powder plant. Because we do not know and cannot know in this record, the use of that testimony should not be permitted to reduce producer income.

As for the NCI study, the Secretary has already determined it should be given little to no weight. As the Secretary succinctly stated,

In contrast to the RBCS and CDFA surveys, the survey of cheese and whey powder manufacturing costs arranged for by NCI was developed solely for the purpose of establishing costs to be used in determining make allowances for this proceeding. The survey was conducted by persons unfamiliar with the dairy industry among cheese processors who would benefit from having overstated costs included in the results. No one who actually conducted the survey was made available to testify, and although the IDFA witness stated that survey participants would testify regarding their responses to the survey later in the hearing, none of the participating firms’ witnesses would respond to questions about their firms’ results.
Later on she stated, the NCI study would be used as a “check.” It is not just that the NCI survey was collected solely for the hearing by those interested in the result, but, noteworthy, it did not provide the kind of costs necessary to establish the cost of drying whey.

It goes without saying that processors want a lower raw milk cost and producers want a higher milk price. Those are givens. Whether a particular factor in establishing those costs should be adjusted one way or another is, under the AMAA, subject to the hearing process. If the cheese processors want it changed, they have the burden to put on sufficient evidence to change it. They did not, and it should not be given to them based on speculation or whim.

B. Cheese

1. There should be a higher Butterfat yield in the cheese formula.

The gross margin identified in the Recommended Decision shows there is about 1.40 per cwt in gross margin that is not accounted for in the formula. This extra value most certainly comes from the unpriced value of whey cream (the ten percent) and the unpriced protein portions. Efforts to argue such products do not come out of NASS cheddar cheese manufacturing should be rejected.

Adoption of the Recommended Decision as regards the Butterfat Adjustment to Protein will mitigate much of the need to correct the butterfat yield in the cheese formula. Clearly, a change in the butterfat yield to, say .92, with a corresponding change in the recommended butterfat adjustment factor from .9 to .92, which the argument for the butterfat adjustor would demand, will result in little change in overall prices. Rather, Select and Continental are presenting the issue again in the event the Secretary backtracks on the butterfat adjustment and, as well, to keep the issue at the forefront in the struggle to insure fairness and accuracy in the component formulas.

Ninety eight percent of the butterfat is recovered in one form or another. The cheddaring process produces cheddar cheese as well as sellable or usable cream in the form of whey cream that can either be reused in the vats or sold as cream on the market. The butterfat recovery in the process is between 91 and 93 percent which leaves 7 to 9 percent of the butterfat left over.
21 * * * That means that fully 98 percent of the butterfat
22 that is delivered to the cheese plant in raw milk is
23 recovered by the plant in marketable form either as whey
24 cream reintroduced into the vat or as whey cream converted
25 to whey butter.

Barbano 893, see, also, Vanden Heuvel 893. Fully 98 percent of the butterfat that is delivered to the cheese plant in raw milk is recovered by the plant in marketable form either as whey cream reintroduced into the vat or as whey cream converted to whey butterfat.

Barbano explained that it is common in the processing of cheddar, barrel or block, to recover the whey cream and reuse it in subsequent vats of cheese. Barbano 712-715. There is no dispute that there is value in this whey cream that is not accounted for in the present formula. As Vanden Heuvel explained, the current value of 1.582 represents 90 percent butterfat recovery and no value for the whey cream. Kraft acknowledges that this has value. Reinke 1041. Kraft has chosen not to introduce the whey cream into their cheese, but their cheese is not part of the NASS survey and this process, since it does not bring the added value of the higher value cheese to the producer formula, should not be considered. Great Lakes Cheese indicated that it recovered in total 94 to 95 % of its butterfat indicating that its whey recovery is about 4 to 5 %. Eastman 1292. California has whey fat recovery in its formula by adding an additional .27 pounds of fat to the formula. Vanden Heuvel 894-896, Exhibit 25, Table 8.

There is evidence that the entire 98 percent of the butterfat ends up in the cheese. The difference between the 98 percent that is in the cheese and the 90 percent in the current regulations is eight percent. Eight percent of 3.5 lbs (3.5% butterfat in one hundred pounds of milk) is 0.28 pounds. Statistics show that in California, cheese plants obtain this extra .28 pounds of butterfat in cheese. Exhibit 25, Table 8. Vanden Heuvel 894-895. The difference between the 3.92 percent in the cheese
and the 3.64 to 3.65 in the raw milk supply is .27 to .28 pounds of butterfat recovered in the process and returned to the vat for a true fat recovery of 98 percent.

The California pricing system explicitly recognizes this value of whey cream in its 4b formula. CDFA adds to the 4b price the amount equal to .27 pounds of whey cream at the CME AA butter price less 19.7 cents (the sum of ten cents for product adjustment and the 9.7 cent butter make allowance). Vanden Heuvel 895.

Kosikowski in “Cheese and Fermented Milk Foods” states that recovery is 93%. The use of 92 percent butterfat recovery is not inappropriate. Barbano 775. Barbano testified that butterfat recovery of 91 to 93 percent were achievable and common. Barbano 523. He suggests a recovery of 91.5. 569, 578, 594. The value of 93 was not only achievable, but probably not the limit. 679.

There was no contradiction to this testimony. Rather, the attack took on three forms—(1) no plant that reports sales to NASS stated what their plant’s yield was. The absence of this data (as contrasted with Land O’ Lakes’ testimony as to exact yields in its plants on NFDM and BMP), only bolsters Barbano’s testimony, if not suggesting that he was too low. After all, if his numbers were really out of line with industry practice, the industry could have, should have, and would have presented detailed and direct testimony to the contrary. It did not, because it chose not to support Barbano’s position. Kraft did state that it got 91 to 92 percent recovery even for its specially designed cheddar. Reinke 1092. DFA stated that 92 was an appropriate recovery. Hollon 1542-43. Great Lakes Cheese testified that it got a “little more” than 90 percent. Eastman 1281.

The second attack was based upon the issue of shrinkage. That issue is addressed elsewhere in this brief and will not be repeated, only that the formulas do recognize the loss of butterfat and casein. Some suggested a shrinkage of two percent. A look at the proposed formula shows that only 98 percent of the butterfat is accounted for. 92 percent is captured in butterfat recovery and six percent in the whey cream recovery, leaving two percent for shrinkage. Vanden Heuvel 893-894. Further, to adjust yield factors to account for losses that occur prior to processing would confuse the
system. As Barbano stated, “you get confused by changing yield factors for purposes other than what really happens in cheese making.” Barbano 681.

Finally, some attack the yields on the issue that not all class III products are cheddar cheese and other cheeses have higher butterfat losses. Yonkers. 283, 296. Reinke 1040. This argument fails the relevance test. The use of cheddar cheese is a proxy for all cheeses. The NASS survey looks for product prices of cheddar, not mozzarella or provolone or muenster. The make allowance is for the production of NASS cheddar, none of the others. Similarly, the yields should not include these other cheeses. IDFA’s witness acknowledge the need for an “apple to apple” comparison when he argued that the make allowances should apply to those who report the NASS survey prices. Yonkers 283 to 284. We agree! And that is why product yields, shrinkage, butterfat recovery, and other similar issues in producing cheese other than that eligible for NASS reporting are inappropriate.

Similarly, Kraft’s statements that it gets 90 percent butterfat recovery and it uses sweet cream to add to the vat are not admissible because none of its cheese is of that reported in the NASS survey. Reinke 1047, 1070.

Select and Continental are not arguing against the Consolidated position presented separately, but want to reiterate that in the cheddar cheese manufacturing, the 90% butterfat recovery rate with nothing further inadequately measures the value of the milk in the hands of processors.

2. The NASS survey, barrels and 640# blocks

In prior decisions the Secretary has determined to reduce NASS barrel surveys by three cent and not include 640# blocks in the survey series. Select and Continental continue to support that position. The arguments are made at pages 42-43 of our initial brief after the hearing. Much of the rest of the discussion on cheese is predicated upon no changes to positions by the Secretary. Nothing has changed in the industry to change that position.

The reason for the barrel to block adjustment is to account for the difference in make allowance between barrels and blocks. Barrels are manufactured, packaged, and handled more
efficiently than blocks. That is part of the reason that barrels have historically been lower than blocks. There was nothing in the hearing record that would support a factual finding otherwise. Land O’ Lakes and DFA, both cheese manufacturing cooperatives, stated that the three cent is a reasonable approximation of the difference between barrels and blocks “attributable to volume utility and cost differences in packaging and handling.” 66 Fed. Reg. 54081. The only testimony for reduction on this basis was of two cents for packaging. The other cost savings were not included. Thus the Secretary was right in holding to the three cent adjustment for lack of evidence.

As to the historic spread, that is not relevant. For purposes of component pricing, a pound of protein has the same value in a 40# block as it does a 500# barrel. The weighted average pricing under the NASS survey price captures that. Under cheese price discovery system in place, adjusting barrel prices to block to reflect historic differences would be arbitrary.

Some cheese manufacturers argued that correcting the block moisture from 39 to 38 percent took care of the three cents. That flies in the face of reality. As the Secretary correctly pointed out “If the difference between block and barrel prices were due to the difference in moisture, the difference between the prices should widen as cheese price increases since the moisture adjustment is based on the price and moisture of the cheese.” 66 Fed. Reg. 54081

C. The Secretary should not set prices by meeting the prices in California

Considering the fact that California has transformed itself into the number one dairy state and soon to be the number one cheese producing state in little more than a decade, it is appealing to consider modeling the decision in this hearing off of the California system. California’s success at developing its own state’s dairy industry and its sheer size and presence in the national market demands that we recognize and respect its influence on supply, demand, and pricing of milk and milk products.
The dairy industry in California has much to be proud about. As much as the rest of the Nation may find such success desirable, the stark truth is that the Secretary cannot make the federal milk marketing orders into California-style dairy units no matter how much she may want to do so. Could a national order like California have the same results as California?

In the first place, California possesses a dairy legal and regulatory scheme that is far more comprehensive and expansive than federal law provides under the AMAA. One key difference is the degree to which persons must participate. The California system, by law and regulation, encompasses virtually every plant that purchases grade A milk in the state and every producer that sells milk. That contrasts with the AMAA and the eleven federal milk marketing orders which are, by law, strictly voluntary for producers, and which only subject fluid processors with distribution in regulated areas to regulation without their consent. All others, including the cheese and manufacturing plants represented by IDFA, can or cannot participate in the FMMOs as they wish and are free to pay as much or as little to producers as they want.

The freedom to not participate in the FMMO as opposed to the obligation to participate in the California system has enormous policy implications on the resulting regulations. There is no question that in a regulated market that obligates a handler to pay a minimum price for its raw product and that at the same time assures all producers of a market for their milk, that minimum price must be such as to assure the buyer a sufficient potential gross margin to profitably continue. To do otherwise would create the situation where the handler is faced with either breaking the law and buying milk at a lower price, not buying all of a producer’s milk, or closing altogether. Simply stated, there is no safety valve. Thus great care must be made to avoid even approximating such levels.

On the other hand, in the FMMO manufacturers are free to pay whatever price they want to pay, even if it is lower than the minimum prices set in this hearing. Thus there is a market clearing safety valve that vents undo pressure. This provides more latitude to the Secretary to establish minimum prices that address the needs of producers as is required by the AMAA.
Besides arising out of different legal and policy roots, the goal of the AMAA is factually limited by the domestic markets. Another characteristic of the California program is that implicitly it uses the compelled participation and blending to economically support its manufacturing plants. Milk production in California has risen 224% in ten years and cheese production has risen 762%. Yonkers 267-268. Domestic cheese production has not approached even a fraction of such explosive growth. As repeatedly stated at the hearing, California plants sell their cheese throughout the Nation. One witness stated that California produces twice what it consumes. Contente 725. California’s piece of the pie has grown considerably. Conversely, however, the FMMO areas of the country, which is just about everything else in the pie, cannot grow as much in cheese as California did because there is not that much of the pie to gain back. Besides, the AMAA specifically prohibits the Secretary from creating trade barriers in establishing FMMOs.

California has a different regulatory infrastructure as well. The law requires that the CDFA audit make allowances, Shiek 1156, and that they be used in establishing prices. Shiek 1155. CDFA also surveys costs of production by producers, also required by law. The result is a body of reliable data upon which California can base its decision on prices which is ultimately a policy one. Vanden Heuvel 927. This regulatory structure also gives the CDFA the ability to quickly modify its programs to meet its own policy goals. Exhibit 25, Table 4. Vanden Heuvel 872-873. That lists a series of hearings held by California resulting in a modification of the pricing formula or prices paid to producers. The FMMO cannot respond so quickly and so often nor should it.

Finally, producer groups in California along with others are now seeking to have California adjust to the federal scheme. This is seen by the letter of Michael Marsh from Western United Dairymen. It would be a sad day indeed if the Secretary reduced prices to meet California’s while California was in the process to make such an effort unnecessary.

III. Conclusion
For the reasons stated above, Select and Continental respectfully request that the Secretary maintain the Recommended Decision’s formulas on protein, butterfat, and non-fat dried milk. If she should decide to abandon the Recommended Decision on the Butterfat Adjustment, then more butterfat recovery should be incorporated in the formula. Finally, the increase in the other solids make allowance should not be permitted.

Respectfully submitted,
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Class III and IV Hearing Decisions

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