Agri·Mark ®

100 Milk Street
Methuen, MA 01844   September 28, 2006
978-689-4442

Mr. Gino Tosi, USDA/AMS/Dairy Programs
Order Formulation and Enforcement Branch
Stop 0231-Room 2971
1400 Independence Avenue, SW
Washington, D.C. 20250-0231

Re: Proposals for the hearing on changes in the Class III and IV price formulas

Dear Mr. Tosi:

Agri-Mark respectfully submits the following four proposals for consideration at the
second Class III/IV price hearing. In addition, we support the Class I/II proposal
submitted by NMPF.
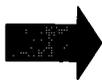
PROPOSAL 1

Use an annual manufacturing cost survey of U.S. cheese, whey powder, butter and nonfat
dry milk plants (located outside of California) to automatically update the manufacturing
allowance for those products used in Class III and IV component prices.

Federal Orders currently use a weekly NASS survey of hundreds of plants to
automatically update dairy commodity prices. The Cornell plant survey should be used
as the basic methodology to update annual manufacturing allowances on a similar basis.
This would allow Class III and IV prices to reflect regularly updated plant costs without
the need for lengthy, untimely and controversial hearings and decisions.

We propose that Market Administrator audit personnel oversee the survey and select the
sample plants as well as collect, audit and assemble the cost information. A random,
stratified sample of plants should be drawn each year and the results applied across the
entire population of plants.

The same methodology should be used in each survey each year. Any change in the
methodology would have to be done via the hearing process.

We initially propose several criteria to be applied across the survey results to set the
applicable make allowance.

1. The plant cost allowance must be set at a level that would allow minimum percentages
of milk volume used and plants in the entire Class III and IV manufacturing plant

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population outside of California to cover their costs. This similar is to the method employed by California to set their state pricing levels.

2. In addition, the national cost allowance must be set at a level that would allow minimum percentages of the milk used by Class III and IV manufacturing plants and the number of plants in any specific Federal Order pooling at least 2 billion pounds of milk annually to cover their costs.

3. The final cost allowance should use the higher of either criteria 1 or 2.

➡ PROPOSAL 2

This adjusts the protein price to correct for USDA's use of the Grade AA butter price to represent the price of whey butter.

Order language

Amend Section 1000.50(n) by including the following additional paragraph:

(4) Subtract $.017 from the price computed pursuant to paragraphs (n) (2) and (n) (3) of this section.

JUSTIFICATION FOR PROPOSAL 2

Under current Federal Order provisions, both the butterfat and protein prices use the Grade AA butter price as the value for all types of butter production resulting from the use of Class III and Class IV milk. While that may be an appropriate value for Class IV component value calculations, it is not so for Class III values.

The Class III yield calculation, for milk testing 3.5% butterfat and 2.99% true protein, assumes a 90% butterfat retention in cheese with the remaining fat being used to produce whey butter. However, the butterfat and protein formulas further dictate that the resulting 0.42 pounds of whey butter be priced as if it were sold as Grade AA butter.

It is illegal under USDA's own regulations for whey butter to be labeled as Grade AA butter and it therefore does not have that Grade AA value in the marketplace. Agri-Mark's whey butter selling prices average more than $.12 per pound below that of Grade AA butter. That $.12 difference multiplied by the 0.42 pounds of whey butter equals $.0504 cent per hundredweight of milk. Using USDA's standard of 2.99 pounds of protein in that same hundredweight of milk, the value per pound of protein should be reduced by $.017 ($.0504 divided by 2.99).

➡ PROPOSAL 3

This proposal reduces the $.03 addition to the NASS survey price for barrel cheddar cheese to $.015 to account for the actual prices differences.

Order language:
Amendment to section 1000.50:

(n) (1) (ii) ...reported by the department for the month plus $.015.

JUSTIFICATION FOR PROPOSAL 3

Under current Federal Order provisions, the average of the NASS survey prices for 40-lb. block and 500-pound barrel cheese, weighted by the volume surveyed of each, is used in determination of the protein price for milk. However, before the average cheese price is determined, $.03 is added to the 500 pound barrel price. According to USDA, this $.03 represented the historical difference in prices (prior to 2000) between block and barrel cheese prices and somehow was a proxy for production costs differences. The only testimony on the $.03 was a vague reference to costs by one witness with no data to substantiate the comment.

Since the 38% moisture factor was included along with protein pricing in January 1, 2000, the historical difference between the block and barrel prices, has averaged $.0174 per pound. The appropriate Order provisions relating to protein pricing were last amended on April 1, 2003. Since April 1, 2003, that block/barrel difference has averaged $.0145 per pound.

Agri-Mark believes the barrel price should be excluded from the protein price calculation since the make allowances are specifically for block cheese production. Clearly an artificial $.03 surcharge primarily based on historical statistics no longer applies and has unduly enhanced the cheese price beyond what the market price for block cheese has been. However, if USDA believes it should maintain the use of the already established barrel price series, the surcharge should be reduced to $.015 until such time that an appropriate plant survey has determined the true costs of block and barrel cheddar cheese production.
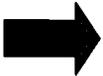
PROPOSAL 4

This proposal combines the weekly NASS and CME cheese prices series to determine a hybrid price series that reflects cheese market price movements on a timelier basis, duplicates the average value of the NASS price series over time, and reduces the volatility of the producer price differential.

CME VS NASS CHEESE PRICES

U.S. cheese manufacturers use the CME market prices as a basis to set their cheese prices. However, USDA uses the NASS cheese price survey to determine the cheese

prices that in turn are used to determine Class III prices each month. While the NASS and CME are closely linked, that relationship usually involves a two week difference.

The two week difference between NASS and CME prices became a serious problem in 2004 when CME cheese prices changed so quickly from week to week that the monthly average between the two price series fluctuated dramatically. In fact, the two prices varied by more than $.10 per pound in seven of the 12 months of 2004.

The following table shows the simple regression results estimating the relationship between the NASS and the CME. The table shows the relationships based on having no time difference as well as one week, two weeks and three week differences. The time period from the beginning of 2003 to early September 2006 was used. As seen in the table, a two week difference in the CME relative to NASS prices shows the best relationship. In fact, during the 193 week period, the CME explained 98.5% of the variation in the NASS.

NASS VS CME WEEKLY CHEESE PRICES RELATIONSHIPS	
REGRESSION ANALYSIS : R Squared Values	
	JAN 4, 2003 - SEPT 9, 2006
CURRENT NASS VS CME	88.3%
1 WEEK DIFFERENCE NASS VS CME	96.9%
2 WEEK DIFFERENCE NASS VS CME	98.5%
3 WEEK DIFFERENCE NASS VS CME	93.1%

source: CM E NASS ANALYSIS REGRESSION SEPT 30 O6.123

The following chart shows the weekly time line for the monthly cheese price used in the Class III and Class I price calculations. Using the month of April as an example, the top of the table shows that the NASS cheese prices for the four weeks of April are used to calculate the Class III price that month. The NASS price is correlated with the CME price for the last two weeks of March and the first two weeks of April, but no adjustment is currently done to relate the two.

CLASS III CHEESE PRICING

CURRENT APRIL USES NASS PRICING FOR FOUR WEEKS OF APRIL

FEB WK 1	FEB WK 2	FEB WK 3	FEB WK 4	MAR WK 1	MAR WK 2	MAR WK 3	MAR WK 4	APR WK 1	APR WK 2	APR WK 3	APR WK 4	
								NASS	NASS	NASS	NASS	
								CME	CME	CME	CME	no adjustment
								CME	CME	CME	CME	
						NASS	NASS	NASS	NASS			
				CME	CME	CME	CME					

PROPOSED APRIL USES CME PRICING FOR APRIL PLUS (NASS PRICING LAGGED 2 WEEKS MINUS CME PRICES LAGGED FOUR WEEKS)

CLASS I CHEESE PRICING

CURRENT APRIL USES NASS PRICING FOR FIRST TWO WEEKS OF MARCH

FEB WK 1	FEB WK 2	FEB WK 3	FEB WK 4	MAR WK 1	MAR WK 2	MAR WK 3	MAR WK 4	APR WK 1	APR WK 2	APR WK 3	APR WK 4
no adjustment	CME	CME		NASS	NASS						
				CME	CME						
			NASS	NASS							
	CME	CME									

PROPOSED APRIL USES CME PRICING FOR 2nd AND 3rd WEEKS OF MARCH PLUS (NASS PRICING FOR FIRST TWO WEEKS OF MARCH MINUS CME FOR LAST TWO WEEKS OF FEB.)

Created by Robert D. Wellington, Agri-Mark   April 3, 2005 | Source: CME NASS ANALYSIS USDA TIME LINE

Underneath the current April Class III pricing time line is an alternative time line showing the weeks to be used in a new proposal that links the cheese price used to calculate the Class III price with the market CME prices. The proposal uses the actual CME weekly prices for April adjusted by the difference between the NASS cheese prices for the last two weeks of March/first two weeks of April and the CME cheese prices for the four weeks of March. This adjusted CME price is referred to as the Hybrid Price.

This proposal essentially uses all the weekly observations of all NASS and CME prices. Over a number of months, the CME current month price series and the previous month CME prices series cancel one another out, leaving only the NASS price series as the average price indicator overtime. This proposal allows the USDA to use up-to-date CME prices needed by the industry while making the appropriate adjustment in those prices to assure that the NASS price is the primary determinant of cheese prices used overtime. If the CME is manipulated in such as a way as to diverge from true NASS prices, this proposal adjusts those CME prices to the actual NASS prices to correct the situation.

The second half of the time line chart shows how the cheese prices for the Class I price determination can also be changed to use the more current CME price series, while also adjusting back to NASS prices. This part of the proposal allows the use of actual CME

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prices for the second and third weeks of March to determine the Class I cheese price, instead of the current first two weeks of NASS pricing. This part of the proposal does use a different set of weeks than currently used, so it may not come back to the specific NASS prices on a historical basis. However, it does maintain an appropriate relationship to the NASS price series.

The following graph entitled "MONTHLY DIFFERENCES BETWEEN NASS AND CME CHEESE PRICE VERSUS HYBRID AND CME PRICES, JAN 2003-AUG 2004", shows the current volatility in NASS versus CME cheese price. These are the darker (or red in the color version) bars. The proposed hybrid cheese price (the CME adjusted by the NASS/CME difference) compared with the CME is shown as grey (or green in the color version). The volatility has been reduced significantly under this proposal.

MONTHLY DIFFERENCES BETWEEN NASS AND CME CHEESE PRICES VERSUS HYBRED AND CME CHEESE PRICES, JAN 2003-SEP 2006
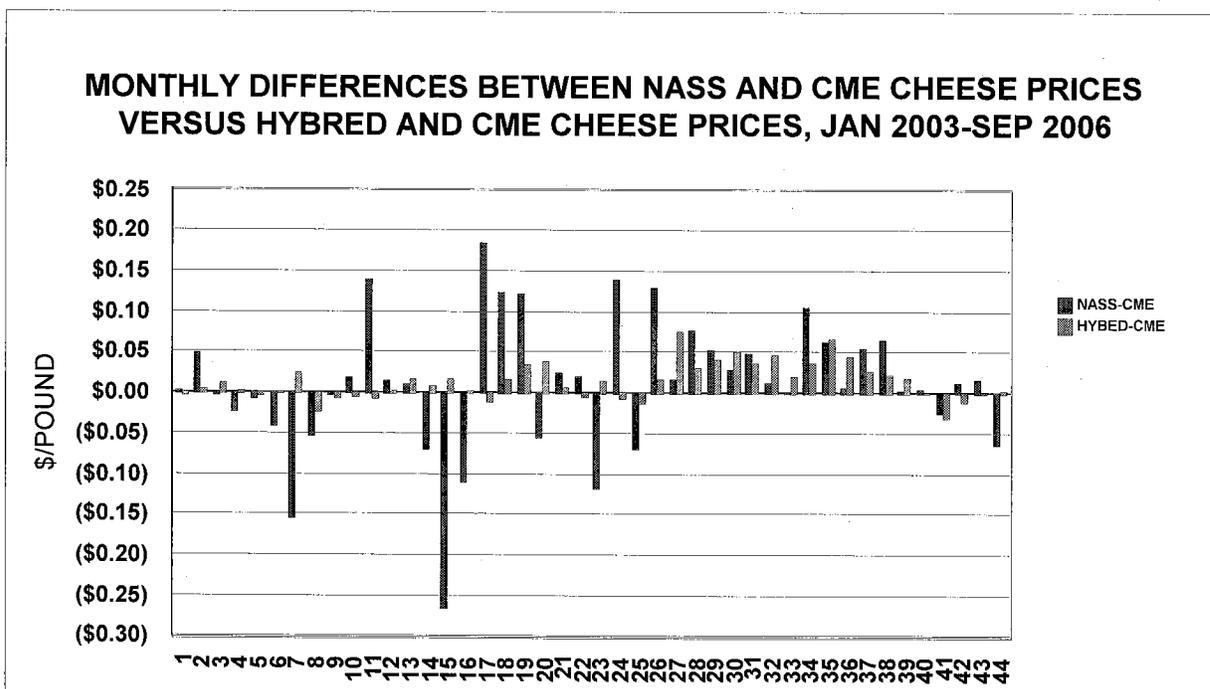
This proposal has a second advantage in addition to better lining up CME and Federal Order prices. By using more current prices, particularly in the Class I price calculation, it also reduces the negative Producer Price Differentials experienced in 2004. The following graph entitled "NORTHEAST PRODUCER PRICE DIFFERENTIAL, 2003-2004" shows this.

NORTHEAST PRODUCER PRICE DIFFERENTIAL, 2003-2004
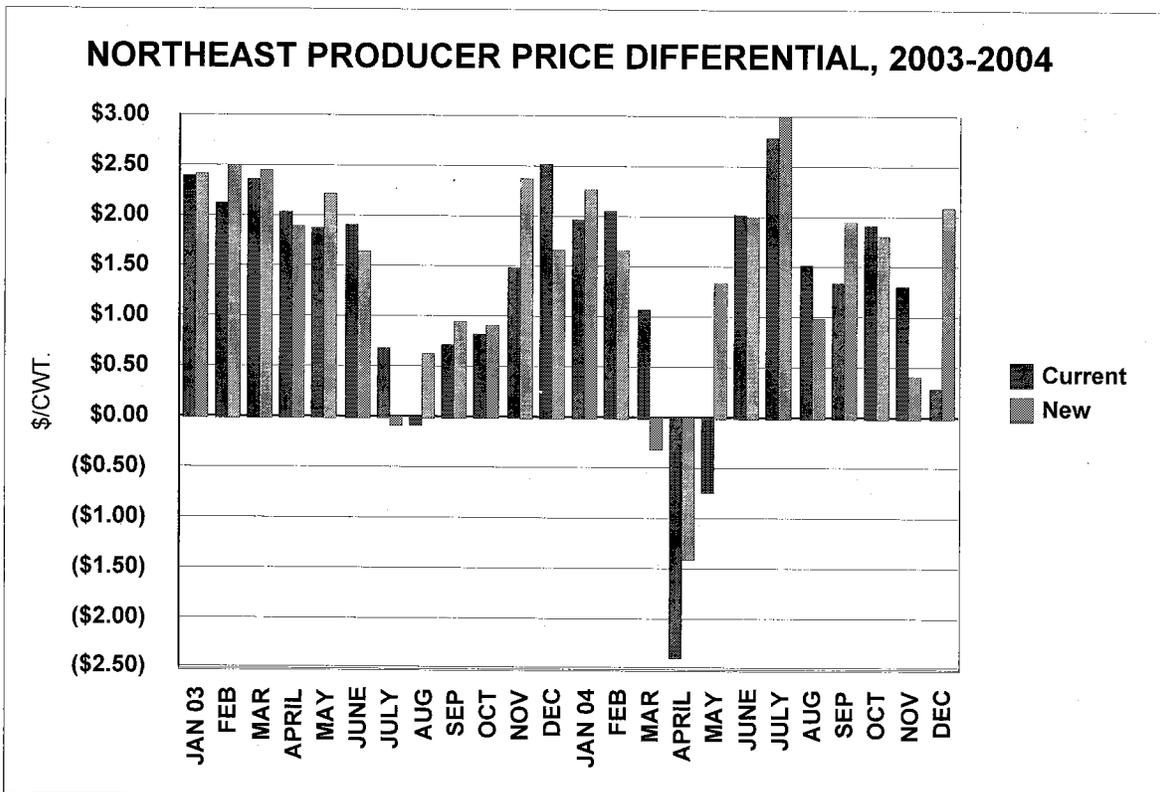
The following two tables compare the current and proposed Hybrid Class III cheese prices. The first table shows the "COMPARISONS BETWEEN NASS, CME AND PROPOSED HYBRID CHEESE PRICES" from January 2003 through August 2006. Over that 44 month period, the NASS and CME price series differed by $.011 per pound on average, but had large variations from month to month. The Hybrid Class III cheese price proposed differed from the CME by $.014, and therefore was within $.003 of the NASS, AND it also eliminated much of the variation between the monthly CME and NASS prices.

The second table shows the impact of the new proposal on Class I, III and Northeast Blend prices as well as Producer Price Differentials (PPDs). The proposal did increase the Class I prices in both 2003 and 2004, but that was due to the weekly price movements in both years. There is nothing inherent in the proposal that would increase or decrease the Class I price. The Class III price was almost the same in 2003, but $.15 lower in 2004. The 2004 average difference was caused by the December 2004 decline in CME cheese prices which was reflected in the proposed Class III cheese prices, but was delayed until January 2005 under current pricing.

Once again, there is nothing inherent in the proposal that would raise or lower average Class III prices over time. The PPD and Blend prices would both rise under the proposal, but each is driven mostly by the higher Class I prices. There is nothing inherent that would raise or lower average PPD's or blend prices over time.

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COMPARISONS BETWEEN NASS, CME AND PROPOSED HYBRID CHEESE PRICES

c; CME NASS ANALYSIS SEPT 30 2006 SUMMARY.123

2003	NASS CHEESE	CME CHEESE	HYBRID CHEESE	DIFFERENCES BETWEEN		
				NASS & CME	HYBRID & CME	HYBRID & NASS
JANUARY	$1.137	$1.135	$1.134	$0.002	($0.001)	($0.003)
FEBRUARY	$1.130	$1.081	$1.085	$0.049	$0.004	($0.045)
MARCH	$1.078	$1.079	$1.092	($0.001)	$0.013	$0.014
APRIL	$1.100	$1.121	$1.124	($0.022)	$0.003	$0.024
MAY	$1.139	$1.144	$1.143	($0.005)	($0.001)	$0.004
JUNE	$1.146	$1.186	$1.187	($0.040)	$0.001	$0.041
JULY	$1.350	$1.504	$1.528	($0.154)	$0.025	$0.178
AUGUST	$1.550	$1.602	$1.581	($0.052)	($0.021)	$0.031
SEPTEMBER	$1.594	$1.597	$1.592	($0.003)	($0.005)	($0.002)
OCTOBER	$1.594	$1.576	$1.572	$0.018	($0.004)	($0.022)
NOVEMBER	$1.494	$1.355	$1.348	$0.139	($0.007)	($0.146)
DECEMBER	$1.326	$1.312	$1.314	$0.014	$0.002	($0.012)
AVERAGE	$1.303	$1.308	$1.308	($0.005)	$0.001	$0.005
2004						
JANUARY	$1.302	$1.292	$1.309	$0.010	$0.017	$0.007
FEBRUARY	$1.326	$1.394	$1.401	($0.068)	$0.007	$0.075
MARCH	$1.568	$1.832	$1.849	($0.264)	$0.017	$0.281
APRIL	$2.052	$2.161	$2.163	($0.109)	$0.002	$0.111
MAY	$2.127	$1.942	$1.932	$0.185	($0.009)	($0.194)
JUNE	$1.841	$1.717	$1.734	$0.124	$0.017	($0.107)
JULY	$1.570	$1.447	$1.482	$0.122	$0.035	($0.087)
AUGUST	$1.517	$1.571	$1.609	($0.054)	$0.038	$0.092
SEPTEMBER	$1.587	$1.562	$1.567	$0.025	$0.005	($0.020)
OCTOBER	$1.526	$1.506	$1.502	$0.020	($0.004)	($0.024)
NOVEMBER	$1.589	$1.705	$1.720	($0.117)	$0.014	$0.131
DECEMBER	$1.715	$1.576	$1.571	$0.139	($0.005)	($0.144)
AVERAGE	**$1.643**	**$1.642**	**$1.653**	$0.001	$0.011	$0.010
2005						
JANUARY	$1.517	$1.585	$1.573	($0.068)	($0.012)	$0.056
FEBRUARY	$1.571	$1.442	$1.459	$0.129	$0.017	($0.112)
MARCH	$1.506	$1.489	$1.563	$0.017	$0.074	$0.057
APRIL	$1.559	$1.482	$1.513	$0.077	$0.031	($0.046)
MAY	$1.477	$1.424	$1.464	$0.053	$0.040	($0.013)
JUNE	$1.485	$1.456	$1.506	$0.029	$0.050	$0.021
JULY	$1.516	$1.466	$1.503	$0.050	$0.037	($0.013)
AUGUST	$1.432	$1.420	$1.467	$0.012	$0.047	$0.035
SEPTEMBER	$1.496	$1.495	$1.515	$0.001	$0.020	$0.019
OCTOBER	$1.500	$1.394	$1.430	$0.106	$0.036	($0.070)
NOVEMBER	$1.397	$1.335	$1.401	$0.062	$0.066	$0.004
DECEMBER	$1.396	$1.390	$1.435	$0.007	$0.045	$0.039
AVERAGE	$1.488	$1.448	$1.486	$0.040	$0.038	($0.002)
2006						
JANUARY	$1.390	$1.334	$1.361	$0.055	$0.027	($0.028)
FEBRUARY	$1.264	$1.198	$1.220	$0.065	$0.022	($0.043)
MARCH	$1.161	$1.159	$1.177	$0.002	$0.018	$0.015
APRIL	$1.165	$1.161	$1.163	$0.004	$0.001	($0.003)
MAY	$1.169	$1.194	$1.164	($0.025)	($0.030)	($0.006)
JUNE	$1.217	$1.204	$1.195	$0.013	($0.009)	($0.022)
JULY	$1.179	$1.163	$1.163	$0.017	$0.001	($0.016)
AUGUST	$1.181	$1.244	$1.247	($0.063)	$0.002	$0.065
AVERAGE	$1.216	$1.207	$1.211	$0.009	$0.004	($0.005)
JAN 2003-AUG 2006 AVERAGE DIFFERENCE				$0.011	$0.014	$0.003

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COMPARISON OF CLASS I, III, PPD AND BLEND PRICES IN THE NORTHEAST ORDER UNDER PROPOSAL 4

		CLASS I			CLASS III			PPD			BLEND		
		CURRENT	NEW	DIFF	CURRENT	NEW	DIFF	CURRENT	NEW	DIFF	CURRENT	NEW	DIFF
2003	JAN	$13.81	$13.81	$0.00	$9.78	$9.77	($0.01)	$2.41	$2.42	$0.01	$12.19	$12.19	($0.00)
	FEB	$13.48	$13.48	$0.00	$9.66	$9.12	($0.54)	$2.13	$2.51	$0.39	$11.79	$11.64	($0.15)
	MAR	$13.06	$13.06	$0.00	$9.11	$8.98	($0.13)	$2.36	$2.45	$0.09	$11.47	$11.43	($0.04)
	APR	$12.89	$12.89	$0.00	$9.41	$9.58	$0.17	$2.04	$1.91	($0.13)	$11.45	$11.50	$0.05
	MAY	$12.96	$12.96	$0.00	$9.71	$9.26	($0.45)	$1.89	$2.22	$0.33	$11.60	$11.47	($0.13)
	JUNE	$12.99	$13.01	$0.02	$9.75	$10.12	$0.37	$1.91	$1.65	($0.26)	$11.66	$11.77	$0.11
	JULY	$13.02	$13.25	$0.23	$11.78	$13.02	$1.24	$0.68	($0.07)	($0.75)	$12.46	$12.96	$0.50
	AUG	$14.22	$16.92	$2.70	$13.80	$14.51	$0.71	($0.08)	$0.63	$0.70	$13.72	$15.14	$1.42
	SEP	$16.96	$17.57	$0.61	$14.30	$14.37	$0.07	$0.71	$0.95	$0.24	$15.01	$15.32	$0.32
	OCT	$17.52	$17.50	($0.02)	$14.39	$14.25	($0.14)	$0.82	$0.91	$0.09	$15.21	$15.17	($0.05)
	NOV	$17.62	$17.54	($0.08)	$13.47	$12.20	($1.27)	$1.48	$2.38	$0.90	$14.95	$14.56	($0.38)
	DEC	$17.09	$15.03	($2.07)	$11.87	$11.73	($0.14)	$2.52	$1.66	($0.85)	$14.39	$13.39	($1.00)
	AVG	$14.63	$14.75	$0.12	$11.42	$11.41	($0.01)	$1.57	$1.63	$0.06	$12.99	$13.04	$0.05
2004	JAN	$15.10	$15.37	$0.27	$11.61	$11.36	($0.25)	$1.97	$2.28	$0.31	$13.58	$13.64	$0.06
	FEB	$14.84	$14.86	$0.02	$11.89	$12.46	$0.57	$2.06	$1.66	($0.41)	$13.95	$14.12	$0.17
	MAR	$15.19	$15.81	$0.63	$14.49	$16.78	$2.29	$1.07	($0.30)	($1.38)	$15.56	$16.48	$0.92
	APR	$16.89	$20.03	$3.15	$19.66	$20.64	$0.98	($2.06)	($1.39)	$0.66	$17.60	$19.26	$1.65
	MAY	$22.90	$23.72	$0.82	$20.58	$19.00	($1.58)	($0.17)	$1.34	$1.52	$20.40	$20.33	($0.07)
	JUNE	$24.38	$22.00	($2.38)	$17.68	$16.35	($1.33)	$2.06	$2.01	($0.05)	$19.74	$18.36	($1.38)
	JULY	$21.20	$20.78	($0.41)	$14.85	$13.33	($1.52)	$2.61	$3.58	$0.97	$17.47	$16.91	($0.56)
	AUG	$17.87	$17.03	($0.84)	$14.04	$14.25	$0.21	$1.53	$0.98	($0.54)	$15.57	$15.24	($0.33)
	SEP	$17.19	$17.96	$0.76	$14.72	$14.42	($0.30)	$1.34	$1.96	$0.62	$16.06	$16.38	$0.32
	OCT	$18.03	$17.57	($0.46)	$14.16	$14.00	($0.16)	$1.91	$1.81	($0.10)	$16.07	$15.79	($0.27)
	NOV	$17.54	$17.02	($0.52)	$14.89	$15.73	$0.84	$1.31	$0.40	($0.91)	$16.20	$16.13	($0.07)
	DEC	$17.68	$18.96	$1.28	$16.14	$14.65	($1.50)	$0.29	$2.09	$1.80	$16.43	$16.73	$0.30
	AVG	$18.23	$18.42	$0.19	$15.39	$15.25	($0.15)	$1.16	$1.37	$0.21	$16.55	$16.61	$0.06

Source: CME NASS ANALYSIS USDA Tab 3 .123

This proposal would address the current CME versus NASS monthly price distortion, while assuring producers that the current NASS price series would be the primary indicator of cheese prices over time. This is a win-win for both cheese manufacturers under the Federal Orders and producers. In addition, it will do no harm to other Class prices and other manufacturers.

We appreciate the USDA's consideration of these four proposals.

Sincerely yours,

Robert D. Wellington
Senior Vice President
Agri-Mark Dairy Cooperative

C: gino.tosi@usda.gov   (USDA Class III IV proposal Sept 30 2006.doc)
    Mr. Erik Rasmussen, USDA Market Administrator