September 29, 2006

Via U.S. Mail and e-mail to gino.tosi@usda.gov

Gino Tosi
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Order Formulation and Enforcement Branch
Stop 0231-Room 2971
1400 Independence Avenue, SW.
Washington, DC 20250-0231

Re: Request for Proposals on Class III and IV Pricing Formulas
        Docket No. AO-14-A74, et al.; DA-06-01

Dear Gino:

This letter is submitted on behalf of Dairy Producers of New Mexico, a voluntary trade organization of dairy producers in New Mexico and West Texas.

In response to the call for proposals published in the Federal Register on June 28, 2006, Dairy Producers of New Mexico requests that the following changes be considered at the forthcoming hearing on Class III and IV milk pricing formulas.

Proposal 1: Protein Price Yield Factors

In § 1000.50(n), change the factor for the yield of protein from 1.383 to 1.405 and change the factor for the yield of butterfat from 1.572 to 1.653.

Rationale: The butterfat recovery utilized in establishing the Class III pricing formulas (90%) is not reflective of the current practices and experienced of handlers. We suggest the use of 94% butterfat recovery, which would result in the changes proposed above. This is consistent with our belief that higher manufacturing costs are the result, in part, of better technology utilized by handlers to capture greater and greater amounts of butterfat from their raw milk. As these higher costs are passed onto producers through manufacturing cost surveys, the pricing formulas should permit producers to obtain the benefit of the greater efficiencies implicit in the make allowances.

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Part of the changes we ask for are attributable to the elimination of shrink as indicated in our Proposal Three.

Evidence submitted by RBCS and CDFA at the hearing in January 2006 showed that the plants surveyed there had significantly higher yields than that implied in the current formula.

Proposal 2: Use of Pricing Series

In § 1000.50, amend the introductory text and paragraphs (l), (m), (n) and (q) by changing the source of product prices in the pricing formulas from the National Agricultural Statistics Service (NASS) to NASS and the Chicago Mercantile Exchange (CME).

Sec. 1000.50   Class prices, component prices, and advanced pricing factors.

Class prices per hundredweight of milk containing 3.5 percent butterfat, component prices, and advanced pricing factors shall be as follows. The prices and pricing factors described in paragraphs (a), (b), ©), (e), (f), and (q) of this section shall be based on a ~~weighted~~ simple average of the most recent 2 weekly prices announced by the ~~National Agricultural Statistical Service (NASS)~~ Chicago Mercantile Exchange (CME) and the prices described in paragraph (o) of this section shall be based on a weighted average for the preceding month of the weekly prices announced by NASS before the 24th day of the month. These prices shall be announced on or before the 23rd day of the month and shall apply to milk received during the following month. The prices described in paragraphs (g) through (n) and (p) of this section shall be based on a ~~weighted~~ simple average for the preceding month of weekly prices announced by ~~NASS~~ the CME and the prices described in paragraph (o) of this section shall be based on a weighted average for the preceding month of the weekly prices announced by NASS. These prices shall be announced on or before the 5th day of the month and shall apply to milk received during the preceding month. The price described in paragraph (d) of this section shall be derived from the Class II skim milk price announced on or before the 23rd day of the month preceding the month to which it applies and the butterfat price announced on or before the 5th day of the month following the month to which it applies.

* * *

(l) Butterfat price. The butterfat price per pound, rounded to the nearest one-hundredth cent, shall be the ~~U.S.~~ average ~~NASS~~ AA Butter survey price reported by the ~~Department~~ CME for the month less ~~11.5~~ 11.08 cents, with the result multiplied by ~~1.20~~ 1.22.

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(m) Nonfat solids price. The nonfat solids price per pound, rounded to the nearest one-hundredth cent, shall be the ~~U.S.~~ average ~~NASS~~ nonfat dry milk survey price reported by the ~~Department~~ CME for the month less ~~14~~ 14.1 cents and multiplying the result by ~~0.99~~ 1.02.

(n) Protein price. The protein price per pound, rounded to the nearest one-hundredth cent, shall be computed as follows:

(1) Compute a ~~weighted~~ simple average of the amounts described in paragraphs (n)(1)(I) and (ii) of this section:

(I) The ~~U.S.~~ average ~~NASS~~ survey price for 40-lb. block cheese reported by the ~~Department~~ CME for the month; and

(ii) The ~~U.S.~~ average ~~NASS~~ survey price for 500-pound barrel cheddar cheese (38 percent moisture) reported by the ~~Department~~ CME for the month plus 3 cents;

(2) Subtract ~~16.5~~ 16.38 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by ~~1.383~~ 1.405;

(3) Add to the amount computed pursuant to paragraph (n)(2) of this section an amount computed as follows:

(I) Subtract ~~16.5~~ 16.38 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by ~~1.572~~ 1.653; and

(ii) Subtract ~~0.9~~ 0.94 times the butterfat price computed pursuant to paragraph (I) of this section from the amount computed pursuant to paragraph (n)(3)(I) of this section; and

(iii) Multiply the amount computed pursuant to paragraph (n)(3)(ii) of this section by 1.17.

(o) Other solids price. The other solids price per pound, rounded to the nearest one-hundredth cent, shall be the U.S. average NASS dry whey survey price reported by the Department for the month minus ~~15.9~~ 14.98 cents, with the result multiplied by 1.03.

* * *

(q) Advanced pricing factors. For the purpose of computing the Class I skim milk price, the Class II skim milk price, the Class II nonfat solids price, and the Class I butterfat price for the following month, the following pricing factors shall be computed using the ~~weighted~~ simple average of the 2 most recent ~~NASS U.S.~~ CME average prices for butterfat, cheese, and non-fat dry milk and the NASS weighted average dry whey from weekly survey prices announced before the 24th day of the month:

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(1) An advanced Class III skim milk price per hundredweight, rounded to the nearest cent, shall be computed as follows:

(I) Following the procedure set forth in paragraphs (n) and (o) of this section, but using the ~~weighted~~ simple average of the 2 most recent ~~NASS U.S.~~ CME average weekly survey prices **for cheese and butter and the weighted average of the 2 most recent average weekly survey prices for dry whey** announced before the 24th day of the month, compute a protein price and an other solids price;

(ii) Multiply the protein price computed in paragraph (q)(1)(I) of this section by 3.1;

(iii) Multiply the other solids price per pound computed in paragraph (q)(1)(I) of this section by 5.9; and

(iv) Add the amounts computed in paragraphs (q)(1)(ii) and (iii) of this section.

(2) An advanced Class IV skim milk price per hundredweight, rounded to the nearest cent, shall be computed as follows:

(I) Following the procedure set forth in paragraph (m) of this section, but using the ~~weighted~~ simple average of the 2 most recent ~~NASS U.S.~~ CME average weekly survey prices announced before the 24th day of the month, compute a nonfat solids price; and

(ii) Multiply the nonfat solids price computed in paragraph (q)(2)(I) of this section by 9.

(3) An advanced butterfat price per pound, rounded to the nearest one-hundredth cent, shall be calculated by computing a ~~weighted~~ simple average of the 2 most recent ~~U.S.~~ CME average ~~NASS~~ AA Butter survey prices announced before the 24th day of the month, subtracting **11.08** cents from this average, and multiplying the result by ~~1.20~~ **1.22**.

Rationale: During the January, 2006 hearing in this proceeding, numerous handlers-both proprietary and cooperative-argued that the circularity of using the NASS survey to establish class prices prevented them from being able to recapture increased costs. The same concern was raised in the 2001 hearing on pricing formulas. By utilizing CME prices for traded commodities instead of the NASS survey, this circularity can be avoided. There is now no CME price for dry whey so use of the NASS survey must continue.

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Proposal 3: Elimination of Farm-to-Plant and Butterfat Shrink

Change all federal component pricing formulas to eliminate both the farm-to-plant shrink and butterfat shrink incorporated into the current formulas. The results of these changes are reflected in the amended regulations listed in Proposal Two.

Rationale: The amount that has been placed in the current formulas is inaccurate and does not reflect current marketing practices. In the Southwest, for example, it is as common for the farm weights and tests to be higher than the plant weights and tests as the inverse. The allocation of the costs associated with any shrinkage or overage is part of negotiations between plants and farmers or cooperatives whereby market forces measure these differences and the parties determine the value thereof. Finally, the amount of shrinkage varies widely between regions and between loads within regions. Spreading the cost of shrinkage from one portion of one region across the whole system unfairly reduces the value of all producer weights.

Proposal 4: Butterfat Shrink

In § 1000.50(l), change the yield factor for butterfat from 1.20 to 1.211.

Rationale: Proposal Four is offered as an alternative to Proposal Three. Obviously, if the pricing formulas eliminate the shrink adjustments, then Proposal Four become irrelevant. But if the Department believes that the butterfat shrink should remain part of the formulas, a mathematical error needs to be corrected.

In the Final Rule adopted in 2002, the Department incorrectly calculated the yield of butterfat by subtracting butterfat shrink (0.0015) from the farm-to-plant shrink adjustment factor (0.9975) and then multiplying the resulting number (0.9825) by the standardized amount of butterfat in milk.

This is incorrect. The correct mathematical calculation is to first multiply the standardized amount of butterfat by the farm-to-plant adjustment factor and then subtract the butterfat shrink. The result of the correct calculation is 3.47625,which when divided by 3.5 and then divided by 0.82, the resulting yield factor is 1.211.

Our own estimates suggest that this error costs dairy producers about $2.5 million per year.

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Proposal 5: Adopt Make Allowances Based on Cornell's Weighted Average Surveys

In § 1000.50(l), adopt a make allowance for butter of 0.1108.
In § 1000.50(m), adopt a make allowance for nonfat dry milk of 0.1410.
In § 1000.50(n), adopt a make allowance for cheese of 0.1638.
In § 1000.50(o), adopt a make allowance for dry whey equal to the make allowance for nonfat dry milk plus 0.88 cents for a total of 0.1498.

These make allowances are incorporated into the amended regulations listed in Proposal Two.

Rationale: The data initially reported by Cornell on September 1, 2006 are the most accurate data we have available on the cost of manufacturing products. These weighted averages should be adopted. For dry whey, however, testimony overwhelmingly from manufacturers was that the difference in the cost of manufacturing nonfat dry milk and dry whey is the additional energy needed to dry whey. This has been the policy of USDA. This proposal makes it more definition policy. Testimony by Dr. Stephenson shows that this additional cost for energy is 0.88 cents ($0.0088) per pound. For additional rationale, please see the brief filed by Dairy Producers of New Mexico following the hearing held in Strongsville, Ohio.

Proposal Six: Enhanced NASS Surveys

Direct the National Agricultural Statistics Service to survey the total milk components purchased and the prices paid for such components at the same time that NASS surveys the prices at which dairy products are sold.

Rationale: From the collection of this additional data, market-driven yields, make allowances, and costs can be ascertained on a timely basis from a verifiable and unbiased source.

If you have any questions about these proposals, I would welcome the opportunity to discuss them with you and others in the Department before any hearing notice is issued.

Very truly yours,
YALE LAW OFFICE, LP
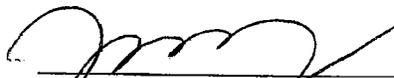
Benjamin F. Yale

cc: Sharon Lombardi