BEFORE THE UNITED STATES DEPARTMENT OF AGRICULTURE 2000 JUL 19 P 12:07

In the Matter of	:	
	:	
MILK IN THE NORTHEAST AND OTHER MARKETING AREAS	:	
	:	DOCKET NO. AO-14-A69, et al. DA-00-03
	:	

BRIEF IN SUPPORT OF CHANGES TO MANUFACTURING MILK PRICES PROPOSED BY SELECT MILK PRODUCERS, INC., ELITE MILK PRODUCERS, INC., CONTINENTAL DAIRY PRODUCTS, INC., AND THE FOLLOWING TRADE ORGANIZATIONS: WESTERN STATES DAIRY PRODUCERS TRADE ASSOCIATION, DAIRY PRODUCERS OF NEW MEXICO, TEXAS ASSOCIATION OF DAIRYMEN, MILK PRODUCERS COUNCIL (CALIFORNIA), CALIFORNIA DAIRY CAMPAIGN, WESTERN UNITED DAIRYMEN (CALIFORNIA), IDAHO DAIRYMEN'S ASSOCIATION, UTAH DAIRYMEN'S ASSOCIATION, OREGON DAIRY FARMER'S ASSOCIATION, AND WASHINGTON STATE DAIRY FEDERATION

JULY 14, 2000

SUMMARY OF PROPOSED CHANGES

1. Change the formulas as follows:

For Cheese: (Cheese price - ***.1536***)*1.405 + ((Cheese Price - ***.1536***)****1.617***- (***0.94****butterfat price)*1.28

For NFDM: (Powder Price - ***0.14)/.9985***

For Butter: (Butter price - ***0.096***)/0.82

For Dry Whey: (Dry Whey Price-***0.15***)/0.968

NOTE: Numbers in ***bold and italics*** represent changes from the Final Rule.

2. *Do* use a simple monthly average of the weekly reported price off of the Chicago Mercantile Exchange (CME) for pricing cheese, NFDM and butter.

3. *Do not* reduce the butter price from the grade AA butter price for any class of milk.

4. *Do not* make any changes to the Class I or II differentials.

5. *Do* issue an interim final rule on changes to the manufacturing prices.

6. *Do* issue a recommended decision addressing changes to the use of Grade AA butter price and respond to proposed changes to class I and II differentials.

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Table of Issues Considered				
No.	**Issue Description**	**Final Rule**	**Position/ Location**	**Explanation**
1	**Cheese** Price Series	NASS	***CME***[1]	The product prices used in the formula can be either the weighted average of the prices reported by NASS each week or the simple average cash price of the CME as reported in *Dairy Market News.*
2	Blocks only	No	***YES***[2]	The use of the NASS survey requires a consideration of whether blocks or barrels should be considered. In the Final Rule, the Secretary uses prices from both blocks and barrels.
3	Include 640# blocks in the NASS survey	No	No	Some proposed that in addition to 40# blocks and 500# barrels, that the NASS survey also include 640# blocks.
4	Adjustment for use of barrels	.03	.03	In the Final Rule, the Secretary adjusted the barrel price by three cents to reflect savings in make allowances so that the number could be used with the block price to come up with a weighted average.
5	Make allowance	.1448[3]	0.1536[4]	This portion of the formula reduces the milk equivalent value of the product price by a value that approximates the cost to make the cheese. This is the place in which policy decisions of what pricing level to set are made.

[1]Positions in ***italic bold*** indicate changes from the Final Rule.

[2]This is presumed in the support of CME average weekly price of 40# blocks. Continuation of the use of NASS and the three cent barrel adjustment would make this choice unnecessary.

[3]This is the make allowance net of the ROI and marketing allowance.

[4]This make allowance is the total allowance for cheese at product price formulations including the three cent barrel adjustment, yields proposed and the dry whey make allowance proposed. It incorporates ROI and market allowance.

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No.	**Issue Description**	**Final Rule**	**Position/ Location**	**Explanation**
6	Marketing allowance	0.0015	.0015[5]	The RCBS study does not include any marketing cost. The marketing allowance is added to the RCBS to approximate the conversion costs. Since in the end the make allowance is a policy decision, the discreteness of this amount presumes an exactitude in the make allowance that simply is not there.
7	ROI Allowance	0.0104	***0.0103***[5]	Similar to the marketing allowance, the concept is that the RCBS and other studies did not consider return on investment in setting the make allowance. Again, like the marketing allowance, the ROI's precision as part of a policy price is inappropriate.
8	Weighing of RCBS survey and CA census	YES	***NO***[6]	In the Final Rule, the Secretary arrived at make allowances by taking a weighted average of the RCBS studies and the California studies. The CDFA results are a census of costs in California while the RCBS is a survey of the Nation, the weighted average as used dramatically increases the impact of California on the pricing.

[5]Amount is included in the proposed make allowance.

[6]Select, WSDPTA, and other organizations oppose this mixing of survey and census. In the end the groups support a make allowance that equals the one derived using this formula but only because other evidence supports that make allowance.

Table of Issues Considered				
No.	**Issue Description**	**Final Rule**	**Position/ Location**	**Explanation**
9	Butterfat recovery	.90	***.92***	The formula for product yield is a variation of the Van Slyke formula which uses an assumed percentage of fat that remains in the cheese during processing. The Final Rule assumed 90 percent. Testimony at the hearing established it was between 91 and 93 percent.
10	Whey butterfat	NO	**YES**	In the production of cheddar cheese, 98% of the butterfat is either recovered in the cheese or as whey fat. All of that is a valuable product of the cheddaring process. The primary use of that whey butterfat in commodity cheddar production is its re-institution into subsequent vats. Of the remaining 8 percent, 6, or three fourths, is recoverable in that way. We proposed capturing that value by multiplying the class III price by .94.
11	Moisture normalization	.38 in vat, .39 adj. for barrels	.38 in vat, ***.38*** adj. for barrels	In the Van Slyke formula, it is necessary to indicate the moisture content of the cheese in order to compute the value of the protein. Under the current rule the Final Rule adjusts the barrel prices to 39 percent, while the implied moisture in the computation is only 38 percent. The issue is whether to normalize these.
12	Change the fat to casein ratio from 1.28	1.28	1.28	This represents the ratio of fat to casein in cheddar cheese, not in the milk supply. Changes in the ratio do not impact price plants pay for milk but do change distribution of the amounts among producers.

Table of Issues Considered				
No.	**Issue Description**	**Final Rule**	**Position/ Location**	**Explanation**
13	**NFDM** Price Series	NASS	***CME***	The product prices used in the formula can be either the weighted average of the prices reported by NASS each week or the simple average cash price of the CME as reported in *Dairy Market News.*
14	Make allowance for NFDM	.1061[7]	***0.14***[8]	This portion of the formula reduces the milk equivalent value of the NFDM product price by the determined value that approximates the amount of NFDM value to be allocated to the plant in the formula as opposed to the producers.
15	Marketing allowance for NFDM	.0015	0.0015[9]	Like the cheese make allowance, the RCBS study of NFDM did not include a cost of marketing. Its inclusion as a separate amountpresumes a precision in the base amount that is simply not there.
16	ROI Allowance for NFDM	.0159	***0.0174***[10]	This represents the return on investment, as opposed to cost of capital associated with a plant. Again it presumes precision in the underlying make allowance which is ultimately a policy decision.

[7]This is the make allowance net of the ROI and marketing allowances.

[8]This make allowance includes all factors in the make allowance including ROI and marketing allowances.

[9]Included in the make allowance of 14 cents.

[10]Included in the make allowance of 14 cents.

Table of Issues Considered				
No.	**Issue Description**	**Final Rule**	**Position/ Location**	**Explanation**
17	Weighing of RCBS survey and CA census in establishing NFDM make allowance	YES	***NO***[11]	In the Final Rule, California costs represent 65% of the weighted costs while they produce only 37% of the powder and no plant in California pays producers the prices that result from the calculation.
18	Yields for NFDM	1.02	***0.9985***	In the production of NFDM a by product of dry buttermilk is also produced. DBP has value. The current rule only accounts for the value of the NFDM as a result of drying the milk and does not credit producers with the value of butter powder. The change in the yield reflects the value of the additional product based on actual data submitted at the hearing.
19	**Butter** Price Series	NASS	***CME***	The product prices used in the formula can be either the weighted average of the prices reported by NASS each week or the simple average cash price of the CME as reported in *Dairy Market News.*
20	Reduce the butter price series by 4 to 9 cents to create a "grade A butter" price to use in the FMMO.	NO	NO	Various proposals request that the Secretary take the product price series, NASS or CME, and reduce it by 4 to 9 cents to create a "grade A" butter price series as in the past. Different proposals used this reduced price only for Class IV while others suggested the change applied to all classes.

[11]Select, WSDPTA, and other organizations oppose this mixing of survey and census. In the end the groups support a make allowance that equals the one derived using this formula but only because other evidence supports that make allowance.

Table of Issues Considered				
No.	**Issue Description**	**Final Rule**	**Position/ Location**	**Explanation**
21	Make allowance for butter	.0922[12]	***.096***[13]	This portion of the formula reduces the milk equivalent value of the product price by a value that approximates the cost to make the cheese. The issue is whether this is to compute actual conversion costs or whether it is a political factor in setting prices. In the end it is really a political factor.
22	Adjust for print and bulk butter	-.0175	***0.0199***	Some of the butter manufacturing costs reported in the RCBS survey is sold as print butter or continentals. This adjustment intends to make the price reflect the value of bulk butter. The NASS survey is for bulk butter.
23	Marketing allowance for butter	.0015	0.0015[14]	Like the cheese make allowance, the RCBS study of butter did not include a cost of marketing. Its inclusion presumes a precision in the base amount that is simply not there.
24	ROI allowance for butter	.0068	***0.0073***[15]	This represents the return on investment, as opposed to cost of capital associated with a plant. Again it presumes precision in the underlying make allowance which is ultimately a policy decision.

[12]This is a *net* make allowance before adjusting for the printing cost of butter and the factors of marketing allowance and return on investment.

[13]This is the *total* make allowance which Select, WSDPTA, and other dairy producer organizations agree is appropriate as explained elsewhere in the brief.

[14]Included in the make allowance proposed.

[15]Included in the make allowance proposed.

Table of Issues Considered				
No.	**Issue Description**	**Final Rule**	**Position/ Location**	**Explanation**
25	Weighing of RCBS survey and CA census for butter make allowance	YES	***NO***[16]	In the Final Rule, California costs represent 65% of the weighted costs while they produce only 37% of the powder and no plant in California pays producer the prices reflected.
26	Yields	82	82	No one argued for changing the yield of .82 pounds of butter in a pound of butterfat.
27	**DRY WHEY** Price Series	NASS	NASS	There are no dry whey cash contracts on the CME thus the only series is the NASS series.
28	Make allowance for dry whey	.137	***.150***	This reports the amount of dry whey allocated to plant manufacturing.
29	Yields	.968	.968	.968 pounds of solids in a pound of dry whey.
	Other issues			
30	Use other solids in formula for Class III	YES	YES	This value is added to assure the Class III price reflects most of value of milk used in the process.
31	Limit changes to Class III and IV	NO	NO	Complex formula. Would require the advance and final computations to be two different formulae rather than one that uses different weeks.

[16]Select, WSDPTA, and other organizations oppose this mixing of survey and census. In the end the groups support a make allowance that equals the one derived using this formula but only because other evidence supports that make allowance.

Table of Issues Considered				
No.	**Issue Description**	**Final Rule**	**Position/ Location**	**Explanation**
32	Whether there are emergency conditions permitting the issue of a final rule	N/A	N/A	The Congress requires that a Final Rule as a result of this hearing be effective January 1, 2001. The question is whether there is sufficient time to complete a proposed and final rule. Not all issues were required by the Congress and therefore all issues are not subject to the limitation.

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I. Introduction and summary of position

A. The Secretary's stated goal of no significant deviation in the BFP replacement values was not met in the Final Rule.

The Secretary repeatedly during the process of the FAIR Act reformation of the federal milk marketing orders (FMMO) stated 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 Final Rule 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 has shown that the class III price itself has provided producers almost fifty cents less of the cheese price than the BFP provided earlier.***

Because we believe that the Secretary truly wishes to restore the producers' share of the manufactured prices, we have proposed changes to yields and make allowances that will do just that.

In the unlikely event that the Secretary does not intend to meet the oft stated goal of no significant deviation from the prior BFP, then two explanations are needed– (1) How does the Secretary justify the fact that given the same market price for dairy products, such as cheese, producers will receive less of the value by as much as 47 cents less per hundredweight, or nearly a nickel a pound per pound of cheese, and (2) What is the justification for the change in policy.

None of the proposals at the hearing, including those of Select, WSDPTA and other organizations, proposed increases of consumer prices for products such as butter, cheese, or creams. None. All of the proposals started with the same market price for dairy products. The difference in the proposals is simply this– what is the rightful share of dairy producers to this market price? The Secretary stated during the reform process that the share would not change. Select, WSDPTA and other organizations propose formulas that will meet that goal. To do otherwise is to take more of the consumer dollar away from rural America and place it in the hands of manufacturers who have no need for this government induced windfall.

Not one single witness or exhibit even suggested that current manufacturing class prices overpaid producers. On the other hand, at least one manufacturer of cheese acknowledged that during the period of time producers averaged 3.7 percent more of the raw product cost for the same consumer price of cheese, his cheese plants were profitable. Though others did not promote the fact that they, too, had succeeded before, the hearing record is abundantly clear that no one argued that those price levels under the prior rule hurt manufacturers.

On the other hand, the dynamics of producers' side is abundant. There has been massive restructuring of production units throughout the United States in response to producers receiving a

smaller and smaller share of the consumer dollar. Though one might forcefully argue that there is justification for an increase in prices over the BFP, Select, WSDPTA and other organizations propose that the producer share of the dairy product dollar under the revised rules merely approximate, not exceed, the prior levels of the BFP.

B. The producer members of Select, WSDPTA and other organizations market milk throughout the United States.

This brief represents the position of Select Milk Producers, Inc., Elite Milk Producers, Inc., Continental Dairy Products, Inc., and the following trade organizations: Western States Dairy Producers Trade Association, Dairy Producers of New Mexico, Texas Association of Dairymen, Milk Producers Council (California), California Dairy Campaign, Western United Dairymen (California), Idaho Dairymen's Association, Utah Dairymen's Association, Oregon Dairy Farmer's Association, and Washington State Dairy Federation (collectively "Select, WSDPTA and other organizations" or the "Dairy Producer Organizations").

The trade organizations represent their dairy producer members in administrative and legislative fora to promote the interests of their members which are located in California, Idaho, New Mexico, Oregon, Texas, Utah and Washington states. The constituent dairy producer members combined produce approximately 30 percent of the Nation's milk supply. The named cooperatives have producers located in New Mexico, Texas, Ohio, Indiana, and Michigan. Milk produced on these farms is marketed in California and all FMMOs except the Northeast.

C. Select, WSDPTA and other organizations propose changes to yields, make allowances as well as the product pricing series.

Select, WSDPTA and other organizations propose meeting the Secretary's goal in two ways– (1) adjusting yields for cheese and NFDM to reflect actual manufacturing experience, and (2)

reducing make allowances for cheese, NFDM, and butter while increasing slightly the make allowance for dry whey. These dairy producer organizations also propose that the CME be used to price cheese, butter, and NFDM. This is not intended as a price enhancement, but to insure accuracy and integrity in the program.

1. Change the formulas as follows:

For Cheese: (Cheese price - ***.1536***)*1.405 + ((Cheese Price - ***.1536***)****1.617***- (***0.94****butterfat price)*1.28

For NFDM: (Powder Price - ***0.14)/.9985***

For Butter: (Butter price - ***0.096***)/0.82

For Dry Whey: (Dry Whey Price-***0.15***)/0.968

NOTE: Numbers in ***bold and italics*** represent changes from the Final Rule.

2. *Do* use a simple monthly average of the weekly reported price off of the Chicago Mercantile Exchange (CME) for pricing cheese, NFDM and butter.

3. *Do not* reduce the butter price from the grade AA butter price for any class of milk.

4. *Do not* make any changes to the Class I or II differentials.

5. *Do* issue an interim final rule on changes to the manufacturing prices.

6. *Do* issue a recommended decision addressing changes to the use of Grade AA butter price and respond to proposed changes to class I and II differentials.

Select, WSDPTA and the other supporting dairy producer organizations address the need to modify the manufacturing formulas, not by a wholesale change in the formulation, but, instead, by measured changes to several specific factors. The Secretary's use of an elegant system of four dairy

commodity prices yielding four component prices that create four class prices plus butterfat should not change. It was well designed and remains a remarkable improvement to FMMO pricing policy.

The Dairy Producer Organizations' primary focus is on the cheese and NFDM yield factors. The explanation of these can be found at sections 48 and 65 respectively. Correcting the yield factors is like making a sure foundation to a building. Make allowances cannot be correctly established without proper yields.

As to the proposals to reduce the value of butter used in one or more of the class butterfat computations, Select, WSDPTA and the other supporting dairy producer organizations oppose these. In the first case Congress directed the Secretary to price butter this way. The direction for a hearing was on the manufacturing formulas, not the butterfat formula. In any case, it is time that the producer price formulas reflect the current and future market for butter. It is a Grade AA butter world. Grade A and B butter make up small, and declining portions of the butter market.

The changes proposed represent a complete and interdependent proposal. It is the ultimate number that counts. Each of the constituent parts work together to yield a formula supported by fact and experience. For example, support for the cheese make allowance of 15.36 cents represents the make for cheese under the yield formulas proposed. The make allowance on dry whey, because of its direct reduction in class III prices is proposed and supported in conjunction with the rest of the protein formula. It would, therefore, be incorrect to state that Select, WSDPTA and other organizations support, for example, a make allowance of 15.36 cents for cheese without concurrent qualification of the product series used or the yields for protein and butterfat.

D. The dairy producer organizations will address all of the issues individually.

This is an extremely complicated proceeding. The Secretary noticed 32 proposals. Select, WSDPTA and other organizations have identified 32 separate issues that individually impact the

ultimate manufacturing prices. Each of the noticed proposals addresses one or more of these issues, but none addresses all of them. There was testimony to completely support some of the proposals. In other cases, the proponent suggested numbers that differed from what was noticed, some had no testimony, and finally, in some, it is unclear where the proponent stood on the noticed proposal. It was a comprehensive hearing. Addressing each of the proposals will not easily address the true issues presented. As a result, Select, WSDPTA and other organizations will address each of the issues raised in the various proposals.

Not knowing the order in which the Department wishes to consider each of these issues, whether the Department wants to address only make allowances for all of the commodities, then similarly address product prices, and then yields, or, instead, address make, product prices, and yield on a commodity-by-commodity basis, Select, WSDPTA and other organizations will address these in a commodity by commodity approach. The following table is designed to assist the Department in finding the position of Select, WSDPTA and other organizations on each issue and argument on each of the issues. The arabic numbers reference the page number of this brief and the roman numerals represent the outline references.

	Generally	**Cheese**	**NFDM**	**Butter**	**Dry Whey**
Product Price	20, III.A	30, IV.A.1	63, IV.B.1	68, IV.C.1	72, IV.D.1
Make Allowances	20, III.B	45, IV.A.2	64, IV.B.2	71, IV.C.2	72, IV.D.2
Yields	27, III.C	48, IV.A.3	65, IV.B.3	72, IV.C.3	74, IV.D.3
Miscellaneous		63, IV.A.5			
Reduce BF	74, V.				

Select, WSDPTA and other organizations identified 32 issues that were addressed at the hearing. Collectively these comprise the manufacturing price formulations, individually they

contribute to, or reduce from, the manufacturing and blend price of producers. A table has been prepared which identifies each of these issues, provides a brief explanation of the issue, the position taken, or implied, in the Final Rule, the position now taken by Select, WSDPTA and other organizations, and where the position of Select, WSDPTA and other organizations is found in this brief. That table is located following the Table of Contents at pages vi through xiii of this Brief.

II. Preliminary issues

A. The policy determination

Though often described in terms of only setting a "make allowance", the reality is that end-product-pricing comprises also the choice of a product series and yield. These three are interrelated and interdependent. The end result is a combination of these three factors to reflect the statutory requirements.

The Secretary has already established the practical policy issue and that is that the class III and IV prices shall approximate the same levels as the previous BFP. Thus those urging their version of an appropriate make allowances missed the critical issue– the policy issue has already been decided by the Secretary, the Congress, the Courts.

The oft repeated phrase that the Secretary cannot set the make allowance "too high" but he can set it "too low" is meaningless at this point. Absent a clear showing, none was even attempted, that the implied relationship between market prices for cheese and the BFP was unduly burdensome on the industry and created disorderly marketing conditions, the make allowance coupled with appropriate product series and yields must result in a price approximating the previous levels.

Besides, if the market could sustain the previous BFP levels, on what basis can we justify not enforcing minimum payments at that level. The theory behind the IDFA and other arguments for higher make allowances, and lower payments to producers is that plants, in their generosity, will, if

they want to, share, what they want to, with some dairy producers, the extra money, in amounts that they want to. The theory implies that if the Secretary backs off on of his statutory obligation under the AMAA, then plants will pay as little for their milk as they possibly can get by with and, in turn, if too many producers go bankrupt from the low prices, plants will, in the plants' self interest, increase prices back to a point that the plants have a supply of milk. The money they keep from producers is their own.

In short, the handlers in this hearing are requesting that the Secretary participate in the act of producer-cide by reducing the producers' share of the product price to put enough producers out of business so plants can buy cheaper product. This call for ever less share of product price to producers flies in the face of the AMAA, an Act that is predicated on the premise that government is to protect producers from plants not proffer them.

This promise of benevolent handlers means that the Secretary can abandon the statutory requirement that he set minimum prices for all producers all of the time. There is no authority to delegate this to handlers.

The Secretary has already made the decision– the goal of BFP replacements that do not significantly deviate from the prior BFP.

1. The law

The previous BFP met the standards of the AMAA. The Courts have agreed. As to the replacement, however, the courts have said they do not comply. Congress has required new hearings on that issue.

a. 608c requires producer economics be a controlling factor

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.

b. The Courts have required this.

In *Minnesota Milk Producers Association, et al., v. Dan Glickman*, 153 F.3d 632 (1998), the Court was asked, in addition to Class I differentials, whether the M-W, then the BFP, properly reflected the cost of feeds as required under the AMAA. The Plaintiffs in that case challenged the minimum prices set by the Secretary on the grounds that the M-W and BFP did not directly address those factors.

In his first amplified decision, the Secretary explained the M-W base price as a component which he used to account for the 608c(18) factors. In his second amplified decision, the Secretary again explained how the M-W base price accounted for the statutorily mandated factors, including cost of feed. The replacement of the BFP, which replaced the M-W price series, must still capture the values. That Court accepted this explanation. The way to do this is to emulate the kind of prices discovered in the base price, the class III and class IV prices and the prices that in the end-product pricing formulas create a competitive market for manufacturing grade milk.

More recently, the District Court for the District of Vermont considered the issue in *St. Albans Creamery v. Dan Glickman,* 68 F. Supp 2d 380 (1999). The Court discussed the issue as follows:

> Yet, while Defendants maintain that the Secretary was under no obligation to adhere to AMAA requirements in this matter, they then suggest that AMAA requirements were met through the indirect consideration of regional feed costs. The Secretary described this indirect valuation in the final order: "As feed costs increase with a resulting decline in production, commodity prices would increase as a result of manufacturers attempting to secure enough milk to meet their needs. Such increases in commodity prices would mean higher prices for milk. The opposite would be true if feed costs were declining." 64 Fed. Reg. at 16095-96.
>
> Defendants' rely on an Eighth Circuit case which found that the Indirect consideration of §608c(18) factors was sufficient in meeting the requirements of the AMAA. Minnesota Milk Producers Association v. Glickman, 153 F.3d 632, (8th Cir. 1998), cert. denied, 119 S.Ct, 1803,119 S.Ct. 1803 (1999). In Minnesota Milk Producers Association v. Glickman, Milk producers sued the Secretary for his failure to create reduced milk price schedules. Plaintiffs claimed that the Secretary was under the duty to regularly consider the §608c(18) factors and update the minimum milk price accordingly. Asserting that agency inaction is presumptively unreviewable, the Eighth Circuit found that Secretary was under no affirmative duty to act in this case, and the timing of the modification the minimum price was discretionary. Therefore, consideration of §608c(18) factors was only required when the Secretary modified the minimum prices.

The question of the validity of indirect consideration of the §608c(18) factors, therefore, was not at issue directly in Minnesota Milk Producers Association v. Glickman. Nonetheless, the District Court below addressed this issue and the Court found that there was sufficient evidence on the record to support an adequate consideration at the §608c(18) factors. However, the Court did not address its reasoning behind the assertion that indirect consideration comports with the AMAA requirement that the Secretary of Agriculture fix prices which are "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" §608c(18) Rather, it simply finds that the Secretary thoroughly explained that these factors were taken into consideration indirectly. Minnesota Milk Producers Association V. Glickman at 645, As this discussion lacks in guidance on the issue of the sufficiency of indirect consideration of §609C(18) factors, this Court looks to the direct language of the statute to determine the sufficiency of the Secretary's consideration, which makes no mention of indirect consideration being adequate in meeting the requirements of §608c(18).

The record shows no direct consideration of regional costs in feed, feed availability, or other region specific economic factors. Defendant's counsel conceded in oral argument that the only consideration of such factors prior to the announcement of the final order was indirect. Record at 44-47. Had such indirect consideration been sufficient, Congress would not have gone to such lengths in drafting §608c(18)'s explicit requirements that feed costs and other regional

> economic considerations be accounted for in the setting of milk prices. Given that the consolidation of the orders creates a concrete and direct effect on milk prices, and that indirect consideration of regional economic factors is imprecise, direct consideration of these factors is required by the AMAA. Since the Secretary failed to adequately consider such factors, the final order violates the AMAA.

Id. The *St. Albans* litigation was ended as Congress directed this hearing be held. Congress did not reject the Court's reasoning, but provided relief in the form of this hearing.

In short, the AMAA requires that the Secretary's establishment of minimum prices for class III and class IV reflect the cost of feeds and the regional issues.

2. The Final Rule's manufacturing costs are too low

Since the price levels of the replacement BFP have been approved by the courts, the Secretary has established a goal to approximate those levels, and the Congress has directed the Secretary to hold hearings on the issue, and reducing producer prices is not an option.

a. The Secretary estimated the replacements to be more than three percent less.

The Secretary stated repeatedly that "the second goal for the BFP replacement is that it should not deviate greatly from the price level of the current BFP." 64 Fed. Reg. 16096 (April 2, 1999). This would bring the class III and class IV prices in compliance with Court decisions. Since the evaluation of the BFP replacement found that the replacement class III price was 3.5 percent below the BFP and the class IV was 3.7 percent below the current BFP, *Id.*, the Final Rule prices must be changed. 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".

b. Congressional Findings

In the Consolidated Appropriations, 2000, the Congress made an express finding that the manufacturing prices were sufficiently different from the proposed rule so as to require additional rulemaking. In the Proposed Rule addressed by the Congress, the Secretary's proposal resulted in class III prices that were ***higher*** than the BFP by 26 cents to 35 cents per hundred weight. The class IV was approximately 20 cents less than the BFP. In the Final Rule, now being challenged, the prices went down from the proposed rule by almost 80 cents per hundredweight on the class III and over twenty cents on the class IV. This reduction in producer prices was viewed as error. While Select, WSDPTA and other organizations do not propose that the levels in the Proposed Rule be used, certainly maintaining the Secretary's goal of no significant departure off of the BFP should be realized and this hearing should result in changes in the yields and manufacturing prices that result in a more approximate price. Congress did not call for a hearing to maintain the levels of the Final Rule.

3. Comparisons show that the resulting prices are too low.

Now that we have six months of data, it is abundantly clear that the class III price is too low.

a. Comparison of implied make allowances shows that the Final Rule prices are too low.

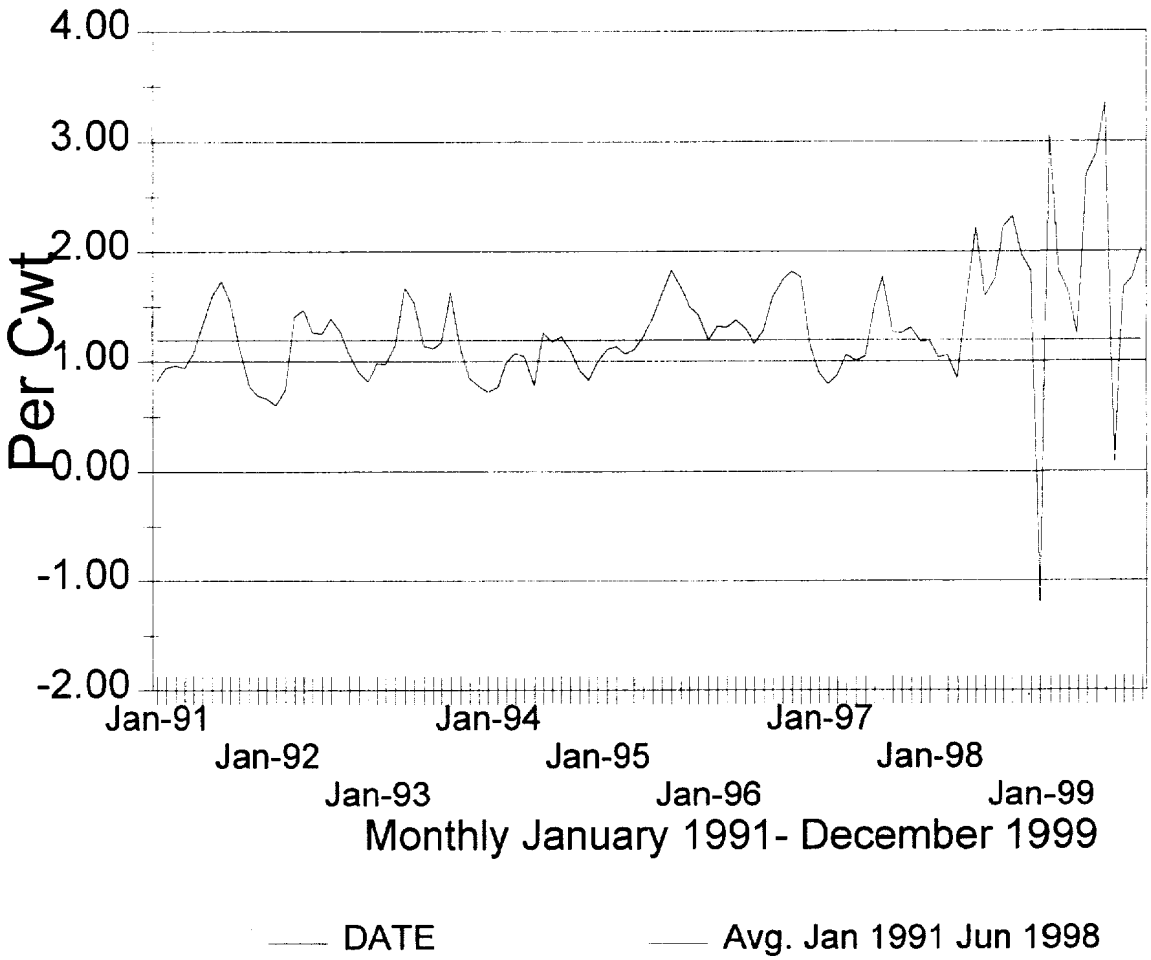
One way to see if the Final Rule meets the goal of no significant deviation from the BFP is to look at the historic relationship between the market prices for cheese as stated on NCE and CME as compared to the M-W or BFP for that month. Using the NCE/CME price series for 40# blocks we subtracted the BFP for the month to derive an approximate conversion cost as shown in Exhibit 25, Table 1. **IMPLIED CONVERSION MARGIN NCE-CME TO BFP, 1991-1999,** Vanden Heuvel 870 . Exhibit 25, **Table 2. SUMMARY IMPLIED CONVERSION MARGIN NCE-**

CME to BFP, 1991-1999 shows the maximum, minimum and mean conversion margins for 1991 through 1999.

Prior to July 1998, the average implied conversion margin was 1.20. For the period of July 1998 through 1999 it was 1.80. Figure 2 plots the implied conversion margins from 1991 to 1999. This chart shows why relying strictly on a comparison of the BFP and replacement price for June 1998 through December 1999 is inappropriate. These were dynamic months. As one commentator testified, 1997 was a more "normal" year. Ledman 1358.

Implied Conversion Margin

1991-1999



A comparison for the first six months of 2000 shows that the spread continues to be too large. The following shows that there is an implied average make of 1.81 with a high of 2.71 in 2000. This shows that the Final Rule is not meeting the goal of the Secretary as required by the Courts and the AMAA.

	CME 40#	MILK VALUE	CLASS III	IMPLIED AVE
January	1.1285	1.140	10.05	1.35
February	1.1090	1.120	9.54	1.66
March	1.1139	1.125	9.54	1.71
April	1.1032	1.114	9.41	1.73
May	1.0950	1.106	9.37	1.69
June	1.2050	1.217	9.46	2.71
Average	1.1258		9.56	1.81

At the time the Secretary set the goal of maintaining the levels of class III, the average implied make was in the range of 1.20. When the Proposed Rule was announced in early 1998, and the goal reaffirmed, the average was 1.20. Everyone recognized that the BFP was failing at the end. To utilize the BFP's dying spasms as indicia of what the future should be is simply wrong.

During a time when manufacturing costs *are shrinking,* as reported by both the RCBS studies and the recent CDFA manufacturing cost study, *there is no justification for increasing conversion margins by as much as sixty percent.* Thus the testing comparing 1998 and 1999 should not be considered as what the BFP level should be.

b. The comparison with the support price shows it is too low.

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 has averaged. $9.56, fully 34 cents below the support price. In the past, the BFP was generally higher than the support price.

B. The use cost of production in setting class III and IV

Although the Secretary has wisely refused to base prices on producer cost of production, it is still incumbent upon the Secretary to determine whether the price levels proposed are such that producers by and large can produce the milk profitably at those levels. CDFA does extensive work on cost of production. The California Cost of Milk Production Annual Survey 1999 reported the average weighted cost to be from 13.39 in 1999. Similarly ERS reports several regional cost of production numbers.

Considering the fact that this year's formula in this market produced an average class III price of about 9.50 which is far less than even the California low cost of production, the Final Rule's prices are, again too low. This further justifies the restructuring of prices to the prior BFP.

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 he 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.

It would be inappropriate and illegal, if not futile, for the Secretary to embark upon a course of end product pricing that sought to match or penny to penny respond to California.

III. General discussion of the factors of product to milk conversion

The use of an end-product-pricing formula requires three factors – product price, allowance for make, and yield. Each factor has specific aspects peculiar to the component being priced.

A. Product Series

The NASS survey has confirmed that the market place uses the CME to price butter and cheese. The extremely tight correlation, in some cases actual matching, of CME and NASS prices means that the CME tells us what the market value of these products is.

One reason that NASS was chosen over the CME when the NCE ended was that the CME had no history, but, several years later, the CME has now proved itself.

Another general aspect in favor of the NASS was that it captured national, rather than regional prices. The difference of only a few cents between CME and NASS block cheddar only confirms that the CME, too, represents the national price. For both, the number virtually matches.

In the end the NASS adds nothing to the CME, but, greatly complicates the process, imposes regulatory pricing on products for the first time, and will, in time yield flat, unresponsive markets.

B. Make allowance

The make allowance is the area where the Secretary can exercise the policy decisions as to what share of a product priced in the market producers will receive. Although actual make data is a starting point, there are other factors such as other product value that plants have to offset, costs and ultimately policy. Here the Secretary can insure the goal has been met.

1. How to find it

The starting point in determining a proper make is what the market tells us the make allowance is. A comparison of a market index, such as CME, with product series tells us what the market accepts as reasonable. During the period prior to 1998, the implied make off of the CME was

1.20 per hundredweight. Vanden Heuvel 870. These were profitable years for cheese plants. Eastham (Great Lakes Cheese) 1288. For 18 months in 1998-1999 the implied make jumped to 1.80 per hundredweight. The hearing record established that those were not normal years for dairy. Stephenson 1017-1020. Ledman 1358. In its own analysis, the Secretary has looked at a period of five years. Kraft acknowledges that there should be no change in the implied make allowance. Reinke at 1037.

This comparison of what plants were required to pay for class III milk and the open market index for cheese (NCE or CME) explains what the market has already adjusted or accepted. In like vein, the CME as an indicator of the market will remain a formula for pricing class III milk that widens the gap between the market price and minimum prices and merely transfers money to plants away from producers.

Some of these are market conditions that are not the result of the rulemaking, but are responses to the market, and the same impact would have occurred regardless of the formulation. Leprino's witness, for example, postulated that the inversion of the barrel to block prices added 17 cents to the class III price. Taylor 1717. This is not the only time that barrels have been higher than blocks. First it is incredible to suggest, as Taylor does, that the Final Rule pricing formula which went into effect January 2000, caused this barrel block inversion in 1998 and 1999 especially since half of that period occurred ***before the Final Rule was announced!*** This is just the sort of twisted number crunching some are using in support of reducing the price to producers.

2. Producers cannot make up deficiencies in the make allowance.

Routinely stated at the hearing was the claim that the "market will make up the difference" in a "too-low" make allowance. The implication is this: Reduce the producers' share of the dairy dollar. This argument is flawed factually, and blatantly illegal.

The AMAA is not a plant protection act. Vanden Heuvel 875. It is a producer protection act. To those who say profitable plants are necessary for profitable producers, the answer is this: when plants were required to pay 40 to 50 cents more of the cheese dollar to producers, plants were profitable. There is simply no justification for transferring hundreds of millions of dollars to plants at this time.

The AMAA was passed in recognition of the ***failure of the market for producers.*** Its genesis and very vitality is predicated upon the well established fact that producers cannot obtain the full value of their milk in free markets.

Producers, too, have investments. In fact the nation's dairy herd alone is worth over ten billion dollars. Gran 1453-55 (a herd of over 8 million milking cows at $1500 per head). In addition dairy farmers throughout the United States have even more invested in facilities, equipment, feed, and replacement heifers. Some have suggested an investment of over $30 billion. The class III and IV prices need to support that investment as well. As a result, Family Farms, USA supports lowering the make allowances. Gran 1440.

To those who opined that a too low make would hurt plants, it is also important to remember that setting minimum class III prices is really to establish class I prices as required by the AMAA. Hollon 1531. The cheese plants are not obligated to pool in the FMMO but by doing so will be subsidized for their milk. No matter what the Secretary establishes class III prices at, the make allowance will be higher than the market will otherwise dictate and produce a lower cost to plants.

Reduced income to producers is not the object of the AMAA. A loss of even thirty cents a hundredweight (the record shows the Final Rule reduced it as much as 47 cents) can be accomplished by a reduction of three cents in the make allowance. Such an amount is significant. Yonkers 412. As Yonkers recognized, if the make allowance is such that there is a thirty cent loss to producers,

it could take two to three years for the production to adjust to that lower price so as to require a price increase from the plants. In the meantime, producers lose money, many go out of business, and plants get richer. Yonkers, 405-412. What a price producers must pay if the Secretary adopts the IDFA logic! Long term viability of producers should be the issue. Vanden Heuvel 872.

3. Plant profits are not limited by FMMO make allowances.

IDFA's logic that the FMMO make allowance traps plant profits is simply untrue. This quote from Yonkers mistakes the real world.

> * * * As I pointed out, that the plant will never have any more money than the make allowance available for the product price it receives; that there is a fixed relationship between the product price it receives and the minimum price using these product price formulas.

Yonkers 413. In the first case, plant prices are not limited by the NASS product prices. In cheese, NASS represents only 10% of all cheese produced. THE REMAINING CHEESE IS ALL SOLD AT HIGHER PRICES. In reality, all but the NASS reporting plants have the freedom to price their product as they wish and all plants, NASS reporting included, have the ability to use added value in the form of packaging, service, location, quality, taste, and a host of other factors to obtain additional money for their products and offset their make. In fact, that is what happened under the BFP. Cropp 1457-1461.

The factual failure to this argument is also apparent in the record. Although there may be some manufacturing premiums in the Southwest and the West, Hollon 1568-1569, Williams 1296, none have made up the in excess of forty cents lost in the current class III formulation. Hollon 1615-

16. In point of fact, even though plants could pay more under the Final Rule, competition in the mountain area is not forcing that to happen. Hollon 1576-1578. Williams (only 30 cents).

4. Other policy issues

Some have pointed out, correctly, that ultimately the make allowance is a policy issue for the Secretary. Vanden Heuvel 877, 910, Schad (NEDC) 1710-12. The Secretary is not the only one who has to consider the policy implications in producer pricing. Manufacturing cooperatives do so all of the time.

17 Q Mr. Schad, you've just described the operations of
18 all these cooperatives, and I think one of your member
19 cooperatives, Agri-Mark, had a speaker today by the name of
20 Mr. Wellington. And he described the relationship of Agri-
21 Mark as a three-legged stool.
22 Do you remember that?
23 A I was out of the room when he --
24 Q You were out of the room.
25 Well, he said that there was producers -- they had
1 their producer side, and their processor side, and they had
2 to balance, and they were also member-owned so the producers
3 had to get profit out of their processor end, but at the
4 same time they needed its producers to get a fair price,
5 right.
6 And you're aware of that, right?
7 A I'm aware of the concept, yes.

Q And that is a challenge that your member cooperatives face all the time as they make all their business decisions, right? Is that correct?

A Yes.

Q Now, in the Northeast, there is a sizeable amount of what we call independent milk; is that correct?

A That's correct.

Q And those producers all receive a blend price, right?

A If they are pooled under the federal order, they draw from the pool, and my -- the large majority of those producers are pooled under the federal order, to my knowledge.

Q Right. Which means they get the blended, the federal order blended price, right?

A Correct.

Q So your cooperative members to compete in that marketplace also have to pay a blend price, right, or close to it, or in that range to be competitive, right?

A To be competitive, you have to pay a minimum of blend price in the Northeast.

Q And your cooperatives are aware of the implications of these make allowances, right, in terms of

6 what it will do to their ability to pay producers and the

7 blends and all that?

8 A Well, as -- yes.

9 Q And they are also aware of their processor side

10 and their capital side of how they have to be profitable,

11 right?

12 A That's correct.

13 Q So they have made -- in viewing all of those

14 issues, they have made a policy decision, haven't they?

15 A Yes.

16 Q That these rates are sufficient that they can meet

17 their goals as a processor, right?

18 A That's correct.

19 Q And as a producer-owned cooperative?

20 A That's correct.

21 Q And also as buying milk from producers, right?

22 A That's correct.

23 Q And that's much akin to the policy issue the

24 Department has to make, right?

25 A I would say so. Yes, sir.

Schad 1710-1712. TVEDC supports NMPF make allowances.

Another argument posited in favor of higher make allowances goes as follows: Cooperatives can pay producers less than the FMMO price and thus they are never limited by the make allowance,

which proprietary plants are. Schad's testimony quoted above dispels that notion. Plants, cooperatives and proprietary plants must pay producers at the blend prices. There is no free pass to cooperatives.

Another aspect of this argument implies that there is no product market response to a too high make allowance. A manufacturing plant capable of making cheese five and six cents less than a competitor will use the extra income to take away market share by reducing prices. Contante 748.

C. Yields

1. In General

In the area of product pricing, the yields represent one area that research and experience can provide relatively precise values. For example, the yields for butter and dry whey went unchallenged at the hearing. The butterfat recovery in cheddar processing fits in a relatively small range of 91 to 93 percent. There seemed to be an agreement that 2 percent was the total loss of fat from the vat to the end. NFDM also had a narrow range of values. These contrast with the wide range of make allowances in the surveys and the unlimited range of values in the pricing series with adjustments.

Thus, product yields is not where to make policy statements and choices. To insure stability and integrity in the formula, the yields should reflect the best return of the product being surveyed. For example, the yields for cheese should be of the type of cheddar cheese used to price the product. Presently, the NASS survey price identifies the price and it is the yields in those plants that matter. Yields from other cheddar or other cheese plants are irrelevant.

2. Shrinkage

The only argument against the Barbano yields was "shrink". Reducing the yields in the formula to account for preprocessing losses is not correct. Barbano 682. Losses attributable to the purchasing of cream, condensed, and other partially processed products are not part of the NASS

formula and should not be considered. Barbano 709. Shrink should not reduce the yields below those established at the hearing.

4 Q Okay. In looking at the flow chart that Mr.

5 Rosenbaum constructed and the embellishments supplied by Mr.

6 Vetne, it's kind of astonishing that there's ever any actual

7 cheese that ends up on a shelf in a grocery store.

Brenner 786 (Questioning)

That tongue-in-cheek statement expresses the exact position the IDFA and others seeking to reduce producer income want the Department to believe– the fiction that plants dump enormous amounts of milk that they have to purchase. In point of fact, IDFA never quantified the losses. It is far from the truth.

There are two types of shrinkage– processing and pre-processing. In the case of processing shrinkage, that is, the loss of product during the manufacturing process such as butterfat in cheddar cheese processing, the loss is already included in the yield formulas. Every bit of it. Barbano states so for the cheese. Barbano 524 (loss of casein), 598 (fat losses after the vat are in the yield formula), 610-611 (the loss of casein is in the formula),775, 787. Vanden Heuvel 898. Schad in his testimony about Land O'Lakes' own powder plant and the yields represents the processing shrinkage. Losses for the making of mozzarella or non NASS qualified cheddar should be ignored because they are not included in the price series or cost surveys. The RCBS study accounts indirectly for shrink as it looks at the pounds of products that go out compared to what it costs to manufacture. Ling 133, In this manner, the BOD's and the losses enumerated by Lenahan at 1254-1256 are accounted for. No adjustment to yield or make is needed.

The losses suggested in Lenahan's testimony should also be refused for other reasons. First, he cannot identify where the losses occur. 1274. The numbers he gave were simple averages. 1258. He explained that a lot of plants were under 2% or even 1%. 1261. As Barbano explained, the losses are in the pipelines due to cleaning. A larger plant cleaning less often will have less loss as a percentage of its operation than a smaller volume plant or one cleaning more often. Barbano 789. The reason is that the losses are attributable to the milk and product left in pipes and emptied from the piping and other vessels for cleaning. It is also a function of the surface area of the handling pipes and vessels. Barbano 758.

Also, for purposes of this hearing, the focus has to be on plants that produce cheddar cheese or other commodities used in the NASS survey, not just any plant. Lenaham cannot identify the plants he studied in terms of what commodities they produce, 1274, let alone the losses from a cheddar processing plant.

Pre-processing losses are very small. Historically, the FMMO has not directly addressed shrink. The implied make subsumes these losses. DFA indicated the amount was about a quarter of a percent. Hollon 1563. Leprino stated that they ranged from 0.015 to 0.25 percent. Taylor 1728. Hershey saw their losses at 0.25 percent as well. 1685. Kraft estimated preprocessing shrink as one fourth to one third of a percent. Reinke 1056. Eastman from Great Lakes Cheese could not quantify the amount of its losses from pre-processing shrink.

Another way to determine the amount of shrink is that in modern, on the farm, ultra filtration plants, the milk is processed through many membranes and pumps and the market administrator has found that this pre-processing and processing shrink is less than one percent. Barbano 770-774. This is the loss comparable to cheese plant handling of the milk. Barbano 774. Thus, Yonkers, who had

no personal knowledge of shrink, but testified of a two percent loss, 297, is simply wrong. The members of NCI whom he promised would testify as to facts, did, and they contradicted him.

California does not consider pre-processing shrink in its formulas. Shiek 1157-1160, 1161. Nor has, nor should, the Secretary in these formulations. Once milk leaves the bulk tank, the farmer has no control over the milk or how it is handled and, therefore, should not pay for this loss. Barbano 678-679. National All Jersey negotiates for its members formulas that pay based upon components. Over the years, its witness has negotiated a lot of these contracts and never has there been an adjustment for farm weight shrinkage. Brown (NAJ) 1665-1666. Besides, under the FMMO, manufacturing plants are not paying the full value for the milk anyway. A portion is subsidized by the difference between the blend price (paid by other, higher use, handlers) and the minimum price paid by the cheese or powder plant. In this way, the system absorbs and adjusts for the preprocessing blend. It is a service to these manufacturers that is now paid for. They should not get credit for something they have been given at no cost.

IV. Commodity specific considerations

A. Cheese

1. Cheese Price Series

a. The weekly average price reported on the Chicago Mercantile Exchange is preferable over the NASS cheddar cheese survey price.

The NASS survey, after years of research and data compilation has established an irrefutable fact -- the CME represents the market price of block and barrel cheddar cheese. The best explanation of the CME is found in this part of the testimony:

6 Q Okay. And what is the role of the Chicago

7 Mercantile Exchange cash market? Is that to sell all the

8 cheese or to reflect a point for a buyer or a seller looking

9 to move or buy product as the market demands?

10 A [Rourke] The Chicago Mercantile Exchange serves a function

11 to -- as a market where you can go and sell product if you

12 wish to do that. It also is used as a mechanism to

13 establish price levels that the industry feels is accurate.

14 Q And do you have any knowledge as to how the

15 industry uses those CME prices that are reported?

16 A The cheese industry generally uses the CME prices

17 as the base price in pricing formulas on which they will

18 base their contract sales. I believe the cheese industry

19 for the most part has been using the weekly average price

20 that is computed by Dairy Market News.

21 The butter industry, when they went to three-day-

22 a-week trading, I don't think there has been as much

23 consensus as to what price to use for their long-term -- for

24 their contract sales. But generally, I think what is in

25 those contracts uses as a base price one of the CME butter

1 prices.

2 Q Either the daily price or the average of the week

3 or the three days?

4 A And it also depends. Some contracts I think are

5 set up on price on day of order or day of make. There is

still not much consensus in the butter industry as to what price they use.

Q So in other words, although it may only list for a particular month 5 blocks sold or 13 blocks or whatever the number was, that, in fact -- that price is used by a large portion of the cheese industry in pricing cheese for that period. Isn't that correct?

A That is my understanding.

Q And most of the cheese?

A I don't have any direct evidence on that.

Q Are you aware of any other index used to price cheese in the United States, cheddar cheese?

A No, I'm not.

Q Okay. What about cheeses other than cheddar: provolone, mozzarella, and the like? Are those also indexed to your knowledge off of the cheddar price reported on the CME?

A Based on the information that we publish in Market News and looking at week-to-week price changes, much other cheese is based on the CME.

Rourke at 20-21.

In support of the accuracy or reliability of the NASS survey, the USDA-NASS witness, Milton, provided charts that showed that the NASS price had a tight connection between the CME prices for blocks and barrels.

10 Q For the record, Ben Yale. Mr. Milton, you
11 indicated several times in there as you were showing some of
12 the charts in Exhibit 8 that the NASS and the CME mirrored
13 each other. Can you tell me whether the NASS reflects the
14 CME prices or the CME reflects the NASS prices?
15 A The only thing I can tell you is usually, like I
16 said, the NASS price data comes -- lags the CME data by a
17 week and it tends to mirror the CME data for a week later.
18 Q Isn't that a statement that the NASS reporting is
19 telling us that the CME price is used by most, if not all,
20 of the plants that report to NASS as a basis for the price
21 that they sell their cheese?
22 A It appears so.

Milton 37. [Emphasis added].

This is not an argument that NASS is correct, it is an argument that the surveys by NASS show that the CME is the price used by the industry and that the CME accurately reflects the market prices.

When IDFA's counsel tried to get Milton to back off of the CME correlation, Milton did not.

7 Q [Rosenbaum] The CME price and the NASS price aren't exactly
8 the same even for a week, isn't that right?

9 A Not exactly. But they -- the correlation is very

10 close.

Milton 54.

Select, WSDPTA and other organizations propose that the cheddar cheese price used in the protein price calculation use the weekly average price as reported by the CME. The positive reasons for this choice are many.

The CME provides the most current price. These are reported weekly in *Dairy Market News.* Rourke 13. NASS is reported one week later, Rourke 14, but that report really reflects the CME price of at least the week before that. As Hollon indicated in his testimony he has found a direct correlation between the 40 pound block cheddar as reported on the CME and the NASS survey price of two weeks later. Hollon 1532-3. Using a two week lag of CME v. NASS block, the NASS averages only 1.4 cents less per pound. On a current basis it is two cents. Exhibit 46 DFA. Other witnesses agreed that there is a correlation. Yonkers 387. Pacheco in response to a question of Ms. Brenner stated that market signals in the CME get transferred to the market place quickly, Pacheco 1148-1149, almost daily. 1148.

The NASS price, after all of its iterations, reports and adjustments, is the CME price. Milton stated this repeatedly. "And you can see the correlation is almost perfect, pretty much the same price." 35-36. "The next chart on 40-pound blocks shows a similar price comparison between the NASS data and the CME price. Here again, a very tight correlation, pretty much the data– two data series almost marry [sic, mirror] each other." 36. This tight correlation shows that the CME is a national, not regional price. *Cf.* Yonkers, 303.

One of the arguments said, but not supported by evidence, is the NASS is a "national" price while the CME is a "midwest" price. Comparisons made by Hollon suggest the difference is less than

two cents a pound. The Cornell Model suggests a price surface that would support higher prices in the FMMO areas. Fourth exhibit found in Exhibit 54. Official Notice taken 1796. Marshall 1722, 1786, 1795. These, in combination, suggest that actual sales of cheese are higher than the CME.

Its most compelling argument is that the CME price represents virtually all cheese sales in the nation. Most buyers index off of the CME. Avenmore, now Glanbia, indexes off of the CME. Williams 1315. The USDA's economist that testified acknowledged as much when he said that most butter and cheese was sold off of the CME. Rourke 21-22. In point of fact, the NASS itself is an index, and verification, albeit delayed, of the CME prices.

Table 5, Exhibit 25 and the testimony of Vanden Heuvel all attest to the fact that all cheeses are a function of the CME price. Vanden Heuvel at 886. By using the CME, the Secretary is recognizing what the marketplace is doing and bringing us closer to the market.

Conversely, Kraft, the nation's largest cheese producer, does not report sales to NASS. Reinke 1063. Even though it proposes that the USDA continue to establish minimum prices with the NASS, Kraft refuses to tell how it prices its own milk. Reinke at 1088. Though Kraft was eager to testify in support of paying less money for its milk, it refused to disclose data necessary to support its contentions. Though no one can be compelled to testify at the hearing and we can respect proprietary information, the Secretary certainly can, and should reduce the weight of any evidence from a witness who proposes on the one hand to have a certain series be used to price raw product, but refuses to explain even in general terms how it is used.

Some argue that the CME is too "thin" a market. Yonkers 302. But anyone who prices product on the CME has the risk that other parties will join to correct or adjust. Vanden Heuvel 972.

9 Q Are you satisfied that the CME prices reflect what

10 the market value is out there?

11 A I'm comfortable with the operation of the Chicago

12 Mercantile Exchange as well as the NASS survey. They both

13 basically represent the same market in about the same

14 values.

15 Q Is it possible for a person to go onto the CME and

16 truly manipulate it on a long term basis?

17 A My opinion is no. That if someone were to somehow

18 bid up the price or drive down the price in the short run it

19 would create arbitrage opportunities for people to buy or

20 sell butter off the exchange, and then bring it to the

21 exchange and make a profit.

22 Q And those people who can participate in such an

23 arbitrage, it's virtually an unlimited number of individuals

24 -- speculators, producers, processors.

Christ 1245-1246.

The smallness of the sales is offset by its universal reliance. Not one single witness admitted or testified to the fact that they priced cheddar or other cheeses on anything other than the CME price. Non cheddar cheeses are indexed off of the CME. The NASS survey verifies the fact that plants price off of the CME. The thinness is only facial, but the few trades showing on the CME are supported by virtually the entire cheese market.

The argument of thinness of trading is vastly outweighed by the open and transparent transactions. Compared with the NASS survey, the CME is not thin at all. Of 49 firms eligible to report sales of the lower valued cheddar, only 29 actually do report, representing 75% of the eligible production.

Exhibit 8. ***This represents 53 percent of the national production of the eligible cheddar.*** Milton 34-35, 50-51, 58-59. As compared to only 29 sellers of one type of cheddar, the lowest value, who are able to set the NASS price, hundreds, if not thousands, of buyers and sellers can participate in the CME. The CME offers everyone-- buyers, sellers, producers and consumers, the opportunity to participate in pricing to insure its honesty and its relevance to the market.

> 20* * * To be sure, the price
> 21 in the CME is manipulated. It is manipulated by buyers,
> 22 sellers and speculators each trying to manipulate in their
> 23 favor the price, but supply and demand forces cause the
> 24 setting of the real price. The rules are fair, and the
> 25 results are transparent. There are many players on all
> 1 sides of the transaction, and any one of them can play.
> 2 In contrast, the NASS can only be manipulated by
> 3 sellers of cheese. They are not disinterested parties.
> 4 There are no rules insuring fairness among the few players.
> 5 Even the reporting of NASS as compared to the CME shows the
> 6 ability to manipulate. Each Friday, NASS publishes the NASS
> 7 prices. Plants can modify their numbers or report for the
> 8 first time after easily calculating what impact the new
> 9 reporting will have on the price. If they wish, they can
> 10 withhold the information if it increases the price and
> 11 report it if it lowers the price.

Vanden Heuvel 880-881.

The CME does not overprice the value of cheese. When viewed in terms of Table 5, Exhibit 25, the CME is already at the bottom of the cheese market. The actual difference is only a few cents per hundredweight. Hollon 1532-3. Protestations by Leprino, Taylor 1721, and Westfarms, Marshall 1800, that the location value is not considered are muted by the fact that with all of the sales, the difference is only a few cents and rather than go through all of the mechanizations of the NASS and its attendant problems, use the CME less one or two cents.

Producer groups who earlier fought the use of the NCE on thinness grounds now support the use of the CME. NFO, Pacheco 1143.

Not everyone reports the prices to NASS. (AMPI) at 1190. Even when the plants do report they have weeks to change the prices, up to five weeks later. Milton 38 and 50. In point of fact there have been repeated changes to the prices after first reported. Nearly all of those changes have resulted in lower prices. See Vanden Heuvel 880, 881. A lot of revisions occurred at Christmas and New Years. Milton 59. Milton stated that these reduced the price less than one tenth of one cent. Milton 59. Even then that translates into millions of dollars to producers. The value he ascribes is to all of the volumes. Such after the fact revisions are not possible on the CME.

Those supporting NASS over the CME are supporting a NASS that does not even exist. Virtually everyone who testified in favor of NASS wanted it mandatory and audited. Hollon 1533, 4. Taylor (Leprino) 1721. NMPF had concerns over the use of the NASS survey as it is currently constituted. Coughlin at 197. IDFA requested improvements in the NASS. Yonkers 305. It is without question that they are not audited. Milton (NASS) 40.

The audits and mandatory prices will not correct after reported changes in prices to reduce costs. The audits and mandatory prices will also not correct the problem of circularity of NASS reporting itself. 210. Circularity, where plants begin to index sales of the NASS and then report the NASS as

that price, is not prohibited. Milton. Even auditing and mandatory reporting will not prohibit, or even find, other schemes to keep the price down such as selling the basic cheddar as part of a larger sale of aged cheeses. Milton at 40. Plants can avoid the reporting to NASS altogether by contracting ahead more of the plants' sales.

California, in setting its product price for its own product formula, uses the CME price less 1.2 cents for its price series.

b. **The NASS, by itself, is regressive and should not be used if another series is available.**

Use of the NASS will result in circularity. NMPF recognized this potential in its testimony. Coughlin at 209. Yonkers 411. Vanden Heuvel 876.

17 And let me also state that it goes back to my
18 primary argument that on the other side, looking at
19 increased prices in the market and how they are returned to
20 farmers, there is actually nothing in the market that the
21 cheese plant or any other manufacturing plant can do to
22 increase the difference between its sales price for its
23 product and the minimum price it has to pay to farmers under
24 Federal Order regulation.
25 That is fixed by this make allowance. That is not
1 true to increases in milk price at the farm level.

Yonkers 440-441.

Use of the NASS will limit plants' abilities to seek additional money, and pay that to producers. Yonkers repeatedly made reference to examples of how plants with "too low" a make allowance

would not be able to recoup payments by pricing higher in the market. The reason was the higher price would be used to raise, penny for penny, the minimum price. See, for example, Yonkers 259.

17 So why can't the handler simply raise its price to
18 $1.29? The problem lies in the Federal Order minimum price
19 formula. As previously noted, the minimum price is the
20 price of the finished product minus the make allowance. In
21 our example, before any finished product price increase, the
22 minimum milk price was $1.27 minus 15 cents equals $1.12.

Yonkers 260.

* * * I

3 think your language was, "The result is always the same
4 because the pricing formula acts as a ratchet."
5 A That is correct.
6 Q So that means, as I understand it, that the plant
7 sells cheese at another two cents, reports that to NASS.
8 NASS announces that price, subtracts off the make allowance.
9 And what they gained up here comes up because the base has
10 risen. Is that what you are saying?
11 A And, of course, all that presumes that that plant
12 is able to extract two more cents in a competitive market.
13 Q I understand that.
14 A But, yes. Yes, that is what I am saying.

Yonkers 388.

The NASS price is more complex. Instead of one weekly number that is averaged monthly when the weekly average of the CME is used, the NASS requires the input of as much as five items each week just to compute the NASS national price for cheddar cheese which assumes the other values are computed. Vanden Huevel at 879. Each of these are subject to revision for up to five weeks. Milton 38, 50.

c. The use of NASS raises other issues

The choice of the NASS survey over the CME brings additional issues to be decided, issues that the CME does not have.

(1) Inclusion of 640# Blocks

Proposals to include 640# blocks in the NASS survey should not be adopted. The NASS survey did use 640# blocks for a while but the Secretary wisely discontinued their inclusion. Official notice taken of NASS Cheddar Cheese Prices, March 1997 through September 1998, at 1770. The volumes then represented only a small percent of the cheese sold, not the 20 to 25% supporters claim is now sold in 640# blocks. For example, in *Dairy Market News*, April 27-May 1, 1998, reported 698, 107 pounds of cheddar in 640# blocks as compared to over 17 million pounds of 40# and 500# barrels. Its price was 5 to 8 cents higher than blocks and barrels. This compares, again as an example to March 2 - 6, 1998, which showed over 2 million pounds in 640# blocks as compared to 12 million pounds in blocks and barrels. Its price was within one to two cents. Nothing has changed since that time to justify the addition.

640# blocks are distinct in more ways than just size from 40# blocks and 500# barrels. They are special order products with no standard of identity. Hollon (DFA) 1536. Even within a single block the range of moisture from the center to the outside as well as the solids is not consistent. See, eg., *Dairy Market News*, March 2-6. 1998. The NASS reports never identified moisture. Generally they

are made for internal purposes, Gulden (AMPI) 1192, Reinke (Kraft) 1066, and not eligible to report in NASS. Sales volume varies widely resulting in wild swing in price. The CME does not offer a contract for 640# blocks, no doubt, for those reasons.

The lack of participation by manufacturers of 640# blocks resulted in "illogical" values for those blocks. Taylor 1767. Since so much is used internally or special ordered, little would be eligible in any case. Hollon 1535. There is no evidence that the little reported represents the large amount of the product sold. Even one of the proponents agreed that without large amounts reported, inclusion was not a good idea.

15 A Yes. If the data series appears to be too weak,

16 it would not make sense to incorporate it.

Taylor 1768.

Without any data on the cost to produce such blocks there is nothing in this record that the Secretary can base an adjustment for the product price between blocks and 640# blocks or the make allowance.

The arguments in favor of including 640# blocks that it will increase participation in the cheese survey are predicated on the failed notion that census numbers are better than representative values. If, in fact, the value of 640# is not much different from the NASS survey now reported, then its exclusion should not be a loss to its proponents.

(2) Adjustment for use of barrels

The three cent barrel to block adjustment should continue. The elimination of the adjustment with no other changes to the formula would result in a reduction of the class III price by 18 cents. As explained elsewhere in this brief, the class III price already fails to meet the stated goal of reform. The hearing record does not support further reductions in this area.

DFA had the only witness that testified with first hand knowledge as to the cost of manufacturing cheese in blocks and barrels for reporting under NASS. That witness made it clear that the three cent adjustment was not only correct but was conditional on DFA's approval of the continued use of barrels in the NASS survey. Hollon 1535. The purpose is to represent the difference in cost of manufacturing both blocks and barrels. Hollon 1562. At that point he suggested that costs in packaging and labor resulted in more than a two cent difference in the cost. The remaining one cent is also explained in the record. Dr. Barbano explained that by adjusting the price of barrels to 39 percent moisture before computing a per pound adjustment for the make resulted in an inflation of the make allowance for barrels. Barbano 889. By using a modification of the Van Slyke formula to adjust the value of the make allowance to 39% moisture from the reported moisture in the same way that the price is adjusted shows that there is in fact an increase in the actual make allowance by about one cent per pound. This moisture adjustment factor is not described by Hollon. Thus combined, the Secretary was absolutely correct when he determined that there be a three cent adjustment.

A number of witnesses suggested that the adjustment was too high. Yonkers' testimony, found variously at 309, 310, 349, 378, should be totally disregarded. First, he, himself, makes no cheese and has no personal knowledge. Second, his testimony suggested others would testify to facts but they did not. Yonkers 461-2.

Similarly, the testimony of Kraft and Leprino, should be given little to no weight as on this issue they do not manufacture and sell 40# block cheddar or 500# barrel cheddar cheese as reported in the NASS survey. Kraft's witness had no personal knowledge of what the costs were. Reinke 1069. They do not buy 40# blocks, 1067, and the analysis provided was done by someone not testifying. 1068. Leprino's witness stated that she had no personal knowledge, she merely stated, "we have been told" Taylor 1723. That is hardly the kind of testimony that supports reducing producer prices.

Those who manufacture the products at issue and are also answerable to producers for pay prices, ie., manufacturing companies, indicate support for the three cents. Wellington 1508, DFA, 1535.

Arguments against the range are that the adjustment is too high. But historically there has been and continues to be such a range. This is because, aside from the packaging, manufacturing, and labor costs, there is no difference in the products. If barrel prices approach or exceed 40# blocks less three cents, the market will shift to the manufacturing of blocks. Arbitrage takes place in the market. Thus there is a market driven support for the Secretary's correct decision to adjust barrel prices by three cents. Hollon 1534, Taylor 1726, Christ 1247.

The CME does not overprice the value of cheese. When viewed in terms of Table 5, Exhibit 25, the CME is already at the bottom of the cheese market. The actual difference is only a few cents per hundredweight. Hollon 1532-3. Protestations by Leprino, Taylor 1721, and Westfarms, Marshall 1800, that the location value is not considered are muted by the fact that with all of the sales, the difference is only a few cents and rather than go through all of the mechanizations of the NASS and its attendant problems, it is preferable to use the CME less one or two cents.

The choice of CME is not to enhance prices.

> 19 Q So that the choice of the CME over the NASS is not
> 20 one for purposes of price enhancement would probably be a
> 21 futile effort. If that was your purpose was to get price
> 22 enhancement by choosing the CME in terms of just a direct
> 23 relationship, it probably would not be successful?
> 24 A Yes, I would agree with that.

Hollon 1569.

Use of the CME will not hurt cheese futures. Yonkers argued that use of the CME would hurt futures markets. Yonkers 304. First, there is very little trading in the CME cheese futures. In *Dairy Market News,* July 3-7, 2000, p.7, there are no reported cheese futures. Even so, the USDA could continue to report NASS numbers but use it in a different way – futures, rather than setting producer pay prices. Yonkers at 390.

2. Make allowance for cheese

The make allowance for cheese, now .1702 should be reduced. For reasons explained here, Select, WSDPTA and other organizations support .1536 for cheddar. In the first case, applying the methodology used by the Secretary in formulating the Final Rule and updating it with new data from both RCBS and CDFA, the allowance should be .1536. The NMPF followed the USDA's approach in the Final Rule. Coughlin 214, Exhibit 10. Evidence supports an even lower make allowance, but with the changes to the yields and other changes, this level will permit the Secretary to reach his goal of approximating pricing levels under the old BFP.

For reasons explained in a separate motion to strike, NCI's numbers should not be used. A fraud was committed in the hearing when the lead witness promised others would testify to the facts of their proposed make allowance, but none did. In contrast, participants to RCBS as well as Dr. Ling were subjected to cross-examination on their numbers.

A make allowance that uses numbers not subject to cross-examination has no integrity. After all, it was the untested numbers of informal rulemaking that brought Congress to require this hearing.

Even if there was testimony, unlike RCBS or even CDFA, there was absolutely no government oversight of the process. Besides, in some cases it duplicates RCBS and gives some plants double weight. This should not be allowed.

The use of CDFA also needs discussion. The methodology in the Final Rule with its use of CDFA make allowances also distorts the weight of the make allowances. California only represents 13 to 14 percent of the cheddar cheese manufactured but its make allowance under the Final Rule, and as proposed by NMPF, gets a 48% weight, or almost four times as much. The derived price is for producers in which California purchased none of the milk. Vanden Heuvel at 907, 909. The RCBS survey does not include any California cheese plants. Ling 154-155.

The inclusion of CDFA's numbers presents other, more serious procedural and legal problems. If the purpose is to find the value of milk used in the FMMO system, then we should not include California. This is not because the California numbers are "bad" numbers. If anything, the CDFA through years of experience backed by the industry, laws, and regulations, has produced a remarkably accurate set of data for what it is. The question is what role, if any, research by a state agency, not subject to federal oversight or review, and not subject to the procedural due process of cross examination provided by law in the AMAA, can have on these federal processes. This is not a trivial consideration, but goes to the fundamental aspect of FMMO rulemaking with its requirement of formal rulemaking. The use of CDFA's numbers in any significant fashion will circumvent this legal requirement. After all, California is not now part of the FMMO. Reliance on CDFA data gives too much ability to a state agency to set FMMO prices. While the Department invited CDFA to the FMMO hearing, outsiders have no similar standing with the CDFA. Diverting the pricing to such a state agency is a denial of due process of non California participants, which is about all of them, in the FMMO hearing process.

The prices in the CDFA, while accurate, are not in response to market conditions that allow plants more freedom in pricing product. Years of end product pricing have directed plants in their pricing

and costing so as to distort the numbers so that the plants can flourish in the California environment, not the FMMO environment.

Finally, even CDFA does not use the make allowance study to set make allowances, because, ultimately, the make allowance is a policy decision by the Secretary. In that way the CDFA numbers can be used to test the decision, but not determine it.

The make allowance needs to harmonize with the NASS. That is, the make allowance needs to be what it takes to make the product reported in NASS. Put another way, the high quality, added cream cheese made by Kraft is not a NASS product and Kraft's costs for cheddar should not be considered in the make allowance. Reinke 1073-1074.

In analyzing the various proposals for make allowances, it is important to keep in mind that this is not a make allowance for all cheeses or even all cheddar cheeses. Instead, this is the make allowance for those cheddar cheeses that qualify for reporting the sales under NASS. As shown at the hearing, without dispute, the other cheeses all sell ***higher than the CME, let alone the NASS price.*** Table 5, Exhibit 25, VandenHeuvel 886.

It should be recognized that in a lower class III make allowance, producers in areas high in cheese production will lose out. The lack of class I prices to add to the blend price will force plants there to pay more than competitors elsewhere with higher blend prices. Williams 1313. Cropp 1457-1458.

Select, WSDPTA and other organizations support a lower make allowance because that is necessary to reflect legally required response to farm supply and demand factors required by the statute and by the AMAA. The court approved BFP showed an implied make between CME and BFP for ten years that averaged about $0.12, not $0.17. This can be seen also in the present pricing of class III and the price support program. At support price of 9.90 the formula is generating a price as low as 9.37.

After all of these considerations and despite the means to get to these, Select, WSDPTA and other organizations support NMPF's suggested make allowance of 0.1536 cents. DFA testified to actual numbers in that range and other manufacturing cooperatives accepted it.

a. Marketing allowance for cheese

There is consensus that the make allowance include value for "marketing". The numbers ranged from none with the CDFA study, 0.0011 argued by IDFA, Yonkers 291, .0015 from NMPF, and .0026 from Westfarm. Marshall 1805. Marshall's statements should be disregarded because his firm did not participate in either the NCI or the RCBS study. 1805. As a result there is no way to know if some of the value would have been included elsewhere. In other words the .0026 is not in addition to the values in the RCBS or the NCI and thus we have no way of knowing if it is duplicative. In as much as it is more than twice what some have testified, it should be disregarded in total.

DFA and National Milk have come to the agreement that the department's earlier use of .015 was correct. Select, WSDPTA and other organizations certainly agree.

b. ROI Allowance for cheese

Select, WSDPTA and other organizations support the inclusion of an ROI allowance of .0104. This is to be in addition to the RCBS. This is not in support of the addition of this allowance to a higher base make allowance.

3. Yields for cheese

Yields have a significant impact on the ultimate price producers are paid. Vanden Heuvel 832. The formula for calculating the protein portion of class III should include a yield more representative of current technology and production of cheddar cheese and should give proper value to the whey cream.

The eminently qualified Dr. Barbano from Cornell testified on his own behalf as to what the yields in cheddar processing are. Barbano 513. He starts out by using what is known as the Van Slyke formula to determine the various yields. With this formula, the value of protein in cheese can be determined by zeroing out the fat, and conversely, determining the fat by zeroing out the protein. Taylor 1729.

To determine the value of protein as a value of a pound of cheese, one needs to know the fat content of the milk, the true protein content of the milk, the percent of fat recovery in the cheese, the proportion of true protein that is casein, and the moisture content of the cheese. Barbano 515. To determine the fat value you need the same values. Barbano 516.

By assuming 3.5 percent butterfat and 2.99's percent true protein, the formula to derive the price of protein is simple math. Barbano 533. Two assumptions, used in the Final Rule however, need to be challenged. In the Final Rule the resulting factor of 1.582 assumes 90 percent fat recovery and 38 percent moisture. Barbano 517, Vanden Heuvel 892. The changes proposed by Select, WSDPTA and other organizations is in one of those assumptions (butterfat recovery) and correction in the pricing to insure that the moisture is correctly adjusted to the correct assumption of 38 percent.

The testimony of Barbano, fundamentally unchallenged, was that for every 100 pounds of butterfat that enters the vat, all but two pounds is recovered or as whey cream. Barbano 776-777. The rest of the discussions on yield address how the class III formula should fully capture that value.

The approach proposed to correct the protein formula in recovering all of the product in cheddar cheese is two fold. The first is to bring the butter recovery formula up to the proper level and the second is to find a means to capture the extra whey cream.

Under current regulations the formula for protein is:

Protein = (Cheese price - .1702)*1.405 + ((Cheese Price -.1702)*1.582-butterfat price)*1.28

This is a simplification and reduction of the Van Slyke formula. Further, under the Final Rule, protein is a residual of the class IV butterfat value. Where the Van Slyke formula determined the number of pounds of cheese from one hundred pounds of milk with certain component characteristics, it can easily be adjusted to determine the value of one pound of protein based upon the same input plus the value of the commodities. The Van Slyke formula is:

$$Lbs.Cheese = \frac{([BF \times BR] + [PR \times CS] - 0.1) \times 1.09)}{(1 - M\%)}$$

Where BF = butterfat lbs

BR = butterfat recovery

PR = true protein pounds, and

CS = percentage of casein in true protein

In 100 pounds of milk at a standard test there would be 3.5 pounds of fat and 2.9915 pounds of true protein in the milk. Thus the formula will look like this:

$$Lbs.Cheese = \frac{([3.5 \times BR] + [2.9915 \times CS] - 0.1) \times 1.09}{1 - M\%}$$

Each of the components, butterfat and protein, can be solved for individually. Since the yield of butterfat equals the cheese yield less the protein yield and the protein yield equals the cheese yield less the butterfat yield, by reducing the formula individual components can be solved as follows:

$$CheeseYield = \frac{[(BF \times BFR) + (PR \times CS - .1)] \times 1.09}{1 - M\%}$$

$$ButterfatYield = \frac{[(BF \times BFR) \times 1.09]}{1 - \%M}.$$

Assuming 3.5 pounds of butterfat in 100 pounds of milk and a butterfat recovery of 90 percent in the vat and applying these number to this formula we get the following:

$$ButterfatYield = \frac{3.5 \times .90 \times 1.09}{1-.38} = 5.5379$$

The yield of a single pound of butterfat can be determined by dividing 5.5379 by the number of butterfat pounds in 100 pounds of milk (3.5).

$$ButterfatYield = \frac{5.5379}{3.5} = 1.582$$

Thus the factor of 1.582 found in the Final Rule is the result of applying Van Slyke's formula and is dependent upon values provided. In the case of the Final Rule, the butterfat yield factor assumes 3.5 pounds of butterfat in 100 pounds of milk, a fat recovery rate of 90 percent and moisture of 38 percent. The 3.5 percent butterfat is appropriate as it is used consistently throughout all the formulas for class prices. The remaining two, fat recovery and moisture, must be determined. Since there is no practical way, nor need to compute actual recoveries each month and moisture can, and should be standardized, it is necessary to determine what those two values will be in terms of a constant in the pricing formula. Vanden Heuvel 890-892.

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.

To correct the butterfat portion of the protein formula it is necessary first to raise the amount of butterfat recovery in the formula to more accurately reflect the industry practice. Kosikowski in "Cheese and Fermented Milk Foods" states that recovery is 93%. We propose using the midpoint which is 92%. The use of 92 percent butterfat recovery is not inappropriate. Barbano 775. Barbano agrees that the formula used by Vanden Heuvel to change the factor of 1.582 is the appropriate way to account for the 92 percent butterfat recovery to 1.617. Barbano 781. Thus the protein formula so developed would be:

$$ButterfatYield = \frac{[(3.5\times.92)\times1.09]}{1-\%M}$$

As for the moisture, the Secretary's choice of 38% is correct.

$$ButterfatYield = \frac{3.5\times.92x1.09}{.62} = 5.661$$

As we noted above, to derive the factor for use in the formula to determine the value of the protein, the butterfat yield factor is 5.661 divided by 3.5.

$$ButterfatYieldFactor = \frac{5.661}{3.5} = 1.617$$

The butterfat yield factor accounts for 92% of the butterfat delivered to the plant. Two percent is lost, leaving six percent that still needs to be valued. Under the Final Rule, 100% of the class IV butterfat price per pound is deducted from the butterfat side of the protein price calculation

with the remaining value allocated to the protein price. What we are proposing is to keep the class III butterfat price the same as the class IV butterfat price but deduct only 94% of the class IV butterfat price per pound from the butterfat part of the protein value to account for the whey cream. We propose 94% of the class IV butterfat price to account for the .06 pounds of whey cream recovered.

There are three approaches that the Secretary can take as regards to this valuable commodity. The first is to ignore it and let the plants keep this value without requiring that they pay producers. This is unacceptable especially in light of the Secretary's expressed goal to have replacement class III equivalent to the BFP. The second is to value it as grade B butter. This approach has two problems. The first is the whey is used in the production of cheese and has the same value as the cream that is introduced as fresh milk. There is no reduction in value in fat. The use of a separate value would require a separate pricing series on a product that represents a small percentage of butter production. The third way is to add a factor that compensates for it in the formula.

Select, WSDPTA and other organizations have chosen this latter approach. Taking advantage of the fact that there is a class IV butterfat adjustment, by only adjusting for 94 percent allows the remaining six percent which is the amount of whey cream recovered, to be factored into the formula.

There is no contradicting evidence that ordinary cheddar includes the process of reusing the whey cream. Though Kraft demands a higher quality by using sweet cream, it does not report its prices to NASS. Reinke 1047, 1070. Although Leprino does not make cheddar, its witness did testify that there is the reuse of whey cream. Taylor 1734.

One of the arguments against the use of whey cream in valuation is that the whey cream is of less value. Taylor 1733, 1761. Reinke 1041. This is not true. The purpose of whey recovery is not to value butter! It is to value the protein as a residual of the butter used. The incorporation of whey

cream recognizes that cheese plants are able to obtain more value of the protein, because they have more fat to bind into the cheese. It is irrelevant what the whey costs because it is not being sold as whey cream, but as full cheddar cheese. The whey cream is returned to the vat to make cheese. That cheese gets the same price per pound as the cheese made from the original vat. There is no factual basis for reducing this value. The make allowances already pay for it.

The protein formula should be as follows:

((Cheese price - make allowance * 1.617) - (class IV butterfat price * .94))* 1.28

There is no need to change the protein yield of 1.405. Vanden Heuvel 898.

4. The ratio of fat to casein should not be changed.

The factor of 1.28 represents the pounds of fat held by one pound of true protein. Barbano 516-517. It is not the composition of milk. Though there was testimony that the ratio of fat to casein *producer milk, as opposed to cheese,* may be less than 1.28, Barbano 516-521, the actual payment by plants is neutral. Keep in mind that the use of 1.28 in this formula is to determine what the value of protein in a pound of cheese is worth by zeroing out the value of the butterfat. Because we are starting with *finished product, not producer milk,* the ratio in producer milk is irrelevant. Leprino argues that the formula should be reduced to 1.19 instead of 1.28. Taylor 1733. What she is arguing, in the relevance of this formula, is that in cheddar cheese a pound of true protein only holds together 1.19 pounds of cheese. She does not say this because she only discusses producer milk content for some of the orders, not all of them. 1733. ***The only evidence in this record is that one pound of true protein holds 1.28 pounds of cheese.***

The issue of producer milk content raised by Leprino's witness is an inter-producer issue , not a producer-plant issue. It addresses a separate problem altogether and that is, the changes in value of fat and protein in cheese will not directly respond to changes in value for protein and fat in producer

milk under the component pricing scheme. The 1.28 is a pivot point. Producers will be paid a different ratio for their milk content. Barbano 570, 573. It is not a plant issue. Though sending signals is important, the issue of protein being a residual of the value of butterfat can not now be addressed because the only proposal addressed to that was Barbano's and it was stricken.

The following discourse between Paul Christ and Barbano firmly establishes the validity of the 1.28.

> 17 BY MR. CHRIST:
>
> 18 Q Dr. Barbano, your first recommendation is that we
>
> 19 change the Class III pricing formula because the existing
>
> 20 formula will reduce the Class III price if the ratio of fat
>
> 21 to protein is below 1.28.
>
> 22 Are you aware of a publication called Federal Milk
>
> 23 Marketing Order Statistics, 1998 Annual Summary?
>
> 24 A No. I've not looked at it.
>
> 25 Q I guess for your information, the Judge took
>
> 1 official notice of this on Monday.
>
> 2 This publication shows a table on page 120 that
>
> 3 identifies the amount of product pounds and butterfat used
>
> 4 to produce cheese under Federal Milk Marketing Orders, and
>
> 5 the number for product pounds is 31,300,000,000, and the
>
> 6 amount for butterfat was 1,229,000,000.
>
> 7 I made the calculation, and the result was 3.95
>
> 8 percent butterfat. Would this be above or below your 1.28

9 threshold number?

10 A That reflects the average fat content of the milk

11 used, I'm understanding from what you said.

12 Q Yes. If the numbers are correct, the average

13 value or the average percentage fat in Federal Order milk

14 used to produce cheese. Would you expect that to be above

15 or below the 1.28?

16 A That average is probably close to the 1.28.

17 Q So in fact respect, with the actual milk being

18 used to make cheese it probably is a neutral effect?

19 A For the cheese maker. If I'm a producer that has

20 a lower ratio in my milk at the farm, it's not a neutral

21 effect. It's only a neutral effect for the producers that

22 are at 1.28.

Barbano 665-666.

Leave the 1.28 alone.

a. Moisture standard for cheese pricing and protein pricing

As explained earlier, one of the assumptions necessary to use the Van Slyke formula is the moisture content. The Secretary correctly used 38 percent assumption when it arrived at the 1.582 formula. No one has seriously proposed a different moisture standard. As explained elsewhere the correction needed is on the assumed butterfat recovery.

The problem of moisture is that the barrel prices rather than adjusted to 38 percent, are adjusted to 39 percent. This significantly reduces the value of the cheese and creates an unseemly formula of

adjusting prices to one moisture, and the protein based upon another assumption. They should be the same. Barbano agreed that these moisture values must match. Barbano 558. Harmonization is critical. Barbano 562.

Barrel cheddar cheese is never made at 39 percent. Barbano 567. No one at the hearing suggested otherwise. The problem, however, is with the blocks. The moisture of blocks is not reported. Milton 39-40. IDFA says the blocks should be at about 38 percent. Yonkers 460. Barbano suggested between 36.5 and 39 percent and near 38 percent. Barbano 559. Thus the assumed moisture should be 38 percent. Vanden Heuvel 889.

Those who suggest the 3 cent barrel to block adjustment covers this moisture are wrong. Taylor 1727. The role of the 3 cent barrel to block adjustment is explained elsewhere. Simply stated it represents the real market reality that the cost to package, manufacture, and handle blocks exceeds barrels by about three cents. Arbitrage in the market will, over time, recognizes that. Changes in the moisture adjustment for barrels to 38 percent has no bearing on that issue.

The factors in the protein formula for butterfat and protein are not arbitrary but, instead are the results of standard computations of the Van Slyke cheddar cheese formula. The butterfat yields and protein are the result, not of an approximate number, but derived by exact computation using the appropriate assumptions. These assumptions are as follows:

Butterfat recovery is .92 or 92%

Moisture is .38 or 38%

Casein as % of true protein is 83.26

Whey cream is valued at .06 pounds of butterfat

The formula before adjustment to the make allowance now reads:

Protein = (Cheese price - .1536)*1.405 + ((Cheese Price -.1536) - .94 *butterfat price)*1.28.

In summary we have captured all of the butterfat recovered in the cheddaring process and the whey cream and added it to the protein value.

It is appropriate at this time to address the various issues of percentage of true protein. Testimony on this issue came from Barbano 559-560, Vanden Heuvel, Taylor, and Brown. Whether the approach is done by increments or otherwise in the end is irrelevant. Select, WSDPTA and other organizations proposed protein formula using the same percent of true protein as the Final Rule and the formulation agrees with National All Jersey in their calculations. Brown. There is no need to carry that discussion any further.

Opponents to this formula did not directly attack the yields. Instead they came at it indirectly. The use of 92% is appropriate. 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 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.

> 20 In addition, the NASS dairy products prices
> 21 surveys that provide the product price data used in the
> 22 product price formulas include both types of plant ownership
> 23 in its survey. In order to ensure an apples-to-apples
> 24 matching of prices and costs, the data used in the Federal
> 25 Order product price formula should make every effort to
> 1 include data from the same sources.

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.

Another preposterous argument against the use of higher butterfat yields was that producers are already paid for the full value of butterfat. Taylor 1734 "The 8 other 10 percent of the butterfat that is not captured in the cheese is valued at the Grade AA value." This line of argument totally distorts what is happening in this formula. Under the Final Rule, the protein value is a residual of the cheese price less the class IV butterfat price. Because of the offsetting of butterfat by adjusting to the class IV price, ***increases in butterfat recovery in the protein formula have no impact on increases in the butterfat price paid to producers***. This was fully established in the cross examination of Taylor.

1 BY MR. YALE:

2 Q All right, assume that the value of cheese under

3 NASS survey, CME, whatever, has been determined to be $1.10.

4 We know that value.

5 A Okay.

6 Q And we know the value of butterfat or we're going

7 to look at the value of butter. But the value of cheese

8 does not change.

9 A Okay.

10 Q And you would agree during a month once we

11 determine the average value of cheese, it doesn't change,

12 right?

13 I mean, once the Department has determined last

14 month's value of the average NASS survey price for cheese

15 and all the adjustments, it's fixed, right?

16 A Right.

17 Q Okay. Now, assuming that the cheese doesn't

18 change but this month the butterfat price -- between two

19 months, the cheese price doesn't change, this month's

20 butterfat price goes up, what will happen to the protein

21 price?

22 A If the butterfat price goes up because the butter

23 market has gone up.

24 Q Right.

25 A Which would be the only way that it could go up.

1 Q Right.

2 A Then the protein price goes down.

3 Q Thank you. And the converse is also true, that if

4 the price of butterfat went down the value of protein went

5 up?

6 A The price of protein under the federal orders does

7 go up.

Taylor 1756-1757.

b. There is no basis to set a class III butter price separate from class IV

Aside from the proposal to change only the class IV butterfat price, there is no provision in the current hearing for a proposed change to price butterfat in cheese based on the cheese, as opposed to butter, prices. Barbano's proposal was denied a role in this hearing. Though we disagree with the ALJ's ruling, time does not allow for reopening at this time.

5. Class III should continue to use other solids in formulae

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.

This formulation, other than a change in the make allowance, should not be eliminated or reduced in value.

B. NFDM

1. Price Series for NFDM

Select, WSDPTA and other organizations continue to support the use of the CME for NFDM. It is true that for some time there has been no trading on the CME for NFDM, but it is also true that during that entire time, NFDM has been at support price levels that approximate the CME price. The range in highs and lows on NFDM in NASS since September 1998 has ranged less than 10 cents per

pound (1.00 to 1.09) as compared to the amount of 90 cents per pound for cheese or nearly 2.00 per pound of butter. In other words, the flat CME price continues to reflect the market for NFDM.

In the NASS, of the 29 firms eligible to report, only 20 do report and they comprise 92 percent of all eligible production. Milton. Without the use of an open market pricing, the Sellers of NFDM will have a virtual monopoly in setting their pries as well as what they pay. This represents 88.3 percent of the national production. Milton 58-59. Unlike cheese where 90% or more of the finished product is not NASS eligible, NFDM is concentrated into few markets.

What this means is that 20 firms who benefit by controlling 88.3 percent of the purchase of milk for NFDM, get to manipulate the prices they pay for the milk by being the only ones who set milk prices. If the CME is used, producers and others can participate in this market.

The use of the NASS survey is tantamount to chartering 20 plants to set what they want to pay for milk which is outlawed by the AMAA. Use of the NASS by the Secretary in the FMMO system is an illegal delegation of the authority to find minimum prices. The result of letting all of the sellers of NFDM send signals to each other to set the price no doubt implicates serious anti-monopoly laws. Because such concentrated price signaling directly relates to the price of milk, the system established by the Secretary creates an oligopsony which will exercise government enforced monopsonic powers – all in violation of federal antitrust law.

2. Make allowance for NFDM

a. General make allowance considerations

Select, WSDPTA and other organizations propose the use of .14 for the make allowance for NFDM. The reason for this choice is that it represents the best of the direct testimony on the subject. Hollon 1529, 1541. Consistent with our general approach, make allowances and yields need to be backed by evidence from producing entities that was tested at the hearing by cross-examination.

b. There should be no weighing of RCBS Survey and CA census in setting the make allowance.

The methodology proposed by NMPF and used earlier by the Secretary gives California make allowances too high a price. California represents 37 percent of the NFDM manufactured but its make allowance gets a 65 percent weight. In the end the make allowance is used to determine a price for producers whose milk was not purchased in California. The use of .14 cents which arises out of this is appropriate for other reasons.

3. Yields for NFDM should be increased.

Select, WSDPTA and other organizations support changing the yield on NFDM. The biggest challenge that was made to the proposal to change the class IV SNF yield was made by Land O' Lakes in their testimony in Exhibit 34, Schad 1210-1215. In this testimony, Land O' Lakes cites specific yield data from their Carlisle butter/powder plant for the month of January to justify the current yield divisor of 1.02. Although this is for only one month, we appreciate the actual data submitted by Land O' Lakes, because we think it demonstrates that the current 1.02 yield divisor is inappropriate.

Those who promote the current 1.02 divisor justify it by making two points: One, they claim that some of the SNF is made into buttermilk powder (BP) which is less valuable than NFDM; and two, they claim that there is "shrinkage" that causes a lower yield.

In Exhibit 34, Land O' Lakes states that the Carlisle plant turned 5,208,381 pounds of SNF into 5,223,382 pounds of NFDM at an average moisture in the finished product of 3.47%. They acknowledged that this was a yield, which would necessitate a yield multiplier of 1.003, which converts to a divisor of .997. They go on to point out that an additional 234,461 pounds of SNF was delivered to the plant and made into BP. They do not specifically give the pounds of BP that was

produced, however if we use the same yield for BP that this plant achieved for NFDM we can conclude that they produced 235,166 pounds of BP.

First, Land O' Lakes' analysis of 1999 powder prices indicates that NFDM price in the Northeast averaged $1.0389 and the BP price averaged $0.7686 per pound. Applying these prices to the various products that were made from the Class IV SNF that was sent to the Carlisle plant, we get the following result:

5,223,382# NFDM x $1.0389 = $5,426,571

235,166# BP x $0.7686 = $ 180,749

Total Dollars $5,607,320

Dividing the total dollars by the total pounds of powder gives a blended value of $1.0272, which is 98.9% of the NFDM value.

Second, Land O' Lakes states that the finished moisture of the NFDM was 3.47%. To determine the percent of shrinkage or loss that happened in the Carlisle plant, we calculated how much finished product at 3.47% moisture would be made from all SNF delivered to the plant.

5,208,381 pounds of SNF made into NFDM + 234,461 pounds of SNF made into BP = 5,442,842 pounds of SNF.

5,442,842# x 1.0347 (SNF plus moisture) = 5,631,709#

Actual pounds of finished product = 5,458,548#

Shrinkage 173,161#

The difference between these two numbers represents the loss or shrinkage that occurred. Dividing the lost pounds by the total predicted pounds with no losses gives the percent loss. In this case it is 3.07%.

According to the CDFA Powder Yield study, Exhibit 26, the weighted average loss for all the plants in the study was 2.13%. While the Carlisle plant is within the range of losses, which ranged from 1.11% to 4.16%, it is significantly higher than the average.

Using the Land O' Lakes data to determine an appropriate yield would result as follows: NFDM product price x .989/.997 = Class IV SNF price. Dividing the .989 by the .997 gives a new divisor for the Class IV formula of 1.008. This number accounts for the lower value of BP and the higher shrink of the Carlisle plant. However, the Carlisle loss percentage is higher than the weighted average in the California study. If we instead use 2.13% loss instead of the 3.07% loss at the Carlisle plant the pounds of finished product from the SNF delivered to the plant would be as follows:

5,442,842# x 1.0347 (SNF plus moisture) = 5,631,709#

Shrinkage at 2.13% = 119,955#

Pounds of finished product = 5,511,754#

5,442,842# SNF / 5,511,754 product = .9875

Therefore using an average loss rate of 2.13% would result in a yield divisor of .9875;

Using this refined data to determine an appropriate Class IV SNF yield which accounts for both the lower value of buttermilk powder and an average shrinkage rate results in the following yield for the Class IV formula.

NFDM product price (less a make allowance) times .989 divided by .9875 equals the Class IV SNF price.

The multiplying by .989 and dividing by .9875 can be shortened to .9985. We therefore amend the Western States Class IV proposal to change the yield for the current divisor of 1.02 to dividing by .9985 to reflect what was in the record.

SNF = (NFDM - .14)/.9985

C. BUTTER

1. Change the price series for butter to the CME.

More than any other commodity, the butter price must track the CME and not NASS. The NASS is circular. Plants buy milk based upon the NASS survey, they process butter, they sell the butter, they report the NASS price. No matter what they do the NASS is a function of what they pay and what they sell the product for. Bob Wellington, of Agrimark, a major manufacturer of butter in the Northeast explained it this way:

> 12 One of the reason it's difficult because we have a circular
>
> 13 structure that was also noted. ***That when you increase the***
>
> ***14 price of butter, and in fact if we have tried to do that to***
>
> ***15 accommodate these higher costs involved, that increase in***
>
> ***16 the price of butter will get built back for the most part***
>
> ***17 back into the NASS survey, and it will just increase our***
>
> ***18 butterfat cost.***
>
> 19 The other classes don't have that circularity, and
>
> 20 that becomes a problem for us.

Wellington 1496 [emphasis added]. ***In large part, the use of the NASS is contributing to the problem of plants adjusting to buying butterfat at Grade AA price instead of the Grade A price.*** Wellington 1496. **Since plants sell at multiples of the CME price, the basis (that is**

the difference between the CME and the actual cash price) can change to reflect the changes in the market conditions. If the product series is based on the CME, then the CME will not change as bases change. On the other hand, if the NASS is the pricing series, then any change in the CME and the basis will show up in the NASS, trapping plants.

Use of the NASS price and the make allowances traps processors into obtaining profit only from the make allowance and not the market. Shad 1231.

5 A That is part of it. The pricing formulas don't
6 allow for let's say ingenuitive marketing on butter when
7 your price is tied to the -- your finished price that you
8 work so hard to market and gain a better margin on is cycled
9 right back into the formula and put on your input cost.

Grandage 1831. This explains his support for the use of the CME for butter.

3 We support Proposal 1 in terms of its use of the
4 CME price for the butterfat calculation, and the reason that
5 we feel that that more accurately holds true for Class IV
6 but not necessarily the other classes of milk is because in
7 Class IV, talking about butter product only , which that
8 price reflects, the price for the input cost is also the
9 price that the product is sold on. And using a NASS survey
10 number any attempt to recoup any costs other than milk input
11 costs in the selling price becomes part of the input cost of

12 the milk price components in the formula. That's not true
13 in the cases of butterfat use in other classifications or
14 other products. * * *
1 Again, number one, the butter cost for the input
2 butterfat is tied directly to the butterfat prices and the
3 sale of butter is also tied directly to those same prices.
4 It's not true for finished products and other butterfat
5 utilization classes. For this reason, butter is not able to
6 pass through any additional cost, whether it would be
7 procurement related to milk or any other cost increase that
8 would occur that would need to be passed through, whether it
9 would be for additional services for a customer, that would
10 end up being reflected in that cost for butter alone.
11 Because those finished product prices are the same
12 as the input prices, the ability to pass through, to change
13 the pricing in relation to the input cost is not there for
14 butter.

Grandage 1824-1825.

The use of the CME to set the market for butter was nearly universally testified to at the hearing. NASS' witness testified that the CME and the NASS mirrored each other. Milton 36. The difference over the last several years amounts to only 6 mills! Coughlin 242, Exhibit 12. Suiza sells its cream at a price over the CME. Yates 816, 818 (answer to Brenner). Land O' Lakes prices off of the CME

butter price. Schad 1232. Friendship Dairies prices off of the CME. Shankback 1641. California prices its butter off of the CME with a factor of -4.5 cents. Couglin 204.

The USDA used CME butter prices for decades in the FMMO system and there has been no opposition to this. 63 Fed. Reg. 35564.

The CME is the most current market price. Use of the NASS restatement of the CME price only delays the impact of the price without bringing any additional data, price, or reliability.

The CME is open and transparent to all. Thus any ability to manipulate the price is limited. Despite the fact that every single sale of milk or milk products involves the price of butter or butterfat and that is reflected in the CME, under the NASS only 25 plants, producing 63 percent of NASS eligible butter tell the rest of the country what the butterfat price is. Milton 58-59. The problems with the creation of an oligopsony in the buying of milk for butter is similar to that for NFDM discussed earlier.

2. Make allowance for Butter

a. The make allowance should be .096 for butter.

The make allowance for butter, now 0.114 should be reduced. In the first case, applying the methodology used by the Secretary in formulating the Final Rule and updating it with new data from both RCBS and CDFA, the allowance should be 0.096. The NMPF followed the USDA's approach in the Final Rule. Coughlin 217, Exhibit 10.

The RCBS showed a simple average of 13.6 cents with a range of 19.04 from the high to the low (values not given). The 9.6 cents would be in that range. It is also a number that approximates the make allowance for California.

This value subsumes the issues of marketing and return on investment.

b. Weighing of RCBS Survey and CA census for butter

The methodology in the Final Rule with its use of CDFA make allowances does create a dispute as to the weight of the make allowances to California. California butter plants in the CDFA study represent only 25 percent of the butter manufactured in the nation, but in the Final Rule's methodology, its make allowance for butter gets a weight of 65%, or over twice the impact it deserves. In the end this heavily weighted make allowance is used to compute prices for producers in which California purchased none of the milk. The objection is made here, not because we object to the result, but, rather, as this system is developed care must be made to correctly determine make allowances.

3. Yields for butter

The yield of 82 was not directly challenged. Land O' Lakes did imply a yield of 81.1 in developing tables for testimony at the hearing. Schad 1205. There was no other evidence presented at the hearing that called for any changes to the yield for butter.

D. DRY WHEY

1. Price Series

There is no series of prices for dry whey comparable to cheese, butter and non-fat dry milk. Though it plays a significant role, dry whey's total contribution to the producer price is limited to a small portion of the class III skim price. As a result, concerns about circularity of pricing, manipulation, and the like, though still present, are at such a level that continuation of the NASS survey is appropriate at this time.

2. Make allowance for dry whey

Select, WSDPTA and other organizations in conjunction with the overall changes to the yields, reduction in cheese make allowances, and other changes, propose increasing the make

allowance for dry whey to 15 cents per pound from the current 13.7 cents. This represents a one cent addition to the proposed 14 cent per pound make allowance for NFDM. The testimony showed that there were additional costs to make dry whey of approximately one cent per pound. The price herein supported is that proposed by NMPF. Coughlin 198.

This price is supported by the only direct testimony on the actual total cost of producing dry whey in an operating plant. DFA's witness testified that based upon its plant experience, it cost 14.78 cents per pound to make dry whey. Hollon 1540.

There was other testimony on the issue of dry whey, to be sure. IDFA proposed 15.92 cents, but, as with its other proposals, presented no evidence from any plants as to actual, as opposed to theoretical, costs. Kraft testified that its new plant at Tulare, California, produced dry whey at 2.6 cents more than it cost to produce NFDM at its older plant at Visalia. Reinke 1041. This does not answer the question of what is the make allowance for dry whey. Leprino's witness testified that theoretically it cost 2.5 cents more to produce dry whey than NFDM. Vankatachalan 1387-1400. Westfarm had similar testimony. Exhibit 54. Marshall 1785.

The fundamental, and fatal, flaw to the discussions of additional costs for dry whey is there is no base provided to add on the costs. Why not just testify as to the cost for dry whey like DFA? Left unanswered is the base the low of 11.02 cents reported by RCBS or the high of 14.723 cents. Ling 158.

There is also the problem with using theoretical computations. In Tillamook's letter to Marshall, Exhibit 54, the decision was made not to make a dry whey plant because the costs were so high. That is not evidence of what the costs are. One plant testified as to its costs and that testimony should be accepted. To those who argue it is too low, they, too, had an opportunity to disclose actual costs and did not.

The impact of this is not insignificant. Due to the 5.9 multiplier in the class III price formula, every penny increase in the make allowance for dry whey translates into an almost six cent reduction in the class III price. As testified and argued elsewhere, the overall class III price is too low. Select, WSDPTA and other organizations support raising the make allowance in this case because it should be and because we believe the Secretary will agree that changes in yields and make allowances for protein will more than offset this reduction.

3. Yields for dry whey

There was no evidence presented at the hearing that called for any changes to the yield for dry whey.

V. There is no basis to reduce the butterfat price to a Grade A level.

Proposals to replace the use of the Grade AA butter price (CME or NASS) should not be adopted. In the first place, the Congress directed the Secretary to implement the Final Rule that used the full value of Grade AA butter. As a result, the change of this fundamental pricing factor can only occur if the Secretary finds there have been changes in economic conditions.

A. There is no justification for reducing the butterfat prices.

Aside from the make allowances, the single most contentious issue in this proceeding involves proposals to reduce the price of butter as used in the pricing formula. These range from reducing "only" the class IV to those who propose a system wide reduction in the butter price series. ***Select, WSDPTA and other organizations oppose any reduction in the price series for butter. The use of AA butter was neither an "oversight" not was it "unintentional".*** The Secretary for several years signaled that the Final Rule pricing on butter would reflect the undisputable fact that our industry has moved almost entirely to a Grade AA butter market reducing A and B butter to marginal players in this dynamic portion of the industry. Producers should be able to participate in this new arena.

None of the proposals to reduce butterfat in any of the classes should be adopted. The reduction of six cents in class IV only under Proposal 8 would reduce class IV prices by 17 cents and producer prices 4.6 cents and the reduction for class II, III, and IV under Proposal 3 would reduce producer prices in the blend by 10.6 cents. Coughlin 201, Hollon 1340. There is no justification in the record to reduce producer income.

Several general theories were given in support of the reduction in the butter price– (1) the use of grade AA without a reduction was an "oversight" or "mistake" on the part of the Secretary, (2) there is an historical relationship that needs to be preserved, (3) there needs to be "alignment with California", and (4) the producer price is too high for the market. Each of these are addressed in turn.

One witness testified that the six cents was already in the market to reimburse plants for the cost. Grandage 1825. **Overall, it is too early to determine how the market will react to this change and whether the theoretical losses and disorderly marketing will actually occur.** Consideration, let alone execution, of lower butterfat prices should await a later date when there is more information.

1. The use of Grade AA butter without adjustment is not an "oversight" or a "mistake".

The use of Grade AA butter is no oversight on the part of the Secretary. As one proponent of reducing the price for class IV stated

> 1 And I just wanted to point out that
> 2 in addition to yesterday's discussion of the BFP Committee
> 3 report, there was a recommended decision, there was a final
> 4 rule, there were -- I personally attended in at least
> 5 different market administrators' offices, demo, show and
> 6 tells, road shows about the implementation and resulting

7 effects of the recommended decision and the final rule.

8 Everyone of those included the AA butter price as a price

9 input. In many cases there was extensive points pointed out

10 to all the attendees that that was going to be if the final

11 rule were adopted

12 In addition, there were articles written by

13 consultants, some of whom have appeared on the stand

14 already, about that effect. There were articles in trade

15 journals about that. And to say that was an oversight, I

16 would say is probably a comical conclusion.

Hollon 1628-30. When questioned as to whether it was an oversight of the government, one witness was forced to admit, it was an oversight of the industry. Ledman 1360-1361.

2. The historical use of Grade A butter and Grade AA with an adjustment has no place in the modern federal milk orders.

Despite the fact that 90 percent or more of the butter is now Grade AA, Rourke 25, and only about 5 percent is Grade B butter, Ledman 1338, a refrain that was repeated over and over again was that the Grade AA price used to pay producers needed to be reduced to reflect the historic Grade A price. Yates 800, Yonkers 312-313. The Secretary's decision to replace the Grade A butter series with Grade AA minus nine cents was also repeatedly presented as an argument in favor of making this change now. One witness estimated that the real difference between NASS and a putative Grade A price was NASS minus two cents. Ledman 1335.

Each and every one of those arguments fails to address the fact that in 1998 when the Secretary made the adjustment to Grade AA minus nine cents, he did so in response to two conflicting

situations. First, the federal milk orders, as then constituted, priced butter as Grade A and Grade A trading had diminished to the point that there was no longer any trading of Grade A butter on the Chicago Mercantile Exchange. Second, the Secretary was in the midst of the FAIR Act reform. Pursuant to authority under the orders, ***the Secretary had the obligation and authority to find a replacement equivalent series for Grade A butter.*** This he could, and did, do by informal rulemaking. At that time the appropriateness of the twenty year old use of Grade A butter in the FMMOswas not addressed as the industry was then addressing complete reform of the FMMOs under the FAIR Act. It made no sense at that time to call for a formal rulemaking hearing to change the FMMOs which were soon to be replaced with a new butterfat price scheme when that was already being addressed more timely through the FAIR Act proceedings.

In this way, arguments that the decision in 1998 established a precedent that the Secretary had to follow in the FAIR Act, are, simply, wrong.

3. <u>The butter price is already aligned with California which uses Grade AA butter.</u>

NMPF opined that one reason requiring the reduction of the class IV butter price was to create better alignment with California. Coughlin 203. The difference, now, between California and the FMMO is 4.79 cents. California reduces the CME by 4.5 cents to reflect the distance from the market. Coughlin 206. Thus the historic alignment between California and the FMMO is already present. ***If the six cents is reduced from the class IV, the California butter at Chicago would be <u>greater</u> than the FMMO butter at Chicago by 5.76 cents!***

The only time in which alignment between California 4a and the FMMO class IV price is an issue is when producer milk is converted to butter. Coughlin 244. In point of fact, the real issue is whether the FMMO should reduce the butterfat prices for the benefit of class I handlers. Yates 800. Land O' Lakes makes a strong statement that relief is due class I handlers. Schad 1199. The cream from class

I handlers is the result of producing a consumer product with higher retail value– skim and low fat milk. 806-807. On a skim basis the retail price of this milk is higher than the full fat milk. In other words, plants are making a sufficient profit on the skim milk to cover the cost of removing and selling the cream at multiples of the CME Grade AA butter price. Schad 1231. Sixty to 65 percent of the butter comes from class I processors. Wellington 1492, Schad 1231, 1204. The NASS survey of butter prices already includes California so that its one quarter of the market can reduce the national price for purposes of pricing butterfat in the FMMOs. Coughlin 213.

4. The resulting price does create too high a price for butter.

From the start, during this period of an "oversight" or "mistake", the price of butter has been the single star in dairy pricing since January 2000. No one presented a single instance of disorderly marketing, or real losses resulting from the new pricing. Strikingly, if there was the need to reduce producer income by 50 to 250 million dollars because of a "mistake" surely there would be hard and actual evidence of real, not imagined, disorderly marketing of milk, imparting even greater losses on the industry.

Grade A cream routinely sells in multiples of the CME butter price. Yates, Shankback 1642. These multiples can be adjusted to meet market conditions. Shankback 1642, Grandage 1826. There is no reason that the use of multiples will adjust to the market.

5. Use the same butterfat value for all classes.

Proposals 3 and 8 propose to reduce the butterfat price for only classes II, III, and IV in the first and class IV in the second. The elegant system established by the Secretary on a uniform butterfat formula for all classes should not be changed. To do otherwise will result in disorderly marketing by giving some classes advantages over other classes for the same butterfat. **The very interclass substitution of butterfat demands that it be priced universally for all classes.**

A price change only to class IV would result in price changes between class II and IV of as much as 43 cents in January and February 2000, and in the end would destroy the wonderful solution of class II pricing that is one of the gems of the Final Rule. Class II handlers will again be subject to widely disparate prices between liquid and dry ingredients. Coughlin 231 (English cross). Failure to include class I in the formula could create some months in which the class II price exceeded the class I price in some orders. IDFA supports a universal butterfat price, albeit a lowered one. Yonkers 313-314. In cross-examination, Marshall of Westfarm opined that different class III and IV butterfat prices could result in costly movement of butterfat from one class to another. 632. See, also, Ledman 1335-1336. Hershey testified that butterfat should be priced the same on all classes. Throne 1675.

Finally, Congress has approved the use of Grade AA prices without reduction. Changes now would violate the law, at least in spirit.

VI. Do emergency conditions exist to warrant the omission of a recommended decision?

The Congress required that the Secretary hold a hearing on manufacturing grade prices and to issue and implement a proposal on January 1, 2001. The complexity of this issue, the lateness of the hearing itself, and the shortness of time make issuance of a proposed rule with invitation for comments and a final rule impossible. Therefore Select and the other dairy producer organizations propose that the Secretary issue an "interim final rule" such as was issued in the Class I transportation credits in the southeastern orders in 1997. This will permit the rule to take effect January 1, 2001, but will also keep the hearing process open for responses to the rule that the Secretary can timely respond to.

The request to reduce class IV butterfat prices, or reduce class II, III, and IV butterfat prices, do not come under the same statutory provision, but, instead, were noticed and heard under the Secretary's plenary authority to consider amendments to the orders when he deems it necessary. In

that regard, Select and the other dairy producer organizations request that a preliminary decision be issued on the reduction of butterfat pricing and permit comments before proposing a rule for consideration by the dairy producers.

Bifurcating the issues in such a way was also done in the hearing on Class I transportation credits as concerned other proposals heard at that time.

VII. Miscellaneous issues

A. Issues involving Class I and II pricing.

Several proposals and witnesses suggested reduction in class I differentials if any increases occur in the class III and IV prices. These differentials were mandated by federal law and cannot now be changed. In time the Secretary has the authority to make changes. That time is not now.

VII. Conclusion

The Secretary has a formidable task ahead, however, the Courts, the Legislature and even the Secretary himself has laid down the guidelines necessary to set the appropriate levels. The propositions in this Brief are based upon attendance at the hearing and a careful and critical review of the hearing testimony and are fully supported in the record.

Respectfully submitted,
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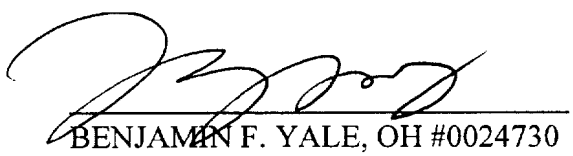

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CERTIFICATE OF SERVICE

I hereby certify that an accurate photostatic copy of the foregoing was served upon the following this 14 day of July, 2000, by ordinary United States Mail service, postage prepaid.

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