Exhibit _____
Federal Order Hearing, Week of September 14, 2006
Docket No. AO-14-A74, et al.; DA-06-01
NMPF Statement and Presentation of Publicly Available Data in Support Of the Incorporation of Energy Cost Indices into any Make Allowance Changes

Introduction

My name is Roger Cryan. I have been Director of Economic Research for the National Milk Producers Federation (NMPF) for six years. Prior to that, I was the economist in the Atlanta Milk Market Administrator's office. My Ph.D. is in agricultural economics from the University of Florida, I am a member of the Secretary of Agriculture's Advisory Committee on Agricultural Statistics and several professional associations, and I have been involved with agriculture and agricultural economics for twenty-five years.

NMPF is the voice of America's dairy farmers, representing over three-quarters of the country's 67,000 commercial dairy farmers through their memberships in NMPF's 33 member cooperative associations.

It is the position of the National Milk Producers Federation that any changes in the manufacturing cost, or "make", allowances for cheddar cheese, nonfat dry milk, butter, and whey should incorporate monthly energy cost adjustors.

It is our intention at this hearing to testify only on the use of energy cost indices with respect to the cost of processing data presented this week, and to ask that notice be taken of pertinent publicly available data, including Producer Price Indices for Industrial Electricity and Industrial Natural Gas[1].

NMPF urges the inclusion of a monthly indexing adjustment to the energy cost components of the recalculated make allowances. The most volatile element of cost, by far, has been energy. Increases in other costs have been more gradual, and have been partially offset by increased productivity in the manufacturing process. Energy price increases in recent years have overshadowed other cost changes and gains in productivity. These increases have not been covered by the current fixed make allowance. The drastic rise and fall of these costs makes a one-time fixed increase in the make allowance inappropriate. When energy prices rise dramatically, fixed make allowances fail to provide adequately for plant costs; when they fall precipitously, they provide an unfair windfall to processors at the expense of producers. NMPF therefore urges USDA to adopt a mechanism that would adjust the make allowances on a monthly basis for changes in energy costs, using the most recent available Producer Prices Indices for Industrial Electricity and Industrial Natural Gas.

Some of this testimony will seem to simply restate our January testimony. However, the introduction of Dr. Stephenson's data and the movement of energy prices since January both demand a modest but significant update of this statement.

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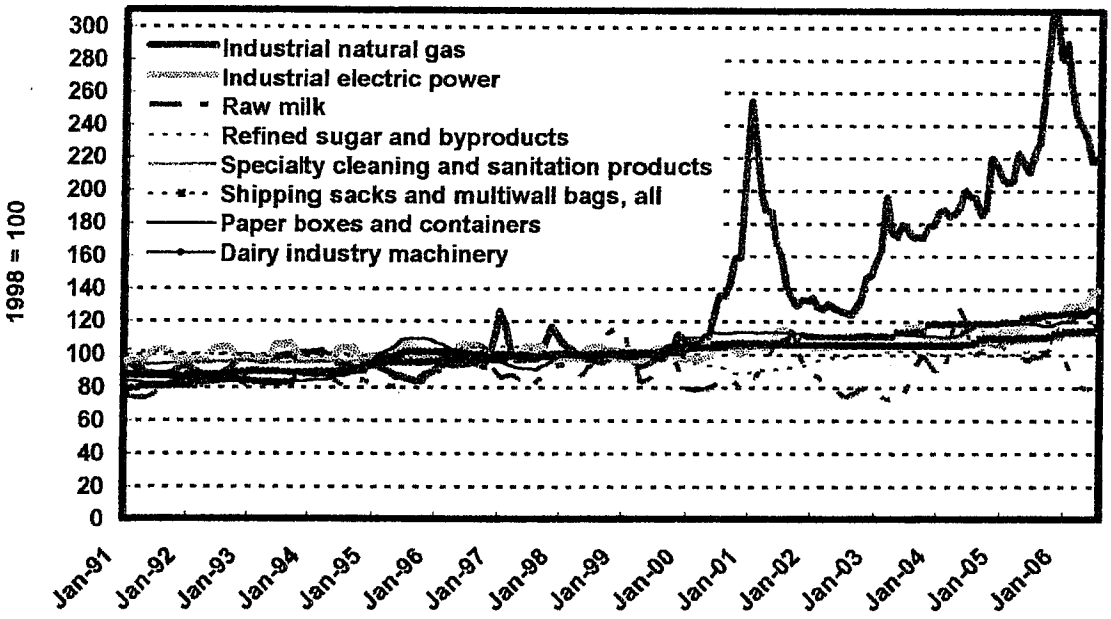
[1] BLS Series WPU0553, Base = Dec 1990, and BLS Series WPU0543, Base = 1982, available from the Bureau of Labor Statistics web site at: http://data.bls.gov/cgi-bin/srgate

Indexing Energy Costs in the Federal Order Make Allowances

Of all components of manufacturing costs, the most volatile by far are energy costs. These can swing violently, while such costs as labor, sewage, laundry, and insurance tend to move slowly and consistently. A fixed make allowance, such as the current one, depends upon an estimated energy cost at a single point in time. If a fixed increase were implemented on the basis of the extraordinarily high energy costs incurred in late 2005, the resulting make allowance would now be excessive, as natural gas prices, for instance, have regressed toward their long-term norms, as our January testimony anticipated. The Producer Price Indices in Figure 1 have been updated since January, and demonstrate this point. [2]

Figure 1. Producer Price Indexes, Selected Processing Inputs



Source: Bureau of Labor Statistics

A regular adjustment to this highly volatile element of the cost of dairy processing is the best way to maintain equity between producers and the processors of the benchmark products.

In the interests of equity and of maintaining each market's capacity for balancing, the Federation urges that the rule that results from this proceeding include formulas to provide for monthly adjustments of processors' energy costs, based on published Producer Price Indices. Such indexing would allow specific and regular adjustments – both up and down – to reflect changes in plants' costs of natural gas and electricity.

[2] The chart shows the following published PPI data series, all adjusted so the annual average for 1998 is equal to 100: WPU016, WPU023103, WPU02320114, WPU023302, WPU023502, WPU0253, WPU0543, WPU0553, WPU06720102, WPU09150218, WPU091503, WPU116101. They may be most easily retrieved from the following Bureau of Labor Statistics web page: http://data.bls.gov/cgi-bin/srgate

NMPF recommends that the energy index adjustments be calculated from the Producer Price Indices for Industrial Natural Gas (BLS Series WPU0553, Base = Dec 1990)[3] and Industrial Electric Power Distribution (BLS Series WPU0543, Base = 1982), weighted by the direct costs of electricity and fuels per pound of product, as estimated for 2004 by USDA/RBS and CDFA and for 2005 by Dr. Stephenson.

Whether the energy cost estimates are expressed in 2004 prices or 2005 prices, the corresponding annual average PPI's would be used as the bases. The 2004 annual average PPI was 201.7 for Utility Natural Gas and 147.2 for Industrial Electricity Distribution. The 2005 annual averages were 249.4 for Utility Natural Gas and 156.2 for Industrial Electricity Distribution.

Although a modest one-time adjustment could move the formulas closer to equity under current conditions, a new fixed make allowance could already be out of date when it is implemented. It will unfairly penalize processors when input prices go above the baseline in the revised survey, and unfairly penalize producers when input prices go below the baseline. An energy cost indexing element can and should be added to the formula.

Calculating the Energy Cost Adjustment

If the make allowances are updated with the 2004-equivalent or 2005-equivalent survey data, we recommend adjusting them each month to account for the often violent rise and fall of energy costs. We recommend that the Electricity and Fuels elements of plant costs be inflated or deflated according to the following formula:

$$\textit{Make adjustment} =$$

$$[\,(\textit{Industrial Electricity PPI}_{current}/\textit{Industrial Electricity PPI}_{2004}) - 1] * \textit{Electricity Cost}_{2004}$$

$$+\,[\,(\textit{Industrial Natural Gas PPI}_{current}/\textit{Industrial Natural Gas PPI}_{2004}) - 1) * \textit{Fuels Cost}_{2004}$$

The resulting make allowances would be equal to a base make allowance plus an energy make adjustment. The energy costs to be inflated could be derived from the energy elements of each cost survey in proportion to their weight in the final calculation of each base make allowance.

The objective of the formula is to adjust the energy components of the cost of processing for each benchmark commodity. Energy is by far the most volatile element of processing cost. Automatic adjustments to energy costs will cause the make allowance to more consistently reflect the costs that it is intended to reflect. The resulting make allowance would be neither too high nor too low, as energy costs swing up and down.

Setting the Energy Cost Base

[3] Another natural gas PPI, WPU0531, tracks the price of natural gas at the wellhead or, where it is a by-product of other processing, at the processing plants. This has been confirmed by personal communication with Melissa Wolter of the Bureau of Labor Statistics.

The energy costs contained in the RBS and CDFA[4] surveys are for 2004. Dr. Stephenson has made calculations to express the energy costs contained in his survey in 2005 prices. Using the same PPI's we are discussing, the Stephenson data (if it is made available to the record) can be expressed at 2004 prices or the RBS and CDFA data can be expressed in 2005 prices. Once all these energy costs are expressed consistently, they could be combined using an appropriate weighting to establish a 2004 or 2005 base energy cost. The make adjustment formulas can use the corresponding annual average PPI's as the denominators, with current PPI's as numerators.

Table 2. Dairy Product Plant Costs, 2004, $/Lb.

USDA/RBCS

Cost items	Cheese	Butter	Powder	Whey
Electricity	0.0043	0.0091	0.0121	0.0101
Fuels	0.0076	0.0095	0.0382	0.0227

CDFA

Cost items	Cheese	Butter	Powder	Whey
Electricity	0.0086	0.0091	0.0170	0.0334
Fuels	0.0078	0.0019	0.0241	0.0226

Sources: USDA/RBCS, CDFA

Table 2 shows 2004 average plant costs of electricity and fuels from the RBCS and CDFA surveys. We offer these for ease of comparison. We hope comparable numbers can be made available from the Cornell survey.

Use of Industrial Natural Gas and Industrial Electricity PPI's

Producer Price Indices are published by the Bureau of Labor Statistics (BLS) as a measure of changes in the prices of a large number of inputs to production. The prices for some inputs are measured separately for residential customers, commercial customers, and industrial customers. Industrial customers include manufacturing and mining. These Indices are published monthly, in mid-month.

The Producer Price Index for Industrial Natural Gas is designated as BLS Series WPU0553. Its base period is December 1990; that is, the index is set equal to 100 for that month. This series tracks the average price of natural gas sold by utilities to industrial customers, defined as manufacturing and mining operations. A note from the economist who works most directly with the Producer Price Index at BLS was provided at the January hearing as an attachment to our statement; the detail of this note clearly distinguishes the Industrial Natural Gas index as the one most directly applicable to manufacturers costs of energy.[6]

The Producer Price Index for Industrial Electric Power Distribution is designated as BLS Series WPU0543. Its base period is 1982; that is, the index is set equal to 100 for the annual average of 1982. This series tracks the average price of electricity sold by utilities to industrial customers, defined as manufacturing and mining operations.

Both of these series can be retrieved from the following page in the website of the Bureau of Labor Statistics using their Series ID numbers:

http://data.bls.gov/cgi-bin/srgate

We ask that notice be given to the data in these series available through the date of this hearing.

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[4] The USDA/RBS and CDFA data are on the record of the January hearing.

Evidence for Applicability of an Energy Cost Adjustors

My January statement and testimony provided evidence of the applicability of energy cost adjustors. I refer the Secretary to that statement.[5]

Monthly Application of Energy Cost Adjustor

The energy price indexes we cite are published monthly by the Bureau of Labor Statistics. The make allowance should be made as current as possible by monthly updating. This would provide for smaller month to month changes than if adjustments were made quarterly or annually. Just as the milk price formulas are calculated and applied each month as a formula of the dairy product prices, so should an energy cost formula be calculated and applied each month in the revised formulas.

Amended Language to Effect Energy Cost Indexing

My January statement offered specific Federal order language to effect our proposal for energy cost indexing of the make allowances. I again refer the Secretary to that statement.

Conclusion

The formulas need to be adjusted on a regular basis to reflect continuing fluctuations in energy costs. The use of an energy price index in the formula is the best and fairest way to deal with this issue. Revised make allowances with energy cost indexing would provide specific relief to plants squeezed by higher energy costs, then reduce make allowances again when the squeeze is off.

We urge Dairy Programs and the Secretary of Agriculture to consider an energy cost adjuster that incorporates monthly energy cost indexing.

[5] Exhibits 58 & 62.