Dairylea
Cooperative Inc.

October 2, 2006

Hearing Clerk
STOP 9200-Room 1031
United States Department of Agriculture
1400 Independence Ave SW
Washington, DC 20250-9200

Delivered By Email

Dear Hearing Clerk:

Dairylea Cooperative Inc. files this brief in response to the hearings called relative to the Federal Order make allowance issue. Specifically, this brief is in reply to the reopened hearing occurring on September 14-15, 2006.

The members of Dairylea, as do many dairy farmers, feel that a better solution to adjusting make allowances is to correct the NASS survey pricing circularity problem as it relates to setting Class III and IV milk prices. Correcting this issue can eliminate the need to adjust make allowances. [1]

Dairylea recognizes that a make allowance is a necessary component in product pricing formulas when using wholesale product prices to determine minimum raw milk prices. However, Dairylea takes issue with the fact that manufacturers can receive a regulated adjustment to their minimum raw milk price for changes to their input costs for such things as energy, fuel, labor, insurance, interest rates and other factors, while dairy farmers can not. Over the last five years, dairy farmers' costs of producing milk have increased substantially – for the same reasons that manufacturers' costs have increased. Yet, at issue, the United States Department of Agriculture is considering increasing make allowances for the manufacturers. Doing so will decrease Class and blend prices to dairy farmers. A Federally mandated decrease in the milk price to dairy farmers is not the appropriate response to the cost of production challenges and the cost-price squeeze facing dairy farmers.

Over the last five years, many manufacturing companies have found ways to mitigate their profitability issues relative to rising input costs. These actions have included reducing over-order premiums paid on their milk purchases, trimming unnecessary costs from their operations, buying inputs in a way that achieve increased pecuniary economies and implementing risk management strategies to manage their input costs. Indeed, some have even increased the sales price of its products to pass along the higher costs. It is well known that this last option, increasing the price of the product is not a viable solution if the manufacturer's product is included in the NASS pricing survey – due to the circularity issue.

[1] Dairylea filed a Class III and IV hearing proposal on September 28, 2006 that deals with correcting the circularity issue and eliminating the need for adjusting make allowances.

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Significant milk production increases earlier this year have been the leading contributor to the lower milk prices. However, the strong growth in milk production has not led to, or is part of, a chronic milk surplus situation. Today the situation is far different than existed in 2002 when the last milk price crisis occurred. At this time during 2002, the Commodity Credit Corporation (CCC) had cumulative year-to-date purchases of skim solids equivalent to 6.8 billion pounds of milk. Right now for 2006, CCC has purchased a cumulative skim solids equivalent to 0.7 billion pounds of milk – just 10 percent of the 2002 amount. In so much as their have been purchases by the CCC this year, the process has been one of handling the year's seasonal milk surplus and holding it for use later – as opposed to removing the milk from the marketplace with no prospects of future use.

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In the Agricultural Marketing Agreement Act of 1937 (AMAA), Congress "declared that the disruption of the orderly exchange of commodities in interstate commerce impairs the purchasing power of farmers and destroys the value of agricultural assets which support the national credit structure and that these conditions affect transactions in agricultural commodities with a national public interest and burden and obstruct the normal channel of interstate commerce."[2] It was this law and this will of Congress that led to the Federal Milk Marketing Order program. Federal Orders were

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- Identify the extent of the make allowance changes justified by the record after taking all other issues into consideration.
- Reduce the change by 52 percent – the average Class I and II utilization under all Federal Orders during 2005.

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- Implement the reduced make allowances. Immediately hold an emergency hearing to develop the record to hold Class I and II prices harmless to a make allowance change.
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Dairylea offers the following solution to this conundrum.

- Identify the extent of the make allowance changes justified by the record after taking all other issues into consideration.
- Reduce the change by 52 percent – the average Class I and II utilization under all Federal Orders during 2005.

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[3] Excerpts taken from the Agricultural Marketing Agreement Act of 1937, as amended.

- Implement the reduced make allowances. Immediately hold an emergency hearing to develop the record to hold Class I and II prices harmless to a make allowance change.
- Upon the implementation of the "hold harmless" decision, increase the make allowances to reflect 100 percent of the change as established in the forthcoming decision on make allowances.
- Expedite the hearing process to reach a permanent solution to the circularity issue.

This approach to the challenge will effectively result in the same impact on blend prices during the initial implementation of the make allowance change as the Class I and II "hold harmless" would have.

Dairylea's members can not support changes to make allowances that also lower Class I and II price levels. Its members, grudgingly, could accept the temporary solution as outlined above, provided it leads to immediate hearings on the Class I and II issue and the circularity issue.

Dairylea appreciated the opportunity to respond to the make allowance issue. If you need additional information or further clarification, please do not hesitate to contact me at 1-800-654-8838, extension 5658.

Dairylea Cooperative Inc. is a farmer-owned agricultural marketing and service organization with more than 2,500 member farms located throughout the Northeast. As the largest milk-marketing organization based in the region, Dairylea sells more than 5.5 billion pounds of raw milk annually through a milk-marketing network that reaches from Maine to Ohio to Maryland. Through its Dairy Marketing Services joint venture, Dairylea members are pooled on Federal Orders 1, 5 and 33.

Sincerely,

Edward W. Gallagher

Edward W. Gallagher
Vice President, Economics and
Risk Management