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January 25, 2002

Joyce A. Dawson, Hearing Clerk  
United States Department of Agriculture  
Room 1081, South Building  
1400 Independence Avenue, S.W.  
Washington, D.C. 20250-9200

**In Re: Milk In The Northeast and Other Marketing Areas**  
**Docket Nos. AO-14-869 et al, and DA-00-03**

Dear Ms. Dawson:

Enclosed are three copies of "Comments and Exceptions of Dairy Farmers of America, Inc., to the Recommended Decision" for the above captioned case.

Thank you for your cooperation.

Very truly yours,

MILSPAW & BESHORE

  
Marvin Beshore

MB:cts  
Enclosure

cc: Gregory Cooper, Esquire (w/encl.)  
Carol Warlick, Marketing Specialist, USDA (w/encl.)  
Henry Sheaffer, Assistant Market Administrator (w/encl.)  
Clifford Carman, Chief, Order Formulation Branch (w/encl.)  
Charles M. English, Esquire (w/encl.)

Joyce A. Dawson, Hearing Clerk

January 25, 2002

Page 2

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Dennis Schad, Land O' Lakes (w/encl.)

Ed Gallagher, Dairylea (w/encl.)

Bob Wellington, Agri-Mark (w/encl.)

Michael Brown, National All-Jersey (w/encl.)

Doug Marshall, Northwest Dairymen (w/encl.)

**BEFORE THE UNITED STATES DEPARTMENT  
OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE**

<b>In the Matter of</b>	:	
	:	
<b>MILK IN THE NORTHEAST AND OTHER MARKETING AREAS</b>	:	<b>Docket Nos.: AO-14-869 et al; DA-00-03</b>

**COMMENTS AND EXCEPTIONS OF DAIRY FARMERS OF AMERICA, INC., TO  
THE RECOMMENDED DECISION**

**I. Introduction.**

These comments and exceptions are submitted on behalf of Dairy Farmers of America, Inc. (DFA). DFA is a Capper-Volstead qualified cooperative which markets milk on behalf of its more than 16, 900 member dairy farms on 10 of the 11 federal milk market orders.

DFA has joined in the consolidated comments filed on behalf of Select Milk Producers, DFA, National All-Jersey and others in support of the protein price formula in the recommended decision. DFA is also a member of National Milk Producers Federation and supports the Federation's comments in support of the recommended decision, except to the extent that different positions on a few issues are stated herein.

DFA wishes to emphasize that the recommended decision is the near-culmination of a long, but necessary, process mandated by Congress to re-evaluate the price formulae for manufacturing classes of milk, in light of the substantial reduction in those class prices which the initial federal order reform decision implemented. The recommended decision, with its fine tuning of the protein component formula in Class III, and the continued rejection of various

attempts to reduce the product price series used to set the minimum prices, is a substantial move in the direction of restoring to dairy farmers the minimum level of revenue for manufacturing classes which pre-dated federal order reform. As such, it is, on balance, a substantial advance in the federal order system and DFA urges its prompt implementation.

**II. DFA Supports the Product Prices, and Adjustments to Those Prices, Adopted in the Recommended Decision for Use in the Class III and IV Price Formulas.**

DFA supports the product prices and adjustments to those prices adopted in the recommended decision for use in the Class III and Class IV formulas. Specifically we support the decisions: (1) To continue the use of NASS-collected prices, rather than CME prices; (2) To refuse to include 640-pound block prices in the cheese prices collected; (3) To maintain the three-cent add-on to barrel prices when averaging barrel and block prices; and (4) To adjust the barrel cheese prices to 38% moisture. We will discuss briefly each of these issues.

**A. NASS Survey Prices Should Continue To Be Used in Class III and Class IV Price Formulas.**

Several proposals in the hearing notice suggested using Chicago Mercantile Exchange (“CME”) prices rather than USDA National Agricultural Statistics Service (“NASS”) prices in Class III and Class IV price formulas. USDA correctly, in our view, adopted NASS prices for the recommended rule. That action has been enhanced and reinforced by the subsequent legislation which will greatly strengthen the reliability, completeness, and integrity of the NASS price series. The NASS prices for dairy products used to formulate Class III and IV minimum milk prices are the correct prices to use, as the Department has concluded.

**B. 640-Pound Blocks of Cheddar Cheese Should Not Be Included in the NASS Survey.**

The Department correctly refused to adopt Proposal 12 which would include 640-pound

blocks of cheddar cheese in prices used to establish Class III milk prices. The record established, and the Department concluded, that there is an insufficient basis of arms-length trading in this cheese variety to make it a part of the market-price for cheese discovered via the NASS survey. The record revealed a lack of sufficient reporters of 640s to make it a viable part of the NASS survey. (Tr. 54-55) That confirmed the National Cheese Exchange experience where trading was disbanded for lack of interest after a short experiment. As the decision noted, much of the trade in 640s tends to involve customer-specified characteristics which would make such transactions unsuitable for a price series. (Tr. 1575). The market in 640-pound blocks of cheddar cheese does not involve sufficient buyers and sellers in arms-length transactions to provide good data to establish the Class III price for producer milk in all federal milk orders.<sup>1</sup>

C. The Department Correctly Found That Three Cents Should Continue to Be Added to the Moisture-adjusted Barrel Cheese Price to Make it Comparable to Block Cheese Prices.

DFA commends the Department for the decision to adhere to the current three-cent adjustment to barrel cheese prices and not to adopt the NCI/IDFA proposal to reduce that adjustment to one-cent (thereby reducing the Class III milk price by 15-20 cents per hundred-weight). The proposal to reduce the adjustment was not supported by the record and was premised upon the demonstrably incorrect proposition that: "This 3¢ really consists of two components [cost of manufacture and a moisture adjustment]" (Yonkers, Tr. 309). In fact, the

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<sup>1</sup> If 640 prices were to be collected and used in the NASS series, another adjustment to the average price, similar to the adjustment for averaging barrels and 40-pound blocks, would need to be determined. Obviously, the cost of manufacturing and packaging a 640-pound block of cheese is something less than that for 16 separate packages of 40-pound cheese blocks. Consequently, the 640-pound block price would need to be adjusted appropriately if it were to be averaged with 40-pound block prices for the purpose of pricing producer milk. When 640s traded on the National Cheese Exchange, they tended to trade at a price between the price of blocks and barrels.

three-cents does not reflect a moisture adjustment factor at all because it is representative of the historical difference in market value of barrel cheese versus block cheese after adjustments for moisture. As the recommended decision concluded, the historical record of barrel and block prices validates that spread which should be retained.

D. The Department Correctly Concluded that the Moisture-adjustment to Barrel Cheese Prices should be to 38% to Make Those Prices Comparable to Block Cheese Prices.

The Department correctly concluded that barrel prices should be adjusted to 38% moisture, rather than 39%, for averaging with block cheddar prices. The only evidence of record concerning the average moisture of block cheese is that it is 38% moisture. Consequently, that is the correct moisture level to which barrel prices should be adjusted. The barrel cheese moisture level is collected by NASS when collecting barrel price data. That figure has been enhanced in reliability by the legislation giving NASS additional tools to enable it to collect and publish universal, accurate and reliable cheese prices. To convert barrel prices to 39% moisture, for price discovery purposes, when block cheese is known to average 38% moisture is nothing more than a cheap-shot price-reducing gimmick for the benefit of cheese manufacturers. The component price formulas, including the make allowances, are carefully crafted to avoid erring on the high side of producer prices in many respects, particularly in areas where precision is not possible. Where precision is possible, and cheese prices can be precisely adjusted to the known comparable moisture, there is no reason that a price series, if it is to have some integrity should not use the correct moisture figure. The Department's decision correctly, and properly, continues to do just that and DFA commends the Department for that decision.

III. Exceptions to the formula for Pricing Other Solids (Whey) in Class III.

In determining the appropriate pricing for other solids in Class III, DFA has two

objections to the recommended decision: First, DFA objects to the proposed increase in the make allowance of nearly 2 cents per pound of dry whey, an increase which is not based on any credible evidence in the hearing record. Secondly, DFA objects to the removal of the price snubber for the value of other solids, which had the effect of “flooring” the price of other solids at \$0.00. Under the recommended decision, cheese makers could actually have their cost of protein reduced by the extent to which the make allowance for whey is greater than the market price. We will discuss each point in turn.

A. There Is No Substantial Evidence to Support the Increased Make Allowance for Whey.

DFA has consistently advocated in this proceeding that the Department should use all credible, reliable information available to it with respect to make allowances and we believe the Department did so with respect to most products and commend the decision in that regard. We wish to comment in two respects with respect to make allowance issues. First, we highly commend the Department’s continued refusal to consider the NCI survey data for cheese manufacturing costs. That survey did not meet minimum acceptable standards for reliable information in a federal administrative, on-the-record rulemaking held pursuant to 5 U.S.C. §§ 556-57. We argued, and continue to believe, that relying upon such data would seriously demean the importance of sworn, first-hand, subject-to-cross-examination testimony which is the touchstone for these hearing records.<sup>2</sup> The Department’s decision preserves the importance of

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<sup>2</sup> The NCI/DFA survey data was not admissible evidence because it was not of the “sort upon which responsible persons are accustomed to rely,” (7 C.F.R. § 900.8 (D) (1)) and would not constitute substantial evidence such as is required for agency action pursuant to the Administrative Procedure Act (5 U.S.C. § 706 (2) (E)). See, e.g., Carter-Wallace, Inc., v. Gardner, 417 F.2d 1086 (4<sup>th</sup> Cir. 1969)(In an administrative hearing, summary exhibit of pharmacy costs and inventories was not admissible where witness was not familiar with underlying data and supporting documents were not available for use in cross-examination.)

the record in these hearings for the future and is an important ruling which should be reaffirmed in the final decision.

However, with respect to establishing the make allowance for whey, the Department has departed from the principles set in the rest of the decision and adopted a whey make allowance which is without record support, other than this discredited NCI data. What is most troubling about the record and the decision on whey processing is that the whey manufacturers were present and had every opportunity to participate with credible, reliable, first-hand information. But, they chose not to do so. This was certainly a studied, intentional decision made with a keen eye on their own self-interest, and their own bottom lines. Thus, neither Kraft, Leprino, Glanbia, Great Lakes, nor any other NCI member came forward with data on their costs of processing whey.<sup>3</sup> In spite of this lack of evidence, the decision rewards the industry with a make allowance higher than DFA's documented costs, relying solely on the discredited NCI study<sup>4</sup>. This is a very, very dangerous precedent. Why, henceforth, should any manufacturers come forth with data, when they can get a "better" result by withholding information, "hinting" at higher costs, and producing an inadmissible "survey". DFA takes exception to establishing the whey make allowance at 15.9 cents per pound on this record.

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<sup>3</sup> Leprino's evidence attempted to document the "add on" cost of drying whey versus drying skim milk and Kraft testified, without detail, to the purported additional costs. The recommended decision correctly notes that there was a paucity of data on the "total cost of drying whey" and the "total costs of either [Leprino or Kraft] operation." Only DFA provided such data, with testimony on the costs of whey processing at its Smithfield Utah block cheddar cheese plant. (Hollon TR. 1540-41). DFA's cost was \$.1478 per pound, including direct and indirect costs, as well as return on investment and marketing expense.

<sup>4</sup> The specific finding was: "the NCI-commissioned study results, rounded to the nearest 1/10 cent, should be used for determining the make allowance." 66 Fed. Reg. at 54085c.3.



B. The Price/value of Other Solids Should Be “Snubbed” at Zero in the Class III Price.

The recommended decision removes the “snubber” from the price of other solids which has the effect of allowing other solids to actually reduce the price of protein (or the PPD) in the event of a price depression for dried whey. DFA takes exception to this and requests that the snubber be reinstated for the following reasons<sup>5</sup>:

1. No snubber creates incentives for disorderly marketing. The absolute minimum “value” for any component for which the processor should be accountable is the cost to dispose of the component. With respect to whey, this would presumably be the cost of spreading the whey on the ground. There is no record evidence of this cost. Nevertheless, removing the snubber would allow processors to, in essence, charge producers for the full cost of drying whey, while not even requiring them to actually incur those costs in drying the product! At the same time, regardless of the price of dry whey, a substantial volume of whey will continue to be marketed for higher value uses, such as whey protein concentrate, at lower processing costs (condensing rather than drying), all at the expense of dairy farmers. Allowing the value of a component to be negative, which is the effect of removing the snubber, has potential effects which were not fully explored at this hearing. Consequently, the status quo should be retained and the value of other solids should continue to be snubbed at zero.

2. Producers have no part in the processor’s whey use decision. It would be fundamentally inequitable for dairy farmers to be “charged” for assumed losses in handling a product when they have no control over, and not even any knowledge of, a cheese processor’s

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<sup>5</sup> Fortunately, prices for whey have been reasonably strong and there is no present reason to expect the elimination of the snubber to become effective. Nevertheless, it is an issue which could arise at any time and should be considered in that context.

decision with respect to use of the other solids. Producers supply the milk components to the processor for its profit-maximizing use and there is absolutely no reason why producers should be required to “pay” for a handler’s decision to use whey in a manner which is more expensive than the cost of disposal. If cheese processors believed a “stop loss” point, or floor other than zero, on the cost of other solids was appropriate, they were obligated to come forward with hard proof of the cost of disposal of whey. Not having done so, they should not be granted a potential windfall by elimination of the snubber. That is what the recommended decision does and it should be revised to restore the snubber.

**IV. DFA Supports the Continued Refusal to Adopt Any Proposals Which Would Change the Differentials for Class II or I Prices or the “Higher of” Mover for Calculating Class I Prices.**

DFA commends the Department’s analysis and reasoning in rejecting Proposals 30, 31, or any modifications to those proposals which would change the basis for calculating Class I and Class II prices or Class I and Class II differentials. All of the reasons given for rejecting these proposals were correct. First, the proposals were beyond the scope of the Congressional mandate for the hearing. As the Notice of Hearing (Exhibit 1) stated: “The purpose of the hearing is to receive evidence with respect to the economic and marketing conditions which relate to reconsideration of the Class III and Class IV milk pricing formulas included in the final rule for the consolidation and reform of federal milk orders. The mandate from Congress via the Consolidated Appropriations Act 2000 (P.L. 106-113, 115 Stat. 1501), requires the Secretary of Agriculture to conduct a formal rule-making proceeding to reconsider the Class III and Class IV milk pricing formulas included in the final rule for the consolidation and reform of federal milk orders and to implement any changes until January 1, 2001.” Neither Proposal 30 (which

proposed to change the Class I differentials) nor Proposal 31 (which would change the Class II differential) were proposals which addressed reconsideration of the Class III or Class IV price formulas. Consequently, those proposals were correctly rejected.

Furthermore, the proposals were not fully debated. The industry rightfully approached this Hearing as one mandated to reconsider Class III and Class IV prices. For that reason, there was minimal consideration given to the practicalities or ramifications of the changes in Class I and Class II differentials proposed in Proposals 30 and 31. Each of these proposals could have very substantial impacts on producers in all markets. It should be sufficient to note that the Class I differential structure has been the subject of many days of federal order hearings; many days of congressional hearings and debates; and substantial federal court litigation. To tinker with the resulting statutorily-mandated system without a focused hearing process would have been quite inappropriate.

Finally, the Hearing Record on the proposals, such as it is, will not support adoption of the proposals<sup>6</sup> and, as the recommended decision fully discussed, the “higher of” rationale is

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<sup>6</sup> The revised Proposal 30, advocated by the Family Dairies USA, would result in substantial reductions in dairy farmer income throughout the federal order system. There was and is nothing in the evidence presented by the proponents of Proposal 30 or elsewhere in the hearing record which supports these revenue reductions to dairy farmers. Furthermore, the proposal presented in testimony at the hearing — to change the formulation of the base price for Class I differentials — was plainly not in the hearing notice and, consequently, hearing participants were not able to fully evaluate its impact, as Mr. Hollon testified. (Tr. 1545-1546). Because of both these procedural and substantive defects, the proposal should not be adopted and the recommended decision should be affirmed.

Proposal 31 was also not supported by the record. All of the evidence of record suggested that the current 70-cent differential between Class II and Class IV was and is an appropriate recognition of the additional value of the Class II soft manufactured products and it does not provide any artificial or inappropriate incentive for substitution of Class IV ingredients for Class II ingredients. *See, e.g.,* Exhibit 45. Furthermore, it is not clear how Proposal 31 could be implemented: presumably, it would require the maintenance in the order of two sets of order language which calculate Class II prices on both a “before” and “after” basis. This would be highly impractical, if it were even possible, and is in no way justified by the hearing record.

fundamentally sound.

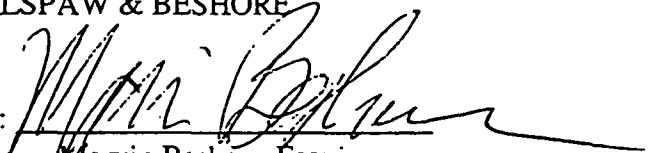
DFA commends the Department for adhering to the decision not to adopt Proposals 30 and 31.

**VI. Conclusion.**

DFA commends the Department for a proceeding which has resulted in better price formulas for Class III and IV milk in the federal order system. DFA dissents and takes exception to the recommended decision solely with respect to the issues involved in the pricing of other solids in Class III and requests that the decision be modified in those respects when made final.

Respectfully submitted,

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