



Glanbia Foods, Inc.
1373 Fillmore Street
Twin Falls, ID 83301

January 25, 2002

Connie Brenner
USDA
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Dear Ms. Brenner:

Please accept the accompanied comments, made on behalf of my employer, Glanbia Foods Inc., into the public records regarding USDA's recommended decision to modify the Class III price formula.

Sincerely yours,

Jeffry O. Williams
Executive Vice President

UNITED STATES DEPARTMENT OF AGRICULTURE BEFORE THE SECRETARY OF AGRICULTURE

In Re:

Milk In the Northeast and
Other Marketing Areas

Docket Nos. AO 14-A69, *et al.*; DA-00-03

GLANBIA FOODS, INC'S COMMENTS ON THE PROPOSED RULE

Glanbia Foods Inc. (formerly known as Avonmore West, Inc.) is a dairy food company headquartered in Twin Falls, Idaho. We operate two cheese plants in the Western federal order, #135. Since we employ only 430 people, we are by USDA's definition, a "small business." As a small business with less economies of scale compared to our larger competitors, USDA's recommended changes in the Class III price will severely impact our profitability. Our analysis indicates Class III prices could increase by as much as \$.48/cwt of milk if your recommended changes are implemented. Since our milk cost represents more than 90% of our total revenues we would have virtually no opportunity to off set a price increase of this magnitude anywhere else in our operation.

Glanbia Foods, is a member of the National Cheese Institute and the International Dairy Foods Association, and we have read the comments submitted by those organizations. We agree with their analysis and we will not attempt to cover all of the points made by IDFA and NCI. Rather, we will focus our comments on a few points that we believe are particularly important for our business.

Federal Order Pricing vs California Pricing

Nearly 90% of the milk produced in Idaho goes into the manufacture of cheese products, therefore the recommended rule as it pertains to Class III milk

is an extremely important issue for the Idaho dairy industry. The Idaho milk market is extremely competitive, with a half dozen major milk buyers operating in our milk procurement area. As a result, we have been forced to pay over-order premiums well above the Class III price to remain competitive. We were somewhat pleased with the changes made by USDA in its final rule effective January 2000 in the sense that it tended to align Class III prices with California's 4B price. This is a point we have long argued. Since our primary competition is cheese manufactured in California, we must have parallel pricing with California's state order to be competitive. Prior to this closer alignment between Class III prices and California's 4B price, we saw a \$.47/cwt difference between Class III and 4B during the period of 1995 – 1999. Assuming a cheddar cheese yield factor of 9.5% for base milk constituents, this price difference made cheese manufacturers operating within the federal order system \$.0497/lb ($$.47/9.5$) of cheese less competitive than cheese manufactured in California. With the final rule changes, the gap between Class III and 4B has narrowed to only \$.27/cwt. That difference of \$.021/lb of cheese [$($.47/cwt - $.27/cwt)/9.5$] has enabled us to compete on a level playing field with California made cheese and hold our markets. We are able to make up most of the \$.021/lb competitive disadvantage due to some cost advantages over California cheese plants in the areas of energy costs, labor costs and transportation costs to Midwestern/Eastern markets. As a result of this trend toward a more even playing field vis-à-vis California, Glanbia invested over \$33 million into our cheese operations in an effort to upgrade our technology and our throughput to gain additional cost efficiencies. Had we anticipated a further erosion of our competitiveness, it is doubtful my company would have made that investment in Idaho.

If USDA's recommended rule takes effect, we will actually be worse off than we were prior to the changes made in the final rule. If we assume the \$.27/cwt difference between Class III and 4B remains fairly constant and we then add the \$.48/cwt your recommended rule will add to Class III we will suddenly find ourselves at a \$.75/cwt ($$.079/lb$ of cheese) disadvantage compared to cheese manufacturers in California. Is it any wonder American cheese production has

increased 47% over the past four years in California while U.S. production and Idaho's production has increased only 6% and 7%, respectively, during the same time period? Furthermore, what was the increase in cheese production over a similar period of time by other historically strong American-style cheese manufacturing states (i.e. Wisconsin and Minnesota) operating with the federal order system? Minnesota was down 1% while Wisconsin was down a whopping 11%. It is our contention that California's growth in American-style cheese production is due, in large part, to this huge gap between Class III and its own 4B price. To make matters even worse, the California Department of Food and Agriculture (CDFA) just this month implemented a \$.007/lb make allowance increase for cheese manufacturers due to rising energy costs. California's make allowance for cheese is now \$.176/lb while the federal order make allowance in the Class III formula is \$.165/lb. If this increase holds, in the face of decreasing energy costs, and USDA changes Class III, our competitive disadvantage will increase to \$.82/cwt (\$.086/lb of cheese). This competitive disadvantage is not sustainable long term. In the commodity American cheese sector margins are razor thin therefore volume and efficiencies are the key to survival. As an example, a \$.086/lb of cheese cost increase would cost Glanbia Foods approximately \$26 million in 2002 based on our budgeted cheese production volumes. Our cheese operations would suffer huge financial losses and eventually we would be forced to re-locate or go out of business. In the short term, because proprietary bulk tank handlers as opposed to cooperatives control the majority of Idaho milk, proprietary cheese manufacturers in the state will be forced out of the pool in order to pay lower un-regulated prices in order to keep their cheese market share. This de-pooling would, in effect, penalize the very producers the federal order pricing system was meant to protect. In the long term how does that benefit the progressive dairy operators that have invested many millions of dollars into their state-of-the-art dairies in Idaho? It is disheartening to see the USDA advocate an increase in Class III pricing. As the largest milk producing state and soon to be the largest cheese producing state, the make up of California's 4B milk price, to include the make allowance and the

yield calculations, cannot be ignored. We operate in a single national market for milk used for the manufacture of bulk cheese products and it defies logic for the federal order pricing program to operate as if that were not the case.

Shrinkage

USDA must account for “shrinkage” – the loss of components -- that occurs in the entire process from collecting milk on the farm through the manufacturing process. Milk is paid for based on weights and components at the farm prior to the milk even being pumped into the milk tanker. All losses of components from that point forward are borne by the manufacturer. Glanbia is one of the largest manufacturers of cheddar cheese in the country, annually producing nearly 280 million pounds of both barrels and blocks. By our own experience over the past several years, we know that all the fat we purchase off the farm does not find its way into cheese or whey cream. Our own experience supports the Hearing Record that there is at least a .25% fat loss between the farm and the plant. Within the plant, fat losses to the drain (1-2%) in addition to unrecoverable fat that ends up in the whey stream after separation (and ultimately ends up in dry whey products) (1.5%) and fat losses associated with cheese “fines” (small cheese particles clarified from the whey and sold as animal feed along with floor sweepings) (another 1-2%) brings our total fat “losses” up to 4-5%. When considering the change to the formula to account for whey cream revenues, USDA is incorrect in assuming that 100% of the fat is recovered as either cheese or whey cream.

Barrel vs Block Price Adjustment

USDA must reduce the adjustment to the price of cheddar cheese in 500-lb barrels from \$.03/lb to \$.01/lb when computing the weighted average cheese price used in the protein price formula. USDA bases its weighted average cheese price on 500-lb barrels adjusted to 38% moisture as promulgated by the tentative final decision, however, when the \$.03/lb adjustment was implemented the weighted average cheese price on 500-lb barrels was adjusted to 39%

moisture (as called for in the final rule) thus justifying the \$.03/lb adjustment. However, now that we are operating with a 38% moisture adjustment, the \$.03/lb adjustment is not warranted. This adjustment accounts for approximately \$.02 of the \$.03 difference in the price of 40-lb blocks versus 500-lb barrels of cheese. Glanbia is one of the largest barrel producers in the U.S. – manufacturing over 190 million pounds per year, but we are also a sizable block producer as well (nearly 90 million pounds). Last year our cost of manufacturing barrels versus block amounted to \$.008 per pound of cheese. The only reason to support the traditional “spread” of \$.03 per pound between blocks and barrels is due to the moisture premium adjustment from 39% moisture. In using barrel prices adjusted to 38% moisture in the weighted average cheese price, USDA should use only a \$.01 adjustment. Making a further \$.03/lb adjustment, as included in your recommended decision, constitutes double counting.

Whey Cream Value

USDA must account for the fact that the value of butterfat in whey cream is less than the value of butterfat in Grade AA butter. Failure to account for this difference in value in the protein price formula assumes handlers receive more value for the whey stream than they actually receive. Glanbia Foods is both a purchaser of sweet cream (Grade AA) and a purchaser/seller of whey cream so we know first hand the difference in the values of these two butterfat products. Our experience tells us there can be a difference of \$.17/lb of butterfat (at the current Grade AA butter market of \$1.3175/lb) between the value of sweet cream and the value of whey cream. Because the hearing record does not support a separate Class III butterfat price, this adjustment for the difference in the value of butterfat in Grade AA butter and the value of butterfat in whey cream must be accounted for in the protein price formula. This adjustment would be similar in principle to how the adjustment for the difference in the value of butterfat in cheese and the difference in the value of butterfat in Grade AA butter is accounted for in the protein price formula of the recommended decision.

NCI Survey vs RBCS Survey

USDA should abandon the use of the RBCS survey for determining the make allowance and utilize an audited survey compiled by NCI member plants. Furthermore, in no case should the make allowance in the Class III formula be allowed to fall below the weighted average make allowance calculated from the NCI survey and the CDFA survey.

In conclusion, it is our hope that USDA would err on the side of allowing make allowances to be too high rather than too low and to err on the side of lower minimum prices. This will allow the marketplace to add additional value to dairy farmer milk checks if the supply and demand relationship warrants such premiums. To tie the hands of processors and mandate premiums over current minimum pricing levels when many processors are teetering on the brink of financial insolvency will only harm our industry long term and that will not benefit the milk producers these rules were designed to protect. Glanbia Foods urges the Department of Agriculture to seriously consider the adjustments advocated in these comments as well as the adjustments submitted by IDFA and NCI.