UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

In re:	)	**Docket Nos. AO 14-A69, *et al.*; DA-00-03**
Milk in the Northeast and	)	
Other Marketing Areas	)	
	)	

COMMENTS OF THE INTERNATIONAL DAIRY FOODS ASSOCIATION REGARDING THE RECOMMENDED DECISION

The International Dairy Foods Association (IDFA) files these comments on behalf of itself and its three constituent organizations (the Milk Industry Foundation, International Ice Cream Association and National Cheese Institute) with respect to the recommended decision regarding changes to the Class III and IV pricing formulas, published on October 25, 2001 (66 Fed. Reg. 54063-96). IDFA strongly disagrees with numerous aspects of the recommended decision. IDFA strongly urges that significant changes be made.

The decision reads as if the central issues presented are highly technical questions relating to product yields and manufacturing costs. Such a techno centric approach necessarily misses the forest for the trees. Two forests loom large yet seem to have been overlooked entirely, although they were repeatedly flagged by hearing witnesses.

First, USDA must adopt regulations that will allow federal order handlers to compete with the ever-growing production of, and competition from, non-federally regulated handlers, chiefly but not exclusively those in California. *The recommended decision turns its back on this concern, and would result in manufacturing milk prices that are substantially higher in the federal system. The gap is so great as to suggest that the federal government has made an affirmative decision that the manufacturing industry should be strongly encouraged to pick up and move out of federally regulated regions of the country (see Section I below).*

Second, the federal order system is highly inflexible, given its inability to adopt regulatory changes with dispatch. It is accordingly incumbent upon USDA to adopt make allowances and yield factors that will be sufficiently flexible to perform well under rapidly changing economic conditions. *The recommended decision takes just the opposite approach (see Section II below). Indeed, the proposed make allowances and yield factors are not only inflexible, they would doom handlers to negative margins (see Section IV below).* IDFA believes that the recommended decision is so flawed as to warrant a reopening of the record so that additional evidence may be received that will allow USDA to correct these and other errors. IDFA urges the Secretary to re-open the record for this purpose.

I. The Federal Orders Must Reflect Competition From California And Other Non-Federally Regulated Areas.

California, which produces more milk than any other state, relies on state regulation for its milk pricing. The importance of California's milk and dairy product production cannot be overemphasized in analyzing the impact of changes in federal order regulations. Yet the recommended decision chooses to ignore it entirely, notwithstanding substantial hearing testimony.

Although raw milk and dairy product production have increased in both California and the U.S. as a whole, the increases for California are staggering. While total milk production in the U.S. increased by 127% between 1980 and 1999, total milk production in California increased by 224%. California's share of national milk production increased from 10.6% in 1980 to 18.7% in 1999. (Yonkers (IDFA) Testimony, Exh. 14 at p.14).

The trend in manufactured product production is even more pronounced. Between 1980 and 1999, all cheese production increased by 199% in the US as a whole, but by 762% in California. California's share of national all cheese production increased from 4.6% in 1980 to 17.4% in 1999. The State's share of total U.S. nonfat dry milk production increased from 20.9% in 1980 to 47.2% in 1999, and its share of U.S. butter production increased from 16.1% to 26.9% during the same period. *Id.*

The hearing notice purported to recognize the impact of dairy products manufactured in non-federally regulated plants, noting that "prices paid for manufactured milk under federal orders cannot get too far our of alignment with the value of milk for manufacturing in the rest of the United States." (Exh. 1 at p. 20096). Yet that is precisely what the recommended decision would do.

The prices paid for milk used in manufactured dairy products under the federal orders are already higher than in California, and the gap will increase tremendously if the recommended decision is adopted. Focusing on cheese, which is by far the largest manufactured use, the incontrovertible numbers show the following:

—before "order reform" was instituted in January 2000, California prices were only slightly lower than federal prices. Specifically, the federal Class III price from September 1998 through December 1999 averaged $13.41/cwt, a modest $0.03 higher than the California Class 4b average of $13.38.

—the "final rule" implemented on January 1, 2000, made this modest gap significantly larger. Using the three-year period from January 1, 1999 through December 31, 2001, and assuming the final rule had been in effect that entire period, the federal order price for milk used to make cheese averaged $11.70/cwt, a significant $0.15 cents higher than the California 4b average during that period of $11.55.

—The "tentative final decision" implemented by USDA on January 1, 2001 (over IDFA's objections) made this gap much worse. Again using the three year period from 1999-2001, and assuming the tentative final decision had been in effect that entire period, the federal order price for milk used to make cheese averaged $11.87/cwt, a very significant 32 cents per hundredweight higher than the California 4b average during that period of $11.55.

—The recommended decision, if adopted, may well be the straw that breaks the camel's back. Once again using the three year period from 1999-2001, and again assuming that the recommended decision had been in effect that entire period, the federal order price for milk used to make cheese averaged $12.17/cwt, a whopping 61 cents per hundredweight higher than the California 4b average during that period of $11.55.[1]

But as bad as this is, it gets even worse. California has just announced that it is increasing make allowances for all products in the product price formulas used to regulate milk prices in that state, which effectively will lower its Class 4b price by seven cents per cwt, effective January 1, 2002. (Attachment B hereto, available at http://www.cdfa.ca.gov/dairy/pubs/DIB/dairyindustryNews.pdf). Thus, the gap

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[1] The data underlying this analysis are set forth in the Table that is Attachment A hereto, and is derived from USDA and State of California official publications.

between the recommended decision price and the California 4b price is actually an astronomical 68 cents per cwt.

That kind of cost disadvantage is simply not sustainable. California has already exhibited an ability to attract production when it has only a modest price advantage. The recommended decision would turn that advantage into a rout.

For some proprietary handlers with multiple plants across the U.S., the opportunity certainly exists to shift an increasing share of production to plants in areas outside of federal order regulation like California. But the ability of some proprietary handlers to shift production to areas outside of federal regulation is hardly reassuring to anyone who wishes to retain manufactured milk production in the federal milk order (FMO) system.

USDA accordingly should reject each and every one of the proposed changes that would increase the federally regulated minimum prices. USDA should instead adopt each and every one of the changes that IDFA discusses in Section III below, in order to at least give federal order handlers a fair shot at holding their own in this increasingly competitive fight.

II. The Need To Preserve At Least Some Flexibility In An Inherently Rigid System.

Before the so-called federal order reforms were implemented January 1, 2000, all federally mandated class prices were based on the Minnesota-Wisconsin price survey, and thus carried with them some inherent flexibility because that

price reflected actual and ever changing supply and demand conditions (at least in the part of the country surveyed).

Now, however, the federal order system is inherently inflexible, because handlers are limited to receiving the make allowances set forth in the class price formulas, based upon the formulas' yield factors, with every penny of increase or decrease in finished product prices passed on to the producer in the form of higher or lower raw milk prices. (See Yonkers (IDFA) Testimony, Exh. 14 at pp. 5-10).

The problem with make allowances is that they are based upon costs derived from surveys that are—at best—a single snapshot in time. Unless USDA is willing to build flexibility into the system by purposely adopting make allowances that are on the high end of the spectrum, the system can work only if USDA gets each and every detail *exactly right*. In order to do that, USDA would have to:

(a) correctly identify each and every cost element;

(b) determine with precise accuracy the actual cost of each of those cost elements—and not just on the day of the hearing and not just on the day USDA puts the regulations in effect, but over the entire period (*i.e.*, years) in which those formulas will set prices; and

(c) correctly determine without error the precise amount of each and every product that will be yielded in production and (for the non-surveyed products) their exact value.

This is a task beyond Herculean, and as we show below, USDA has in fact made some critical errors in its analyses and formulas. A modicum of humility would dictate that USDA openly acknowledge that it should err on the low side when establishing class formulas, because (a) failure to do so will ensure that handlers will disinvest from manufacturing facilities because they are being denied the return necessary to justify investment, and (b) the marketplace, and in particular competition between handlers and manufacturing coops, can be depended upon to correct for unduly low prices through over order premiums.[2]

In respect to these points, it should be noted that the state of California has many more years of experience in using product price formulas to regulate milk prices. The California Department of Food and Agriculture (CDFA) does NOT automatically adopt into its regulations the average make allowance derived from its audited cost survey. Rather, as explained by Dr. Schiek, "CDFA is under no statutory obligation to tie the level of manufacturing allowances to the weighted manufacturing cost or to any other specific cost level reported in those studies. Basically the manufacturing allowance has been viewed by CDFA as one of several policy tools that can be used in establishing reasonable manufacturing milk price levels pursuant to a public pricing hearing. " (Tr. 1161-62).

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[2] The economic analysis underpinning this conclusion was developed at great length in the hearing testimony of Dr. Robert Yonkers, Hearing Exh. 14, and in the Post Hearing Brief of the International Dairy Foods Association at 2-18, which we incorporate by reference.

One reason not to adopt mechanically the results of a make allowance survey is that to do so would by definition mean that the one-half of cheese produced in plants with greater than average costs would be forced out of business. In fact, California has long recognized that this would not be in the long run best interest of that state's dairy industry. USDA should not become so focused on a techno centric approach to product price formulas that it loses sight of the real prize—a regulatory system that makes economic market sense, and which results in orderly marketing of all milk.

This precise point was the principal theme of the hearing testimony of noted dairy economist Mark Stephenson, who emphasized that "the real danger in regulating minimum prices is to regulate a price that is too high." (Hearing Exh. 29). "If processors must pay more than a market clearing price, they will not want to buy as much milk as is available. Farmers then may be left with unsold milk, or their cooperatives will be forced to find outlets for distressed sales of milk. This would constitute one form of disorderly marketing - something federal orders are supposed to prevent." (Hearing Exh. 29).

For example, if one of the elements of cost is energy, and energy costs rise, then either the order formula has to be quickly changed, or the formula has to have been designed so as to accommodate such increases. Yet changing federal orders is a notoriously laborious process, and the recommended decision tries to eliminate

every last vestige of flexibility, purporting to incorporate in the pricing formulas every theoretical product yield and every alleged bi-product of value. In so doing it has missed the mark badly, not only because it has overstated values and understated costs, but because it has left no play in the joints for when those values or costs rise or fall, as they inevitably must do (and indeed, they have even during the months since the hearing was held).

Bearing in mind these critical overarching themes, IDFA will now turn to some of the specific defects in the recommended decision that must be addressed. Although IDFA through these comments is proposing several changes to the proposed rule, this should not be interpreted as an endorsement of that rule even if all of these changes are made. Experience with the milk orders since the so-called reforms were implemented January 1, 2000, coupled with the many deficiencies identified as a result of these hearings, make clear that the order system is flawed and that broader reforms are required. IDFA and its constituent organizations have already begun to pursue such reforms and will continue those efforts.

III. The Recommended Decision Should Be Changed in Several Critical Respects.

Several changes must be made to the FMO provisions contained in the recommended decision.

1. USDA must account for "shrinkage"—the losses of components between the farm bulk tank and the finished products—and do so with respect to all of the

10

product price formula yield factors. The recommended decision's suggestion that shrinkage has already been addressed in the formulas is simply and demonstrably false.

2. USDA must reduce the adjustment to the price of cheddar cheese in 500-lb barrels from 3-cents to 1-cent when computing the weighted average cheese price used in the protein price formula. USDA must do so because it has already accounted for 2 of the 3 cents through other formula adjustments, and the recommended decision therefore is engaging in double counting.

3. 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, and do so through the protein price formula. Failure to do so results in a formula that is based upon false assumptions regarding how much money handlers receive for by products.

4. USDA must recalculate the cheese yield factor in the protein price formula directly from data in the hearing record, rather than merely relying on past, rounded factors and data. The factor should be changed from 1.405 to 1.383.

5. USDA should adjust the yield factors in the butter and nonfat dry milk product price formulas to account for the loss of components.

6. USDA should utilize the NCI survey materials in determining make allowance, rather than the data from RBCS.

7. USDA should reduce the Grade AA butter price used in the butterfat price formula for all classes of milk by 6 cents per pound; failing that, USDA should increase the make allowance used in the butterfat price formula for all classes of milk by 4.5 cents per pound.

1. All of the Yield Factors Must Include An Element for Shrinkage.

Yield factors must be sufficiently flexible as to account for shrinkage—the loss of milk components between the farm bulk tank, where the milk is measured and priced, and the finished product, whose wholesale market price is used to calculate FMO minimum component values.

A handler that is required to pay the minimum price for milk obviously cannot recover that cost of components lost between the farm to finished product through the corresponding sale of finished product, since by definition no such finished product can be made from lost components. Yet the FMO product price formulas provide that the amount of milk and components are measured and paid for at the farm in the farm bulk tank, while the make allowances, yield factors, and product prices are based only on the amount of product produced in the manufacturing plant. The only way the system can work is to account for shrinkage, either as a direct adjustment or by its inclusion in the yield factors.

The recommended decision contends that shrinkage has already been addressed. That contention is false.

The recommended decision first states that this problem is addressed because the orders "have always provided an allowance for shrinkage." But the order provisions regarding shrinkage merely provide that pool plants need only pay the lowest class price for the amount of components considered to be allowable shrinkage. 7 C.F.R. 100.43(b). The mere fact that a handler need only pay the lowest class price for milk deemed to constitute shrinkage in no way undercuts the salient points that (i) the milk has to be paid for, and (ii) no moneys are collected by the handler through finished product sales that can pay for any cost associated with this milk.

Indeed, the fact that the handler need only pay the lowest class price for milk deemed to constitute shrinkage is really quite beside the point. We are dealing here with the yield factors and pricing formulas applicable to Class III and IV plants, which by definition are either paying the lowest, or second lowest, class price for all of the milk they buy. The existing shrinkage provisions in the federal orders are therefore either entirely irrelevant, or at a minimum only marginally relevant.

The recommended decision also claims that there is no need to include a factor for shrinkage in the yield factors because the CDFA and RBCS cost surveys upon which the recommended decision bases its make allowances purportedly use a "process which should take shrinkage into account." This claim appears to have

been made up out of whole cloth. Not a single witness advanced this claim at the hearing.

To the contrary, the two cited surveys only seek to determine cost of manufacturing based on the pounds of end product produced. The cost of the milk itself is explicitly excluded from the surveys, and there is no other mechanism by which shrinkage is accounted for.

Indeed, the only testimony addressing this issue with respect to the CDFA cost survey stated unequivocally that shrinkage was not accounted for in the survey: "Several cost categories are not included in the CDFA costs studies [including] the raw milk value associated with shrinkage." (Testimony of Dr. William Schiek, Agricultural Economist, Dairy Institute of California, Tr. 1161). Similarly, the RCBS survey data (Hearing Exh. 9) lists the "cost items" covered by the survey, none of which relates in any way, shape or form to raw milk costs generally or shrinkage in particular

Furthermore, the yield factors set forth in the recommended decision rely principally upon the testimony of Dr. David Barbano. Dr. Barbano explicitly testified that his yield formulas did *not* account for shrinkage. But Dr. Barbano did testify to the considerable component losses suffered at several stages in the process, including between the farm bulk tank and the plant receiving silo, between the receiving silo and the vat, churn or dryer, and finally between the vat, churn or

dryer and the pounds of actual components captured in the final product. (Tr. 595-97, 648-662, 706-09). Dr. Barbano prepared a graphic illustration of the many steps along the way where the handler experiences loss of components. (Hearing Exh. 20).

The hearing record is filled with testimony from a number of witnesses describing the existence of component loss, or shrinkage, between the farm bulk tank and the receiving plant. None of this testimony was contested in the hearing record. Dr. Barbano stated that "the loss from the farm tank to the plant can be a big loss." (Tr. 758). Ms. Taylor of Leprino testified that component losses between the farm and the point of receipt at the plant ranged from 0.15% to over 0.25%. (Tr. 1728). Mr. Reinke of Kraft testified that some processors experience losses up to 0.33%. (Tr. 1056). Others also testified that, in general, losses across the industry between the farm and the point of receipt at the farm averaged 0.25% or less. (Hollon (DFA), Tr. 1563; Throne (Hershey), Tr. 1685).

In addition to the average 0.25% loss of volume of milk between the farm bulk tank and the receiving plant, Ms. Taylor of Leprino stated that, because fat has a propensity to cling to surfaces such as the walls of tanks and pipes, there is a noted difference between butterfat tests of milk measured at the farm bulk tank and at the receiving plant, and that this difference resulted in a 0.015 reduction in the percent butterfat (Tr. 1728).

In addition to farm to plant losses of components, hearing testimony described the additional loss that occurs within the plant. Dr. Barbano commented in detail on losses during receiving, separation and pasteurization, in piping, and in other vessels throughout the cheese production and finishing process, and throughout the whey and whey cream recovery and finishing process. (Barbano Tr. 651-54,707-10,749-50). Finally, Lenahan of Ecolab testified that a study of effluent leaving 51 cheese plants showed an average loss equal to 2.35% of the plants' Biological Oxygen Demand (BOD) intake. This effluent BOD is virtually all the result of raw ingredient loss and finished product loss. (Tr. 1251-56). Mr. Lenahan cautioned that his calculations understated the average true loss, because the study data did not include the high BOD waste streams that are diverted to animal feed, land application, or other disposal methods rather than discharged to wastewater treatment systems. (Tr. 1251-56).

IDFA therefore strongly urges USDA to account for shrinkage by using more liberal yield factors in all of the product formulas. This is most easily accomplished by including an allowance equal to 0.25% of the volume of components in all the federal order product price formulas, as well as an additional allowance for a reduction of 0.015 in the butterfat test. In addition, the hearing record contains ample, uncontested evidence that cheese plants experience an

additional 2.35% loss of components after the plant has received the farm milk, and the formulas must be changed to reflect this loss as well.

2. USDA should reduce the adjustment to the price of cheddar cheese in 500-lb barrels from 3-cents to 1-cent when computing the weighted average cheese price used in the protein price formula.

The recommended decision makes an equally glaring mistake by increasing the price of cheddar cheese in 500 pound barrels by 3 cents, rather than one cent, when computing the weighted average cheese price used in the protein formula. USDA bases its decision on the fact that a number of parties, including DFA, LOL and ADCNE, testified that three cents is an acceptable and reasonable spread between blocks and barrels and that there is no compelling reason to change the three-cent addition to the barrel price.

What USDA has totally overlooked, however, is that all of these parties were addressing the price spread that exists between the price of 40-lb blocks at average moisture content and the price of 500-lb barrels *adjusted to 39% moisture.* But the tentative final decision bases its weighted average cheese price on 500-lb barrels *adjusted to 38% moisture.* The adjustment to 38% moisture *by itself* already accounts for 2 of the 3-cent difference in the price of 40-lb blocks versus 500-pound barrels. Making a further 3-cent adjustment, as is done in both the tentative final decision and the recommended decision, constitutes double counting.

To demonstrate this point, we start first with the methodology used by NASS in its cheese price survey. In collecting data for the two products, NASS requires manufacturers to report the price received for cheese sold in 40-lb blocks; for cheese sold in 500-lb barrels, NASS requires both the price received and the average moisture content of the cheese sold in that form. (Hearing Exh. 22).

NASS utilizes the survey data for 500-lb barrel cheese in the following manner. The reported price is multiplied by the following factor: (100 minus the standard percent moisture content) divided by (100 minus the reported percent moisture content). Until the implementation of the tentative final decision, the standard moisture content was 39%. *In fact, this was the only NASS published price series for cheese sold in 500-lb barrels; there was no reported price for cheese in 500-lb barrels adjusted to 38% moisture.*

Therefore, all the witnesses testifying about the three cent difference between the price of cheese in 40-lb blocks and the price of cheese in 500-lb barrels were testifying to the price of cheese in 500 lb barrels adjusted to 39% moisture content (because, of course, they were testifying at a hearing taking place before the tentative final decision had been issued).

But as noted, the tentative final decision utilizes a survey price at which the price of cheese in 500-pound barrels has been adjusted to 38% moisture content. The effect of that adjustment can be seen through a few examples. We will start

18

with the prices reported the week the hearing was held, ending May 13, 2000. NASS reported the actual price of cheese sold in 500-lb barrels to be $1.1456, but the average moisture content was 35.39 percent. Therefore, NASS used the following equation to calculate the price of cheese sold in 500-lb barrels adjusted to 39% moisture: ($1.1456 * ((100 − 39) / (100 − 35.39))), which equals $1.0816 as reported by NASS.

If instead, NASS had adjusted the price to a standard moisture content of 38%, the equation would have been ($1.1456 * ((100 − 38) / (100 − 35.39))), equal to $1.0993. Thus, the change in reporting the standard moisture content from 39% to 38% would have increased the reported NASS price by 1.77 cents per pound of cheese. That change to reporting at 38% moisture by itself thus fully accounts for approximately 2 cents of the difference in the price of 40-lb blocks and 500-lb barrels reported at 39% moisture.

To make a further 3-cent adjustment as to the 500-lb block would clearly be double counting, because it would result in a total five-cent difference between 40-lb blocks and 500-lb barrels, rather than the three cent difference that the hearing record supports. Because the adjustment from 39% to 38% moisture has already accounted for 2 cents of the difference, only a 1-cent further adjustment can be justified.

Other examples prove the same point. Just one year earlier, the week ending May 15, 1999, the actual price of cheese sold in 500-lb barrels was reported by NASS to be $1.2955, with moisture content of 34.74 percent. Using the NASS equation above, the price adjusted to 39% moisture (the only moisture-adjusted price reported by NASS at that time) was $1.2109.

However, adjusting the price to 38% moisture would have resulted in a NASS reported price of $1.2309, a price increase of 1.99 cents per pound of cheese. Again, this was not due to any additional money changing hands between buyers and sellers of cheese in 500-lb barrels, but merely due to reporting the observed average price at a different moisture content. And again, it would clearly be wrong to fail to take into account the effect of this change in moisture adjustment before making the additional adjustment to reflect the difference in block and barrel prices.

Let's look at one more example. One year after the hearing was held, NASS reported the price for cheese in 500-lb barrels to be $1.5824 for the week ending May 12, 2001, at an average moisture content of 35.18 percent. Had NASS then calculated a price adjusted to 39% moisture, as it had for all published reports up until January 2001, the price would have been reported as $1.4891. However, due to implementation of the tentative final decision January 1, 2001, NASS instead reported the price adjusted to 38% moisture as $1.5135, 2.44 cents per pound of

cheese higher. Once again, this was not due to any additional money changing hands between buyers and sellers of cheese in 500-lb barrels, but merely due to reporting the average price at a different moisture content.

These three examples reflect the impact of changing the standard moisture content across the range of observed prices for cheese in 500-lb barrels in recent years. In May 2000, cheese prices were near the Dairy Price Support Program purchase price, while cheese prices in May 1999 were nearer the 5-year average of prices, and cheese prices in May 2001 were well above average. Yet in all three cases, using a standard moisture content of 38% rather than 39% had the effect of increasing the price by approximately 2 cents.

This issue may be best illustrated by an examination of the actual data published by NASS at the time it shifted from reporting the price of cheese in 500-lb barrels at 39% moisture to doing so at 38% moisture. In the weekly Dairy Products Prices report released on January 12, 2001, USDA reported the actual price received in the week ending December 30, 2000 for cheese in 500-lb barrels at actual moisture content of 35.81% to be $1.1858, and reported the price adjusted to 39% moisture to be $1.1268. One week later on January 19, 2001, USDA reported the exact same price information with respect to 500-lb barrels at actual moisture content, but this time it reported the price adjusted to 38% moisture to be $1.1452, or 1.84 cents per pound higher. NASS did not report any increase in the

actual price received at the actual moisture content of 35.81%; the increase of 1.84 cents was entirely due to using a different standard moisture content.

In short, all the parties who testified to a 3-cent difference between cheese sold in 40-lb blocks and 500-lb barrels were referring to the difference between the price for cheese sold in 40-lb blocks at an unadjusted moisture content, and the price for cheese sold in 500-lb barrels adjusted to 39% moisture. The tentative final decision's change to using a standard moisture adjustment of 38% for 500-lb barrels already accounts for 2 cents of this difference. Therefore, USDA must reduce from the current 3-cents to 1-cent the adjustment that is added on top of the moisture adjusted price for cheese in 500-lb barrels, to offset the two-cent increase in price resulting from the change in the standard moisture adjustment.

3. USDA should account for the fact that the value of butterfat in whey cream is less than the value of butterfat in Grade AA butter, and do so in the protein price formula.

In the recommended decision, USDA states that "[s]ince all the butterfat used in Class III is to be priced on the basis of its value in butter, an adjustment must be made to account for the difference in butterfat values between cheese and butter." USDA goes on to conclude that this adjustment is only necessary for the 90% of butterfat that is recovered in the finished cheese.

However, the same line of analysis should be followed to account for the difference in butterfat values between sweet cream used to make Grade AA butter

22

and whey cream. In fact, USDA later in the recommended decision applies a method to value whey butter by subtracting 9 cents per pound from the Grade AA butter price. USDA clearly recognizes that whey cream has a lower value than sweet cream used to make Grade AA butter. But the only testimony regarding the value of butterfat in whey cream versus sweet cream was by Reinke (Kraft), who testified that the value of butterfat is discounted by 40-cents per pound in whey cream versus sweet cream. (Reinke (Kraft) Tr. 1041).

Because, as USDA itself points out, the hearing record does not support requiring a separate Class III butterfat price, this adjustment for the difference in the value of butterfat in Grade AA butter and whey cream must be accounted for in the protein price formula, just as the adjustment for the difference in the value of butterfat in cheese and Grade AA butter is accounted for in the protein price formula of the recommended decision.

The hearing record contains uncontested testimony that not all the butterfat that is not captured in the cheese ends up in a marketable, finished product. As detailed above, Lenahan of Ecolab testified that the loss of components as milk moves through the plant to become finished products is 2.35% of what is received at the plant. Dr. Barbano also testified that the butterfat loss during the cheddaring, salting and pressing stage is 2%, and in addition sweet whey contains 1.25% butterfat, so not all the butterfat ends up in whey cream. This is on top of the

0.25% loss of components, and additional decrease in butterfat test of .015, between the farm and plant.

The loss of components should be accounted for in the protein price formula. Starting with standard farm milk with a component test of 3.5% butterfat, the farm to plant loss will be 0.25% plus an additional reduction in butterfat test of 0.015, resulting in only 3.4763 pounds of butterfat in 100 pounds of milk with 3.5% butterfat as measured at the farm bulk tank. With 90% retention of butterfat in the cheese, this leaves 0.3476 pounds of butterfat in the whey stream.

However, there are additional losses of this butterfat. As detailed above, these include a 2.35% loss of the original volume of butterfat entering the vat, and the butterfat which ends up in sweet whey, which has a butterfat content of 1.25%; 2.35% of the original vat butterfat of 3.4763 pounds reduces the volume of butterfat in the whey stream by 0.0817 pounds, and the 1.25% butterfat content of 5.88 pounds of sweet whey further reduces the amount of butterfat by 0.0735 pounds. These adjustments, based on the facts contained in the hearing record, reduce the 0.3476 pounds of butterfat coming off the vat by a total of 0.1552 pounds, which means only 0.1924 pounds of butterfat ends up in whey cream, or about 5% of the 3.5 pounds of butterfat as measured at the farm.

In the recommended decision, USDA assumes 10% of the butterfat as measured at the farm ends up in whey cream, double the actual amount. Therefore,

24

USDA should change the 0.9 factor used to adjust the butterfat value used in the protein price formula to 0.95, to reflect that only 5% of the butterfat as measured at the farm ends up in whey cream. In addition, USDA should make a further adjustment, equal to the 40 cent per pound discount for whey cream versus sweet cream times the 5% of butterfat which ends up in the whey cream, by subtracting an additional 2 cents from the butterfat value adjustment in the protein price formula. The butterfat adjustment portion of the protein price formula should be as follows: ((1.582 * net cheese price) – (0.95 * butterfat price) - \$0.02) * 1.17, where the net cheese price is the cheese price minus the make allowance, and the butterfat price is the Class III and IV butterfat price.

4. USDA should reduce the cheese yield factor from 1.405 to 1.383.

In the recommended decision, USDA devotes considerable attention to explaining the basis for the cheese yield factor used in the protein price formula. However, this discussion only serves to reveal that the development of this factor is laced with errors in underlying assumptions, as well as a considerable rounding of values. USDA should recalculate the cheese yield factor use in the protein price formula, utilizing far more reliable data presented in the hearing record. This approach will result in a cheese yield factor of 1.383.

USDA's 1.405 factor is based upon a 1.32 factor first used in the protein price formula in the Upper Midwest milk marketing orders in January 1996. This

1.32 factor was derived by applying the Van Slyke cheese yield formula. USDA assumed the use of total crude protein, a 90% fat retention factor, 78% casein retention, and 38% moisture content in cheese to arrive at the following equation: ((((3.2 * 0.78 - 0.1) * 1.09) / 0.62) / 3.2), which equals 1.316, which USDA rounded up to 1.32. In the reform process, USDA adopted true protein rather than total crude protein, and used the ratio of the two in average composition milk, 3.3% total crude protein to 3.1% true protein (a ratio of 3.3 / 3.1, or 1.0645). The result, 1.32 times 1.0645, equals 1.405.

As pointed out by USDA in the recommended decision, this formula was based upon several assumptions, as well as one significant rounding of a figure. The formula assumes that only 78% of casein is retained in the finished product, when hearing testimony supports a higher number like 82.2%. In addition, the formula is based on the assumption that standardized milk contains 3.2 pounds of total crude protein, while the hearing record supports that standardized milk only contains 2.9915 pounds of true protein. Finally, this 1.32 factor was subsequently adjusted by USDA by the ratio of total crude protein to true protein, to reflect the fact that the orders implemented as of January 1, 2000, rely on true protein. The ratio of total protein to true protein was said by USDA to be 3.3 to 3.1 pounds in milk. Therefore, (1.32 * (3.3 / 3.1)) equals 1.405, the cheese yield factor now in use.

USDA should not continue to utilize the 1.405 factor, for several reasons:

First, Dr. Barbano testified that the actual casein retention of true protein is between 82.2% and 82.4%. (Tr. 578). USDA should therefore recalculate the formula using the low end of this very narrow range, or 82.2%, rather than continue to use the erroneous assumption of 78% retention.

Second, rather than using the 3.2 pounds of *total* crude protein in standardized milk, USDA should use the 2.9915 pounds of *true* protein in standardized milk. This adjustment is necessary to conform the formula to one based upon true protein, an adjustment already made with respect to other aspects of the formula.

In addition, as explained earlier, this formula must be adjusted for the 0.25% loss of components between the farm and plant. Thus, the 2.9915 must be multiplied by 0.9975, with a result of 2.9840, the pounds of true protein received at the plant based on the 2.9915 pounds of true protein as measured at the farm.

Finally, USDA should not round to only two significant digits, as it did when it converted to 1.32 the 1.316 that resulted from the previous formula.

Corrected for these three errors, the proper formula becomes: $((((2.9840 * 0.822 - 0.1) * 1.09) / 0.62) / 2.9915)$, which equals 1.383. USDA should therefore replace the 1.405 cheese yield factor in the protein price formula with the correctly calculated 1.383 factor.

This change, combined with the change to the butterfat adjustment portion of the protein price formula, results in the following protein price formula, which USDA should adopt: (1.383 * net cheese price) + ((1.582 * net cheese price) − (0.95 * butterfat price) - $0.02) * 1.17.

5. USDA should adjust the yield factors in the butter and nonfat dry milk product price formulas to account for the loss of components.

Ample, uncontested hearing testimony on the loss of milk components between the farm and plant applies not just to milk moving to cheese plants, but to any processing facility. Therefore, USDA should make changes to the yield factors in both the butterfat and nonfat solids price formulas to account for this loss. In addition, USDA continues to overvalue that portion of nonfat solids which ends up in buttermilk, and should adjust the yield factor in the nonfat solids price formula to reflect this.

As detailed above, the hearing record contains ample, uncontested testimony regarding the loss of components between the farm and plant. In addition to the general volume loss of 0.25%, there is an additional loss equal to a decrease in the butterfat test of 0.015. Therefore, one pound of butterfat as measured at the farm will lose 0.0025 pounds in the transfer from farm to plant, plus suffer an additional loss of 0.015 due to the reduced component test. The result is that the plant will receive for only 0.9825 pounds of butterfat available for processing. While IDFA

firmly believes there would be additional loss of component in processing butter, the hearing record does not contain any testimony on this subject.

The 0.9825 pounds of butterfat at the plant from 1 pound of butterfat as measured at the farm will yield (0.9825 / .82) = 1.198 pounds of butter. This means that one pound of butterfat at the farm will yield 1.198 pounds of butter, a yield factor of 0.835, not the 0.82 currently used in federal orders.

Therefore, USDA should change the butter yield factor to 0.835 in the butterfat price formula. The loss of components also affects the nonfat solids price formula.

In addition, USDA continues to overvalue the nonfat solids that end up in buttermilk. In the recommended decision, USDA claims that, "To assure that the result represents a minimum price, the low or high areas of ranges of numbers related to the manufacture" of NFDM and BMP were used. However, USDA has misused the hearing record, and continues to insist on using values that result in a price far above the minimum.

First, USDA chooses to use a BMP price relationship to NFMD of 80%. However, several witnesses testified that, over long periods of time, this relationship averaged less than this (Yonkers IDFA) Tr. 299, Schad (LOL) Tr. 1214). In fact, USDA in the recommended decision cites data that on the price relationship for the first four months of 2000, "BMP prices generally averaged

less than 70% of NFDM prices." USDA clearly should not propose a rule that would incorporate a return far greater than that actually received in the marketplace over a four-month period. Therefore, USDA should use 70% in calculating the relative value of BMP to NFDM in order to reflect a true minimum value.

Second, USDA misuses testimony from the witness from AgriMark, who did not testify that the cost of manufacturing BMP was 1 to 3 cents higher than the NFDM make allowance adopted by USDA in the decision, but rather that the cost of manufacturing BMP was 1 to 3 cents higher than AgriMark's cost of manufacturing NFDM. Prior to this statement, the witness from AgriMark testified that its costs of manufacturing NDFM were 17.2 cents per pound of product. (Wellington (AgriMark) Tr. 1486). Therefore, the witness was testifying that the cost of manufacturing BMP was 19.2 to 21.2 cents per pound, not the 16 cents per pound adopted by USDA based on this testimony. In addition, as adopted by USDA, the value is only two cents above the make allowance adopted for NFDM, not the high end of the 1 to 3 cents range, as USDA claimed to have utilized. USDA should adopt a make allowance of 21 cents for this calculation.

Finally, USDA assumes a yield of 0.053 pounds of BMP and 0.955 pounds of NFDM from each pound of nonfat solids. However, this is nonfat solids as measured at the farm, not at the plant. Therefore, USDA should adjust these yields downward by .25% to account for the loss of components between the farm and

plant. The correct yields from one pound of nonfat solids as measured at the farm become 0.0528 pounds of BMP and 0.9526 pounds of nonfat dry milk.

Therefore, the estimate of the value of finished products, should be recalculated as follows:

BMP: ($1.03 * .70) - $0.21 = $0.511; $0.511 * .0528 = $0.027613

NFDM: ($1.03 - $0.14) = $0.89; $0.890 * .9526 = $0.847814

The sum of these values is $0.875427. Following the method outlined by USDA in the recommended decision, this value is divided into $0.89 to arrive at the proper yield factor to be used in the nonfat solids price formula: $0.89 / $0.875427 = 1.0166.

Therefore, USDA should change the yield factor in the nonfat solids price formula from a divisor of 1.00 to 1.0166.

6. USDA should utilize the NCI survey in place of the RBCS survey.

The recommended decision continues to cling to the discredited notion that the RBCS survey is appropriate for purposes of determining make allowances. As pointed out by Ling (USDA) Tr. 73-81, the RBCS survey was never intended to be used as for setting make allowances in federal order product price formulas. The purpose was only to serve as benchmarks of in-plant costs of manufacturing.

The notion that the RBCS surveys are prepared for a neutral purpose, as compared to the NCI surveys commissioned for purposes of the hearings, is

completely misplaced, and USDA is simple ignoring undisputed testimony that so establishes. Ling testified that at the November 1999 annual meeting of the National Milk Producers Federation, NMPF urged members to submit data to the RBCS so that it could be used in the upcoming hearing on Class III and IV product price formulas.

Furthermore unimpeachable evidence demonstrates that the RBCS data is inherently suspicious and unreliable. The results of the most recent RBCS survey purport to demonstrate that the larger the cheese plant, the higher the costs of operations (Ling (USDA) Tr. 142), which is simply not true, because larger plants are more efficient and therefore have lower costs of manufacturing. (Ling (USDA) Tr. 140-41), (Yonkers (IDFA), Tr. 335-36). In addition, Wellington (Agrimark), Tr. 1481-86 specifically described the lack of attention paid to the RBCS survey by one respondent, which resulted in under-reporting of the costs of manufacturing in this survey. This directly contradicts USDA's conclusion the costs provided are accurate.

The recommended decision errs in failing to utilize the data from the NCI surveys. The claim that the entities that participated in these surveys would not answer questions about it is simply false. At most, they did not testify as to their own plants' individual costs, but of course that data is not available from the plants

that participated in the RBCS survey either. Accordingly, the RBCS survey should be replaced with the NCI survey.

IDFA has already demonstrated why USDA needs to utilize a make allowance that errs on the side of being too high rather than too low. The 17.02 cent make allowance advocated by NCI should be adopted in lieu of the lower make allowance set forth in the recommended decision. In no case should the cheese make allowance be set less than the weighted average of 16.87 cents calculated from the NCI survey and CDFA data.

7. USDA should reduce the Grade AA butter price used in the butterfat price formula for all classes of milk by 6 cents per pound; failing that, USDA should increase the make allowance used in the butterfat price formula for all classes of milk by 4.5 cents per pound.

USDA continues to ignore significant testimony from many industry participants that the federal order reforms implemented in January 2000 significantly changed the relationship between the market price of butter and the value of butterfat regulated under federal orders. This appears to be another case of losing sight of the forest for all the trees. The critical issue here is the negative and unwarranted impact on dairy markets that have resulted from USDA's action that has squeezed long-standing industry price relationship between butter and butterfat.

By changing from the value of Grade A butter used to price butterfat under federal orders prior to January 2000, to a Grade AA butter price value, USDA

significantly increased the minimum price. This is not due to any increase in the actual price received for all grades of butter by manufacturers, but rather only due to the change in the grade of butter used by USDA to calculate the minimum price.

For this reason, IDFA continues to support having USDA adjust the Grade AA butter price used in the butterfat price formula for all classes of milk by minus 6 cents, in order to return the regulation of butterfat values to its historical relationship with actual market butter prices.

This problem could also be addressed by changing the butter make allowance to account for the cost of handling cream. As stated elsewhere in these comments, the make allowance surveys used by USDA in the product price formulas specifically exclude all costs related to milk ingredients. Therefore, added costs associated with the use of bulk cream to make butter, and all other dairy products using bulk cream as an ingredient, are not accounted in the make allowances adopted in the recommended decision (nor in the final rule and tentative decision which preceded it).

NASS publishes every other week the average price paid for milkfat sold in the form of bulk cream. It is easy to see from this data series that the price paid per pound of butterfat in cream far exceeds the value of that butterfat for use in Grade AA butter as established by USDA's butter product price formula.

Ample testimony from LOL, DFA, and AgriMark supports the fact that there are real costs associated with handling and transporting cream, regardless of whether that cream is used to make butter or any other product like ice cream. This testimony indicated an average handling and transportation cost of 6 cents per pound of butterfat.

The same three parties also generally supported the detailed testimony of LOL that about two-thirds of all butter produced in the U.S. is made from bulk cream rather than farm milk. This means that the 6 cents higher costs apply to 66.7% of the butterfat used to manufacture butter, resulting in an average cost across all butterfat used to make butter of 6 times .667, or 4.5 cents per pound.

Therefore, if USDA does not change the recommended decision to adjust the Grade AA butter used in the butterfat price formula by minus 6 cents per pound, USDA should at a minimum increase the make allowance in the butterfat price formula used for all classes of milk by 4.5 cents per pound of butter.

IV. The Recommended Decision's Discussion of "Gross Margins" Is Seriously Flawed.

Finally, IDFA feels it incumbent to comment upon USDA's statement that the hearing record "provides ample basis for believing that the margins allowed for cheese-makers under these recommended price formulas should be entirely adequate for them to maintain their operations." USDA purports to calculate that the "gross margin" of cheese manufacturers is $2.52 per hundredweight under the

provisions of the recommended decision. The analysis that purportedly supports this conclusion is hopelessly flawed.

We start with the fundamental observation that USDA is using the term "gross margin" in a very unusual manner. "Gross margin" typically refers to the gross profit divided by sales, which is equal to each sales dollar left over after paying for the cost of goods sold. (This is as distinguished from "net margin," which is the amount of each sales dollar left over after *all expenses* have been paid (including taxes, etc.).

But here, USDA used the term "gross margin" to refer to something quite different—the purported amount of the sales dollar left over after paying for the cost of milk at the federal order minimum prices. In other words, all other costs have been excluded.

USDA does not even set forth the exact methods it used to calculate a gross margin, and the hearing record contains no testimony regarding such a method. As discussed below, we have attempted to recreate what appears to be USDA's method, and it is seriously flawed.

But even more importantly, as demonstrated below, if USDA incorporated the costs that manufacturers incur for things other than milk—that is, if USDA had developed a true "gross margin" figure—it would have recognized that the

recommended decision would result in a negative gross margin—the very result that IDFA has warned against.

a. USDA's calculation of "gross margin". IDFA has attempted to recreate the figures provided by USDA in the recommended decision, despite the lack of detail provided by USDA therein. Note that IDFA does not agree with the assumptions made by USDA in its gross margin analysis (as we outline in detail below), but felt it was important to try to recreate the results as presented by USDA as a starting point.

Our analysis assumed actual component tests reported by the Upper Midwest order, as well as NASS prices for cheese and dry whey, and the NASS Grade AA butter price minus 9 cents. Like USDA, our analysis included the 19-month period from January 2000 through July 2001. Based on this data, and the yield factors contained in the final rule and the recommended decision (which were the same), we estimate that the average product yields for this analysis were 9.90 pounds of cheese, 5.90 pounds of whey, and 0.44 pounds of whey butter (note that for this step in our analysis, we did not assume any shrinkage loss). After calculating the gross revenue from these products using NASS product prices, we then calculated the federal order minimum price for the milk at average component tests. Subtracting the latter from the former results in a "gross margin" as that term is used (incorrectly) by USDA.

Under the provisions of the final rule, we calculated an average gross margin under the assumptions above to be $2.99, close to USDA's "approximately $3.00." However, under the provisions of the recommended decision, we calculated an average gross margin during the 19-month period of only $2.50, close to, but two cents below, the $2.52 average reported by USDA.

b. The errors in USDA's analysis. USDA then proceeded to make a grave error in comparing this gross margin to the make allowances for cheese only. The error is that the plant would also have costs associated with the manufacture of dry whey and whey butter. USDA included these two products in calculating gross revenue, but did not account for them in comparing the gross margin to the plant's total make allowance.

Using the recommended decision make allowance of 16.5 cents per pound of cheese, and assuming a cheese yield of 9.9 pounds, a plant would have had costs of $1.634 per cwt of milk processed based solely on the cost of processing cheese. However, as noted above, the plant would also have had the costs of processing dry whey, calculated under the recommended decision make allowance to be 5.9 pounds of dry whey times 15.92 cents per pound, or $0.939. In addition, the plant would have had costs related to the manufacture of whey butter, equal to 0.44 pounds of whey butter times the butter make allowance of 11.5 cents per pound, or $0.051.

The sum of the total cost of turning 100 pounds of milk at the assumed component tests into finished products is $2.624 ($1.634 + $0.939 + $0.051), well above the $2.52 "gross margin" which USDA claims is "entirely adequate" for cheese plants to maintain operations. *It is incomprehensible that USDA believes that incurring a net loss of 10 cents from turning 100 of milk into finished Class III products will maintain the viability of plant operations.* (In fact, as noted, IDFA could not replicate USDA's results of a gross margin of $2.52, and calculates the net loss to be 12 cents rather than 10 cents).

Moreover, as stated earlier, the foregoing analysis assumes the correctness of the USDA assumptions that went into its gross margin analysis, many of which are not correct. There are at least six major errors in USDA analysis.

First, the recommended decision assumes that cheese plants received 2 cents more per pound of cheese than under the final decision, merely due to the change in the standard moisture adjustment used for the price of cheese in 500-lb barrels. As IDFA carefully explained in Section III(2) above, all USDA has to do is look at the NASS <u>Dairy Products Prices</u> reports published on January 12 and January 19, 2001, to see that the actual price received by cheese manufacturers for cheese sold in 500-lb barrels is exactly the same, regardless of the whether the standard moisture is 39%, as in the January 12 report, or 38%, as in the January 19 report. Reducing the 3-cent adjustment to 1-cent to account for this fact lowers the "gross

margin" as calculated above by 10 cents per cwt of milk, thus increasing the net loss for a cheese plant from 12 cents to 22 cents per cwt.

Second, USDA has overvalued the gross revenue a cheese plant receives from whey butter. Many cheese plants lack the facilities to process whey cream into whey butter, and must steeply discount the butterfat in that whey cream when selling to a handler that can perform that processing. Significant costs are incurred in transporting that whey cream to the handler. (Reinke (Kraft) Tr. 1041). According to this testimony—which is the only testimony in the record regarding the value of butterfat in whey cream versus sweet cream—the value of butterfat is discounted by 40-cents per pound in whey cream versus sweet cream. Therefore, USDA overestimated the value of whey cream when it used the Grade AA butter price minus 9 cents. IDFA calculates that this USDA error overvalued whey cream in the gross margin analysis by over 2 cents per cwt of milk. This increases the net loss by the cheese plant from 22 cents to 24 cents per cwt.

Third, USDA used Upper Midwest area data on component tests in farm milk in performing its gross margin analysis. Data for other federal order areas reveals that component tests in this market are certainly the lowest among federal order areas. The Western and Southwest have lower butterfat tests; the Northeast has a lower protein test; and the Mideast, Northeast, Central, and Southwest areas have lower other solids tests. In addition, this analysis by USDA fails to consider

that these are average component tests across all regulated milk in these marketing areas. Without specific data on the component tests of milk received at individual plants in various federal order areas, the exact impact of this on USDA's gross margin analysis is difficult to calculate, but we estimate this could increase the net loss by the cheese plant by six cents, from 24 cents to 30 cents per cwt.

Fourth, USDA references the make allowances resulting from data in the CDFA and RBCS surveys. For the reasons IDFA has already identified, these numbers are understated by at least $0.37 per pound (16.5 cents in the formula versus at lest 16.87 cents actual). Correcting for that error raises the net loss by four cents, from 30 cents to 34 cents. Moreover, those figures are based on average plant costs. USDA makes no provisions for the one-half of cheese production from plants whose costs are higher than this average, and would suffer severe strain from such a drastic decrease in their gross margins (even assuming that USDA had calculated accurately average gross margins).

Fifth, USDA's gross margin analysis ignores the fact that the prices received for finished products are not the same across the country. Ample testimony was given regarding the difference in prices, especially for the orders in the western United States, where wholesales prices for cheese, butter, and dry whey average below the national average. If the actual market prices received for finished products average as little as one cent per pound of product less in the federal order

41

areas in the western United States—and NASS figures show that this is a very conservative assumption—then the net loss by the cheese plants in those areas would increase by 16.2 cents, from 34 cents to over 51 cents per cwt.

Sixth, USDA ignores the loss of components between the farm and finished products. As shown earlier in these comments, there is ample, uncontested testimony in the hearing that these costs are real and experienced by manufacturers every day. Accounting for these losses would, again, significantly increase the loss a cheese maker would experience under the provisions of the recommended decision. The loss of components between the farm and plant would increase the net loss by nearly four cents per hundredweight, from 51 cents to 55 cents per cwt, and further losses of components in the plants would increase this even more.

USDA blithely states that "the lower gross margins under the recommended formulas could lead to reduced over-order premiums to reflect increased milk costs and maintain current gross margins." Nowhere does USDA does cite testimony that supports that over-order premiums of this magnitude are common throughout the geographic areas regulated by FMO. And, of course, as a matter of basic economics, there are no over-order premiums available if USDA has raised the regulated price to a point where it has ensured handler losses.
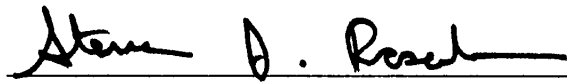
The many errors surrounding USDA's efforts to determine cheese manufacturers' gross margins further illuminates why governmental regulation

simply cannot be relied upon to determine with precision exactly how much money should go to dairy farmers and how much should go to processors. USDA's formulas must provide considerable play in the joints in order to accommodate inevitable errors of judgment as well as changing economic conditions and costs. The marketplace provides the only means by which these matters can be addressed. Contrary to the attitude reflected in the recommended decision, the decrease or elimination of over order premiums will create, rather than decrease or eliminate, disorderly marketing conditions.

CONCLUSION

The recommended decision is flawed, so flawed that the record should be re-opened. At a minimum, USDA should adopt the changes set forth in these comments.

Respectfully submitted,

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January 25, 2002

Relationship between California and Federal Order Cheese Milk Prices (1998 - 2001)

Month	Current Cl 4b Cwt	Revised Cl 4b Cwt	BFP	Final Rule	Tent Dec	Rec Dec
Sep-1998	15.40	15.34	15.10			
Oct-1998	16.37	16.30	16.04			
Nov-1998	16.81	16.74	16.84			
Dec-1998	17.14	17.07	17.34			
Jan-1999	14.34	14.28	16.27	15.86	16.07	16.21
Feb-1999	11.29	11.22	10.27	11.35	11.52	11.80
Mar-1999	11.52	11.44	11.62	11.50	11.68	11.95
Apr-1999	11.48	11.42	11.81	11.64	11.82	11.85
May-1999	10.68	10.61	11.26	10.91	11.09	11.19
Jun-1999	11.91	11.84	11.42	11.03	11.22	11.63
Jul-1999	13.96	13.88	13.59	12.92	13.13	13.38
Aug-1999	16.90	16.84	15.79	15.61	15.83	15.95
Sep-1999	15.06	14.99	16.26	15.60	15.82	15.90
Oct-1999	11.66	11.60	11.49	12.48	12.67	12.75
Nov-1999	9.88	9.81	9.79	10.57	10.73	10.86
Dec-1999	9.67	9.60	9.63	9.91	10.07	10.10
Jan-2000	9.58	9.52		10.05	10.20	10.21
Feb-2000	9.28	9.21		9.54	9.68	9.73
Mar-2000	9.34	9.27		9.54	9.69	9.78
Apr-2000	9.27	9.21		9.41	9.56	9.72
May-2000	9.17	9.10		9.37	9.52	9.79
Jun-2000	9.98	9.91		9.46	9.61	9.96
Jul-2000	10.64	10.56		10.66	10.81	11.01
Aug-2000	10.57	10.50		10.13	10.26	10.49
Sep-2000	11.32	11.25		10.76	10.90	11.09
Oct-2000	9.01	8.94		10.02	10.15	10.36
Nov-2000	8.71	8.64		8.57	8.69	9.19
Dec-2000	9.39	9.32		9.37	9.50	10.03
Jan-2001	9.22	9.15		9.85	9.99	10.26
Feb-2001	10.05	9.98		10.13	10.27	10.65
Mar-2001	11.34	11.28		11.26	11.42	11.87
Apr-2001	12.12	12.05		11.90	12.06	12.65
May-2001	14.16	14.09		13.66	13.83	14.46
Jun-2001	14.82	14.75		14.83	15.02	15.64
Jul-2001	14.96	14.88		15.27	15.46	16.04
Aug-2001	15.26	15.18		15.36	15.55	16.22
Sep-2001	15.55	15.48		15.71	15.90	16.64
Oct-2001	12.30	12.23		14.34	14.60	14.89
Nov-2001	10.60	10.53		11.10	11.31	11.63
Dec-2001	10.97	10.90		11.58	11.80	12.08
Averages						
9/98 - 12/99	13.3794	13.3113	13.4075			
1999	12.3625	12.2942	12.4333			
2000	9.6883	9.6192		9.7400		
2001	12.6125	12.5417			13.1008	
1999 - 2001	11.5544	11.4850		11.7014	11.8731	12.1656

Summary	9/98 - 12/99	1999	2000	2001	1999 - 2001
BFP less 4b	0.0281	0.0708			
BFP less Rv 4b	0.0962	0.1392			
Fin Rule less 4b			0.0517		0.1469
Fin Rule less Rv 4b			0.1208		0.2164
Tent Dec less 4b				0.4883	0.3186
Tent Dec less Rv 4b				0.5592	0.3881
Rec Dec less 4b					0.6111
Rec Dec less Rv 4b					0.6806

DAIRY INDUSTRY NEWS

Department Announces Hearing Decision

On November 29, 2001, the Department held a public hearing to consider amendments to the Stabilization and Marketing Plans for Market Milk (Plans). The amendments under consideration regarded an increase in the manufacturing cost allowances for processing raw milk into dairy products because of increased energy costs dairy processing plants have incurred. Having carefully weighed the contents of the hearing record, the Department has determined that these allowances should be increased.

The increase in allowances will result in processors having to pay less for farm milk because of higher operating costs. The adjustment will take effect for milk delivered to processing plants on or after January 1, 2002. Evidence and testimony entered into the hearing record documented higher costs for both electricity and natural gas that dairy processors have paid over the past 18 months. These higher costs have significantly affected dairy processing plants' overall operating costs.

The adjustments to the minimum pricing formulas will be as follows:

+ For Butter and Whey Butter – the manufacturing cost allowance is increased from 9.7 to 10.2 cents per pound of finished product.

+ For Cheese – the manufacturing cost allowance is increased from 16.9 to 17.6 cents per pound of finished product.

+ For Nonfat Dry Milk – the manufacturing cost allowance is increased from 14.0 to 16.1 cents per pound of finished product.

Because the Class 2 (cream, yogurt and cottage cheese) and Class 3 (frozen products) pricing formulas are set as a fixed differential above Class 4a (butter and nonfat dry milk) prices, the adjustments made in the Class 4a manufacturing cost allowances will also be reflected in Class 2 and 3 prices.

Copies of the Department's decision may be obtained by contacting the Dairy Marketing Branch at 916-654-1456. You may also download a copy from the Department's website at www.cdfa.ca.gov/dairy. From the main page, click on [Public Hearings] and then on [Dairy Hearings and Results]. Should you have any questions or desire further information, please contact Eric Erba or Tom Gossard at 916-654-1456.

2002 Assessment Rates Established for the CMAB & CMMAB

The Department recently approved the 2002 assessment rates applicable to the California Milk Advisory Board (CMAB) and the California Manufacturing Milk Advisory Board (CMMAB). These two producer-funded programs conduct dairy promotion and research activities on behalf of California's dairy farmers.

The 2002 CMAB assessment rate for market milk and the 2002 CMMAB assessment rate for manufacturing milk have both been set at ten cents (**$0.10**) per hundredweight. These rates are unchanged from the 2001 rates.

As in the past, these assessments will be collected from the first handlers who purchase or otherwise acquire possession of milk from producers. Each handler shall in turn deduct such assessments from payment owed to their producers.

Please call Dennis Manderfield of the CDFA Marketing Branch at (916) 654-1245 if you have any questions about these assessments.

New Security Measures at CDFA

December brought new security measures for all visitors and employees at the CDFA Sacramento headquarters building at 1220 N Street. Security personnel will ask visitors to sign in and they will be given a temporary visitor's badge. By notifying us in advance of a visit, we can advise Security and minimize delays as you enter the building. Building entrances will continue to be 1220 N Street or 1215 O Street. The alley and side entrances will be locked at all times.

California Milk Processor Board Appointments

The Marketing Order for Fluid Milk Products provides for an administrative body to be known as the California Milk Processor Board (CMPB). The CMPB is composed of nine members from three districts and one member-at-large, all of whom shall be handlers of fluid milk products. CDFA recently conducted nomination procedures to fill the CMPB district positions and based on these procedures, the following individuals have been appointed to serve a three-year term:

<u>Northern California (3 members)</u>
Herm Benedetti* (Clover-Stornetta Farms, Inc.)
Michael Lasky* (Berkeley Farms, Inc.)
Kelly Olds (Super Store Industries)

<u>South Valley (1 member)</u>
Richard Shehadey* (Producers Dairy Foods)

<u>Southern California (5 members)</u>
Ted De Groot* (Rockview Farms)
Thomas P. Dolan* (Driftwood Dairy)
Pat McColgan (Dean Foods)
Richard Walrack* (Santee Dairies, Inc.)
Jim Wegner* (Safeway)

* Signifies incumbent

CDFA appreciates all those who participated in the nomination process. Pursuant to the Marketing Order for Fluid Milk Products, the member-at-large position, currently held by Mr. Steve James with Swiss Dairy, will be filled based upon a recommendation of the CMPB to CDFA. If you have questions about the CMPB, please contact Mr. Jeff Manning, CMPB Executive Director, at (510) 883-1085 or Steven Donaldson, CDFA Marketing Branch, at (916) 654-1245.

DATA SUMMARIES

COMMERCIAL PRODUCTION OF ALL MILK
Production of all milk on farms and ranches in California during November 2001 totaled 2.7 billion pounds – 5.1 percent more than the quantity produced during November 2000. For the twelve months ending in November 2001, total milk production increased 2.9 percent relative to the same period in 2000.

MANUFACTURED PRODUCTS
For the month of November2001, as compared to November 2000, the total manufacture of butter decreased 3.3 percent; manufacture of nonfat dried milk for human consumption increased 5.2 percent; manufacture of total cheese increased 10.9 percent; and manufacture of total frozen products increased 5.7 percent.

SALES OF CLASS 1 MARKET MILK
Sales of Class 1 market milk products in California during November 2001 were down 1.2 percent relative to sales during November 2000.