

National Milk Producers Federation

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January 31, 2001

Hearing Clerk
Room 1081, South Building
U.S. Department of Agriculture
Washington, DC 20090-6456

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To Whom It May Concern:

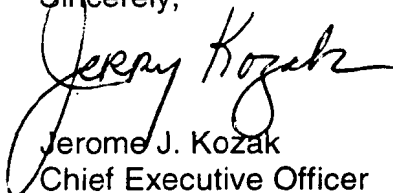
The National Milk Producers Federation (NMPF) exceptions in the matter: **Milk in the Northeast and Other Marketing Areas; Tentative Decision, Docket Number AO-14-A69, et al.: DA-00-03**, are submitted herewith. The issues in this decision were considered at a May 8-12, 2000 hearing held in response to a congressional mandate to reconsider the Class III and Class IV milk pricing formulas implemented January 1, 2000

Headquartered in Arlington, VA, NMPF develops and carries out policies that advance the interests of dairy producers and the cooperatives they collectively own. The 27 NMPF member cooperatives market the majority of the U.S. milk supply

NMPF supports the decision with one exception ---- **NMPF urges USDA to revert to using the monthly average NASS AA butter price to calculate the butterfat price for both Class III and Class IV milk.** Our analysis shows that the provisions in the tentative decision providing for different butterfat prices in Class III and Class IV could reduce dairy producer revenues and create disorderly marketing conditions. We believe that this is an unintended consequence that requires reconsideration. Our comments include a quantitative analysis of the economic implications on dairy producer revenue from the change in the Class III butterfat value under the tentative decision.

NMPF will be glad to respond to any questions or provide additional information to support our comments. Thank you for considering our comments and exceptions.

Sincerely,


Jerome J. Kozak
Chief Executive Officer

Attachment: Exceptions to Tentative Federal Order Decision

Jerome J. Kozak, Chief Executive Officer James P. (Tom) Camerlo, Jr., President Elwood Kirkpatrick, First Vice President
Charles Beckendorf, Second Vice President Robert Dever, Third Vice President
Donald Storhoff, Secretary/Treasurer Clyde Rutherford, Assistant Secretary/Treasurer

NATIONAL MILK PRODUCERS FEDERATION
Exceptions in the Matter
Milk in the Northeast and Other Marketing Areas; Tentative Decision

Docket Number (AO-14-A69, et al.: DA-00-03)

The National Milk Producers Federation (NMPF) welcomes the opportunity to file exceptions on USDA's tentative decision on a hearing held May 8-12, 2000 in response to a congressional mandate to reconsider the Class III and Class IV milk pricing formulas implemented January 1, 2000.

NMPF is the national trade association that represents dairy producers and the cooperative milk marketing associations they own and operate throughout the United States. NMPF is the national voice of nearly 60,000 dairy producers. The Federation develops and carries out policies that advance the well being of U.S. dairy producers and the cooperatives they collectively own. NMPF's 27 member cooperatives market the majority of the U.S. milk supply and manufacture 45% of the butter, 55% of nonfat dry milk, and 30% of the cheese marketed in the U.S.

NMPF acknowledges USDA's hard work and diligence to meet the time deadline imposed by the Congress. NMPF commends USDA on the tentative final decision and supports the modification to the Class III and Class IV milk pricing formulas with one major exception. The different butterfat prices in Class III and Class IV are also used to calculate Class I milk values. This change in butterfat pricing could reduce dairy producer revenues and could create disorderly marketing conditions.

NMPF urges USDA to revert to using the monthly average National Agricultural Statistics Service (NASS) AA butter price to calculate both the Class III and Class IV butterfat prices. As a necessary complement to this, NMPF also urges USDA to revert to using the protein price calculation used in 2000, incorporating the make allowances, cheese price series, and yield factors in the tentative final rule.

Reduction in Class I Revenue

The tentative final decision establishes the Class I price per hundredweight as the higher of the advanced Class III or advanced Class IV prices **at 3.5 percent butterfat**. In months when the Class I price is based on the advanced Class III price the Class III butterfat price will be higher than the Class IV butterfat price. A higher Class I butterfat price results in a lower Class I skim milk price. Since the average butterfat test of all Class I milk is approximately 2 percent, a higher butterfat price results in a lower Class I price at the 2 percent butterfat level.

Table 1 attached illustrates how the tentative decision impacts Class prices. Hypothetical NASS survey prices as follows were used:

PRODUCT	PRICE PER POUND		
	Tables 1 & 4; Table 2, Example 1	Table 2, Example 2	Change
Cheese	\$1.35	\$1.35	N/C
Whey	\$0.20	\$0.20	N/C
Nonfat Dry Milk	\$1.01	\$1.01	N/C
Butter	\$1.10	\$1.15	+\$0.05

Impact on Class I Prices

Table 1 (attached) shows the impact of using the cheese price vs. the butter price to establish the Class III butterfat value based on hypothetical NASS survey prices. The impact on Class III milk containing 3.5 percent butterfat is small but milk containing 2 percent butterfat has a very significant price decline. Whenever the Class III price at 3.5 percent butterfat is higher than the Class IV price at 3.5 percent butterfat the tentative decision provides that the Class I price is based on the Class III price. In this example, the higher Class III butterfat price (\$1.87 per pound) under the tentative decision results in the Class I price for milk containing 2 percent butterfat, the approximate average test for all Class I milk, being \$1.27 per hundredweight less than what it would have been before to the tentative decision.

Tables 2 through 4 show impacts on producer revenue at various prices for cheddar cheese and butter. Table 2 shows the impact per hundredweight and Table 3 shows the impact in total. Table 4 demonstrates this impact at a specific set of prices, showing that in Class I milk at a 2% butterfat test, the increase in butterfat value is clearly outweighed by the decrease in skim value, and that there is no offsetting increase in the value of residual cream sent to Class II or Class IV uses.

Whenever the Class III price is used to establish the Class I price the provisions in the tentative decision will cause dairy producer revenue from Class I milk to decline. We believe USDA did not intend this consequence and we urge careful reconsideration of this specific element of the tentative final decision.

Producers cannot afford the Class I revenue loss that would occur under the tentative decision whenever the Class I price is based on the Class III price. **To correct the problem NMPF urges USDA to revert to using the monthly average NASS AA butter price to calculate both the Class III and Class IV butterfat prices. It should be emphasized, however, that NMPF continues to strongly support using the higher of the Class III or Class IV prices as the Class I price mover.**

Impact on Volatility and Orderly Marketing

Table 5 illustrates how a small change (\$0.05 per pound) in the butter price results in the Class IV price at 3.5 percent butterfat increasing \$0.22 per hundredweight. The increase raises the Class IV price at 3.5 percent butterfat to \$11.98 or \$0.09 higher than the Class III price at 3.5 percent butterfat. As a result, the Class IV price becomes the Class I price mover. Although the Class IV price at 3.5 percent butterfat rose only \$0.22 per hundredweight, using the Class IV price rather than the Class III price to determine the Class I price results in the Class I skim milk price increasing over \$2.00 per hundredweight and the Class I butterfat price decreasing over \$0.50 per pound. Price volatility of that magnitude is not orderly marketing. **The volatility in the Class I skim milk and butterfat prices should be addressed by reverting to using the monthly average NASS AA butter price to calculate both the Class III and Class IV butterfat prices.**

Impact on Producer Revenue from Butterfat Substitution in Cheese

Separate butterfat prices for Class III and Class IV can create an economic incentive for cheese manufacturers to substitute butterfat classified and priced as Class IV as an ingredient in cheese to reduce costs when the Class IV butterfat price is less than the Class III butterfat price. Such substitution is feasible since current standards of identity for cheese permit plastic cream, a Class IV product, to be used to produce all types of cheese. The standards of identity also allow other Class IV products such as butter, butteroil and anhydrous milkfat to be used to produce processed cheese, cheese food, and non-standard cheese.

In the extreme, where all Class III butterfat is substituted, producer revenue could be reduced by the difference between the Class III and Class II butterfat prices times 1.5 billion pounds per year of Class III butterfat. Based on futures prices on January 22, 2001, we estimate that the average Class III butterfat price will be 23¢ per pound higher than the Class IV butterfat price in 2001; this represents a potential annual loss of \$350 million from producer revenue. **Using the monthly average NASS AA butter price to calculate both the Class III and Class IV butterfat prices eliminates any undue economic incentive to use Class IV products or Class II cream to produce cheese.**

Corollary Changes to the Protein Price Calculation

A lower protein price corresponds to a higher Class III butterfat price in the calculation of Class III values. It is this lower value for Class III (and so Class I) skim components that is the direct cause of the decreases in producer income outlined above. Although a butterfat value is implicit in the protein price calculation in the tentative final decision, it must be made explicit in order to implement the reversion to a Class III butterfat price calculated from a butter price. All other changes to the protein price contained in the tentative final decision were arrived at independently of the decision to base the Class III butterfat price on a cheese price.

Using the protein price calculation used in 2000, changing only the cheese price series, the butterfat price calculation, and the cheddar cheese make allowance as specified in the tentative final decision, would be most consistent with the record, with the conclusions contained in the tentative final decision, and with the reversion to the use of the monthly average NASS AA butter price to calculate both the Class III and Class IV butterfat prices.

Conclusion

NMPF fully supports all aspects of the tentative final decision with one exception, as noted. NMPF believes that although USDA was acting in good faith to address the issue raised in the May 2000 hearing, the decision to adopt a different butterfat value for Class III brings about unintended consequences which can severely erode dairy producer income.

For the reasons cited, the National Milk Producers Federation urges USDA to adopt the modifications described in these exceptions. Adopting the modifications proposed by NMPF is needed to prevent dairy producer revenue from being reduced.

National Milk Producers Federation appreciates the opportunity to submit exceptions to the tentative final rule and commends USDA for their hard work under tight time constraints. We stand ready to respond to any questions or provide additional information to support our proposals. Thank you for considering our exceptions.

Table 1 - Exceptions to Tentative Decision, Docket AO-14-A69, et al., : DA-00-03

NATIONAL MILK PRODUCERS FEDERATION					
COMPARISON of CLASS III PRICE FORMULAS BEFORE and AFTER JANUARY 1, 2001					
This table shows the impact of using the NASS cheese price rather than the NASS butter price to calculate Class III butterfat price.					
CLASS III - BEFORE JANUARY 1, 2001 With Modifications*		NASS Survey**	Amount Per lb.	Per Cwt. Price	
				3.5% BF	2% BF
Protein Price	$((\text{NASS Chz Survey (38\% m)} - .1650) * 1.405) + (((\text{NASS Chz Survey} - .1650) * 1.582) - \text{Butterfat price}) * 1.28$	1.3500	2.53	7.56	7.67
Butterfat Price	$((\text{NASS Butter Survey} - 0.115) / 0.82)$	1.1000	1.20	4.20	2.40
Other Solids Price	$((\text{NASS Dry Whey Survey} - .140) / .968) (\text{Price Snubbed @ } \$0.00)$	0.2000	0.06	0.35	0.36
Class III Price 3.5%	$((\text{Protein Price} * 3.1) * .965) + (\text{Other Solids} * 5.9 * .965) + (\text{Butterfat Price} * 3.5)$			12.11	
Class I Mover 2%	$((\text{Protein Price} * 3.1) * .98) + (\text{Other Solids} * 5.9 * .98) + (\text{Butterfat Price} * 2.0)$				10.43
CLASS III - AFTER JANUARY 1, 2001 - TENTATIVE DECISION					
Protein Price	$((\text{NASS Chz Survey (38\% moisture)} - .1650) * 1.405)$	1.3500	1.66	4.98	5.06
Butterfat Price	$(\text{NASS Chz Survey} - .1650) * 1.582$	1.3500	1.87	6.56	3.75
Other Solids Price	$((\text{NASS Dry Whey Survey} - .140) / .968) (\text{Price Snubbed @ } \$0.00)$	0.2000	0.06	0.35	0.36
Class III Price 3.5%	$((\text{Protein Price} * 3.1) * .965) + (\text{Other Solids} * 5.9 * .965) + (\text{Butterfat Price} * 3.5)$			11.89	
Class I Mover 2%	$((\text{Protein Price} * 3.1) * .98) + (\text{Other Solids} * 5.9 * .98) + (\text{Butterfat Price} * 2.0)$				9.16
*The formulas in effect before January 1, 2001 were modified to incorporate the manufacturing allowance and other revisions effective January 1, 2001.					
** NASS Survey - The prices used are hypothetical, not actual prices.					

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Tables show loss from reduced Class I value under tentative final rule.

Negative values mean Class III is the Class I mover.

<u>Class I Bf Test</u>	<u>Whey Price</u>	<u>NFDM</u>
2.00%	0.20	1.01

Table 2 - Impact on Producers, per Hundredweight of Class I Sales

Butter Price	Cheese Price									
	1.00	1.10	1.20	1.30	1.35	1.40	1.50	1.60	1.70	1.80
0.70	0.00	0.00	(1.75)	(2.04)	(2.19)	(2.34)	(2.64)	(2.94)	(3.24)	(3.54)
0.80	0.00	0.00	0.00	(1.81)	(1.96)	(2.11)	(2.41)	(2.71)	(3.01)	(3.31)
0.90	0.00	0.00	0.00	(1.58)	(1.73)	(1.88)	(2.18)	(2.48)	(2.78)	(3.08)
1.00	0.00	0.00	0.00	(1.35)	(1.50)	(1.65)	(1.95)	(2.25)	(2.55)	(2.85)
1.10	0.00	0.00	0.00	0.00	(1.27)	(1.42)	(1.72)	(2.02)	(2.32)	(2.62)
1.15	0.00	0.00	0.00	0.00	0.00	(1.31)	(1.60)	(1.90)	(2.20)	(2.50)
1.20	0.00	0.00	0.00	0.00	0.00	(1.19)	(1.49)	(1.79)	(2.09)	(2.39)
1.30	0.00	0.00	0.00	0.00	0.00	0.00	(1.26)	(1.56)	(1.86)	(2.16)
1.40	0.00	0.00	0.00	0.00	0.00	0.00	(1.03)	(1.33)	(1.63)	(1.93)
1.50	0.00	0.00	0.00	0.00	0.00	0.00	0.00	(1.10)	(1.40)	(1.70)
1.60	0.00	0.00	0.00	0.00	0.00	0.00	0.00	(0.87)	(1.17)	(1.46)
1.70	0.00	0.00	0.00	0.00	0.00	0.00	0.00	(0.64)	(0.94)	(1.23)
1.80	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	(0.71)	(1.00)
1.90	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	(0.48)	(0.77)

Table 3 - Total Annual Impact on Producers, in Millions of Dollars

Butter Price	Cheese Price									
	1.00	1.10	1.20	1.30	1.35	1.40	1.50	1.60	1.70	1.80
0.70	0	0	(676)	(791)	(849)	(907)	(1,023)	(1,139)	(1,254)	(1,370)
0.80	0	0	0	(702)	(760)	(818)	(934)	(1,049)	(1,165)	(1,281)
0.90	0	0	0	(613)	(671)	(729)	(845)	(960)	(1,076)	(1,192)
1.00	0	0	0	(524)	(582)	(640)	(755)	(871)	(987)	(1,102)
1.10	0	0	0	0	(493)	(550)	(666)	(782)	(898)	(1,013)
1.15	0	0	0	0	0	(506)	(622)	(737)	(853)	(969)
1.20	0	0	0	0	0	(461)	(577)	(693)	(808)	(924)
1.30	0	0	0	0	0	0	(488)	(603)	(719)	(835)
1.40	0	0	0	0	0	0	(399)	(514)	(630)	(746)
1.50	0	0	0	0	0	0	0	(425)	(541)	(656)
1.60	0	0	0	0	0	0	0	(336)	(452)	(567)
1.70	0	0	0	0	0	0	0	(247)	(362)	(478)
1.80	0	0	0	0	0	0	0	0	(273)	(389)
1.90	0	0	0	0	0	0	0	0	(184)	(300)

Notes: Shows reduction in Federal Order value of Class I milk based on use of cheese prices to price Class III butterfat, contingent on various combinations of cheese and butterfat prices. Class I sales on Federal Order markets contain about 2% butterfat on average; 2000 sales projected as 38,726,594,000 lbs. Value is \$0.00 if Class IV formula is the Class I mover.

Tables 4 - Exceptions to Tentative Decision, Docket AO-14-A69, et al., : DA-00-03

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When Class III is the Class I mover, using a cheese-based butterfat price formula almost always causes a higher Class I butterfat price and a lower Class I skim price, than using a butter-based butterfat price. Class I use is skewed toward skim milk, so a higher butterfat price reduces Class I value; and there is no offsetting increase in the value of residual cream going to Class II or IV use.

Calculation of Loss per Cwt. of Class I Sales from Using Cheese-Based Butterfat Formula

Class I Bf Test	Whey Price	NFDM	Butter Price	Cheese Price
2.00%	0.20	1.01	1.10	1.35

100 Lbs. of producer milk is shipped to a Class I plant:

96.50 lbs. skim
3.50 lbs. bf

Cream is removed to reduce Class I test to market average:

Fluid milk value:

Class I: 2.00%

94.13 lbs. skim
1.92 lbs. bf

Cream value:

Class IV at test: 40.0%

2.37 lbs. skim
1.58 lbs. bf

Total value per cwt. of producer milk:

96.50 lbs. skim
3.50 lbs. bf

Total value per cwt. of producer milk

	Using cheese-based Class III butterfat		Using butter-based Class III butterfat		Diff. In Value
	Price*	Value*	Price*	Value*	
Class I: 2.00%					
94.13 lbs. skim	\$5.53 /cwt.	\$5.20	\$8.20 /cwt.	\$7.72	(\$2.52)
1.92 lbs. bf	1.87 /lb.	3.60	1.20 /lb.	2.31	1.29
		8.80		10.03	(1.22)
Cream value:					
Class IV at test: 40.0%					
2.37 lbs. skim	7.83 /cwt.	0.19	7.83 /cwt.	0.19	0.00
1.58 lbs. bf	1.20 /lb.	1.90	1.20 /lb.	1.90	0.00
		2.08		2.08	0.00
Total value per cwt. of producer milk:					
96.50 lbs. skim		5.39		7.90	(2.52)
3.50 lbs. bf		5.50		4.20	1.29
Total value per cwt. of producer milk		10.89		12.11	(1.22)

Loss to pool associated with new Class III bf calc., per cwt. shipped: **(\$1.22)**
x CI I % in example (CI I lbs./100)

Loss to pool associated with new Class III bf calc., per cwt. Class I: **(\$1.27)**

* Class I or II differentials would be added uniformly to volumes, so would have no net effect.

Table 5 - Exceptions to Tentative Decision, Docket AO-14-A69, et al.; : DA-00-03

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CLASS III & IV PRICE FORMULAS - TENTATIVE DECISION

Example 1		Class I price mover based on Class III price (\$11.89) higher than the Class IV price (\$11.76) at 3.5% butterfat but \$0.99 less at 2% butterfat.			
CLASS III		FORMULAS			
		NASS Survey*	Amount Per lb.	Per Cwt. 3.5% BF	Price 2% BF
Protein Price	((NASS Chz Survey (38% moisture)- .1650) *1.405)	1.3500	1.66	4.98	5.06
Butterfat Price	(NASS Chz Survey -.1650) * 1.582	1.3500	1.87	6.56	3.75
Other Solids Price	((NASS Dry Whey Survey - .140) / .968) (Price Snubbed @ \$0.00)	0.2000	0.06	0.35	0.36
Class III Price 3.5%	((Protein Price * 3.1)*.965)+(Other Solids*5.9*.965)+(Butterfat Price *3.5))			11.89	
Class I Mover 2%	((Protein Price * 3.1)*.98)+(Other Solids*5.9*.98)+(Butterfat Price *2.0))				9.16
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CLASS IV					
Nonfat Solids Price	((NASS NDM Survey - 0.140)	1.0100	0.87	7.56	7.67
Butterfat Price	((NASS Butter Survey - 0.115) / 0.82)	1.1000	1.20	4.20	2.40
Class IV Price 3.5%	((Solids Price * 9) *.965+ (Butterfat Price *3.5))			11.76	
Class I Mover 2%	((Solids Price * 9) *.98+ (Butterfat Price *2))				10.07

Example 2		Class I price mover based on Class IV price (\$11.98) higher than Class III price (\$11.89). Shows volatility that could occur in Class I skim and butterfat prices even though Class III and Class IV prices are close.			
CLASS III					
		NASS Survey*	Amount Per lb.	Per Cwt. 3.5% BF	Price 2% BF
Protein Price	((NASS Chz Survey (38% moisture)- .1650) *1.405)	1.3500	1.66	4.98	5.06
Butterfat Price	(NASS Chz Survey -.1650) * 1.582	1.3500	1.87	6.56	3.75
Other Solids Price	((NASS Dry Whey Survey - .140) / .968) (Price Snubbed @ \$0.00)	0.2000	0.06	0.35	0.36
Class III Price 3.5%	((Protein Price * 3.1)*.965)+(Other Solids*5.9*.965)+(Butterfat Price *3.5))			11.89	
Class I Mover 2%	((Protein Price * 3.1)*.98)+(Other Solids*5.9*.98)+(Butterfat Price *2.0))				9.16
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CLASS IV					
Nonfat Solids Price	((NASS NDM Survey - 0.140)	1.0100	0.87	7.56	7.67
Butterfat Price	((NASS Butter Survey - 0.115) / 0.82)	1.1500	1.26	4.42	2.52
Class IV Price 3.5%	((Solids Price * 9) *.965+ (Butterfat Price *3.5))			11.98	
Class I Mover 2%	((Solids Price * 9) *.98+ (Butterfat Price *2.0))				10.19

* NASS Survey - The prices used are hypothetical, not actual prices.