MS. WHITESIDES: Whitesides.

JUDGE HUNT: Whiteside, okay.

MS. WHITESIDES: And I represent Hershey Foods Corporation.

Mr. Schad has graciously agreed to let Audrey Throne testify ahead of him --

JUDGE HUNT: All right.

MS. WHITESIDES: -- since she has some time constraints today.

JUDGE HUNT: Good afternoon.

MS. THRONE: Good afternoon.

Whereupon,

AUDREY F. THRONE

having been duly sworn, was called as a witness and was examined and testified as follows:

JUDGE HUNT: And would you state and spell your name, please? Thank you.

THE WITNESS: My name cheeses Audrey Throne. That's spelled A-U-D-R-E-Y, T-H-R-O-N-E.

MS. WHITESIDES: Your Honor, we have passed out copies of her written testimony, and we would like to identify it as the next consecutive exhibit number. I think we are on 51.

JUDGE HUNT: Yes, you're right, 51.

(The document referred to was

marked for identification as
Exhibit No. 51.)

MS. WHITESIDES: Please proceed with your testimony.

THE WITNESS: Good afternoon. My name is Audrey Throne and I am testifying today on behalf of Hershey Foods Corporation regarding Hershey's position on the various proposals which have been submitted to reconsider the Class III and Class IV milk pricing formulas in the final rule.

I have been employed by Hershey for 20 years, and my present position is manager of dairy ingredients. My responsibilities include buying all of the milk and dairy ingredients that Hershey Foods uses in making its products in North America.

I grew up on a dairy farm in Pennsylvania and my entire career at Hershey Foods has been in milk sanitation and procurement.

Hershey Foods is the leading North American manufacturer of quality chocolate, confectionery and chocolate-related grocery products. In addition, we export Hershey's branded products to more than 90 countries worldwide. In 1999, Hershey's total sales were $3.9 billion.

Our principal brands include Hershey's Milk Chocolate and Milk Chocolate with Almonds Bars, Hershey's

Kisses Chocolates and Hershey's Hugs Chocolates, Kit-Kat Wafer Bar, Reeses Peanut Butter Cups, Jolly Rancher Candy, Payday Peanut Caramel Bar, Twizzlers Candy, Whoppers Malted Milk Balls, and York Peppermint Patties, to name just a few.

Hershey Foods Corporation was founded by Milton Hershey in 1894, and he located his manufacturing plant in the heart of Pennsylvania's dairy country where he could obtain the large supplies of fresh milk needed for making his method of high quality milk chocolate.

Today, Hershey Foods Corporation operates more than a dozen confectionery plants throughout the United States, Canada and Mexico. We still use primarily fresh fluid milk in making our products, such as Hershey's Milk Chocolate Bars, Hershey's Kisses Chocolates, and Hershey's Milk Chocolate Bars with Almonds. These products have a distinctive flavor and texture that the American public has recognized and enjoyed for many decades. And one important reason for that distinctive Hershey favor is that Mr. Hershey's methods call for fresh fluid milk.

As I said before, my responsibilities include buying the fresh fluid milk that Hershey Foods uses in its milk chocolates and other products, as well as all other dairy ingredients used in our manufacturing operations.

In 1999, Hershey Foods bought more than 1.5 million pounds of fresh fluid milk every day.

The price relationship between Class IV milk on the one hand and Class II milk on the other is significant for the future of the dairy industry in this country. Several of the proposals for adjusting the Class IV price would have the ripple effect of increasing the price of Class II milk. USDA should avoid any step that would increase the Class II price or increase the price difference between Class II and Class IV milk.

The trend already is for food manufacturers to reduce their use of Class II milk, and any increase in the price difference between Class II and Class IV milk will accelerate the trend. This trend harms diary farmers.

Class II food manufacturers are reducing their reliance on traditional domestic fluid milk by reformulating products to eliminate the dairy component, substituting nondairy fats, using imported dairy ingredients and relocating manufacturing operations in foreign countries.

For example, imports of milk protein and of anhydrous milk fat, which are alternative dairy ingredients, have risen dramatically in recent years. These imports have replaced some domestic Class II milk because they are less expensive.

Moreover, once a manufacturer changes its processes or formulations to eliminate Class II milk, it is extremely difficult and expensive to reverse that change.

For these reasons, Hershey submits that if USDA reduces the price of fat, it should do so for all classes. USDA should not discriminate in favor of Class IV by reducing the price of fat for that class alone.

In addition, the make allowance for Class IV should not be decreased and the yield factor for nonfat dry milk should not be changed.

Hershey also submits that USDA should issue a recommended decision for public comment before adopting a final rule. In requiring this rulemaking, Congress did not state that there were emergency conditions in the market that would justify dispensing with a recommended decision and public comment.

To the contrary, the congressional objection to the final rule USDA adopted in 1999 was based on what Congress perceived as inadequate public comment.

The price of butterfat should be the same for all classes. Several parties propose that the price of butterfat be reduced by six cents per pound, and that's Proposals 3, 4, 5, and 8. These proposals differ, however, on whether this reduction should be applied uniformly to all classes or whether the reduction should benefit Class IV alone.

Hershey submits that if conditions in the market warrant a six-cent reduction in the price of butterfat this reduction must be applied across the board. There is no rational justification for reducing the price in one class while leaving it unchanged in other classes.

There are at least four reasons against reducing the price of butterfat in Class IV alone.

First of all, reducing the price of fat in Class IV alone will provide an artificial incentive to use more cream to produce butter. The market should determine the use of fat because the market can and the market will allocate fat to the most efficient use. Reducing the price of fat in Class IV but not in Classes II or III will provide an artificial incentive to use more cream to produce better.

By calling this incentive artificial, I mean only that the free market would not provide this incentive on its own.

All classes of milk compete for the same fat. The price that sellers of excess cream are obligated to pay for that butterfat is determined by the first use of the excess butterfat sold. Therefore, if you reduce the Class IV butterfat price six cents per pound and leave butterfat prices in other classes unchanged, it means that sellers of excess cream will have a six-cent per pound lower obligation if that butterfat is sold for use in Class IV products.

As a result, users in other classes will have to pay six cents more per pound of milk fat to attract that fat away from Class IV users.

Class IV manufacturers will always be the preferred outlet for sellers of milk fat because their obligation for that butterfat will be lower. Favoring Class IV will cause Class II manufacturers to use butter or other ingredients.

Many Class II products compete on grocery store shelves with food products made from Class IV milk. If USDA makes fat used in Class II more expensive than the identical fat used in Class IV, then butter and other ingredients will become more economical than fresh cream for use in Class II products.

Class III-A pricing, when it was introduced in 1993, had the same effect on the use of skim milk.

Class II manufacturers will then be forced to use those substitutes to remain competitive. While there are FDA standards of identity for many Class II products, those standards often permit the use of ingredients such as butter, and many products made from Class II milk or cream are not subject to any standard of identity.

Additionally, products such as anhydrous milk fat can be imported for less. For example, import statistics from the Census Bureau indicate that the quantity of AMF imported into the United States increased from only 110, and that should have been thousand kilograms, or more simply, tons, so increased from only 110 tons of AMF in 1995 to more than 10,500 tons in 1999. Obviously, this reveals a significant increase in the importation of alternative dairy ingredients.

To the extent that substitutes for cream are not available to Class II manufacturers, then a reduction for Class IV alone places them at a competitive disadvantage.

Both the International Dairy Foods Association and the National Milk Producers Federation have conducted an economic analysis of the effect on Class II prices of reducing the price of fat in Class IV by six cents per pound without any reduction in other classes. These analyses show that this one class reduction would increase the difference between Class II and Class IV by 21 cents per hundredweight.

Thus, the current differential, which is fixed at 70 cents, would in effect be increased to more than 90 cents. I believe that these analyses to be correct.

This dramatic increase in the difference between Class II and Class IV would place Class II manufacturers at a substantial competitive disadvantage.

As I noted above, one effect will be to force Class II manufacturers who compete with products made with Class IV milk to seek cheaper alternatives. Where cheaper substitutes are not available, however, the Class II manufacturers will be placed at a substantial and unfair cost disadvantage. This is especially a concern for my company because many of our competitors use skim milk and fat made from Class IV milk rather than Class II fluid milk. A difference of 91 cents per hundredweight would put Hershey at a cost disadvantage relative to its competitors of at least $4 million per year.

Favoring Class IV alone could force the Class II price above the blend price in some orders, with the result that Class II users will depool.

Based on my practical experience with milk prices, I believe it is likely that a reduction in the fat price that is limited to Class IV would cause the Class II price in some orders to be greater than the producer blend price. In this situation many Class II users would have a strong incentive to depool their milk and thus take advantage of the lower blend price.

Indeed, the current 70-cent differential is already having exactly this effect in some orders, and increasing the Class II price further relative to the Class IV price will accelerate the trend toward depooling.

The current make allowance for Class IV should not be decreased. In its Notice of Hearing, USDA gave its assessment that reducing the make allowance for nonfat dry milk would have the effect of increasing the price of Class I and Class II milk. This price increase would reduce the volume of milk used in those classes and consequently increase the volume of milk used in Class III and Class IV.

I agree with USDA's assessment. It seems to me that it would be irrational to force more milk into uses that USDA considers surplus at the expense of consumer-driven products such as fluid milk and food products.

In addition, as discussed earlier, increasing the price of Class II milk will force manufacturers to use less expensive substitutes, including some imported products. Moreover, any increase in the price difference between Class II and Class IV milk, even if the increase is inadvertent, will place Class II manufacturers at a substantial competitive disadvantage.

Market forces correct any effect of a make allowance that is too large through the mechanism of negotiated over order premiums. Thus, any claim that the make allowance should be decreased should be rejected by USDA because free market forces will force buyers to pay premiums.

On the other hand, if the make allowance is too small, then production of nonfat dry milk will move to cooperative plants that are not subject to minimum price regulation or to plants outside the Federal Order System.

The yield factor should not be changed from the current 1.02. Several proposals have been made to reduce the yield factor for nonfat dry milk. They are Proposals 26, 27 and 28. The rationale for these proposals appears to be that the amount of nonfat dry milk produced from skim milk will be greater than the amount of nonfat solids in the skim milk because of the moisture that remains in the nonfat dry milk even after drying.

The flaw in this rationale is that there are unavoidable losses of milk from the farm to the drying plant and within the plant itself. Thus, not every pound of nonfat solids is recoverable in the form of nonfat dry milk. Moreover, some nonfat solids go into cream during the separation process and therefore are not captured in the nonfat dry milk.

USDA recognized these losses in adopting the 1.02 yield factor. USDA should reject the proposals to change the current yield factor.

USDA should publish a recommended decision for public comment. USDA should not omit a recommended decision for public comment during this rulemaking.

First, while Congress called for an emergency rulemaking, it did not intend for USDA to bypass the recommended decision phase which was designed to ensure that rules, such as the milk pricing formulas, reflect not only the agency's expertise, but also public opinion. Congress obviously recognized the importance of obtaining public comment on these milk formulas because it insisted USDA return to further rulemaking because the final rule did not adequately reflect public comment from the initial rulemaking.

Second, there are no emergency marketing conditions that exist to warrant the omission of the recommended decision and public comment phase. There is no emergency milk marketing situation that would warrant omitting the public comment period on the secretary's proposal.

Hershey and other interested parties are entitled to an opportunity to comment on the secretary's recommended decision. Considering the importance of milk pricing, USDA should, at the very least, allow interested parties a minimum number of days to comment on the proposal.

In conclusion, Hershey favors allowing milk prices to be set by the free market, not by regulation. USDA should reject any proposal for the price of Class IV that will have the ripple effect of increasing Class II prices or that would increase the price difference between Class II and Class IV milk. Such proposals will ultimately harm dairy producers by driving manufacturers away from Class II milk and forcing them to adopt substitute ingredients, some of which will be imported. Such proposals will also place Class II manufacturers at a substantial competitive disadvantage.

In addition, Hershey believes it is important for USDA to allow public comment on a recommended decision in this proceeding.

Respectfully submitted.

MS. WHITESIDES: Your Honor, we would like to move for Exhibit 51 to be admitted into the record as evidence.

JUDGE HUNT: Does anyone object to 51?

(No response.)

JUDGE HUNT: There being no objections, Exhibit 51 will be received into evidence.

(The document referred to, previously identified as Exhibit No 51, was received in evidence.)

MS. WHITESIDES: The witness is available for further questions.

JUDGE HUNT: Yes, Mr. Yale.

CROSS-EXAMINATION

BY MR. YALE:

Q My first question is where are the exhibits of the Hershey Candy Bars and the others?

A As you will recall when we arrived on Sunday, it was 96 degrees. Makes it a little though.

Q I would have licked the wrappers.