

# Statement of Dairy Farmers of America, Inc.

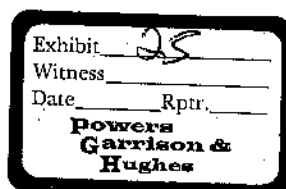
DFA is a member-owned Capper Volstead cooperative of 11,500 farms producing milk in 49 states. DFA pools milk on 9 of the 10 Federal Milk Marketing Orders. DFA is a member of the National Milk Producers Federation. (NMPF)

DFA is a supporter of Federal Milk Marketing Orders. Orders are an economically proven marketing tool for dairy farmers and we believe without them dairy farmers' economic livelihood would be worse.

The central issue of this hearing is to review and determine if the current product price formulas for Class I and II milk adequately reflect the cost of producing and marketing that milk to its intended use and if not what might be a better formula. Failure to address this issue will be detrimental to the members of DFA both in their day-to-day dairy farm enterprises and in the milk processing investments that they have made. We appreciate the swift response that the Secretary has given to this issue. We have worked hard to compile data and evidence with the other members of NMPF to support the proposal and feel we have substantial information to put into the record. We think that the Dairy Division's new direction of more narrowly focused Hearing topics will serve the industry well and will provide for a more clear hearing record.

DFA supports Proposals 1 – 5 as offered by NMPF and supports the testimony of Dr. Cryan as he outlined the need for the changes, the workings of the various price formulas and the results from the changes.

The dairy industry is under tremendous margin stress at the farm level. According to our records in 2006 DFA has seen 830 farms cease dairy operations nationwide thru the first 10 months of the year with 121 of them in October alone. At our most recent Corporate Board meeting there was a keen interest from our Directors in milk prices for next year, estimates of



milk production cost factors, how much the make allowance changes in California and the Federal Order system would lower milk prices and the impact this proposal milk prices. They urged staff to work hard to explain to the Secretary how this proposal would be helpful to their operations.

In the Make Allowance Hearing of January 2006, DFA supported changes such as this proposal would establish as a part of a group of proposals. The combination included support of minimal and reasonable adjustments in the make allowances for Class III and IV price formulas and the inclusion of an energy index in those formulas. We also supported provisions that would insure that Class I and Class II prices would not be lowered as a result of any changes in the manufacturing class price formulas. While we were disappointed that the Class I and II proposals were not allowed to be included in that Hearing record, we are pleased that it is being heard now.

The make allowance changes that were justified in that Hearing (**Proposed Rule - [Docket No. AO-14-A74, et al.; DA-06-01]**) were reflective of the changing economic factors that affect the cost of manufacturing milk into dairy products. While many cost factors were outlined, the one with the most pronounced effect was energy costs. Perhaps the second most significant factor was that the formulas themselves had not been revised in many years and much of the data that supported them was several years old.

A key factor identified in the make allowance hearings is the problem with the use of the NASS prices in the formulas. Clearly the formula mechanics prevent a manufacturer of benchmark commodities from recovering cost increases by raising prices. Thus a change in make allowances is the only way given the current price formula construction that manufacturers can recover their increased costs. But Class I and Class II products are not so constrained. These products are not part of the NASS survey and manufacturers are not limited in any way by the product price formulas from recovering any costs of production they may have thru negotiations with buyers.

But under our current price formula mechanisms when Class III and IV prices are lowered, prices for Class I and II products are lowered at the same time. Because of the pooling provisions of Orders all farmers share in the lowered returns.

Even though it is difficult to explain and accept, many (but not all) DFA members accepted the changes in make allowances as they affected Class III and IV operations because they realize the need to have viable manufacturing operations to provide a market for milk. In some cases they market their milk thru a DFA owned manufacturing facility whose operating statement will benefit from the make allowance change. While their preference is to have all businesses seek cost recovery from the marketplace, they supported the make allowance changes – and directed management to vote positively in the 9 referenda votes where DFA had a ballot. But just as vocally they have asked their staff and management to support this Hearing proposal because it does direct those businesses (many of which they are partial owners of) to look find a way other than the make allowance as a better method for cost recovery.

DFA owns and operates plants that condense milk in California, New Mexico, Texas, Colorado, Indiana, Pennsylvania and Louisiana for sale to third parties and for use in our own operations. In those areas our direct costs are in the range as outlined by Dr. Cryan in the construction of the Class II skim milk price formula – 6 to 7.5 cents per pound of solids. We have a variety of equipment and the cost range reflects that range. In some of these same plants and in cheese plants we operate, we frequently re-hydrate non-fat dry milk for use in the plant. Our costs range from  $\frac{3}{4}$  cent to 1.5 cents per pound of powder. The cost range reflects that in some facilities we have invested capital to use a tote system which reduces labor, waste and product loss, while in others we "empty bags" which has a lowered capital cost but increased labor, product loss and clean-up and bag disposal costs.

DFA manufactures butter and several concentrated milk-fat products at plants in California, Texas and Minnesota. Additionally we operate and manage a very large and substantial cream common marketing agency. I surveyed staff members in all four businesses and none were aware that any traditional Class II product manufacturers purchased butter or concentrated fat

products for regular use in Class II products. They noted that large volume plants desired cream as an ingredient because it contained other milk proteins and other solids in addition to butterfat, which had desirable product formulation characteristics and the fact that it was already in fluid form was a benefit in the manufacturing process.

DFA markets milk to fluid use buyers in every Federal Order except Order 1131. Our costs to serve those markets have risen dramatically as a result of energy costs. Some of those costs are offset with negotiated premiums but in no case is the full cost covered by either a negotiated premium or by an Order transportation credit.

DFA has supported either the institution of, or modifications in, Order transportation credits in Hearings for Orders 32 and 33 and in a request for a Hearing in Order 1. In Orders 5 and 7 we offered and supported proposals to modify existing transportation credits and institute new programs to offset increases in fuel costs.

Specifically, testimony in the Southeast Hearing, as referenced in our brief, noted two significant instances of increased costs:

**The increasing volumes of supplemental milk are documented on Hearing Exhibit 34 prepared by the Market Administrator. From July 2000 through November 2005, the pounds of supplemental milk volumes on which transportation credits have been claimed increased constantly. Comparing month to month from 2000 to 2005: In July 2000 there were claims on 31.7 million pounds; in July 2005, there were 107.7 million pounds; for August 2000 the claims were for 64.8 million; for August 2005, for 137.8 million; for September 2000, 78.3 million; for September 2005, 117.8 million; for October 2000, 75.7 million; for October 2005, 127.9 million; for November 2000, 66.9 million; for November 2005, 98.1 million. The distances milk traveled varied from 578 to 627 monthly average miles in 2000; in 2005 the monthly averages had increased to a range of 682 to 755. More milk for more miles requires more funding for the supplemental supplies.**

Furthermore, the monthly cost of supplemental supplies has increased by an additional factor because of the increases in transport costs for milk. An estimate of the total monthly costs for supplemental milk in Order 7 over the periods since 2000 can be made using the Market Administrator's Exhibit of pounds on which credits were claimed; applying the marketwide average Class I utilization of 65% (which represents the portion of deliveries on which credits apply); and using the average cost per loaded mile documented by Mr. Sims. The result is that in 2005, the gross cost of transporting supplemental milk to Order 7 was 2 to 3 times as expensive (using the months of July through November for which there is complete record evidence).

Due to fewer farms and declining milk volumes in the Southeast, increased mileages necessary to service markets and increased diesel prices, the costs to serve fluid use markets have increased. This phenomenon is consistent in all markets.

While some of these costs are offset by negotiated premiums they are insufficient and it is very difficult to match the volatility exhibited by energy costs. With regard to the Order provisions for transportation credits – they are deliberately set below costs in line with the philosophy of order minimum values. They only apply to the Class I portion of a load of milk – while costs, are based on full load factors. They are constructed based only on changes in fuel costs even though other costs have changed. In the southeast they only apply for part of the year and only on supplemental milk supplies. In every-day commerce, the costs are year round and on every load.

Because of the size of farms and the rising number of cows necessary to cash flow a new operation, increasingly farms are being located further and further from metropolitan areas necessitating increased costs to service the processor. As processing plants get larger in volume processed, the incidence of any processing schedule less than seven days of either running or receiving milk pushes up balancing costs. Even the normal flow of holidays and seasonality become more expensive to deal with as plant capacity increases. Balancing plants in many parts of the US are few in number and small in capacity when measured against the

dedicated manufacturing facilities of the Upper Midwest, the Southwest and West. As they close due to low volume driven inefficiencies the miles necessary to reach the ones still operating increase.

## **Emergency Conditions**

There is a clear need for this record to proceed under the provisions for emergency rules. The industry expects the make allowance changes announced in November to be implemented by February, 2007. When that occurs all producers in Federal Orders will see Order blend prices decline by approximately 20 cents per hundredweight from the make allowance change. This will not include any further price declines that usually occur seasonally at this time. Our testimony indicates that producer costs have increased to service fluid use markets. Increased costs and the February institution of a price reduction is a difficult combination for the dairy producer industry to deal with. Many producers would consider that combination worthy of emergency considerations.

The issues at this Hearing are narrowly defined and the Hearing scope is limited. All parties have ample representation in the room today. And I suspect as the week proceeds will demonstrate that they have ample data to supply for the record. We would request a tight briefing schedule of only a few weeks to be set by the Administrative Law Judge.

We thank the Secretary for calling this proceeding and we look forward to the final decision as the next step in the process of keeping Orders current with the industry needs.