

Testimony of
Dairylea Cooperative Inc.

Presented by
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Vice President, Economics and Risk Management

Presented at the
Federal Milk Marketing Order
Class III and IV Hearing
Indianapolis, IN
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In Support of
Proposal No. 20 Relative to a
Regulated Cost of Production Add-on

My name is Edward Gallagher. I am the Vice President of Economics and Risk Management for Dairylea Cooperative Inc. My business address is 5001 Brittonfield Parkway, Syracuse, NY.

I have been employed by Dairylea for the past eleven years and previous to that, I was employed by the Office of the Market Administrator, New York-New Jersey Marketing Area. I served in a variety of capacities during my 12 years at the Market Administrator's office, including the last 5 years as its Chief of Market Analysis, Research and Information. I have a Bachelor of Science degree from Cornell University and a Masters of Science degree from The Ohio State University. Both degrees were in agricultural economics. I was raised on a dairy farm in Central New York. I have an extensive dairy economics, milk marketing and Federal Order back ground. I have testified at numerous milk marketing regulatory hearings at both the Federal and state levels.

Dairylea Cooperative requests that the United States Department of Agriculture amend Federal Orders in a manner that assists dairy product manufacturers in passing their production costs on to the wholesale and retail dairy product markets (i.e., the marketplace). The Dairylea proposal, which requests the implementation of a "cost add-on" process as it relates to the National Agricultural Statistical Service (NASS) Product Price Survey will:

- Eliminate the pricing circularity imbedded in the NASS Product Price Survey;
- Create a mechanism for all dairy product manufacturers to use to assist them in passing on higher production costs, regardless of whether a manufacturer's product is included in the NASS Survey;
- Allow for regular updates to facilitate manufacturers in passing along their production cost increases in a more timely basis;
- Reduce and perhaps eliminate the need for future make allowance changes – which have had a divisive effect on dairy industry relationships;
- Appease dairy farmers' negative sentiment that Federal orders operate in a manner that facilitates manufacturers to pass their higher production costs down to producers; and,
- Provide a positive step forward in preparing the U.S. dairy product manufacturing industry for the inevitability of the real business world faced by dairy farmers and other businesses that do not have Federal assistance in mitigating higher production costs by lowering prices received by suppliers.

This proposal is fashioned after a real world effort by milk powder manufacturers to pass along higher energy related production costs to their wholesale and retail accounts. In 2004 and 2005, Dairy America implemented energy surcharges when selling powder. The Dairy America selling price was increased by a cost add-on to the

powder sales price. Their customers accepted the cost add-on and paid the powder price plus the add-on. Exhibit 1 is an actual Dairy America invoice from December 2005. The line "December Surcharge" identifies a price per pound of \$.0293. This value was charged to the customer to cover the higher energy costs of producing the nonfat dry milk powder. During the product price survey process, NASS, at the request of USDA's Dairy Division, picked up the full sales price as the NASS price – the powder price of \$.9883 plus the add-on of \$.0293. Dairy America sells 75 percent of the U.S. powder production and almost two-thirds of U.S. powder production is included in the NASS survey. Dairy America's use of the energy surcharge effectively raised the milk price for its members and prevented them from capturing additional income to offset higher production costs -- **this is the circularity that Dairy America attempts to correct with this proposal.**

The Dairy America proposal creates a regulated maximum cost add-on. The Dairy America members, or any manufacturer with product included in the NASS survey, could use the cost-add on to pass on their higher production costs without increasing the regulated price of the raw milk they use. The result would be to effectively end, or at least significantly mitigate, the NASS survey/Federal Order Class price circularity problem.

Make allowances have become controversial to many dairy farmers. The Dairy America members view the make allowance as a cost of production credit to manufacturers – financed through lower regulated milk prices. Like dairy product manufacturers, dairy farmers also face higher production costs. They too have incurred higher energy, fuel, labor, interest charges and other input costs. Recently dairy farmers have also incurred substantially higher feed costs. However, dairy farmers do not receive a regulated cost of production credit to offset these higher costs. For instance, the Federal government does not provide a cost of production credit that forces dairy input suppliers to sell their products to farmers, at a lower cost. There is not a Federal mechanism for dairy farmers to push their higher production costs back to feed dealers by forcing them to sell feed at a lower price. Instead, farmers are often encouraged to be more cost efficient or asked to negotiate higher prices in the market place to cover their higher production costs.

The Dairy America members and other dairy farmers are wondering why the pricing system does not work the same way for manufacturers as it does for them. Presently, as make allowances are increased, farmers are asked to pay their own milk production cost increases as well as taking on the burden of a portion of manufacturers' production cost increases.¹

Dairy product manufacturers operate businesses. Businesses get to choose how to mitigate rising costs through a number of management practices – including increasing

¹ Between 2002 and 2005, USDA reports that the average operating plus hired labor cost for producing milk increased by \$1.68 per hundredweight – an increase of 15.3 percent. These costs likely increased further during 2006. With aggressive Federal and state level incentives to increase bio-fuel production, additional cost escalation will occur during 2007. Data contained in Exhibit 2 taken from USDA's web address at: www.ers.usda.gov/Data/CostsAndReturns/data/recent/Milk/R-USMilk.xls.

their sales prices. For the vast majority of dairy products that are processed or manufactured, the option of increasing their sales price as a means of mitigating or eliminating production cost increases is a relevant option. However, if the business manufactures a product that is included in the NASS Price Survey, that option, partially, and, in theory completely, is unavailable. That is because the cost of production increased sales price will be picked up in the NASS Price Survey and ultimately will increase the price of the raw milk which was used to manufacture the dairy product. This prevents the manufacturer of NASS Price Surveyed product from pricing their way out of a situation of rapidly rising costs of production, as a part of its business strategy.

In his testimony at the January 2006 Federal Order make allowance hearing, Dr. Robert Yonkers described the challenge of the circularity issue in the following way:

“What is equally important to recognize is that the handler cannot escape from its conundrum by raising its finished product prices, either. We can see why this is so by returning to our example. Recall that the handler is selling cheese for \$1.40, the make allowance is 15 cents, and the minimum price of milk is therefore \$1.25. The handler is losing 2 cents for every pound of cheese it makes because its true costs of manufacturing is 17 cents, but it only has 15 cents left over after it pays for its milk.

So why can't the handler simply raise its price to \$1.42? The problem lies in the federal order minimum price formula. As previously noted, the minimum price is the price of the finished product minus the make allowance. In our example, before any finished product price increase, the minimum milk price was \$1.40 minus \$0.15 equals \$1.25. After the finished product price increase, the minimum milk price is \$1.42 minus 0.15 equals \$1.27. Thus, all of the money derived from the increase in the finished product price has gone directly to the farmer, in the form of a higher, legally-mandated minimum milk price. None of the money derived from the finished product price increase has gone to the handler. After paying the now higher minimum milk price, the handler only has 15 cents left over—precisely the same amount as before it raised its finished product prices.

The same effect will result no matter how much (or, for that matter, how little) the handler attempts to raise its finished product prices. You can plug any price increase you want into the equation. The result is always the same, because the pricing formula works as a ratchet. All of the finished product price increase gets passed on to the farmer in the form of a higher minimum milk price. None of it is available to the handler to make up for the shortfall between the make allowance and the handler's true costs of manufacturing.

Any steps it might take would be as futile as a dog chasing its own tail.

The example I have been using has focused upon cheese and its make allowance. But the same principles apply equally to all of the make allowances contained in the pricing formulas.”²

This circularity issue perpetuates the need to make regulated changes to milk prices by adjusting make allowances – under the broad assumption that costs will rise over time. An alternative approach is needed - one that brings a larger measure of market orientation to the regulated pricing structure. And, one that brings better balance to the financial stakes surrounding make allowance changes.

The DairyIea members request the implementation of an alternative process that results in production costs being passed up through the system instead of back down to them. The alternative approach allows manufacturers to pass cost of production increases through the system and into the marketplace instead of passing these costs back down to farmers.

- ✓ It would allow NASS price survey participants to utilize a cost of production surcharge when selling their product, without the surcharge being included in the NASS price;
- ✓ The cost of production surcharge would be determined in a hearing and be fixed until changed by USDA;
- ✓ A NASS survey participant could pass along cost increases greater than the surcharge amount, but the NASS pricing survey would only credit them up to the maximum amount of the established cost of production surcharge;
- ✓ The plant utilizing this surcharge would have to show it was a negotiated add-on; and,
- ✓ To facilitate manufacturers in passing their costs on relative to products excluded from the NASS price survey, the Market Administrators would publish the cost surcharge in their Class III price announcement, each month.

Some of the dairy industry’s best economic thinkers would say that implementation of the DairyIea proposal is unnecessary. They might comment that adjusting make allowances gets you to the same place – even if circularity exists. The theory goes that a make allowance change would eventually result in the manufacturers higher production costs being shared by both producers and marketplace via lower milk prices and higher marketplace prices. They would recognize that the initial impacts of a make allowance change would not result in an equal sharing of burden between producers and marketplace. In fact, they would say that, initially, 100 percent of the cost falls into lower producer prices. Over time, as production is impacted by lower prices,

² Testimony of the National Cheese Institute, January 2006 Federal Milk Order Hearings, Docket NO. AO-14-A74, et al.; DA-06-01. Marked as Exhibit 67.

dairy product prices rise – along with producer prices – and in the end some equilibrium level is met where both producers and the marketplace are sharing the higher manufacturing costs.

USDA's economic analysis for the most recent make allowance hearing can be pointed to as empirical evidence that this process is expected to occur.³ It has been widely reported that the most recent make allowance change reduces Class III prices by \$.25 per hundredweight, immediately. The USDA analysis predicts that during 2007, the impact on Class III prices would be minus \$.19 per hundredweight – suggesting that some form of supply response occurs during the first year that transfers some of the cost to the marketplace. The USDA analysis shows that by 2015, the negative impact to producer prices would be reduced to \$.08 per hundredweight. This suggests that, in the long run, the dairy farmer cost of the Class III make allowance change, as it relates to Class III values, would be \$.08 and the marketplace cost would absorb \$.17.

By continuing to use USDA's analysis, it calculates that the first year's impact on milk revenues would be a reduction of \$190 - \$195 million – depending on whether the measurement in change is the All-Milk Price or is the change in Total Federal Order Cash Receipts (see Exhibit 3).⁴

Dairylea does not dispute the theory that underpins the thought process that reaches the above conclusions. In fact, we agree that the Federally regulated dairy pricing world, inclusive of circularity and make allowances, works this way⁵. However, it works this way because people have chosen to have it work this way. There is nothing that says it has to work this way.

Dairylea believes it can and should work differently. Dairylea believes that the first year revenue effect should be entirely absorbed by marketplace and that over time producer prices and revenue should decline as markets adjust to higher wholesale prices – the exact opposite progression as occurs with the current make allowance change. Dairylea believes that the elimination of the circularity issue is a necessity in pushing the first year effect off the back of dairy farmers and squarely on to the backs of those in the marketplace. Doing so would have save producers millions of dollars. USDA estimated that the current process cost producers approximately \$190 million during 2007. By changing the system to push costs up, a larger amount, and perhaps all of the \$190 million would have been absorbed by the marketplace and not producers. Over time, the end result would have been the same in price value – meaning the long run share of the cost absorption by dairy farmers would have likely been the same, but producers would have been financially better off getting to that equilibrium point.

³ See USDA Agricultural Marketing Service (AMS), Economic Analysis, Class III and IV Make Allowances, Tentative Final Decision, November 2006.

⁴ *Ibid*, Table 3, page 6 and Table 11, page 15.

⁵ Although, no one really will ever know how the \$.25 first run effect gets shared with marketplace.

All of us know that a dollar is worth more today than a year from now. Many of us are likely familiar with net present value analysis.⁶ Using USDA's analysis for the impact on producer revenue from 2007 to 2015 as a result of the make allowance changes and using an 8 percent discount rate, the net present value of the change to producer revenue is minus \$819 to \$826 million (see Exhibit 4).⁷ Since the value of the production asset is determined by the future earnings potential of the asset, the net present value analysis shows that the collective production assets of the U.S. dairy farming sector were devalued by \$819 to \$826 million due to the increase in the make allowances. Dairylea believes that a large portion of the \$819+ million net present value loss would have been avoided if the process worked in the reverse order whereby the costs would be initially pushed to the marketplace. In theory, dairy producers would eventually see lower revenue as demand slowed as a result of higher marketplace prices and ultimately lowering prices to producers. However, the net decline in producer revenue would be less than the amount occurring due to the present system of adjusting make allowances.⁸

Dairylea recognizes that there is a fuzzy and gray time frame as to when and how manufacturers' costs of production get pushed up through the marketplace or down to producers. Some could argue that during the time period that manufacturers wait for a make allowance increase, it is in fact pushing costs off in both directions. If so, this would suggest that no make allowance change is needed. Others could argue that manufacturers push costs entirely back to producers via lower over-order premiums – again suggesting that no make allowance change is needed. Still others could argue that manufacturers are absorbing these costs – which if so, is a problem that needs to be addressed.

However, the solution to this problem should not be one where producers' assets are devalued by over \$819+ million dollars. Instead, **people** need to change the pricing culture and practices of the dairy industry. We recognize that in today's Federal order milk pricing regulatory environment, the leadership of USDA and Dairy Division is needed for this to occur. Dairy producers need your leadership in getting this done. The dairy manufacturing sector needs regulatory assistance in passing their higher production costs on to the marketplace. Dairylea has the full faith in the industry that this can be accomplished.

This is the essence of the Dairylea proposal. It creates a mechanism for dairy manufacturers to use to help them pass their costs on to the marketplace. It will lead to a change in how people think and act and a process that has the potential to save producers millions of dollars.

⁶ Net present value analysis calculates the discounted value today of an income stream received in the future.

⁷ I assumed that 100% of the change in the Class I revenue was a result of the lower Class III prices and that the revenue change for Class I and Class III were combined and discounted in this analysis.

⁸ The discussion of manufacturing costs is slicing a couple of pennies per pound pretty thinly. In reality, the marginal cost impact is so small that passing on one or two cents a pound of additional cost may not be a recognized factor in the market place and demand may not be impacted in any measurable way – meaning higher production costs could be passed on without hurting manufacturers or lowering milk prices.

The easiest way to eliminate the circularity issue would be to utilize Chicago Mercantile Exchange (CME) cash traded prices in the Federal Order pricing formulas – in lieu of the NASS pricing surveys. Not only would pricing circularity be eliminated, but the issues affecting manufacturers due to the timing lag between NASS and the CME would be corrected. Unfortunately, at present, the CME only has viable cash markets for cheese and butter but not whey and nonfat powders. A complete elimination of the circularity issue could not be achieved by replacing CME prices with NASS prices – although an improvement could be made by utilizing cheese and butter prices from the CME instead of NASS survey prices.

Agri-Mark has proposed a method of adjusting NASS prices in an attempt to recreate them as more current CME cash prices. The NASS surveying process reports prices that are two weeks old so Federal order manufacturing prices are always two weeks behind the cash market changes at the CME. This is troubling to manufacturers since they sell their product at the current CME price but pay for raw milk based on the lagged NASS prices. In a declining market, manufacturers have a higher likelihood of operating at a loss since the base CME sales prices will be less than the NASS price that determines raw milk costs.

The key element here is that manufacturers sell their product based on the cash CME price. Over the last seven years, the U.S. dairy products manufacturing industry has had the chance to vote on the price discovery mechanism to use that forms the basis of their weekly pricing. Their choices have been the “current” CME cash exchange or the “lagged” NASS survey. The dairy industry has overwhelmingly chosen the CME cash exchange.

An important element in using a pricing series is its transmission of information from day-to-day, week-to-week and month-to-month. From a longer run historical perspective, these short-term price changes, are for the most part, transmitted in the same manner by both series. This would be expected since the NASS survey picks up information on spot wholesale prices which are based on the CME cash price.

A disorderly marketing condition exists due to the use of the NASS pricing survey due to its lag and the impact on short-term manufacturing losses. This can be corrected without impacting price transmission, since the industry uses CME prices to price their product. Knowing that the CME cash prices reflect day-to-day supply and demand changes and NASS pricing tracks CME pricing, it would be appropriate to utilize CME prices in place of NASS wherever possible.

One of DairyLea’s goals is to eliminate the pricing circularity as it affects Federal Order Class III and IV prices. DairyLea supports using CME cheese and butter prices as a replacement for NASS cheese and butter prices.

In the absence of this change, or in addition to this change, the DairyLea proposal will help eliminate the pricing circularity. From our perspective, it is a perfect complement to using CME cheese and butter prices in that it will end the circularity

embedded in whey and nonfat powder prices, which will still use the NASS pricing survey.

USDA would determine the maximum cost add-ons and publish them on a monthly basis in their Federal Order Class III and IV price announcements. USDA would hold periodic Class III and IV dairy products cost of production hearings – perhaps once per year.⁹ At each hearing, it would review the make allowance calculations for cheese, whey, nonfat dry milk and butter as prescribed in the Tentative Final Decision published November 22, 2006. It would make a determination as to the cost per pound change in the make allowance values. The positive difference would become the maximum allowable cost add-on that could be excluded from NASS survey pricing for each surveyed product – cheese, whey powder, butter and nonfat dry milk.

An illustration of the calculation of the maximum allowable cost add-on can be shown by modifying the table in Exhibit 5.¹⁰ It is this formulation that Dairylea proposes that USDA use to determine the maximum allowable cost add-on for each product. Exhibit 6 is USDA's calculation of the make allowances if the updated California data is used.¹¹ This will be utilized to show the calculation of the maximum allowable cost add-on. Exhibit 7 is Dairylea's modified version of Exhibit 6. Exhibit 7 calculates the maximum allowable cost add-on using the update California data. Comparing Exhibit 6 to 7, note that the line "Scenario make allowance" in Exhibit 6 has been changed to "Target Make Allowance" in Exhibit 7 and that additional lines of information have been added in Exhibit 7 that are not in Exhibit 6. In Exhibit 7, using the cheese calculation as a reference, the cost add-on calculation utilizes the "Target Make Allowance" of \$.1711 per pound and subtracts the existing make allowance now used under the federal order program, \$.1682 per pound. This results in a value of \$.0029 per pound which is called the cost of production change. The cheese cost of production change becomes the maximum allowable cheese cost add-on under the Dairylea proposal.

Dairylea supports the National Milk Producers Federation's proposal to adjust make allowance by an energy index. The Dairylea proposal works in a complimentary fashion to the National Milk proposal. Both can be implemented. In determining the cost add-on pursuant to the Dairylea proposal, the energy cost change reflected by the National Milk proposed calculation, would be subtracted.

⁹ Dairylea would submit that this process could occur without hearing and that USDA could use the formulation as prescribed in the November 22, 2006 Tentative Decision and accompanying documentation. At the point that both the California Department of Food and Agriculture and the Cornell Program on Dairy Markets and Policy manufacturing cost of production data are updated, USDA can use the methodology to automatically recalculate the cost-of-production add-on and begin to report the new add-on

¹⁰ USDA Agricultural Marketing Services (AMS), Economic Analysis, Class III and IV Make Allowances, Tentative Final Decision, November 2006, Economic Analysis Staff, Dairy Programs, Office of the Chief Economist, page 2.

¹¹ USDA Agricultural Marketing Services (AMS), Preliminary Economic Analysis, Class III and IV Prices, February 2007, Economic Analysis Staff, Dairy Programs, Office of the Chief Economist, page 8.

A brief example will show how the two proposals complement one another. Exhibit 8 identifies USDA's projected calculations of the NMPF energy index.¹² Using projections for 2007, the NMPF proposal would increase make allowances in the following manner:

USDA's Estimated Make Allowance
Changes From the Application of the
NMPF Proposal, 2007

<u>Product</u>	<u>\$/lb</u>
Cheese	\$0.0023
Butter	\$0.0015
NFDM	\$0.0062
Dry Whey	\$0.0056

The changes due to the NMPF proposal would be subtracted from the changes identified in Exhibit 7. This NMPF adjusted calculation is shown in Exhibit 9. As can be seen, Exhibit 9 uses the same format as Exhibit 7 but has added additional lines for the adjustment from the NMPF energy index. For the calculation of the cheese cost add-on, the \$.0023 increase in the make allowance due to energy costs is backed out of the cost of production change. The cost of production change was \$.0029 per pound. Subtracting the \$.0023 energy cost of production increase from this number results in a value of \$.0006 per pound. The \$.0006 per pound would become the month's maximum cost add-on. This means that if a NASS survey participant reported in their NASS survey that they sold their Cheddar cheese for \$1.40 per pound plus a \$.0006 cost add-on, the NASS survey would only incorporate the \$1.40 into the calculation of the Class III price.

The Dairylea proposal does not suggest a negative cost add-on. As can be seen for dry whey and butter, the NMPF energy adjustment is greater than the calculated cost of production change. In these cases, the Maximum Cost Add-on would be zero.

It is hoped that all manufacturers could use the cost add-ons in pricing dairy products to their customers. For instance, a Cheddar manufacturer whose product was not included in the NASS survey, could use the published cost add-on as a means of passing its increased cost of producing Cheddar cheese on to its customers. Similarly, a mozzarella manufacturer may be able to do the same thing.

Presently, USDA publishes the Fluid Milk Promotion Order's \$.20 assessment on Class I milk on a monthly basis when announcing Federal Order Class I prices. This process has assisted Class I handlers in passing on this cost to its customers (see Exhibit 10). Different yet but related, the Pennsylvania Milk Marketing Board has implemented a fuel adjuster to be added to Class I over-order prices under its jurisdiction. The Pennsylvania Milk Marketing Board uses the Federal Department of Energy's, Energy

¹² USDA Agricultural Marketing Service (AMS), Preliminary Economic Analysis, Class III and IV Prices, February 2007, Economic Analysis Staff, Dairy Programs, Office of the Chief Economist, pg 24 and 25.

Information Administration's (EIA), publication of regional diesel fuel prices to assist in calculating the fuel surcharge that is passed on to dealers and the marketplace. Federal Orders 5 and 7 also utilize EIA information in their transportation credit programs and publish calculated information to assist the industry in determining transportation credit reimbursement. As previously indicated, Dairy America successfully implemented a cost add-on a few years ago. The point here is that Federal agencies have been assisting private entities in passing along cost factors – both by providing a mechanism to communicate the costs to the industry and by providing the information to use to determine the cost add-on.

Public Law 106-532 (Exhibit 11) requires USDA to conduct mandatory pricing surveys of Class III and IV manufacturers that produce at least 1 million pounds of product each year. It is from this law that the NASS Dairy Product Price survey was developed. It requires the Secretary to take any necessary actions to verify the accuracy of the information submitted. It provides a mechanism for a Federal court to enforce the law and assess a civil penalty of as much as \$10,000 per occurrence for, among other things, inaccurate reporting.

Manufacturing plants would submit a modified Dairy Products Pricing Survey each week. See Exhibit 12 for copies of the existing surveys for cheese, whey, butter and nonfat dry milk. Plants would continue to report the total dollar sales and/or dollars per pound as they presently do. These values would be inclusive of the cost add-on. The existing survey could easily be modified to identify the cost per pound and the pounds of product, or total dollars, of the regulated cost add-on that was included in any of the plant's sales. As additional information, the plant would provide copies of invoices as evidence that the cost add-on was a separately charged item and that the cost add-on does not exceed the maximum allowable value as determined by USDA for any of the product that is priced with a cost add-on. In order for the plant to receive the cost add-on credit against their sales, it would have to show on the invoices that the add-on was a separately negotiated factor, as evidenced by it being clearly indicated as such on the invoice, and that it did not exceed the maximum allowable amount. For product that is properly documented as a cost add-on, the total dollar value of the add-on on the product that was priced with the add-on will be subtracted from the total dollars of sales included in the report, to determine the plant's NASS survey price and its contribution to the weekly price calculation.

Periodically, Federal Order auditors will conduct audits to assure that the submitted information is correct. I am not aware whether this is happening now but Congress has given the Secretary the authority to verify the accuracy of the information.

If, upon audit, it is found that a survey participant has incorrectly claimed the cost add-on, USDA will add the value back into the next weekly calculation of its product price survey. If the audit finds that the survey participant incorrectly claimed the cost add-on over a number of weeks, the values can be added to the price survey on a weekly basis by adding the total dollars of the inappropriately claimed cost add-ons and dividing by the number of weeks involved.

To facilitate correct reporting, USDA should conduct a series of visits to the plants providing the information, in advance of the implementation of the cost add-on program. Additionally, during the first month of implementation, auditors should visit the plants of those submitting information for an audit and review of procedures. Certainly, a systematic approach of visiting the plants or plant groups that are the largest contributors, in pounds of product included in the pricing surveys, should be visited first.¹³

The Dairylea proposal is included as Exhibit 13. It would amend section 1000.50 of all orders by adding a section (r) requiring the exclusion of the maximum cost of production add on “surcharges” from inclusion in the NASS survey prices used to calculate the class prices. It would also amend section 1000.53(a) of all orders by adding a section (12) requiring the publication of the maximum cost of production “surcharges”.

It is Dairylea’s intent that the process used to exclude the maximum cost of production add-on from the NASS survey follow our testimony presented herein or as adjusted in our post-hearing brief.

Thank you for the consideration of this proposal that is important to the members of Dairylea Cooperative.

¹³ A plant group would be someone like Dairy America or a large multi-plant cooperative where one centralized office is submitting the NASS survey data on behalf of the plants in the particular system.

Exhibit 1

Dairy America Energy Surcharge

4974 E. CLINTON STE C-221, FRESNO, CA93727
Tel:559-251-0992 Fax:559-251-1078

12/01/05

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PLANT LOCATION: 82 CDI - FRESNO

6008	GRD A LH 2200#	41,800.00	0.9883	41,310.94
9636	PALLETS	19.00	8.5000	161.50
9136	DECEMBER SURCHARGE	41,800.00	0.0293	1,224.74
9131	FREIGHT PWDR	1.00	650.0000	650.00
9643	FUEL TAX SURCHARGE	1.00	188.5000	188.50

43,535.68

P.O BOX 31001-0813, Pasadena, CA 91110-0813

561089

600659 808533

43,535.68

Exhibit 2

USDA Cost of Production Data

U.S. milk production costs and returns per hundredweight sold, 2000-2005 1/

Item	2000	2001	2002	2003	2004	2005
dollars per cwt sold						
Gross value of production:						
Milk	12.63	15.36	12.47	12.86	16.58	15.64
Cattle	1.05	1.12	1.03	1.17	1.35	1.40
Other income 2/	0.57	0.74	0.60	0.69	0.75	0.86
Total, gross value of production	14.25	17.22	14.10	14.72	18.68	17.90
Operating costs						
Feed--						
Feed grains	1.22	1.27	1.47	1.51	1.28	1.22
Hay and straw	1.51	1.67	1.69	1.67	1.71	1.89
Complete feed mixes	1.43	1.50	1.53	1.62	1.87	1.63
Liquid whey and milk replacer	0.08	0.05	0.07	0.09	0.11	0.11
Silage	1.09	1.06	0.95	0.94	0.97	1.67
Grazed pasture and cropland	0.08	0.08	0.08	0.08	0.11	0.08
Other feed items 3/	1.08	1.12	1.22	1.27	1.42	1.26
Total, feed costs	6.49	6.75	7.01	7.18	7.47	7.86
Veterinary and medicine	0.65	0.66	0.66	0.68	0.69	0.73
Bedding and litter	0.16	0.16	0.16	0.16	0.17	0.18
Marketing	0.27	0.27	0.27	0.28	0.28	0.30
Custom services	0.53	0.54	0.53	0.55	0.55	0.57
Fuel, lube, and electricity	0.48	0.47	0.46	0.51	0.56	0.81
Repairs	0.53	0.56	0.56	0.57	0.57	0.65
Other operating costs 4/	0.01	0.01	0.01	0.01	0.01	0.01
Interest on operating capital	0.26	0.16	0.08	0.05	0.08	0.19
Total, operating cost	9.38	9.58	9.74	9.99	10.38	11.30
Allocated overhead:						
Hired labor	1.14	1.19	1.25	1.30	1.35	1.37
Opportunity cost of unpaid labor	3.54	3.58	3.71	3.75	3.78	3.87
Capital recovery of machinery and equipment 5/	3.23	3.41	3.42	3.42	3.50	3.92
Opportunity cost of land (rental rate)	0.06	0.06	0.06	0.06	0.09	0.07
Taxes and insurance	0.18	0.18	0.18	0.18	0.19	0.20
General farm overhead	0.49	0.50	0.51	0.52	0.54	0.57
Total, allocated overhead	8.64	8.92	9.13	9.23	9.45	10.00
Total costs listed	18.02	18.50	18.87	19.22	19.83	21.30
Value of production less total costs listed	-3.77	-1.28	-4.77	-4.50	-1.15	-3.40
Value of production less operating costs	4.87	7.64	4.36	4.73	8.30	6.60
Supporting information.						
Milk cows (head per farm)	93	95	95	96	96	96
Output per cow (pounds)	19,974	20,003	19,992	20,032	20,076	20,045
Milking frequency greater than twice per day (percent of farm)	3.38	3.50	3.50	3.56	3.66	3.67
Homegrown feed cost (percent of total feed cost) 6/	34	34	34	34	34	35
Milk cows injected with bST (head per farm)	17	17	17	17	18	18

1/ Developed from survey year base, 2000

2/ Income from renting or leasing dairy stock to other operations; renting space to other dairy operations; co-op patronage dividends associated with the dairy; assessment rebates, refunds and other dairy-related resources; and the fertilizer value of manure production.

3/ Cotton seed meal, protein supplements, protein byproducts, vitamin or mineral supplements, nonprotein byproducts, alfalfa cubes or pellets, green chop, corn stalks, and antibiotics and other medicated additives.

4/ Manure disposal fees, permits, and licenses, and odor control costs.

5/ Machinery and equipment, and housing, manure handling, and feed storage structures, and dairy breeding herd.

6/ Percent of feed cost from charge for homegrown feed. Homegrown feed items are charged at their market price to reflect the opportunity cost of using the feed items in milk production.

Exhibit 3

USDA's Estimated Make Allowance Change Impact, November 2006

	Units		2007	2008	2009	2010	2011	2012	2013	2014	2015	9 Yr. Ave.
All Milk	\$/cwt.	Baseline	14.56	14.55	14.47	14.48	14.69	14.85	14.85	15.19	15.41	14.79
	"	Impact	-0.11	-0.08	-0.07	-0.05	-0.04	-0.04	-0.04	-0.03	-0.02	-0.02
Avg. MILC Payment (MILC payments/milk production)	percent	Baseline	-0.78	-0.56	-0.45	-0.35	-0.28	-0.24	-0.21	-0.16	-0.16	-0.35
	"	Impact	0.10	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Producer Revenue (including MILC)	mil. \$	Baseline	26,861	27,113	27,239	27,570	28,248	28,890	29,047	29,960	30,634	28,396
	"	Impact	-191	-166	-156	-125	-111	-115	-98	-82	-84	-125
	percent	Baseline	-0.71	-0.61	-0.57	-0.45	-0.39	-0.40	-0.34	-0.27	-0.27	-0.44
	"	Impact										

	Units		2007	2008	2009	2010	2011	2012	2013	2014	2015	9 Yr. Ave.
Milk Cows	1000s	Baseline	9,085	9,058	9,005	8,950	8,896	8,839	8,778	8,728	8,673	8,890
	"	Impact	-3	-4	-6	-7	-7	-8	-8	-8	-8	-6
Yield per Cow	percent	Baseline	-0.03	-0.05	-0.06	-0.07	-0.08	-0.09	-0.09	-0.09	-0.09	-0.07
	"	Impact	0.00	-0.01	-0.02	-0.03	-0.04	-0.04	-0.04	-0.05	-0.05	-0.03
Milk Production	Pounds	Baseline	20,266	20,660	20,995	21,351	21,696	22,079	22,341	22,655	22,966	21,668
	"	Impact	0	-3	-5	-7	-8	-9	-10	-11	-12	-7
Farm Use	percent	Baseline	0.00	-0.01	-0.02	-0.03	-0.04	-0.04	-0.04	-0.05	-0.05	-0.03
	"	Impact										
Markings	Mil. Prds.	Baseline	184,123	187,147	189,048	191,102	192,997	195,146	196,103	197,738	199,193	192,511
	"	Impact	-51	-117	-167	-204	-231	-252	-267	-278	-286	-206
Farm Use	Mil. Prds.	Baseline	900	800	800	700	700	600	500	500	400	656
	"	Impact										
Markings	Mil. Prds.	Baseline	183,223	186,347	188,248	190,402	192,297	194,546	195,603	197,238	198,793	191,855
	"	Impact	-51	-117	-167	-204	-231	-252	-267	-278	-286	-206
	percent	Baseline	-0.03	-0.06	-0.09	-0.11	-0.12	-0.13	-0.14	-0.14	-0.14	-0.11
	"	Impact										

Table 11. Federal Order Cash Receipts

	Units		Baseline Impact	2007	2008	2009	2010	2011	2012	2013	2014	2015	9 Yr. Ave.
	mil. \$	"		2007	2008	2009	2010	2011	2012	2013	2014	2015	9 Yr. Ave.
Class I	mil. \$	Baseline	6,517	6,558	6,339	6,357	6,424	6,461	6,406	6,582	6,587	6,470	6,470
	"	Impact	-96	-84	-77	-71	-66	-63	-62	-58	-57	-70	-70
Class II	percent	Baseline	-1.47	-1.28	-1.21	-1.11	-1.03	-0.98	-0.96	-0.88	-0.86	-1.09	-1.09
	"	Impact	3	11	15	17	18	18	19	20	18	16	16
Class III	mil. \$	Baseline	3,224	3,248	3,383	3,472	3,570	3,679	3,732	3,790	3,954	3,561	3,561
	"	Impact	0.10	0.33	0.43	0.49	0.51	0.50	0.52	0.53	0.47	0.44	0.44
Class IV	mil. \$	Baseline	6,508	6,693	6,676	6,817	7,015	7,175	7,217	7,497	7,637	7,026	7,026
	"	Impact	-91	-76	-68	-61	-56	-54	-53	-49	-50	-62	-62
Total	percent	Baseline	-1.40	-1.13	-1.01	-0.89	-0.80	-0.75	-0.73	-0.65	-0.65	-0.88	-0.88
	"	Impact	1,940	1,942	2,005	2,079	2,140	2,198	2,181	2,199	2,286	2,108	2,108
Total	mil. \$	Baseline	18,188	18,441	18,403	18,724	19,150	19,513	19,535	20,069	20,464	19,165	19,165
	"	Impact	-195	-157	-138	-122	-112	-108	-103	-95	-98	-125	-125
	percent	Baseline Impact %	-1.07	-0.85	-0.75	-0.65	-0.58	-0.55	-0.53	-0.47	-0.48	-0.65	-0.65

Exhibit 4

Net Present Value Impact Table

**USDA's Estimated Impact on Producer
Revenue Resulting From Increased
Make Allowances***

<u>Year</u>	<u>All-Milk Price</u>	<u>FMMO Cash Receipts</u>
	<u>mil. \$</u>	
2007	(\$191)	(\$195)
2008	(\$166)	(\$157)
2009	(\$156)	(\$138)
2010	(\$125)	(\$122)
2011	(\$111)	(\$112)
2012	(\$115)	(\$108)
2013	(\$98)	(\$103)
2014	(\$82)	(\$95)
2015	<u>(\$84)</u>	<u>(\$98)</u>
Total	(\$1,128)	(\$1,128)
NPV**	(\$826)	(\$819)

* Data from Exhibit 3 a and b.

** Using an 8% discount rate.

Exhibit 5

USDA's Calculation of Proposed Make Allowances, November 2006

Table 1. Calculation of Proposed Make Allowances

Cheese	
Weighted average cost, Cheddar cheese, \$/pound:	
CDFA Study ¹	0.1769
Cornell Study ²	0.1638
2005 volume, American cheese ³	
California	
Cheddar	522,624
Colby and Monterrey Jack	332,080
Total American	854,704
U.S. other than California	
Cheddar	2,529,791
Colby and Monterrey Jack	428,455
Total American	2,958,246
U.S.	
Cheddar	3,052,415
Colby and Monterrey Jack	760,535
Total American	3,812,950
Weighted average cost per pound:	
Before sales and administrative costs	0.1667
Sales and administrative costs	0.0015
Proposed make allowance	0.1682

Whey	
Weighted average cost, \$/pound:	
Cornell Study	0.1941
Sales and administrative costs	
	0.0015
Proposed make allowance	0.1956

NDM	
Weighted average cost, \$/pound:	
CDFA Study--medium cost plants	0.1733
Cornell Study ⁴	0.1423
2005 volume, 1000 pounds:	
California	506,452
U.S. other than California	679,652
U.S.	1,186,104
Weighted average cost per pound	
Before sales and administrative costs	0.1555
Sales and administrative costs	0.0015
Proposed make allowance	0.1570

Butter	
Weighted average cost, \$/pound:	
CDFA Study	0.1368
Cornell Study	0.1108
2005 volume, 1000 pounds:	
California	407,872
U.S. other than California	939,355
U.S.	1,347,227
Weighted average cost per pound:	
Before sales and administrative costs	0.1187
Sales and administrative costs	0.0015
Proposed make allowance	0.1202

¹ Weighted Average Manufacturing Costs for Butter, Nonfat Powder, Skim Whey Powder and Cheddar Cheese, California Department of Food and Agriculture, Costs for Calendar Year 2004, Amended January 2006

² Cost of Processing in Cheese, Whey, Butter, and Nonfat Dry Milk Plants, by Mark Stephenson, Cornell Program on Dairy Markets and Policy, September 2006

³ Source for all volumes: USDA, National Agricultural Statistics Service, 2005 values

⁴ The text of the Cornell study indicates that the weighted average nonfat dry milk manufacturing cost is \$0.1410 per pound. This was corrected to \$0.1423 at the hearing.

Exhibit 6

USDA's Calculation of Make Allowances for Scenario A, February 2007

Table 4. Calculation of Make Allowances for Scenario A

Cheese	
Weighted average cost, Cheddar cheese, \$/pound:	
CDFA Study ¹	0.1914
Cornell Study ²	0.1638
2006 volume, ³ American cheese, 1000 pounds:	
California	822,230
U.S. other than California	3,115,858
U.S.	3,938,088
Weighted average cost per pound:	
Before sales and administrative costs	0.1696
Sales and administrative costs	0.0015
Scenario make allowance	0.1711

NFDM	
Weighted average cost, \$/pound:	
CDFA Study--medium cost plants	0.1872
Cornell Study ⁴	0.1423
2006 volume, 1000 pounds:	
California	613,240
U.S. other than California	614,304
U.S.	1,227,544
Weighted average cost per pound	
Before sales and administrative costs	0.1647
Sales and administrative costs	0.0015
Scenario make allowance	0.1662

Whey	
Weighted average cost, \$/pound:	
Cornell Study	0.1941
Sales and administrative costs	0.0015
Scenario make allowance	0.1956

Butter	
Weighted average cost, \$/pound:	
CDFA Study	0.1408
Cornell Study	0.1108
2006 volume, 1000 pounds:	
California	448,590
U.S. other than California	995,674
U.S.	1,444,264
Weighted average cost per pound:	
Before sales and administrative costs	0.1201
Sales and administrative costs	0.0015
Scenario make allowance	0.1216

¹ Summary of Weighted Average Manufacturing Costs for Butter, Nonfat Powder, Cheddar Cheese, and Skim Whey Powder, Jan.-Dec. 2005 data, released November 29, 2006

² Cost of Processing in Cheese, Whey, Butter, and Nonfat Dry Milk Plants, by Mark Stephenson, Cornell Program on Dairy Markets and Policy, September 2006

³ Source for all volumes: USDA, National Agricultural Statistics Service, 2006 values

⁴ The text of the Cornell study indicates that the weighted average NFDM manufacturing cost is \$0.1410 per pound. This was corrected to \$0.1423 per pound at a previous hearing.

Exhibit 7

Dairylea's Modified Version of Exhibit 6, Calculating the Maximum Cost Add-on

Modified Version Scenario A, Calculating Maximum Cost Add-on

Cheese	
Weighted average cost, Cheddar cheese, \$/pound:	
CDFA	0.1914
Cornell	0.1638
2006 volume, American Cheese, 1000 pounds	
California	822,230
U.S., other than California	<u>3,115,858</u>
U.S.	3,938,088
Weighted average cost per pound	
Before sales and administrative costs	0.1696
Sales and administrative costs	<u>0.0015</u>
Target Make Allowance	0.1711
Cost add-on calculation	
Target Make Allowance	0.1711
Existing Make Allowance	<u>-0.1682</u>
Cost of Production Change	0.0029
Maximum Cost Add-on	0.0029

Whey	
Weighted average cost, \$/pound:	
Cornell Study	0.1941
Sales and administrative costs	<u>0.0015</u>
Target Make Allowance	0.1956
Cost add-on calculation	
Target Make Allowance	0.1956
Existing Make Allowance	<u>-0.1956</u>
Cost of Production Change	0.0000
Maximum Cost Add-on	0.0000

NFDM	
Weighted average cost, \$/pound:	
CDFA Study - medium cost plants	0.1872
Cornell Study	0.1423
2006 volume, 1000 pounds	
California	613,240
U.S., other than California	<u>614,304</u>
U.S.	1,227,544
Weighted average cost per pound	
Before sales and administrative costs	0.1647
Sales and administrative costs	<u>0.0015</u>
Target Make Allowance	0.1662
Cost add-on calculation	
Target Make Allowance	0.1662
Existing Make Allowance	<u>-0.1570</u>
Cost of Production Change	0.0092
Maximum Cost Add-on	0.0092

Butter	
Weighted average cost, \$/pound:	
CDFA Study	0.1408
Cornell Study	0.1108
2006 volume, 1000 pounds	
California	448,590
U.S., other than California	<u>995,674</u>
U.S.	1,444,264
Weighted average cost per pound	
Before sales and administrative costs	0.1202
Sales and administrative costs	<u>0.0015</u>
Target Make Allowance	0.1217
Cost add-on calculation	
Target Make Allowance	0.1217
Existing Make Allowance	<u>-0.1203</u>
Cost of Production Change	0.0014
Maximum Cost Add-on	0.0014

Exhibit 8

Indexed Energy Costs and Effective Make Allowances for Scenario J, Per USDA, February 2007

Table 13. Indexed Energy Costs and Effective Make Allowances for Scenario J

Cheese								
	Year	Electricity		Fuels		Non-energy costs held constant	Effective make allowance	Change from Interim Final Rule
		PPI, Series WPU 0543	Cost per pound	PPI, Series WPU 0553	Cost per pound			
Base	07/04-06/05	150.1	0.0082	213.4	0.0078	0.1524	0.1684	0.0002
Proposal results using projected PPIs	2007	174.1	0.0095	234.4	0.0086	0.1524	0.1705	0.0023
	2008	174.8	0.0095	232.1	0.0085	0.1524	0.1704	0.0022
	2009	172.1	0.0094	215.0	0.0079	0.1524	0.1697	0.0015
	2010	168.0	0.0092	205.2	0.0075	0.1524	0.1691	0.0009
	2011	161.8	0.0088	192.5	0.0070	0.1524	0.1683	0.0001
	2012	158.0	0.0086	187.7	0.0069	0.1524	0.1679	-0.0003
	2013	156.4	0.0085	181.9	0.0066	0.1524	0.1676	-0.0006
	2014	155.4	0.0085	182.2	0.0067	0.1524	0.1675	-0.0007
	2015	155.3	0.0085	180.9	0.0066	0.1524	0.1675	-0.0007

Butter								
	Year	Electricity		Fuels		Non-energy costs held constant	Effective make allowance	Change from Interim Final Rule
		PPI, Series WPU 0543	Cost per pound	PPI, Series WPU 0553	Cost per pound			
Base	07/04-06/05	150.1	0.0080	213.4	0.0017	0.1106	0.1203	0.0001
Proposal results using projected PPIs	2007	174.1	0.0093	234.4	0.0019	0.1106	0.1217	0.0015
	2008	174.8	0.0093	232.1	0.0018	0.1106	0.1218	0.0016
	2009	172.1	0.0092	215.0	0.0017	0.1106	0.1215	0.0013
	2010	168.0	0.0090	205.2	0.0016	0.1106	0.1212	0.0010
	2011	161.8	0.0086	192.5	0.0015	0.1106	0.1208	0.0006
	2012	158.0	0.0084	187.7	0.0015	0.1106	0.1205	0.0003
	2013	156.4	0.0083	181.9	0.0014	0.1106	0.1204	0.0002
	2014	155.4	0.0083	182.2	0.0015	0.1106	0.1203	0.0001
	2015	155.3	0.0083	180.9	0.0014	0.1106	0.1203	0.0001

Table 13 continued on next page.

Table 13 continued

Nonfat dry milk

	Year	Electricity		Fuels		Non-energy costs held constant	Effective make allowance	Change from Interim Final Rule
		PPI, Series WPU 0543	Cost per pound	PPI, Series WPU 0553	Cost per pound			
Base	07/04-06/05	150.1	0.0189	213.4	0.0239	0.1150	0.1578	0.0008
Proposal results using projected PPIs	2007	174.1	0.0219	234.4	0.0263	0.1150	0.1632	0.0062
	2008	174.8	0.0220	232.1	0.0260	0.1150	0.1630	0.0060
	2009	172.1	0.0217	215.0	0.0241	0.1150	0.1607	0.0037
	2010	168.0	0.0212	205.2	0.0230	0.1150	0.1591	0.0021
	2011	161.8	0.0204	192.5	0.0216	0.1150	0.1569	-0.0001
	2012	158.0	0.0199	187.7	0.0210	0.1150	0.1559	-0.0011
	2013	156.4	0.0197	181.9	0.0204	0.1150	0.1551	-0.0019
	2014	155.4	0.0196	182.2	0.0204	0.1150	0.1550	-0.0020
	2015	155.3	0.0196	180.9	0.0203	0.1150	0.1548	-0.0022

Dry whey

	Year	Electricity		Fuels		Non-energy costs held constant	Effective make allowance	Change from Interim Final Rule
		PPI, Series WPU 0543	Cost per pound	PPI, Series WPU 0553	Cost per pound			
Base	07/04-06/05	150.1	0.0246	213.4	0.0172	0.1538	0.1956	0.0000
Proposal results using projected PPIs	2007	174.1	0.0285	234.4	0.0189	0.1538	0.2012	0.0056
	2008	174.8	0.0286	232.1	0.0187	0.1538	0.2012	0.0056
	2009	172.1	0.0282	215.0	0.0173	0.1538	0.1993	0.0037
	2010	168.0	0.0275	205.2	0.0165	0.1538	0.1979	0.0023
	2011	161.8	0.0265	192.5	0.0155	0.1538	0.1958	0.0002
	2012	158.0	0.0259	187.7	0.0151	0.1538	0.1948	-0.0008
	2013	156.4	0.0256	181.9	0.0147	0.1538	0.1941	-0.0015
	2014	155.4	0.0255	182.2	0.0147	0.1538	0.1940	-0.0016
	2015	155.3	0.0255	180.9	0.0146	0.1538	0.1938	-0.0018

Exhibit 9

Modified Version of Calculating Maximum Cost Add-on Reflecting the NMPF Energy Adjuster

Modified Version Scenario A, Calculating Maximum Cost Add-on and Reflecting NMPF Energy Adjustment

Cheese	
Weighted average cost, Cheddar cheese, \$/pound:	
CDFA	0.1914
Cornell	0.1638
2006 volume, American Cheese, 1000 pounds	
California	822,230
U.S., other than California	<u>3,115,858</u>
U.S.	3,938,088
Weighted average cost per pound	
Before sales and administrative costs	0.1696
Sales and administrative costs	<u>0.0015</u>
Target Make Allowance	0.1711
Cost add-on calculation	
Target Make Allowance	0.1711
Existing Make Allowance	<u>-0.1682</u>
Cost of Production Change	0.0029
NMPF Energy Adjustment	<u>-0.0023</u>
Maximum Cost Add-on	0.0006

NFDM	
Weighted average cost, \$/pound:	
CDFA Study - medium cost plants	0.1872
Cornell Study	0.1423
2006 volume, 1000 pounds	
California	613,240
U.S., other than California	<u>614,304</u>
U.S.	1,227,544
Weighted average cost per pound	
Before sales and administrative costs	0.1647
Sales and administrative costs	<u>0.0015</u>
Target Make Allowance	0.1662
Cost add-on calculation	
Target Make Allowance	0.1662
Existing Make Allowance	<u>-0.1570</u>
Cost of Production Change	0.0092
NMPF Energy Adjustment	<u>-0.0062</u>
Maximum Cost Add-on	0.0030

Whey	
Weighted average cost, \$/pound:	
Cornell Study	0.1941
Sales and administrative costs	<u>0.0015</u>
Target Make Allowance	0.1956
Cost add-on calculation	
Target Make Allowance	0.1956
Existing Make Allowance	<u>-0.1956</u>
Cost of Production Change	0.0000
NMPF Energy Adjustment	<u>-0.0056</u>
Maximum Cost Add-on	0.0000

Butter	
Weighted average cost, \$/pound:	
CDFA Study	0.1408
Cornell Study	0.1108
2006 volume, 1000 pounds	
California	448,590
U.S., other than California	<u>995,674</u>
U.S.	1,444,264
Weighted average cost per pound	
Before sales and administrative costs	0.1202
Sales and administrative costs	<u>0.0015</u>
Target Make Allowance	0.1217
Cost add-on calculation	
Target Make Allowance	0.1217
Existing Make Allowance	<u>-0.1203</u>
Cost of Production Change	0.0014
NMPF Energy Adjustment	<u>-0.0015</u>
Maximum Cost Add-on	0.0000

Exhibit 10

USDA Class I Price Announcement with Processor Assessment Add-on

**UNITED STATES DEPARTMENT OF AGRICULTURE
 AGRICULTURAL MARKETING SERVICE
 DAIRY PROGRAMS
 MILK MARKET ADMINISTRATOR**

APPALACHIAN MARKETING AREA
 Federal Order No. 5
 Phone: 502-499-0040
 Fax: 502-499-8749
 E-Mail: friedly@malouisville.com

10301 Brookridge Village Blvd.
 Louisville, Kentucky 40291-4467
 (Mail) P. O. Box 18030
 Louisville, Kentucky 40261-0030
<http://www.malouisville.com>

**ANNOUNCEMENT OF ADVANCED CLASS PRICES AND PRICING FACTORS
 FOR APRIL 2007**

	PRICE @ 3.5% BF <i>(per cwt.)</i>	SKIM MILK PRICE <i>(per cwt.)</i>	BUTTERFAT PRICE <i>(per lb)</i>
CLASS I PRICE ^{1/}	\$18.10	\$13.60 ^{1/}	\$1.4206
Transportation Credit	0.15	0.15	0.0015
Processor Assessment ^{2/}	<u>0.20</u>	<u>0.20</u>	<u>0.0020</u>
Total	\$18.45	\$13.95	\$1.4241
CLASS II PRICE		\$9.69	

FACTORS USED IN PRICES FOR APRIL 2007

Advanced Pricing Factors ^{1/}:

Advanced Class III Skim Milk Pricing Factor <i>(per cwt)</i>	\$10.50
Advanced Class IV Skim Milk Pricing Factor <i>(per cwt)</i>	\$8.99
Advanced Butterfat Pricing Factor <i>(per lb)</i>	\$1.3896

NASS Product Price Averages for the Two Most Recent Weeks Ending March 17, 2007:

Cheese <i>(per lb)</i>	\$1.3656
Butter <i>(per lb)</i>	\$1.2782
Nonfat Dry Milk <i>(per lb)</i>	\$1.1655
Dry Whey <i>(per lb)</i>	\$0.7021

MILEAGE RATE FACTOR <i>(per cwt per mile):</i>	\$0.00442
EIA Average Diesel Fuel Price <i>(per gallon) ^{3/}:</i>	\$2.587

- ^{1/} Class I skim milk price is announced at the higher of the advanced Class III or IV skim milk pricing factors plus the base zone (Mecklenburg County, NC) differential of \$3.10 and is subject to location adjustments
- ^{2/} The processor assessment is an obligation under the Fluid Milk Promotion Order (7 CFR § 1160.101 et seq.) The Order requires that all persons who process and market commercially more than 3,000,000 pounds of fluid milk products in consumer-type packages in the 48 contiguous States and the District of Columbia on a monthly basis, excluding those fluid milk products delivered to the residence of a consumer, be assessed 20 cents per hundredweight on all marketings of such packaged fluid milk products during the month
- ^{3/} A simple average of the four most recent weeks of the Energy Information Administration's (of the U.S. Department of Energy) announced diesel fuel prices for the Lower Atlantic and Gulf South regions is used to determine the variable Mileage Rate Factor (§ 1005.83)

Released: March 23, 2007

HAROLD H. FRIEDLY, JR.
 Market Administrator

Exhibit 11

US Public Law 106-532 Dairy Product Mandatory Reporting

Public Law 106-532
106th Congress

An Act

To amend the Agricultural Marketing Act of 1946 to enhance dairy markets through dairy product mandatory reporting, and for other purposes.

Nov. 22, 2000
[S 2773]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Dairy Market
Enhancement
Act of 2000.
7 USC 1621 note

SECTION 1. SHORT TITLE.

This Act may be cited as the “Dairy Market Enhancement Act of 2000”.

SEC. 2. DAIRY PRODUCT MANDATORY REPORTING.

The Agricultural Marketing Act of 1946 (7 U.S.C. 1621 et seq.) is amended by adding at the end the following:

“Subtitle C—Dairy Product Mandatory Reporting

“SEC. 271. PURPOSE.

7 USC 1637

“The purpose of this subtitle is to establish a program of information regarding the marketing of dairy products that—

“(1) provides information that can be readily understood by producers and other market participants, including information with respect to prices, quantities sold, and inventories of dairy products;

“(2) improves the price and supply reporting services of the Department of Agriculture; and

“(3) encourages competition in the marketplace for dairy products.

“SEC. 272. DEFINITIONS.

7 USC 1637a

“In this subtitle:

“(1) **DAIRY PRODUCTS.**—The term ‘dairy products’ means manufactured dairy products that are used by the Secretary to establish minimum prices for Class III and Class IV milk under a Federal milk marketing order issued under section 8c of the Agricultural Adjustment Act (7 U.S.C. 608c), reenacted with amendments by the Agricultural Marketing Agreement Act of 1937.

“(2) **MANUFACTURER.**—The term ‘manufacturer’ means any person engaged in the business of buying milk in commerce for the purpose of manufacturing dairy products.

“(3) **SECRETARY.**—The term ‘Secretary’ means the Secretary of Agriculture.

7 USC 1637b.

“SEC. 273. MANDATORY REPORTING FOR DAIRY PRODUCTS.

“(a) ESTABLISHMENT.—The Secretary shall establish a program of mandatory dairy product information reporting that will—

“(1) provide timely, accurate, and reliable market information;

“(2) facilitate more informed marketing decisions; and

“(3) promote competition in the dairy product manufacturing industry.

“(b) REQUIREMENTS.—

“(1) IN GENERAL.—In establishing the program, the Secretary shall only—

“(A)(i) subject to the conditions described in paragraph (2), require each manufacturer to report to the Secretary information concerning the price, quantity, and moisture content of dairy products sold by the manufacturer; and

“(ii) modify the format used to provide the information on the day before the date of enactment of this subtitle to ensure that the information can be readily understood by market participants; and

“(B) require each manufacturer and other person storing dairy products to report to the Secretary, at a periodic interval determined by the Secretary, information on the quantity of dairy products stored.

“(2) CONDITIONS.—The conditions referred to in paragraph (1)(A)(i) are that—

“(A) the information referred to in paragraph (1)(A)(i) is required only with respect to those package sizes actually used to establish minimum prices for Class III or Class IV milk under a Federal milk marketing order;

“(B) the information referred to in paragraph (1)(A)(i) is required only to the extent that the information is actually used to establish minimum prices for Class III or Class IV milk under a Federal milk marketing order;

“(C) the frequency of the required reporting under paragraph (1)(A)(i) does not exceed the frequency used to establish minimum prices for Class III or Class IV milk under a Federal milk marketing order; and

“(D) the Secretary may exempt from all reporting requirements any manufacturer that processes and markets less than 1,000,000 pounds of dairy products per year.

“(c) ADMINISTRATION.—

“(1) IN GENERAL.—The Secretary shall promulgate such regulations as are necessary to ensure compliance with, and otherwise carry out, this subtitle.

“(2) CONFIDENTIALITY.—

“(A) IN GENERAL.—Except as otherwise directed by the Secretary or the Attorney General for enforcement purposes, no officer, employee, or agent of the United States shall make available to the public information, statistics, or documents obtained from or submitted by any person under this subtitle other than in a manner that ensures that confidentiality is preserved regarding the identity of persons, including parties to a contract, and proprietary business information.

“(B) RELATION TO OTHER REQUIREMENTS.—Notwithstanding any other provision of law, no facts or information

Regulations

obtained under this subtitle shall be disclosed in accordance with section 552 of title 5, United States Code.

“(3) VERIFICATION.—The Secretary shall take such actions as the Secretary considers necessary to verify the accuracy of the information submitted or reported under this subtitle.

“(4) ENFORCEMENT.—

“(A) UNLAWFUL ACT.—It shall be unlawful and a violation of this subtitle for any person subject to this subtitle to willfully fail or refuse to provide, or delay the timely reporting of, accurate information to the Secretary in accordance with this subtitle.

“(B) ORDER.—After providing notice and an opportunity for a hearing to affected persons, the Secretary may issue an order against any person to cease and desist from continuing any violation of this subtitle.

“(C) APPEAL.—

“(i) IN GENERAL.—The order of the Secretary under subparagraph (B) shall be final and conclusive unless an affected person files an appeal of the order of the Secretary in United States district court not later than 30 days after the date of the issuance of the order.

“(ii) FINDINGS.—A finding of the Secretary under this paragraph shall be set aside only if the finding is found to be unsupported by substantial evidence.

“(D) NONCOMPLIANCE WITH ORDER.—

“(i) IN GENERAL.—If a person subject to this subtitle fails to obey an order issued under this paragraph after the order has become final and unappealable, or after the appropriate United States district court has entered a final judgment in favor of the Secretary, the United States may apply to the appropriate United States district court for enforcement of the order.

“(ii) ENFORCEMENT.—If the court determines that the order was lawfully made and duly served and that the person violated the order, the court shall enforce the order.

“(iii) CIVIL PENALTY.—If the court finds that the person violated the order, the person shall be subject to a civil penalty of not more than \$10,000 for each offense.

“(5) FEES.—The Secretary shall not charge or assess a user fee, transaction fee, service charge, assessment, reimbursement fee, or any other fee under this subtitle for—

“(A) the submission or reporting of information;

“(B) the receipt or availability of, or access to, published reports or information; or

“(C) any other activity required under this subtitle.

“(6) RECORDKEEPING.—Each person required to report information to the Secretary under this subtitle shall maintain, and make available to the Secretary, on request, original contracts, agreements, receipts, and other records associated with the sale or storage of any dairy products during the 2-year period beginning on the date of the creation of the records.

“(d) AUTHORIZATION OF APPROPRIATIONS.—There are authorized to be appropriated such sums as are necessary to carry out this section.”.

Approved November 22, 2000.

LEGISLATIVE HISTORY—S. 2773:

CONGRESSIONAL RECORD, Vol. 146 (2000):

Oct 26, considered and passed Senate and House.

○

Exhibit 12

NASS Product Price Survey Instruments



**DAIRY PRODUCTS PRICES
CHEDDAR CHEESE**
Week Ending Saturday _____



**NATIONAL
AGRICULTURAL
STATISTICS
SERVICE**

National Agricultural Statistics Service
U S Department of Agriculture,
Rm 5030, South Building
1400 Independence Ave , S W
Washington, DC 20250-2000
Phone 1-800-727-9540
Fax: 202-690-2090
Email nass@nass.usda.gov

Dear Cheddar Cheese Producer:

USDA is collecting weekly information on cheddar cheese sales and prices to be published in the Dairy Products Prices Release every Friday. Your cooperation in filling out this form and returning it is requested. Response to this survey is mandatory under Public Law No. 106-532. The information that you provide is important in estimating U.S. cheddar cheese prices. Individual reports will be considered confidential and will not be used in a way as to disclose company proprietary information. Please "fax" the report promptly.

Please make corrections to name, address and Zip Code, if necessary.

INSTRUCTIONS

Sale:

When a transaction is completed, i.e. cheese is "shipped out" and title transfer occurs. Report for sales of Cheddar cheese only. Price is f.o.b. processing plant/storage center. Report moisture content of barrel cheese when sold. Report prices for "bare" or "naked" cheese with only minimum packaging as required for 40 lb. Blocks.

Include:

Total volume sold and total dollars received or price per pound. Include only cheese 4 – 30 days in age. CME Sales initial manufacturer sales only. CCC purchases under the Dairy Price Support and related programs.

Exclude:

Intra-company sales.
Transportation and clearing charges from price.
Block cheese that will be aged.
Resales of purchased cheese.
Forward pricing sales: sales in which the selling price was set (and not adjusted) 30 or more days before the transaction was completed.

See additional instructions on reverse side

If you have any questions, please call 202-690-2168.

CHEDDAR CHEESE SALES for the WEEK ENDING SATURDAY _____				
1. PLANT LOCATION	POUNDS OF CHEDDAR	TOTAL DOLLARS OR DOLLARS / LB.		MOISTURE CONTENT
500 lb. Barrels				
	511		531	541
	lb.	\$	\$. _____	_____ %
	512		532	542
	lb.	\$	\$. _____	_____ %
	513		533	543
	lb.	\$	\$. _____	_____ %
	514		534	544
	lb.	\$	\$. _____	_____ %
	515		535	545
	lb.	\$	\$. _____	_____ %
40 lb. Blocks				
	611		631	
	lb.	\$	\$. _____	
	612		632	
	lb.	\$	\$. _____	

INSTRUCTIONS FOR COMPLETING CHEDDAR CHEESE PRICE SURVEY

Report total pounds sold and total dollars received (or price per pound) for all bulk transactions during the week. Please report cheese sales according to the following terms and definitions.

1. **Sale:** When a transaction is completed, i.e. cheese is "shipped out" and the transfer occurs.

2. **Variety:** Cheddar cheese

3. **Style:**

40# blocks
500# barrels

4. **Moisture content:**

40# blocks – Exclude cheese that will be aged.

Barrels – Report moisture content of cheese sold, not to exceed 37.7%. NASS will adjust price to a benchmark of 38.0% based on standard moisture adjustment formulas.

5. **Age:**

Not less than 4 days or more than 30 days on date of sale.

6. **Grade:**

Barrels – Wisconsin State Brand, USDA Extra Grade or better.

40# blocks – Wisconsin State Brand, USDA Grade A or better.

7. **Color:**

Barrels – White

40# blocks – colored between 6-8 on the National Cheese Institute color chart.

8. **Packaging:**

40# blocks – Price should reflect cheese wrapped in a sealed, airtight package in corrugated or solid fiberboard containers with a reinforcing inner liner or sleeve. Exclude all other packaging costs from the reported price.

Barrels – Exclude all packaging costs from the reported price.

9. **Price:**

Price should be reported as price per pound or total dollars received.

Price is f.o.b. processing plant/storage center.



DAIRY PRODUCT PRICES BUTTER

Week Ending Saturday _____



**NATIONAL
AGRICULTURAL
STATISTICS
SERVICE**

National Agricultural Statistics Service
U S Department of Agriculture,
Rm 5030, South Building
1400 Independence Ave., S W
Washington, DC 20250-2000
Phone 1-800-727-9540
Fax 202-690-2690
Email nass@nass.usda.gov

Dear Butter Producer:

USDA is collecting weekly information on butter sales and prices to be published in the Dairy Products Prices Release every Friday. Your cooperation in filling out this form and returning it is requested. Response to this survey is **mandatory** under Public Law No. 106-532. The information that you provide is important in estimating U.S. butter prices. **Individual reports will be considered confidential and will not be used in a way as to disclose company proprietary information.** Please "fax" the report promptly.

Please make corrections to name, address and Zip Code, if necessary.

INSTRUCTIONS:

Sale:

- When a transaction is completed, i.e. butter is "shipped out" and title transfer occurs.
- Report sales of butter that meets USDA Grade AA standards, 80% butterfat, salted, fresh or storage.
- Price is **f.o.b.** processing plant/storage center.
- Report prices and quantities for all 25 kilogram and 68 pound box sales.
- Report sales quantities in total pounds.

Include:

- Total volume sold and total dollars received or price per pound.
- CME Sales: Initial manufacturer sales only.
- CCC purchases under the Dairy Price Support and related programs

Exclude:

- Transportation and clearing charges from price.
- Unsalted and Grade A butter.
- Intra-company sales.
- Resales of purchased butter.
- Forward pricing sales: sales in which the selling price was set (and not adjusted) 30 or more days before the transaction was completed. This exclusion does not include sales through the Dairy Export Incentive Program (DEIP).

If you have any questions, please call 202-690-2168.

BUTTER SALES for the WEEK ENDING SATURDAY _____				
1. PLANT LOCATION	POUNDS OF BUTTER		TOTAL DOLLARS	OR DOLLARS / LB.
	211	lb.	221\$	231\$
	212	lb.	222\$	232\$
	213	lb.	223\$	233\$
	214	lb.	224\$	234\$
	215	lb.	225\$	235\$



DAIRY PRODUCTS PRICES DRY WHEY
 Week Ending Saturday _____



NATIONAL AGRICULTURAL STATISTICS SERVICE

National Agricultural Statistics Service
 U S Department of Agriculture,
 Rm 5030, South Building
 1400 Independence Ave, S W
 Washington, DC 20250-2000
 Phone 1-800-727-9540
 Fax 202-690-2090
 Email nass@nass.usda.gov

Dear Dry Whey Producer:

USDA is collecting weekly information on dry whey sales and prices to be published in the Dairy Products Prices Release every Friday. Your cooperation in filling out this form and returning it is requested. Response to this survey is mandatory under Public Law No. 106-532. The information that you provide is important in estimating U.S. dry whey prices. Individual reports will be considered confidential and will not be used in a way as to disclose company proprietary information. Please "fax" the report promptly.

Please make corrections to name, address and Zip Code, if necessary.

INSTRUCTIONS

Sale:

- When a transaction is completed, i.e. dry whey is "shipped out" and title transfer occurs.
- Report sales of USDA Extra Grade edible nonhygroscopic dry whey.
- Price is f.o.b. processing plant/storage center.
- Report prices and quantities for all 25 kilogram bag, 50 pound bag, tote and tanker sales.
- Report sales quantities in total pounds.

Include:

- Total volume sold and total dollars received or price per pound.

Exclude:

- Transportation charges from price.
- Sales of Grade A dry whey.
- Sales of dry whey more than 180 days old.
- Intra-company sales.
- Resales of purchased dry whey.
- Forward pricing sales: sales in which the selling price was set (and not adjusted) 30 or more days before the transaction was completed.

If you have any questions, please call 202-690-2168.

DRY WHEY SALES for the WEEK ENDING SATURDAY _____			
1. PLANT LOCATION	POUNDS OF DRY WHEY	TOTAL DOLLARS	OR DOLLARS / LB.
	311 lb.	321 \$	331 \$
	312 lb.	322 \$	332 \$
	313 lb.	323 \$	333 \$
	314 lb.	324 \$	334 \$
	315 lb.	325 \$	335 \$



**DAIRY PRODUCTS PRICES
NONFAT DRY MILK**
Week Ending Saturday _____



**NATIONAL
AGRICULTURAL
STATISTICS
SERVICE**

National Agricultural Statistics Service
U S Department of Agriculture,
Rm 5030, South Building
1400 Independence Ave., S W
Washington, DC 20250-2000
Phone: 1-800-727-9540
Fax: 202-690-2090
Email: nass@nass.usda.gov

Dear Nonfat Dry Milk Producer:

USDA is collecting weekly information on nonfat dry milk sales and prices to be published in the Dairy Products Prices Release every Friday. Your cooperation in filling out this form and returning it is requested. Response to this survey is mandatory under Public Law No. 106-532. The information that you provide is important in estimating U.S. nonfat dry milk prices. Individual reports will be considered confidential and will not be used in a way as to disclose company proprietary information. Please "fax" the report promptly.

Please make corrections to name, address and Zip Code, if necessary.

INSTRUCTIONS

Sale:

When a transaction is completed, i.e. nonfat dry milk is "shipped out" and title transfer occurs. Report sales of USDA Extra Grade and USPH Grade A, nonfortified nonfat dry milk. Price is f.o.b. processing plant/storage center. Report prices and quantities for all 25 kilogram bag, 50 pound bag, tote and tanker sales. Report sales quantities in total pounds.

Include:

Nonfat dry milk manufactured using low or medium heat process.
Total volume sold and total dollars received or price per pound.
CME Sales initial manufacturer sales only.
CCC purchases under the Dairy Price Support and related programs.

Exclude:

Transportation and clearing charges from price.
Sales of nonfat dry milk more than 180 days old.
Nonfat dry milk manufactured using high heat process.
Sales of instant nonfat dry milk.
Sales of dry buttermilk products.
Intra-company sales.
Resales of purchased nonfat dry milk.
Forward pricing sales: sales in which the selling price was set (and not adjusted) 30 or more days before the transaction was completed. This exclusion does not include sales through the Dairy Export Incentive Program (DEIP).

If you have any questions, please call 202-690-2168.

NONFAT DRY MILK SALES for the WEEK ENDING SATURDAY

1. PLANT LOCATION	POUNDS OF NONFAT DRY MILK	TOTAL DOLLARS	OR	DOLLARS / LB.
	411 lb.	421 \$		431 \$
	412 lb.	422 \$		432 \$
	413 lb.	423 \$		433 \$
	414 lb.	424 \$		434 \$
	415	425		435

Exhibit 13

Dairylea's Proposal

Federal Order Proposal submitted by Dairylea Cooperative Inc.

Amend section 1000.50 by adding a new section as follows:

(r) Manufacturing Surcharges. For the purposes of determining the NASS survey prices for this section, as reported by the Department, cost of production add-on surcharges, up to a maximum value as contained in part (1) of this section, shall not be included in the NASS survey prices.

(1) the maximum cost of production add-on surcharges shall be as follows:

- (i) chesc \$0.0xxx per pound;
- (ii) butter \$0.0xxx per pound
- (iii) whey powder \$0.0xxx per pound, and
- (iv) nonfat dry milk \$0.0xxx per pound

(2) To be excluded from the NASS survey price, cost of production factors must be shown on the appropriate invoice as a separately negotiated surcharge to the normal price charged on the invoice, up to the maximum amount as shown for such product pursuant to part (1), above. Failure to show the add-on as such will result in any such values being included in the NASS survey price.

Amend section 1000.53 (a) by adding a new section as follows:

(12) The rates as determined in 1000.50 (r) (1).