Testimony in Support of
Proposal #1 to Update Make Allowances on an Emergency Basis

Prepared by
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Representing
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Introduction and Background

My name is Craig S. Alexander. I am testifying today on behalf of O-AT-KA Milk Products Cooperative, Inc. ("O-AT-KA"). I am the Manager of Dairy Ingredient Sales and Regulatory Affairs. The business address is Cedar and Ellicott Streets, Batavia, NY 14021. I received a Bachelor of Science degree in Economics and Political Science from SUNY Albany and then a Master of Science degree in Agricultural Economics from Cornell University in 1985. In the past 20 years I have worked for Upstate Farms Cooperative, Dairy Institute of California, Cornell University and O-AT-KA in a variety of capacities involved with dairy economics, market analysis, regulatory impact of State and Federal orders, and bulk milk and dairy commodity sales. I have testified at numerous State and Federal order hearings.

First let me say that we appreciate USDA calling this hearing to consider emergency changes to the outdated make allowances in the Class III and IV price formulas. An expedited decision from this hearing is critical to our cooperative owners. As we head into the spring months facing increased milk production and balancing needs, the unrecoverable processing costs that are being discussed at this hearing, will likely worsen.

O-AT-KA is owned by three producer-owned cooperatives: Upstate Farms Cooperative, Inc., Niagara Milk Cooperative, Inc. and Dairy Farmers of America. In 2005, O-AT-KA processed 577 million pounds of milk. We employ about 300 in plant and office personnel. O-AT-KA manufactures a full line of canned evaporated milk products, a variety of long shelf life formulated specialty beverages in cans and glass bottles. We also process bulk fluid cream and skim condensed and last year produced 16.5 million pounds of butter and 16.4 million pounds of nonfat dry milk.

In the late 1950s, O-AT-KA was formed as a joint venture of dairy cooperatives to balance milk supplies in the Western New York area. Although over time additional product lines have been added at O-AT-KA, the mission of handling the swings in milk production and changes in demand from other non-Class IV uses on a daily, seasonal, and yearly basis has not changed. For example, we see milk volumes range by 80% from midweek lows to the weekend highs. We experience 50% variation between fall low months to spring flush months. In producing nonfat dry milk, the extremes are even greater as we produced just 433,000 pounds last November compared with over 2 million pounds last May. In the last five years we have had 30% swings from low to high in total annual milk volumes.

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The Compton study showed a total cost of $0.1427/lb. for bulk butter in 2004. Adding the CDFA factor for ROI brings the total to $0.1497/lb. Based on these costs, our processing costs for butter are $0.0347/lb above the current make allowance of $0.115/lb. On the 16.5 million pounds of butter produced in 2005, this difference between the current make allowance and our costs represents a deficit of $572,550. This is a conservative number as we have short term transportation and outside warehousing costs that we did not include.

The combined total of unrecovered make allowance costs for both nonfat dry milk and butter is $1.9 million for 2005. We expect 2006 may be as bad or worse for the cooperatives and their producers owning O-AT-KA.

O-AT-KA Supports Proposal #1

Specifically, O-AT-KA supports the application of the CDFA and RCBS data as detailed in Mr. Wellington's testimony. We feel this is a conservative yet representative approach to the data. The survey data shows that both California and Federal order plants have had increased costs over the years since AMS first used the data for setting make allowances. We support use of the combined data as discussed by Mr. Wellington and want to underscore that, in general, our costs are farther out of line on nonfat dry milk than on butter. As a first step we support moving the make allowance on nonfat dry milk from $0.14/lb to $0.1867/lb. The Agri-Mark proposal uses the medium cost group of nonfat dry milk plants in the California survey and the weighted average for the RCBS data. The medium group for California is more representative of similar plants in Federal Orders and after all it is Federal Order pricing we are working to determine.

In general we feel that while make allowances should not overcompensate plants, a weighted average means that half of the milk will not have costs covered. If the largest California butter/powder plants are included in determining make allowances, the average costs will be pulled down and many balancing plants purchasing federal order milk, including our own, will continue to bear the burden of an insufficient make allowance. We ask that the Department keep in mind that cost inefficiencies of balancing plants are a function of the swings of milk production and changes of demand from other uses. Dr. Ling, in his response to questioning, stated that it is the butter-powder plants that are doing relatively more of the balancing. These will have higher than average costs compared to large plants producing the same commodities in heavy manufacturing areas such as California with less variation in supply.

In January 2005, the Department published a final decision from the Northeast Pooling Provisions hearing. [Federal Register: Vol.70, No. 19]. The decision rejected a proposal for marketwide payments for balancing and states in part:

> The Class III/IV pricing formulae adopted in the Class III/IV Interim Decision (65 FR 768832, published December 7, 2002) included a factor to offset the cost of balancing performed by butter-powder manufacturing plants. Official notice is hereby taken of the Class III/IV Final Decision (67 FR 67906, published November 7, 2002). The Class III/IV Final Decision that adopted product price formulas for all Federal milk marketing orders, including the Northeast order, gave specific recognition to costs associated with balancing in the make allowance factor in setting the Class III and Class IV milk price. (pages 4951-4952)

volumes continuing to increase this winter, and already available capacity is being stretched to the limit. We are extremely concerned about our ability to process milk while sustaining increased losses. We believe it is critical for USDA to act as quickly as possible, foregoing the normal recommended decision procedures and move to immediate implementation of changes on an interim basis.

If left to run its course, unchanged make allowances will undercut the very ability of the federal order program to preserve minimum pricing for milk. Minimum class pricing will be undermined, disorderly conditions will increase as uneconomic milk movements and alternative sales under class will be sought out to avoid processing losses or simply because plants have closed and there is no home.

As a producer-owned cooperative we are concerned about producer income and the impact of increasing make allowances. However, studies such as the one by the Department and prepared for this hearing, have not taken into account the costs of outdated make allowances to producers such as ours that have already occurred. The studies have also not taken into account the costs over time as inadequate make allowances force plant closings, reduce outlets, lower premiums, increase hauling costs and therefore lower returns to all producers. As discussed earlier, this scenario is not theoretical, it is already happening in the Northeast.

Again, we thank the Department for holding this hearing and we ask for a decision and implementation as soon as possible. Thank you.