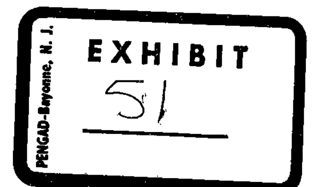
My name is Don Desjarlais and I serve as the General Manager of Family Dairies USA-a multi-purpose USDA qualified Cooperative headquartered in Madison, WI. I appear here today on behalf of the 3,700 family dairy farmer members who own the Cooperative.

At the outset, our dairy farmer members want everyone to know, they empathize with manufacturers who are seeing their operating margins squeezed by accelerating energy costs. Our members fully understand margin squeeze because their own dairy farms' bottom lines are being negatively impacted by the same energy cost increases. The proposed solution to these serious energy price hike problems suggested by the petitioners-Agri-Mark, et.al.-would be to increase manufacturing cost allowances for Classes III and IV. Such make allowance adjustments might, indeed, afford manufacturer's a cost of production guarantee. Economists agree however, that such adjustments would lower Class III prices; and we suggest that the money needed for these adjustments would come right out of our producer members' milk checks-thus making the whole proposal a non starter.



Our members are particularly sensitive to the negative impact rising energy costs are having on their own operators. Early in 2005 (well before the current Agri-Mark request) our Board of Directors and management contacted top Federal Order 30 officials about the possibility of requesting a Federal Order hearing that could produce a fuel adjustment or energy allowance for producers through the Federal Order System. The Order officials considered the Family Dairies USA request and informed the Board Chairman that while they were sympathetic with producer cost problems, there was no authority in the Order System to address those concerns. They suggested that perhaps the Secretary of Agriculture, himself, or the Congress would be the proper venue for redress.

It appears then, the internal Federal Order rules do allow consideration of an emergency hearing to address manufacturers' energy cost of production problems, but do not afford the same consideration to producers' concerns.

Since these internal rules do suggest sort of a double standard, our members believe that when the Secretary does issue the proposed rule in this matter; he should use extreme caution to see that the decision does not solve the problem of manufacturers at the expense of producers.

In conclusion, we should like to enter into the record the summary paragraphs of a paper written by Professor Ed Jesse and Brian Gould of the University of Wisconsin dated October 2005 concerning this very subject. The views expressed reflect exactly those of Family Dairies USA members.

Table 3 Comparison of Energy Cost Increase by Product (Cents per Hundredweight of Cheese Milk)				
Date	***Cheese***	***Whey***	***Butter***	***Total***
Annual 2003	17.96	22.68	0.31	40.95
April 2004	17.98	23.54	0.32	41.84
April 2005	19.86	26.96	0.35	47.17
Sept. 2005	22.85	30.96	0.40	54.21

Summary and Conclusions

This analysis points out several problems with using product price formulas to establish a value for milk used to make cheese. These problems stem from the fact that product price formulas do not and cannot replicate competitive conditions except, perhaps, coincidentally. In particular, competition would dictate cheesemakers gross margins rise and fall in response to changing costs. Formulas hold margins to a fixed amount that can only be changed through a laborious hearing process.

Compared to the time period prior to adopting product price formulas to set federal order prices, cheesemaker gross margins are more stable from month-to-month and show no discernible trend. Margins based solely on cheese value have fallen since product price formulas were adopted, indicating that cheesemakers who do not obtain the value of butter and whey assumed in the formulas are losing ground.

Changes in product price formulas that became effective in April 2003 altered assumed product yields. In particular, the value of butter took on a more important role in setting the Class III price and thereby affecting cheesemakers' margins. High butter prices relative to cheese prices since early 2004 have increased the cost of cheese milk relative to its cost using previous formulas.

While the product yields used in the Class III formulas reasonably reflect conditions in "conventional make procedure" cheese plants, formula assumptions with respect to cheese and butter prices are questionable. Adjustments made to the barrel cheddar price elevate the value of cheese used in the Class III price formula above the NASS block cheddar cheese price. The formula assumption that values whey cream butter at the Grade AA butter price is invalid.

Using readily available cost data and numerous assumptions, we simulated the impact of higher natural gas and electricity prices on the cost of manufacturing cheddar cheese along with associated dry whey and butter. We estimate that since 2003, energy costs per cwt of milk processed into cheese increased by more than one third, adding about 13 cents per hundredweight to manufacturing costs.

Unless offset by higher product prices, correcting the flaws in product price formulas that we have noted would result in a lower Class III price. This raises the question of whether changes would inequitably alter the sharing of revenues between dairy farmers and cheesemakers. Put more directly, farmers can argue — quite legitimately — that since they receive no assurance of profitable milk prices under federal orders, why should cheesemakers be treated any differently.

In response, we note that fixed cheesemakers margins may be fine if they assure reasonable profitability, promote efficiency and productivity growth, and encourage competition for cheese milk at prices above the federal order minimum. On the other hand, fixed margins can be a serious problem if they consistently yield sub-par returns and cause disinvestment in cheesemaking. Farmers and cheesemakers are partners — both must be profitable over the long run to sustain a healthy dairy industry.