

**UNITED STATES DEPARTMENT OF AGRICULTURE**

**Agricultural Marketing Service**

**7 CFR Parts 1000, 1001, 1005, 1006, 1007, 1030, 1032, 1033, 1124, 1126, 1131, 1135.**

**[Docket No. AO-14-A69, et al.; DA-00-03]**

**Milk in the Northeast and Other Marketing Areas; Tentative Decision on Proposed Amendments**

**Class III and Class IV Milk Pricing Formulas**

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**Comments of the  
MIDWEST DAIRY COALITION**

*(Associated Milk Producers, Inc.; Ellsworth Cooperative Creamery; Family Daries USA; First District Association; Foremost Farms, USA; Manitowoc Milk Producers; Midwest Dairymen's Company; Milwaukee Cooperative Milk Producers; Minnesota Department of Agriculture; Minnesota Milk Producers Association; Wisconsin Cheese Makers Association; Wisconsin Department of Agriculture; Trade, and Consumer Protection; Wisconsin Farm Bureau Federation; and Wisconsin Federation of Cooperatives.)*

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## **INTRODUCTION**

In response to the USDA Tentative Final Decision on Class III and IV milk price formulas, published in the Federal Register on December 7, 2000, the Midwest Dairy Coalition is submitting these comments.

Our comments focus on two main areas of concern:

- 1) The negative implications of creating a separate Class III butterfat formula; and
- 2) Response to the criticisms made by USDA of Proposal Number 30 (as modified) regarding the relationship between Class III and IV and the Class I mover.

## **SEPARATE BUTTERFAT AND PROTEIN PRICING FORMULAS**

The Midwest Dairy Coalition has joined with a broad cross-section of the dairy industry, representing both producer and processor interests, in filing comments requesting USDA to return to the general format of the Class III butterfat and protein formulas originally implemented with Federal Milk Marketing Order Reform. (See comments filed by National All-Jersey, Inc., *et al*).

We are in agreement with USDA's concern about the negative relationship between the protein price and the butterfat price, and negative effects on Class III prices when cheese prices are very low relative to butter prices, as occurred in December of 2000. However, while the USDA action to create a separate Class III butterfat price would address this concern, it creates even larger problems. Most notably, the creation of separate butterfat prices for Class III and IV creates a strong incentive for use of Class IV butterfat sources (such as anhydrous butterfat or butter) for the manufacture of non-standard cheese. Not only would this fat substitution result in revenue loss to dairy producers, but it would create an economic incentive for cheese makers to move more toward production of non-standard cheese in order to take advantage of lower-cost fat sources.

In addition, the creation of a separate Class III butterfat price, as specified in the Tentative Final Decision, would result in the overvaluation of fat relative to protein, and send inaccurate market signals to dairy producers regarding the relative values of fat and protein. Currently, there is a deficit of protein in milk produced in the Upper Midwest, which has resulted in the need for other sources of protein to be brought into the region for use in cheese production. Many genetics programs have been developed to help producers increase the protein composition in their milk, to respond to this market need. To make formula changes that increase the value of fat and reduce the value of protein sends a signal that is entirely contrary to the market and counterproductive for the cheesemaking sector that is so critical to our region.

Therefore, we are urging USDA to return to the general format of the Class III butterfat and protein formulas originally implemented with Federal Milk Marketing Order Reform, and to implement an alternate mechanism to assure that spikes in butter prices do not lead to reductions in Class III prices.

### **CLASS I MOVER**

In response to the USDA "Invitation to Submit Proposals- Class III and IV Prices," dated January 31, 2000, the Midwest Dairy Coalition submitted a proposal regarding the relationship between Class III and IV prices, and the Class I mover. Family Dairies USA submitted a similar proposal. The two proposals were summarized and combined by AMS, and listed in the Notice of Hearing as Proposal Number 30.

During the hearing, Mr. Gary Gran presented testimony in support of Proposal Number 30, on behalf of the Midwest Dairy Coalition and Family Dairies USA. In Mr. Gran's testimony, he clarified and amplified upon the brief proposal description provided in the Notice of Hearing. Proposal Number 30 recommended that the existing mover, the higher of the advanced Class III or advanced Class IV price, be changed to a weighted average of the advanced Class III and advanced Class IV prices, with the weighting based on the portion of manufacturing milk used for Class III and Class IV during the previous year.

In its Tentative Final Rule, USDA concluded that "[A]side from the fact that the proposal to use a weighted average of the Class III and Class IV prices as the Class I mover was not noticed for consideration in this proceeding, it should be rejected on the basis of its lack of merit."

Several of the reasons cited by USDA as a demonstration of the lack of merit of Proposal Number 30 deserve response:

**1) USDA asserted that the proposal was not noticed for consideration in the hearing.**

To the contrary, a proposal regarding the relationship between Class III and IV price and the Class I mover was submitted and subsequently listed by USDA in the hearing notice as Proposal Number 30. During the hearing, Mr. Gran of Family Dairies USA modified the proposal to more specifically propose that a weighted average of Class III and IV prices be used in setting Class I prices.

The proposal, as modified, was discussed in depth during the hearing. Opponents of the proposal took advantage of the opportunity to cross examine the witness who presented the proposal. In response to objections raised regarding the proposal's inclusion in the hearing record, Administrative Law Judge Hunt clearly overruled objections raised to the proposal's inclusion in the hearing record. In addition, the proposal was the subject of numerous post-hearing briefs.

In stark contrast, the Tentative Final Decision included a change in the Class I mover which was truly unnoticed, not discussed at all during the hearing, not subject to cross-examination, and therefore not addressed in any post-hearing brief. Specifically, the Tentative Final Rule adopted the use of the higher of the advanced Class III or Class IV milk prices at 3.5 percent butterfat as the new Class I mover, instead of the old method of using skim values.

In addition, the Class I mover formula adopted by USDA is significantly less meritorious than Proposal Number 30 (as modified), because it continues to completely decouple Class I prices from the underlying value of milk used in cheese production, by far the largest of all manufactured milk uses.

**2) It was argued during post-hearing briefing that since the 1960s the dairy industry has used a Class I mover tied to a market-clearing price represented by a weighted average of milk used in butter, cheese and powder. The Tentative Final Decision attempts to negate this argument, by countering that previous Class I movers were biased toward the Upper Midwest, because they were based on prices of milk and dairy products in the Upper Midwest and “ included very little powder, as that areas manufactures a higher percentage of cheese relative to NFD, than the rest of the U.S.”**

The argument made by USDA is valid as a justification for using a national base of manufactured dairy products, rather than an Upper Midwest base, in setting Class I prices. Indeed, a Class I mover that is reflective of national prices is superior to one relying on prices in one region alone. However, the argument used by USDA is entirely irrelevant as a justification for maintaining a Class I mover based on the higher of advanced Class III or Class IV milk prices, because this measurement is even less reflective of national manufacturing milk prices than the Class I movers in effect prior to Federal Order Reform.

**3) During post-hearing briefing, some fluid milk handler representatives wrote in support of Proposal Number 30 (as modified). The comments of these handlers were summarily dismissed by USDA, with the following remark: “Any means of reducing Class I prices to handlers should meet with the approval of these processors, regardless of the economic merits of the proposal.”**

It is a cause for concern that USDA is rejecting the comments of a significant portion of the dairy industry, merely on the assumption that those handlers will do anything to reduce their raw milk costs, no matter how economically unjustified the method of achieving those cost reductions may be. Is this to suggest that fluid milk handlers' comments are rejected out of hand by USDA as being hopelessly self-serving, and therefore lacking in validity?

Fluid milk processors are no more or less self-interested in their arguments than any other federal order participant. USDA should use its authority to weigh the economic merits based on the comments and input of all the interested parties, not to dismiss the comments of one sector based on an assumption of excessive self interest.

**4) The Tentative Final Decision argues that “the higher of the Class III or Class IV prices are used to move the Class I price to assure that fluid plants will be better able to attract milk away from manufacturing uses.”**

The federal milk marketing order system sets minimum prices for milk. Minimum prices should be set at levels that allow market supply and demand conditions to influence actual milk prices. Under the pricing system, fluid plants are free to pay above minimum prices to attract milk away from manufacturing uses and into fluid use, in response to market conditions. Proposal Number 30 (as modified) does not preclude fluid plants from increasing prices in order to attract milk for fluid uses.

However, using the higher of advanced Class III or IV milk prices as the Class I mover could result in setting a minimum fluid price that is above the market-clearing price for milk, especially if the “higher” price is not representative of manufacturing markets. If, as USDA’s own analysis shows, Class IV continues to be the mover for Class I, it would not be representative of manufacturing markets because Class IV only represents less than 10 percent of production under federal orders.

Minimum Class I prices should not be set at levels that deny fluid markets the ability to respond to supply and demand conditions.

**In Closing**

We urge USDA to review the decision to create a separate Class III butterfat formula, and to explore other options to assure that spikes in butter prices do not negatively effect Class III values during periods of low cheese prices. While we appreciate the intent of USDA in creating a separate Class III butterfat price, we believe that the negative ramifications of this action outweigh the benefits.

In addition, we urge USDA to reconsider its decision to reject Proposal Number 30 (as modified in the hearing record), and make the necessary adjustments to the Class I mover to assure that it more adequately reflects the value of milk used in cheese, the predominant manufacturing use for milk in this country.