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August 11 2004

Ms. Dana Coale
Acting Deputy Administrator
Dairy Programs
USDA/AMS/Dairy Programs,
STOP 0225–Room 2968
1400 Independence Avenue, SW
Washington, DC 20250-0225

Re: Invitation to Submit Proposals for a Public Hearing to Amend the Pooling Provisions of the Central Marketing Order, dated July 12, 2004.

Dear Ms Coale:

I am writing in response to USDA's July 12th announcement inviting comment on possible proposals for a hearing regarding the pooling provisions in the Central Order.

The purpose of this letter is to urge USDA not to consider a hearing for the purpose of dealing with market attachment (depooling) on a market by market basis, but instead to do so as part of a national hearing which puts that issue into a proper context with other issues related to the Class III and IV price formulas.

- As you know, there are a number of justifications for a national hearing to update the 2000-2003 process, which reviewed and modified the Class III and IV formulas. Those formulas were based on data heard at a hearing in May of 2000, at which the principal evidence on manufacturing costs dated from 1998 and 1999. (See Dr. Ling's 1998 study, Hearing Exhibit #9.)
- During the past five years since the hearing, labor costs (which represented roughly 1/3 the cost of manufacturing in Dr. Ling's exhibit) have risen about 20% (per the national index of wages in manufacturing published by the Bureau of Labor Statistics, Department of Labor).

- Even more alarming has been the increase in energy costs, particularly natural gas. Our research indicates a roughly a 250% increase in natural gas costs (from the \$2 per btu range, to over \$6). Dr. Ling's exhibit indicated that fuels other than electricity represented 13.6% of the costs of drying powder, and of course the department recognized in the decisions that whey requires more energy to dry than powder (more water).
- We are not optimistic about any relief in energy prices in the near or mid-term. As you may know, Chairman Greenspan has warned of an impending natural gas crisis, and the potential effect on the U.S. economy. Today's record world prices for oil also suggest that energy cost adjustments are of paramount importance as the Federal Order system moves forward. The experience of 2000-03 indicates that those adjustments should be a priority for your Order Formulation group.

The purpose of this letter is not to request such a hearing at this time. Mike Brown of our staff is working with you and others in the Dairy Division to develop such a proposal. We are optimistic that this can be delivered to you in the near future.

However, the purpose of this letter is to suggest that depooling should be – and must be – part of the larger discussions about conversion costs and make allowances. As you well know, one primary purpose of the Class III and IV formulas is to “fairly” allocate the money from the commodity market between processors and the producers in the pool. Depooling impacts that allocation, by shifting revenue at times from the marketwide producer pool to plants or their suppliers.

One goal of the Class III and IV formulas is to ensure that plants can be profitable, so that producers will have a market. That goal requires considering all aspects of overall plant profitability, including plant revenue opportunities like depooling. It's all linked.

Limiting depooling without reconsideration of today's make allowances and the rest of the Class III and IV formulas could represent a dramatic change in the terms of profitability of plant operations. It could easily lead to closure of marginal operations in some regions, which in turn could lead to disorderly market conditions in those regions.

We recognize that a hearing will be held soon in the Upper Midwest region to consider depooling and other aspects of market attachment. We recognize that those proposals will be heard, and may generate some useful approaches that could be followed in a national hearing. We are not commenting in this letter on the merits of that proposal for the Upper Midwest market. We will participate in that hearing and put our comments on the record, as is proper for that proceeding.

With respect to the Central Order, and perhaps other orders where the “depooling” issue is raised, I respectfully suggest that the need to revisit the Class III and IV formulas is a much more urgent issue, and a much better priority for the scarce resources of the Order Formulation branch.

Thank you for your consideration of our views.

Sincerely,

Douglas C. Marshall
Sr. Vice President
Northwest Dairy Association

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