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International Dairy Foods Association

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March 28, 2023

Ms. Dana Coale, Deputy Administrator
USDA - AMS - Dairy Programs
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Re: Petition of the International Dairy Foods Association ("IDFA") For a Hearing to Amend Federal Milk Marketing Orders

Dear Deputy Administrator Coale:

The International Dairy Foods Association ("IDFA") hereby petitions the Secretary of Agriculture to institute a proceeding to amend all current Federal Milk Market Orders (FMMOs), 7 C.F.R. Parts 1000–1135. This Petition supports a Petition filed by the Wisconsin Cheese Makers Association ("WCMA"). The petitions seek to relieve the economic hardships on cheese, nonfat dry milk, butter and whey manufacturers due to dramatically higher costs of manufacturing these products since USDA last established manufacturing cost factors (make allowances) based on industry cost data from 2005–2006.

IDFA has been prepared to file a petition for a hearing to update make allowances since early February 2023, but IDFA postponed any submission in a good faith effort, engaging in substantive and lengthy discussions with National Milk Producers Federation "NMPF" seeking industry consensus. Unfortunately, such consensus is not possible, beyond the fact that both IDFA and NMPF agree that the make allowances last updated in 2008 need to be updated.

1. Introduction and Summary

Ever since the U.S. Department of Agriculture more than twenty years ago began using component pricing to set minimum milk prices for manufactured (Class III and IV) products, the Department has hewed hard to one straightforward, overriding principle: **minimum manufacturing product prices must incorporate a "make allowance" consistent with the average cost of manufacturing the core Class III and IV products, as determined by the most recently available cost data.** As USDA explained when it first adopted this approach effective January 1, 2000:

> The make allowances contained in the proposed rule were developed primarily from make allowance studies conducted at and published by Cornell University and an analysis of manufacturing plant size in relationship to the data contained in the Cornell studies. Audited cost of production data published by the California Department of Food

> and Agriculture was also used in determining a reasonable level of make allowances.
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> . . . Both handler and producer interests argued that failure to cover processors' costs of converting milk to finished products results in a disincentive to produce finished dairy products. They expressed concern that the disincentive would discourage investment in the manufacturing sector, leading to reduced manufacturing capacity and reduced outlets for producers' milk.

Milk in the New England and Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Orders, 64 Fed. Reg. 16,026, 16,096 (Apr. 2, 1999).

Since that time, USDA has on four separate occasions held hearings to amend make allowances. In every instance, USDA has updated (increased) the make allowances to reflect more recent cost of production data. As shown by the following excerpts from the Department's decision-making, the Department has without exception continued to apply the same foundational principle: make allowances should reflect the weighted average of actual manufacturing costs:

December 2000:

> As supported by most of the hearing participants, the make allowances incorporated in the component price formulas under the Federal milk orders should cover the costs of most of the processing plants that receive milk pooled under the orders. . . .
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> . . . . [M]anufacturing costs used to determine appropriate make allowances for cheddar cheese, butter and nonfat dry milk in this proceeding are calculated primarily from a weighted average of the RBCS [Rural Business Cooperative Service] and CDFA [California Department of Food and Agriculture] surveys, with a check against the NCI [National Cheese Institute] survey cost of manufacturing cheddar cheese. The cost of manufacturing nonfat dry milk continues to be used as the cost of making whey powder due to the nature of the information in the hearing record about the actual costs of drying whey.

Milk in the Northeast and Other Marketing Areas; Tentative Decision on Proposed Amendments and Opportunity To File Written Exceptions to Tentative Marketing Agreements and to Orders, 65 Fed. Reg. 76,831, 76,839–40 (Dec. 7. 2000).

November 2002:

> As supported by most of the hearing participants, the make allowances incorporated in the component price formulas under the Federal milk

> orders should cover the costs of most of the processing plants that receive milk pooled under the orders. In part, this approach is necessary because pooled handlers must be able to compete with processors whose milk receipts are not priced in regulated markets. The principal reason for this approach, however, is to assure that the market is cleared of reserve milk supplies.
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> This final decision finds that continuing to use an average make allowance of dairy manufacturing plants' costs is appropriate. Reliance on product-price formulas necessitates the need to reflect and to offset the manufacturing costs incurred and is supported by the record even though there is disagreement on exactly how to accomplish this. Using an average make allowance provides a reasonable measure to reflect and offset manufacturing costs and is the only reasonable measure that can be supported by the record evidence.

Milk in the Northeast and Other Marketing Areas; Decision on Proposed Amendments to Tentative Marketing Agreement and To Orders, 67 Fed. Reg. 67905, 67915 (Nov. 7, 2002).

November 2006:

> This tentative final decision proposes to adopt, on an interim final and emergency basis, changes to the manufacturing allowances contained in the Class III and Class IV product price formulas applicable to all Federal milk marketing orders. . . .
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> The price formulas used to compute Class III and Class IV prices contain a factor called a manufacturing (make) allowance. The make allowance factor represents the cost manufacturers incur in making raw milk into one pound of product. . . . The[current] make allowances were last amended in 2003 and were determined on the basis of a California Department of Food and Agriculture (CDFA) and a USDA Rural Business Cooperative Service (RBCS) survey of 1998 manufacturing costs. The current make allowances were computed by taking a weighted average of the CDFA and RBCS surveys and adjusting for return on investment, general and administrative costs and marketing costs.
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> This tentative final decision finds that combining the weighted average manufacturing costs of the [most recent] CDFA survey and CPDMP study for cheese, nonfat dry milk and butter into a single weighted average is appropriate for updating make allowances for those three products. The CPDMP study weighted average manufacturing cost of

> dry whey (without California) should be used for the dry whey make allowance.

Milk in the Northeast and Other Marketing Areas; Tentative Final Decision on Proposed Amendments and Opportunity To File Written Exceptions to Tentative Marketing Agreements and Orders, 71 Federal Register 67,467, 67,469–70, 67,487 (Nov. 22, 2006).

June 2008:

> This tentative final decision adopts on an interim basis, a proposal published in the hearing notice as Proposal 1 which seeks to amend the manufacturing allowances for butter, cheese, nonfat dry milk (NFDM) and dry whey using the most currently available data . . . .
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> The make allowances adopted represent national manufacturing cost averages for cheese, butter, NFDM and dry whey. As found and determined in previous rulemakings on this issue, an estimation of manufacturing costs for national application requires that national production volumes of these commodities be considered in determining the level of make allowances to be relied upon and used in the Class III and Class IV product-pricing formulas.

Milk in the Northeast and Other Marketing Areas; Tentative Partial Final Decision on Proposed Amendments and Opportunity To File Written Exceptions to Tentative Marketing Agreements and Orders, 73 Federal Register 35,305, 35,308, 35,325 (June 20, 2008).

Nearly 15 years have passed since make allowances were last updated. Accurate and up to date make allowances are critical to a properly functioning FMMO program. For Class III (cheese) and Class IV (butter and nonfat dry milk) products, a manufacturer is legally required by the FMMO to pay the farmers supplying it milk the money the manufacturer receives from selling its finished products to customers (as determined by monthly audited surveys of actual finished product prices for the core Class III and IV products), minus the cost incurred in making those products, as set forth in the FMMO regulations (the "make allowance"). As AMS stated when it last revised make allowances in 2008:

> The ability of a manufacturer to offset cost increases are limited by the level of make allowances in the Class III and Class IV price formulas. Manufacturing processors are charged the FMMO minimum price for producer milk used to produce Class III and Class IV products. However, plant manufacturing cost increases may not be recovered because Class III and Class IV product-price formulas use make allowances that are fixed regardless of market conditions and change only by regulatory action.

Id. at 35,323.

The current make allowances were established by USDA based on evidence presented at FMMO hearings held in 2006 and 2007. The evidence presented was based on industry cost data from the periods 2005–2006, the most recent data available at that time. Actual cheese, butter, whey and nonfat dry milk plant manufacturing and related costs have risen significantly in the sixteen years since. However, FMMO regulations strictly prevent these dairy product manufacturers from in any way recovering any portion of those higher costs through higher sales prices or other means.

When USDA implemented the 1996 Farm Bill's directive to reform FMMOs, it fundamentally altered the formulas for establishing the minimum prices which regulated dairy processing plants must pay dairy producers and milk marketing cooperatives for milk used in all dairy products. In doing so, USDA established a fixed relationship between the wholesale price of dairy products used in those formulas and the minimum class prices, with that fixed relationship based on the cost of producing cheese and other manufactured products (the "make allowances"). However, USDA provided no mechanism to adjust that fixed relationship short of conducting a formal rule-making process.

Neither Congress nor USDA intended to threaten the economic viability of the U.S. cheese, butter, nonfat dry milk or whey industries by forcing manufacturers to lose money on every pound of dairy products produced, or potentially injure dairy producers by eliminating these important outlets for farm milk. However, the current system of FMMO regulated price formulas, unlike its predecessor, fixes the difference between the value cheese, butter, whey and nonfat dry milk manufacturers obtain in the marketplace for their products and the minimum price they must pay for the milk used to make those products based on the industry costs as they existed at or before a May 2000 hearing at which the make allowances were established and then modified after a January 2006 hearing and a hearing convened over several month from February through July 2007. Without any mechanism to adjust the make allowances in response to changes in industry costs, manufacturers are trapped into either losing money on every pound of product produced or stopping production entirely.

The method employed following the May 2000 hearing used to establish make allowances used a weighted average (by volume of dairy product production) of two sources of industry cost data. The first was the annual published summary of the industry cost audit conducted by the California Department of Food and Agriculture (“CDFA”). The second was based on the results of a survey of dairy cooperative manufacturing plant costs conducted by the Rural Business Cooperative Service of USDA (“RBCS”). At the 2006 and 2007 hearings, proponents presented updated data from CDFA and RBCS. In addition, proponents introduced evidence provided by Dr. Mark Stephenson from Cornell University who presented a research study conducted by the Cornell Program on Dairy Markets and Policy (“CPDMP”). CPDMP assessed the cost of cheddar cheese, dry whey, butter, and nonfat dry milk.

AMS concluded after the 2006 proceeding that CPDMP presented a more comprehensive set of FMMO costs than RBCS, and AMS declined to further use RCBS. AMS also concluded that combining the CPDMP data with the CDFA data for California plants generally established a superior set of data on which to determine revised make allowances. AMS thus decided to use a single weighted average of milk volumes studied by CDFA and CPDMP for three of the products - cheese, butter and nonfat dry milk plus a fixed marketing cost of $0.0015. As to dry whey, AMS concluded that it would be best to use the CPDMP manufacturing costs plus the same marketing cost of $0.0015. AMS chose not to rely on CDFA study for whey costs due to plant “outliers.” 71 Federal Register 67,467, 67,486 (November 22, 2006).

The cheese, butter, whey and nonfat dry milk manufacturing industries urgently need immediate relief from the highly injurious fixed relationship between output prices and minimum regulated milk prices that do not reflect current industry costs. In the intervening years, RBCS data (that AMS declined to use) has not been collected and disseminated. The California State Order was replaced by the California Federal Order effective November 1, 2018. Nonetheless, CDFA study data of the precise kind relied on in the 2006 and 2007 formal rulemaking proceedings is available through 2016. In addition, AMS requested Dr. Mark Stephenson (formerly at Cornell and then at the University of Wisconsin) to perform a new study using the techniques and methodologies employed by CPDMP. Dr. Stephenson and AMS published the results of that study based mostly on 2018 data on February 14, 2022. *See* Federal Milk Marketing Orders, Agricultural Marketing Service, 2021 Cost of Processing Study, https://www.ams.usda.gov/rules-regulations/moa/dairy (last visited Mar. 27, 2023); Mark Stephenson, *Cost of Processing in Cheese, Whey, Butter and Nonfat Dry Milk Plants* (Dec. 2021), https://dairymarkets.org/cop/Report/2021_COP_Report.pdf. But costs have continued to spiral upwards since 2018.

In 2022, IDFA retained Dr. William Schiek, CEO of the Dairy Institute of California, to analyze and update, the CDFA data from 2006–2016, first by corroborating Dr. Stephenson's AMS commissioned study relying on data through 2018 and then to further updating the CDFA studies through 2022. IDFA and the WCMA have also jointly retained Dr. Stephenson to update his 2018 study data through the most current time period available to him.

This updated data supports and justifies IDFA's Petition here to bring the FMMOs in line with the modern cost data. Specifically, IDFA seeks immediate consideration of the following proposed change in FMMO regulations:

> **Update the make allowances used in all FMMO minimum class price formulas using the most recently available industry cost data.**

IDFA requests that USDA promptly issue a Notice of Hearing on the requested changes in the FMMO class price formulas.

2. Explanation of the Problem

As discussed above, the make allowances currently used throughout the FMMO system for cheese, dry whey, butter and nonfat dry milk were updated, as discussed above, after two hearings held in 2006 and 2007. At that time, industry cost data was available for the years 2005–2006, and this formed the basis of testimony of a number of industry participants. In a decision based on those hearings, USDA fixed the make allowances for cheese, butter and nonfat dry milk by using data from two sources presented at the hearing. The first source was based on actual plant cost audits conducted by the California Department of Food and Agriculture (CDFA). The second source relied on the studies conducted by CPDMP. In both cases, the data came from actual industry costs during the period 2005–2006. The method adopted by USDA was to weight these two data sources by the volume of cheese, butter and nonfat dry milk represented by each data source and add a fixed marketing cost of $0.0015. The method adopted by USDA for dry whey was to rely solely on the CPDMP studies plus the same fixed marketing cost of $0.0015. 71 Fed. Reg. at 67,486.

At the same time, USDA's National Agricultural Statistics Service (NASS) conducts weekly surveys of dairy product transaction prices (cheddar cheese, dry whey, butter and nonfat dry milk) from manufacturing plants across the entire United States. These weekly averages are used to calculate monthly, weighted average prices for these four products. The Department then uses those monthly average prices to determine the minimum component and class prices. In this manner, the FMMO minimum price of farm milk changes in conformity with changes in the wholesale prices of the manufactured dairy products in the market. While those prices thus adjust constantly, cheese, butter, whey and nonfat dry milk manufacturers on the cost side are trapped in a 16-year-old cost structure that fails to account for the significant cost increases.

As noted above, the manufacturing cost allowances presently in place throughout the FMMO system for these products are based upon cost data from surveys and data dating to 2005 and 2006. Manufacturing costs for all dairy products have soared significantly in the intervening 16 years. Even a layperson is abundantly aware of the unprecedented increase in costs for business operations during the recent years. It would be incorrect, and in fact unreasonable, to assume that somehow technology or other efficiency improvements at plants have somehow offset these escalating costs.

As correctly recounted by Agri-Mark in its 2005 submission to AMS:

> Dairy product manufacturers under Federal Milk Orders are trapped into a fixed make allowance with no opportunity to cover their higher costs no matter what the price of their dairy products are. If manufacturers raise their product prices to cover higher costs, those higher prices automatically lead to higher milk prices, leaving no additional net income to apply to the higher costs.

Letter from Robert D. Wellington, Sr. Vice President for Econ., Commc'ns & Legis. Affairs, Agri-Mark Dairy Coop., to Dana Coale, Deputy Adm'r, Dairy Programs, USDA Agric. Marketing Serv. (Sept. 29, 2005) at 3, https://www.ams.usda.gov/sites/default/files/media/DYClassIIIIVMakeAllowancesAgriMarkReq.pdf.

Despite the significant cost increases, FMMO provisions have effectively stopped manufacturers from covering these higher costs through higher sales prices or other means. The amount of time that has elapsed since the last hearing and rulemaking on these pricing formulas is almost twice as long as the interval from AMS first establishing formula prices in Federal Order Reform in 2000 and the updates adopted in 2007 and late 2008 based upon 2005 and 2006 data. Industry faced an emergency then and faces and even greater emergency now.

AMS retained Dr. Mark Stephenson to conduct an updated survey of Class III and IV plant costs. That study was published by AMS last February and is based mostly on 2018 data. This study confirms enormous cost increases since the current allowances were set (note that Dr. Stephenson allocated energy costs between butter and nonfat dry milk differently than by CDFA or CPDMP; IDFA proposes to account and adjust for that at any hearing as it concludes that nonfat dry milk costs are overstated while butter costs are understated):

	Current Make Allowances	Stephenson Study 2018 Costs
Cheese	$0.2003	$0.2491
Butter	$0.1717	$0.1426
Whey	$0.1991	$0.2665

Nonfat Dry Milk	$0.1678	$0.2948

In the intervening time since 2018, significant additional cost increases have occurred. IDFA proposes that in considering the need for a hearing (and at the hearing as submitted evidence) USDA take into account, in addition to Dr. Stephenson's study, an updated cost study by Dr. William Schiek, CEO of the Dairy Institute of California, previously presented to USDA in November 2022. This hearing request provides in summary Dr. Schiek's most current projections, based on CDFA studies and updated with indices, that encompass 2022:

Cheese	$0.3021
Whey	$0.2968
Butter	$0.2379
NFDM	$0.2668

At the hearing, IDFA will also ask USDA to consider and take into account an updated version of the USDA-commissioned study "Cost of Processing Study for Cheese, Whey, Butter and Nonfat Dry Milk Plants" released by Dr. Stephenson in early 2022. The Wisconsin Cheese Maskers Association and the International Dairy Foods Association have commissioned Dr. Stephenson to update his study with 2022–2023 data. IDFA will also provide testimony and support for accounting for Dr. Stephenson's allocation of costs between butter and nonfat dry milk in order to adjust it to prior practice.

The existing use of fixed out-of-date make allowances is a major problem for all dairy product manufacturers producing cheese, butter, whey and nonfat dry milk. These everyday losses are impossible to sustain. IDFA members include both farmer owned cooperatives many of whom are routinely returning dairy farmer payments with significant deductions from FMMO uniform minimum prices because of these losses. Proprietary members of IDFA are also absorbing losses, attempting to sell specialty cheeses at prices designed to mitigate losses, and/or otherwise failing to invest in plants and facilities. In fact, investments in plants overall are stagnant. This is not sustainable for the plants, nor for dairy farmers who depend on these plants as outlets for their raw milk.

In January, 2023, CoBank Cooperative, one of the largest private providers of credit to the rural economy, acknowledged the need to update make allowances in in their Knowledge Exchange publication, "Updating Make Allowances is Central to the Future of Federal Milk Marketing Orders," which is posted in the Knowledge Exchange section of the CoBank website. https://www.cobank.com/knowledge-exchange/dairy/updating-make-allowances-is-central-to-the-future-of-federal-milk-marketing-orders

Noting that "make allowances were last updated in 2008 and were based on data from as far back as 2006", the CoBank publication cited several federal statistics on cost increases. "Labor costs in dairy product manufacturing climbed 48% per unit of production, according to the U.S. Bureau of Labor Statistics. From 2006 to 2022, the industrial rate prices for electricity rose 64%.

The CoBank publication concluded that "Cost structures among handlers will continue to change over time, requiring future adjustments in make allowances. While updating make allowances does not guarantee more investment in new processing assets with every handler, not updating them may result in lost growth opportunities for the dairy industry over the long term."

IDFA understands and appreciates the concerns of our members' dairy farmer patrons for whom increased make allowances mean lower regulated minimum prices. However, the loss of significant plant capacity and the resulting loss of competition will mean greater pain for everyone, including especially dairy farmers. Such losses of plant capacity would certainly result in disorderly marketing conditions that FMMOs are designed to alleviate not exacerbate. IDFA cooperative members and other dairy product manufacturers that serve as nearby outlets for local dairy farmer milk and as balancers of billions of pounds of FMMO milk cannot come close to covering their costs under current FMMO provisions. As AMS itself explained when it last increased make allowances in 2008:

> Opponents of increasing make allowances argue a number of points—that they are already set at too high a level, that dairy farmer production costs also have increased significantly due to higher energy and feed costs, that processors should look beyond asking dairy farmers to receive less for their milk by charging more for manufactured products, and that make allowance increases should be made only when all dairy farmer production costs are captured in their milk pay price. These are not valid arguments for opposing how make allowances should be determined or what levels make allowances need to be in the Class III and Class IV product-pricing formulas. The record demonstrates that current make allowance levels are not reflective of the costs manufacturers incur in processing raw milk into the finished products of cheese, butter, NFDM and dry whey.
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> Additionally, the Class III and Class IV product-price formulas establish derived classified prices for producer milk that are used nationally in all Federal milk orders. When dairy farmer production costs exceed the value for which products are sold in the marketplace, no source of revenue from the marketplace is available to cover those costs.
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> In the aggregate, the costs of producing milk are reflected in the supply and demand conditions for the dairy products. When the supply of milk is insufficient to meet the demand for Class III and Class IV products, the prices for these products increase as do regulated minimum milk prices paid to dairy farmers because the milk is more valuable and this greater milk value is captured in the pricing formulas. Dairy farmers face no regulatory minimums in their costs and face no regulated minimum payment obligation in the way that regulated handlers must pay dairy farmers for milk.

73 Fed. Reg. at 35,324.

IDFA is aware and supportive of USDA and industry efforts for USDA itself to have the authority and funding to conduct regular, audited dairy product cost studies. A long-term solution would be to have such studies efficiently used to update Section 50 make allowances on a regular basis. However, this requires Congressional action both to authorize and fund the audits. It will likely then take at least another year or two, if not longer, after (not yet introduced, must less passed) legislation before such information can be available. Following that approval is the long hearing process before a solution can be implemented. The dairy manufacturing industry cannot wait for that data to become available, be debated by the industry, and initiate a lengthy hearing and decision process which considers all aspects of the Class III and IV FMMO price formulas. These 16 years of dated manufacturing allowances must be updated immediately using the best available means.

CONCLUSION

Current manufacturing allowances are well below the actual costs involved in manufacturing cheese, whey powder, butter, and nonfat dry milk powder. Every day that goes by means losses on the part of manufacturers who provide outlets for billions of pounds of Federal Order milk production as well as balancing services to their respective Orders. We clearly need this proposal considered on promptly to address these serious economic problems.

IDFA member companies and other dairy product manufacturers regulated by FMMOs are trapped by a fixed make allowance in combination with a surveyed commodity price, leaving no opportunity to cover their higher costs. If manufacturers raise their product prices to cover higher costs, those higher prices automatically lead to higher minimum component and class prices. IDFA's proposal is very straightforward and can be accommodated through a very short hearing. The proposed method for determining make allowances is identical to that supported by most dairy producer groups during prior hearings, and adopted by the Department. IDFA is not proposing to reconsider or change the methodology used to set minimum prices, or the FMMO formulas, or the data sources used in those formulas. IDFA only proposes to update the formulas by using the most currently available make allowance data from the same sources previously utilized.

IDFA urges that USDA hold a hearing as soon as possible and move expeditiously to a decision.

Respectively Submitted,

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