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April 13, 2023

The Honorable Thomas J. Vilsack, Secretary
U.S. Department of Agriculture
200A Whitten Building
1400 Independence Avenue, S.W.
Washington, D.C. 20250

RE: Petitions received by USDA for FMMO Hearing on Make Allowances

Dear Secretary Vilsack,

As a grassroots producer-led organization, American Dairy Coalition has been engaged in consensus-building, seeking to work with all sectors of the industry, engaging dairy farmers, and making sure they have a voice in issues such as Federal Milk Marketing Order changes.

In our July 2022 correspondence with you and your department about a hearing on the Class I pricing change that was implemented in May 2019, we understand and appreciate the consensus you wish to see. In that regard, our understanding has been that a future FMMO hearing would likely be comprehensive and not limited to only the Class I pricing formula.

Today, we write because we are specifically concerned about how you will handle the recent petitions from the International Dairy Foods Association (IDFA) and Wisconsin Cheese Makers Association (WCMA). These petitions seek a hearing limited to updating make allowances based on voluntary cost surveys.

According to its petition, IDFA states that, "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."

We do not share this opinion, and we see others objecting also. We want you to know that aside from NMPF and IDFA, dairy farmers also have a position. In our role as a grassroots dairy farmer organization, we do not support a hearing in which the scope is limited to only updating make allowances. We also do not support make allowance updates that are based on voluntary surveys that may exclude important and relevant data.

Where do we see consensus? In October 2022, the American Farm Bureau held a dairy stakeholder forum in Kansas City, with participation of geographically diverse dairy farmers and representatives from the cooperative and processing sectors. At this forum, one item achieved unanimous consensus: *Return the Class I mover to a 'higher of' formula.*

Two other items achieved majority support: *Increase Class I differentials to reflect changes in the marketplace;* and *<u>Increase transparency</u> in relation to the make allowances by making processing cost surveys of plants <u>mandatory and audited</u>.*

It is clear that a comprehensive hearing is needed to ensure equity in the examination of federal milk pricing. Dairy farmers cannot take another hit to their milk checks while their costs are also rising -- costs that are not included in the FMMO milk pricing equations.

As indicated, we have worked diligently for the past three years to engage dairy farmers and the industry in seeking a hearing to evaluate the Class I mover change and/or to go back to a 'higher of' formula. The change to an averaging method was made legislatively without a hearing and without a producer referendum. The legislative language gave USDA discretion to conduct a hearing about the change after two years of implementation.

It has now been four years, and during that time, the change negatively and inequitably impacted dairy farmers with a cumulative net loss of over $900 million in Class I value, alone. The current formula places asymmetric risk on dairy farmers, whose milk checks are often at the whim of processor pooling decisions. This affects how risk management tools work in divergent markets.

We've learned through this example that a one-shot-deal to tweak FMMOs ends up harming dairy farmers. In the Class I example, farmers were assured the change would be 'revenue-neutral' and would 'increase industry investments.' The result of the change was not revenue-neutral, and farmers are paying the cost of 'progress' instead of sharing the burden and risk.

On the investment side, we saw a huge turnover in Class I milk processing assets through pre-pandemic bankruptcies of the fluid milk sector's largest bottlers within the first 6 to 8 months of the Class I pricing change. An unprecedented number of milk plant closures have followed.

Our dairy producers are concerned that another one-shot-deal -- this time to update make allowances -- has the potential to take additional value from their net milk checks. Meanwhile, there are no safeguards to prevent milk buyers from continuing to cover their costs directly from farm milk checks by continuing to erase quality and other premiums and to deduct 'balancing fees,' 'marketing adjustments,' fuel surcharges, and other means.

IDFA's petition for a hearing cites a CoBank report in its rationale. This report talks about how dairy processing cost structures will continue to change. It suggests that if make allowances are not updated, market access could be lost, and future growth opportunities jeopardized. At the same time, the report states that "raising make allowances does not guarantee more investment in new processing assets with every handler."

The CoBank report acknowledges that, **"The first effect of increasing make allowances would be to lower prices paid to farmers, reducing the industry's vulnerability to international competitors and export market access that offers important long-term benefits."**

ADC questions why the FMMO minimum pricing system should be used to draw funds from farmers to subsidize milk processing capacity growth. We question why farmers should have revenue cuts to "reduce vulnerability to international competitors." These are long-term industry outcomes that fall outside of the defined purpose of the FMMOs and outside of what the make allowances are designed to do.

According to USDA, make allowances are designed to cover the costs of taking raw milk and converting it into the four basic products -- just those products from which the component value is captured in the end-product pricing formulas.

In fact, milk component pricing that is credited with make allowances only captures the value of about 10% of milk sales today. This figure has been cited by at least two economists. The only products that are included in the circular end-product pricing formulas are:

1) Bulk cheddar *(currently excludes bulk mozzarella and excludes specialty cheeses),*
2) Bulk butter *(currently excludes the now high-volume sales of unsalted bulk butter),*
3) Nonfat dry milk *(currently excludes the more uniform, higher quality, higher value, globally traded skim milk powder and other milk powders)*, and
4) Dry whey *(currently excludes significant sales of whey protein concentrate, a globally traded product).*

We understand that USDA does not have rulemaking authority to include any of the non-formula bulk products that are noted in parentheses above within its weekly National Dairy Product Sales Report (NDPSR). That is, unless these products are included in the end-product pricing formulas. The current legislative language of the Livestock Mandatory Reporting Act limits dairy price reporting to a weekly survey of prices for the end-products in the FMMO pricing formulas.

This means the products accounting for up to 90% of milk sales do not have their value captured in the NDPSR even for informational purposes, let alone for use in the end-product pricing formulas. The component price credit, or make allowance, is therefore moot for up to 90% of the milk market.

This includes the way milk component processor credits (make allowances) for Class III and IV products continue to impact the Class I mover. At current levels, this amounts to $2.17 to $3.17 per hundredweight as an embedded reduction, even though processors of Class I (and Class II) products do not incur the costs of making cheese, butter, NFDM or dry whey.

Perhaps it is time for Class I processor costs to also be surveyed to look at how to allocate capital to improve Class I marketing and infrastructure. The sustainability of the FMMO system is predicated on Class I. This is the only class of milk that is obligated to participate in the FMMO revenue-sharing pools.

We also know from Pennsylvania Milk Marketing Board data and Southeast sources that the cost to balance the Class I market is around $1.00 per hundredweight, which is currently borne by dairy farmers through milk check deductions and loss of premiums. Retailers across much of the U.S. use milk as a loss-leader and will not pay over-order premiums.

We understand dairy processors have seen their costs increase since make allowances were last updated. However, at the same time, there has been a big increase in the number and volume of non-formula products, in some cases made at plants that also make in-formula products.

Processors have the flexibility to offset costs for the additional sales opportunities these non-formula products represent without having the increased value they extract from consumers captured and used in the FMMO formulas that establish the minimum prices paid to farmers.

Voluntary cost surveys to update make allowances should not be continued. ADC is concerned about the data that could be excluded by more efficient plants choosing not to be surveyed. We are also concerned about the inclusion of "return on investment" in one of the cited surveys used in one of the petitions. If hearings are conducted to adjust make allowances, the amount of any adjustment must be based on *mandatory* cost surveys. These surveys must also indicate how costs and overhead to make non-formula products are excluded from costs to make in-formula products.

Additionally, ADC believes expanded price reporting is necessary before a decision is made concerning future make allowance updates. Congress has a role to play here, to authorize price reporting for informational purposes. The beef industry has a boxed beef cutout value published daily to show the wholesale value of all beef cuts from a beef carcass. We do not seek price-reporting of every product made from a hundredweight of milk. However, we believe it is reasonable to include additional bulk dairy products, for informational purposes, in the weekly NDPSR.

Farmers have waited several years without any movement by USDA to have a hearing to examine the Class I mover change. Meanwhile, farmers have been negatively impacted, and FMMO participation has dropped to just 60% of U.S. milk production. It would be regrettable to see a hearing move forward that is limited to only updating make allowances while farmers' concerns on the Class I mover and other issues are ignored.

As the industry changes and as risk management tools are promoted by USDA, farmers must have confidence that these tools will perform as intended when they need them most. Their confidence in these tools has already been reduced by the dysfunctional class price alignments that have increased since the Class I pricing change was made.

Farmers overwhelmingly support the FMMO system, knowing there is no substitute available for oversight and transparency. However, farmers must have confidence that the FMMO system is equitable and that it is not going to be used to extract additional funds to achieve industry goals outside of the system's purpose.

We look forward to a future comprehensive hearing, not one in which the scope is limited to updating make allowances based on voluntary surveys.

Thank you for your consideration,

Best regards,

Laurie Fischer, CEO, American Dairy Coalition
cc Bruce Summers