NAJ

National All-Jersey Inc.

UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

Re: Proposal to Establish a Federal Milk Marketing Order for California

Docket No. AO-15-0071

Hearing in Clovis and Fresno, California

September – November 2015

Post-Hearing Brief for National All-Jersey Inc.

National All-Jersey Inc. (NAJ) is a national membership organization of over 1,000 milk producers, including nearly 100 members in California, and other people interested in supporting equitable milk pricing. Approximately 20 percent of NAJ members own dairy cattle other than Jerseys. NAJ's milk marketing policy is to advocate for milk pricing programs that will price milk based on its most valuable components in accordance with their use in consumer products. NAJ provided testimony and supporting documentation during the hearing held in Clovis and Fresno, California.

FMMO Pricing

NAJ's testimony (Exhibit 81) outlined the advantages to the California dairy industry from Federal Milk Marketing Order (FMMO)-style pricing because FMMOs price protein and other solids separately. The existing state milk marketing order administered by the California Department of Food and Agriculture (CDFA) combines the value of protein and other solids into payment for solids nonfat (SNF). Payment for SNF implies that protein and other solids have the same value when they clearly do not. From 2009 to 2014, FMMO monthly protein prices averaged $2.94 per pound, other solids averaged $0.31 per pound and SNF prices averaged $1.22 per pound (Exhibit 82, table 9). Clearly, valuing protein at $2.94 per pound instead of the SNF value of $1.22 per pound sends a much stronger signal to the industry, and to producers in particular, to emphasize protein production.

Furthermore, NAJ's testimony showed the importance of protein to the California dairy industry. The vast majority of California's milk solids are used to manufacture milk powders (California Class 4a) as well as cheese and whey products (California Class 4b) (Exhibit 82, table 2). Production of skim milk powder and whole milk powder, which are protein-standardized, is increasing (Exhibit 82, tables 5 and

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6). Yields of skim milk powder and whole milk powder are positively impacted by higher levels of protein in producer milk (Exhibit 82, table 7). Higher protein milk not only increases cheese yields, but also results in higher protein whey (Exhibit 82, table 3). Production of whey protein concentrates and whey protein isolates, which are protein-standardized, is also increasing (Exhibit 82, table 4). Higher protein milk also results in less fortification required for fluid milk to meet California's SNF standards (Exhibit 82, table 8), thus lowering the amount of fortification allowance credited to processors before pooled receipts are paid to producers.

Producer Price Differential

Exhibit 30, pages 19 and 20, outlines the Cooperatives' proposal to eliminate the standard Producer Price Differential (PPD) payment to producers on a per hundredweight basis. In place of the PPD, the Cooperatives' propose to adjust producer component values for protein, butterfat and other solids in proportion to the components' relative contribution to the Class III price the previous fiscal year, defined as December 1 through November 30. Months with positive PPDs will have producer component values increased, and months with negative PPDs will have producer component values decreased. Three reasons are cited for having the California PPD be different than the other FMMOs utilizing multiple component pricing.

1. Producers find the concept of PPDs confusing.
2. Negative PPDs are even more difficult to explain to producers.
3. Because the existing state order does not incorporate a PPD, eliminating the PPD from a California FMMO will result in one less pricing complexity to explain to producers should a FMMO be implemented in the state.

However, the Cooperatives' PPD proposal adds confusion to the concept of PPDs instead of reducing it. First, a traditional, per-hundredweight PPD will be calculated and announced each month (Wegner, tr. 1676 and tr. 1710), but won't be paid to producers on a per hundredweight basis. Following the calculation of the traditional per-hundredweight PPD, four additional calculations are needed.

1. Annually determining the proportional Class III value for each component (protein, butterfat and other solids).
2. Combining the gross PPD dollars available to the pool each month with the annual per-component adjustment factors to determine the total PPD dollars to be assigned to each component (protein, butterfat and other solids).

3. Each month dividing the total PPD dollars assigned to each component (protein, butterfat and other solids) by the total pooled pounds of protein, butterfat and other solids to determine that month's per pound price adjustment for each component.

4. Adding (or subtracting) the monthly per pound component adjustments to (or from) the announced FMMO component values for protein, butterfat and other solids to determine the California producer pay price for protein, butterfat and other solids.

The four additional steps in the PPD calculation add exponentially to the complexity of explaining PPDs to producers. In addition, because the end result will be producer component values that are different than the component values announced and paid in other FMMOs, NAJ's expects producers will soon question and be confused as to why they are being paid different values for their components than producers in other FMMOs.

Exhibit 35, page 8 includes an example of computing a single month's PPD using the Cooperatives' proposal. However, none of the Cooperatives' witnesses provided a multi-month or multi-year analysis of the potential impact of their modified PPD proposal. Exhibit 82, Table 9, entered into the hearing record by NAJ, is a monthly PPD approximation analysis for the years 2009 to 2014. This analysis determined that the Order's PPD would have been negative for 43 out of the 72 months during that six-year period. The monthly average PPD would have been -$0.27/cwt. The results of this analysis lead NAJ to two additional objections to the Cooperatives' PPD proposal.

1. Because PPDs will typically be negative for a California FMMO, the Cooperatives' PPD proposal will negatively impact producer component values, thus dis-incentivizing production of components. Because protein is typically the most valuable milk component (Exhibit 82, Table 9), protein will be assigned the largest negative PPD value. NAJ, as part of both its testimony and this brief, has outlined the importance of protein to the California dairy industry. A process that will assign the largest negative value, and thus the greatest 'negative production incentive', to milk's most valuable component flies in the face of economic logic. If FMMO-style pricing is adopted by California, producers will be incentivized to produce protein. To negate that incentive by applying a negative PPD value to protein will be counterproductive.

2. Because PPDs are projected to be negative nearly 60 percent of the months, the Cooperatives' proposal will result in producer component values to be reduced the same proportion of months. By assigning PPD values to component values, producers with higher than average components will be assessed a greater negative PPD value than producers with average or

below average components (Wegner, tr. 1719). In fact, NAJ's analysis (Exhibit 82, table 9) showed that herds with component levels two standard deviations higher than average component levels would have been assessed an average PPD of -$0.31/cwt., which is a $0.04/cwt. greater deduction than for producers with average components. Conversely, producers with milk components two standard deviations less than average would have only been assessed an average PPD of -$0.23/cwt., or a $0.04/cwt. less deduction than producers with average components. The Cooperatives' PPD proposal will result in producer milk highest in components, and therefore providing the greatest value to the California dairy industry and to the individual producer, being assessed the largest deduction from the Order's projected negative PPDs. Therefore, the milk which provides the California dairy industry with its greatest value will be assigned the largest PPD cost, while milk with the lowest value will be assigned the least PPD cost. Such a system runs counter to providing producers economic signals to produce milk components with the greatest value to the market.

Mandatory Pooling

NAJ also opposes the Cooperatives' proposal that all California plants be categorized as pool plants, also known as mandatory pooling. Such a provision has not been implemented and is not needed in other FMMOs. Because PPDs are positive the vast majority of the time, manufacturing plants are drawn to pool their milk in order to share in the Order's PPD. On the rare occasions that PPDs are negative, other FMMOs discourage manufacturing plants from depooling their milk through provisions that limit how much milk can be re-associated (repooled) with the Order in subsequent months.

NAJ's PPD analysis estimated that PPDs in a California FMMO would have been negative most months between 2009 and 2014. Therefore, manufacturing milk would have little, if any, incentive to be pooled. Further examination of the PPD analysis shows the most significant root cause of the negative PPDs. According to CDFA data, the monthly value of California's producer quota program averaged slightly more than $11,600,000 (Exhibit 82, table 9, column "Quota net RQA"). The monthly average of the PPD values was approximately -$8,800,000. If California did not have producer quota value, which will be paid from pooled receipts before calculating the pool's uniform price, its projected PPDs would, on average, be positive, as they are in other FMMOs. Essentially, the Cooperatives' proposal asks for mandatory pooling of manufacturing milk, which does not exist in any other FMMO, in order to pay for producer quota value, which also does not exist in any other FMMO.

CDFA requires mandatory pooling of California Grade A milk. The hearing record included witnesses testifying (DeJong, tr. 4390-4391, and others) that there have been times when surplus California milk has not been able to find a processor in the state willing to buy the milk at CDFA-stipulated minimum prices. Therefore, the surplus milk had to be sold to calf ranches to feed calves, dumped, or transported out of state where manufacturing plants could pay below FMMO Class prices for milk. Milk hauled out of state incurred significant transportation costs. One of the primary drivers behind the Cooperatives' proposal to promulgate a FMMO in California is to increase milk prices because FMMO regulated minimum prices are almost always higher than CDFA regulated minimum prices (Exhibits 19 and 20). However, combining higher FMMO regulated prices with mandatory pooling leads to the logical conclusion that times when surplus California milk will not be able to find a willing California manufacturing plant will become more frequent. As noted previously, the most likely options for surplus milk is for it to be dumped, used for animal feed or transported out of state. All three options fit the definition of disorderly marketing.

Finally, in FMMOs, producers can choose to sell their milk to a plant that is not regulated, and, therefore, not participate in the regulated revenue pool. The Cooperatives' proposal denies producers in California that choice. If all plants that purchase milk are required to be pooled, there is no non-pool marketing option for producers.

Class III and IV Prices for California

The proposal from the Dairy Institute of California included a request that if a FMMO is recommended for California, its price formulas for Class III and IV milk be based only on commodity prices received by Western manufacturing plants instead of the National Dairy Products Sales Report, which is used by all other FMMOs. As stated in testimony, NAJ opposes this request. Having different price formulas in different Orders can and does lead to disorderly marketing. Currently FMMOs, 5, 6 and 7 price milk on a fat-skim basis while the surrounding Orders employ multiple component pricing. High and low component milk moves between the Orders due to regulatory incentives and not market need, and at the expense of market efficiency. While the issue of Western regional milk pricing may be worthy of consideration, those deliberations should include the FMMOs in proximity to California, and perhaps all FMMOs before individualized pricing is implemented in a single Order. Should the Secretary recommend a FMMO for California which includes Class III and IV price formulas specific to the Order,

NAJ suggests a delay in implementation of a Final Order until USDA can convene a national hearing covering the other Orders to afford them the same consideration granted to California.

Conclusions

The California dairy industry would benefit from pricing protein and other solids separately as is done in the FMMOs instead of pricing them together as solids nonfat as is done by CDFA. However, NAJ urges the Secretary to reject the Cooperatives' PPD proposal as it will, in most months, reduce producer component prices, thus muting the economic signal to produce components. NAJ also urges the Secretary to reject the Cooperatives' proposal for mandatory pooling as it will lead to increased disorderly marketing in times of surplus milk. Finally, NAJ opposes the Dairy Institute of California's proposal to establish unique price formulas for a California FMMO. If there is merit to regionalized milk prices, the process should include deliberation of all FMMOs via a national hearing and not to establish separate price formulas for a single Order.