UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE

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In the Matter of: Milk in the Northeast and Other Marketing Areas	Docket No. 23-J-0067 AMS-DA-23-0031

POST -HEARING BRIEF SUBMITTED ON BEHALF OF EDGE DAIRY FARMER COOPERATIVE

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Post-Hearing Brief of the Edge Dairy Farmer Cooperative

Edge Dairy Farmer Cooperative ("Edge") hereby submits its post-hearing brief in the above-captioned proceeding. Edge is an association that represents the interests of over 800 dairy farmers. All our members ship to privately owned processing plants. In 2023, our members produced 16 billion pounds of milk, which makes Edge the third largest cooperative in the country.[1] Edge maintains a unique position as a non-manufacturing cooperative of farmers who, when pooled, must live by the minimum pricing and other factors without exclusion or opportunity to "reblend."

Edge participated in this hearing with the objective of addressing disorderly marketing that led to the hearing. We believe that the U.S. Department of Agriculture's ("USDA's") recommendation should adhere to the following principles as it compares proposals and decides adjustments across all marketing orders:

- U.S. dairy sector is characterized by free entry and exit. It is not possible to permanently enhance dairy farm profitability through regulation and administrative actions. However, public policy measures can introduce distortions which create regional winners and losers among producers and processors. Policy changes should be restrained to those minimally necessary to maintain effective price discovery, orderly marketing, and ensure safe and sufficient supply of beverage milk.
- Negative "producer price differentials" ("PPDs") are a symptom and manifestation of disorderly marketing. Class I milk pricing should be reformed to minimize incidence and magnitude of negative PPDs.

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[1] *See* Madison Sifford, *Top 50 co-ops remain fairly consistent*, Hoard's Dairyman (Sept. 25, 2023) (including self-reported 2022 data from dairy cooperatives).

- Risk management effectiveness can be substantially reduced through regulatory uncertainty and misalignment of actual milk component tests and standards used for classified pricing.

Edge's Accepted Proposals

Edge submitted two accepted and two logical outgrowth proposals in four of the five areas initiated through the hearing. The two logical outgrowth proposals were accepted by the Administrative Law Judge at the hearing without opposition by USDA or other proponents. All proposals that Edge presented contribute to our aim to improve price discovery of all classes of milk, eliminate negative PPDs, and maintain and/or improve risk management opportunities.

I. ADJUSTING THE STANDARD BUTTERFAT TEST IS A LOGICAL OUTGROWTH OF ACCEPTED PROPOSALS #1 AND #2.

A. USDA Can Consider Adjustments to Submitted Proposals to the Extent That Such Adjustment Is a Logical Outgrowth of the Initial Proposal.

It is a well understood principle, that Federal Milk Marketing Order hearings are an opportunity for USDA "to receive evidence with respect to the economic and marketing conditions related to the proposed amendments" as well as obtain information regarding "appropriate modifications" to make to the orders. *See* 88 Fed. Reg. 47396 (Jul. 24, 2023). The hearing process is an opportunity for USDA to hear from all interested parties on the benefits or drawbacks of a certain proposal and determine appropriate modifications to the proposals prior to issuing final revisions and initiating the referendum process. *See Alto Dairy v. Veneman,* 336 F. 3d 560, 569-70 (7th Cir. 2003); *Walmsley v. Block*, 719 F. 2d 1414, 1418 (8th Cir. 1983). Put succinctly,

> The purpose of a rulemaking proceeding is not merely to vote up or down the specific proposals advanced before the proceeding begins, but to refine, modify and

supplement the proposals in light of evidence and arguments presented in the course of proceedings.

Alto Dairy, 336 F.3d at 569.

However, the modifications to proposals are not unlimited and must reflect a "logical outgrowth" of the original proposal. *See id.; Brennan v. Dickson,* 45 F.4th 48, 69-70 (2022). The initial inquiry in applying a logical outgrowth is whether the agency provided "interested parties to the possibility of the agency adopting a rule different than the one proposed." *Sprint Corp. v. FCC*, 315 F. 3d 369 (D.C. Cir. 2003). Undoubtedly, USDA placed all parties on notice that it would make modifications to the proposals under consideration. Specifically, the Agricultural Marketing Service ("AMS") submitted its own proposal (Proposal 22), which stated it was to "make such changes as may be necessary to make the respective marketing orders conform with any amendments thereto that may result from this hearing." *See* 88 Fed. Reg. at 47399. Failure to permit such logical and related modifications would not permit the agency to learn from the hearing process and require the starting a new procedural round of hearings. *See Chocolate Manufacturers Ass'n v. Block*, 755 F.2d 1098 (4th Cir. 1985) (citing *International Harvester Co. v. Ruckelshaus*, 478 F.2d 615, 632 n. 51 (D.C. Cir. 1973)).

B. If Proposal 1 Is Adopted, USDA Must Also Adjust the Standard Butterfat Test.

Proposal 1 by NMPF introduces a protocol for updating standard protein, other solids, and nonfat solids tests for the purpose of deriving class milk prices. These proposed modifications reasonably reflect the changes to the U.S. dairy herd composition and genetics. However, the proposal is incomplete, as it ignores the steady increase in butterfat tests.

The change to butterfat tests would not have any effect on net handler obligations to the producer settlement fund, nor PPDs, or uniform prices. However, to proceed ignoring the upward trend in butterfat tests would complicate risk management practices. When producers wish to stabilize their milk revenue, they typically use Chicago Mercantile Exchange ("CME Group") futures and options, or USDA programs such as Dairy Revenue Protection and Livestock Gross Margin for Dairy Cattle. The update in Proposal 1 by NMPF would result in a butterfat to protein ratio of 1.08 – down from the current ratio of 1.17. If standard butterfat tests are not increased at the same time as protein and other solids tests, then when producers hedge their milk revenue using products that are based on Class III milk or Class IV milk prices, they will tend to be under protected against a decline in butterfat prices.

Accepting Proposal 1 without also adjusting the butterfat factor would cause more disorderly marketing of milk as it works against the goals of effective risk management for dairy farmers. Similarly, accepting Proposal 2 rather than Proposal 1 would have similar effects, however Edge finds Proposal 1 to be more comprehensive and favorable to price discovery and risk management for more dairy farmers. Under these circumstances, maintaining the status quo with the butterfat test, and only applying the proposed changes to protein, solids, and nonfat solids tests, is an appropriate modification that follows logically from the initial proposal.

As such, Edge respectfully requests the Secretary to apply the same methodology by updating all milk components, not just protein, other solids and nonfat solids, but also butterfat.

II. BARREL CHEDDAR CHEESE PRICES SHOULD CONTINUE TO BE USED IN DERIVING THE PROTEIN PRICE, WITH APPROPRIATE REDUCTION IN IMPORTANCE OF BARREL PRICES.

Proposals 3 and 4 suggest different ways to update or adjust the inclusion of blocks, barrels and other items in setting the protein price formula. In our opinion, barrel cheddar cheese currently has an influence on the protein pricing formula that is not commensurate with the share of barrel versus block cheddar cheese production. Thus, reform is merited.

However, rather than fully eliminating barrels – which we believe represent one-third of cheddar cheese production – or adding a 640-pound block which can add basis risk, we suggest a novel method that would likely result in an appropriately reduced barrel cheese weight in determining the monthly protein price. The implementation has three steps. First, expand the scope of the National Dairy Products Sales Report ("NDPSR") survey to capture all barrel cheddar cheese produced in the U.S., including forward priced barrel cheese. Second, based on information contained in the USDA National Agricultural Statistical Service ("NASS") Dairy Products report, determine the ratio of barrel cheddar cheese pounds reported in NDPSR to total U.S. cheddar cheese production reported by NASS, and round it to the nearest five percent (5%) for use in the protein price formula. Third, to support risk management practices, make the relative weights of block and barrel predictable far into the future. Consistent within our proposals, Edge suggests a consistent yearly cycle of a September 15 calculation for use 15.5 months later. For example, AMS should announce NDPSR 500-pound barrel cheese pricing weight percentage for calendar year 2027 no later than September 15, 2025.

Edge believes that USDA should continue use of barrel cheese prices to determine the protein price as necessary, but with a deemphasis on barrel cheese prices compared to block cheddar prices.

III. MAKE ALLOWANCES SHOULD BE BASED ON MANUFACTURING PLANTS AT THE TECHNOLOGICAL FRONTIER.

Edge cautions against unwarranted and excessive increases in the make allowances. Dairy manufacturing plants across the nation differ widely in their size, efficiency, and technology. In our opinion, some of those differences are driven by capital allocation decisions. Some manufacturers have decided to reinvest and modernize their plants, while others have prioritized social safety net expenses, such as subsidized hauling charges, or job security for staff. The purpose of make allowances is to determine a fair price for milk components given freely established wholesale prices for undifferentiated bulk dairy commodities. Such a formula should reflect the technological frontier, not the decisions of some manufacturers to forgo modernization of their facilities. Setting make allowances based on the technological frontier is only possible once USDA conducts a mandatory survey of manufacturing costs. In absence of such a survey, USDA should err on the side of caution and not adjust make allowances to such degree as to provoke subsidized production of commodity products in areas where such production would not otherwise make sense.

IV. CLASS I MILK PRICING SHOULD NOT INTERFERE WITH RISK MANAGEMENT NOR INCREASE BEVERAGE MILK PRICES BEYOND NECESSARY LEVELS.

Various arguments were put forward by dairy producer interests regarding Class I pricing. Edge is left with the impression that the ultimate, unstated objective of several Class I pricing proposals is simply to maximize the aggregate handler obligations to FMMOs for Class I milk, so that the additional revenue can be used to offset the negative impact of increase in make allowances to milk checks. To make the decision regarding Class I pricing that best balances the interest of

U.S. taxpayers, beverage milk consumers, milk processors and dairy farmers, the USDA should ask the following questions:

1) Have there been any significant shortages in the supply of beverage milk to retail stores?

   The record does not support an affirmative answer as evidence was not provided at the hearing to demonstrate a significant shortage of beverage milk to retail stores.

2) Is the reason that motivated the reform in Class I milk pricing in 2018 still relevant today?

   Edge believes this is indeed the case. The reason to pursue "average-of" approach to pricing Class I milk was to facilitate risk management by beverage milk manufacturers and wholesalers. Nothing in the record of this hearing suggests that risk management would become *less* important over the next decade.

3) Is it still necessary to use advanced pricing to facilitate orderly marketing of fluid milk products?

   Edge believes advanced pricing is outdated, and no longer necessary to facilitate supply chain coordination. The primary effect of the use of advanced pricing appears to be opportunistic depooling.

4) Is the Class I pricing method that results in the highest beverage milk price when Class IV milk price exceeds substantially Class III milk price in the best interest of U.S. milk consumers?

   A larger share of production of dry milk products is exported, whereas most cheese produced in the U.S. is consumed domestically. Depressed cheese prices, relative to milk powder prices, are thus likely to be more correlated with an adverse economic situation faced by U.S. milk consumers. When consumers do not find eating in restaurants as affordable, they will also feel pressure at the grocery store.

A Class I milk price that reflects international economic outlook more than the domestic situation is thus not in the best interest of US consumers.

5) <u>Is the Class I pricing method that results in the highest beverage milk price when Class IV milk price exceeds substantially Class III milk price in the best interest of *all* U.S. dairy farmers?</u>

Edge believes the answer is "NO" – it is also not in the best interest of *all* dairy farmers. When cheese prices are depressed, dairy farmers located in areas where Class I utilization is below national average may be worse off if the 'higher-of' pricing method is used instead of 'average-of' or Class III-based pricing as proposed by Edge. This holds *even if* the "higher-of" method results in the Class I price that is *higher* than what Class I price would be under the current regime or one of the alternative proposed replacements. If Class I price is higher, then U.S. All-Milk price will be higher. If the U.S. All-Milk price is higher, then the Dairy Margin Coverage ("DMC") margin will be greater. If the DMC margin is low enough, then a greater margin would imply lower DMC payments to farmers. The effect of lower DMC payments could overshadow the effect of higher uniform prices, and that is especially important to "small business" dairy farms as defined for the purposes of this hearing.

Edge's Proposal 16 is the only proposal heard at this hearing that would:

(a) Facilitate risk management by fluid milk manufacturers and large commercial buyers;

(b) Eliminate outdated advanced pricing and thus reduce the incidence and magnitude of opportunistic depooling; and

(c) Align Class I prices to correlate with economic outlook for U.S. milk consumers.

For all these reasons, we urge the USDA to adopt proposal #16. Proposal 16, known as Class III Plus, provides wins for farmers and processors alike. It provides the risk management improvements sought by processors and farmers as well as the transparency in price discovery sought by dairy farmers.[2] Dairy farmers also loudly ask for more innovation and growth of the fluid milk category, which is facilitated and encouraged by allowing fluid milk (Class I) processors to manage their risk. As a reminder, these are minimum prices to which our members are constrained – and which many other dairy farmers and their cooperatives are not.

V. REGULATORY UNCERTANITY CAN DAMAGE DAIRY FARMERS' ABILITY TO PURSUE EFFECTIVE RISK MANAGEMENT.

Highly developed markets for private risk management, and a comprehensive public-private dairy safety net provide U.S. dairy farmers with a competitive advantage in export markets. The fundamental precondition for effective functioning of commodity exchanges is to have regulatory certainty. If a buyer or a seller of dairy futures contracts does not know what amount of make allowance will be in place at the time when the contract is settled, they will not be as willing to trade the contract unless the odds are strongly in their favor. Lack of liquidity on commodity exchanges may then lead to suspension of offers for public-private programs such as Dairy Revenue Protection and Livestock Gross Margin for Dairy Cattle. Dairy farmers could have a

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[2] Edge also believes that Class III Plus delivers on Congress's promise to provide better risk management tools for processors when it drafted the Agriculture and Nutrition Act Of 2018 ("2018 Farm Bill"). Throughout the drafting and hearings related to passage of the 2018 Farm Bill, Congress stressed the importance of risk management tools for producers and processors alike – providing the basis for adjusting the Class I milk price from the "higher of" to the "average of". By implication, USDA should also ensure that effective risk management is imbued in any changes made to the marketing orders.

lower share of their milk marketings covered under a risk management plan and could be less resilient (more sensitive) to price shocks.

Stability of make allowances since 2009 have facilitated substantial growth in open interest and volume on the CME Group dairy contracts, as well as the development of new public-private risk management programs. To avoid creating liquidity problems on CME Group products, the USDA should be prudent in setting the timeline for implementation of changes to make allowances and standard component tests, as those modifications could affect how cheese, butter, dry whey, nonfat dry milk, Class III milk and Class IV milk prices are set. This is particularly relevant given the expectation that FMMO hearings will be more frequent in the next decade than they were in 2010s, due to mandatory surveys of processing costs.

Conclusion

Edge urges USDA to adopt Proposal 1 with the butterfat update (which is a logical outgrowth of NMPF's initially submitted Proposal 1). Further, Edge urges adoption of Proposal 3 with the adjustment to the weighted block/barrel average (which is a logical outgrowth of the initially submitted Proposal 3). USDA must also consider the technological frontier in manufacturing as the starting point for setting make allowances. Edge strongly urges USDA to adopt Proposal 16 as it balances the needs for risk management, eliminates outdated advancing pricing while reducing incentives to depool milk, and correlates Class I prices to the economic outlook for U.S. fluid milk consumers. Finally, USDA should not make changes to Class I milk pricing that would jeopardize risk management or neglect to address the negative impact of advanced pricing on handlers' incentives to remain consistently pooled.

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Dated: April 1, 2024

CERTIFICATE OF SERVICE

Milk in the Northeast and Other Marketing Areas
Docket No.: 23-J-0067

Having personal knowledge of the foregoing, I declare under penalty of perjury that the information herein is true and correct, and this is to certify that a copy of the POST-HEARING BRIEF SUBMITTED ON BEHALF OF EDGE DAIRY FARMER COOPERATIVE has been furnished and was served by electronic mail upon the following parties on April 3, 2024 by the following:

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