UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

AGRICULTURAL MARKETING SERVICE

In re: Milk in the Northeast and Other Marketing Areas	7 CFR Parts 1000 *et seq.* Docket No. 23-J-0067; AMS-DA-23-0031

CARMEL, INDIANA
AUGUST 2023

TESTIMONY OF FAIRLIFE, LLC – PART I REGARDING NATIONAL HEARING ON FEDERAL MILK MARKETING ORDER PROPOSALS

September 8, 2023

I. BACKGROUND

A. PERSONAL BACKGROUND

My name is Tim Doelman, CEO of fairlife, llc. I am one of the founders of fairlife and its predecessor companies that started 25 years ago. I have a B.S. in Dairy Science from California Polytechnic State University in San Luis Obispo, CA. I grew up on a family dairy farm in Washington State and have been involved with most aspects of the dairy industry. I lead fairlife's mission to nourish the modern world through great tasting nutrition.

B. COMPANY BACKGROUND

fairlife markets value added dairy products throughout the US and Canada. We have four plants in the U.S. and one in Canada. Our plants are in Coopersville, MI (Order 33); Dexter, NM (Order 126); Goodyear, AZ (Order 131); and Fair Oaks, IN (Order 33). Our products are sold in all 50 states. The milk we purchase is regulated on Orders 33, 126, and 131. Each plant has Class I, II, and IV utilizations. We purchase 100% of our milk from cooperatives. We employ around 800 people in the U.S. Our corporate headquarters are at 1001 W. Adams St., Chicago, IL.

II. SUPPORT FOR MIG PROPOSALS

I am a member of the Milk Innovation Group ("MIG") and support its proposals at this hearing. I am here today to testify on MIG's Proposal 15.

A. Proposal 15: MIG's Base Class I Skim Milk Price ("Mover").

1. Hedging is a risk management tool.

Hedging is the practice of securing a future price for a commodity now. Agreeing on a future price between a buyer and seller gives both parties financial certainty. As a seller, a farmer can know what his or her milk will be worth in the future. As a buyer, a processor will know what the milk will cost in the future. This tool creates financial stability for both parties. Hedging also tends to reduce price volatility of the commodity. This is favorable for both the producer and processor as well as the end buyer of the bottled milk.

2. Currently, the Base Class I Skim Milk price formula allows Class I processors to hedge.

The current Class I base skim milk price formula allows for processors to hedge their milk costs with certainty. Currently, it is the average of Class III and Class IV prices plus a $0.74 adjuster. In other words: 50% Class III and 50% Class IV pricing. A processor can buy Class III and Class IV futures at a 1:1 ratio and know exactly the price to be paid for Class I skim during that same time period.

This gives the processor the ability to set pricing to customers with certainty. The result is that pricing is fixed and guaranteed for some time into the future.

3. Hedging is important for everyone – farmers, processors, and especially retailers and consumers.

Price certainty and stability is good for the processor, the customer, and the end consumer because the price is stable and secure. First, farmers will be better served if processors can offer more stable and consistent prices for their milk. That allows farmers to better evaluate their own financial risks and plan accordingly. It is of course better for processors to have more stable milk prices, supported by the risk management hedging creates. More price stability in our number one input cost – raw milk – allows processors to undertake long-term planning, reliably develop plant capacity, and invest capital in processing that has more certainty in creating a return on that investment. Finally, when selling our products to both retailers and, from there, ultimate consumers, price stability helps the entire dairy industry. Our retail customers are frequently looking to set prices out for 6 to 12 months. When price uncertainty does not allow us to set prices for that long, fluid milk processors risk losing shelf space to plant-based and other alternative beverage products. It serves everyone participating here if we can do what we can to make milk a more attractive product for retailers to carry in their stores or use in restaurants or coffee shops.

Second, the more companies that participate in hedging, the more effective the hedging actually becomes. The more processors who participate in hedging, the more liquid the futures market becomes. The more liquid the futures market, the more likely it will accurately reflect

market conditions. The more accurate it reflects market conditions, the better the futures market serves as a tool for farmers to hedge their milk sales and lock in pricing. Everyone wins with a highly active futures market, from the farmer to the processor to the customer to the consumer.

4. fairlife hedges its Class I price risk.

At fairlife, we have an active hedging program. We only recently were able to participate in any kind of hedging for Class I products, with the change in the Base Class I Skim Price from the "higher of" to the "average of" in 2019. It has become an important part of fairlife's risk management, and a tool I hope to be able to continue using in the future. Our hedging program allows us to know what we will pay or a range of what we will pay in the future. Our customers do not like lots of volatility for various reasons. Our program allows us to set pricing with customers with more certainty. As erratic pricing turns consumers off, more stable pricing is good for maintaining and growing sales.

An example of hedging is as follows. A milk processor desires to set a stable price for their milk for the next six months. The processor buys 50% Class III and 50% Class IV contracts of the same volume anticipated to sell during those six months. The processor's underlying milk cost driver is now set for those six months. The processor now goes to their customer and sets their milk price to their customer. That way if, for example, Class III prices were to rise significantly the processor could still honor that milk price to its customer. Because although the processor would pay more for its raw milk, it would get the benefit of those higher prices through the Class III contracts it purchased (thereby offsetting its increased milk costs).

It is my belief that more processors would use this type of hedging with more time to understand the benefits and how to incorporate it into their operation.

5. MIG's Proposal 15 is a win-win – it allows processors to hedge and results in similar financial results for farmers as they would get under a return to the "higher of."

I understand that farmers have objections to the current formula for the Base Class I Skim Milk price and prefer that we return to the old method using the higher of Class III or Class IV to

determine the Class I price yielded a higher price. I sympathize with those concerns but see no reason why industry would return to an unworkable formula when we have a better option that can provide a platform for more value and growth across the industry as a whole.

The current method takes the average of the Class III and Class IV price and adds a "historical" Class III / IV difference of $0.74/cwt to the III/IV average. The downside with the $0.74 historical difference is that it is static. If there are underlying shifts in the difference between Class III and IV or there is a once in a lifetime event like the Covid lockdowns, the historical difference won't capture the shift in the way the "higher of" difference could have. Although a rare occurrence, it is a fair complaint when it happens if the desire is to maintain the same Class I milk value determinants. The solution lies in preserving the ability to hedge Class I while capturing market anomalies in determining the base Class I skim milk price.

The MIG proposal essentially preserves Class I hedging ability while capturing market anomalies in the Class III / IV market spread, ensuring that the farmer, over time, gets about the same value for their milk if it were in the old higher of program. Conceptually, the MIG proposal accomplishes this by replacing the "historical" $0.74/cwt spread adjuster with a dynamically calculated rolling adjuster. The rolling adjuster is calculated as a 24-month moving average of the Class III / IV higher of difference. Another important point is that the rolling adjuster is applied with a 12-month lag to ensure market participants can secure futures at least 12 months into the future. Without the 12-month lag, a processor would not be able to buy futures and have price certainty because the Class III / IV adjuster calculation uses data that is occurred in the past 24 months and the processor needs to apply that calculation to the next 12 months of futures prices.

The specifics of the MIG proposal are calculated as such:

A. For each of the preceding months, calculate the "higher of" the advanced Class III or IV skim price (in other words, the pre-May 2019 method).

B. For each of the preceding months, calculate the "average of" the advanced Class III and IV skim price (in other words, the post-May 2019 method, without the $0.74).

C. Calculate the difference between (A) and (B).

D. Monthly, calculate the adjuster by averaging (C) for the preceding 24 months with a 12-month lag (this is the "Rolling Adjuster"). For example, if this were in place now, the Rolling Adjuster for January 2023 would have been average of (C) for January 2020 to December 2021. And then the Rolling Adjuster for February 2023 would be the average of (C) for February 2020 to January 2022. And so on.

E. Monthly, average the Class III and IV skim prices for that month and add (D) (the Rolling Adjuster).

Setting the Base Class I Skim Milk price based on this average of the Class III and IV prices, plus the adjuster, ensures that the Class I price maintains more consistency month to month, but takes into account the pricing in other classes. For example, in looking at the spikes in Class III prices caused by pandemic-era policies, those spikes would have raised the Base Class I Skim Milk price in a more gradual way, but also with a longer-term impact than if the price skewed in immediate reaction to those changes. Thus, farmers will actually get the benefit of high prices over a longer period of time, but Class I processors will not be facing immediate, unpredictable impacts from changes to manufacturing class prices. Having an adjuster that reflects the actual marketplace also ensures that any changes in the industry over time will not conflict with the pricing formula – its dynamic nature will move with any changes in consumer preferences or market wide shifts.

6. Hedging is an important part of helping stem or reverse the decline of Class I sales and encourage innovation.

The ability to hedge is an enabler for more innovation and investment in the fluid milk space. As companies work to create value in the fluid milk space, price certainty becomes more important. Large investments are necessary for both marketing and manufacturing infrastructure. Knowing the core cost of the product allows companies to estimate product pricing and likely returns to support their investments and marketing activities. It is equally important that the ability to hedge is market based and spread across as many participants as possible. This is the best way to ensure markets are liquid and representative of a commodity's value.

III. CONCLUSION

In conclusion, there are many proposals for FMMO change under consideration. I see these as centering around two key principles for USDA to consider: how can we ensure that milk value calculations are updated to current marketplace conditions without stalling the industry through over-regulation? I do support updating the milk value calculations when industry facts change, but these must be minimum pricing changes, consistent with USDSA's minimum pricing policy, and with all segments of the industry in mind. To support the move towards market-based price discovery, the industry should embrace hedging and futures development. Whereas Class II, III, and IV can all be effectively hedged, the "higher of" concept for Class I is incompatible with hedging. MIG Proposal 15 preserves fluid milk processors' ability to hedge while delivering the historical "higher of" value for farmers. Similarly, updating make allowances and MIG's Proposal 20 to remove non-applicable premiums are examples of updating the milk value calculations. The dairy industry should move towards market-based price discovery and work towards less regulation. Government-mandated price regulations distort markets and result in a less efficient marketplace, resulting in a smaller market and stymying innovation necessary for growth. Let us encourage growth and innovation so that we can ensure a vibrant and bright future for the dairy industry.

DATED this 7th day of September, 2023.

By */s/ Tim Doelman*
TIM DOELMAN