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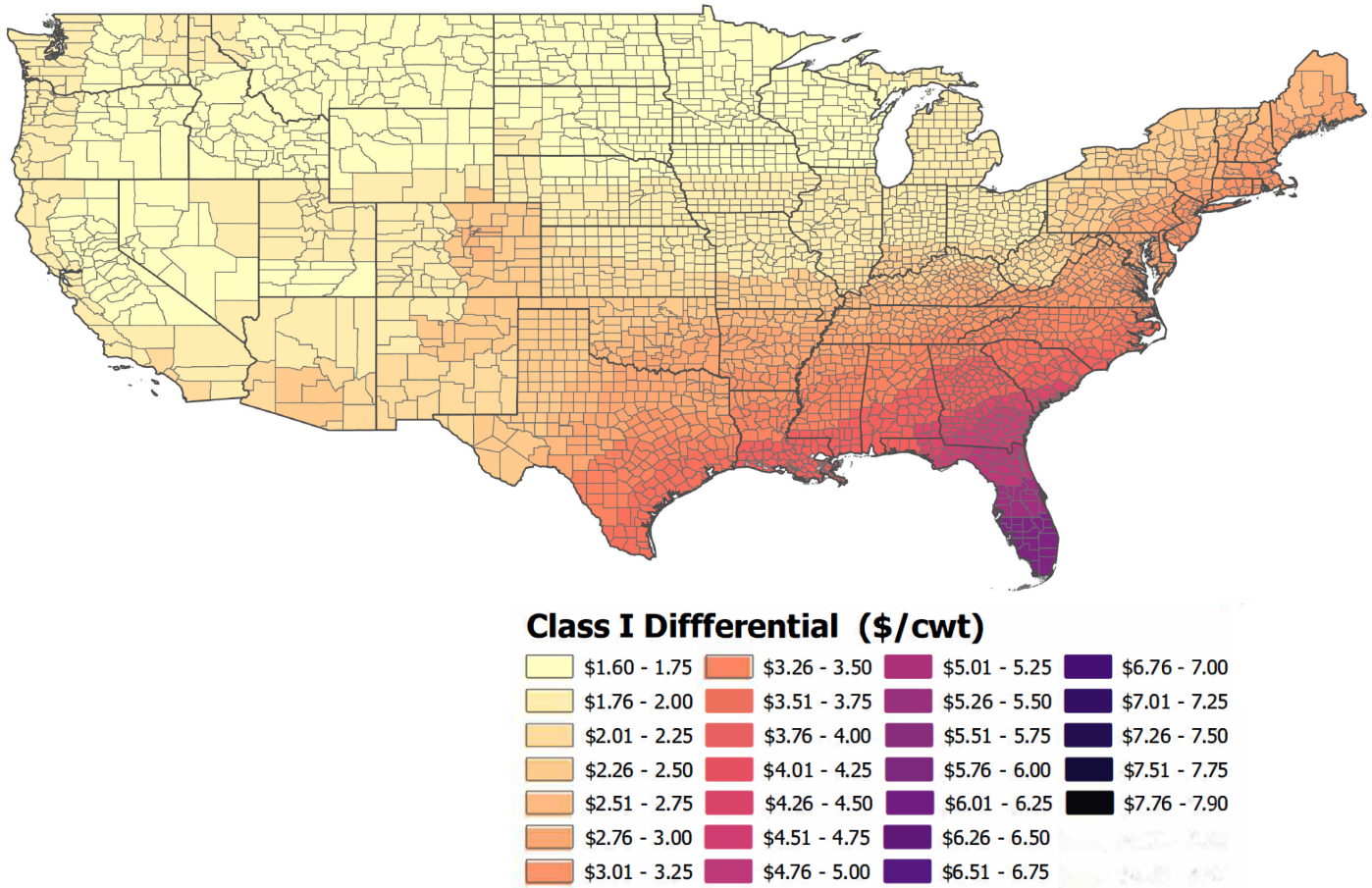
Federal Milk Marketing Order Hearing
Carmel, Indiana

Current Class I Differential

Current Class I differentials range from $1.60 to $6.00

Four Parts:

1) $0.40 compensation for Grade A status
2) $0.60 market balancing for supplying Class I
3) $0.60 to incentivize producers to supply milk for fluid use
4) $0.00 to $4.40 county-level location adjustment (unchanged in MIG's Proposal 20)



Source: Exhibit 441 p. 2 Map 1

The $1.60 Base Class I Differential

- During FMMO reform, USDA sought to to establish the base Class I differential at the "***lowest value necessary***" to ensure sufficient milk supply for fluid use.
- USDA acknowledged that setting the Class I differential at too high a level would "be an incentive to overproduce for fluid needs."

> The $1.60 minimum differential level proposed is perceived to be the lowest value necessary under present supply and demand conditions to maintain stable and viable pools of milk for Class I use in markets that are predominantly manufacturing oriented. Applying this minimum differential to each of the three low pricing areas will ensure that low utilization and surplus markets will have similar differentials. However, having a larger portion of Class I value pooled could mute price signals to producers more than prices determined strictly by market forces. If the blend price exceeds the marginal value of milk in manufacturing, there would be an incentive to overproduce for fluid needs.
>
> Milk in the New England and Other Marketing Areas, 63 Fed. Reg. 4802, 4909 (Jan. 30, 1998) (emphasis added)

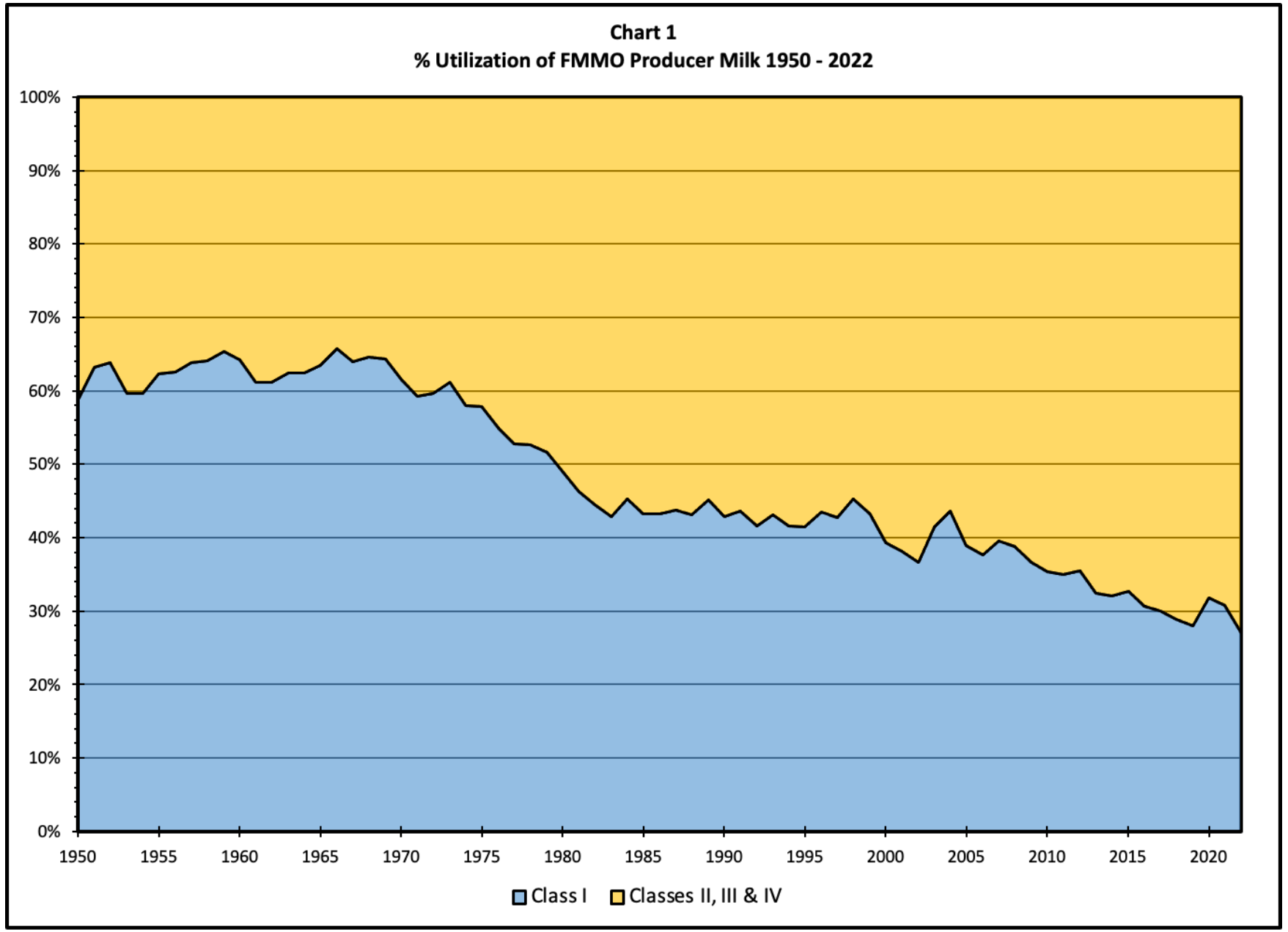


Chart 1
% Utilization of FMMO Producer Milk 1950 - 2022
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
2020
Class I
Classes II, III & IV

Base Class I Differential Elements No Longer Cost Justified

- **Grade A: $0.40 / cwt**
  - Grade B milk is not relevant to FMMO pricing today
  - >99% of milk is Grade A – see MIG 15A
  - Nearly all plants whether fluid or not exclusively receive Grade A milk
- **Balancing: $0.60 / cwt**
  - Balancing costs are borne by processors and/or cooperatives and/or producers
  - Even day receiving & raw milk storage
  - Cap ex for raw milk storage and finished goods warehousing
  - Cost of the inventory itself
  - Longer shelf life – HTST, ESL, Aseptic
- **Incentive to Serve Class I: $0.60 / cwt**
  - Presumption that a pool-wide “incentive” is needed does not hold today
  - Compensation needs to go directly to Class I suppliers

MIG Proposal 20

- No one benefits from ever-lower Class I sales
- We must recognize today's market realities
- Reducing the $1.60 base Class I differential is opportunity to reinvigorate fluid milk
- Over-order premiums provide a mechanism for Class I processors to directly compensate milk suppliers
- It is time for the Class I differentials to be updated