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 CRYSTAL CREAMERY, PART 2 REGARDING NATIONAL HEARING ON FEDERAL MILK MARKETING ORDER PROPOSALS

September 16, 2023

I. BACKGROUND

A. PERSONAL BACKGROUND

My name is Jacob Schuelke and my background in the dairy industry began growing up on a dairy farm in New York State. I then went on to receive a bachelor's degree in agricultural business from Cornell University and a master's degree in agricultural economics from the University of Wisconsin-Madison, where I was a research assistant under Ed Jesse on a variety of dairy marketing research projects. From there I worked in the extension service as a dairy business management educator. My career in the private sector started with Hilmar Cheese where I was their dairy economist. Then I moved on to California Dairies where I was the head of milk pooling and payment. Next, I went to work for a start-up called Valley Milk LLC where I helped incorporate and receive Capper-Volstead certification for their milk supply cooperative. Over the last three years I have been working for Crystal Creamery as their CFO and head of milk procurement.

B. COMPANY BACKGROUND

Crystal Creamery is an all-inclusive dairy operation with plants in Modesto and Fernbridge, California. Our headquarters is 529 Kansas Ave., Modesto, California 95351. We have about 750 employees. Crystal Creamery qualifies as a small business under the SBA. We produce Class I fluid milk, Class II products (ice cream, cottage cheese, sour cream), we supply the Class III market with condensed milk, and both of our production facilities have a Class IV dryer to balance the milk supply. Our Modesto facility also has butter manufacturing capabilities.

We supply our plants through a diversified network of direct ship dairies, Class III/IV manufacturers supplying milk for pooling access, a number of local cooperatives with organic and conventional milk supplies, and up until a few months ago our own dairy farm.

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 20.

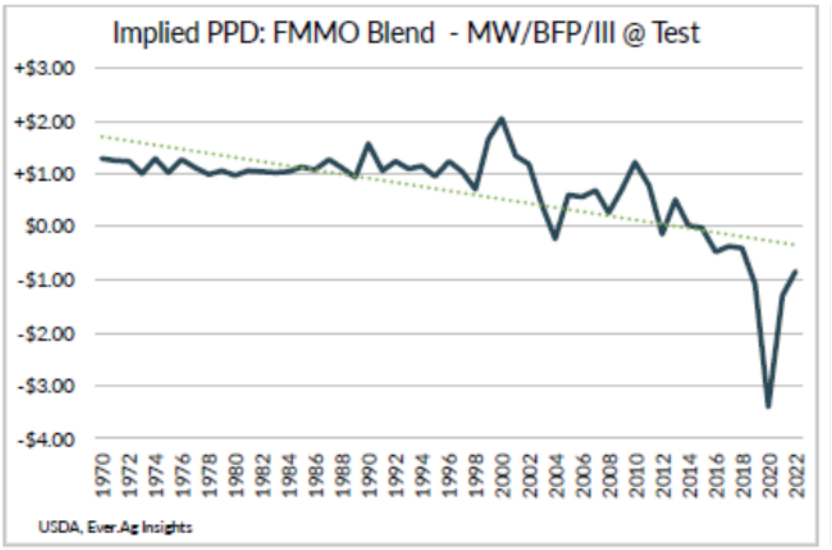
A. The FMMO System is Failing Farmers who Supply Proprietary Class I Plants.

I would like to speak on behalf of my direct ship farmers and say unequivocally that the problem today is that Crystal's farmers are not getting paid enough for their milk. However, the problem is not that the fluid manufacturers are not paying enough into the system, it is that the farmers who supply the Class I distributing plants are not getting paid equitably and orderly compared to farmers who do not actually serve or readily serve when needed the fluid market.

In simplest terms the FMMO bulletin describes the system of pooling used by the orders. https://www.ams.usda.gov/sites/default/files/media/DairyFMMOBooklet.pdf Under FMMOs, fluid plants pay the most for milk, manufacturing plants less, and then all farms in the pool receive payment equally. Unfortunately, every data point and real world example will show that uniform prices are not happening. Farmers supplying the fluid market are getting paid less than non-fluid.

A recent analysis done by Ever.ag and presented by Phil Plourd at the 2023 California Creamery Operators Association meeting looked at the average blend pay price generated by FMMO's and the results are the challenge that we face in supplying direct ship milk to the plant. This graph below highlights that over the past five years in the FMMO system farmers would be better off with a contract selling milk into a cheese plant for Class III minus $1.00 cwt than receiving the FMMO blend price.

Figure 1



But the answer here is not to force Class I processors to pay more into the pool (either through raising the base Class I skim milk price (aka the "mover") and/or maintaining/raising the Class I differential. Any increased proceeds would just be diluted and spread over all pooled producer milk. Instead, we need to innovate FMMOs to lessen the pool burden on Class I processors and release us to better compensate our direct-ship farmers. If FMMOs are designed to ensure a sufficient supply of fluid milk, then decreasing Class I contributions into the pool is necessary to allow us to better incentivize our own suppliers to continue shipping to a Class I plant over other manufacturing plants.

Old assumptions inherent in FMMOs no longer hold – the perception that keeping Class I prices high creates orderly marketing does not line up with reality because the opposite of what was intended has been happening for five years straight. This market disruption is a market failure of payment parity that can easily be remedied in any number of ways but given the limited scope of this hearing we must focus on the tools available.

How much more can we afford to take from organic and direct ship farmers to write an endless stream of MA checks to other industry participants? Unfortunately for Crystal Creamery

we cannot offer up anymore. If it were just a few months ago I would also be able to testify here as an operator of a dairy farm in California that lasted for over 80 years and five generations of ownership but sadly that has come to an end. This is not the outcome of poor general markets or mismanagement but the outcome of a government mandated system that over the last five years has forcibly made us the lowest paid dairymen in the order. Without the ability to depool (like other classes), without the ability to reblend (like cooperatives) and without the ability to direct payments from the pool to the farm (because of FMMOs), Crystal was unable to pay prices high enough to keep our own dairy farm viable. This was an ongoing loss that could not be sustained and the difficult decision had to be made. In the last two years we have lost over half of our direct shippers to handlers that receive economic benefits from depooling.

Here is the mathematical example of perception vs reality for what is happening in FMMO's today.

Figure 2

$1.70 Differential Class I Plant Example

	Cheese Depool Month			**Powder Depool Month**			**Average**	
	Perception	Reality		Perception	Reality		Perception	Reality
Class III	$ 20.00	$ 20.00	Class III	$ 15.00	$ 15.00		$ 17.50	$ 17.50
Class IV	$ 15.00	$ 15.00	Class IV	$ 20.00	$ 20.00		$ 17.50	$ 17.50
Class I	$ 19.94	$ 19.94	Class I	$ 19.94	$ 19.94		$ 19.94	$ 19.94
	Utilization			Utilization				
Class III	45%	0%	Class III	45%	90%		45%	45%
Class IV	45%	90%	Class IV	45%	0%		45%	45%
Class I	10%	10%	Class I	10%	10%		10%	10%
Blend	$ 17.74	$ 15.49	Blend	$ 17.74	$ 15.49		$ 17.74	$ 15.49
Pay Price			Pay Price					
Class III	$ 17.74	$ 20.00	Class III	$ 17.74	$ 15.49		$ 17.74	$ 17.75
Class IV	$ 17.74	$ 15.49	Class IV	$ 17.74	$ 20.00		$ 17.74	$ 17.75
Class I	$ 17.74	$ 15.49	Class I	$ 17.74	$ 15.49		$ 17.74	$ 15.49

The comment that all manufacturers can de-pool at any time is not true, look at any pool report for a de-pool month in any order and you will always see some milk there unprofitably. I am one of those plants that cannot de-pool because of my Class I utilization. I am not able to keep

my Class II, III, and IV utilization overpayments and give them to my farmers like the majority can. Those monies are paid into the pool and we struggle just to make blend and compete in the marketplace against manufacturers that do not pay class prices. By the rules of the system that other manufacturers get to play by, we should have been able to pay that money directly to our farmers, not the opportunistic participants in the pool who are in only when it is to their advantage. The money is not shared equitably and this is a devastating, unorderly, and unequal outcome. The heaviest burden is placed on direct ship dairy farms and that is not what anyone originally intended in this system. Unless changes are made, eventually the only remaining conventional fluid milk processors could be cooperatives, who can reblend and do not actually have to pay Class I minimum prices. That said our remaining dairy farms stick with us because there are few outlets for milk and base programs are closed to new members, so you can join and pay into a cooperative like the existing members but you will have zero base so you will not get paid the same.

Even under current regulations, the system does not ensure money goes to the producers actually supplying Class I. In California there is only a 10% Class I delivery requirement. So, for every dollar paid in by Class I processors the only guarantee is that $0.10 will actually make it to the farms making physical deliveries and the other $0.90 is available to farms who supply the Class I market on a less frequent basis (if at all). In our plant we have direct ship dairies that must market 100% of their milk through the pool and they are the lowest paid producers on the order because of it. We also have organic suppliers that are both direct ship and cooperative supply. It is estimated that 55% of all organic utilization is fluid so 55% of their sales are in the Class I market but they only get back 10% of this value.

Class I direct ship and organic farms that actually supply the fluid market are without question the farmers losing the most value in the order because they are forced by law into a system that takes money from their checks and spreads it across the entire industry. This is simply unsustainable and counter to the stated purpose of ensuring a sufficient quantity of pure and wholesome milk, which is in the public interest.

B. Support for MIG's Proposal 20: Class I Base Differential

If industry is unable or unwilling to reexamine the system as a whole, there is only one tool left available to fix the current market failure: the Class I Base Differential. And MIG's Proposal 20 does that.

Lowering the base Class I differential is the only tool proposed that would help alleviate the unequal treatment that Class I producers get in this system and address the inflated minimum prices under current formulas. Lowering the pool obligation and then paying a direct credit to the supplying dairy farm would be a fair resolution here, but USDA refused to even consider MIG's proposal with that mechanism. The unprecedented market failures of inequality that Class I direct shippers are feeling can only be fixed by alleviating Class I pool obligation burdens. The organic and direct ship Class I producers coming forward in this process cannot continue to be overlooked or miscategorized as general market discontentment. USDA needs to let over order premiums play their role in maintaining Class I competitiveness.

First and foremost, it should be noted that base differentials do not move milk. In our system there are only three ways to move milk and those are: 1) over order premiums, 2) location adjustments, and 3) credits.

A portion of the current base differential exists to promote the production of Grade A milk. Its original function was to encourage farms shipping grade B milk to go through the process of becoming Grade A so that they could supply the Class I market. It is no longer valid as the milk supply today is almost entirely Grade A. Therefore, this portion of the base differential simply boosts pool revenue and does not move milk or encourage Grade A production. When incorporated into orders with nearly 100% Grade A milk supply and a 10% delivery requirement all this money just serves to encourage opportunistic pooling and unequal payments by the 90% that doesn't have to be physically delivered to a distributing plant.

The California experience regarding Grade B milk production emphasizes that there is no longer a need to promote the adoption of Grade A practices. Because of a California state tax on

Grade A milk that remains in place today, farmers have a $0.40/cwt economic incentive to not be Grade A. Several manufacturers built their procurement strategies around that. However, in the past couple of years even those manufacturers stopped taking in Grade B milk because it made their cream, condensed, UF, and spot milk unmarketable to such a degree that they could not function in our Grade A environment. They had to eliminate receiving Grade B milk despite California's $0.40/cwt. subsidy. Not only is this portion of the Class I differential not needed anymore, but also there is the instructive California experience which shows that manufacturing plants won't accept Grade B milk any more than fluid plants would.

Second, as described above, the $0.60 incentive in the base Class I differential does not actually "incentivize" service of the Class I market – it does the opposite and pays 90% of the money to non-fluid shippers thus subsidizing the shift away from fluid. The only way to attract milk to Class I plants over manufacturing plants is to release us from burdensome pool obligations, and free up resources to pay farmers directly to service our plants.

Third, I understand that $0.60 of the base Class I differential is for "balancing" costs. With our powder and butter manufacturing capabilities Crystal is uniquely positioned to consider the challenges and trade-offs inherent in balancing. We have invested heavily into powder manufacturing and our costs of production for that are much higher than current make allowances. We are able to sustain these losses because we use the powder plant to balance our milk supply and that does two things. First it enables us to have a direct ship program and second it enables us to enter into steady milk volume contracts with handlers that are at a lower premium rate because they don't have variable commitments. Because of our powder plant we are a buyer of spot milk, almost never a seller. Despite not needing any balancing we still struggle to attract direct shippers at the blend price plus a competitive quality and bonus program. Yet we are still having to pay $0.60 / cwt into the pool, to pay for balancing costs we already pay for via our own balancing efforts.

With respect to balancing, organic faces particular challenges. Organic utilization for fluid milk is relatively high, about 55% nationally. However, there are very limited manufacturing uses where they can get an organic premium. Crystal's Humboldt facility is the primary organic balancing plant for the west coast. We charge four times the NFDM standard make allowance for balancing. Organic handlers routinely pay this because it is better than spot sales into the conventional market. In summary organic farms are paying $0.60/cwt for balancing in these formulas and then they routinely pay $6.00/cwt or more for real balancing services.

Figure 3

Comparison NFDM Make Allowance & Organic NFDM Tolling ($/lb NFDM)				
Current	Proposal 7	Proposals 8 & 9 Year 1	Proposals 8 & 9 Year 4	Humboldt Organic Today
$0.1678	$0.2100	$0.2198	$0.2716	$0.70

Is there any wonder why the blend price has averaged below Class III for the last five years? The inherent base premium structure subsidizes this outcome and fluid handlers need to pay over order premiums to overcome this to compete and keep their plants going. Fluid handlers don't have a problem paying a fair price for milk and we have no problem transitioning this premium to a direct credit but continuing to take 90% of the premiums to subsidize the demise of direct shippers has led us to an unstainable end. This has to stop.

III. CONCLUSION

The problem experienced by the larger system today is the same problem that the Western order experienced first in the early 2000's. Sure, there is always general discontentment with markets and rules, but in addition to that frustration, fluid direct shippers have been bearing an additional burden for the past five years that the average dairy farm does not address in their testimony. When 90% of the farms can derive an economic benefit at the expense of 10% of the farms you get disorderly marketing. Fixing the inequality is not going to be in the economic

interests of the 90% benefiting; but if an affirmative vote is unlikely for an FMMO that includes the appropriate Class I differential of $0, that is merely a reflection of a system that doesn't fit modern needs (just as we saw with the Western Order being voted out). We cannot afford to hide this reality and decide to make the inequalities worse.

AMS needs to offer a solution that is both in the public interest and also re-facilitates the orderly and equitable marketing of milk to the nation. This Proposal 20 is the only tool available for discussion that does that.

DATED this 16th day of September, 2023.

By */s/ Jacob Schuelke*
JACOB SCHUELKE