UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

AGRICULTURAL MARKETING SERVICE

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

CARMEL, INDIANA
AUGUST 2023

TESTIMONY OF SALLY KEEFE, PART 2 REGARDING NATIONAL HEARING ON FEDERAL MILK MARKETING ORDER PROPOSALS

September 8, 2023

I. BACKGROUND

I am the owner and principal of skFigures, a company that provides dairy consulting services to all verticals of the dairy industry. I am here today as a representative of the Milk Innovation Group ("MIG").

I received my B.A. in Economics from Middlebury College and my M.B.A. in finance and entrepreneurship from the University of Colorado. Before entering the organic dairy field, I worked as an environmental economics and policy consultant. Beginning in 1996, I worked in Operations and Milk Procurement for Horizon Organic Dairy. I joined Aurora Organic Dairy as Supply Chain Director in 2003 and was a key member of the team who launched that new, innovative organic dairy company. I served in this and other roles in supply chain management before I became the Vice President of Legal & Government Affairs for Aurora Organic Dairy in 2007. I served in this role until 2012. In this capacity, I directed the company's legal, regulatory, and legislative activities, and was active in both the dairy and organic industry arenas.

In 2012, I left Aurora Organic Dairy and founded skFigures. I provide management consulting services as well as technical and policy expertise to agriculture and food businesses. I have particular expertise in Federal Milk Marketing Orders and have testified in prior FMMO proceedings. My clients include farmers, agricultural cooperatives, dairy processors, corporations, trade associations, and investors.

II. SUPPORT FOR MIG PROPOSAL 15

I am a consultant and expert for the Milk Innovation Group ("MIG") and am testifying in support of its Proposal 15 here today. MIG's base Class I skim milk price proposal retains the current "average of" formula while changing the adjuster from a static $0.74 per hundredweight to a rolling adjuster. MIG proposes updating the adjuster monthly using a 24-month look back period with a 12-month lag, i.e., the preceding 13-to-36-month period.

A. Estimated Class I prices are roughly equal between Proposals 15 and 13, but Proposal 15 retains Class I risk management.

The most important point to consider in weighing MIG's Proposal 15 versus NMPF's Proposal 13 is that each would return roughly the same amount of money to farmers. The importance of this fact cannot be overstated. Both proposals provide base Class I skim milk prices at very similar levels and thus have similar effects on Class I milk prices and uniform producer prices[1] in turn. As shown in Exhibit MIG – 9A, I compared Proposal 15 to the current "average of plus $0.74 adjuster" formula as well as Proposal 13's "higher of" formula. The table below summarizes my results.

Comparison of Monthly Average Base Class I Skim Milk Prices ($/cwt)			
Year(s)	**Current**	**Proposal 15**	**Proposal 13**
2018	$6.56	$6.54	$6.23
2019	$8.40	$8.29	$8.31
2020	$11.13	$10.89	$12.89
2021	$10.83	$10.86	$10.75
2022	$13.03	$13.94	$13.64
2018 – 2022 (5 yr.)	$9.99	$10.10	$10.36
2013 – 2022 (10 yr.)	$10.23	$10.30	$10.41
2008 – 2022 (15 yr.)	$10.37	$10.40	$10.51
2003 – 2022 (20 yr.)	$10.05	$10.07	$10.15
Notes: The advanced Class III and IV skim milk pricing factors used for this analysis are from Exhibit 15 "Announcement of Advanced Prices and Pricing Factors - January 2000 - August 2023."			

[1] The uniform price impact varies by FMMO based on the Class I utilization of the respective order.

There are a few important observations from this table. First, for some years (2021 and 2022), MIG's Proposal 15 would return *more* money to dairy farmers than NMPF's Proposal 13. That is because the benefits to farmers of a high year, like 2020, are experienced over time through MIG's lag adjuster. Second, NMPF's Proposal 13 would have resulted in higher returns for 2020 than MIG's Proposal 15. But I do not believe that USDA policy should be based upon extraordinary events of 2020 which included COVID supply and demand shocks and USDA's Food Box program. The Food Box Program, while well intended and needed for other reasons, greatly distorted FMMO pricing. Third, the broader the window of time considered, the more Proposals 15 and 13 converge around a similar price – this means that it is critical we take a full view of how the proposals will impact pricing over time and that, here, they have roughly the same impact.

Recognizing that both Proposals 13 and 15 result in similar quite returns to farmers, it is easier to weigh the other impacts of each – namely that MIG's base Class I skim milk price proposal preserves risk management opportunities for both producers and Class I processors. The proposed "average of plus rolling adjuster" formula also offers a more general benefit of lower price volatility throughout the market from farmer to consumer. This reduced volatility helps support the growth of the dairy industry as a whole, as it makes the cost of milk more stable and consistent for retailers and consumers.

B. Base Class I Skim Milk Price

MIG proposes replacing the current fixed $0.74 adjuster with a rolling adjuster that is updated monthly to ensure that it continues to reflect current market conditions. When USDA adopted the current base Class I skim milk price formula, it recognized the critical policy goal of ensuring that Class I processors had access to risk management tools. It also noted how important these tools were to small businesses:

> The change in the Class I price formula applies uniformly to both large and small businesses. The dairy industry has calculated that applying the "higher of" provisions to skim milk prices has returned a price $0.74 per hundredweight above the average of the two factors since the pricing formulas were implemented in 2000. Thus, the inclusion of the $0.74 in the calculation should make the change roughly revenue neutral. At the same time, it is anticipated that using the average of the Class III and Class IV advanced pricing factors in the Class I skim milk price formula will allow handlers to better manage volatility in monthly Class I skim milk prices using Class III milk and Class IV milk futures and options. Until now, uncertainty about which Class price will end up being higher each month has made effective hedging difficult. Amending the Class I skim milk price provisions may help small businesses better utilize currently available risk management tools.

Federal Milk Marketing Orders—Amending the Class I Skim Milk Price Formula, 84 FR 8590-01 (Mar. 11, 2019)

MIG understands that dairy farmers object to the prices the current formula has generated and wish to change it. In light of that position, MIG aimed to develop a proposal that could meet the goals of both producers and processors: a proposal that generated similar returns to the old "higher of" formula for farmers while ensuring Class I processors could utilize risk management.

As noted above, MIG can establish through simple and indisputable math that its base Class I skim price ensures farmer returns in line with what they would have received had the "higher of" Proposal 13 been in place. Below, and through the testimony of MIG members, we also explain how important risk management is to Class I processors and how our Proposal 15 fulfills that important policy goal established by USDA (along with better serving the industry as a whole by tempering price volatility).

C. Additional Benefits from MIG's Proposal 15 over Proposal 13 (and Similar Proposals)

MIG's Proposal 15 has two significant benefits that are lacking from competing proposals, which are borne from its features of a year-long lag and rolling average adjuster over time.

First, MIG's Proposal allows for Class I processors to hedge. The 12-month lag in MIG's Proposal is critical for processors to be able to stake their positions and hedge the market. And

the average of the two classes, as opposed to bouncing between one or the other, provides necessary predictability to hedge price risk.

Risk management is important throughout the dairy industry, agriculture, and indeed many markets and transactions in today's world. No matter the class utilization of the milk or which side of a transaction you're on, risk management is critical. For Class I fluid processors, hedging is a vital tool to reduce price risk and provide stable prices over time to customers. MIG members will provide specific testimony regarding hedging and their operations. We understand that IDFA witnesses will be doing the same. Processors have had limited time to integrate this change into their risk management efforts. Additionally, MIG is concerned that adoption of this valuable tool by fluid processors been slowed by regulatory uncertainty *i.e.*, whether this agricultural industry standard practice will remain viable for Class I.

Second, a fundamental question is always "what does the customer want?" Most grocery store buyers aren't dairy specialists, they are procurement specialists. Reducing price volatility is a key issue for them. They want stable margins for themselves and stable prices for the consumer. Addressing the customer's risk management needs is an important sales point. Doing so is not a convenience for the processor, but a vital part of successfully understanding and meeting the buyer's needs. This is important for industry-wide success – producer and processor alike.

The rolling adjuster continuously updates and provides dynamic market signals. In tandem with that real-time update, the 24-month lookback stabilizes the price by moving gradually, a benefit to the entire industry as it makes dairy a more reliable and "safe" purchase for customers including both retailers and food service. By changing gradually but continuously, it also makes it easier to adapt to the change.

D. Proposal 15 Description and Regulatory Language

MIG proposes an "average of" based Class I skim milk price formula with a rolling adjuster. MIG proposes updating the adjuster monthly using a 24-month look back period with a

12-month lag, *i.e.*, preceding the 13-to-36-month period. For clarity, we provide a narrative and a mathematical example below of how Proposal 15 would work in practice if adopted:

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

B. For each prior month, 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 13-to-36-month period (this is the "Rolling Adjuster" with a 24 month look back period with a 12-month lag). For example, if this were in place for January 2024, the Rolling Adjuster would be the average of (C) for January 2021 to December 2022. And then the Rolling Adjuster for February 2024 would be the average of (C) for February 2021 to January 2023. And so on.

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

Calculating as an example, assuming Proposal 15 had been in place, the base Class I skim price for January 2017:

1. Adjuster = $0.95
    a. Average of difference between "higher of" and "average of" for Jan. 2014 to Dec. 2015, as found in the third to last column.
2. Average of advanced skim milk pricing factors = $8.34
    a. Average of the January 2017 Class III pricing factor ($9.61) and the Class IV pricing factor ($7.07)
3. Proposal 15 base Class I skim milk price: $9.29
    a. Add the Average and Adjuster: $8.34 + $0.95

This proposal amends 7 C.F.R. § 1000.50(b) as follows. Additions are red font. ~~Deletions are red strikethrough font.~~

§ 1000.50 Class prices, component prices, and advanced pricing factors.

(b) Class I skim milk price. The Class I skim milk price per hundredweight shall be the adjusted Class I differential specified in § 1000.52, plus the adjustment to Class I prices specified in §§ 1005.51(b), 1006.51(b) and 1007.51(b) of this chapter, plus the

simple average of the advanced pricing factors computed in paragraph (q)(1) and (2) of this section rounded to the nearest cent, plus the Class I skim price adjuster rounded to the nearest cent ~~$0.74 per hundredweight~~.

(1) Class I skim price adjuster. The Class I skim price adjuster per hundredweight shall be a 24-month simple average of the difference between the higher of the advanced pricing factors computed in paragraph (q)(1) and (2) and the simple average of same for the preceding 13 to 36 month period.

(2) The skim price adjuster shall change monthly.

III. MIG POSITION ON OTHER BASE CLASS I SKIM MILK PRICE PROPOSALS

A. MIG Opposes Proposals 13, 16, 17, and 18.

MIG is opposed to the three "higher of" proposals (13, 17, and 18) as they would severely limit risk management opportunities for Class I processors. MIG is also opposed to the three "eliminate advanced pricing" proposals (16, 17, and 18).

Advance pricing for Class I remains critical for a dominant share of the fluid market both because retailers expect and demand knowing their prices in advance and because the current ability to hedge Class I is still relatively new. The fluid milk industry and especially traditional fluid milk retail customers, are not yet using hedging sufficiently to permit this regulatory change. USDA policy should reflect market conditions, not mandate a change for which the Class I traditional market is not yet prepared.

With respect to proposal 16, MIG is also concerned about pricing Class I solely off Class III as this would be a significant departure from the current practice and completely divorce fluid milk supply and demand from Class IV. We have heard testimony from some cooperatives that Class IV is the ultimate balancing utilization.

B. MIG Supports Proposal 14 as an Alternative to Proposal 15.

MIG prefers its Proposal 15, but if USDA prefers IDFA's Proposal 14 to Proposal 15, MIG would find that acceptable. We believe that our proposed moving average without a floor is more consistent with FMMO concerns over an adequate supply of milk for fluid use and orderly

marketing. Additionally, Proposal 14's adjuster changes annually while Proposal 15's adjuster changes monthly. Changing the adjuster annually heightens the overall impact of the changes in any given fiscal quarter/year versus the prior year. That said, IDFA's Proposal 14 meets the same policy goals as MIG's Proposal 15 and so would be a successful alternative if USDA concludes a change is necessary.

IV. CONCLUSION

As noted, there is little difference between the financial results within the federal orders between Proposals 13 and 15. There has also been testimony from NMPF about the importance of hedging with respect to the implementation date, if any, for Proposal 1. The CME has testified over its concerns over FMMO impacts on hedging. Edge has expressed concerns about hedging and FMMO policy. Class I, as the only segment that must participate in the FMMO system, is entitled to some (we would prefer more) of the risk management tools available to everyone else. Depriving Class I of the hedging opportunity that the current formula provides is simply a terrible mistake and would further erode the ability of Class I to survive, let alone grow, in any meaningful fashion.

DATED this 7th day of September, 2023.

By */s/ Sally Keefe*
SALLY KEEFE