Opposition Testimony (Proposal Numbers 10, 11 and 12)

Testimony Presented By:
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This testimony is presented on behalf of California Dairies, Inc., hereafter CDI, and is submitted in opposition of Proposal Numbers 10, 11 and 12.

My name is Rob Vandenheuvel, and I am Senior Vice President of Member and Industry Relations for CDI, headquartered at 2000 North Plaza Avenue, Visalia, CA 93291. CDI is a Capper-Volstead cooperative association qualified to market milk on Federal Milk Marketing Orders, hereafter FMMOs, is a member of National Milk Producers Federation, hereafter National Milk, and opposes Proposals 10, 11 and 12. I also serve on NMPF's Executive Committee, Economic Policy Committee, and Federal Order Task Force.

CDI is co-owned by 258 member-owners, operating 297 member farms, all within the state of California. Our member farms produced 17.1 billion pounds of milk in 2022, or 41 percent of California's total production. Of that total, 10.3 billion pounds, or 60.6 percent, was received and processed at one of six CDI-owned manufacturing facilities, while the other 6.7 billion pounds, or 39.4 percent, was sold as bulk raw milk to dairy product processors throughout the State. Among the products produced by CDI-owned manufacturing facilities, butter and powder are a vast majority, as four of our six facilities produce butter and all six facilities produce milk powders. CDI also produces a range of processed fluids that are marketed in bulk to customers primarily in the Western United States.

CLASS III/IV FORMULAS

CDI strongly supports a thorough examination of all elements of the Class III and IV formulas, including the various price discovery mechanisms, make allowances and product yields. National Milk's Economic Policy Committee discussed all three of these items in the exhaustive work done over the past two years to compile our comprehensive set of proposals being considered at this hearing.

Unfortunately, in the absence of broad-based industry-wide data in the area of product yields, we did not pursue an update to any of the product yields as part of our comprehensive package. Realizing that there were likely yield improvements that could be considered once that broad-based industry-wide data was available, National Milk opted to instead take a more tempered approach to the long-overdue make allowance adjustment that was included in our proposal. As I stated in my earlier testimony regarding the make allowance levels in Proposal Number 7, the lack of available data on product yields is one of a few specific reasons CDI is supporting a tempered make allowance adjustment in this hearing that is less than what the available data

indicates the cost of processing could be, as estimated by Drs. Mark Stephenson and Bill Schiek.

Select Milk Producers, Inc., hereafter Select, has done a laudable job in their submittal of Proposals 10, 11 and 12 to create a preliminary dataset in the area of yields, but given limitations in that dataset – which I will discuss in more detail in this testimony – it is the position of CDI and National Milk that this issue is best addressed in the context of a comprehensive review of make allowances and yields following the collection of mandatory manufacturing cost and yield data under authority being pursued in the current Farm Bill.

PROPOSAL 10: BUTTERFAT RECOVERY

CDI is not directly engaged in the manufacturing of cheese, so I am not prepared to provide technical testimony on this proposal. I would merely comment that in the absence of broad-based, validated data from a mandatory plant cost and yield study, National Milk has indirectly addressed this potential yield improvement by proposing a tempered adjustment to make allowances.

PROPOSAL 11: FARM-TO-PLANT SHRINK

The Federal Order regulations require handlers to account to producers and the pool on the basis of farm bulk tank weights and tests. As such, it is appropriate to account for reasonable variances between milk weights at the farm and what is physically received at the plants. While the information presented in this hearing by Select provides interesting insight into how a cooperative of their size and profile has been able to manage those farm-to-plant variances, CDI has concerns with Proposal 11's intent to completely eliminate any accounting for farm-to-plant shrink in establishing product yields in the Class III and IV formulas.

Select is in a unique position in the marketplace. The combination of full load pickups at the farm, typically measured by an on-farm scale, and at least occasionally transported in supertankers certainly has the potential of reducing the long-term gap between weights measured at the farm compared to weights received at the plant. However, even with Select's near-optimal structure, testimony given by Cheslie Stehouwer on behalf of Select noted that over the course of a year, deliveries from their own member-farms to their Michigan facility saw plant weights that on a weighted average basis were 0.20 percent below reported farm weights *(page 4 of Select-4, or Hearing Exhibit 218)*. Further, that same table indicates that according to Select's records, receipts of milk to their Michigan facility supplied by other cooperatives saw variances in plants weights that on a weighted average basis were as much as 0.32 percent below reported farm weights.

Further, on the issue of whether the additional butterfat yield adjustment of 0.0150 pounds of butterfat per hundredweight of milk is warranted, Select provides no direct data comparing farm-to-plant butterfat shrink in their testimony, other than the general statement that "to the extent that [butterfat losses] occur, they do not occur at a rate greater than overall solids losses." I believe the rebuttal testimony of Alison Krebs of Leprino Foods yesterday provided an fair assessment of the potential additional butterfat losses that can occur as butterfat "clings" to the walls of both the farm tank and/or the milk tanker in the process of loading and unloading tankers at the farm as well as at the plant.

Select's population of member farms may have unique characteristics that mitigate some of this risk of milk and component shrink, but it is the position of CDI and National Milk that a change to the current farm-to-plant shrink calculations should not be adjusted based on single-source data.

Select's testimony claims that "the vast majority of milk produced in the United States is produced on farms with sufficient cows to produce a full tanker load at each pickup." In attempting to substantiate this claim, Select's testimony notes that "assuming every-other-day pickups, a farm milking 375 or more cows will fill a full 50,000-pound tanker."

There are some issues with this analysis. First, in order for a farm to facilitate every-other-day pickups, the farm must have the available milk storage capacity to hold 48 hours of production. Second, to achieve the intended efficiencies, that on-farm milk storage must include at least one tank or silo that is capable of holding enough volume to completely fill a milk tanker. To illustrate this point, I would like to explore a sample herd with 375 milking cows producing an average of 67 pounds per day, as referenced in Select's testimony *(Select-1 or Exhibit 216)*. That dairy, producing an annual average of 25,000 pounds per day, may currently have on-farm capacity holding 30,000-35,000 pounds, in order to handle the seasonal ebbs and flows of their daily milk production. Accordingly, the idea of every-other-day pickups would not work in this case without additional investment on the farm. For the sake of this example, I will assume that there is adequate space within the milkhouse to add additional on-farm capacity. Adding another tank that could hold 30,000-35,000 pounds, or a second day of milk production, and may allow for better hauling efficiencies, as a truck could fully load their tanker in a single stop. However, such an investment by the farm would do nothing to improve the farm-to-plant shrink, as unloading two separate on-farm tanks back-to-back would likely have no improvement to shrink when compared to unloading one of those tanks each day. Instead, the farm would need to replace their current on-farm holding tank with a tank or silo that could hold at least 50,000 pounds (or larger, in order to handle the seasonal swings in milk production). Only then, with a single hose used to completely unload the tank into the milk tanker, could the improvement in farm-to-plant shrink be realized.

Beyond the detailed logistics of holding up to 48 hours of milk, there are also other considerations that must be taken into account. Every-other-day pickups mean that some of the milk in that tank may be up to 47 hours old at the time of pickup. While that may still meet Grade A requirements, it adds additional cost and risk to the farm. First, that milk must be held at 45 degrees or colder for up to 47 hours, resulting in higher cooling costs. Second, the longer the time between milk production and pickup, the more opportunity for any bacteria present in that milk to grow.

This exploration is not intended to disparage efforts to improve on-farm infrastructure in order to facilitate supply chain efficiencies. CDI has recognized this opportunity, and several years ago implemented a "stop charge" in the hauling expense charged each month to our members for their on-farm pickups. This stop charge applies every time a truck must arrive at the dairy to pick up milk, which in turn directly incentivizes our member farms to "build" full loads of milk and minimize the number of times the truck must stop at their farm. CDI recognizes that our member farms are generally larger than the average U.S. dairy farm, with a weighted average of about 2,000 milking cows per facility. However, even with that profile and a direct financial incentive

created by CDI to build full loads, an analysis of all milk pickups in 2022 indicated that only 73 percent of all our milk pickups were full load pickups. This is despite the fact that 99 percent of CDI's member milk supply is produced on member farms producing at least 25,000 pounds per day (or enough to build a full 50,000 pound load at least every 48 hours).

Incentives and Disincentives

Chris Allen's testimony on behalf of Select stated that "achievable efficiencies should be promoted rather than discouraged." CDI agrees that the construct of Federal Order formulas can play a role incentivizing or disincentivizing participant behavior. However, in this particular case, it should be noted that an elimination of the accounting for farm-to-plant shrink in the formula, as proposed, would place an added cost on the cooperative and other buyers of milk, while the ability to improve the farm-to-plant shrink is firmly in the hands of the producer.

Buyers of raw milk already have in inherent incentive to minimize farm-to-plant shrink, as payments to farmers are based on farm weights, so any variance between farm and plant weights contributes to plant loss. However, some of the efficiencies on-farm – such as investing in an on-farm scale or flow meters – are essentially asking for the dairy to absorb at least some of the farm-to-plant shrink rather than that burden falling on the plant.

If Proposal Number 11 were in place, the producer would be paid as if 100 percent of the milk in their farm tank is delivered to the plant, whether they make that investment or not.

The Select witness noted that USDA could decide to modify, rather than eliminate, the current farm-to-plant shrink factors built into the Class III and IV yield factors. However, it is the position of CDI and National Milk that due to the lack of broad-based, industry-wide data to support such a change, and our approach to propose a comprehensive package that takes a balanced and tempered approach in light of that lack of available data, Proposal Number 11 should be rejected.

PROPOSAL 12: CLASS IV SNF YIELD

As stated earlier in this testimony, National Milk shares an interest in a robust re-evaluation of all factors in the Class IV formula, including the assumed solids-not-fat, or SNF, yield. However, as also noted earlier in this testimony, National Milk believes that such a re-evaluation is best conducted following the collection of broad-based, validated data from a mandatory plant cost and yield study conducted by USDA.

The current make allowance and yield in Class IV SNF formula is based on nonfat dry milk, or NFDM. As noted in Select's testimony, this yield factor does not include an adjustment for buttermilk powder, a byproduct of the butter churning process that has different uses in the market, different costs of manufacturing and different price points from NFDM.

Select went further in their testimony, stating that USDA's "policy decision" in the 2002 Final Decision was "erroneous" in opting not to adjust the product yield factor to include the solids that end up in buttermilk powder. However, there are multiple reasons why a more cautious approach was and continues to be warranted in the absence of additional data.

Lack of validated product price data

Despite both products being processed through a similar drying process, buttermilk and NFDM are two different products, both in their component composition and their utilization in the marketplace.

With regard to component composition, NFDM may not have more than 1.25 percent butterfat, while buttermilk powder may not have less than 4.5 percent butterfat. Given this difference, the products are not interchangeable, and have different demand and customer profiles. Buttermilk powder tends to be purchased for cake mixes and bakery pre-mixes, while NFDM tends to be purchased as a protein source for cheesemaking, confectionary and nutrition purposes.

Select has testified as to the price alignment between buttermilk powder and NFDM in their experience as a marketer of both products. They have also conducted an analysis of results from *Dairy Market News*, a weekly publication of USDA's Agricultural Marketing Services.

While this serves as an interesting starting point for data collection in this area, there are important limitations to this data. First off, Select's own data is limited by the sample size of their transactions. While Select's witness did not state the total production volume of butter or buttermilk powder, their data is nonetheless a single source that based on testimony, includes some months where no buttermilk is dried due to a lack of butter churn activity.

Further, while *Dairy Market News* has its place in the market as a market information source, it falls well short of the standards set by the National Dairy Product Sales Report as a broad-based, volume-weighted and validated source of price discovery for buttermilk powder. Weekly *Dairy Market News* price ranges are unaudited, unweighted, and limited to those market participants who choose to participate in direct communications with USDA staff compiling those weekly reports. There are no reporting standards, such as restrictions on fixed price contracts or specification details that would differentiate buttermilk powder sold for traditional bakery utilization vs. buttermilk powder with a higher specification sold for use in infant formula, as Select noted is their market of choice for their buttermilk powder. These comments are not intended to disparage the *Dairy Market News*, which provides a good summary of market status and trends. It is simply a recognition of the limitations of this dataset.

Lack of validated processing cost data

References to manufacturing costs for buttermilk powder both in previous hearing records and in this hearing have been general at best. Select's testimony has referenced a previous estimate dating back to the 2002 Final Decision that the cost of producing buttermilk powder is two cents higher than the cost of producing NFDM. However, for multiple reasons, this is not an adequate datapoint to justify a change in the Class IV SNF calculation as a result of this hearing.

First, a more thorough review of the 2002 Final Decision indicates that the concept of a buttermilk powder make cost equal to NFDM make cost plus two cents was not universally accepted. The final decision includes references to testimony of buttermilk powder processing costs up to 3 cents higher than NFDM processing costs at the time.

Further, those references are now more than 20 years old. Testimony provided by Select's witness Steve Cooper indicated that there are multiple efficiency losses associated with drying buttermilk powder when compared to the process of drying NFDM. The first is the need for additional "purge time," as a clean break is needed on those dryers that are processing both buttermilk powder and NFDM. In addition, with buttermilk powder having more than three times the amount of butterfat as NFDM, Mr. Cooper noted the need to run the dryer at a slower speed. This not only would result in higher utility costs as noted by Mr. Cooper – which can vary from region to region, with my home state of California likely on the higher end of that cost spectrum – but also would result other manufacturing costs, such as processing labor, increasing on a per-unit basis as it is spread out over a smaller volume of processed milk solids per hour.

Minimum prices and other formula considerations

It should not be ignored that we are setting a minimum price, and that the largest handler impact of these proposals would be felt by manufacturing cooperatives that operate Class IV plants largely for balancing purposes. These plants play a critical role in orderly milk marketing, as they unlock the potential for proprietary manufacturers to purchase milk as-needed for optimal manufacturing and marketing efficiencies. However, the formulas include no specific accommodation for those balancing costs.

Despite this reality facing CDI and other cooperative members of National Milk, we are collectively taking a tempered and balanced approach when it comes to adjustments to the manufacturing milk price formulas. This is intentionally done as we believe that while some level of adjustment to those calculated milk prices is warranted in the near-term, given the changes in cost structure over the past 15 years, a more substantial adjustment to all elements of the formula, including make allowances and yields, is best done with the backdrop of broad-based, industry-wide, validated cost and yield data.

ADDITIONAL CONSIDERATIONS

All milk solids subject to Class IV component prices

When milk is purchased – or more appropriately, when butterfat and SNF is purchased – for Class IV use, the handler must account for all solids purchased, not just those that are ultimately converted into butter or nonfat dry milk. A reasonable debate on how to properly structure the Class IV component formulas is a fair exercise, particularly if additional data is secured that could provide an updated industry-wide, validated perspective on market prices, manufacturing costs or yield changes. However, claims that the manufacturing of buttermilk powder represents "pure profits" since buttermilk powder is not explicitly referenced in the Class IV SNF calculation, as referenced on at least one occasion during the examination of Select witnesses, is unfounded in light of the fact that all milk solids are purchased at the Class IV component price.

NFDM yield vs. SNF yield

During the redirect of Steve Cooper, Select's counsel posed a question to the witness relating to the current yield factor of 0.99 in the Class IV SNF formula. The question led the witness to answer that 1 pound of SNF should be able to produce 1.02 pounds of NFDM, since NFDM has certain volume of moisture. However, it should be noted for the record that the 0.99 yield factor

is not applied to the Class IV SNF price, but instead to the NFDM price, net of the make allowance. In other words, the formula does not purport to assume that 1 pound of Class IV SNF would make 0.99 pounds of NFDM, but rather that 1 pound of NFDM can be made from 0.99 pounds of SNF. As stated earlier, a reasonable debate about yield factors is fine, including if and how to account for buttermilk powder in a regulated formula, but I do not believe Select intended to enter into the record that when looking specifically at the production of NFDM, that it would take 1.02 pounds of SNF to make 1 pound of NFDM.

CONCLUSION

In conclusion, National Milk has proposed five updates to the Federal Order milk pricing formulas for this hearing, in addition to our focused effort to authorize USDA to conduct mandatory plant cost and yield studies. That comprehensive package was carefully crafted as a balanced approach, taking into account the industry-wide data that we have, while also being mindful of the industry-wide data we currently lack. It is the net result of that package, rather than the individual proposals themselves, that garnered unanimous support from National Milk's Board of Directors.