

**United States Department of Agriculture  
Before The Secretary of Agriculture**

**In re: [Docket No. 23 – J – 0067; AMS-DA-23-0031]  
Milk in the Northeast and Other Marketing Areas**

**Hearing beginning August 23, 2023**

**Testimony Presented By:**

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My name is Calvin Covington. This testimony is presented in **opposition to the portions of proposals 16, 17, and 18 which eliminate advanced pricing.**

This testimony is presented on behalf of Southeast Milk, Inc. (SMI) with the support of National Milk Producers Federation (NMPF). SMI is a long-time member of NMPF.

My off-farm career in the dairy industry covers 50 years, working with dairy farmers and their organizations. This work includes preparing proposals for and presenting testimony at many federal milk marketing order (FMMO) hearings over the past five decades. I retired from SMI as their CEO in 2010, but remain involved in the dairy industry, particularly, in the areas of milk pricing and federal order regulations. Since leaving full-time employment with SMI, my association with the cooperative continues, including serving as their Interim CEO most recently in 2022, and representing the cooperative on FMMO and dairy policy issues. This includes serving as a member of the NMPF federal order task force which developed this and the other proposals presented at this hearing.

SMI is a Capper-Volstead cooperative and a pool handler in the Florida and Southeast FMMOs. SMI is responsible for supplying all the raw milk needs for four pool distributing plants located in the Florida FMMO and one pool distributing plant in the Southeast FMMO.

As of June 30, 2023, SMI's membership consists of 114 dairy farmer members who own and operate 119 Grade A dairy farms. SMI estimates 93 of these members meet the Regulatory Flexibility Act's definition of a small business.

SMI extends its appreciation to the Secretary of Agriculture and the Dairy Division staff for holding this hearing.

The reasons for opposing the elimination of advanced pricing are as follows:

1. The nature of packaged fluid milk. I estimate about 90% of packaged fluid milk sales is considered conventional, and processed using high temperature-short time (HTST) pasteurization. Conventional packaged fluid milk is the most perishable dairy product in the dairy case. In practical terms, packaged fluid milk is marketed using “just-in-time” strategies. Most buyers of packaged fluid milk, especially large retail grocers receive fluid milk deliveries multiple times per week. It is common for retail grocers to refresh their dairy cases with packaged fluid milk frequently throughout the day. There is no practical method to store HTST packaged fluid milk for more than what would represent a few days of a retailer’s needs. This is unlike many Class III and Class IV retail products, such as butter and cheese, which can be stored for longer periods.

Grade A farm milk delivered to pool distributing plants, marketing conventional HTST packaged fluid milk, is processed, packaged, distributed, and sold in a relatively short time period. It just makes good economic and business sense to know at the time of purchase the price of the product with a relatively short shelf life, especially compared to other dairy products. FMMO advanced pricing of Class I milk provides this price. Without advanced pricing, this pricing goes away. Waiting until most of the product is already distributed, and much of it consumed before knowing the price, is not a prudent business practice.

2. Pricing of packaged fluid milk. Most HTST packaged fluid milk, especially private label sales, and institutional sales (schools) is priced by fluid processors to its customers, monthly, based on some type of pricing formula. In simple terms, the formula has as its base, the raw milk cost. The raw milk cost is significant and the highest single item cost of the total expense to process and package a unit of conventional HTST fluid milk.

The monthly FMMO Class I milk price is used to determine the base raw milk cost in the pricing formula. Most dairy plants manufacturing cheese or butter, base their selling price, generally, off Chicago Mercantile Exchange (CME) daily cash prices. Fluid milk plants marketing excess cream use the CME butter price to establish the base selling price. A buyer of cheddar cheese or cream can look at CME prices and know the base price they would expect to pay for a truckload of block cheddar cheese or a load of cream. Fluid milk has no daily price basis such as the CME. The base price is the announced FMMO Class I price.

To further explain packaged fluid milk pricing and the need for advanced pricing I provide the following example. Assume I own a group of grocery stores. I contract with a fluid milk processor for gallon jugs of private label packaged conventional white fluid milk for my stores. My monthly price for the packaged fluid milk is based on a formula negotiated with the fluid milk processor. The formula is the monthly FMMO Class I price at the location of the fluid plant; packaging cost – resin used to make the jug, cap, and label; and any added ingredient cost, plus a tolling fee. In this formula, assume the cost of raw milk represents 75% or more of my total cost of a gallon of whole milk at the fluid milk's plant dock.

Using the month of September 2023 as an example, I knew, on August 23 of the prior month the price for the packaged milk I will purchase from the fluid processor during the month of September. How did I know the price? FMMOs announced the September Class I price in advance on August 23. This advanced price notice enabled me to set my retail store milk prices for September prior to the beginning of the month. Knowing my packaged milk cost in advance allowed me to consider any milk promotion plans. Advanced FMMO Class I pricing allowed me as a retailer to know the packaged milk price in advance. Advanced pricing allowed the fluid milk processor to know the price the plant would receive for the packaged fluid milk prior to the raw milk being processed, packaged, and sold.

Now look at my situation as a retail grocer under proposals 16, 17, and 18 which eliminate advanced pricing. For the packaged fluid milk, I purchase in September, I will not know the cost until the afternoon of October 4. Why? Without advanced Class I pricing it would be October 4 before the September Class I price is announced. Again, the price of the raw milk represents at least 75% of my packaged milk cost. Most of the packaged fluid milk I purchased in September has been sold, before the price I pay for the product is known. From a retail grocer's perspective this is not orderly marketing of fluid milk.

History tells us there can be significant month-to-month price increases in the Class I milk price. Advanced pricing tells us what the next month's milk price will be, and plans can be made accordingly. Without advanced pricing, the actual announced FMMO Class I price would not be known until the following month, after most of the product has already been distributed and sold. When there is a significant monthly increase in the Class I price, I see the possibility of retailers going back to their fluid milk processor, and the fluid milk processor going back to the dairy farmer cooperatives supplying them with milk seeking price relief when there is a large month-to-month price increase. This is not orderly marketing. It opens the potential of fluid milk processors in the same marketing area not having equitable raw milk costs. And, the potential of producers in the same marketing area not having uniform pricing.

3. Additional burden on fluid milk processors and cooperatives. If the sections of Proposals 16, 17, and 18, which eliminate advanced pricing, were adopted, it would be unrealistic to think many retail grocers would not seek some type of continued advanced pricing on Class I products. This due to the example just given, and the tradition of advanced Class I pricing. Fluid milk processors and cooperatives that supply raw milk to fluid processors would be asked to respond to that request.

To meet the request, fluid processors and/or cooperatives would need to calculate an estimated advanced Class I milk price. An estimated advanced Class I price would require later “true-ups” to the final announced FMMO Class I price. Doing this would require additional accounting and record keeping. Plus, there is the potential “true ups” could be upside limited. This means fluid milk processors and/or their milk suppliers take the hit when prices rise faster than forecast, as indicated above.

On past occasions cooperatives were asked by fluid processors to develop Class I price estimates in advance of the FMMO Class I price announcement with the promise to “true-up” later. Let me share with you an actual example.

It was December and the January Class I price announcement date was just a few days before Christmas that year. Some fluid milk processors and their customers wanted to get a jump-start on Christmas. They wanted to have their January milk price announcements out of the way several days before Christmas. Fluid processors asked their supplying milk cooperatives to estimate the January Class I mover and announce the cooperative’s Class I price several days before the actual January Class I announcement.

Desirous to meet the request of its customers, the cooperatives agreed, including a future “true-up.” The “true-up” is the difference between the estimated Class I price and final Class I price, up or down. The “true-up” is carried over to the February price announcement. The cooperative does not receive the final settlement for February milk until March. The “true-up” would not be reflected in the dairy farmer’s milk check until the check received in March for February milk.

If all this sounds complicated, it was. Personally, I can tell you when this was done it was one big mess. It met the definition of disorderly marketing. I regretted agreeing to do it, and departing from the FMMO advanced price schedule. It was not done again. The scenario just described is for a one-off pricing date accommodation. Imagine how complex this could get if these estimations and “true-ups” occur monthly.

Adding to the market disorder created by “true-ups” there is the possibility of notably different Class I raw milk costs across competing Class I milk buyers. These would not be due to differences in prices based on plant location, but rather variations in effective prices due purely to differences in the forecasts of Class I prices. Unequal pricing for the same product is disorderly and should be avoided.

4. Institutional buyers of fluid milk products. School systems and other public institutions such as military bases and prisons are large buyers of packaged fluid milk. Most schools and public institutions purchase packaged fluid milk based on a pricing formula, similar to what I used in my earlier example. These pricing formulas are known for their being rigid and strict with the only change being monthly changes in the raw milk cost. Advanced Class I prices allows schools and other public institutions to know in advance their monthly milk costs, and plan accordingly. It would be a challenge to have a “true-up” program with a school or military commissary and to explain to them why they could not know the milk price prior to purchase, and why they needed to “true-up” beyond what they already paid for milk.
5. Class I price. Fluid milk processors pay the highest regulated raw milk price. The Class I price is higher than Class II, III or IV. Eliminating Class I advanced pricing creates a one-sided change. Dairy farmers retain the economic benefits of a higher Class I price, but fluid milk processors lose the pre-knowledge of their raw product cost.
6. Dairy farmer benefits. Advanced pricing benefits dairy farmers by providing a mild buffer to blend price fluctuations. When Class III and Class IV milk prices are falling, advanced class prices are the last to be impacted. This buffers the inevitable declines in the blend price. Depending upon Class I utilization, this buffering can be a little or a lot, but it is nonetheless present and important.

The one place in FMMO pricing where the industry, and, in particular dairy farmers, get a peek over the fence at what prices may be coming at them are advanced class prices. Advanced prices provide a real-time look forward for milk pricing trends. They are the first regulated prices to signal what is coming. Elimination of advanced pricing removes this market signal. With advanced pricing there is no doubt when dairy product prices increase, there is a lag period before the Class I price increases. On the other hand, when dairy product prices decline, there is a lag period before the Class I price declines. Over the years dairy farmers have regularly expressed to me that they want to know as far in advance as possible the direction milk prices are moving. Advanced pricing helps provide a look forward for the milk price direction.

7. Little benefit. Reducing the potential of price inversions is the justification provided for eliminating advanced pricing. There is no argument, eliminating advanced pricing helps reduce price inversions. NMPF and its member cooperatives recognize the need to reduce price inversions. Adoption of NMPF proposals 1, 13, and 19 would help do so.

The marginal benefit from eliminating advanced pricing does not exceed the marginal cost. As the old saying goes, “do not let the cure be worse than the disease.” Advanced pricing provides benefits to all involved in the fluid milk food chain from dairy farmers to consumers. Advanced pricing should not be eliminated just in order to help solve a single challenge.

FMMOs do not establish or regulate the retail price of packaged fluid milk. However, some acknowledgement of FMMOs and its impacts on retail marketing of Class I fluid milk is appropriate. It is helpful to retailer grocers and institutional buyers to know the cost of packaged fluid milk in advance. The current system of FMMO advanced Class I pricing addresses this need. Advanced pricing allows retailers to better implement their marketing strategies, and allows institutional buyers easier budgeting.

Advanced pricing has served the fluid dairy industry well for many years. This hearing shows there are FMMO provisions where processors and producers have differences of opinion. Advanced pricing is one FMMO provision that most fluid milk processors and those cooperatives who supply fluid milk to these processors largely agree on. We strongly encourage the Secretary of Agriculture to retain the advanced pricing provisions in all FMMOs.

Respectfully submitted,

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on behalf of Southeast Milk, Inc.