National Milk Producers Federation, Inc.

Testimony on Proposal Number 20

Milk In the Northeast and Other Marketing Areas

Doc. No. 23-J-0067; AMS-DA-23-0031

My name is Jeffrey Sims, I am Chief Market Analysis Officer of Lone Star Milk Producers, Inc. Lone Star Milk Producers is a Capper-Volstead cooperative association qualified to market milk on Federal Milk Marketing Orders (FMMOs) and is a member of National Milk Producers Federation (NMPF).

This testimony is presented on behalf of NMPF, in opposition to Proposal Number 20 as advanced by the Milk Innovation Group (MIG). Proposal Number 20 fails on numerous levels, and if adopted, would inject calamitous disorderly marketing conditions into the U.S. milk marketing system, and would be entirely contradictory to the aims and purposes of FMMOs, and the requirements of the Agricultural Marketing Agreement Act (AMAA).

The challenges and concerns with Proposal Number 20 are:

1. Proposal Number 20 seeks to reduce every one of the approximately 3,100 county, parish, and independent city Class I differentials listed in §1000.52 by $1.60 per hundredweight, leaving a large portion of the country with an effective Class I differential of $0.00 per hundredweight. The Proposal Number 20 suggested Class I differential reductions, and in some large geographic areas the complete elimination of Class I differentials, would reduce the FMMO pool values by $650,000,000 to $670,000,000 annually across the FMMO system. While this fact should be obvious, there is no guarantee that any of the $660,000,000 would materialize in the form of over FMMO prices.

2. The establishment of a substantial portion the country at a Class I differential level of $0.00 per hundredweight would significantly increase the incidences of Class I Price inversions, since the announced FMMO Class I price in those geographic areas with an effective $0.00 per hundredweight Class I differential would be the Class I Base Price, aka the Class I Mover. The reduction of Class I differentials by $1.60 per hundredweight across the board would substantially increase the incidence of negative Producer Price Differentials. Negative PPD's remain a major concern in the eyes of dairy producers. Provisions which would tend to increase the incidences of, and magnitude of, negative PPD's will not be embraced in the dairy farmer community.

3. Proposal Number 20 would reduce, or even eliminate, the regulated price economic incentives to supply milk to Class I plants. This reduction in the incentive to supply Class I plants would exist both in FMMOs with substantial dairy product manufacturing, and in those FMMOs that are predominately Class I.

4. Proposal Number 20 ignores, or assumes away, the substantial costs of balancing Class I plants, and ignores, or assumes away 25 years of increases in milk hauling costs.

5. Proposal Number 20 ignores the substantial amount by which the on-farm milk production costs of Grade A milk exceed the on-farm milk production costs of Grade B milk.

6. Proposal Number 20 would effectively return much of the country to individual handler pools which can cause market disorder, rather than marketwide pools which have been determined by the Secretary to enhance orderly marketing and effectuate the declared policies of the AMAA.

7. Proposal Number 20 would create conflicts with other FMMO provisions.

8. Proposal Number 20 makes no improvements in the Class I price surface to encourage milk to move from reserve milk supply areas to areas of milk need despite substantial increases in the cost of milk hauling that have occurred since the establishment of the current Class I differentials in most of the country 24 years ago. Proposal Number 20 would in fact, disincentivize the delivery of milk from reserve supply areas to milk deficit areas.

9. Proposal Number 20 improperly concludes that Class I demand will increase with reduced, or eliminated, Class I differentials.

10. Proposal Number 20 relies on substantial, immediate, and permanent increases in over FMMO prices to transmit dairy product values through to raw milk, and to the dairy farmers who decide how much milk to produce, and where to sell their milk. If such increases in over FMMO prices were to occur, a highly speculative occurrence at best, there is no guarantee that such increases would be immediate and permanent, and certainly no assurance that the over FMMO prices would rise sufficiently to offset the $660,000,000 loss in FMMO pool revenues.

These identified problems with Proposal Number 20 build on each other, creating a towering inferno of disorder that not only threatens the supply of milk for Class I use, it threatens the supply of milk for this nation for all uses of milk. Furthermore, it represents an imminent and unmistakable risk to the existence of the FMMO system itself. It is certainly plausible that the ultimate objective of Proposal Number 20 is in fact just that, the destruction of the FMMO program.

PROPOSAL NUMBER 20 REDUCES THE FMMO POOL REVENUES IN ALL FMMOs

The impact of Proposal Number 20 on FMMO pool values would amount to an FMMO-wide reduction of $650,000,000 to $670,000,000 per annum, which translates to a national average blend price reduction of $0.43 to $0.49 per hundredweight. This amount of milk price reduction would severely damage the supply of milk for all uses, and would particularly impair the supply of milk to Class I. These values are computed in Exhibit NMPF-112A.

Milk value reductions of this magnitude certainly fails to recognize the AMAA's directives to USDA on fixing prices at levels insuring a sufficient quantity of milk. The adoption of Proposal Number 20 would cause USDA to fail in meeting its statutory obligation under the AMAA.

PROPOSAL NUMBER 20 INCREASES THE INCIDENCES OF CLASS I PRICE INVERSIONS, AND INCREASES THE INCIDENCES AND MAGNITUDE OF NEGATIVE PPDs

As previously demonstrated in testimony and Exhibits introduced at this Hearing (Exhibit NMPF-37, Exhibit NMPF-37A), and in Exhibit NMPF-112A , with the establishment of a substantial portion of the U.S. having a Class I differential of $0.00 per hundredweight would come an increase in the occurrence of Class I price inversions, increases in the incidences of and increases in the magnitude of negative PPDs, and increases the occurrences of the associated depooling, to such a level that disorder in the marketing areas would become the rule rather than the exception.

Further, presuming the Secretary wisely returns the Class I Mover computation to the higher-of the Class III and Class IV advanced skim milk prices, there will be price inversions with Class II any time that the 'higher of' is the advanced Class IV skim milk price. Even more concerning, the price inversion with Class II would extend to any county, city or parish that today carries a Class I differential less than $2.30 per hundredweight. Because today's weighted average Class I differential is roughly $2.60 per hundredweight, every time that the Class IV advanced skim milk price exceeds the Class III advanced skim milk price, nearly half of the country will experience a Class I to Class II skim milk price inversion relative to the Class II skim milk price. Furthermore, in many FMMOs, the Class II price would regularly be the highest of all the Class prices.

Expressed mathematically:

$2.30 per hundredweight - $1.60 per hundredweight = $0.70 per hundredweight [where $1.60 per hundredweight is the Proposal Number 20 differential reduction].

Thus, if Class IV is the 'higher of', then Class IV sets the Class I price.

Closely associated with the issue of Class I price inversions is the issue of the occurrence of negative PPDs. Exhibit NMPF-112A examines the impact of Proposal Number 20 on Class I revenues in each FMMO for the period of 2021 through 2022. The data provided indicates that Proposal Number 20 would substantially increase the incidence of and magnitudes of negative PPDs. NMPF's analysis shows that during 2021 the occurrences of negative PPD's

under Proposal Number 20 would have increased by about 42 percent versus the current pricing structure. In that year, under the Proposal Number 20, even the Appalachian and Southeast FMMOs would have experienced blend prices at the FMMO base pricing zones at levels below the Class III price in two months. During 2022, a year marked by a relatively low Class III prices as compared to Class IV, there was only one FMMO, for one month, that announced a negative PPD. Had Proposal Number 20 been in effect, three FMMO's would have announced negative PPD's for two months each, and one additional FMMO would have announced a negative PPDs for one month. In 2022, under Proposal Number 20, the incidences of negative PPDs would have increased 700 percent.

The negative PPDs displayed in Exhibit NMPF-112A, are calculated at the various FMMO base pricing zones, and would be even further negative in FMMO zones with a negative location adjustment off the base pricing zone.

The increased incidences of Class I price inversions in several of the FMMOs, for example FMMO 30 and FMMO 51, by decreasing Class I differentials by $1.60 per hundredweight brings into real question why even have a FMMO. The implications here are likely no accident.

Price inversions and negative PPDs lead unquestionably to the depooling of milk, and bring about disorder in markets. Depooling for pricing reasons disrupts the equity of producers' returns, resulting in prices that may not accurately reflect the producers' role in supplying the markets. When depooling occurs, producers no longer have assurance that the prices they receive correspond to the milk's value at the plants and FMMOs they serve, and there is no guarantee they will receive the average market value for their milk. This situation naturally raises legitimate concerns across the producer community about the fairness of regulated milk pricing. Pervasive dairy farmer mistrust of their regulated milk pricing system is the worst form of market disorder.

PROPOSAL NUMBER 20 REDUCES OR ELIMINATES THE INCENTIVE TO SUPPLY MILK FOR CLASS I USE

The establishment of a $0.00 per hundredweight location value zone, or zones, would remove the incentive to supply Class I plants, or significantly reduce the incentive to supply Class I plants, in both the FMMOs with substantial hard product manufacturing, and the FMMOs that are predominantly Class I, such as in the southeastern U.S.

As proposed in Proposal Number 20, in any civil geographic description designated in §1000.52 with a Class I differential of $0.00 per hundredweight, the Class I FMMO price for the month would be the Class I Base price, aka the Class I Mover. So mathematically displayed: Mover + $0.00 per hundredweight = Class I Price at location. Consequently, the Class I price would generally be very close in value to either the Class III price, the Class IV price, or both. There would be no regulated price incentives to supply Class I plants.

In the significant hard product manufacturing regions, a $0.00 per hundredweight, or near $0.00 per hundredweight Class I differential would erase any incentive to supply milk to Class I. Given that Proposal Number 20 would lead to a significant portion of the country experiencing scenarios in which the monthly Class I price aligns closely, or even equals at least one of the manufacturing class prices, why would producers show any interest at all in meeting Class I demand? This problem is exacerbated by the costs of balancing Class I plants. This problem with Proposal Number 20 creates a two-fold disaster: no money in the Class I price to encourage milk to be drawn from manufacturing uses in times of tight supplies of milk, and no money to compensate dairy farmers for the substantial difference in the cost to supply to Class I processors compared to the costs of supplying manufactured dairy product plants. Class III and Class IV plants very often have substantially less volatility in their milk receiving than do Class I plants, and thus are easier to serve with milk. Manufacturing plants also tend to be located closer to milk production centers.

Dairy farmers would then be right to ask the logical question, why should I sell my raw milk to Class I plants for no more money than I can get from Class III sales, especially when you also want me to absorb the costs of balancing the inherently large weekly and seasonal variations in Class I sales? To ask the question is to answer it.

The obvious result would be that when pool revenues become virtually identical between Class I and Class III or Class IV, producers (and their cooperative associations) will become, at best, indifferent towards serving Class I demand, or perhaps even completely disinclined to supply Class I. Clearly this is in direct conflict with the intent and aims of FMMOs. The highly foreseeable end game resulting from adoption of Proposal Number 20 would be the destruction of the FMMO program, and the orderly marketing of milk that results from its existence.

Class I differentials should exhibit a positive "slope" or "price gradient" that effectively traverses from regions of milk surplus to areas with low milk supplies, thereby incentivizing the flow of milk from reserve supply regions to milk deficient regions. This need for a price gradient to incentivize milk movements is confirmed in Dr. Stephenson’s testimony (Exhibit MIG-16, page 6 of 13). As transportation costs escalate, this price gradient must likewise adjust, ensuring a price differential between areas that justly compensates dairy farmers for the increased expenses incurred in milk delivery.

Proposal Number 20 fails to address the need for updating the regulated price gradient, while simultaneously channeling 660 million dollars from price underpinning into the collective coffers of Class I processors, from the Proposal Number 20’s across the board reduction in Class I differentials of $1.60 per hundredweight. However, as conclusively demonstrated in NMPF's Proposal Number 19, the current Class I price gradient begs for significant revision, as the price surface has notably fallen short in reflecting the current cost of milk hauling. Proposal Number 20 dismisses the undeniable and harmful effects of 25 years of escalating hauling costs as inconsequential.

An immediate impact of Proposal Number 20's reduction in Class I differentials would be a substantial deterioration in the blend price gradient between the areas of reserve milk supply and FMMOs 5, 6 and 7, which are the most milk-deficit FMMOs in the U.S.

Since FMMOs 5, 6, and 7 have the highest Class I utilization percentages in the U.S., the negative blend price impact on a per hundredweight basis from Proposal Number 20's decrease in Class I revenue will also be greatest in these three milk-deficit FMMOs. Exhibit NMPF-112B shows that the blend price gradient between the areas of reserve milk supply and FMMOs 5, 6, and 7 narrows under Proposal Number 20, and narrows by significant margins. Depending on the year, the location of the milk source, and the location of the milk destination, the blend price incentive to move milk to the southeast diminishes in a range of roughly $0.50 per hundredweight to more than $1.00 per hundredweight. Proposal Number 20 directly defies a primary principle of FMMOs, encouraging milk to be made available for Class I use, and to encourage the movement of milk toward areas of milk need.

We find it particularly ironic, and telling, that counsel for MIG spent considerable time questioning NMPF witnesses why Proposal Number 19 didn't propose a Class I differential higher than the USDSS model two-month average for Miami, Florida, when the MIG Proposal Number 20 would reduce the blend price by a greater amount in the Florida FMMO than any other place in the country. This disconnect between MIG's simultaneous two positions is irreconcilable.

Further, Counsel for MIG seemed to hold the USDSS model and its results as sacrosanct, and as providing the definitive picture of what a U.S. Class I price surface should look like. Yet, Proposal Number 20 fails to make any adjustments to the Class I price surface slope at all, ignoring the evidence that incentives to supply Class I milk need to increase, not weaken.

PROPOSAL NUMBER 20 WOULD NEGATE THE IMPACT OF POOLING PROVISIONS OR MILK DELIVERY PERFORMANCE STANDARDS

Proponents of Proposal Number 20, not so obliquely, state that the same objective to get milk to move for Class I uses as establishing adequate prices, as required by the AMAA, can be achieved by adjusting pooling provisions and performance standards in the FMMOs. Fourth grade math not only disproves this argument, but also lays bare the true objective of Proposal Number 20.

In the regions with Proposal Number 20's Class I differentials which would be at or near $0.00 per hundredweight, the Class I prices and the manufacturing Class prices will be essentially be equal, at least over time. From simple math, we know then that the Class I utilization percentage, and its complement, the manufacturing class utilization percentages, will be immaterial to the blend, because the blend will be the same as the manufacturing class prices. You can remove all the manufacturing class milk from the FMMO pool you want to, the blend price answer remains the same.

For example, assume for a month the Class I mover equals $17.00 per hundredweight, which is derived in one way or another from Class III and Class IV prices. Assume further, the manufacturing class price to be $17.00 per hundredweight. Ignore any impact of advanced Class I pricing versus final Class III and IV pricing. At the $0.00 per hundredweight Class I differential zones, the Class I price for the month is in fact, the Class I mover. Thus,

90% Class I: $17.00 * 0.90 = $ 15.30 per hundredweight

10% Manufacturing Classes $17.00 * 0.10 = $ 1.70 per hundredweight

$15.30 + $1.70 = **$17.00** blend per hundredweight

10% Class I: $17.00 * 0.10 = $ 1.70 per hundredweight

90% Manufacturing Classes $17.00 * 0.90 = $15.30 per hundredweight

$1.70 + $15.30 = **$17.00** blend per hundredweight

The Class I utilization percentage loses all influence on whether milk gets delivered to Class I. In any FMMO where the Class I differential is equal to $0.00 per hundredweight, or close to $0.00 per hundredweight, no matter how high the Class I utilization, having Class I and manufacturing Class prices virtually equal, means no increase in the blend price, and in fact, means that the blend price will be, much of the time, equal to the manufacturing class prices.

In areas where the Class I prices and the manufacturing class prices become virtually equal at a location, the decision on whether to serve Class I will be largely one of logistics costs, uninfluenced by the milk price. The foreseeable result is that some Class I plants may not get served, because they are more distant from a milk supply than the hard product manufacturing plants, and are more costly to balance.

Consequently, in the $0.00 per hundredweight Class I differential zones, with Class I and manufacturing class prices being indistinguishable from each other, no matter what the class utilizations for the pool, there is no real reason to have a producer revenue pool at all, and thus no reason to have an FMMO at all. This is a fact that cannot have eluded the proponents of Proposal Number 20 when they drafted it. The objective behind the strategy now becomes clear. Undoubtedly, the complete elimination of the FMMO program is the ultimate objective of Proposal Number 20.

PROPOSAL NUMBER 20 DOES NOT RECOGNIZE THE SUBSTANTIAL COSTS OF BALANCING CLASS I MARKETS AND DOES NOT RECOGNIZE MORE THAN 25 YEARS OF INCREASED HAULING COSTS

The removal or significant decrease in the minimum level of Class I differentials removes from the FMMOs any compensation to dairy producers for taking on the substantial, and ever-continuing cost of balancing Class I plants. In fact the Proponents of Proposal Number 20 ignore the costs of balancing Class I plants, rather, opining that balancing costs can be remedied by the installation of more raw milk silos at Class I plants. Substantial and credible evidence has been submitted at this hearing on the variation in Class I producer milk day to day, within calendar weeks, within calendar months, and that Class I seasonality still exists and is costly to manage. Substantial testimony has been presented at this hearing attesting to the continued and in fact, substantially increased cost of servicing Class I markets. No reasonable individual can claim that managing the variation in Class I demand comes at no cost, nor is it easy, nor should those balancing costs fall solely on the dairy farmers who supply Class I plants.

Clear and convincing evidence has been submitted at this Hearing on the increases in milk hauling costs, and how those increases in milk delivery costs are today, not tomorrow, threatening the continued supply of milk to Class I plants. Proposal Number 20 in essence denies that milk delivery costs have increased, and suggests that the current spatial relationship of milk prices is sufficient to encourage milk to be supplied to Class I plants. Nothing could be more incorrect.

Proponents of Proposal Number 20's own witness, Dr. Stephenson, in his prepared statement noted on page 6 of 13, that "milk has relative regional values, where milk in certain locations can be 'more valuable' than milk in other locations because of relatively tighter supply. Federal Orders try to capture regional variation with Class I differentials." Yet Proposal Number 20 does nothing to recognize the need to update the location values with a revised and modernized Class I price surface, reflective of increases in hauling costs that have occurred since the Class I differentials were last updated nationally, more than two decades ago.

Extensive testimony has been presented at this hearing detailing the need to update the FMMOs make allowance provisions, due to substantial increases in the cost of converting raw milk into useable dairy products, that is, the costs of enhancing milk's product and form utility. Notably absent in Proposal Number 20 is the reflection of 25 years of increased hauling costs which convert milk in its time and place utility. The complete rejection of any recognition of the costs of moving milk per mile, and the increases in miles milk actually moves because milk production centers have migrated farther from cities where the Class I plants are generally located, further threatens the supply of milk to Class I plants.

The proponents of Proposal Number 20 show their true colors by supporting amended provisions that recognize increases in the costs of converting farm milk to manufactured products, yet ignore either as inconsequential or non-existent, the increases in the costs of getting farm milk to fluid processing plants.

PROPOSAL NUMBER 20 DOES NOT RECOGNIZE THE SUBSTANTIAL COSTS OF PRODUCING GRADE A MILK VERSUS GRADE B MILK

Proponents of Proposal Number 20 are questioning the significance and influence of Grade B milk supplies; are espousing the premise that there is no milk production cost difference between Grade A and Grade B milk; or in the alternative, if Grade B milk does exist in consequential quantities, it presumes no dairy farmer would ever revert to Grade B from Grade A.

Evidence presented at this hearing show that consequential supplies of Grade B milk do exist and have a market; and the on-farm milk production cost difference between Grade A and Grade B is of such significance that if there is no financial incentive to produce Grade A milk, reversion to Grade B could be a viable option at the farm level.

Proposal Number 20 not only ignores the existence of the considerable difference in milk production costs for Grade A milk and Grade B milk, whose cost of production difference have been proven definitively in evidence presented at this hearing, the proponents of Proposal Number 20 actually imply that the on-farm cost of producing Grade A milk is less than the on-farm cost of producing Grade B milk.

Testimony presented in support of Proposal Number 20 cites the FMMO Reform Decision, stating that the per hundredweight costs to producers to (1) maintain Grade A status is $0.40 per hundredweight; (2) the cost incurred in balancing Class I markets is $0.60 per hundredweight; and (3) the incentives necessary to attract milk to Class I is $0.60 per hundredweight; totaling the current $1.60 per hundredweight minimum Class I differential. By advocating for a reset of the minimum Class I differential level to $0.00 per hundredweight, proponents are implying that each of these three categories of Class I milk delivery costs today are zero, or netted against each other total zero.

Proposal Number 20's proponent submitted for consideration at this hearing an un-noticed proposal for a Class I assembly credit of $0.55 per hundredweight, a proposal that would have had these Class I plant balancing costs come out of each FMMO's producer revenue pools. Several Proposal Number 20's proponent witnesses touted this proposal in their testimony in support of Proposal Number 20. Notably absent however in the testimony is the mention of this telling aspect of the revenue source for these credits in the un-noticed proposal. Proponents of the un-noticed balancing cost proposal not only want to reduce the pool revenues by millions of dollars, by wiping away $1.60 per hundredweight from the Class I price, they also wanted producers' blend prices to be further reduced by paying balancing costs to farms delivering to the Class I plants from the FMMO pool. This fact shows to be blatantly false any statements made by proponents that they want to let an unregulated pricing market work in incentivizing milk to be delivered to Class I plants, and that these Class I plants will now and eternally more pay the costs for balancing the Class I plants directly to their dairy farmer suppliers if the Secretary will just deregulate them. The plain language of the un-noticed proposal is that these proponents actually don't want to pay the

costs for balancing their Class I plants, they want dairy farmers to bear those costs. How anyone can believe that dairy farmers will be compensated for performing the balancing of Class I plants outside the FMMOs when Class I plants are left on their own to decide whether or not to pay them, is beyond understanding.

This un-noticed balancing cost proposal admits on its face that there are indeed real costs of assembling and delivering milk to Class I plants. Despite this, proponents of Proposal Number 20's will likely contend, even after making a proposal that admits Class I assembly costs are real, and exceed zero, that no Class I plants are today going without sufficient milk. Thus, by the Proposal Number 20 way of thinking, there is no need to include any incentives imbedded in the Class I price to supply Class I, so this element of the minimum differential must have a value of zero. In regard to the portion of the $1.60 current minimum Class I differential, Proposal Number 20 argues that the costs of producers maintaining their Grade A license versus Grade B license must be negative, and in fact must be a negative $0.55 per hundredweight.

This can be shown by simple math. Under Proposal Number 20 the cost of assembly and balancing is $0.55 per hundredweight as proponents of Proposal Number 20 profess. There is no need for the Class I price to carry any incentive to supply Class I, so that cost can be set to zero under Proposal Number 20. The sum of the assembly cost and balancing cost and Grade A versus Grade B milk production cost difference must be zero, which leads to the conclusion that Grade A versus Grade B milk production cost must be negative $0.55 per hundredweight. Amazingly, the Grade B milk production cost must be higher than Grade A milk production cost to make the math work. The notion that dairy farmers encounter a $0.55 per hundredweight reduction in on-farm operations costs for producing Grade A milk compared to Grade B milk is nonsensical on its face, and especially so when viewed in light of the evidence on Grade A milk production costs versus Grade B milk production costs presented at this hearing.

Expressed mathematically:

Where (Balancing Costs) + (Grade A to Grade B production cost difference) + (Needed Incentive to Supply Class I) = $0.00

And, Needed Incentive to Supply Class I = $0.00

And, Assembly and Balancing Costs = $0.55

Then: Grade A versus Grade B Difference + Balancing Costs = $0.00

Thus: Grade A versus Grade B = $(0.55), i.e. Grade A milk is cheaper to produce than Grade B milk.

As an aside, or perhaps an object lesson, if Grade A milk has become the *de facto* standard, and thus no practical alternative exists for the sale of milk as other-than-Grade A, why should we continue to have codified Grade A standards at all? Under that premise, we can

scrap the Pasteurized Milk Ordinance and let milk plants and dairy farmers police themselves on matters of health, sanitation, and consumer protection. Of course this is an argument in the absurd, but points to human nature and how people, left to their own devices, can act purely in self-interest, to the detriment of the public, and to the detriment of their counterparties in business.

PROPOSAL NUMBER 20 WOULD CREATE CONFLICTS WITH OTHER PROVISIONS OF FMMOs

In an obscure, but none-the-less telling example of how Proposal Number 20 would cause unintended consequences, consider the classification of shrinkage, overage, bulk inventory, and the Other Uses of milk specified in §1000.40(e). Consider, the proposed $0.00 per hundredweight Class I differential zones, and zones with a near-zero Class I differential. Now consider a three-Class price inversion, that is, all three of the Class II, Class III and Class IV prices exceed the Class I price. According to NMPF Exhibit 37A three-class price inversions have occurred with a frequency of about 12 percent of the time. In this case, excess and allowable shrinkage would be both be priced as Class I, as would overages to the extent the overages were less than the plant's Class I usage. In the three-class inversion circumstance, the classification of milk that was dumped, used for animal feed and lost, as provided in §1000.40(e) would likewise be classified as Class I. Again, this result is nonsensical and contradicts the intent of FMMO's.

While certainly these examples show the lack of reasonableness of Proposal Number 20, if we extend this examination even further, the conditions caused by this proposal get even wilder. Milk used in the §1000.40(e) Other Uses, depending on the severity of the Class I price inversions, and the particular FMMO's base zone differential, could be classified differently in FMMOs with higher differentials than FMMOs with Class I differentials set at $0.00 per hundredweight. Imagine the industry conversation when a winter storm causes milk to be dumped across neighboring FMMOs and the classification of the dumped milk in the two FMMOs is different. That would result in differing values for the milk dumped. The dairy media would have a field day with that bizarre milk pricing event.

We won't further burden the record with the multiple implications of Proposal Number 20 for classification and allocation of Other Source Milk under §1000.44, other than to say that all the provisions that have an allocation beginning with Class IV, and then stepwise up-allocation from there, certainly would be turned on their ear when the Class I price is the lowest priced Class, and regularly so. Installing provisions that create more disorder than they alleviate simply does not make sense, and flies in the face of the AMAA's purposes.

PROPOSAL NUMBER 20 WOULD EFFECTIVELY RETURN MUCH OF THE COUNTRY TO INDIVIDUAL HANDLER POOLS

Several of the witnesses supporting Proposal Number 20 did not even try to cloak their disdain for the FMMO program and market-wide pooling, instead, in effect, espousing the self-serving, but disorderly, return of individual handler pools.

An important element, if the Secretary were to adopt Proposal Number 20, would be a reversal of the Secretary's rejection, long ago, of individual handler pools as an orderly method of handler and producer milk pricing. The reliance on over FMMO prices to encourage milk to be delivered to Class I plants will actually defeat multiple purposes of FMMOs, first, uniform classified pricing, and second, the objective of the FMMOs to eliminate ruinous competition for milk sales.

Over FMMO prices, except in some rare cases, are not pooled, that is, the billing supplier of milk generally keeps the over FMMO premium for themselves. Also, in many regions, over FMMO prices are class-specific, a fact basically acknowledged by the proponents of Proposal Number 20 when they encourage the Secretary to allow them set their own Class I price. Having Class I differentials at or near $0.00 per hundredweight, that are supposed to be replaced with over FMMO prices, means any additional milk price value associated with the delivery of milk for Class I would be handler specific, a circumstance which would have the same result as creating individual handler pools.

The Secretary's rejection of individual handler pools as tools to encourage orderly marketing is reasoned and proper. When dairy farmers are paid for their milk based on the Class I utilization of the specific plant to which they deliver, rather than at the marketwide Class I utilization, dairy farmers will seek to deliver to plants with the highest Class I utilization, because those plants will likely return the most money per hundredweight for the milk. This is exactly the marketing scheme envisioned by the proponents of Proposal Number 20, when they say, virtually in unison and with a coordinated voice, that the Secretary should let them direct their individual plant Class I values to the farmers delivering milk to their plants.

The natural consequence of an individual handler pool marketing structure is that dairy farmers will begin fighting for the ability to supply the higher-paying Class I plants. The only bargaining chip the farmers have is price, and when the basic additional value of Class I milk is not regulated, they will begin bidding down the over FMMO premiums - a milk marketing eventuality described by Dr. Stephenson on page 3 of 13 of Exhibit MIG-16. This pernicious competition and the disorderly markets that follow it, is exactly what FMMO pooling is designed to eliminate. The logical progression of price deregulation to declining dairy farmer income, and declining costs of milk to processing plants is doubtless not lost on the proponents of these thinly disguised individual handler pools. In fact, they are counting on it.

PROPOSAL NUMBER 20 IMPROPERLY CONCLUDES THAT CLASS I DEMAND WILL INCREASE WITH REDUCED, OR ELIMINATED, CLASS I DIFFERENTIALS

Proponents' Proposal Number 20 basic argument, stripped of all disguise, is that dairy farmers are already being paid too much for Class I milk everywhere in the contiguous United States. Furthermore, the sentiment appears to be that dairy farmers should gladly accept prices for their milk that are grossly insufficient to compensate them for delivering to high-cost-to-service Class I plants. The supposed trade-off then becomes that decreasing Class I differentials will yield a positive impact on Class I sales, and with those increases in Class I sales will come blend price increases.

Earlier in this testimony I described the fallacy of supposed blend price increases when manufacturing Class and Class I prices are virtually identical.

Contrary to assertions by proponents of Proposal Number 20, the demand for fluid milk is price inelastic, hence a reduction in the milk price will have limited impact on Class I demand. In fact, evidence at this hearing suggests that a large measure of the decline in Class I per capita demand is due to changing consumer preferences, as opposed to high fluid milk prices. For instance, more and more consumers are changing breakfast habits, eating less cereal with milk and eating more cream cheese and bagels and more yogurt – all examples of a consumer preference change within the dairy categories. Additionally, there are preference changes to non-dairy milk-like beverages that are more expensive than traditional real fluid milk products. One of the fastest growing beverage milk lines are the high-protein reduced-lactose milks. Data presented at this hearing shows high-protein reduced-lactose milk having a retail price per gallon more than twice the price of traditional milk gallon jugs, which suggests factors other than price are impacting demand. Hence, the reduction in the milk price that would emanate from a reduction in the Class I differential from Proposal Number 20 would have little impact on Class I milk sales.

Further, any hypothetical increases in Class I product consumption resulting from lowering FMMO Class I prices presupposes that Class I prices and consumer retail prices move together or proportionately, whether up or down. If there is any consumer demand response to milk price changes, it is a response to fluid milk <u>retail</u> price changes. It is highly unlikely that the typical fluid milk consumer regularly or closely monitors FMMO Class I prices.

The cause and effect relationship between changes in FMMO Class I prices and a retail fluid milk price response is tenuous at best. A January 4, 2024 article in Hoard's Dairymen explored this question.

Hoard's determined that, in 2023 retail milk prices reached their highest level ever, at a national average $4.34 per gallon, and rose on average $0.08 per gallon from the 2022 average retail price, an increase of about 1.9 percent. For 2022, the annual simple average of the twelve monthly Class I movers was $23.66 per hundredweight, and with an approximate national average Class I differential of $2.60 per hundredweight, the annual national average Class I price for 2022 was $26.26 per hundredweight, at 3.5 percent butterfat content. Using

the same method for 2023, the simple annual average Class I mover was $19.20 per hundredweight, yielding, at the presumed $2.60 per hundredweight national average Class I differential, a national average annual Class I price of $21.80 per hundredweight, a decrease of $4.46 per hundredweight, or a 20.5 percent decline in the national average Class I price. To be clear, retail fluid milk prices rose 1.9 percent from 2022 to 2023, in a year when the national average Class I price fell 20.5 percent. We are supposed to believe, based on the Proposal Number 20 pricing and demand elasticity theory, that reducing Class I prices will spur fluid milk product demand because retail prices will invariably follow the FMMO Class I price changes. History certainly suggests otherwise.

The Hoard's Dairymen article can be found at https://hoards.com/article-34567-a-gallon-of-milk-broke-records-in-2023.html .

Previous evidence has been introduced at this hearing largely confirming the Hoard's retail pricing comparison – see IDFA Exhibit-435 and IDFA Exhibit-436, prepared by Dr. Balagtas.

PROPOSAL NUMBER 20 PLACES THE ULTIMATE INCENTIVES TO SUPPLY CLASS I MARKETS ON OVER FMMO PREMIUMS

It has been conclusively demonstrated in this proceeding that the reliance by the Secretary on substantial increases in over FMMO prices to insure a sufficient quantity of milk is not only ill-advised, it is destined to fail in accomplishing the mission of FMMOs, and would in fact constitute an abrogation of the Secretary's responsibilities under the AMAA. Previous testimony has documented the challenge in securing adequate Class I over FMMO premiums. Inadequate over FMMO premiums are one of the reasons why NMPF proposed an increase in Class I differentials. Over the past 15 years for example, in the southeastern FMMOs, Class I over FMMO premiums have declined significantly. In fact, the implementation of the Proposal Number 19 Class I differentials will not cover the loss in over FMMO premiums in the Florida market which have occurred over the past 15 years.

A few witnesses at this hearing representing a small subset of processors have warned of the danger in setting regulated milk prices too high. This is a reasonable argument – but reasonable only when including the rest, the flip side if you will, of the story. There is also substantial and foreseeable danger in setting the regulated prices too low, leaving it to the whims of the marketplace to establish an extreme portion of the milk's value to be passed back to dairy farmers. The record of this hearing is replete with the real life history of over FMMO pricing, and its limitations, and its impermanence. The Secretary should pay particular note that the very parties that benefit the most from over FMMO prices, and benefit when they increase - dairy farmers, are also warning of over FMMO prices' limitations, and that they simply can't be relied upon over any appreciable stretch of time. On the other hand, the supporters of lowering regulated milk prices and then theoretically substituting market-set prices for the regulated prices are those parties who benefit from that reduction in regulated prices, and benefit again when over FMMO prices crumble,

which they most certainly will do eventually. It is also an imperative to note that processors of milk hold the marketplace advantage in what level of over FMMO prices exist in that marketplace.

Also worth noting is that proponents of Proposal Number 20 have little upside price risk in submitting Proposal Number 20. It is easy to advance a proposal based on untested theories and pronouncements from the ivory tower on the wonderful and prosperous days that will accrue to all dairy industry participants from partial price deregulation. After all, these proponents are offering to test these theories in the marketplace – but test them with a $660,000,000 per year research grant provided by dairy farmers. We must weigh the risks of Proposal Number 20 and who bears them. Prosperity is a possibility, but only an ambiguous possibility at best. A reduction in the minimum milk price is guaranteed under Proposal Number 20.

The Secretary has repeatedly reaffirmed, and as recently as the 2023 Final Decision on transportation cost provisions in FMMOs 5, 6, and 7, that there are indeed costs to supplying the Class I marketplace, and that these milk supply costs are not fully accounted for in over FMMO premiums.

IMPLICATIONS OF PROPOSAL NUMBER 20

Proposal Number 20 fails to recognize several basic facts of milk marketing and the need to address these facts by regulated pricing:

- There is quantifiable and substantial differences between the cost of producing Grade A milk versus Grade B milk.
- There remains a need to incentivize delivery of milk to Class I use in preference to the other classes by establishing a Class I price superior to the manufacturing Class prices.
- There are substantial costs of balancing the highly variable demand of Class I plants.
- Continued financial incentives are required to entice milk to move from reserve supply areas to milk deficit regions.
- Milk is bulky and expensive to transport, and the costs of moving milk and supplying Class I plants have seen significant increases in costs over the last 25 years.
- Milk is a perishable product, and there continues to exist an imbalance of market power of processors over dairy farmers.

Proposal Number 20 ignores or assumes away as irrelevant these basic factors in raw milk marketing. How increases in milk delivery costs, balancing costs, and Grade A milk production costs have in net vanished in the last 25 years is truly a mystery, but a mystery

left unsolved by the proponent of Proposal Number 20. Paradoxically, no one is claiming that processing plant production costs for dairy products have evaded the overall increases in product conversion costs, yet Proposal Number 20 blatantly implies dairy farmers' costs of getting milk to markets have not changed in 25 years, or suggests that if hauling costs have increased, those increases are insignificant.

In light of these multiple and multiplicative abject failures, proponents of Proposal Number 20 then somehow think it is reasonable to reduce $660 million per year from dairy farmers' FMMO pool revenues, with the promise that over FMMO prices will instantly and permanently spring up to levels that will keep dairy farmers financially whole. The proponents of Proposal Number 20 are not really seeking wholeness for the dairy industry, they are seeking for themselves the holy grail for pricing influence - unregulated pricing, and the ability for, as buyers of milk, to establish the price paid to dairy farmers, no matter how low that price may be.

To state again, the predictable result of these market failures would undeniably lead to producers questioning the need for FMMOs. The Secretary must consider who benefits from price deregulation, producers, or processors?

The Secretary has rightly acknowledged that substantial costs of supplying Class I milk exist, and it is imperative the FMMO Class I prices provide appropriate compensation to dairy farmers for bearing these costs. The FMMO Program has, as required by statue, and for the reasons convincingly reiterated in this proceeding, never relied on over FMMO prices to establish the price levels necessary to insure that there is a sufficient quantity of pure and wholesome milk. The Secretary must continue to uphold this policy and update the Class I differentials to account for these increased Class I milk supply costs, in order to continue to ensure the consuming public that a consistent and adequate supply of milk will grace the shelves of their local stores.

Now, after pointing out the plethora of overt problems with Proposal Number 20, we are obliged to point out the obvious objectives the Proposal. **It is abundantly clear that Proposal Number 20 is aimed ultimately at the complete destruction of the FMMO program, and the Secretary must view Proposal Number 20 in that light.**

The proposal to reduce Class I differentials by $1.60 per hundredweight everywhere in the contiguous 48 states, in the presence of such overwhelming evidence that Class I differentials should in fact be increased, would make Proposal Number 20 dismissible as simply hypocritical if it were not so serious an issue. It is quite obvious that Proposal Number 20 has been submitted, not because it would increase orderly marketing, not because it would insure a sufficient quantity of milk, not because it would provide uniform pricing to producers and uniform pricing to processing plants, but rather, as an argument in the absurd against NMPF's Proposal Number 19. Clearly one motivation of Proposal Number 20 is simply to offer the Secretary the gamut of *opinion* (not the gamut of logic or fact) on what should be done about Class I differentials as a result of this hearing. The ever-so-thinly veiled

objective is to simply say, 'Mr. Secretary, there is a wide range of opinion on Class I differentials, whether the differentials should be increased or decreased, so Mr. Secretary, the path of least resistance is to default to the *status quo*'. This argument contradicts everything we know about the costs of servicing the Class I marketplace, and everything we have learned over decades of marketing a highly perishable product, plus the voluminous testimony presented at this hearing supporting the increased cost of supplying milk to Class I markets. We know the Secretary will not be taken in by this maneuver.

If the Secretary truly believes that an unregulated marketplace can do the job of protecting the U.S. milk supply, USDA would have terminated the FMMO program already. Numerous Secretaries of Agriculture have over and over affirmed and reaffirmed the necessity of FMMOs in meeting their statutory requirements under the AMAA. Proposal Number 20 disputes the very essence of FMMOs and their mission.

Proposal Number 20 advances the proposition that FMMO Class I prices should no longer be adjusted to reflect differences in the location value of milk or adjusted when the costs of delivering milk change; the proposal suggests the costs of balancing the substantial variations in Class I demand is either nonexistent or irrelevant, or even if these balancing costs do exist these costs are dairy farmers' problem not Class I plants' problem; and suggests that FMMO milk prices sufficient to sustain milk production at adequate levels can be replaced by unregulated milk prices, prices that processors of milk can erase at will. Even more disturbing is that a single processor of milk can erase over FMMO prices over wide geographies, by establishing a standard of refusing to pay them.

SUMMARY

FMMOs cannot meet the mission of the AMAA without Class I differentials. The AMAA requires incentives for milk to be delivered to Class I plants. With no Class I differentials, the USDA is then dependent on unregulated over FMMO premiums to create the economic incentive to meet its mission under the AMAA. So an FMMO with no economic incentives to move milk to Class I violates the AMAA, and is therefore should be considered illegal. USDA must uphold the law, and thus by regulation it cannot have a situation with a FMMO and no Class I differentials.

Whenever industry discusses with USDA potential amendments to the FMMOs, invariably, a USDA staff member will remind us that we must look at the enabling legislation for FMMOs, the AMAA. They are right in these reminders; we must follow the law.

So, let's remind ourselves of what the AMAA says, and how Proposal Number 20 fails to follow the law, or at least suborns the Secretary to fail to follow the law.

The plain language of the AMAA says "he [meaning the Secretary] shall fix such prices as he finds reflect such factors, insure a sufficient quantity of pure and wholesome milk, and be in

the public interest". The factors to be considered include "the available supplies of feeds, and other economic conditions which affect market supply and demand for milk".

Let's repeat, "shall fix such prices". "Fix".

The AMAA does not direct the Secretary of Agriculture to rely on the bargaining power of dairy farmer producers to set sufficient milk prices, the AMAA does not direct the Secretary to rely on the benevolence of the buyers of milk to set sufficient milk prices, the AMAA does not direct the Secretary to rely on the invisible hand of supply and demand to set sufficient milk prices, and the AMAA does not direct the Secretary to rely on divine providence or shear dumb luck to set sufficient milk prices.

It is the Secretary's job and duty to fix those prices that insure a sufficient quantity of milk. Nobody else, no other force, it's on the Secretary.

The plain and straightforward reason the AMAA wisely and appropriately places this job square in the Secretary's hands is that these other options or alternative methods always fail, always. We can rely on the Secretary and the power bestowed by the AMAA to fix the milk prices to bring forth a sufficient quantity of milk. The dairy industry and the consuming public can't depend on anything else to get the job done. It's just that simple.

Proposal Number 20 asks the Secretary to ignore the Secretary's responsibility to <u>fix</u> prices. The Secretary must follow the law, and USDA must deny Proposal Number 20 in its entirety.

This concludes our prepared testimony. Thank you.