'RETURN to HIGHER OF' TESTIMONY – Chris Hoeger
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Testimony Presented By:
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Prairie Farms Dairy supports National Milk Producers Federation (NMPF) Proposal for restoring the Higher Of for establishing Class I mover from original Federal Order Reform.

My name is Chris Hoeger. This testimony is presented in support of NMPF's Proposal 13: Restore the original Federal Order Reform Class I Skim "higher-of" mover as Proposed by NMPF. This testimony is presented on behalf of Prairie Farms Dairy, Inc. (PF). My career in the Dairy Industry covers over 22 years working in various roles from Sales Representative to several Executive level roles. I currently serve in the role as Vice President of Procurement and Member Services. I have served on several various committees with many various dairy industry organizations. I have been on the NMPF Federal Order Task Force the last couple of years and on the NMPF Economic Policy Committee for the last decade.

PF is a Capper-Volstead cooperative. As of June 30, 2023, PF membership is comprised of 668 conventional dairy farms located in nine Midwestern States. PF has 668 members that make up our supply of milk. Prairie Farms is the U.S. 2nd largest fluid milk bottler with bottling plants located in the Midwest. We operate through wholly owned subsidiaries or joint ventures with 30 pool-distributing plants that are located throughout sixteen Midwestern States from the Canadian border to the Mexico/Gulf of Mexico border. PF also operates over 20 other manufacturing facilities that produce cheese, ice cream and cultured products. PF purchases between 20% to 30% of our milk supply from various supply partners and outside sources for its plants. PF has pool-distributing plants in six Federal Milk Market Orders; with the majority of our plants and milk supply are in FMMO 32.

PF was part of the consensus of organizations that originally supported moving to the "average-of" the Class III and IV skim to set the Class I mover when it was presented by NMPF and IDFA in 2018. We were supportive of the move as we felt that we might see increase hedging activity from our customer base, whereas prior to the change to the "average-of" mover, our hedging on Class I products was non-existent. We felt that our customers would be more active on hedging after changing to the new formula for price discovery.

Since 2018, we have seen many challenges with milk pricing for the producer community, not the least of which is the unexpected creation of disorderly marketing, especially with extreme price volatility. We have found several issues that have negatively affected the producer community as well as milk processors.

Since going to the "average-of" price mover, several problems have become evident with this pricing mechanism (as compared to the "higher-of" mover previously used):

1) Revenue to producers was significantly reduced without recovery. PF members were severely impacted due to the price volatility due to increased de-pooling of milk in the various multiple component pricing (MCP) orders where they have farms and plants.
2) Class I prices meant to incentivize movement to fluid processors should have created more orderly marketing. Instead, they actually created marketing that is more disorderly.

#1 Revenue to producers was significantly reduced without recovery.

Since changing to the ”average-of” in May of 2019, there has been more volatility in producer pricing due to additional depooling and creating disparity of producer pay prices. The incorporation of the ”average-of”in the Class I formula has led to a significant increase in depooling between the classes of milk. Farms that are suppliers to a pool distributing plant do not have the ability to depool their milk. With the ”average-of”f formula, producers will fall in to two groups, i.e., the haves and have nots, as there are always some depooling of either Class III or Class IV milk. The ”average-of”analysis shows that there is asymmetric risk when the difference between Class III and IV advance skim pricing factors is greater than $1.48 per cwt. as per Peter Vitaliano’s testimony. This asymmetric risk increases the probability of depooling which negatively affects producers supplying to pool-distributing plants. Pool-distributing plants do not have the ability to depool milk, so these plants are required to take the pooled price while others can de-pool and take advantage of the price inversions. This occurred in the fall of 2019 prior to the 2020 complications caused by Covid issues that were encountered in the latter part of 2020 and early 2021. Those who could de-pool were able to avoid the price inversion, while others had to stay in the pool and absorb the impact of the increased Class III prices.

The USDA recognized this became an issue and attempted to remedy the situation through Pandemic Market Volatility Assistance Program (PMVAP), but those payments did not occur for some time after when producers had to endure the pricing problem and those were unique circumstances that may not allow USDA to provide such assistance again in the future should such an increase in prices occur again. PF dairy producers are appreciative of the support from the USDA through the PMVAP payments made in 2022 and 2023 for the changes to the cheese prices, in part caused by USDA’s Food Box program. However, those payments did not fully compensate all producers or as timely as it would have been under the “higher-of” Class I pricing formula. Dairy producers want a pricing system that gives them market indicators at the time and not payments received later from the taxpayers. In fact, many dairy producers were no longer in business when the PMVAP payments were distributed. The “higher of” would compensate the producers at the time the milk is sold and supports moving milk in an oversupply to its highest value use.

#2 Disorderly Marketing due to higher depooling

Another issue generated from the ”average-of” versus the ”higher-of” is higher incidences of depooling. This results when one of the manufacturing classes is higher than the average pool price. In 2022 and 2023, PF experience a situation where some of the closest milk supply to a Class I market became unavailable unless it received a premium due to the milk being utilized for a higher value more distant market providing a higher return. As such, that closer milk was not part of the pool because it was shipped to other locations outside of the pool. When this situation occurs, it forced PF to secure milk supplies from further markets due to the financial inequities between classes. PF tried to secure milk to supply its plants that would have been less than 150 miles from supply to the plants but was asked to

pay a premium over the Over Order Premium to secure and move this milk. The supplier did not want the consequences of this milk being pooled and opted to sell the milk to further away markets to secure the higher premium price and avoid the pool. This occurred when the spread between Classes III and IV were larger than $1.48 per cwt. and supply conditions in other markets. These inefficiencies of swapping markets and driving up prices because of the desire to de-pool and capture higher market prices in other areas, it resulted in disorderly market conditions. Due to thedisorderly marketing, PF saw higher costs caused by moving milk around, which increased the food miles costs and added more environmental concerns from transporting milk a farther distance. As shown in the chart below, since switching to the ”average-of” mover, the Producer Price Differentials (PPD) has become larger and tended to be more negative more frequently when compared to ”higher-of.” Data from FMMO 32 during the 6-year period prior to May 2019 revealed 27.36% of the months were associated with a negative PPD, averaging (-$.34) per cwt. and the 4-year period since May 2019 shows a negative PPD in 37.36% of the months with an average of (-$2.85) per cwt.

Table 1. PPD by month, 2013 to present

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
January	$ 0.43	$ 0.40	$ 0.36	$ 0.66	$ 0.55	$ 0.52	$ 0.97	$ 0.58	$ (1.60)	$ 0.71	$ 0.80
February	$ 0.86	$ (0.14)	$ 0.32	$ 0.41	$ (0.05)	$ 0.32	$ 1.18	$ (0.11)	$ (1.38)	$ 1.07	$ 1.21
March	$ 0.94	$ 0.35	$ (0.07)	$ 0.13	$ 0.43	$ (0.30)	$ 0.72	$ 0.15	$ (1.00)	$ 0.70	$ 0.38
April	$ 0.58	$ (0.11)	$ (0.19)	$ 0.28	$ 0.20	$ (0.13)	$ 0.17	$ 0.44	$ (1.79)	$ 0.23	$ (0.07)
May	$ 0.13	$ 1.01	$ (0.21)	$ 0.77	$ (0.07)	$ (0.07)	$ 0.24	$ 0.10	$ (2.18)	$ 0.01	$ 1.63
June	$ 0.78	$ 1.39	$ (0.42)	$ 0.62	$ 0.06	$ 0.32	$ 0.64	$ (7.51)	$ 0.23	$ 1.04	
July	$ 1.24	$ 1.42	$ (0.06)	$ 0.02	$ 1.07	$ 0.68	$ 0.09	$ (8.69)	$ 0.35	$ 1.79	
August	$ 1.01	$ 1.51	$ -	$ (0.82)	$ 0.56	$ 0.14	$ 0.25	$ (3.62)	$ 0.55	$ 2.72	
September	$ 1.03	$ 0.23	$ 0.86	$ (0.07)	$ 0.36	$ (0.45)	$ (0.60)	$ (0.72)	$ 0.20	$ 2.38	
October	$ 1.03	$ (0.36)	$ 0.82	$ 0.53	$ (0.33)	$ 0.49	$ (1.29)	$ (7.38)	$ (0.64)	$ 0.98	
November	$ 0.85	$ (0.56)	$ 1.30	$ (1.36)	$ (0.90)	$ 0.78	$ (3.00)	$ (8.50)	$ 0.22	$ 1.27	
December	$ 1.08	$ 1.69	$ 1.31	$ (0.53)	$ 0.12	$ 0.96	$ (1.29)	$ 0.51	$ 0.67	$ 0.90	

#3 Hedging/Risk Management

PF supplies many types of large and small customers within retail, convenience store, QSR and food service outlets. PF was supportive of the ”average-of” price mover as we believed it would support our customers’ ability to hedge more Class I product. That has not been the case. Under the ”higher-of” price mover, the only real fixed price contracts were done by schools. PF absorbed the risk of these fixed price arrangements, as it was a nominal part of our overall business. Since moving to the ”average-of” price , we have not seen an increase in Class I fixed price sales agreements. Our fixed price sales agreements continue to be requested and utilized by the same customers prior to the change. If anything, we have more customers interested in fixed price agreements for Class II products. PF has seen a decrease in producer forward contracting with our members engaged in hedging/risk management. Negative PPDs is a negative basis that dairy producers are unable to hedge or mitigate the risk. As shown below, the two farms that have hedged for many years as a way to manage their margins are an example of what dairy producers received for a revenue stream.

Table 2. Producer negative basis analysis, July 2020 to December 2020

	Dairy Farm A		Dairy Farm B		PPD	Farm A Net Price	Farm B Net Price
	Pounds	Hedged Price	Pounds	edged Price	(Negative Basis)	Received	Received
Jul-20	2,200,000	$ 18.93	150,000	$ 16.53	$ (7.51)	$ 11.42	$ 9.02
Aug-20	2,200,000	$ 16.94	140,000	$ 16.59	$ (8.69)	$ 8.25	$ 7.90
Sep-20	2,000,000	$ 16.36	140,000	$ 16.10	$ (3.62)	$ 12.74	$ 12.48
Oct-20	2,000,000	$ 16.48	150,000	$ 16.12	$ (0.72)	$ 15.76	$ 15.40
Nov-20	1,200,000	$ 16.35	140,000	$ 15.91	$ (7.38)	$ 8.97	$ 8.53
Dec-20	1,200,000	$ 16.13	140,000	$ 15.71	$ 0.51	$ 16.64	$ 16.22

The negative basis makes managing milk price risk considerably more difficult for dairy producers. The result is that dairy producers are not engaging in risk management tools like they did previously.

In summary, dairy producers have used risk management tools for decades to support their business and manage their margins. Basically, dairy producers have made sacrifices by taking on additional risk themselves and giving up a higher Class I price under the assumption processors would develop their own risk management tools for Class I, but processors have not done so. PF has not seen an increase in customers requesting Class I fixed priced agreements after changing to the ”average-of” Class I formula. We need to return to the ”higher-of” so dairy producers can have a reliable tool in their toolbox to manage their business without the need inviting in additional risk.

PF expresses its appreciation to the Secretary of Agriculture and the Dairy Division for holding this hearing. We strongly recommend the Secretary to adopt NMPF’s Proposal 13: Return to the ”higher-of” for calculation of the Class I Skim Mover. This will promote orderly marketing of milk and ensure an adequate supply of milk for Class I operators to serve their markets.

Respectfully submitted,

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