Support for Class I Differential Surface – Supporting NMPF Proposal #19

My name is Michael John, and I am Executive Vice President of Milk Marketing for Maryland and Virginia Milk Producers Cooperative, Inc. (MDVA), located at 13921 Park Center Road, Suite 200, Herndon, Virginia. MDVA is a member of NMPF, and I serve as a member of NMPF Economic Policy Committee, and a member of the Class I Working Group. The Class I Working Group was assigned the responsibility of developing updates to the current Federal Order Class I differentials, and for proposing amendments to the method for computing the Class I mover. The purpose of my testimony is to provide support to NMPF's proposed changes to the Federal Order Class I differentials.

The overwhelming majority of MDVA's member milk is pooled on Federal Order 1 and Federal Order 5. MDVA's members own and operate three pool distributing plants; two are located in Federal Order 5, and one is located in Federal Order 1 (Table 1). In addition, MDVA's members own and operate two pool supply plants, one located in Federal Order 5, as well as one located in Federal Order 1. The majority of MDVA's member milk is received and processed by Class I plants, including the three plants owned by our members, serving markets in Federal Orders 1 and 5. With most of our milk serving the Class I market and the remaining percentage of our milk mostly supplying our member-owned Pool Supply Plants, we fully understand and support the need to update and increase the Class I differentials.

Table 1. MDVA Plants and Locations

Federal Order 1	**Type**
Landover, MD	Pool distributing plant
Laurel, MD	Pool supply plant

Federal Order 5	**Type**
High Point, NC	Pool distributing plant
Newport News, VA	Pool distributing plant
Strasburg, VA	Pool supply plant

The Cost of Supplying the Class I Market:

To consistently supply pool distributing plants, whether member-owned or operated by a third party, MDVA's pool supply plants give us the ability to balance fluctuations in processing demand and in raw milk production. Constant ebbs and flows of milk orders placed by customers and their subsequent effects on the movement of milk are a fact of supplying the Class I market. This balancing adds additional costs and requires a steady and reliable source of revenue to serve the market. In part, Class I differentials were instituted to help meet these revenue requirements. At MDVA, we are constantly moving milk from supply points located in Federal Order 1 to demand points located in Federal Order 1 or Federal Order 5. Fluctuations in milk needs and milk movements can vary tremendously depending on the time of the year. An example of a large seasonal variation of milk flowing from Federal Order 1 to Federal Order 5, would be to compare the month of April to the month of September. In a typical year, we have moved twice as much milk from Federal Order 1 to Federal Order 5 in September versus April. If we look at changes that occur during the week, for example, comparing a Saturday to a Wednesday, we see definite fluctuations in demand between the days of the week.

In addition to the cost associated with servicing the Class I Market, the cost of transportation to move the milk has increased. As outlined on page 39 of NMPF's hearing request and in subsequent NMPF testimony, the cost of moving milk has greatly increased from the early 2000s. The proposed increase in Class I differentials is to provide some cost relief to those experiencing increased costs to move milk to Class I plants and to make sure incentives are high enough to attract raw milk to Class I processing plants. It has been over 15 years since Class I differentials have been increased in Federal Order 5. In the face of enormous transportation costs increases, that means the mechanism to attract milk from supply points has become less effective. The cost of transportation has increased significantly, and at least a portion of that cost needs to be satisfied through an increase in the Class I differentials. To continue to meet customer demands for milk, our dairy farmer-members must make up the difference in that cost which comes directly out of their monthly milk checks.

Internally, we have designated a hauling subsidy to cover this cost. This subsidy can fluctuate dramatically from month to month based on the fluctuations in supply and demand and in the cost of transportation, which includes the cost of fuel. Table 2 below gives some examples of transportation rate increases since 2008. The rates below are based on what the trucking industry calls "running mile rates." If they were calculated on a loaded mile rate, the rates below would be doubled.

Table 2: Comparison of Hauling Rates Jan 2008 vs Jan 2023

Round Trip Miles = 171						
Year	**Origin**	**Destination**	**Ave Load LBS**	**Total $**	**Rate Per Mile (RPM)**	**RPM % Change**
2008	Federal Order 1	Federal Order 1	47,500	$450.02	$2.63	
2023	Federal Order 1	Federal Order 1	55,000	$701.47	$4.10	
Difference			**7,500**	**$251.45**	**$1.47**	**56%**
Round Trip Miles = 732						
Year	**Origin**	**Destination**	**Ave Load LBS**	**Total $**	**Rate Per Mile (RPM)**	**RPM % Change**
2008	Federal Order 1	Federal Order 5	48,500	$1,118.07	$1.53	
2023	Federal Order 1	Federal Order 5	51,000	$1,883.53	$2.57	
Difference			**2,500**	**$765.46**	**$1.04**	**68%**
Round Trip Miles = 303						
Year	**Origin**	**Destination**	**Ave Load LBS**	**Total $**	**Rate Per Mile (RPM)**	**RPM % Change**
2008	Federal Order 5	Federal Order 5	47,500	$599.55	$1.98	
2023	Federal Order 5	Federal Order 5	49,000	$982.79	$3.24	
Difference			**1,500**	**$383.24**	**$1.26**	**64%**

The Changes for Class I Differentials:

Based on the need for changes to Class I differentials to help cover the additional costs, I will give examples of how we determined changes in the Class I Differentials for our geography.

As shared by Jeff Sims in his testimony, NMPF created four regional Class I Working Groups. With MDVA located in the Mid-Atlantic region as well as in the Southeast, we were involved in two of the four working groups, the Northeast-Mideast Region, and the Southeast-Southwest region. Both regions started with the results from the University of Wisconsin's spatial price model. This model was run using data from two specific months, May 2021, and October 2021. We averaged the results of these two months, and that established a base for the Class I differential analysis. Our next step was to review the current price relationships between specific locations and compare those to what the model revealed.

For example, in Federal Order 1, the current Class I differential relationship between Landover, Maryland and Frederick, Maryland is $3.00 per hundredweight at Landover versus $2.90 per hundredweight at Frederick for a difference of $.10 per hundredweight. Continuing with this two-city example, the model suggests the Class I differentials should be increased to $4.90 per hundredweight for Landover, Maryland and to $4.55 per hundredweight for Frederick, Maryland. The resulting price relationship then becomes $.35 per hundredweight, which is significantly higher than the current price relationship. Recognizing that these two locations are only about 55 miles apart and recognizing both are in the same competitive market, a $.35 per hundredweight difference would create an artificial competitive advantage of one processor over another relative to the regulated cost of raw milk. The Northeast

Working Group took this into consideration when proposing revisions to the model's results for NMPF's Class I differential proposal. In another example, when comparing Philadelphia, Pennsylvania to York, Pennsylvania the current difference is differentials is $.15 per hundredweight. The model increased Class I differentials for both locations by $1.65 per hundredweight and $1.70 per hundredweight respectively for a differential difference of $.20 per hundredweight, thus closely preserving the historic price relationship.

The Southeast Working Group followed the same basic analytics as the Northeast Working Group when reviewing locations within Federal Order 5. To give an example, the current Class I differentials for Mt. Crawford, Virginia and Verona, Virginia are the same at $2.90 per hundredweight. The model determined a $.10 per hundredweight higher differential for Verona, Virginia. These two locations are approximately fifteen miles apart and compete in the same markets. We kept the price relationship the same as current by increasing the differentials in both locations by $1.80 per hundredweight to a new proposed differential of $4.70 per hundredweight.

In a second Federal Order 5 example, the current Class I differentials for Lynchburg, Virginia and Newport News, Virginia are the same at $3.20 per hundredweight. The model determined a $.40 per hundredweight higher differential for Newport News, Virginia. Because these two locations serve the same geographical market, and both locations draw farm milk from the same milk sheds, we decided to keep the current price relationship and proposed a differential of $5.00 per hundredweight for both locations.

Analyzing these price relationships throughout Federal Orders 1 and 5 led the Northeast and Southeast Working Groups to follow two guiding principles. Namely, that the Class I differentials needed to increase to cover the additional costs of servicing fluid milk markets and to maintain current price relationships between fluid markets to avoid as much as possible unnecessary or unwarranted changes in competitive relationships.

In sum, MDVA supports the proposed price differential changes to update and modernize the differentials to better reflect the market increases in costs of serving the Class I market and of moving milk from supply areas to deficit areas, and to recoup some of the increased costs that have occurred since the last time differentials were updated.

I want to thank USDA for having this hearing and thank you for the opportunity to speak on behalf of MDVA's dairy farmer members.