

UNITED STATES DEPARTMENT OF AGRICULTURE  
BEFORE SECRETARY OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE

IN RE: MILK IN THE NORTHEAST AND | Docket No. 23-J-0067  
OTHER MARKETING AREAS | AMS-DA-23-0031  
National Pricing Hearing | 88 FR 47396 (July 24, 2023)

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*National All-Jersey, Inc.  
Post-Hearing Brief*

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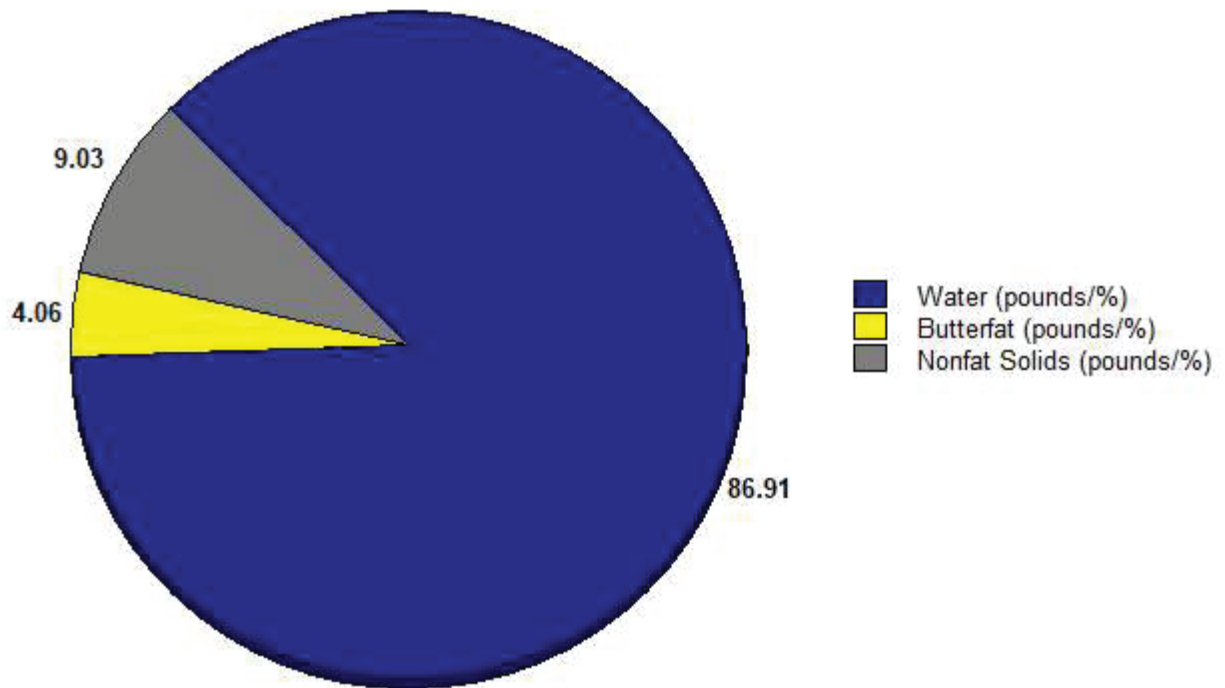
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## AVERAGE FARM MILK COMPOSITION 2022\*



### 2022 Range of Components in Milk Plant Receipts of Producer Milk/CWT\*

Butterfat: <3.60 to 4.60< pounds or %  
 NFS: <8.79 to 9.37< pounds or % (includes protein and lactose)  
 Protein: <2.91 to 3.59< pounds or %

### 2022 Average nonfat components in skim portion of milk\*

NFS:  $9.03/95.94 = 9.41\%$   
 Protein:  $3.25/95.94 = 3.39\%$

\*Source: USDA Exhibits 17-18, 44; Ex 113 (IDFA-24); Exs 102- 103 (MIG-3 and 3-A); Exs 106 (MIG 4-A) pp 6-9; Exs 113 (MIG 5-A).

## *National All-Jersey, Inc. Post-Hearing Brief*

### *I. Introduction*

National All-Jersey (NAJ) is a membership organization including over 900 milk producers. NAJ was organized in 1957 by the American Jersey Cattle Association to promote equity for producers (dairy farmers) in milk pricing and dairy policy. NAJ carries out its mission through market development, milk price regulation advocacy, policy issues, research, industry relations and information and education.<sup>1</sup> In USDA's Federal Milk Marketing Order (FMMO) program, NAJ has long been a leading advocate of regulatory integrity and of classified price formulas that enhance milk marketing efficiency and recognize the value of protein and other nonfat solids (NFS) in milk, including multiple component pricing (MCP) programs.<sup>2</sup>

USDA has regulated minimum milk prices paid by processors (handlers) to producers (dairy farmers) for nearly a century. The current program for eleven regional markets was created in 1999 following a Congressional mandate for FMMO reform,<sup>3</sup> with some subsequent regulatory adjustments. Regulated prices are set monthly by market-based economic formulas. Highest prices apply to milk in Class I (bottled or fluid) use. Lower prices are calculated by formulas for milk used to produce Class II "soft" products (ice cream, yogurt, etc.), Class III cheese products, and Class IV milk powder, condensed milk and other products.

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<sup>1</sup> Hearing Ex. 72 (NAJ-7), Tr. 513- 520; NAJ's sister organization, the American Jersey Cattle Association, is the nation's oldest dairy breed association. For more information on NAJ and AJCA, see: <https://www.usjersey.com/>.

<sup>2</sup> NAJ's price formula hearing activities are illustrated in: 53 Fed. Reg. 686, 705 (Jan. 11, 1988) (Great Basin MCP); 56 Fed. Reg. 57850, 57852-53 (Nov. 14, 1991) (Mid-Atlantic MCP); 58 Fed. Reg. 33347, 33367 (June 17, 1993) (Ohio and Indiana MCP); 60 Fed. Reg. 41833, 41834-35 (Aug. 14, 1995) (MCP in five Midwest markets, for which NAJ was the lead proponent); 60 Fed. Reg. 43066, 43071-74 (Aug. 18, 1995) (Michigan MCP); *A Preliminary Report on Alternatives to the Basic Formula Price*. Basic Formula Price Committee, Dairy Division, AMS, April 1997, NAJ FMMO reform BFP proposal at pp 26-28, <https://web.archive.org/web/19970709133050/http://www.ams.usda.gov/dairy/dybfprep.pdf>; 67 FR 67906, 67927-28 (November 7, 2002) (Class III and IV price formula); 78 FR 9248, 9250-56 (February 7, 2013) (Class III and IV price formula)

<sup>3</sup> 64 FR 16026 (April 2, 1999) (final FMMO reform decision).

Milk pricing is often a contentious process.<sup>4</sup> In the current hearing, USDA is considering proposals by dairy stakeholders to re-evaluate or update milk pricing formulas for all four classes of milk, and for the Class I price mover(s). As may be expected, most proposals (pro and con) are driven by economic self-interest.<sup>5</sup> USDA's function is to determine where conflicting stakeholder interests intersect with the public interest as expressed in the AMAA and FMMO policy precedent.<sup>6</sup>

Conflicting Class I proposals in this hearing range from bare minimum regulation, like Option 1 B in FMMO reform 25 years ago, to higher Class I prices, like enhanced versions of FMMO reform Option 1 A.<sup>7</sup> The current hearing debate on prices for market-clearing manufacturing use (class III and IV) focuses on what commercial dairy products should be price-surveyed to derive the regulated value of milk components, how much of the manufacturing cost processors are allowed to

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<sup>4</sup> Second Circuit Judge Frank colorfully described historical milk pricing contentiousness: "The city-dweller or poet who regards the cow as a symbol of bucolic serenity is indeed naive. From the udders of that placid animal flows a bland liquid indispensable to human health but often provoking as much human strife and nastiness as strong alcoholic beverages." *Queensboro Farms Prod. v. Wickard*, 137 F. 2d 969 (2nd Cir.1943).

<sup>5</sup> 64 FR at 16146 (FMMO Reform) ( The positions and arguments offered [on FMMO price formulas] are largely issues of the self-interest of entities."); 78 FR 9248, 9270 (Feb. 7, 2013) (Final make allowance decision), lack of industry consensus reflects different milk marketing and processing interests.

<sup>6</sup> E.G. Nourse, et al., USDA, *Report to the Secretary of Agriculture by the Federal Milk Order Study Committee* (April 1962) ("Nourse Report"), <https://ia801207.us.archive.org/33/items/CAT88711267/CAT88711267.pdf> ; [https://www.b.org/files/2019FMMO/Report\\_to\\_the\\_Secretary\\_of\\_Agriculture\\_by\\_the\\_Federal\\_Milk\\_Order\\_Study\\_Committee-1962.pdf](https://www.b.org/files/2019FMMO/Report_to_the_Secretary_of_Agriculture_by_the_Federal_Milk_Order_Study_Committee-1962.pdf) , Dr. Edwin Nourse was Committee chairman. The Nourse Report explains that to achieve the public interest and orderly market objectives of the AMAA, the Secretary must:

- "try to obtain the best compromises possible, often confronted with strong pressures and resistances on the part of groups with conflicting views and interests. (p II-2-4);
- "reconcile conflicting claims (pp III-7 to -8)
- "bring the three economic functions of the milk industry—producer, consumer, and handler—into the best commercial equilibrium attainable (pp III-8 to III-10 n.1)
- "protect the interests of all groups affected by an order, not just those whose milk is priced and pooled by that order." (p III-20), and
- "avoid short-run partisan positions in the interests of fluid milk producers. (p III-31).

See also, *Zuber v. Allen*, 396 US 168, 195-96 (1969), discussion under "Relevance of Producer Approval." The Nourse Report has been relied upon in several court opinions: *Zuber v. Allen*, 396 US 168, 189-91, n 5-6 (1969); *Schepps Dairy, Inc. v. Bergland*, 628 F. 2d 11, 16 n 29 (DC Cir. 1979); and *Willow Farms Dairy, Inc. v. Freeman*, 206 F. Supp. 239, 242 n. 8 (D. Md. 1962). Occasional departure from some policy recommendations of the *Nourse Report* is illustrated in *Milk Marketing: A Report of the U.S. Department of Justice to the Task Group on Antitrust Immunities* (1977), pp. 292-326 (pressure pooling discussion). ([https://books.google.com/books/about/Milk\\_Marketing.html?id=Bn6WFj1Dml8C](https://books.google.com/books/about/Milk_Marketing.html?id=Bn6WFj1Dml8C) .

<sup>7</sup> 64 FR at 16108-16118. FMMO Reform pricing Option 1 B would have resulted in the lowest Class I prices, and Option 1 A the highest. In the final decision, USDA adopted a compromise, modified Option 1 B. Congress later mandated use of somewhat higher Class I prices in Option A. 64 FR 70868 (Dec. 17, 1999).



recover, and whether the half-century agency policy of nationally uniform prices to handlers for all manufacturing class milk should be continued.<sup>8</sup>

Hearing proposals for the Class I price mover (formerly known as the “basic formula price”) advocate use of current Class III and IV reference price formulas, component-adjusted Class III and IV reference price formulas, averaging of manufacturing class reference prices, and discontinuation of the policy of advance announcement of Class I prices. Fat/skim market manufacturing class prices may also increase by proposed component-adjusted reference prices.

Resolution of competing proposals in this hearing requires, we believe, careful examination of USDA policies, statutory requirements for FMMO milk pricing, and related court opinions, that have set administrative standards for milk price rulemaking since the 1930s. This regulatory history was addressed as “background” to NMPF proposals by Craig Alexander (Ex 245 (NMPF-31)) and is summarized below in greater detail. This history supports an outcome that will best promote competitive equity among handlers and fair revenue distribution among producers, including Proposals 1 and 2 adjustments to Class III and IV skim component factors used to calculate related Class I price values.

## *II. The Setting: Federal Milk Price Regulation, 1933 – 1999, A Brief History of Methods, Milestones, Policies, and Trend to Pricing Uniformity*

Federal milk price regulation began with temporary Depression-era authority in the Agricultural Adjustment Acts of 1933 and 1935, and permanent authority in the Agricultural Marketing Agreement Act of 1937 (AMAA).<sup>9</sup> The AMAA

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<sup>8</sup> See 39 FR 8712 (March 6, 1974) (Final Decision, 32 market manufacturing class pricing and classification), in which USDA adopted the M-W survey price as the nationally uniform price for milk used to produce cheese, butter and powder (Class III in most markets), and as the “basic formula price” for moving the regulated Class I price. The M-W price had previously been adopted as the national basic formula price for advance Class I pricing purposes, but not applied universally as the manufacturing class price. 37 FR 1388 (Jan. 28, 1972) (Final Decision, 62 marketing orders).

<sup>9</sup> 7 USC §608c, as amended. Brooks, Neil, *The Pricing of Milk Under Federal Marketing Orders*, 26 GEO. WASH. L. REV. 181 (1958) at 187-88, reproduced at [https://nationalaglawcenter.org/wp-content/uploads/assets/bibarticles/brooks\\_milk.pdf](https://nationalaglawcenter.org/wp-content/uploads/assets/bibarticles/brooks_milk.pdf). Brooks, who was Assistant General Counsel for USDA, provides a comprehensive history of milk price regulatory law through the 1950s; Manchester, Alden C. and Don P. Blayney, *Milk Pricing in the United States* (ERS, UDA, Agriculture Information Bulletin No. 761, Feb. 2001) pp. 3-4 [https://www.ers.usda.gov/webdocs/publications/42300/15268\\_aib761\\_1\\_.pd?v=0](https://www.ers.usda.gov/webdocs/publications/42300/15268_aib761_1_.pd?v=0); *Milk Marketing*: (DOJ Report, n. 6, *supra*), pp. 76-152.

authorizes price regulation by agreement between farm product buyers and sellers, regulation by USDA “order” in the absence of agreement, or by a combination agreement and order. All milk price regulations have been by Federal Milk Marketing Orders for defined milk marketing areas. The objective of FMMO price regulation is “orderly” marketing of farm milk by: (1) uniform minimum prices to be paid by handlers (milk processors, manufacturers, and other buyers) by classified pricing – how milk is used (7 USC §608c(5)(A)), and (2) uniform minimum prices paid to producers (dairy farmers) regardless of how milk is used by receiving handlers ((7 USC §608c(5)(B)). Early judicial review concluded that this system of price regulation and pooled revenue distribution is Constitutional, but USDA is constrained in departure from price ‘uniformity’ requirements in FMMO rules.<sup>10</sup>

From the mid-1930s to the 1960s, federal milk price regulation focused primarily on the dairy economy in local metropolitan milk markets. There were 82 regulated milk marketing areas in 1962. Local Class I prices in these early years were set by many methods, with “Class I differentials” added to 1) surveyed manufacturing plant milk pay prices, or 2) butter powder and cheese product price formulas, or 3) non-dairy economic formulas.<sup>11</sup> The term applied to these formulas was “basic formula price” or “Class I price mover.” Milk used for manufacturing use was priced in one class or in many classes, depending on the local market. The price formulas for manufacturing class use were frequently different from the basic formula price. And manufacturing product or use classifications varied widely from market to market.

With advancing transportation and production technologies, industry consolidation, and increasing recognition of a national market for milk and dairy

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<sup>10</sup> The constitutionality of the FMMO program was confirmed in *US v. Rock Royal Co-op.*, 307 U.S. 533 (1939). Limitations on agency departure from uniform price requirements of §§608c(5)(A) and (B) were addressed in *Brannan v. Stark*, 342 US 451 (1952) and *Zuber v. Allen*, 396 U.S. 168 (1969). Application of the ‘prohibit’ clause of §608c(5)(G) – “no marketing... order applicable to milk ... shall prohibit” – was addressed in *Lehigh Valley Coop. Farmers, Inc. v. U.S.*, 370 US 76 (1962), involving a fluid milk pricing trade barrier.

<sup>11</sup> See Post-Hearing Brief of the International Dairy Foods Ass’n (dated Feb. 13, 2024), at 24 – 28 and associated appendices, w/ FMMO provision excerpts from the 1930s to 1970s; USDA, Nourse Report, at pp II-1-10 – II-1-11, US GAO, *Milk pricing: New Method for Setting Farm Milk Prices Needs to Be Developed*, (GAO Nov. 1989) (<http://archive.gao.gov/d26t7/140069.pdf>), at p. 41 (discussing early history of FMMOs).

products, USDA moved to make FMMO classification and pricing rules more uniform and nationally coordinated, following many of the observations and recommendations of the 1962 “Report to the Secretary of Agriculture by the Federal Milk Order Study Committee” (Nourse Report, n. 6, *supra*). In January 1972, USDA adopted the M-W survey price as the uniform national “basic formula price” for Class I pricing purposes.<sup>12</sup> In 1974 USDA adopted the M-W survey price as the national uniform price for manufacturing class milk (Class III, cheese, butter and powder) and provided uniform classification of milk used to produce most manufactured products.<sup>13</sup> At that time, there were as many as eleven different price formulas for milk put to similar use.<sup>14</sup> The 1974 Decision explained that:

“...differences in the classification and pricing of milk are often disruptive to the competitive relationships of handlers and to the marketing of producer milk. \*\*\* [I]f a uniform classification and pricing scheme was to be implemented to any substantial degree the variety of pricing formulas now applicable in these several markets should not be continued....”<sup>15</sup>

The Final 1974 Decision also rejected requests by dominant cooperatives in some markets for a local exception to national manufacturing price uniformity. UDA, for example, advocated retention of a butter-powder formula “snubber” for the Central Arizona Class III price. USDA initially agreed to accommodate UDA in a revised recommended decision but changed its mind in favor of national Class III price uniformity in the Final Decision.<sup>16</sup>

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<sup>12</sup> 37 FR 1388 (Jan. 28, 1972) (Final Decision following Dec. 1971 hearing). <https://www.govinfo.gov/content/pkg/FR-1972-01-28/pdf/FR-1972-01-28.pdf>

<sup>13</sup> 39 FR 8452 (March 5, 1974) (Final Decision). <https://www.govinfo.gov/content/pkg/FR-1974-03-05/pdf/FR-1974-03-05.pdf>

<sup>14</sup> 39 FR at 8456.

<sup>15</sup> 39 FR at 8453, 8459.

<sup>16</sup> 39 FR at 8459. The Recommended Decision, like the Final Decision, provided for national Class III price uniformity. 37 FR 19210 (Sept. 19, 1972). <https://www.govinfo.gov/content/pkg/FR-1972-09-19/pdf/FR-1972-09-19.pdf>. Producer exceptions led USDA to recommend retention of a butter-powder snubber Class III price for Arizona and some other markets. 38 FR 25282, 25287 (Sept. 12, 1973) (revised Recommended Decision), <https://www.govinfo.gov/content/pkg/FR-1973-09-12/pdf/FR-1973-09-12.pdf> This did not survive final analysis. UDA had also proposed a local exception to the national uniform Class II price, advocating for Class III plus 25 cents. 39 FR at 8456. USDA adopted a national uniform price of Class III plus 10 cents.

Uniform application of the Class III price to a large variety of manufactured dairy products proved difficult to sustain in the 1980s – 90s because Class III (M-W survey) prices were driven by Midwest demand for milk used to make cheese, while the value of milk for use in nonfat dry milk (NFDM) was driven by Western milk powder production. As a result, skim milk used in butter-powder production often produced revenues below regulated Class III prices, with losses accruing primarily to operating cooperatives, creating pricing inequity between handlers and between producers. USDA responded by creating a new Class III-A price for skim milk used to produce NFDM. The new formula price was not quite uniform – it was lower for two western markets (Arizona and Pacific Northwest) than elsewhere – and it did not apply to fat and skim milk in cream used to produce butter.<sup>17</sup>

Further pursuit of uniformity and equity in FMMO minimum milk price regulation was the foundation for evolving use of Multiple Component Pricing (MCP) in the 1980s and 1990s. Since their inception, FMMOs had fixed prices for one milk solid component – butterfat – and placed the residual value in skim milk, containing water and nonfat solids (NFS). NFS consists of protein, minerals and lactose in milk. But the unregulated market had adjusted milk pay prices for many years based on skim protein or NFS content similar to price adjustments for fat content. The 1962 Nourse Report discussed potential evolution of regulated MCP plans and explained the pricing equity reasons for so doing.<sup>18</sup> The State of

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<sup>17</sup> 56 FR 65801 (Dec. 19, 1991) (Tentative Decision, adopting III-A classification for three markets); <https://www.govinfo.gov/content/pkg/FR-1991-12-19/pdf/FR-1991-12-19.pdf> ; 58 FR 58112 (Oct, 29, 1993) (Final Decision adopting III-A classification and price formulas for all FMMO markets). [FR-1993-10-29.pdf \(govinfo.gov\) https://www.govinfo.gov/content/pkg/FR-1993-10-29/pdf/FR-1993-10-29.pdf](https://www.govinfo.gov/content/pkg/FR-1993-10-29/pdf/FR-1993-10-29.pdf) . Cream containing about 40% butterfat and 60% skim, used to produce butter and buttermilk powder, continued to be priced as Class III milk.

<sup>18</sup> Nourse Report at II-1-17 to 18: “The problems of pricing milk are made more complex by the fact that the constituents of milk vary because of breed, season of the year, stage of lactation, and feed and management practices. The components of milk are butterfat, solids-not-fat, and water. Milk with different concentrations of these components has a different monetary value to the receiving handlers. \*\*\* An alternative to use of the traditional butterfat differential is to establish separate prices for fat and solids-not-fat....\*\*\*\*

The problem of determining "appropriate" differentials is one of bringing about equality of the "net values" - to handlers -- of milk of different content. When this equality is achieved producers are efficiently guided in making their own decisions with respect to breed of cattle, feeding and management practices, and other variables which affect solids content.”

California adopted butterfat/NFS MCP plans for state milk price and pooling regulation in the mid-1960s.<sup>19</sup>

The first FMMO with regulated MCP was the Great Basin Order, in which MCP was advocated as a means to advance more uniform classified pricing to handlers and more uniform distribution of milk revenues to producers, as required by the AMAA. The MCP plan provided for per pound protein pricing of milk used to produce manufacturing class products similar to per pound pricing for butterfat. The Great Basin formula for protein pricing per pound was tied to the residual value of skim milk in the M-W (3.5% fat) survey price, applied to market-wide protein production, for handler obligations. Producers uniformly received the weighted average value of total market protein in all classified uses in a “producer protein price” as part of their milk check.<sup>20</sup>

MCP was adopted for the Mid-Atlantic Market in 1991, for which NFS rather than protein was the non-fat component priced.<sup>21</sup> Again, promotion of AMAA objectives of uniform handler class prices and uniform producer blend prices was emphasized.<sup>22</sup> This was followed by MCP protein pricing for the Ohio and Indiana markets, NFS pricing for the Pacific Northwest and protein pricing for the Idaho markets, MCP protein pricing for five Upper Midwest markets, and MCP protein pricing for the Southern Michigan market.<sup>23</sup> The evolving MCP plans provided a

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<sup>19</sup> Crop, Robert, *Milk Pricing and Pooling in California* (Cornell Program on Dairy Markets and Policy, Issues and Options No. 0-10, March 1996), reproduced at <https://dairymarkets.org/pubPod/pubs/O10.pdf> ; California Department of Food and Agriculture, *Milk Pricing in California* (Oct. 2012), [https://www.cdfa.ca.gov/dairy/pdf/Milk\\_Pricing\\_in\\_CA.pdf](https://www.cdfa.ca.gov/dairy/pdf/Milk_Pricing_in_CA.pdf) ; 53 Fed. Reg. 686, 700 (Jan. 11, 1988) (Final MCP Decision, Great Basin FMMO) (citing testimony about the 20-year history of MCP in California). URL below.

<sup>20</sup> 53 FR 686, 701-704 (Jan. 11, 1988) (Final MCP Decision, Great Basin FMMO) <https://www.govinfo.gov/content/pkg/FR-1988-01-11/pdf/FR-1988-01-11.pdf> ; 7 CFR Part 1139 (1989), reproduced at 53 Fed. Reg. at 717 – 731. Sections 1139.50(e) (milk protein price), 1139.61 (computation of weighted average differential price), and 1139.62 (computation of producer protein price).

<sup>21</sup> 56 FR 57850 (Nov. 14, 1991) (Final Mid-Atlantic MCP Decision), <https://www.govinfo.gov/content/pkg/FR-1991-11-14/pdf/FR-1991-11-14.pdf> .

<sup>22</sup> 56 FR at 57854. In the absence of FMMO component pricing, “handlers are not paying uniform prices and producers are not receiving uniform prices.”

<sup>23</sup> Final MCP Decisions for the Ohio and Indiana markets (58 Fed. Reg. 33347 (June 17, 1993), <https://www.govinfo.gov/content/pkg/FR-1993-06-17/pdf/FR-1993-06-17.pdf> ; Pacific Northwest and Idaho markets (59 Fed. Reg. 8546 (Feb. 23, 1994) <https://www.govinfo.gov/content/pkg/FR-1994-02-23/pdf/FR-1994-02-23.pdf> ; five Upper Midwest markets (60 Fed. Reg. 41833 (Aug. 14, 1995)

variety of – therefore non-uniform – methods to apply the residual (non-fat) value of skim milk in the M-W survey price to the preferred MCP plan skim component. To assist this process, the M-W survey reports began to include monthly information on protein and NFS content of milk in the M-W survey.<sup>24</sup> This allowed better MCP price coordination not only with monthly changes in the market value of products produced by M-W plants, but also with seasonal and yearly variations in the producer milk nonfat component content to which the M-W (Basic Formula) pay price survey was applied.<sup>25</sup>

In the 1990s, USDA also undertook comprehensive review of Class I pricing, use of the Basic Formula Price (M-W survey) as the Class I and II price mover, and continued use of the M-W survey for BFP and Class III pricing purposes. In 1991, a 43-day hearing with over 200 witnesses addressed proposals for changes in Class I and II pricing and uniform product classification.<sup>26</sup> Ensuing litigation focused on Class I pricing and use of the M-W price to reflect 7 USC §608c(18) classified price supply and demand standards. These issues were addressed in “amplified decisions” of USDA, and the agency’s resolution was approved by the 8<sup>th</sup> Circuit Court of Appeals.<sup>27</sup> Due to declining Grade B milk production, USDA also modified the M-W survey price by adding a product price update procedure to the formula, creating a new “base month M-W” as the Basic Formula Price – a stopgap pending FMMO Reform.<sup>28</sup> A number of alternative basic formula / Class I price movers

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<https://www.govinfo.gov/content/pkg/FR-1995-08-14/pdf/95-19677.pdf> ; and Southern Michigan market (60 Fed. Reg. 43066 (Aug. 18, 1995) <https://www.govinfo.gov/content/pkg/FR-1995-08-18/pdf/95-20347.pdf> .

<sup>24</sup> NASS, Prices Received Minnesota-Wisconsin Manufacturing Grade Milk, (M-W Milk Price Series) ’95-’99. <https://web.archive.org/web/20000816171442/http://usda.mannlib.cornell.edu/reports/nassr/price/zpr-bb/>

<sup>25</sup> 53 Fed. Reg. 686, 700, 703-04 (Jan. 11, 1988) (Great Basin MCP); 58 Fed. Reg. 33347, 33368 (June 17, 1993) (Ohio and Indiana MCP); 59 Fed. Reg. 8546, 8547 (Feb. 23, 1994) (Northwest and Idaho MCP); 60 Fed. Reg. 43066, 43069-70, 43075 (Aug. 18, 1995) (Michigan MCP).

<sup>26</sup> 58 FR 12634 (March 5, 1993) (Final Decision) <https://www.govinfo.gov/app/collection/fr/1993/03/05>

<sup>27</sup> 61 FR 49081 (Sep. 18, 1996) (2d Amplified Decision) <https://www.govinfo.gov/content/pkg/FR-1996-09-18/pdf/FR-1996-09-18.pdf>; *Minnesota Milk Producers Ass'n v. Glickman*, 153 F. 3d 632 (8th Circuit 1998).

<sup>28</sup> 60 FR 7290 (Feb. 7, 1995) (Final Decision), <https://www.govinfo.gov/content/pkg/FR-1995-02-07/pdf/95-2448.pdf> .

were also considered at that 1992 hearing, but found to be inferior for supply/demand pricing standards or maintaining class price relationships.

USDA then turned its attention to FMMO reform, as had been mandated by Congress in the 1996 Farm Bill. The Farm Bill authorized alternative formulas for the Basic Formula Class I price mover and manufacturing class prices by “use of uniform multiple component pricing when developing 1 or more basic formula prices for manufacturing milk,” and required use of informal notice and comment rulemaking rather than the usual hearing process.<sup>29 30</sup>

### *III. FMMO Reform Milk Pricing: Price Formulas, Policy, and Amendments*

USDA planning for 1999 FMMO reform included organization of agency-staffed study committees to make recommendations for price structure, basic formula pricing, classification, uniform provisions, and regional issues. For milk pricing issues, USDA sought economic expert guidance from university study groups: Class I price structure study led by Cornell University, and Basic Formula (and related manufacturing price) study led by Texas A&M University.<sup>31</sup>

The Basic Formula University Study Committee submitted an interim report in October 1996 with detailed evaluation of eleven BFP options, including MCP, product price and competitive pay price formulas.<sup>32</sup> In this evaluation, the Committee applied proposed MCP and product price formulas to an “adjusted M-W” price that used a constant “standard” 3.15% protein content of producer milk “based on the prevailing protein test as reported by AMS/USDA.”<sup>33</sup> This resulted in

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<sup>29</sup> Section 143 of the Federal Agriculture Improvement and Reform Act of 1996. 7 U.S.C. §7253.

<sup>30</sup> 7 U.S.C. §§7253(a)(3)(B) and (b)(1). USDA’s FMMO reform rulemaking paraphrased the uniform MCP authorization as applying to “basic prices for manufacturing milk” rather than “basic *formula* prices...” 63 FR 4802, 4803 (Jan. 30, 1998) (Recommended Decision), 64 FR 16026, 16027 (April 2, 1999) (Final Decision). In the end, uniform MCP prices were provided for all manufacturing classes, and the resulting Class III and IV reference prices were used as replacements for the Basic Formula Price for Class I price mover purposes.

<sup>31</sup> 63 FR at 4803 (Recommended Decision), 64 FR at 16027 - 29 (Final Decision).

<sup>32</sup> AN ECONOMIC EVALUATION OF BASIC FORMULA PRICE (BFP) ALTERNATIVES Interim Report AFPC Working Paper 96-5 <https://www.afpc.tamu.edu/research/publications/89/bfp1.htm> .

<sup>33</sup> *Id.*, Interim Report, Ch. 2. The source of USDA’s “prevailing” 3.15% protein test information is not revealed. Protein test information from MCP markets, as reported in Federal Milk Order Market Statistics, as well as protein tests included in M-W survey price reports, all indicate a higher average than 3.15% protein

subtracting from the reported M-W survey price some of the producer revenue attributed to higher protein tests. This produced consistently lower “adjusted” M-W prices in the fall when “the natural average protein test is much higher... than the 3.15 percent standard.” It also neutralized the seasonal benefit of applying residual M-W skim value to protein and other components as used in existing MCP milk orders at the time.<sup>34</sup>

Relying in large measure on the University Study Committee report, the agency-staffed Basic Formula Price Committee released a preliminary BFP report in April 1997 (AMS BFP Report). This included several MCP and product price options, including a four-class, multiple component pricing plan to compute prices for milk components in cheese and butter/powder production in Class III and IV, respectively, and with a BPF replacement based on the average of or higher of these prices (Option 1 in the Report). For this purpose, the AMS Report adopted the 3.15% protein standard for Class III pricing, and an 8.5% NFS standard for Class IV pricing for milk with 3.5% butterfat.<sup>35</sup>

In USDA’s FMMO Reform Recommended Decision, the 3.15% protein standard for Class III was retained, but the Class III other solids and Class IV NFS standard were increased slightly to reflect a consistent 8.65% NFS standard for 3.5% butterfat milk. This was converted to 3.3% protein and 9.0% NFS per cwt. skim milk.<sup>36</sup>

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during the 1990s for milk at test. However, 3.15% does appear to conform to long-prevailing conventional wisdom since the 1980s (or before) that producer milk *containing* 3.5% butterfat also contains about 3.15% protein (total protein). Vitaliano, Ex. 62 (NMPF-1) p 4. See US General Accounting Office, *Milk pricing: New Method for Setting Farm Milk Prices Needs to Be Developed*, (GAO Nov. 1989) (<http://archive.gao.gov/d26t7/140069.pdf>), at p. 22 (“... , milk with a 3.5-percent butterfat content, on average, contains about 3.15-percent protein.”).

<sup>34</sup> *Id.* In addition, the University Committee applied milk product yields from a hundredweight of standard milk as contained in a 1991 AMS study: 4.27 pounds of butter, 8.07 pounds of NDM, 0.42 pounds of dry buttermilk, 9.87 pounds of cheddar cheese, and 0.238 pounds of whey butter.

<sup>35</sup> AMS, Dairy Division, *A Preliminary Report On Alternatives To The Basic Formula Price* (April 1997), <https://web.archive.org/web/19970709133050/http://www.ams.usda.gov/dairy/dybfprep.pdf>.

<sup>36</sup> 63 FR at 4883, 4886 (Recommended Decision). Like the 3.15% total protein factor (n. 33, *supra*), the source of the 8.65%/9.0% NFS factor is not clearly revealed in the FMMO Reform decisions.



The FMMO Reform Final Decision retained these standard composition factors but adjusted (reduced) the protein portion to represent “true protein” in producer milk rather than total protein (containing some non-protein nitrogen) used in the Recommended Decision, previously used in the BFP committee reports, and also used for MCP pricing and protein reporting purposes in FMMO orders through 1999. The “true protein” standard was calculated at 3.1% for skim milk. The “other solids” standard was reciprocally adjusted to 5.9%, retaining the total standard NFS of 9% in skim milk.<sup>37</sup> The fixed standard milk composition factors were created to provide for Basic Formula Replacement / Class I price mover purposes, as explained in the university and agency BFP reports, and for announcement of standardized milk class reference prices per hundredweight, as had long been done for class prices announced with adjustment to a 3.5% butterfat standard.

The FMMO Reform Final Decision recognized that “because milk used in manufactured products obtains its value from the components of milk, it is the components that should be priced....”<sup>38</sup> To advance this objective, the Decision proceeded to create uniform multiple component pricing for milk used to produce Class III and IV manufactured products, as had been suggested in the 1996 Farm Bill. Separate uniform component price formulas were created for four components: 1) butterfat,<sup>39</sup> 2) protein used in Class III skim milk, 3) “other solids” used in Class III skim milk, and 4) NFS used to produce Class IV milk powder and other products. These uniform classified component prices were to be derived from surveyed/reported dairy product market prices that reflected month-to-month changes in milk component value. The product price component formulas contained fixed adjustments for manufacturing costs (make allowance) and product yields from producer milk.<sup>40</sup> The pricing formulas were contained in expanded 7 CFR

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<sup>37</sup> 64 FR at 16096, 16098 (Final Decision).

<sup>38</sup> 64 FR at 16092.

<sup>39</sup> The uniform butterfat price applied to Class III and IV uses. Adjustments by timing and differential values were made to the butterfat price for use in Class I and II price formulas. 7 CFR Part 1000.50.

<sup>40</sup> 64 FR at 16092-93 (component pricing overview, based on University Study Committee analysis), 16093-94 (discussion of commodity prices used to estimate component value), and 16096 – 16101 (discussion of make allowance and related product yields to be used). The fixed nature of make allowances and product

Part 1000 General Provisions applicable to all milk orders: a butterfat per pound price in §1000.50(l), a nonfat solids price per pound in §1000.50(m), a protein price per pound in §1000.50(n), and other solids price per pound in §1000.50(o).<sup>41</sup>

By virtue of the multiple component pricing approach for milk in manufacturing classes II, III and IV, FMMO reform replaced uniform class prices per milk hundredweight with uniform class prices per milk component pound. The Final Decision explained that this feature eliminated inequities that previously resulted from use of a uniform skim price to manufacturers receiving milk of varying manufacturing value due to non-uniform skim component content:<sup>42</sup>

This pricing system eliminates the need for regional yields based on regional differences in milk composition. The value of milk will be adjusted automatically based on the level of components contained in the milk in each order even though the component prices are the same nationally. This automatic adjustment means that handlers will pay the same price per pound of component but may have differing per hundredweight values based on the milk component levels, creating equity in the minimum cost of milk used for manufacturing purposes.

By this method, USDA explained that FMMO Reform manufacturing class pricing continued agency policy since the 1970s of nationally uniform prices for milk used to produce manufacturing class products.<sup>43</sup> For hundredweight standardized

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yields in the rules predictably required amendment of rules as manufacturing costs increased and product yields increased. Since FMMO reform, USDA has updated make allowances several times to account for cost and yield changes.

<sup>41</sup> In effect, FMMO Reform resulted in a national milk pricing order contained in 7 CFR Part 1000, and separate regional pooling orders governing revenue distribution and eligibility in 7 CFR Parts 1001 - 1135.

<sup>42</sup> 64 FR at 16100.

<sup>43</sup> 64 FR at 16100: “This decision replaces the current BFP with a national Class III price and a national Class IV price.” The evolution of agency policy for nationally uniform Class III prices since the 1970s is discussed above, at pp. 4-5. The FMMO Reform Rules, however, did not fully apply the “same price per pound of component” to Class II, III and IV milk in the remaining fat/skim markets – Appalachian, Southeast, Florida, and Arizona. For these markets the calculated component price per pound was applied to standard reference prices used for BFP-replacement purposes in the higher of Class III and IV hundredweight prices. I.e., all skim milk in Class II, III and IV uses in these markets was to be priced as if it contained 9% NFS, or 3.1% true protein and 5.9% other solids. The Final Decision expressed the view that the MCP per pound formulas provide “corresponding hundredweight prices” in fat/skim markets (id. at 16091); that the MCP formulas provide a “hundredweight price equivalent” in fat/skim markets (id. at 16105). As discussed below, USDA’s 1999 “price equivalent” conclusion has become increasingly inaccurate since FMMO reform due to the static nature of fixed components in the BFP-replacement formula and the dynamic (increasing) nature of component content in producer milk. Skim components in Class II, III and IV milk prices for the four fat/skim

reference price purposes, the final rules contained definitions for a Class II price (7 CFR §1000.50(d)), a Class III price (7 CFR §1000.50(h)), and a Class IV price (7 CFR §1000.50(j)), each adjusted to 3.5% butterfat and the “standard” 9% nonfat solids, or 3.1% protein and 5.9% other solids, in skim milk, depending on use.

In addition to providing regulated prices per component pound for milk used in manufacturing classes, the uniform multiple component pricing system adopted in FMMO reform was used to provide a replacement for the Basic Formula Price for purposes of moving Class I prices, as had been recommended in the 1996 Farm Bill and by the university and agency BFP study committees. The MCP formula met economic and policy objectives for a BFP replacement by conforming with supply-demand pricing standards in section 608c(18) of the AMAA, by not deviating greatly from the BFP/M-W survey prices in place for almost 40 years, and by prompt response to national changes in supply and demand for milk.<sup>44</sup> The M-W had measured milk prices that efficient handlers could afford to pay, automatically incorporating changes dairy product values, manufacturing costs, varying value of component content in Grade B milk, and other economic factors.<sup>45</sup> The Final Decision provided for use of the higher of advance (projected) Class III or IV prices, at standard composition values, as the BFP replacement for moving per hundredweight prices for Class I milk.<sup>46</sup> This continued the M-W response to

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markets are significantly undervalued. Manufacturing class component prices are not uniform nationally, nor uniform among handlers within the fat/skim markets.

<sup>44</sup> 64 FR at 16094-96: “Application of the BFP and USC Committees’ criteria for BFP replacement to the various BFP alternatives and consideration of comments received in response to the proposed rule resulted in the determination that the component pricing product price formulas contained in this final rule best meet the stated goals and criteria for the replacement of the BFP.”

<sup>45</sup> 60 FR 7290, 7298 (Feb. 7, 1995) (Final Decision, Base Price M-W) (USDA determined in 1961 that the M-W survey price “was superior to product formulas... in establishing the basic formula price to purchase milk at prices commensurate with the more efficient concerns’ ability to pay for the product.” See also, NASS, USDA, *Prices Received, Minnesota-Wisconsin Manufacturing Grade Milk, 1998 Summary* (June 1999), (“The [M-W survey] price is f.o.b. plant or receiving station, before [various deductions].... It includes quantity, quality, protein, and other premiums paid to producers.”) <https://web.archive.org/web/20000816171442/http://usda.mannlib.cornell.edu/reports/nassr/price/zpr-bb/>

<sup>46</sup> 64 FR at 16094-95, 16101-103. The advance (projected) Class I price formula, based on the “higher of” advance manufacturing class III or IV prices, was contained in 7 CFR §1000.50(b) “Class I Skim Price,” and applied per hundredweight to milk with standardized components. Since 2018, this section has provided for

changing product values and related manufacturing plant ability to pay for milk,<sup>47</sup> but the BFP replacement no longer captured changes in manufacturing costs. The fixed composition standard formula also no longer captured changes in the value of variable and increased components in milk. The latter features of the M-W, not included automatically by MCP product price formulas, would need to be addressed by future pricing rule amendments.

There remained the question of what price addition, or Class I differential, to apply to the BFP replacement. The Final Decision explained the objectives and policies for Class I price differentials.<sup>48</sup>

- Class I differentials should be coordinated with but higher than manufacturing class values. This is intended “to generate enough revenue to assure that the fluid market is adequately supplied.”
- Class I prices should be announced in advance, to accommodate packaged fluid milk marketing practices.
- Because of advance Class I pricing and monthly changes in Class III and IV price movers, the effective Class I differential – “the actual difference between the Class I and manufacturing use prices in a month – is not the same as the Class I differential stated in an order.” The effective Class I differential therefore needs to be high enough to allow Class I handlers to compete with manufacturers for the available supply of milk.
- A Class I differential that is too low may produce frequent price inversion – a Class I price below the manufacturing class prices – resulting in manufacturing class handlers removing more valuable Class III or IV milk from the available pool milk supply (“depooling”), thereby creating competitive inequity between Class I plants and manufacturing plants, and between producers who supply Class I plants and those who supply

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advance Class I skim prices based on the average of advance Class III and IV standard component skim prices per hundredweight plus \$0.74.

<sup>47</sup> 64 FR at 16092 ( The price handlers can afford to pay for milk is determined by the price for which the finished product can be sold.”).

<sup>48</sup> 64 FR at 16102 - 03.

manufacturing plants. Higher differentials will reduce depooling events and resulting market disorder.

The Final Decision addressed these issues by reducing the time lag for advance notice of Class I prices, providing a new feature of advance notice of Class I butterfat prices,<sup>49</sup> and national location-specific Class I prices under “modified Option 1 B,” with a Class I differentials ranging from \$1.45/cwt in Seattle and \$1.60 in Minneapolis to \$4.20/cwt in Tampa.<sup>50</sup> Congress intervened a short time later, mandating adoption Option 1 A, with Class I differentials ranging in metropolitan markets from \$1.70 in Minneapolis to \$4.30 in Miami, which USDA incorporated into a final FMMO reform rule effective January 1, 2000.<sup>51</sup> For Minneapolis, the Final Rule represented a \$0.50/cwt increase in the differential between Class I and the manufacturing class reference price.

Following 1999 FMMO Reform, several hearings were held to adjust the manufacturing class MCP price formulas for butterfat, nonfat solids, protein and other solids in order to account for changes in manufacturing costs (make allowance) and product yield. The result of these hearings also updated and changed the per pound component prices to apply to standardized per hundredweight reference prices for Class I, II, III and IV. Some post-Reform product classification changes were also made, along with regional restraints in depooling and repooling practices.<sup>52</sup> And in 2018 Congress mandated use of

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<sup>49</sup> 64 FR at 16102 – 03.

<sup>50</sup> 64 FR at 16108 – 16121.

<sup>51</sup> 64 FR 70868 (Dec. 17, 1999) (Final Rule adopting Option 1 A Class I prices).

<sup>52</sup> 67 FR 67906 (Nov. 7, 2002) (make allowance/price formula); 71 FR 78333 (Dec. 29, 2006) (make allowance); 78 FR 9248 (Feb. 7, 2013) (make allowance/product yield); and 69 FR 9763 (March 2, 2004) and 69 FR 57233 (Sep. 24, 2004) (reclassification of condensed and evaporated milk to Class IV), in which, notably, all of the proponents [of reclassification proposals] are handlers who operate nonpool plants and, accordingly, are not regulated by any Federal milk marketing order.” 69 FR at 9768; Depooling decisions, *E.g.*, 83 FR 14110, 14159 (Apr. 2, 2018) (California Decision); 71 FR 54152, 54159-61 (Sept. 13, 2006) (Central Market Decision); 71 FR 54136, 54139-44 (Sept. 13, 2006) (Upper Midwest Decision).

average advance Class III/IV component prices to move Class I prices, rather than “higher of” as provided in the Final FMMO Reform Decision.<sup>53</sup>

For over 24 years, however, no hearings were held to update or reexamine the standardized skim milk component factors of 9% NSF (3.1% protein and 5.9% other solids) used for advance Class I pricing and for hundredweight reference price purposes in the 1999 FMMO Reform price formulas. In March 2023, the National Milk Producers Association (NMPF) petitioned USDA to hold a hearing to amend 7 CFR §1000.50 standard component factors. Other NMPF proposals included manufacturing make allowances in the component price formulas, product price references, product yields, and price structure for Class I and II milk in uniform FMMO General Provisions, 7 CFR Part 1000. Other industry stakeholders also submitted Part 1000 amendment proposals. NAJ submitted a milk component factor proposal that was similar to the NMPF proposal except on timing of future component factor updates. That hearing convened in August 2023 and concluded in January 2024.

The issue of updating standard skim milk composition factors in a manner consistent with the AMAA and evolution of over 60 years of FMMO milk pricing policy is the primary focus of this post-hearing brief.

*IV. The Skim Milk Composition Factors: Factual Basis, Proposals, Objectives, Record Evidence, And Proposed Price Amendments*

There is no dispute that the content of NFS, protein and other solids in producer milk has progressively and significantly increased since FMMO reform in the late 1990s, as has butterfat content. Average skim milk components in all FMMO markets with available test results for 2000 and 2022 were as follows:<sup>54</sup>

<u>Year</u>	<u>NFS %</u>	<u>Protein %</u>	<u>Other Solids %</u>
2000	9.04	3.13	5.91
2022	9.41	3.39	6.02

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<sup>53</sup> 84 FR 8591 (Mar. 11, 2019), amending 7 CFR 1000.50(b) *Class I skim milk price*. This legislative action provided Class I processors a new opportunity to use risk management tools that had long been available to producers and to Class III and IV handlers.

<sup>54</sup> Ex 64 (NMPF-2), p. 5; Metzger Ex 66 (NAJ-1), and Ex 72 (NAJ-7) p 2.

The trend of higher solids components in skim milk is expected to continue due to economic signals to producers from component values and improved production techniques.<sup>55</sup> Because the value of farm milk is derived from these components, as incorporated in the uniform multiple component price formulas,<sup>56</sup> increased components in skim milk has resulted in greater value in the skim portion of producer milk compared to component content in the 1990s standard formula and in component content during early years following FMMO reform.

*A. Application of Standard Skim Solids Factors to Class I Prices.*

The greater value in the skim portion of producer milk, however, has not been incorporated into price formula values for Class I milk. Class I skim milk is priced as if it contains 9% NFS (or 3.1% protein and 5.9% other solids). Although the minimum FMMO price paid by Class I handlers is adjusted for variable butterfat content, it is not adjusted for higher (or variable) NFS content. This is significant because USDA has long recognized that Class I prices should be fixed in relation to the value of milk in manufacturing class uses, and in relation to manufacturers' ability to pay for milk.

The Class I differential is intended to reflect the desired Class I to Class III/IV price relationship to better allow Class I handlers to compete with manufacturing class handlers for pool milk supplies, to promote price and cost equity among handlers, to avoid milk price inversion and depooling of manufacturing class milk, to promote milk revenue equity among producers, to promote supply efficiency, to assure an adequate supply of milk is available for fluid use.<sup>57</sup> Prior to FMMO Reform, the M-W survey/BFP price dynamically captured seasonal and annual changes in milk composition as part of many competitive economic factors automatically incorporated in the resulting Class III price, which

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<sup>55</sup> Van Amburgh, Ex 96-97 (NMPF-3 and NMPF 3-A).

<sup>56</sup> 64 FR at 16092

<sup>57</sup> 60 FR at 7298 (1995); 63 FR at 4881, 4892 (1998); 64 FR at 16102 (1999); 67 FR at 67936 (2002); Metzger, Ex 72 (NAJ-7), pp 2, 4 and 7; Covington, Ex 64 (NMPF-2), pp 7-8; Hoeger, Ex 77 (NMPF-5), pp 3-4.

served as the basic formula price (Class I price mover). The Class I to Class III price relationship was therefore consistently maintained.

In the process of FMMO Reform, USDA evaluated BFP alternatives against the pricing attributes of the then-existing M-W/BFP in tracking supply and demand conditions and changes in milk value reflected in product prices.<sup>58</sup> The selected BFP-replacement product price component formula tracked well. But it was not designed to account for future changes in producer skim milk components or the added skim value of greater component content in the Class III and IV reference prices.<sup>59</sup>

Since FMMO reform, the standard factor Class III and IV reference prices per hundredweight result in corresponding *increasing spreads* between announced “standard” manufacturing class reference prices and the actual value of Class III/IV milk. As observed by USDA data and expert witness analysis, the 2022 announced (standard factor) Class III average skim price was \$0.83/cwt lower than the actual value of Class III skim milk with average protein and other solids. Similarly, the 2022 announced (standard factor) Class IV average skim price was \$0.61/cwt lower than the actual value of Class IV skim milk with average NFS.<sup>60</sup>

Likewise, the use of static “standard” component factors has caused a corresponding and progressive *narrowing spread* between effective milk manufacturing class values and imputed values contained in the Class I formula price. For months in which the Class III price is the Class I price mover, the target FMMO Reform Minneapolis Class I differential of \$1.70 was reduced in 2022 (by the manufacturing value increase) to an effective value price spread of just \$0.87 (or

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<sup>58</sup> 63 FR at 4883 (Recommended Decision), 64 FR at 16096 (Final Decision).

<sup>59</sup> The university BFP committee interim report acknowledged that its proposed standard composition formula consistently understated the FMMO M-W BFP milk value in the fall months, when “the natural average protein test is much higher... than the 3.15 percent standard.” Interim Report AFPC Working Paper 96-5, Ch. 2, <https://www.afpc.tamu.edu/research/publications/89/bfp1.htm>. Thus, future understatement of milk value by the proposed formula, as skim component content increased, was predictable. Like fixed make allowances in the formulas, the need for amendment of “standard” components could be foreseen.

<sup>60</sup> Covington, Ex 64 (NMPF-2), pp.6; Gallagher, Ex 109 (NMPF-4), pp. 13-15; Metzger, Exs. 66-67, 72 (NAJ-1-2 and 7 p. 2-3).



\$0.47 in 1999 buying power adjusted for inflation). Applied to the average of 2022 effective Class III and IV prices, the effective value differential is reduced to \$0.98.

Further illustration of the significant standard component vs actual value milk price difference is shown Tables 1 and 2 below. Data published in the March 2023 AMS report of *Final Class Prices by Order* at standard component reference values is reproduced in Table 1.<sup>61</sup> In Table 2 manufacturing class prices are adjusted for each market to reflect actual values of average Class II, III and IV milk at the “uniform price per pound of component” (64 FR at 16100) provided by formulas in 7 CFR §§1000.50(f), (g), (l), (m), (n), (o), and (q).

**Table 1 – March 2023**

**Standardized Federal Milk Order Minimum Class Prices/CWT for Milk of 3.5 Percent Butterfat**

<b>23-Mar</b>	Class Prices @ 3.50% BF			
	Current Standard Components			
	<u>Class I</u>	<u>Class II</u>	<u>Class III</u>	<u>Class IV</u>
Northeast	\$22.24	\$ 19.52	\$ 18.10	\$ 18.38
Appalachian	\$22.39	\$ 19.52	\$ 18.10	\$ 18.38
Florida	\$24.39	\$ 19.52	\$ 18.10	\$ 18.38
Southeast	\$22.79	\$ 19.52	\$ 18.10	\$ 18.38
Upper Midwest	\$20.79	\$ 19.52	\$ 18.10	\$ 18.38
Central	\$20.99	\$ 19.52	\$ 18.10	\$ 18.38
Mideast	\$20.99	\$ 19.52	\$ 18.10	\$ 18.38
California	\$21.09	\$ 19.52	\$ 18.10	\$ 18.38
Pacific Northwest	\$20.89	\$ 19.52	\$ 18.10	\$ 18.38
Southwest	\$21.99	\$ 19.52	\$ 18.10	\$ 18.38
Arizona	\$21.34	\$ 19.52	\$ 18.10	\$ 18.38

Manufacturing class milk, however, derives its value from actual component content in the milk.<sup>62</sup> The Final March 2023 Class Prices report is modified in Table 2 below to reveal actual manufacturing class price values per hundredweight based on average component content for each market. For MCP markets, FMMO pricing captures the actual value shown in Table 2. For fat/skim markets, FMMO

<sup>61</sup> USDA Exs 15 and 16 data, published in part at Dairy Program, AMS, USDA *Final Class Prices by Order, March 2023*, [https://mymarketnews.ams.usda.gov/filerepo/sites/default/files/3355/2023-03-31/696487/ams\\_3355\\_00020.pdf](https://mymarketnews.ams.usda.gov/filerepo/sites/default/files/3355/2023-03-31/696487/ams_3355_00020.pdf)

<sup>62</sup> 64 FR at 16092; Vitaliano, Ex 62 (NMPF-1) p 5; Covington, Ex 64 (NMPF-) p 4.

prices are fixed at Table 1 levels although the actual value shown in Table 2 is greater.

**Table 2 – March 2023**

**Actual Value Federal Milk Order Minimum Average Class Prices/CWT for Milk of 3.5 Percent Fat**

<b>23-Mar</b>	<b>CWT Class Prices @ 3.50% BF</b>			
	<b>Current Actual Components</b>			
	<b>Class I</b>	<b>Class II</b>	<b>Class III</b>	<b>Class IV</b>
Northeast	\$ 22.24	\$ 19.83	\$ 18.59	\$ 18.67
Appalachian*	\$ 22.39	\$ 19.81	\$ 18.52	\$ 18.65
Florida*	\$ 24.39	\$ 19.65	\$ 18.27	\$ 18.51
Southeast*	\$ 22.79	\$ 19.93	\$ 18.78	\$ 18.76
Upper Midwest	\$ 20.79	\$ 19.88	\$ 18.64	\$ 18.71
Central	\$ 20.99	\$ 20.00	\$ 18.88	\$ 18.83
Mideast	\$ 20.99	\$ 19.90	\$ 18.71	\$ 18.73
California	\$ 21.09	\$ 20.00	\$ 18.97	\$ 18.83
Pacific Northwest	\$ 20.89	\$ 20.09	\$ 19.14	\$ 18.90
Southwest	\$ 21.99	\$ 20.01	\$ 18.91	\$ 18.83
Arizona*	\$ 21.34	\$ 20.08	\$ 19.14	\$ 18.90

\*Appalachian, Southeast, Florida, and Arizona components derived from Hearing Ex. 44 (USDA). For other markets, Ex. 17. All prices from Ex. 15-16.

To an increasing degree, the “standard” factor milk price formulas do not serve the price relationship objectives expressed in the FMMO reform decision. Like consideration of variable “effective” Class I differentials due to advance Class I pricing and dairy product price volatility in providing a regulated price spread,<sup>63</sup> skim composition changes affect “effective differential” analysis. Amendment of standard skim milk composition factors is necessary to help avoid periods of price inversion, depooling disorder, understatement of relative Class I milk values, milk supply inefficiency, and FMMO-created disincentives to supply milk for Class I use.<sup>64</sup>

Several fluid (Class I) handler representatives missed the point of price spread/effective differential need for component factor updates. They argued that increased components in Class I milk does not make that milk inherently more

<sup>63</sup> 64 FR at 16102-103 (Final Decision).

<sup>64</sup> Metzger, Ex 72 (NAJ-7), pp 2, 4 and 7; Vitaliano, Ex 62 (NMPF-1), pp 4-5; Covington, Ex 64 (NMPF-2), pp 7-8; Hoeger, Ex 77(NMPF-5), pp 3-4; Ex 69 (NAJ-4) Negative PPDs Working Paper 21-01); Ex 76 (Edge-2).

valuable because higher skim components do not create more packaged product volume nor more packaged product market value.<sup>65</sup> For most Class I products this is true. But the FMMO Class I pricing reference to Class III and IV manufacturing value means that more skim solids and value in manufacturing class milk should also result in a higher regulated value for Class I milk if the price relationship is to be maintained.

Although updates of the milk price formula standard composition factors are long overdue, it would be imprudent to make any change effective without advance notice of at least 11 months. This is because projected FMMO Class III and IV reference price announcements, based on standard components, are used in risk management transactions on the CME, in programs offered by USDA's Risk Management Agency, in forward pricing and other negotiated contracts. These include CME Class III and IV futures and options contracts. Risk management contracts are based on price projections up to 24 months from the date of the contract, but on any given date most (90% +/-) open interest contracts expire within 10 months. Any change in the FMMO price formulas, including standard composition, make allowance, product yield, and product prices used, could – if not implemented by delayed effective date – adversely affect contract expectations, result in lost revenue to contracting parties, and damage the public interest benefits of commercial and government risk management programs.<sup>66</sup>

There are conflicting temporal considerations in updating standard skim milk component factors. The update should reflect composition data that is as recent as possible, but that data should also be as representative as possible. To provide representative data, average composition (and composition changes) over a prior full year (or more) should be measured. Although this builds in some delay, it is reasonable and necessary. The need to accommodate risk management would add additional but necessary delay between announcement and effective date.

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<sup>65</sup> *E.g.*, Ex 102 (MIG/Hood-3), pp 8-9; Ex 105 (MIG/Shehadey- 4), p 3; Keefe, Ex 111 (MIG – 5), pp 6-7.

<sup>66</sup> Metzger, Ex 72 (NAJ-7), pp 7-8; Covington, Ex 64 (NMPF-2), p 8; Gallagher, Ex 109 (NMPF-4); Krema, Ex 78 (CME-1); Bozic, Ex. 75 (Edge-1).

The NMPF proposed standard skim component proposal (hearing Proposal 1) would update components based on recent years' data with delayed effective date implementation. It contains five temporal limitations for future updates: 1) review of composition changes would be done once each year; 2) the representative data period would be simple average nonfat skim solids components for three previous years; 3) no change in the standard skim milk formula would be announced unless the review shows a simple average NFS component increase of at least 0.07 percentage points;<sup>67</sup> 4) at least three years from any change must pass before the next change is made; and 5) the effective date would be delayed for twelve months after the announcement of a pricing (composition) change.<sup>68</sup>

The NAJ proposal (hearing Proposal 2) is very similar, except for future updates. It would provide an annual announcement of composition changes and resulting standard skim milk formula price changes, without a built-in 3-year lag or a minimum percentage point increase threshold. It would apply to changes for all skim components, not just NFS. It would provide for review each year of national average FMMO skim milk composition for the prior calendar year and make standard skim milk price changes for each component effective starting in January the year following review. So the effective date in the future would be eleven months after review and announcement.<sup>69</sup>

NMPF's stated preference to wait three years or more between announced changes in standard skim milk prices was revealed in testimony to be primarily driven by perception of convenience or policy rather than by economics or risk management practices. Basically, less frequent price formula changes are better than more frequent: less frequent is deemed by NMPF to be a "more orderly process."<sup>70</sup> But the dairy industry deals each month with changes in product prices, class prices, and component prices that are frequent, significant, and often volatile.

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<sup>67</sup> Protein represents about 1/3 of NFS. The 'other solids' 2/3 portion is less variable and much less valuable than protein.

<sup>68</sup> Covington, Ex 64 (NMPF-2), pp 8-10; Gallagher, Ex 109 (NMPF-4), p 2.

<sup>69</sup> Metzger, Ex 72 (NAJ-7), pp 7-8. Since milk FMMO milk component data is published each month, handlers would have much more than 11 months to observe and project future composition factor changes.

<sup>70</sup> Covington, NMPF-2, pp 10-11.

Yearly composition updates would be far less frequent, far more predictable, and far less extreme in degree, than monthly price changes that are familiar to handlers.

The NAJ proposal for annual review and component content updates in standardized skim milk reference prices is supported by sound economics and FMMO market evidence. Any change in average milk composition undermines the intended Class I to manufacturing class price relationship. When producer milk skim component content increases from year to year it results in an adverse reduction in the spread between manufacturing class prices (or the price mover) and Class I prices, and a corresponding increase in the spread between announced “standard” composition Class III/IV prices and actual value of Class III and IV milk.<sup>71</sup> The orderly marketing objectives for restoration of optimal class price relationships should not have to wait two or more years to be addressed. The NAJ proposal also better serves risk management. With smaller skim factor changes than the NMPF proposal, there will be less adverse impact on contracts with more than 12 months ‘open interest’ at the time component changes are announced.

*B. Application of the Skim Milk Composition Update Proposals to Class II, III and IV Regulated Prices in the Southeast Region and Arizona*

NMPF’s Proposal 1 to update standard skim milk composition factors in announced 3.5% milkfat reference prices has two milk price amendment objectives: 1) to restore the national manufacturing class to Class I price relationship by increasing the Class I price mover(s) formerly known as Basic Formula Price(s), and 2) to provide regionally higher Class II, III and IV manufacturing use regulated prices in so-called fat/skim markets – Orders 5 (Appalachian), Order 6 (Florida), Order 7 (Southeast), and in Order 131 (Arizona) – because those manufacturing class prices significantly understate the actual component-based value of milk and are consistently lower than regulated prices for manufacturing class milk uses in the seven other FMMO markets.<sup>72</sup> In the seven MCP markets, actual value of

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<sup>71</sup> Exs. 66, 67, and 71 (NAJ-1, 2, and 6).

<sup>72</sup> Hearing Proposal 2 by NAJ would provide similar national and regional price adjustments if adopted. But NAJ submitted another complementary proposal to adjust manufacturing class pricing more moderately and precisely in the fat/skim markets. This proposal, for full MCP pricing, was rejected for hearing by AMS

manufacturing class milk is “automatically” captured in the uniform price per component pound regardless of variable component content.<sup>73</sup>

1. *The Problem of Undervalued Class II, III, and IV Milk in Fat/Skim Markets*

NAJ fully concurs with NMPF’s identification of regional problem: underpayment of actual milk value in regulated prices for Class II/III/IV milk by fat/skim market milk handlers. These facts are undisputed and conclusively established in the hearing record. We will briefly summarize.

The historical background for this aspect of the hearing is explained in pages 3 - 8, above. Since the 1970s, USDA has advanced a consistent policy of national FMMO uniformity in the classification of dairy products for pricing purposes, and national uniformity of milk prices in each manufacturing class use.<sup>74</sup> This trend continued in FMMO reform by use of “uniform multiple component pricing” in formulas for basic manufacturing class prices, as encouraged in the 1996 Farm Bill.

The final 7 CFR § 1000.50 rules in FMMO Reform provided for manufacturing class price uniformity by “the same price per pound of component” rather than the same price per milk hundredweight previously used.<sup>75</sup> There was some difference in application of the uniform component prices to individual markets. For MCP markets, uniform component prices per pound of component are applied to *actual* components in milk received by handlers. The “same price” per component pound results in “differing per hundredweight values based on the [differing] milk component levels.”<sup>76</sup> The hundredweight value differs from handler to handler, and market to market, as illustrated in Table 2, above.

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because it sought a regional not national price change. Ex. NAJ-8. Hearing Ex. 61. The ALJ later affirmed the discretionary decision of AMS to exclude the NAJ proposal from the hearing. ALJ Order dated Dec. 11, 2023.

<sup>73</sup> 64 FR at 16100.

<sup>74</sup> 67 FR 67906, 67937 (Nov. 7, 2002) (Final Decision). “Class III and Class IV dairy products compete in a national market. Because of this, Class III and Class IV milk prices established for all Federal milk marketing order areas are the same.\*\*\* Although the M–W was first adopted in 1963, it was not until the mid 1970’s that the M–W established a uniform class price for milk used in Class III products in all Federal milk orders.”

<sup>75</sup> 64 FR at 16100.

<sup>76</sup> *Id.*

For fat/skim markets, the uniform component price was (and is) applied to standard components fixed for Class II, III and IV reference price purposes, announced at standard 3.5% butterfat content. The different application of handler obligations for Class II, III and IV uses in fat/skim vs. MCP Orders is contained in Section 60 (“handler’s value of milk”) in each Order. For fat/skim markets (*e.g.*, 7 CFR §1131.60(a)), the handler’s skim milk price obligation is based on *pounds of skim milk in each of the four classes* times the “*applicable skim ... price*,” a cross-reference to standard composition skim milk prices in 7 CFR §§1000.50(e), (i), (k), and (q)(2). For MCP Orders, the handlers’ skim milk price obligation for Class II, III and IV is based on *pounds of component content* (NFS, protein, other solids) times the applicable *component price*. *E.g.*, 7 CFR §§1126.60(b), (c) and (d), defining Class II value, Class III value, and Class IV value, respectively. In fat/skim markets, therefore, handler Class II, III and IV minimum price obligations would be based on handlers’ imputed components of 9% NSF or 3.1% protein and 5.9% other solids in skim milk. The FMMO Reform Decision opined that this process would produce “corresponding” and “equivalent” manufacturing class prices in MCP and fat/skim markets.<sup>77</sup>

The “equivalent” price conclusion in 1999 can be reconciled with the “same price per component pound” objective of FMMO Reform, and with the requirement of “uniform” handler prices for each class of milk, if it was USDA’s intention at the time to provide skim values for fat/skim Order manufacturing class prices applied to farm milk produced at 9% NFS or 3.1% protein and 5.9% other solids in the skim portion. As explained above (pp. 9 - 11), data examined by the university and agency BFP study committees confirmed long-standing conventional wisdom that milk produced at 3.5% contains about 3.3% total protein (or 3.1% true protein) and almost 9% NFS in the skim portion. Averaged regulated prices based on these factors would not overstate the component value of skim milk. So even when seasonal NFS is naturally higher in the fall months, or if NFS composition

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<sup>77</sup> 64 FR at 16091, “corresponding hundredweight prices” in fat/skim markets; and at 16105, “hundredweight price equivalent” in fat/skim and MCP markets.

increased from year to year, applying the *minimum* Class II, III, or IV price to a low common denominator value for the skim solids portion would arguably conform to AMAA *minimum* and *uniform* price requirements if “uniform” is construed to mean ‘pretty much the same’.<sup>78</sup>

Data on NFS content for MCP and fat/skim markets after FMMO reform reinforces the BFP committees’ conclusion that milk produced *at* 3.5% fat contains approximately 3.1% true protein and just about 9% NFS in the skim portion. Exhibits USDA-17, 18 and 44. But the data also show that for farm milk containing more than 3.5% milkfat, the composition of nonfat components in the skim portion is also greater than ‘standard’ composition milk. And that composition has increased progressively over 24 years, resulting in an ever-widening spread between the value of skim components contained in milk produced *at* 3.5% and milk produced at higher farm tests. The progressive skim value difference is addressed in Proposals 1 and 2 to update the Class I price mover formula nationally, and to increase manufacturing class prices in fat/skim markets.

## 2. *The “Uniform Price” Dilemma in Proposed Regulatory Solutions*

The undervaluation of manufacturing class milk in the fat/skim markets has been evident for a long time, as explained in NMPF’s March 2023 hearing proposal. With increased production of skim components in producer milk, reflected by dynamic changes in hundredweight manufacturing class skim milk component

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<sup>78</sup> USDA has not expressly interpreted the word “uniform” as used in the AMAA. Detached from context, the word “uniform” could mean the same, pretty much the same, or consistent in practice. *Scheenstra v. California Dairies, Inc.*, 213 Cal.App.4th 370, 394-95; 153 Cal.Rptr.3d 21 (2013). The context in AMAA §608c(5) strongly supports a narrow – “the same” – interpretation of the word “uniform.” It should be observed, however, that on some occasions USDA has been satisfied with a ‘pretty much the same’ pricing result. 28 FR 11956, 11976 (Nov. 8, 1963) (NY-NJ and Connecticut Order Decision) (uniform handler price requires ‘a reasonable standard of uniformity’); 56 FR 57850, 57855 (Nov. 14, 1991) (Mid-Atlantic MCP Decision, seasonal Class III price adjustments as exception to national class price uniformity has not produced competitive disorder); (60 Fed. Reg. 41833, 41836 (Aug. 14, 1995) (Midwest MCP) (manufacturing class prices should be “fairly uniform” among markets).

If NFS content in the skim portion of producer milk is consistently 9% or more in handler receipts in fat/skim markets, it does not offend the AMAA §608c(5)(A) mandate of *minimum uniform* prices for the regulated portion of milk value to be uniform but understated. Handlers in fat/skim markets receiving more than 9% NSF would simply have a variable, non-uniform, and unregulated economic benefit. They could elect to share this benefit in over-order premiums paid to producers. But it would also be an economic benefit not enjoyed by their competitors in MCP markets, which raises other statutory and agency policy concerns.



values (Table 2), the static (standard composition) formula used for Class II, III and IV in fat/skim markets (Table 1) results in undervalued manufacturing class prices based on average skim milk components and on actual (but variable) components in skim milk received by individual handlers.<sup>79</sup> This should not continue in light of the manufacturing class price uniformity policy.

The hearing record on skim milk composition proposals (Proposals 1 and 2) demonstrates more clearly the current departure of fat/skim order Class II, III and IV prices from the uniform price objectives of the AMAA, uniform price policies of USDA, uniform MCP formula in the 1996 Farm Bill, and AMAA proscriptions against prices that create competitive disadvantage in national dairy product markets. The statutory and policy standards are:

- 1) Uniform class prices, 7 USC § 608c(5)(A): “minimum prices for each use classification” ... “shall be uniform as to all handlers;”
- 2) Uniform producer prices regardless of handler use, 7 USC § 608c(5)(B);
- 3) “Uniform class price[s] for milk used in [manufactured] products in all Federal milk orders;” 67 FR at 67937 (2002);
- 4) “Uniform multiple component pricing when developing... basic... prices for manufacturing milk.” 7 USC §§7253(a)(3)(B), 64 FR at 16027; and
- 5) All FMMO provisions should apply so as to not “in any manner limit” the marketing of dairy products produced in any US market, 7 USC §608c(5)(G).<sup>80</sup>

For manufacturing class pricing in fat/skim markets, hearing proposals 1 and 2 require a fresh look at consistency with uniform price objectives expressed in the AMAA and in agency policy since the 1930s – prices that place handlers “in the same competitive position in respect to a minimum price for milk entering the same use.” Nourse Report pp. I-4, II-4-4.

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<sup>79</sup> See n. 90, *infra*, for record references to component variability in handler milk receipts.

<sup>80</sup> It is noteworthy that the protected class intended to benefit from the “in any manner limit” clause of §608c(5)(G) – unregulated or nonpool dairy product manufacturing plants located anywhere – would by definition not have any administrative remedy available by procedures in 7 USC §608c(15)(A).

(i) *Milk Price Non-Uniformity in Fat/Skim Markets, Current and Proposed, For Class II, III and IV Milk*

The current departure in uniform manufacturing class pricing between handlers in fat/skim markets (in Table 1) and MCP markets (in Table 2), is clear. Undervaluation of fat/skim manufacturing class milk is also revealed in USDA data, as explained by witnesses for NMPF and NAJ. The fat/skim markets’ ‘standard factor’ formulas undervalued Class III milk by \$0.83/cwt and Class IV milk by \$0.61/cwt compared to average 2022 component milk value/cwt in the 7 MCP markets by NMPF analysis.<sup>81</sup>

The NMPF and NAJ update formulas would have applied average skim milk components from 2020 for use in 2022 component factor formulas. The average skim component content for 2020 and 2022, along with average 2022 components in the three southeast fat/skim markets,<sup>82</sup> are shown in Table 3 below:

*Table 3: Average FMMO Skim Components 2020, 2022 And Orders 5, 6, and 7 Averages for 2022*

<u>FMMO Order(s)</u>	<u>Year</u>	<u>Components in % and Pounds/CWT Skim</u>		
		<u>Protein</u>	<u>OS</u>	<u>NFS</u>
National	2020	3.30	6.01	9.31
National	2022	3.39	6.02	9.41
Appalachian (5)	2022	3.27	6.02	9.29
Florida (6)	2022	3.20	5.99	9.18
Southeast (7)	2022	3.38	6.01	9.38
3-market Av.	2022	3.30	6.01	9.30

In each of the three southeast markets, more protein, other solids, and nonfat solids were produced per cwt. skim milk than imputed by the current price formulas (3.1 protein, 5.9 other solids, and 9.0 NFS). The formulas create discounted prices.

Based on 2022 component prices, the 2022 composition average for the three

<sup>81</sup> Covington, NMPF-2 pp 6-7; Gallagher, NMPF-4 pp 13-15.

<sup>82</sup> NAJ-3 (Ex 68), data from USDA-18 and 44 (Ex 18 and 44). Exhibits 44 and 68 also contain some surrogate skim component data for Arizona (Order 131), but USDA did not disclose actual skim solids data although fat solids information was provided.

markets reveals current undervaluation of – a) protein per CWT skim by \$0.463 in Order 5, \$0.272 in Order 6, and \$0.763 in Order 7; and b) SNF by \$0.436 in Order 5, \$0.270 in Order 6, and \$0.571 in Order 7.<sup>83</sup> The three markets on average had about the same components in 2022 as the 2020 national average used for updating. But the inter-market variability applied to component value confirms departure from price uniformity as required by policy and statute. Component content (and value) varies even more from handler to handler.<sup>84</sup> The non-uniform pricing problem would unfortunately be aggravated by overvaluation if proposed skim component updates are applied to manufacturing class prices in the fat/skim markets, as illustrated in Table 4 on the following page.

*(ii) Milk Price Non-Uniformity in the Arizona Fat/Skim Market: Unique Aggravating Circumstances*

The current and proposed manufacturing price inequities illustrated for the three southeast markets also apply to Arizona handlers in competition with other handlers within and without the market. Unique among the fat/skim markets, Arizona has a large manufacturing presence, with about 2/3 of producer milk in Class III and IV use.<sup>85</sup> And milk used to produce Class III and IV products is almost entirely marketed by a single cooperative handler.<sup>86</sup>

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<sup>83</sup> 2022 average component prices per pound were: \$2.7238 for protein, \$0.4188 for other solids, and \$1.5021 for NFS.

<sup>84</sup> E.g., Ex 113 (IDFA-24), Saputo plants' skim composition at various southeast plants ranging from 9.0% NFS to 9.5% NFS; Exs 102-103 (MIG-3 and 3-A), HP Hood plants' variable skim composition; Exs 105-106 (MIG-4 and 4-A); Exs 112-113 (MIG-5 and 5-A) (Sally Keefe's skim component value analysis); Ex 455 (MIG-17-A), Anderson Erickson Dairy skim component and butterfat averages Ex 463-64 (MIG-23-A and 23-B), and Tr 10890, Tim Kelly, Shamrock Foods, stating that Shamrock's skim components are less than proposed in Proposals 1 and 2, but not disclosing actual components; Tr. 11344, Tim Doelman, protein in Fairlife producer milk receipts range from 3.1 to 3.4. Charging Class IV handlers a skim price based on 9.41% NFS content when the milk actually contains less NFS would produce an FMMO-unique version of shrinkflation.

<sup>85</sup> Ex. 44 (USDA-44). Arizona Class II utilization is about 15% and Class I about 25%. Depooling of Class III and IV milk, as illustrated in Ex 44 Order 131 data by periodic sharp monthly reduction and later rebound of volume in these classes, affects reported pool utilization percentages.

<sup>86</sup> UDA's share of the Arizona producer milk market is about 80%+, Tr. 8617-18 (Butcher). UDA's role as the single Arizona supplier of milk for Class III and IV product use was noted in 1999 (64 FR at 16067, 16163), and remains true today, Tr. 8693, 9730-31 (Butcher), Tr. 983 (Brown).

Table 4 - Comparison of Handler Class III and IV Component Costs in Fat/Skim and MCP Markets May 2022 current and proposed price factors\*

5/22 Handler Components at Skim Milk Test						
	SNF	P				
MCP Handler NE	9.286%	3.283%				
Handler A SE	9.286%	3.283%				
Handler S SE	9.000%	3.100%				
MCP Handler Std.	9.000%	3.100%				
Handler X SE	9.036%	3.334%				
FMMO Component Factors						
Skim Component Factors	SNF	P				
Current	9.000%	3.100%				
Proposed (2020 Av. Test)	9.310%	3.300%				
2022 Average Test	9.410%	3.390%				
5/22 Announced Component Price / lb						
Price (FMMO)	\$ 1.6253	\$ 3.8696				
Regulated Minimum Skim Price/cwt.						
	Current Factors		Proposed Factors		Difference	
	SNF	Protein	SNF	Protein	Class IV	Class III
MCP handler NE	\$ 15.093	\$ 12.704	\$ 15.093	\$ 12.704	\$ -	\$ -
Handler A SE	\$ 14.628	\$ 11.996	\$ 15.132	\$ 12.770	\$ 0.504	\$ 0.774
Handler S SE	\$ 14.628	\$ 11.996	\$ 15.132	\$ 12.770	\$ 0.504	\$ 0.774
MCP Handler Std.	\$ 14.628	\$ 11.996	\$ 14.628	\$ 11.996	\$ -	\$ -
Handler X SE	\$ 14.628	\$ 11.996	\$ 15.132	\$ 12.770	\$ 0.504	\$ 0.774
Regulated Class III & IV Prices Applied to regulated value per Component Pound						
	SNF			Protein		
	Current Factors	Proposed Factors	Change	Current Factors	Proposed Factors	Change
MCP handler NE	\$ 1.6253	\$ 1.6253	\$ -	\$ 3.8696	\$ 3.8696	\$ -
Handler A SE	\$ 1.5752	\$ 1.6295	\$ 0.0543	\$ 3.6539	\$ 3.8896	\$ 0.2357
Handler S SE	\$ 1.6253	\$ 1.6813	\$ 0.0560	\$ 3.8696	\$ 4.1193	\$ 0.2497
MCP Handler Std.	\$ 1.6253	\$ 1.6253	\$ -	\$ 3.8696	\$ 3.8696	\$ -
Handler X SE	\$ 1.6188	\$ 1.6746	\$ 0.0558	\$ 3.5981	\$ 3.8302	\$ 0.2322
Fat-Skim (Advantage) or Disadvantage per Component Pound						
	Current Factors		Proposed Factors			
	SNF	P	SNF	P		
MCP handler NE						
Handler A SE	\$ (0.0501)	\$ (0.2157)	\$ 0.0042	\$ 0.0200		
Handler S SE	\$ -	\$ -	\$ 0.0560	\$ 0.2497		
MCP Handler Std.						
Handler X (vs MCP same components)	\$ (0.0065)	\$ (0.0271)	\$ 0.0493	\$ (0.1316)		
Per pound disadvantage S vs. A			\$ 0.0518	\$ 0.2296		
Per pound disadvantage S vs. X			\$ 0.0067	\$ 0.2891		
Per cwt Handler S vs A component value			\$ 0.4821	\$ 0.7577		
Per cwt handler S vs X component value			\$ 0.0603	\$ 0.8962		

\*Handler component content sources: MCP Handler NE and Handler A is average NE reported content for May 2022, Ex 17 and 44; Handler S and Handler MCP Std. is May 2022 components at Saputo Ky plant (same as current standard component factors), Ex 113 (IDFA-4); Handler X is average May 2022 components for the SE Market, USDA Ex. 44. Proposed Factors applies national average 2020 components to 2022 pricing.

As in the southeast, the Arizona manufacturing class price discounts reduce *pro tanto* the FMMO blend price of every pool producer, cooperative members and non-members alike. But the benefit of the Class III and IV discounts for milk used to produce cheese and Class IV products accrues to a single cooperative entity by competitive cost advantage for NFDM and other Class IV product sales in national and international markets, and by revenue enhancement in MCP-priced sale of high protein milk for manufacturing use, none of which is shared with non-coop producers in the blend price.<sup>87</sup> The price discount and revenue shift can be further leveraged to the disadvantage of non-members by depooling Class III and IV milk, and by segregating milk supplies so that the cooperative's manufacturing plant customers receive milk of highest component value, while lower component content milk is directed to distributing plant (Class I and II) customers.<sup>88</sup>

The market-wide discount price and limited beneficiary revenue shift in Arizona appears to be functionally equivalent in result to the blend price reduction and revenue shift described in *Brannan v. Stark*, 342 US 451, 463-64 (1952), which the Court deemed to be inconsistent with the AMAA uniform handler price mandate of §608c(5)(A) and the uniform producer price mandate of §608c(5)(B).<sup>89</sup>

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<sup>87</sup> UDA's use of private (unregulated) MCP pricing for its manufacturing class use milk sales is described in un rebutted testimony of Mike Brown (Tr. 982-83, 999 -1003). UDA later produced a witness, Brent Butcher, who did not contradict Mr. Brown's description of the UDA MCP program.

<sup>88</sup> Segregation of producer milk supplies to maximize component revenue in Arizona would be a rational, revenue-enhancing practice under the MCP plan described by Mike Brown. This would be facilitated by the fact that there are less than 70 producers in the pool, almost all located near Phoenix, and individual farms produce per day on average about four 50,000 lb standard tanker loads or three Arizona super-tankers. Butcher, Tr. 8692-93, 8697-98, 8726-29; Exs. 379-380. This process would also provide to UDA unique depooling incentives that are not available to competitors in MCP markets who (when pooled) are charged the full regulated price for each pound of skim component received. Arizona's competitors also face regulated depooling -repooling restrictions. *E.g.*, 83 FR 14110, 14159 (Apr. 2, 2018) (California Decision); 71 FR 54152, 54159-61 (Sept. 13, 2006) (Central Market Decision); 71 FR 54136, 54139-44 (Sept. 13, 2006) (Upper Midwest Decision). No similar constraint in Arizona aggravates the disadvantage to Arizona's MCP market competitors – a disadvantage that would continue regardless of any 'component factor' amendment on Proposals 1 and 2.

<sup>89</sup> The price rules in *Brannan* involved "establishment of the system of payments to be made to cooperatives only and to be funded by deductions from prices paid all producers." 342 US at 463. In Arizona, UDA is not identified in the rules as the targeted revenue shift beneficiary, but it has been understood since FMMO Reform that UDA is the principal Class III and IV manufacturing use supplier. 64 FR at 16163 ("one seller"), Tr. 8693, 9730-31 (Butcher), Tr. 983 (Brown). The non-member producers who are uniquely burdened by the price discount include farms supplying Shamrock Foods in Phoenix and two plants in Yuma (Tr. 8714, 8746

The skim component update factors proposed by NMPF and NAJ, if applied to Arizona manufacturing class milk, would somewhat mitigate the existing revenue shift. But segregation of high component producer milk for supply to Class III and IV plants would likely continue undervaluation of that milk and maintain some competitive advantage over handlers in MCP markets that pay full value for all components in milk receipts. Since distributing plants with Class II use inevitably receive milk of variable components, including some below the proposed component factor update, overpayment of component value and non-uniformity in component costs would be experienced in Arizona as it would for southeast handlers (Table 4).<sup>90</sup>

### *3. Suggested Administrative Options to Address the Issues.*

Assuming USDA decides to update skim milk composition for the Class I price mover(s), as NAJ and NMPF urge, there are options available to the agency to address the other issue of current and proposed fat/skim market manufacturing price dysfunction.

USDA could conclude that the US average skim milk composition change, as proposed to be applied with a minimum 2-year lag between measured composition and effective price changes, would not significantly overvalue average skim milk in fat/skim markets. Hearing Ex. 68, NAJ-3; Metzger, Tr. 543 (update would overvalue average fat/skim prices by \$0.04/cwt). This might conform to a ‘just about the same’ construction of the term “uniform” on a 3-market average basis but not tackle the troubling fact of composition (and value) differences from plant to plant.<sup>91</sup>

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(Butcher), Tr. 10887 (Kelly)), and farms in three Texas counties, two New Mexico counties, and three California counties (Ex. 58 p 12).

<sup>90</sup> Shamrock Foods’ skim components are below proposed factor levels (Kelly, Tr. 10890), and Arizona market average skim components also appear to be marginally lower than national MCP market average. Mike Brown, Ex. 98 (IDFA-4) pp 23-26.

<sup>91</sup> *E.g.*, Ex 113 (IDFA-24), Saputo plants’ skim composition at various southeast plants ranging from 9.0% NFS to 9.5% NFS; Exs 102-103 (MIG-3 and 3-A), HP Hood plants’ variable skim composition; Exs 105-106 (MIG-4 and 4-A); Exs 112-113 (MIG-5 and 5-A) (Sally Keefe’s skim component value analysis); Ex 455 (MIG-17-A), Anderson Erickson Dairy skim component and butterfat averages Ex 463-64 (MIG-23-A and 23-B), and Tr 10890, Tim Kelly, Shamrock Foods, stating that Shamrock’s skim components are less than proposed in Proposals 1 and 2, but not disclosing actual components; Tr. 11344, Tim Doelman, protein in Fairlife producer milk receipts range from 3.1 to 3.4. Some of these witnesses based an opinion of proposed overpriced manufacturing class milk on current components and current prices, neglecting to account for the proposed

USDA could address the issue by future efficient or less efficient hearing alternatives for MCP pricing in current fat/skim markets following a decision in this proceeding but well before the effective date of any skim composition factor amendment in proposals 1 and 2.<sup>92</sup> Hearing evidence unquestionably demonstrates that MCP pricing in the fat/skim markets would avoid the uniform price issues and avoid results in which skim components are overpriced, underpriced, or not priced at all in fat/skim markets.<sup>93</sup> The FMMO Reform objective of charging the “same price per component pound” for all manufacturing class use in all markets could then be realized (or reestablished) by an MCP hearing for the four markets in the near future.<sup>94</sup>

For the pending hearing, as in any FMMO hearing, regulatory remedies available to USDA include no change to full adoption of a proposal and choices in between. For manufacturing class prices in fat/skim markets, this could include use of different skim milk factors than apply to the Class I price mover(s), just as FMMOs in the past used different formulas for the “basic formula price” (Class I

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delay of 2-years or more between measured composition changes and effective date of a price change. The HP Hood witness, for example, claimed overpayment for 2021 and 2022 if the proposals had applied based on skim composition for those years of 3.39% protein and 9.41% NFS. In contrast, the delay factor built into the NAJ proposal would have used composition factors of 3.29% - 3.3% protein and 9.29% - 9.31% NFS for 2021 and 2022.

<sup>92</sup> A new and separate MCP hearing would likely require resubmission of evidence contained in the record of this pending proceeding. A reopening of the current proceeding for MCP consideration is within USDA's discretion and would be much more efficient. Alternatively, the Secretary can issue a Partial Recommended Decision on issues for which all remedial alternatives are on the table (such as make allowance), and defer on other issues with an agency invitation or agency initiative to expand solutions not currently on the table.

<sup>93</sup> Metzger, Ex 68 (NAJ-3), Tr. 543, 606; Brown, Ex 98 (IDFA-4) p 29; Ex 99 (IDFA-5), slides 14, 16); Brown Tr. - 1006-07; Saputo, Ex 113 (IDFA-24) p 3-5. MCP pricing “does not affect the total per hundredweight value of milk.” 64 FR at 16141. But this hearing shows that imputed skim component content formulas for fat/skim markets clearly and adversely affect regulated value and market value per hundredweight of milk.

<sup>94</sup> 64 FR at 16100. By signaling an intent to hold a future hearing on MCP issues, as AMS suggested in its July 24 letter <https://www.ams.usda.gov/sites/default/files/media/USDAResponseJulyNationalAllJersey.pdf>, USDA would not necessarily show predisposition in the outcome of that hearing, but only on the need for hearing, as is the agency's duty. 7 CFR §900.3(b) (“shall” issue a Notice of Hearing). Perhaps the future hearing a variation of the MCP plan currently in place for 7 markets or a different structure of Class II, III and IV pricing for the four markets would resolve the uniform price issue; USDA may also in such hearing provide a clear interpretation of “uniform” by which different manufacturing class pricing in the four markets can be sustained. But if current pricing or formulas in Proposals 1 and 2 apply without addressing the issue, USDA may eventually have no option but to employ the more extreme measure of suspension or termination of order provisions that do “not tend to effectuate the declared policy” of the AMAA. 7 USC §608c(16).

use) and for Class III (manufacturing class) pricing purposes. E.g., 7 CFR §§1131.50-51 (1974). Perhaps, for example, Northeast Order average skim milk composition values should be used for fat/skim market Class II, III and IV manufactured price formulas because Northeast averages correspond more closely to averages observed in the three southeast markets. This might produce regulated prices that are ‘just about the same’ to competing handlers within fat/skim markets, but not provide inter-market price uniformity.

If the Secretary, like NAJ, is concerned about adverse consequences of competitive disadvantage to handlers, inequity to producers, and to integrity of the FMMO program if milk is overpriced in any class for long, it may be best to leave fat/skim manufacturing class prices where they are for now with the understanding that the issue will be addressed in some manner in the near future. Just as the current version of FMMO General Provisions incorporate Class I skim and butterfat price exceptions for some individual markets (7 CFR §1000.50(b) and (c)), a new subsection at the end of Section 1000.50 could preserve current skim composition factors for use in fat/skim markets’ manufacturing class prices until the problem is better resolved later.<sup>95</sup>

## V. *Comments on Other Hearing Issues*

Each of the many pricing formula proposals on the table in this hearing were primarily addressed by proponents and opponents in isolation from other proposals.

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<sup>95</sup> The following amendment to the end of §1000.50 is suggested for this purpose:

(\_) **Skim Component Pricing Factors in Certain Markets.** For application to manufacturing class prices in Orders 5, 6, 7, and 131, the protein, other solids and nonfat solids price multiplier used in foregoing paragraphs (i), (k), (q)(1)(ii), (q)(1)(iii), and (q)(2)(ii) shall be as follows: protein price times 3.1, other solids price times 5.9, and nonfat solids price times 9.”

If USDA amends the skim component factors only for application of the Class III and IV reference price function for moving Class I prices (as NAJ suggests), this would be a conforming amendment signaled by AMS Proposal 22 in the Hearing Notice. *Alto Dairy v. Veneman*, 336 F. 3d 560, 569-70 (7<sup>th</sup> Cir. 2003) (An important function of milk order rulemaking hearings is to refine, modify, and supplement the proposals in the light of evidence and arguments presented in the course of the proceeding.”); *Walmsley v. Block*, 719 F. 2d 1414, 1418 (8<sup>th</sup> Cir. 1983) (the notice of hearing “need not specify every precise proposal which [the agency] may ultimately adopt as a rule.”). The suggested amendment is also consistent with AMS’s opinion, expressed in the July 24, 2023, letter to NAJ, that change to manufacturing class pricing in the fat/skim markets is a regional not national issue. A similar amendment may apply if USDA concludes on the limited record that the non-uniformity problems arise primarily in Class II use – in which case an equalizing reduction in the Class II differential for fat/skim markets might be considered.



They are, however, all interrelated. USDA’s function will be to examine the projected impact of each proposal in combination with others, and reconcile the cumulative result of selected options against the underlying “public interest” pricing standard of 7 USC § 608c(18) to best preserve regulatory integrity. Nourse Report, pp. III-7 to III-10.<sup>96</sup> Some proposed pricing changes appear to focus on short-term revenue benefits more than long-term pricing stability. These are undoubtedly politically popular with many beneficiary constituents but may not measure up to decision-making standards embedded in the AMAA and long-standing agency policies. We address two milk pricing issues that appear to fall in this category.

*A. Class I Mover – Higher of or Average of Class III and Class IV Prices*

Proposals to override Congress’ selection of an “average-of” Class I price movers, and return to “higher of” Class III or IV price references for the month, are supported with enthusiasm by producers and dairy cooperatives based on the perception that this would produce higher producer Class I revenues, at least in the short term.<sup>97</sup> The perception is based on highly divergent Class III and IV reference prices (price movers) since 2018 and an expectation that this will continue in the future.

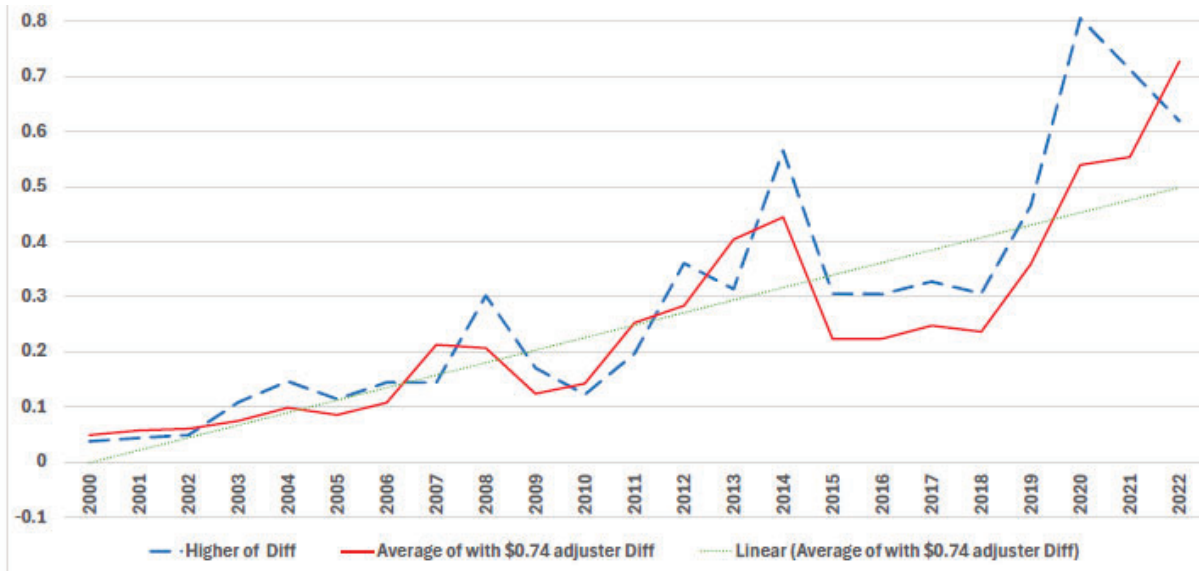
The price divergence analysis relies on “standard” milk composition factors currently in place, and in future price inversion assumptions, that do not account for composition factor amendments nor potential Class I differential amendments. With revised composition factors, Class III and IV price divergence would still have occurred, as shown below in Table 5, but the restored Class III/IV to Class I price spread would mitigate price inversion/depooling events:

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<sup>96</sup> See fn. 6 , *supra*.

<sup>97</sup> *E.g.*, Covington, Ex 248 (NMPF-34), pp 2, 5; Hoeger, Ex 247 (NMPF-33); Craig Alexander, Ex. 245 (NMPF-31), p 7: Ex 505 (AFBF-6).

Table 5: “Average of” vs “Higher of” Mover at Actual Components<sup>98</sup>



For long-term Class I pricing purposes, we are persuaded that the alternative proposed by IDFA in Proposal 14 better protects long-term producer milk revenue, provides less Class I price volatility, and preserves equitable risk management opportunities for Class I handlers<sup>99</sup> – whose market participation is mandatory and the *raison d’etre* for FMMO-regulated milk prices.

*B. Use of Barrel Cheddar Price Surveys for Class III Component Pricing*

Proposal 3, to eliminate the Cheddar cheese 500-pound barrel price series survey from protein price formula calculations, is also driven by perceptions that Class III component prices and producer revenue would thereby be enhanced.<sup>100</sup> We believe that long-term price enhancement is not supported by record evidence,

<sup>98</sup> Table 5 (a graph) applies announced component prices (USDA Exs. 15-16) to actual average CWT value of Class III and IV milk by component content (USDA Exs. 17-18), with a trend line similar to what would have been produced if component factor updates in Proposals 1 and 2 had been in place since FMMO Reform.

<sup>99</sup> Mike Brown, Exs. 275 and 286 IDFA-37 and -49); Marin Bozic, Ex 297 (Edge 15). Note also that FMMO Reform decision and the BFP committee recommendations favoring “higher-of” Class III/IV for Class I pricing did not factor in an addition of 74 cents for “average of” analysis, or use of a similar formula such as proposed by IDFA and Edge to reduce price inversion/depooling events.

<sup>100</sup> Vitaliano Ex. 114 (NMPF-6); Darin Hanson, Ex 117 (NMPF-7); Bauer, Ex 119 (NMPF-8); Hallock, Ex 326 (NMPF-66); Reynolds, Ex. 132 (NMPF-11); Emma Downing Reynolds, Ex 132 (NMPF-11).

that Class III regulated milk value was not intended to be limited to block cheddar price discovery in FMMO reform, and that producer price enhancement is not, in any event, the regulatory standard by which USDA has set Class III prices in the past.

It is undeniably true that the per pound market price of block and barrel cheese has diverged significantly since 2017, with barrel cheese priced about \$0.11 per pound less than block cheese from 2017 to 2022. Prior to 2017, barrel cheese prices were sometimes higher, sometimes lower, with an average difference of one cent per pound.<sup>101</sup> Block and Barrel cheddar have different uses, different buyer markets, and limited substitutability.<sup>102</sup> A large measure of the recent price spread may be attributed to a simple function of supply and demand. Prior to 2017, there was considerable investment in barrel cheddar manufacturing plants without comparable investment in increased block cheddar capacity.<sup>103</sup> More recently, however, block cheddar manufacturing capacity has expanded or is planned for expansion. As a result, the supply of block cheddar is expected to increase, and barrels may again become the more valuable cheddar product per pound in many months.<sup>104</sup>

The function of the NDPSR price for manufacturing class milk is to provide a reference for pricing components in all uses of the classification. For butter and dry milk products, the fat, nonfat solids and moisture composition vary little among products (or milk uses) in the class. So it is of little significance that NDPSR butter represents only 9% of total butter production.<sup>105</sup> The surveyed product is much the same as non-surveyed butter. The same is not true for Class III cheese. Cheese

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<sup>101</sup> Hanson, Ex 117 (NMPF 7) p 7.

<sup>102</sup> Bauer, Ex 119 p 2; Brown, Ex 127 (IDFA-30) pp 5-7.

<sup>103</sup> Bozic, Ex 134 (Edge 4) p. 2.

<sup>104</sup> Bozic, Ex 134 (Edge 4) pp 2-3 ; Emma Downing Reynolds, Ex 132 (NMPF 11) p 4; Schlangen (AMPI), Tr. 2657.

<sup>105</sup> Hanson, Ex. 117 (NMPF 7) p 4.

comes in many varieties,<sup>106</sup> each of which has unique characteristics of fat, protein, moisture, and market, and which may further vary by plant or location of production and buyers' specifications.<sup>107</sup> The protein price and other solids component prices, applied to Class III uses, are intended to provide nonfat component values for skim milk used to produce cheese, not just cheddar cheese.<sup>108</sup> Cheddar cheeses (block and barrel) are surveyed for price because they have standardized composition that, in turn, can be used to reliably calculate respective component milk values and the manufacturing costs applied in the "make allowance" formula. The 3 cents difference to which proponents refer was an adjustment made for make allowance (manufacturing cost) purposes,<sup>109</sup> not to create interchangeable cheddar product clones for cheese component valuation.<sup>110</sup>

It would be inconsistent with USDA's emphasis in FMMO reform on determining a "market-clearing" price for Class III and IV uses to apply the perceived higher of two product values (block and barrel cheddar) for the Class III price. It would be more consistent with that objective to use the "lower-of" in any given month. 64 FR at 16094 – 95.. We are not proposing that. Barrel cheddar has important market clearing and balancing functions that are not as evident when milk is used for block cheddar production.<sup>111</sup> Raising the Class III skim component

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<sup>106</sup> Ex. 117, p 8; Vitaliano Ex 141 (NMPF-6 A), listing 17 varieties of cheese, plus "other." Ex. 141 shows its "source" as USDA/NASS, AMS/NDPSR. That would be true for cheese varieties but not true for representations as to which of these products are priced off block prices and barrel prices or how. The latter are apparently the witness' opinion from undisclosed sources and no explanation of what is the price relationship to blocks or barrels or how that relationship is applied. Ex. 114 (NMPF-6) p 5.

<sup>107</sup> See ARS, USDA, *Cheese Varieties and Descriptions* (Agr. Handbook No. 54, 1953, and Rev. 1969) describing about 18 cheese grouping types and over 400 varieties worldwide. <https://play.google.com/books/reader?id=DY8wAAAAYAAJ&pg=GBS.PP2&hl=en> (1969 Rev.), <https://archive.org/details/CheeseVarieties> (1953).

<sup>108</sup> Barrel and block cheddar are both included in cheese price surveys to ensure that the resulting regulated price is "representative of the national cheese market." 73 FR 35306, 35328 (June 20, 2008).

<sup>109</sup> Reynolds, Ex 132 (NMPF-11) p 3.

<sup>110</sup> NMPF asserted that the FMMO Reform decision "effectively assume[d]" that "block and barrel cheddar cheese are... essentially the same product, simply in different packaging..." Vitaliano, Ex 141 p 6; and that barrel cheese for FMMO Reform Class III component pricing was "used to represent a synthetic 40-pound block". Hanson, Ex 117 (NMPF-7) p 6. Neither statement accurately represents the content of FMMO decisions during or after FMMO Reform.

<sup>111</sup> Ex 127 (IDFA-30) pp 5-7.

prices by eliminating barrels would possibly provide temporary producer price enhancement. But this would come by compromise of barrel producers' short-term viability, long-term producer revenue, and FMMO regulatory integrity.

## *VI. Conclusion*

This proceeding has again demonstrated that competing objectives of economic self-interest by dairy industry stakeholders provides little room for industry consensus on FMMO milk price formula issues. AMS provided hearing procedures and logistics that allowed broad and effective opportunity by interested parties to address issues on the table.

The task before AMS is formidable. But we are confident that the agency can again reconcile competing interests in its role as “protagonist for provisions in the order which, in the wide experience of its staff, would best serve the stated purposes of the Act.” Nourse Report, pp III-8, III-31.

Respectfully submitted

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April 1, 2024

## CERTIFICATE OF SERVICE

### Milk in the Northeast and Other Marketing Areas

Docket No.: 23-J-0067

Having personal knowledge of the foregoing, I declare under penalty of perjury that the information herein is true and correct, and this is to certify that a copy of the NATIONAL ALL-JERSEY POST-HEARING BRIEF has been furnished and was served by electronic mail upon the following parties on April 1, 2024 by the following:

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