



Via U.S. Mail and Email to
FMMOhearing@usda.gov

June 14, 2023

Ms. Dana H. Coale
USDA/AMS/Dairy Programs
U.S. Department of Agriculture
STOP-0225 Room 2530
1400 Independence Avenue, S.W.
Washington, D.C. 20250-0225

Re: Petition of the International Dairy Foods Association for a Hearing to Amend the Class I Mover in All Federal Milk Marketing Orders: IDFA's Proposed "Floored Class I Mover," Proposed as an Alternative to National Milk Producers Federation Proposal 3

Dear Deputy Administrator Coale:

By letter dated May 1, 2023, the National Milk Producers Federation ("NMPF") petitioned USDA to conduct a hearing to consider several NMPF proposals to amend the current Federal Milk Marketing Orders. NMPF proposal 3 proposes that the Class I mover, which is currently set at the simple average of the Class III and Class IV advanced price plus \$0.74, revert to the Class I mover that existed prior to May 1, 2019, namely, the higher of the Class III or Class IV advanced price. In this letter, we refer to the NMPF proposal as the "higher of Class I mover."

By notice dated June 1, 2023, USDA indicated an intention to consider holding hearings on NMPF proposal 3 as well as other specified proposals and invited interested parties to submit any alternative proposals by June 14, 2023.

The International Dairy Foods Association ("IDFA") has carefully examined NMPF proposal 3. IDFA has concluded that Proposal 3 is flawed because it precludes meaningful access to risk management tools and therefore fails to foster the purposes that lead to the Class I mover being changed to its present language on May 1, 2019. IDFA has identified an alternative approach that will both foster those purposes *and* address the concerns that underlie the NMPF proposal. ***This IDFA alternative proposal incorporates the core concept of the NMPF "higher of" proposal but adjusts it in a manner that: (a) preserves the purposes that led to the Class I mover being changed to its present language on May 1, 2019, (b) encourages increased sales of Class I products, which have been in steady decline for many years, and (c) is guaranteed to put more dollars into the pockets of dairy farmers than either the current Class I mover or NMPF proposal 3.*** We refer to the IDFA alternative proposal as the "Floored Class I Mover."

The rationale behind IDFA's alternative Floored Class I Mover proposal, and the specific amendment IDFA is seeking, are as follows.

Prior to May 1, 2019, FMMOs set the skim milk component of the Class I price in each month as equal to the higher of the Class III or Class IV advanced price (the “Class I mover”) plus a specified Class I differential that varied based upon the geographic location of a given Class I plant.

In 2017 and 2018, industry — both processors and dairy farmer cooperatives — joined together after careful study and analysis to jointly propose, promote, and successfully secure legislation, contained in the Agriculture Improvement Act of 2018, Public Law 115–334 (Dec. 20, 2018), implementing a substitute approach to determining the Class I mover. Effective May 1, 2019, that substitute approach set the Class I mover for the skim milk component of the Class I price in each month as the simple average of the Class III and Class IV advanced prices plus \$0.74. We will refer to this approach (which is the one currently in effect) as the “average of plus \$0.74 Class I mover.”

We emphasize that this successful legislative effort was a joint processor-dairy farmer effort. Attachment A to this letter is one of many examples of communications to members of Congress submitting a *joint* IDFA-NMPF statement supporting the adoption of this new “average of plus \$0.74 Class I mover.” That joint statement is entitled “NMPF and IDFA Dairy Price Risk Management Recommendations.” The joint statement plainly stated:

- “Both IDFA and NMPF support changing the Class I mover from the higher of Class III and Class IV to the simple average of Class III and Class IV, with an adjustment in Class I differentials based on historical relationships between the current and proposed mover.”
- “Both IDFA and NMPF support: changing the formula for the Class I price from the higher of Class III or IV to the average of Class III and IV plus \$0.74 per cwt. for determining the price of Class I skim milk...”

This substitute approach was intended and designed to be price neutral. In other words, based upon an extensive and careful review of historical data, both processors and dairy farmer cooperatives individually and jointly concluded that over time, including several different time periods, a skim milk Class I price mover based on the simple average of the Class III and Class IV advanced price plus \$0.74 produced the same average Class I price as the existing skim milk Class I price based the higher of the Class III or Class IV advanced price. Of course, in some years, the old formula would have produced a higher price, and in some years, a lower price, but over time, the effect would be price neutral.

Why did the processor and dairy farmer communities make the considerable effort of securing legislation to effectuate this change if the resulting prices and revenues were going to be the same? The reason is simple: the change substantially enhanced Class I processors’ and dairy farmers’ ability to accurately predict Class I prices, and thereby made it effectively possible for the first time for both Class I processors and dairy farmers to engage in forward price hedging with respect to Class I milk or products.

A hedge is a strategy that seeks to limit price risk exposures in financial assets. It can be thought of as a form of price insurance. A company engaged in hedging is insuring itself against a negative event’s impact on its finances. For a fluid milk processor, a hedge limits its financial exposure (losses) from entering into a fixed price contract with its retail customers for future deliveries of

its fluid milk products and then suffering substantial losses because the regulated cost of the raw milk used to make those products ends up being materially higher than anticipated. Hedging limits the processor's financial exposure because the counterparty to the hedge agrees to pay the processor if the hedged price ends up exceeding a specified dollar amount.

Of course, this hedge protection comes at a cost; the processor must pay the counterparty an agreed-upon amount of money for agreeing to provide the hedge. From the perspective of the processor, the potential benefits from the hedge — price stability — must justify the cost of the hedge. Conversely, from the perspective of the hedge counterparty, the amount it demands to be paid for the hedge must justify the risks it is taking if the hedged price ends up exceeding the specified dollar amount.

Forward price hedging is especially important in today's world because in critical segments of the fluid milk product market — including those segments that are demonstrating the greatest growth and potential future growth — customers are demanding that processors provide long-term fixed price contracts, rather than contracts with prices that fluctuate month to month to reflect changes in the Class I regulated milk price. This is especially prevalent with respect to extended shelf life (ESL) products, higher value-added products and food service. Meaningful access to risk management tools such as hedging are important today and will become even more important going forward as these more stable priced products represent a disproportionately large percentage of the growth opportunities in the fluid space.

To meet these customer needs/demands, a processor must offer a competitive, fixed price for its fluid milk products over an extended period, at a point in time when the processor does not yet know the price it will have to pay for the raw milk used to make that product. The processor cannot enter into a fixed purchase price for that raw milk: the FMMO program requires that the processor pay at least the minimum Class I price in effect during the month of purchase. Hedging is what allows a fluid milk processor to take on the risk of entering into a fixed sales price for its finished products, without jeopardizing its financial well-being if raw milk prices rise during the period covered by the contract.

So how does “the higher of Class I mover,” as was in effect before May 1, 2019, and which NMPF Proposal 3 seeks to reinstate, impact this? A system that re-sets Class I raw milk prices each month based upon the “higher of” the Class III or IV advanced price for the month (plus a Class I differential) renders hedging highly problematic and effectively unavailable:

- Use of “the higher of Class I mover” increases Class I price volatility, meaning additional risk, as the “higher of mover” switches back and forth between Class III and IV, causing the Class I price to fluctuate more wildly. Increased cost volatility equates with greater risk, and that greater risk must be built into (increase) the cost of the hedge.
- Increased hedge costs result in higher consumer prices, and reduced consumption, because the increased cost of the hedge must be built into the processor's product pricing.
- Price risk management (hedging) for Class I generally involves direct participation in CME Class III and IV futures, or over-the-counter fixed price agreements, usually backed with

the sell side using CME futures. However, in a “higher of Class I mover” world, the utility of hedging with futures/options is severely limited, given that which “higher of” mover (Class III or Class IV) will be in effect at the expiration of the right to exercise the futures/options is not known in advance. This creates insurmountable chaos:

- Which contract do you use to hedge: Class III or Class IV? You cannot know in advance which will be relevant.
- One cannot effectively switch mid-hedge whenever the expected mover changes. Class III and Class IV futures markets are simply not liquid enough to simultaneously buy/sell significant volumes of Class III/Class IV futures at identical prices precisely as the higher of the futures prices is switching.
- Once the hedges are placed, if the higher of Class I mover switches from Class III to Class IV, or vice versa, so that the hedger is protected with the wrong contract, the result is an unexpected loss to the long-hedger (the processor) and an unexpected gain to the short-hedger (the counterparty).
- Hypothetically, the processor could take option positions in both Class III and Class IV. However, that is cost prohibitive since it requires paying double the options premium.
- During the period when the “higher of Class I mover” was in effect, some processors, retailers and restaurant chains did attempt to use over the counter (swaps) instruments to hedge Class I milk purchases. Specifically, they looked to the markets for derivative contracts that settled to the Class I mover to avoid the issues with exchange based hedging strategies. However, the sellers of such products realized the potential for extra gains to the seller in the event that the higher of mover switched while the contracts were in place, and merely added those anticipated gains into the cost of the Class I mover settled hedges. This rendered the hedges under higher-of pricing cost prohibitive and less precise.

The absence of realistic opportunities to hedge under the “higher of Class I mover,” both when that mover was in effect, and if NMPF proposal 3 were adopted, negatively impacts the fluid milk sector and the dairy industry as a whole. Value-added milk products (flavored single-serve, lactose-free, protein enhanced, organic, etc.) represent one of the few growth opportunities in the fluid milk arena. Retailers of these products demand flat pricing from their suppliers for an extended period (often an entire year).

The primary competitors to these products: bottled waters, soft drinks, plant-based beverages, etc., all offer stable pricing (often an entire year) to retailers, which allows those retailers in turn to (a) provide the stable shelf pricing preferred by consumers, and (b) maintain predictable margins to the retailer. The value-added milk bottler’s choice is not between offering stable pricing or moving prices monthly. But rather, the choice increasingly is between offering stable pricing or losing their space in the beverage case or the restaurant menu to other products.

A recent study by Texas A&M University Professors Dr. Ariun Ishdorj and Dr. Oral Capps found both high “own price” elasticity of demand for most of these value-added dairy products (*i.e.*, a 1% price increase results in greater than a 1% decline in volume sales), and high “cross price” elasticity with their non-dairy alternatives. Ishdorj and Capps, *A Deeper Look at Milk and Competing Beverage Price Elasticities*. Without the necessary tools to manage flat pricing of fluid milk products, bottlers must either forgo the business or accept the margin risk. Offering flat fluid milk product pricing with fluctuating input costs typically leads to additional margin being built into pricing to cover the risk of fluctuating input costs, resulting in less competitive shelf pricing leading to declining sales. Declining sales mean less producer milk sold at Class I prices, more milk forced into Class IV channels, and declining blend prices for producers.

All of these concerns and motivations were fully recognized by both IDFA and NMPF in 2017 and 2018 when they successfully lobbied Congress to replace the old “higher of Class I mover” with the new average of Class III and Class IV plus \$0.74 mover. In their joint “NMPF and IDFA Dairy Price Risk Management Recommendations” (Attachment A), IDFA and NMPF explained that “changing the Class I mover to the [simple average of the Class III and Class IV advanced price *plus* \$0.74] would”:

- “balance processor desire for better price risk hedging with cooperative and dairy producer desire to maintain FMMO integrity.
- eliminate the uncertain basis that occurs when the mover shifts between Class III and Class IV.
- allow the use of existing Class III and Class IV futures and options to manage Class I price risk with minimal changes to the FMMO system.
- provide several benefits that can result from the ability to hedge longer-term costs for fluid milk products.
- allow processors to manage price risk for dairy beverage ingredients, as they currently can for non-dairy ingredients.
- allow dairy producers to effectively hedge the Class I portion of their producer milk payments, as they currently can for the other portion of their payments.
- encourage and promote the use of dairy ingredients in new fluid milk and dairy-based beverages that meet Class I specifications.”

When USDA adopted the new Class I mover effective May 1, 2019, it similarly recognized that “[t]he dairy industry has calculated that applying the ‘higher of’ provisions to skim milk prices has returned a price \$0.74 per hundredweight above the average of the two factors since the pricing formulas were implemented in 2000,” and that “the inclusion of the \$0.74 in the calculation should make the change roughly revenue neutral.” USDA likewise recognized that “[a]t the same time, it is anticipated that using the average of the Class III and Class IV advanced pricing factors in the Class I skim milk price formula will allow handlers to better manage volatility in monthly Class I skim milk prices using Class III milk and Class IV milk futures and options. Until now, uncertainty

about which Class price will end up being higher each month has made effective hedging difficult.” USDA, Agricultural Marketing Service, *Federal Milk Marketing Orders— Amending the Class I Skim Milk Price Formula*, 84 Fed. Reg. 8590, 8591 (Mar. 11, 2019).

Since May 1, 2019, multiple fluid processors have been using the risk management tools such as hedges that the current Class I mover facilitates. Some food service companies (the buyers of fluid milk products) have also used such tools, independently of their fluid milk product suppliers. For example, during the pre-May 1, 2019 period when the Class I skim mover was set at the "higher of" the Class III or Class IV advanced price, Nestlé, the world's largest food company, and an active dairy processor in the United States, was unable to use hedging for its Class I product purchases. The unpredictability as to which class would end up setting the mover made hedging a practical impossibility and posed a significant business risk. Now that the Class I mover is based upon the average of the Class III or Class IV advanced prices plus a fixed amount, Nestle is able to hedge a significant portion of its Class I milk purchases and mitigate that risk.

Notwithstanding the previous consensus between dairy farmers and processors to support the adoption of the current “average of Class I mover,” and its success in the real world, NMPF has now submitted a proposal (NMPF Proposal 3) that would repeal the Agriculture Improvement Act of 2018 revision to the Class I mover formula, and return FMMOs to the prior approach that relies upon the higher of the Class III or Class IV advanced price to set the Class I skim price each month. This NMPF proposal would discard the benefits achieved from the 2018 legislative changes, as it will, for the reasons detailed above, eliminate any realistic ability to engage in Class I hedging. Both dairy processors, their customers and the entire dairy supply chain would suffer.

The principal stated justification for the NMPF proposal is that the economic shocks in 2020 resulting from the Covid pandemic caused anomalous impacts on Class III and Class IV prices, such that the use of the simple average of the Class III and Class IV advanced price plus \$0.74 produced a Class I skim price materially less than would have resulted under the previous “higher of” approach and resulted in substantial depooling.

No one questions the serious nature of that pandemic. But IDFA questions whether a single, anomalous year resulting from a worldwide catastrophe warrants any material revisiting of the Class I mover formula. Dairy farmers were far from unique in experiencing serious but temporary dislocations resulting from Covid. Dairy processors themselves also faced material dislocations, as school milk, food service, and educational institution sales evaporated.

Recognizing the temporary but material dislocations suffered by dairy farmers, the federal Government stepped in. The United States Government paid producers \$400 million (\$300 million in the first tranche and another \$100 million recently) to compensate dairy farmers. And while its results were perhaps not evenly felt by all, dairy products were a key component of the COVID-era Farmers to Families Food Box Program which distributed more than 173 million food boxes to Americans across the country, at a cost of over \$5 billion, and led to booming cheddar cheese sales, which greatly benefitted cooperatives and independent farmers supplying milk to, or owning, those cheese plants.

Excluding the anomaly of 2020, processors’ and farmers’ joint analysis and operating assumption that over time, the “average of plus \$0.74 Class I mover,” based upon the simple average of the

Class III and Class IV advanced price plus \$0.74, produces the same average Class I price as the “higher of “Class I mover,” based on the higher of the Class III or Class IV advanced price continues to be completely valid. Outside of 2020, the “higher of” and “the average of plus \$0.74” movers are nearly identical over a 5, 10 or 15 year period.

	Time Period	Advanced Price		50:50 + \$0.74	Higher of III/IV	50:50 + \$0.74 vs.
		III	IV			Higher of
5 Year	2017-19,21-22	\$17.18	\$17.06	\$17.83	\$17.84	-\$0.01
10 Year	2012-19,21-22	\$17.44	\$17.09	\$17.98	\$17.99	-\$0.02
15 Year	2007-19,21-22	\$16.86	\$16.55	\$17.41	\$17.43	-\$0.01

For all these reasons, a very solid case can be made for retaining the current “average of plus \$0.74 Class I mover”. Nevertheless, in the spirit of cooperation, IDFA is proposing an alternative to the NMPF proposal — what IDFA is calling “the Floored Class I Mover.” **This “Floored Class I Mover” will put more dollars into dairy farmer pockets than either the current “average of plus \$0.74 Class I mover” or NMPF’s proposed “higher of Class I mover,” while preserving the critical goal of enabling hedging.** And this is true even including the anomaly of 2020.

Here is how the IDFA “Floored Class I Mover” would work. First, under this IDFA proposal, \$0.74 will be the *minimum* amount added each month to the simple average of the Class III and Class IV advanced price. This will be the case even in those months in which the Class I skim milk price (and thus payments to dairy farmers) would have been *lower* if based on the old “higher of” system — which the NMPF proposal would reinstate — that sets the Class I mover as the higher of the Class III or Class IV advanced price. ***In these months, the IDFA proposal will result in a higher price to dairy farmers than the NMPF proposal.***

Second, under this IDFA “Floored Class I Mover” proposal, there will be a “look back and make whole” process. If over the two prior twelve month periods from August through July adding \$0.74 to the simple average of the Class III and Class IV advanced price resulted in a lower Class I skim price than would have resulted had the Class I skim price been based upon the old “higher of Class I mover” (the higher of the Class III or Class IV advanced prices), then the Class I mover will increase to be equal to the difference between the simple average of the advanced Class III and Class IV price over those two prior twelve month periods.

In other words, the Class I skim milk price paid over time will never fall below the Class I skim milk price that would have adhered upon the old “higher of Class I mover” (which NMPF seeks to reinstate). But the Class I skim milk price over time will be higher when the “higher of Class I mover” would have been less than the simple average of the Class III and Class IV advanced price plus \$0.74.

For example, during the period August 2019 through July 2021, the Class I skim milk pricing formula based upon the simple average of the Class III and Class IV advanced price (\$9.95) plus \$0.74 resulted in an average Class I skim price mover of \$10.69. The average Class I skim milk price mover in that two-year period would have been \$11.68 (i.e., \$0.99 higher) if based on the

higher of the Class III or Class IV advance price. Accordingly, under the IDFA “Floored Class I Mover,” including its “look back and make whole” process, the Class I skim milk price mover in all months in 2022 would be the simple average of the Class III and Class IV advanced price plus \$1.73 (\$0.74 plus \$0.99). Thus, through this use of a \$1.73 adder rather than a \$0.74 adder, dairy farmers would have “made up” the \$0.99 shortfall between the use of the “higher of Class I mover” and the “average of Class III and Class IV advanced price plus \$0.74.”

Looking at the following year, during the period August 2020 through July 2022, the Class I skim milk pricing formula based upon the simple average of the Class III and Class IV advanced price (\$11.38) plus \$0.74 resulted in an average Class I skim price mover of \$12.12. The average Class I skim milk mover in that two-year period would have been \$12.90 (i.e., \$0.78 higher) if based on the higher of the Class III or Class IV advance price. Accordingly, under the IDFA “Floored Class I Mover,” including its “look back and make whole” process, the Class I skim milk price mover in all months in 2023 would be the simple average of the Class III and Class IV advanced price plus \$1.52 (\$0.74 plus \$0.78). Once again, through this use of a \$1.52 adder rather than a \$0.74 adder, dairy farmers would have “made up” the \$0.78 shortfall between the use of the “higher of Class I mover” and the “average of Class III and Class IV advanced price plus \$0.74.”

By contrast, during the earlier period August 2018 through July 2020, the Class I skim milk pricing formula based upon the simple average of the Class III and Class IV advanced price (\$7.80) plus \$0.74 would have resulted in an average Class I skim price mover of \$8.54. The average Class I skim milk price mover in that two-year period would have been \$8.50 (i.e., \$0.04 **lower**) if based on the higher of the Class III or Class IV advance price. Under the IDFA “Floored Class I Mover,” including its “look back and make whole” process, the average Class I skim price mover in all months in 2021 would be the simple average of the Class III and Class IV advanced price *plus* \$0.74. Dairy farmers would **not** have to “give up” the extra \$0.04 through a lower regulated price. Dairy farmers will instead retain that extra \$0.04.¹

Thus, by its very design, under the IDFA “Floored Class I Mover” proposal, the Class I price paid to dairy farmers over time will **never** fall below the price that would have adhered under either the current “average of plus \$0.74 Class I Mover” or NMPF’s proposed “higher of Class I mover,” i.e., if the Class I mover were the higher of the Class III or Class IV advanced price. Rather, the

¹ One might ask why the IDFA proposal bases the “make whole adder” upon Class I skim milk prices over the two most recent August through July twelve month periods, rather than over the two most recent calendar years. The answer is that long term Class I product sales contracts between processors and retailers are often negotiated and entered during the months immediately prior to the beginning of each calendar year. In order to engage in effective hedging in connection with those contracts, Class I processors need to know at the time of those contract negotiations the amount of the “make up adder” that will be in effect during the calendar year for which Class I product sales prices are being negotiated. If the “make whole adder” that will be in effect during the calendar year for which Class I product sales prices are being negotiated were to be based on regulated Class I prices in effect during the prior calendar year, Class I processors would not yet know at the time of contract negotiations the amount of that “make up adder,” because the Class I prices during the last months of that prior calendar year would not yet have been set. The use of an August through July period solves that problem.

IDFA “Floored Class I Mover” proposal will increase prices to dairy farmers as compared to both the current “average of plus \$0.74 Class I mover” or NMPF’s proposed “higher of Class I mover,” and would have done so even if it were in effect during 2020.

The impacts on the Class I price of the NMPF “higher of Class I mover” proposal, and the IDFA “Floored Class I Mover” proposal, as compared to the “average of plus \$0.74 Class I mover” now in effect, are as follows, over the ten-year period from 2013 through 2022:

NMPF Class I Mover Proposal (the higher of Class III or Class IV advanced price): **\$0.19 higher average Class I price as compared to the current “average of plus \$0.74 Class I mover”**

IDFA Class I Mover Proposal (the average of Class III and Class IV advanced prices plus the higher of: (a) \$0.74 or (b) the difference between the simple average of the Class III and Class IV advance prices over the two prior twelve-month periods from August through July): **\$0.21 higher average Class I price as compared to the current “average of plus \$0.74 Class I mover”**

Why does IDFA support this approach, recognizing that it will raise the minimum Class I prices paid by its Class I processor members? Because, unlike the NMPF “higher of Class I mover” proposal, the IDFA “Floored Class I Mover” proposal will preserve the purposes that underlay the original decision to switch away from the “higher of Class III or Class IV advanced price” approach: by providing greater price predictability, and allowing both farmers and Class I processors to engage in hedging, to the benefit of all participants in the dairy industry.

The IDFA proposal will do so because in advance of any calendar year, both dairy processors and dairy farmers will know that the Class I price during each month of that calendar year will be the average of the Class III and Class IV advance prices plus a fixed amount (plus the Class I differential). That fixed amount in each month of that calendar year will either be \$0.74 or a higher number, with that higher number equal to the difference between the average Class III and Class IV advance prices over the previous two August through July time periods.

The additional rationales advanced by NMPF for returning to the “higher of” Class I mover do not warrant returning to that mover.

NMPF contends that basing Class I on the higher of Class III or Class IV would more accurately reflect the value of milk in the different categories of use in a four class system. But the value of Class I products do not reflect the value of Class III or IV products. This is obvious in the fact that the markets for butter and cheese have been growing, while the market for Class I products has been falling. The Class I differential is a regulatory construct, not a reflection of the relative value of the products that fall within it as compared to other classes.

NMPF contends that given the separation of manufacturing milk into two classes, using the higher of Class III and IV would assure that shifts in demand for any one manufactured product will not lower Class I prices. But as demonstrated in the chart above, the IDFA proposal would raise Class I prices, resulting in higher Class I prices than the NMPF proposal.

NMPF contends that using the higher of Class III or Class IV to move Class I prices will help to reduce the volatility in milk prices. Yet a Class I mover like the NMPF proposal, which routinely and unpredictably switches between Class III and Class IV, creates, rather than reduces, volatility. The joint “IDFA-NMPF Dairy Price Risk Management Recommendations” itself recognized “the uncertain basis that occurs when the mover shifts between Class III and Class IV” under the “higher of” Class I mover. And the more volatile the price, the higher the price a retailer needs to charge to protect against margin loss, resulting in diminished sales.

NMPF contends that the “higher of” formula helped address class price inversions and depooling. Producer Pay Differential (PPD) is the difference between total handler obligations to the pool and the total component value of milk. Negative PPD (plus lax pooling requirements) are the leading cause of depooling, *i.e.*, when it is more advantageous for a non-Class I handler to be out of the pool than in it.

An extensive economic analysis by Marin Bozic and Chris Wolfe, Agricultural Economics professors at the University of Minnesota and Cornell respectively, indicates the beneficial impact on PPD of adjusting make allowances accurately to reflect actual dairy processing costs. This is the very purpose of the make allowance amendments that IDFA has already submitted to USDA for inclusion in a milk order reform hearing: to adjust make allowances to more accurately reflect real processing costs. As the economists explain:

Orderly marketing must also include incentives to direct milk to dairy products where the milk adds the most value. That in turn means incentives for production capacity utilization to be low enough to allow flexibility in dairy product production in response to changes in demand. **One step toward that realignment might be to adjust make allowances to accurately reflect dairy processing costs.** Our models show that adjusting make allowances can reduce the spread between the value of skim solids in cheese and dry milk products, and thus increase PPD [producer pay differential] both directly, and indirectly through incentives to augment aggregate cheese making capacity. **The “average-of” approach [to setting the Class I mover] results in a higher PPD when the value of skim solids is sufficiently similar in cheese and milk powder markets, and thus should perform more advantageously to dairy producers if the underlying drivers of wide spreads between class III and class IV milk prices are properly addressed.**

Bozic and Wolf, *Negative Producer Price Differential in Federal Milk Marketing Orders: Explanation, implications, and policy options*, J. Dairy Sci. 105:424:440 at pp. 438-39 (2022), available at <https://doi.org/10.3168/jds.2021-20664>.

These authors also noted that an underlying problem leading to depooling is the general decline in Class I product sales:

On the issue of depooling, it is important to note that, historically, equalization in producer prices was driven by large revenue transfers from beverage milk class to manufactured milk classes. With waning of fluid milk sales and growth in domestic and export demand for manufactured products, in most market orders class I revenue is no longer sufficient to provide even short-term equalization of mailbox prices for producers whose milk is used in powder versus cheese production. *Id.*

IDFA's "Floored Class I Mover" is designed to foster the very fluid milk sales growth that these economists rightly identify as serving as the bulwark against depooling.

For all these reasons, IDFA requests that as an alternative to NMPF Proposal 3, the following proposed amendment to the Class I mover be included in a hearing to be called pursuant to 7 C.F.R. § 900.1, *et seq.*, to, *inter alia*:

Amend 7 C.F.R. § 1000.50(b) to provide as follows: (no deletions; additions appear in red font):

§ 1000.50(b) Class I skim milk price. The Class I skim milk price per hundredweight shall be the adjusted Class I differential specified in § 1000.52, plus the adjustment to Class I prices specified in §§ 1005.51(b), 1006.51(b) and 1007.51(b) of this chapter, plus the simple average of the advanced pricing factors computed in paragraph (q)(1) and (2) of this section rounded to the nearest cent, plus **the higher of: (a) \$0.74 per hundredweight or (b) the difference between the simple average of the advanced pricing factors computed in paragraphs (q)(1) and (q)(2) of this section over the two prior twelve month periods from August through July.**

Respectfully Submitted,



Mike Brown
Chief Economist
International Dairy Foods Association
1250 H Street NW, Suite 900
Washington, DC 20005
202-737-4332

cc: Bruce Summers, Administrator, Agricultural Marketing Service, USDA
Erin Taylor, Director, Order Formulation and Enforcement Division, USDA/AMS/Dairy

From: Dave Carlin <dcarlin@idfa.org>
Sent: Friday, September 29, 2017 2:53 PM
To: Fischer, Bart <Bart.Fischer@mail.house.gov>; Knigge, Mary <Mary.Knigge@mail.house.gov>;
troy.phillips@mail.house.gov
Cc: Michael Dykes <mdykes@idfa.org>; Jim Mulhern <jmulhern@nmpf.org>
Subject: Corrected Concept Paper on Dairy Price Risk Management

Good afternoon,

At our meeting on Wednesday, I inadvertently handed out an earlier version of our concept paper that describes our dairy price risk management agreement. The final version is attached above. Most of the differences between the two versions are stylistic, but the final version does clarify that the agreement would remain in effect unless modified by amending the orders at a national hearing.

My apologies for any confusion this has caused.

Regards,

Dave

J. DAVID CARLIN

Senior Vice President, Legislative Affairs and Economic Policy
International Dairy Foods Association
1250 H St. NW, Suite 900
Washington, D.C. 20005
P: 202-220-3502
M: 202-262-1612
E: dcarlin@idfa.org
www.idfa.org | [Facebook](#) | [Twitter](#)

MAKING A DIFFERENCE FOR DAIRY

NMPF and IDFA Dairy Price Risk Management Recommendations for the Upcoming Farm Bill

Goal: Provide tools needed to allow processors, cooperatives and dairy producers to better manage price risk on all Classes of milk regulated under Federal Milk Marketing Orders (FMMO).

Both IDFA and NMPF support changing the Class I mover from the higher of Class III and Class IV to the simple average of Class III and Class IV, with an adjustment in Class I differentials based on historical relationships between the current and proposed mover.

Changing the Class I mover to the above referenced price format would:

- balance processor desire for better price risk hedging with cooperative and dairy producer desire to maintain FMMO integrity.
- eliminate the uncertain basis that occurs when the mover shifts between Class III and Class IV.
- allow the use of existing Class III and Class IV futures and options to manage Class I price risk with minimal changes to the FMMO system.
- provide several benefits that can result from the ability to hedge longer-term costs for fluid milk products.
- allow processors to manage price risk for dairy beverage ingredients, as they currently can for non-dairy ingredients.
- allow dairy producers to effectively hedge the Class I portion of their producer milk payments, as they currently can for the other portion of their payments.
- encourage and promote the use of dairy ingredients in new fluid milk and dairy-based beverages that meet Class I specifications.

Both IDFA and NMPF support:

- changing the formula for the Class I price from the higher of Class III or IV to the average of Class III and IV plus \$0.74 per cwt. for determining the price of Class I skim milk (equivalent to \$0.71 per cwt. for the Class I price at 3.5% fat), and
- implementing this change legislatively in the Farm Bill and maintaining it in effect thereafter unless modified by amendment through formal rulemaking under the Agricultural Marketing Agreement Act.

Both IDFA and NMPF support extending the current FMMO forward pricing program for Class II, III and IV milk, recognizing that:

- the use of risk management is now a widely-accepted practice for these classes of milk.
- the FMMO Risk Management Program use would continue to be reported to USDA.

Both IDFA and NMPF agree that effectuating these changes will improve price risk management for Class I milk.