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WISCONSIN CHEESE MAKERS ASSOCIATION

March 28, 2023

Ms. Dana Coale, Deputy Administrator
USDA - AMS - Dairy Programs
1400 Independence Avenue, S.W.
Washington, D.C. 20250-0225

Re: Petition of the Wisconsin Cheese Makers Association ("WCMA") For a Hearing to Amend Federal Milk Marketing Orders

Dear Deputy Administrator Coale:

The Wisconsin Cheese Makers Association ("WCMA") submits this Petition to the United States Department of Agriculture ("USDA"), Agricultural Marketing Service ("AMS") Dairy Programs seeking a hearing to amend all make allowances in the Federal Milk Marketing Order ("FMMO") program administered by Dairy Programs.

Accurate and up-to-date make allowances are absolutely critical to a properly functioning FMMO program. For Class III (cheese) and Class IV (butter and nonfat dry milk) products, a manufacturer is legally required by the FMMO to pay the farmers supplying it milk the money the manufacturer receives from selling its finished products to customers (as determined by monthly audited surveys of actual finished product prices for the core Class III and IV products), minus the cost incurred in making those products, as set forth in the FMMO regulations (the "make allowance"). As USDA stated when it last revised make allowances in 2008:

> The ability of a manufacturer to offset cost increases are limited by the level of make allowances in the Class III and Class IV price formulas. Manufacturing processors are charged the FMMO minimum price for producer milk used to produce Class III and Class IV products. However, plant manufacturing cost increases may not be recovered because Class III and Class IV product-price formulas use make allowances that are fixed regardless of market conditions and change only by regulatory action.

Milk in the Northeast and Other Marketing Areas; Tentative Partial Final Decision on Proposed Amendments and Opportunity To File Written Exceptions to Tentative Marketing Agreements and Orders, 73 Fed. Reg. 35,306, 35,323 (June 20, 2008).

WCMA's proposal seeks to have USDA take the requisite "regulatory action" and amend the manufacturing allowances for Class III and Class IV product formulas, as enumerated in 7 C.F.R. § 1000.50, in order to reflect the substantial increase in plant manufacturing costs since make allowances were last revised in 2008. WCMA's amendment will be based on record evidence that WCMA anticipates will include the most current studies of Dr. Mark Stephenson published by AMS in 2022, a new study that Dr. Stephenson is undertaking to update that study to take into consideration 2022–2023 data, and a study by Dr. William Schiek.

WCMA's proposal is:

> **Amend § 1000.50 milk price formulas by revising the existing manufacturing allowances for butter, nonfat dry milk, cheese, and whey powder based upon evidence obtained from the hearing record. Amendments to these manufacturing allowances would directly affect the milk component values used in Federal Milk Marketing Order milk price formulas for all classes of milk.**

This proposal language is nearly identical (except for the studies relied on) to the language USDA previously published as Proposal 1 for the 2006 make allowance hearing requested by the cooperative Agri-Mark in September 2005. Milk in the Northeast and Other Marketing Areas; Notice of Hearing on Proposed Amendments to Tentative Marketing Agreements and Orders, 71 Fed. Reg. 545, 551–552 (Jan. 5, 2006). WCMA proposes revising the manufacturing allowances for cheese, whey powder, butter and nonfat dry milk using more recent and accurate studies and other information to update the current 7 C.F.R. § 1000.50 class prices (as set forth below):

Subsections:

(l) <u>butterfat price</u>, current butter manufacturing allowance of 17.15 cents per pound,

(m) <u>nonfat solids price</u>, current nonfat dry milk manufacturing allowance of 16.78 cents per pound,

(n)(2) and (n)(3)(i) <u>protein price</u>, current cheese manufacturing allowance of 20.03 cents per pound,

(o) <u>other solids price</u>, current whey powder manufacturing allowance of 19.91 cents per pound, and

(q)(3) <u>advanced butterfat pricing factor</u>, current butter manufacturing allowance of 17.15 cents per pound.

JUSTIFICATION FOR PROPOSAL

As USDA has cogently explained::

> The Class III and Class IV product-price formulas, among other factors, use the market prices of the manufactured products from which make allowance factors are subtracted. The remaining value, when converted to a milk equivalent basis, is the value of raw milk. Accordingly, the accuracy of deriving the minimum value of raw milk is dependent on the accuracy of the

> commodity sale prices reported **and in large part the accuracy of the manufacturing costs factors, or make allowance factors, that are used in the pricing formulas.**

73 Fed. Reg. 35,305, 35,324 (June 20, 2008) (emphasis added).

WCMA has approximately 87 members including, for the purpose of this Petition, both proprietary and cooperative operators of pool and nonpool handlers primarily located in Wisconsin and the Upper Midwest. The pool handlers are directly subject to FMMO regulated minimum prices while nonpool handlers compete against pool handlers for their raw milk supply. All of WCMA's operating members (there are several WCMA members who do not operate milk manufacturing facilities), are thus directly impacted by FMMO minimum classified prices and especially Class III and IV prices announced by AMS each month. In short, FMMO Class III prices provide the baseline for all WCMA members in making dairy farmer patron payments. The vast majority of WMCA members operating manufacturing plants qualify as small businesses for purposes of FMMO rulemaking.

FMMO Class III and IV prices are established based upon product formulas for cheese, whey, powder, butter, and nonfat dry milk. WCMA's exclusive proposal is to update the manufacturing allowances for cheese, whey powder, butter and nonfat dry milk. The current make allowances were fixed by AMS based upon significantly outdated cost data from 2005–2006, yet are still used to establish minimum prices for milk under all FMMOs. Actual manufacturing and other costs considered in make allowances have risen dramatically during the past 16 years. Despite these cost increases, FMMO provisions have effectively stopped manufacturers from covering these higher costs through make allowances. The amount of time that has elapsed since the last hearing and rulemaking on these pricing formulas is almost twice as long as the interval when AMS first established formula prices in Federal Order Reform in 2000 and adopted updates in 2007 and late 2008 based upon 2005 and 2006 data.

AMS itself retained Dr. Mark Stephenson to conduct an updated survey of Class III and IV plant costs. That study was published by AMS in February 2022, and that study is based mostly on 2018 data and certainly shows enormous cost increases since the current allowances were set. In the intervening time since 2018, significant additional cost increases have occurred. At the hearing, WCMA will ask USDA to consider an updated version of this USDA-commissioned study "Cost of Processing Study for Cheese, Whey, Butter and Nonfat Dry Milk Plants" released by Dr. Stephenson in February 2022. WCMA and the International Dairy Foods Association have commissioned Dr. Stephenson to update his study with 2022–2023 data.

WCMA proposes that in considering the need for a hearing (and at the hearing as submitted evidence) that USDA take into account in addition to Dr. Stephenson's study, an updated cost study by Dr. William Schiek, CEO of the Dairy Institute of California. Dr. Schiek's most current projections, based on CDFA studies and updated with indices, encompass costs to manufacture cheddar cheese, dry whey, butter and nonfat dry milk in 2022. Dr. Schiek has determined that the cost to manufacture cheddar cheese has risen 51%, dry whey has risen

49%, butter has risen 39%, and nonfat dry milk has risen 59% compared to the current make allowance values.

The historical context of USDA's prior updates to the pricing formulas demonstrates we again find ourselves at a moment in time that demands such an urgent change. As Agri-Mark accurately stated in 2005:

> On January 1, 2000, the basis for determining class prices for milk regulated under Federal Milk Marketing Orders was changed dramatically. Prior to that date, most class prices were determined using the competitively set M-W and Basic Formula Prices (BFP) that were paid for milk by dairy product manufacturers in the Upper Midwest. Those prices moved up or down as cheese and other dairy product prices moved. Those prices also moved if manufacturing costs changed and plants had more or less net income available to pay farmers for their milk.
>
> When the Federal Orders were amended under major reform provisions in January 2000, the basis for determining class prices was shifted to an end-product pricing system. Rather than surveying competitively set farm milk prices, under this revised system, USDA surveys competitively set nationwide cheese, whey powder, butter and nonfat dry milk commodity wholesale prices. USDA then inserts those dairy product prices into formulas which, in turn, are used with administratively set product yields and manufacturing cost allowances in Order to determine the class prices to be paid by handlers for farm milk.
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> For the Class III milk price for example, the system functions by obtaining the cheese and whey products prices, and then subtracting fixed manufacturing allowances in order to end up with the net farm milk value. Appropriate yield factors are also used to convert dairy product pounds to pounds of raw farm milk components (and eventually, hundredweights of farm milk).
>
> When USDA seeks the appropriate current dairy product prices to use in its class price calculations, it conducts weekly surveys of hundreds of plants so a reasonable monthly average price can be determined. The Department then automatically uses those prices to determine the appropriate class and component prices. Rightfully so, USDA wants the price of milk to be responsive to any changes in the prices of the corresponding dairy products. However, similar care is not taken with the manufacturing cost allowances used in the same formulas. The fixed manufacturing cost allowances, currently in place throughout the Federal Order system, are completely unresponsive to any changes in actual

> costs until a Federal Order hearing is held and a USDA decision is determined to amend the appropriate provisions of the Federal Order regulations.

Letter from Robert D. Wellington, Sr. Vice President for Econ., Commc'ns & Legis. Affairs, Agri-Mark Dairy Coop., to Dana Coale, Deputy Adm'r, Dairy Programs, USDA Agric. Marketing Serv. (Sept. 29, 2005) at 2–3, https://www.ams.usda.gov/sites/default/files/media/DYClassIIIIVMakeAllowancesAgriMarkReq.pdf.

As noted above, the manufacturing cost allowances currently in place throughout the FMMO system for these products as of October 1, 2008, are based upon cost data from surveys and data dating to 2005 and 2006. Manufacturing costs for all dairy products have soared significantly in the intervening 16 years. Even a layperson is abundantly aware of the unprecedented increase in costs for business operations during recent years. It would be incorrect, and in fact unreasonable, to assume that somehow technology or other efficiency improvements at plants have somehow offset these escalating costs.

Again, as correctly recounted by Agri-Mark in its 2005 submission to AMS:

> Dairy product manufacturers under Federal Milk Orders are trapped into a fixed make allowance with no opportunity to cover their higher costs no matter what the price of their dairy products are. If manufacturers raise their product prices to cover higher costs, those higher prices automatically lead to higher milk prices, leaving no additional net income to apply to the higher costs.

Id. at 3.

This is a major problem for dairy product manufacturers like the plant operator members of WCMA. In the Upper Midwest, a fair measure of the health of the cheese industry is a comparison of where producer pay prices are relative to Class III. In 2013–2014, the Upper Midwest saw on average a $1.50 premium paid over Class III. Without updated make allowances, cheese plants today are fortunate to return the Class III price; more often we see prices under Class III. This is clear evidence that the current make allowances are insufficient to cover plants' costs.

Furthermore, in February and March 2023, WCMA member cheese producers responded to a WCMA survey seeking percent changes in business costs, reflecting the time frame 2019 to 2022. While make allowances have not been updated since 2008, this survey asked members for cost changes in a more readily-researchable span of time. Those percent change data were averaged (simple average) to produce the following results received from 18 respondents which WCMA concludes is a representative sample of operators of large, medium and small cheese plants:

- The base wage level at these cheese manufacturing sites rose an average of 20.2% from 2019 to 2022 (18 respondents);
- The cost of a single-person health policy premium rose an average of 20.9% from 2019 to 2022 (18 respondents);
- The cost of electricity per kWh rose an average of 14.1% from 2019 to 2022 (18 respondents);
- The cost of natural gas per MMBtu rose an average of 68.9% from 2019 to 2022 (18 respondents);
- The cost of cultures used in cheese production rose an average of 15.8% from 2019 to 2022 (18 respondents);
- The cost of salt used in cheese production rose an average of 18.8% from 2019 to 2022 (17 respondents);
- The cost of cardboard packaging (bulk cheese boxes) used in cheese production rose an average of 25.8% from 2019 to 2022 (17 respondents); and
- The cost of plastic packaging (bulk cheese bags) used in cheese production rose an average of 36% from 2019 to 2022 (17 respondents).

Sixteen of the eighteen respondents are small businesses as defined by the U.S. Small Business Administration. The respondents are headquartered in six states (producing cheese in those states and additional states).

These everyday losses and significant cost increases discussed above are impossible to sustain. Farmer-owned cooperatives in this region are routinely returning dairy farmer payments with significant deductions from FMMO uniform minimum prices. Proprietary members of WCMA are absorbing losses, attempting to sell specialty cheeses at prices designed to mitigate losses, and/or otherwise failing to invest in plants and facilities. This is not sustainable for the plants, nor for dairy farmers who depend on these plants as outlets for their raw milk.

WCMA understands and appreciates the concerns of our dairy farmer patrons for whom increased make allowances mean lower regulated minimum prices. However, as USDA itself explained when it last increased make allowances in 2008:

> Opponents of increasing make allowances argue a number of points—that they are already set at too high a level, that dairy farmer production costs also have increased significantly due to higher energy and feed costs, that processors should look beyond asking dairy farmers to receive less for their milk by charging more for manufactured products, and that make allowance increases should be made only when all dairy farmer production costs are captured in their milk pay price. These are not valid arguments for opposing how make allowances should be determined or what levels make allowances need to be in the Class III and Class IV product-pricing formulas. The record demonstrates that current make allowance levels are not reflective of the costs manufacturers incur in processing raw

> milk into the finished products of cheese, butter, NFDM and dry whey.
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> Additionally, the Class III and Class IV product-price formulas establish derived classified prices for producer milk that are used nationally in all Federal milk orders. When dairy farmer production costs exceed the value for which products are sold in the marketplace, no source of revenue from the marketplace is available to cover those costs.
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> In the aggregate, the costs of producing milk are reflected in the supply and demand conditions for the dairy products. When the supply of milk is insufficient to meet the demand for Class III and Class IV products, the prices for these products increase as do regulated minimum milk prices paid to dairy farmers because the milk is more valuable and this greater milk value is captured in the pricing formulas. Dairy farmers face no regulatory minimums in their costs and face no regulated minimum payment obligation in the way that regulated handlers must pay dairy farmers for milk.

73 Fed. Reg. at 35,324.

Furthermore, the loss of significant plant capacity and the resulting loss of competition will mean greater pain for everyone, including dairy farmers. Dairy product manufacturers that serve as nearby outlets for local dairy farmer milk and as balancers of billions of pounds of FMMO milk cannot come close to covering their costs under current FMMO provisions.

WCMA is aware and supportive of USDA and industry efforts for USDA itself to have the authority and funding to conduct regular, audited dairy product cost studies. A long-term solution would be to have such studies efficiently update Section 50 make allowances on a regular basis. However, this requires Congressional action both to authorize and fund the audits. It will likely take at least another year or two, if not longer, before (not yet introduced, much less passed) legislation authorizes the initiation of such audited cost studies. Following Congressional approval, a long hearing process would precede a fully developed plan for USDA plant audits. The dairy manufacturing industry simply cannot wait several more years for this solution, as plants suffer growing losses each day as a result of the current obsolete cost structure. These dated manufacturing allowances must be updated as expediently as possible using the best available means.

CONCLUSION

Current manufacturing allowances are well below the actual costs involved in manufacturing cheese, whey powder, butter, and nonfat dry milk powder. Every day that goes by means losses on the part of manufacturers who provide outlets for billions of pounds of Federal Order milk production as well as balancing services to their respective Orders. We clearly need this proposal considered at a hearing to be held as soon as possible to address these serious economic problems.

Thank you for your consideration.
Sincerely,

John T. Umhoefer
Executive Director
Wisconsin Cheese Makers Association