

Modified Additional Proposals for Federal Milk Marketing Order Pricing Hearing **American Farm Bureau Federation**

June 20, 2023

The American Farm Bureau Federation (AFBF) has nearly 6 million members in all 50 states and Puerto Rico, including many thousands of cooperative and independent dairy farmers. All of these dairy farmers are indirectly or (mostly) directly affected by the pricing provisions of the Federal Milk Marketing Orders (FMMOs). They play a crucial role in the development of AFBF dairy policy. Each of the proposals outlined and defended in the following pages is based explicitly on that policy, developed through a grassroots process in which farmers make the decisions at every step of the way.

As requested by USDA, each original AFBF proposal is outlined, with explanations of the need, the potential impacts, and how each proposal would support orderly marketing.

In addition, we support the National Milk Producers Federation's (NMPF) five proposals to varying degrees, and so we largely defer to NMPF's original petition to justify these issues being addressed in a FMMO hearing, though we claim any of them as our own in the event that NMPF withdraws said proposal. As NMPF's proposals are the starting point for setting the scope of the proposed hearing, we begin with them here.

Addressing the NMPF Proposals

Again, we support the five proposals of NMPF to varying degrees, but believe each of them provides a sound basis for introducing the respective issue to an FMMO hearing. For these, we offer only notes, largely deferring to NMPF's petition for justification and formal order language, but outlining any substantive difference in our position, with explanation for that difference.

However, we would ask USDA to consider each of these five proposals, as outlined by NMPF and with any modifications described below, to be AFBF's proposal to represent in the event that NMPF withdraws any of these proposals.

1. Return Class I mover to "higher-of" Class III or IV formula

We support this NMPF proposal as written.

As NMPF has outlined, the Class I mover based on the "average-of" Class III or IV has had terrible impacts on dairy farmers and dairy markets when the Class III and Class IV prices have substantially diverged, creating inverted Class I/Class III price relationships which result in large negative producer price differentials (PPDs) and heavy de-pooling. We believe that changes in the market could lead to similar price misalignments between Class I and Class IV in the near future, as cheese making capacity grows and cheese prices fall. For these reasons, we believe that a return to the "higher-of" formula will be important to maintaining reasonable price alignments and avoiding the chaos of negative PPDs and de-pooling in the future.

We will further address this briefly in the discussion of our proposal to end advanced pricing below, but substantially defer to NMPF's petition for substantiation.

2. Drop barrel cheese from Class III component and price calculations

We support this NMPF proposal as written.

As NMPF outlines in its proposal, barrel cheese represents roughly 50% of the volume in the National Dairy Product Sales Report (NDPSR) but is used to set prices for only about 10% of cheese in the U.S. market. Price divergence between block and barrel prices now creates a "cheddar" cheese price for use in the formulas that is not representative of the value of cheese. We expect that the elimination of the barrel price from the survey will contribute to an even greater reliance on block prices in the U.S. cheese market, further reinforcing the block price as the appropriate foundation for the Class III protein and skim milk price.

Again, we defer to NMPF's petition for substantiation.

3. Adjust Class I differentials to reflect current conditions

We support an update of the Class I differentials based on changing market conditions, consistent with the logical case made by NMPF. We agree that higher Class I prices will contribute to reducing the price misalignment of Class III or IV prices being higher than Class I and uniform prices, and so contribute to more orderly marketing. We also believe that it is important, as a matter of fairness, to implement changes, such as this one, that would tend to raise farmer prices at the same time as changes, such as make allowance increases, that would tend to lower farmer prices.

However, we also look forward to a careful review – before and during the hearing – of the data and analysis that NMPF used to set their numbers, including testimony from someone who can fully explain the economic model used. Alternatively, analysis by USDA could provide a sound foundation for the adjustment of these values. In any case, changes to FMMO pricing must be based on a solid and transparent record.

Here again we largely defer to NMPF's petition for substantiation.

4. Incorporate updated component values into Class III and IV price formulas

AFBF supports the updating of the component values in the Class III and IV skim price formulas, based on the same logic presented by NMPF. Adjusting these values will more accurately define the market value of skim milk used in the skim/butterfat markets and in Class I in all markets.

In component markets, it will ensure that Class I milk prices reflect at least the national average component value, rather than a low outdated value, which undermines the premium for Class I intended by FMMO pricing formulas, per years of FMMO hearing proceedings. This higher value for Class I will, like the adjustments to the Class I differentials, increase the Class I price, reduce the incidence of price misalignments with Class III and IV prices, reduce the incidence of negative PPDs, and so reduce

incentives for de-pooling, which undermines orderly marketing and the principle of uniform pricing in the market.

In addition, raising the value of Class III skim milk in the skim/butterfat markets will reduce the current misalignment of FMMO minimum prices for Class IV and (especially) Class III milk between those markets and bordering component markets. Today, proprietary and cooperative manufacturing plants located in FO 32 or 126, for example, have undue incentive to pool the milk they receive in FO 5 or 7, because the FMMO minimum price at an average test for that milk in a skim/butterfat order is substantially lower than the minimum price for the same milk in a component order. This incentive contributes to “pool-riding” in the deficit markets of the Southeast, and undermines the uniform price in those markets, which makes supplying those deficit markets more difficult.

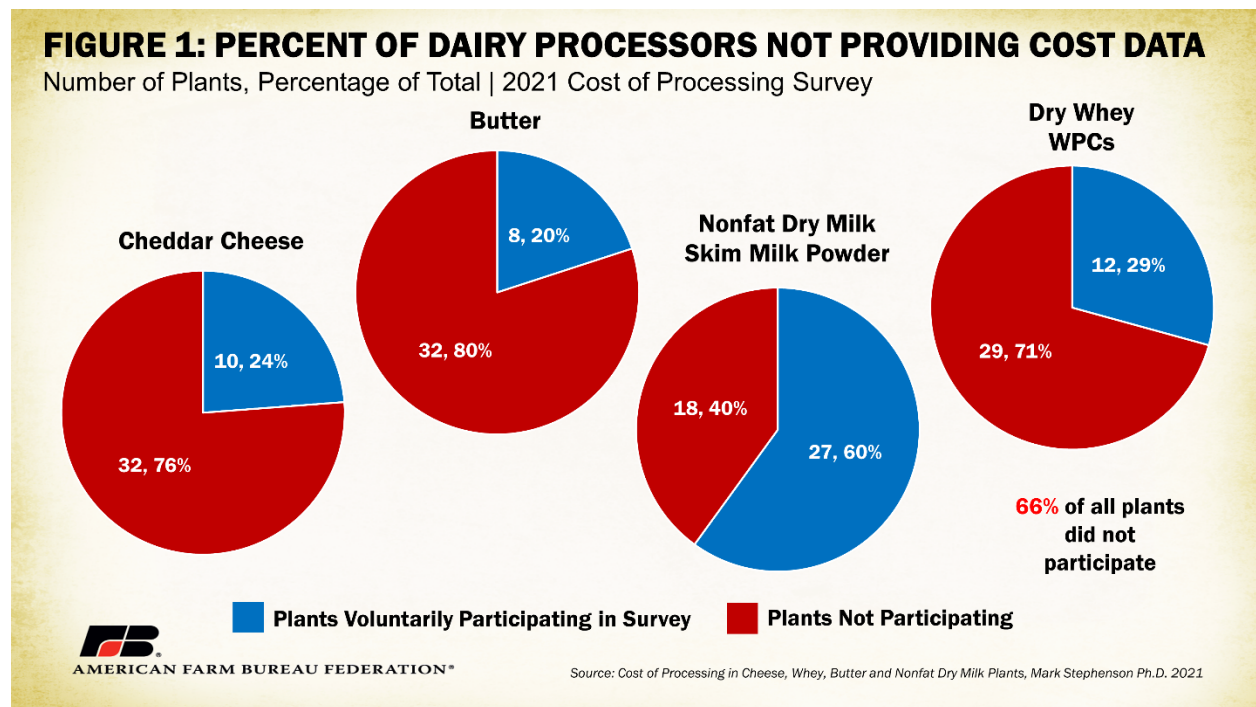
Adjusting these component values in the Class III and Class IV price formulas, therefore, will improve the orderly marketing of milk in multiple ways.

We defer to NMPF’s petition for additional justification and substantiation.

5. Adjust Class III and IV make allowances, using mandatory and audited USDA cost and yield survey

AFBF supports adjusting make allowances to reflect the changes in cost and technology, following the same general logic as NMPF’s petition. We believe, however, that such adjustments cannot be fairly undertaken except using the data from a mandatory and audited USDA survey of, at least, the plants participating in the NDPSR survey.

At the time of order reform, product formula prices were instituted using a combination of a voluntary survey and a mandatory and audited survey. (64 FR 16096, et seq.)



The voluntary survey, conducted by Dr. Stephenson, among others, and used as a primary source for order reform, was one of a series of studies that had been undertaken as a means of evaluating and

benchmarking plant costs for the benefit of the plant operators. Because that survey's purpose had not previously been the setting of regulatory parameters, there was no obvious bias in the self-selection of participants. Each participant was, presumably, interested in a full picture of costs, including seeing how they stacked up. However, more recent surveys, particularly the 2021 update conducted by Dr. Stephenson, was commissioned by USDA with the clear intention of making its results available for proposals to update the make allowance. This, unfortunately, creates a clear incentive for dairy manufacturers to be selective in their choice of participation, if not in the accuracy of their reporting. As a result, whatever value the original voluntary survey had for the original development of the make allowances in the price formulas has been substantially undermined by potential bias in the survey. The recent survey, for example, represents only 60% of the nonfat dry milk plants participating in the NDPSR, 29% of the dry whey plants, 24% of the cheddar cheese plants, and 20% of the butter plants. The conclusion is that it would be unfair to increase the make allowances based on this survey.

The mandatory surveys were those of all manufacturing plants in the state of California, conducted and audited by the California Department of Food and Agriculture (CDFA). This full accounting of processing costs was a useful component of the overall data used to set make allowances at the time of order reform because California has been the largest milk-producing state since 1993, with over 18% of U.S. production in 2022, the largest butter-producing state since about the same time, with roughly a third of current U.S. production, and the largest nonfat milk-producing state, with 44% of U.S. production in 2022. California is also the second-largest cheese-producing state, with 17% of U.S. production in 2022. The California survey represented (and represents) a large and representative sample of commodity dairy processors in its own right, and also provided an important check on the overall results from the voluntary survey. This CDFA survey could provide useful data for a make allowance adjustment, but it was discontinued in 2017, after the promulgation of an FMMO in California.

Our conclusion is that any fair update of the make allowances must be based on a mandatory and audited survey of – at least – the plants participating in the NDPSR. We believe that USDA currently has the authority to collect such a survey under the Book and Records provision of the Agricultural Marketing Agreement Act of 1937, as amended. Specifically:

“(A)ll handlers subject to an order, shall severally, from time to time, upon the request of the Secretary, furnish him with such information as he finds to be necessary to enable him to ascertain and determine the extent to which such agreement or order has been carried out or has effectuated the declared policy of this chapter...” 7 USC 608d (1)

While the funding challenges of conducting and auditing a mandatory survey may be an appropriate administrative concern for USDA, the fundamental legal authority to conduct such a survey exists, and so consideration of such a survey should be allowed within the scope of this proposed hearing.

Only a mandatory and audited survey of costs (and processing yields) can provide a fair basis for adjusting make allowances (and yield factors) within the current pricing structure, just as it has been clearly established that only a mandatory and audited survey of manufacturers' prices can provide a fair basis for setting the monthly milk and component prices used in the FMMOs.

We believe that such a survey should be conducted once every two years in order to appropriately balance the value of the data with the burden on the processors. This is close to a realistic estimate of the time it takes to undertake an FMMO hearing from petition to implementation; more frequent surveys would be unproductive, although the biannual survey could collect two years of data.

(See *California Manufacturing Cost Annual, 2016 Data*, California Department of Food and Agriculture, at: <https://www.cdffa.ca.gov/dairy/pdf/Annual/2017/ManufacturingCostAnnual2016Data.pdf>; NASS QuickStats, annual milk and dairy product production data, see <https://quickstats.nass.usda.gov/>; Munch, Daniel. Tracking Federal Milk Marketing Order Policy Developments, Market Intel report, April 13, 2023. See: <https://www.fb.org/market-intel/tracking-federal-milk-marketing-order-policy-developments>; USDA-commissioned 2021 Cost of Processing Study and associated materials: <https://www.ams.usda.gov/rules-regulations/moa/dairy/cost-of-processing>)

Additional AFBF Proposals

The following proposals are offered in addition to those proposed by NMPF, the International Dairy Foods Association, or the Wisconsin Cheese Makers Association. Each of these proposals is outlined, with explanations of the need, the potential impacts, and how each proposal would support orderly marketing.

6. Adjust yields (along with make allowances) based on the same mandatory and audited survey

Proposal: AFBF proposes that the yield factors in the Class III and Class IV component price formulas be adjusted to reflect the actual yields at manufacturing plants, based on the same biannual mandatory and audited survey upon which the make allowances should be adjusted.

As with the make allowance, any fair update of the yield factor must be based on a mandatory and audited survey of – at least – the plants participating in the NDPSR. We believe that USDA has the authority to collect such a survey under the Book and Records provision of the Agricultural Marketing Agreement Act of 1937, as amended. Specifically:

“(A)ll handlers subject to an order, shall severally, from time to time, upon the request of the Secretary, furnish him with such information as he finds to be necessary to enable him to ascertain and determine the extent to which such agreement or order has been carried out or has effectuated the declared policy of this chapter...” 7 USC 608d (1)

While the funding challenges of conducting and auditing a mandatory survey may be an appropriate administrative concern for USDA, the fundamental legal authority to conduct such a survey exists, and so consideration of such a survey should be allowed within the scope of this proposed hearing.

Only a mandatory and audited survey of (costs and) processing yields can provide a fair basis for adjusting (make allowances and) yield factors within the current pricing structure, just as it has been clearly established that only a mandatory and audited survey of manufacturers’ prices can provide a fair basis for setting the monthly milk and component prices used in the FMMOs.

We believe that such a survey should be conducted once every two years in order to appropriately balance the value of the data with the burden on the processors. This is close to a realistic estimate of the time it takes to undertake an FMMO hearing from petition to implementation; more frequent surveys would be unproductive.

Need: The current milk price and component formulas use yield factors based on a combination of a standard Van Slyke formula and evidence regarding the actual product yields at processing plants. As technology has evolved and new efficiencies have been found in the production of dairy products, those

changes should be reflected in the yield factors. This is a matter of fairness in general, but particularly if adjustments to the make allowances will reduce the regulated producer milk price. Make allowance increases without the corresponding yield adjustments will substantially understate the value of milk and components to processors and undermine the producer pay price under the FMMOs.

Impact: The exact impact of this change is unknown until survey results can be collected; however, the trends in both the voluntary surveys through 2004 and the CDFA mandatory survey through 2016 demonstrate that improvements in efficiency have substantially offset the increases in many manufacturing costs. For example, labor costs have not risen as fast as wage rates because of increasing productivity. We would similarly expect at least a partial offsetting of the impact of make allowance increases implemented under proposal 5, above, based on increasing efficiencies in conversion of milk into dairy products.

Language: The yield factors in 7 CFR 1000.50 (l), 7 CFR 1000.50 (m), 7 CFR 1000.50 (n)(2), 7 CFR 1000.50 (n)(3)(i-iii), and 7 CFR 1000.50 (o) each to be adjusted according to the results of a mandatory and audited processing cost and yield survey.

7. Universal milk check transparency requirements, including clarification of value of pooled milk

Proposal: The FMMOs currently have significant milk check transparency requirements for proprietary handlers of producer milk in section 73(e) or (f) of each order. These requirements should be 1) extended to cooperative handlers, and 2) expanded to require clear delineation of volumes, minimum order value, and actual payment for pooled and nonpooled milk.

1) The transparency required for proprietary handlers is significant, and includes, as applicable, volumes of milk and components, as well as somatic cell count; minimum payment rates under the order; an accounting for deductions; and net payments. This basic level of handler transparency should be provided to all producers, including cooperative producers. In the case of cooperative handlers, this could be considered part of the basic market information requirement as part of cooperative services: the Market Administrator could collect the market services assessment and provide formatted milk check information to producers as part of their market information services if the cooperative handler will not.

2) The information required in section 73(e) or (f) should be expanded to include a separation of pooled and nonpooled milk. This is important because it helps farmers clearly understand the relationship between the producer's actual pay price and the price for such milk if paid the federal order minimum price. Separate accounting of pooled milk (on each order on which a producer's milk is pooled) and nonpooled milk can provide a clearer comparison of the milk check bottom line to the regulated minimums.

Need: Farmers have indicated to us that milk checks often lay out the Class III value of their milk components and present the balance between their pay and the Class III value as a "producer price differential," offering the impression that the Market Administrator is responsible for a price level that is actually below the federal order minimum price. They have also indicated that milk checks often do not specify the pool status of their milk in a given month, which makes it difficult for them to understand the milk's market value and the impact of the FMMO.

Impact: These changes would have no direct impact on producer prices, except to the extent that they can make more informed decisions as suppliers to a proprietary handler or as cooperative members. They would contribute to orderly marketing by assisting farmers in understanding how the FMMO relates to them, and by allowing them to respond to more accurate price signals.

Language: The following proposed language is for an order with multiple component pricing, including a somatic cell count adjustor, as the most complicated example. We can offer language for skim/butterfat markets at a hearing.

1030.73

...

(f) In making payments to producers pursuant to this section, each handler shall furnish each producer, ~~except a producer whose milk was received from a cooperative association handler described in § 1000.9(a) or (c)~~ a supporting statement in a form that may be retained by the recipient which shall show:

(1) The name, address, Grade A identifier assigned by a duly constituted regulatory agency, and payroll number of the producer;

(2) The daily and total pounds, and the month and dates ~~such~~ milk was received from that producer;

(3) The total pounds of butterfat, protein, and other solids contained in the producer's milk;

(4) The somatic cell count of the producer's milk;

(5) The daily and total pounds, and the month and dates producer milk on this market was received from that producer;

(6) The total pounds of butterfat, protein, and other solids contained in the producer's producer milk on this market;

(7) The somatic cell count of the producer's producer milk on this market;

(8) The minimum rate or rates at which payment to the producer for producer milk on this market is required pursuant to the order in this part;

(9) The rate used in making payment if the rate is other than the applicable minimum rate;

(10) The total value of the producer milk on this market at the minimum rate or rates at which payment is required pursuant to the order in the part;

(11) The total value of the producer's producer milk in this market at the rate or rates used;

(12) The total value of the producer's milk at the rate or rates used;

(13) The amount, or rate per hundredweight, or rate per pound of component, and the nature of each deduction claimed by the handler; and

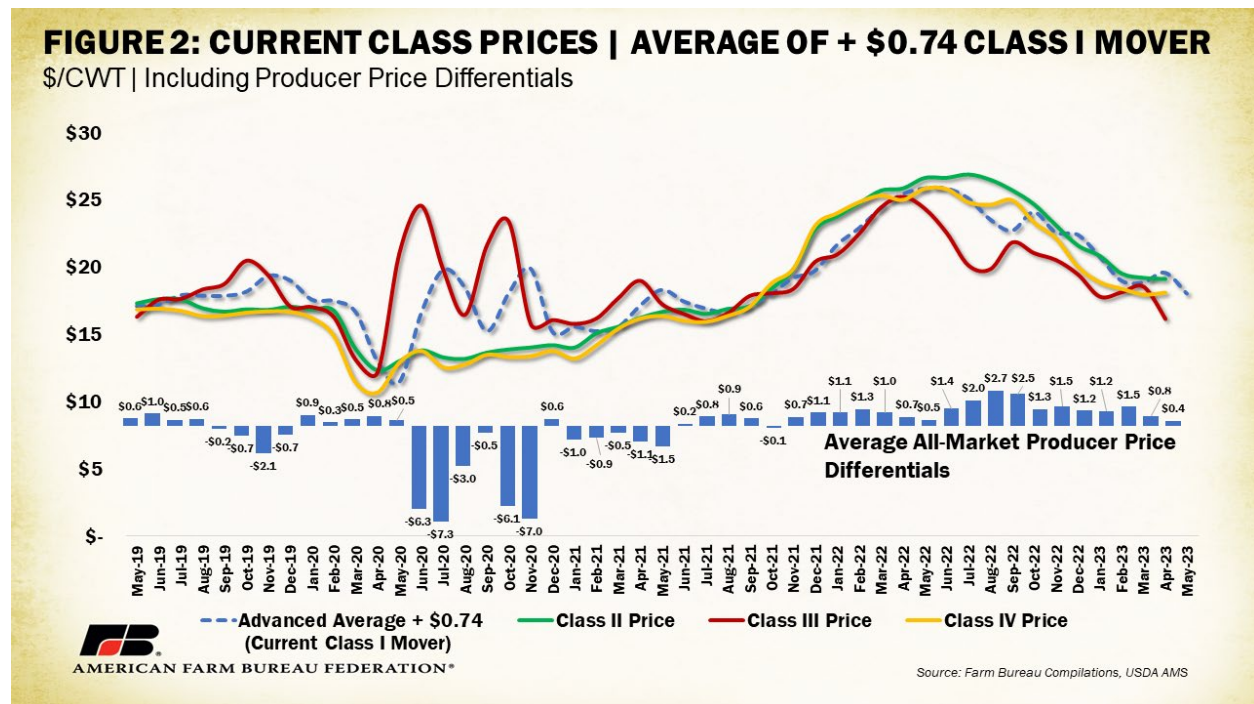
(14) The net amount of payment to the producer or cooperative association.

8. Eliminate advanced pricing of Class I milk and Class II skim milk

Proposal: AFBF proposes to end the advanced pricing of Class II skim milk and components and Class I milk and components. The Class II skim milk price would be equal to the Class IV skim milk price plus the Class II differential; the Class II nonfat solids price would be equal to the Class IV nonfat solids price plus one-hundredth of the Class II differential. The Class I skim milk price would be the higher of the Class III or Class IV skim milk price plus the Class I differential; and the Class I butterfat price would be equal to the butterfat price plus one-hundredth of the Class I differential.

Need: Under the current Class I and Class II pricing formulas, weighted average dairy product prices from the first two weeks of one month are used to calculate advanced prices used to price Class I and Class II products for the following month. So, for example, advanced prices are announced on June 22 for Class II skim milk and Class I milk delivered this July, while Class III and IV prices will not be final until August 2. This arrangement creates a long lag between when the advanced prices and current prices are announced for that same month and means that the advanced prices (Class II skim milk and components and Class I skim milk and butterfat) can be based on weekly data that is 25 to 40 days older, on average, than the basis for the "current" prices (Class II butterfat and all Class III and IV prices).

This means when market prices rally, current prices can be much higher than advanced prices, leading to low and negative PPDs. This creates an opportunity to de-pool milk from the order to benefit from the non-pooled value of the recently elevated prices (without sharing that value with the pool) and further depress the PPD.



Impact: By removing advanced pricing, all commodity prices would be announced during the same month using the same data, removing any lag time within the pricing system. Combining this adjustment with a switch back to the "higher-of" Class I mover could further reduce price spreads that contribute to a higher probability of handlers de-pooling from the marketplace. Figures 2-5 illustrate the current class price system, the current class price system including a shift to an announced Class I base pricing, the current class price system including a shift to announced Class I base pricing and a switch to the higher-of Class I mover, and what the class price system would have looked like with announced pricing and a switch to the higher-of Class I mover, respectively (all else held equal). Notably with both adjustments made, the Class I base price moves in tandem with the higher-of price between Class III and Class IV with no lag present.

These shifts would clearly reduce the likelihood of price misalignments and related negative PPDs and de-pooling.

Another impact would be the likely demand for bottlers and retailers to find opportunities to forward price. These opportunities exist in the marketplace, including off-exchange swaps, the use of derivatives based on Class III and IV futures and options, and the likely development of a Class I futures and options complex at the CME Group, based on an expected call for such from the industry.

As it is, there is a one- to two-week lag between the announcement of the advanced Class I price and the expiration of Class III and IV futures contracts that would underlie a cross-hedge. During this two-week period prior to the contract expiration, the market is absorbing new information on cheese, butter, dry whey and nonfat dry milk entering the market. Due to this uncertainty, the underlying futures prices two weeks from expiration have a volatile basis with the advanced prices. In any case, a Class I futures contract would offer greater basis certainty than advanced prices cross-hedged against Class III and IV futures.

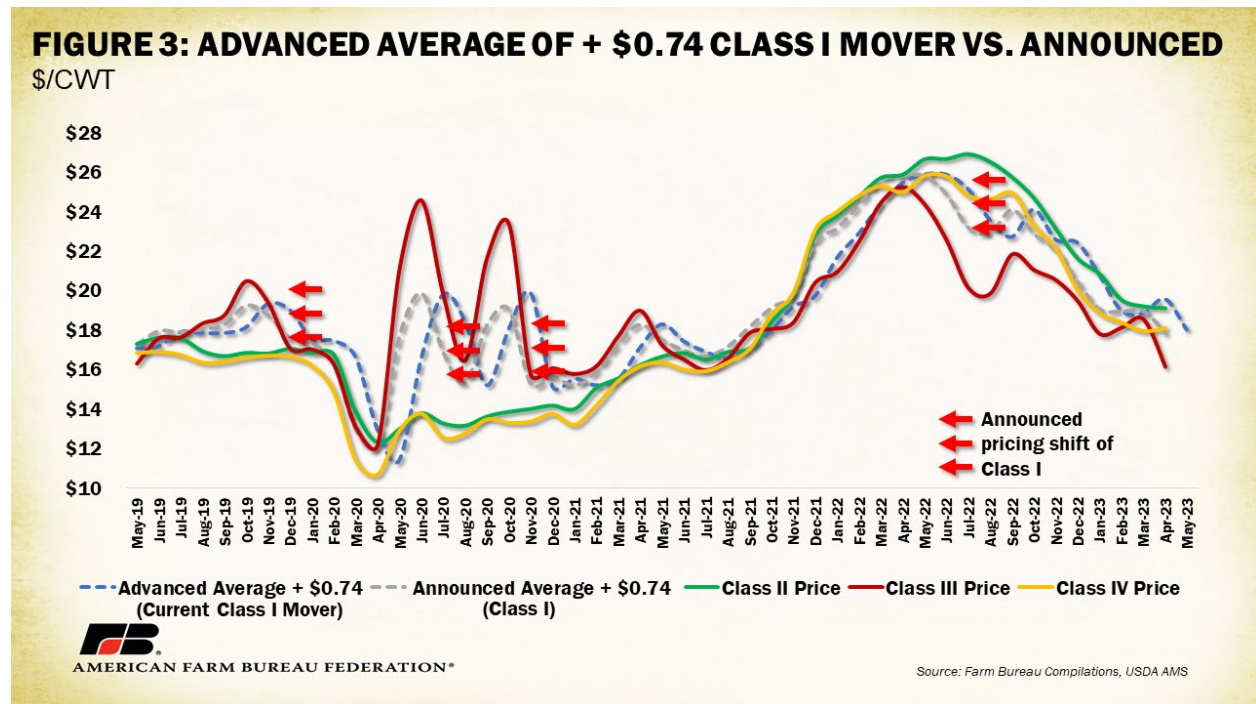


FIGURE 4: ADVANCED AVERAGE OF + \$0.74 CLASS I MOVER VS. ANNOUNCED
\$/CWT

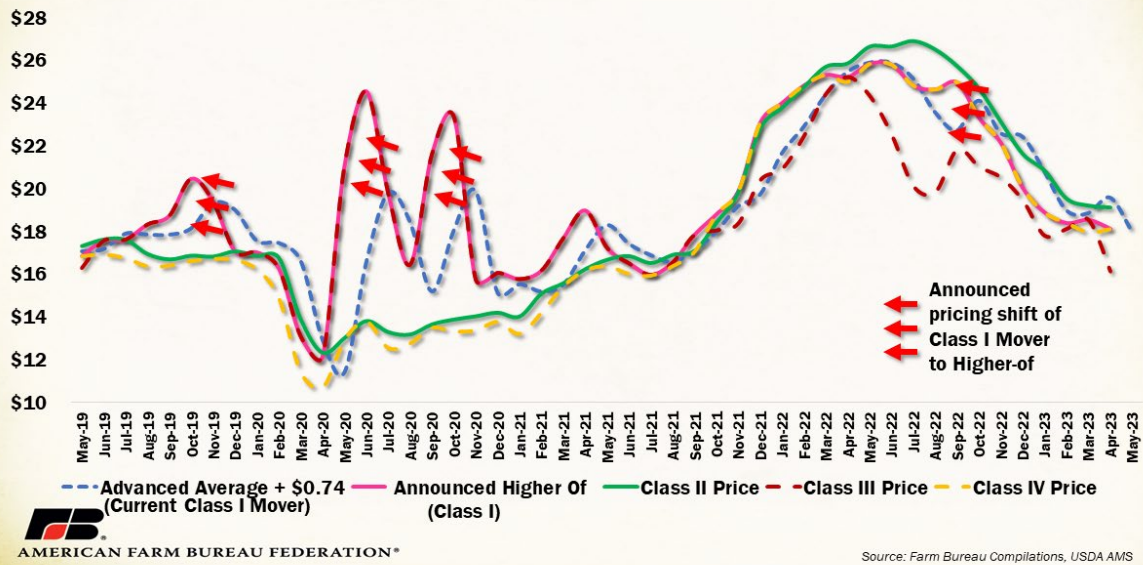
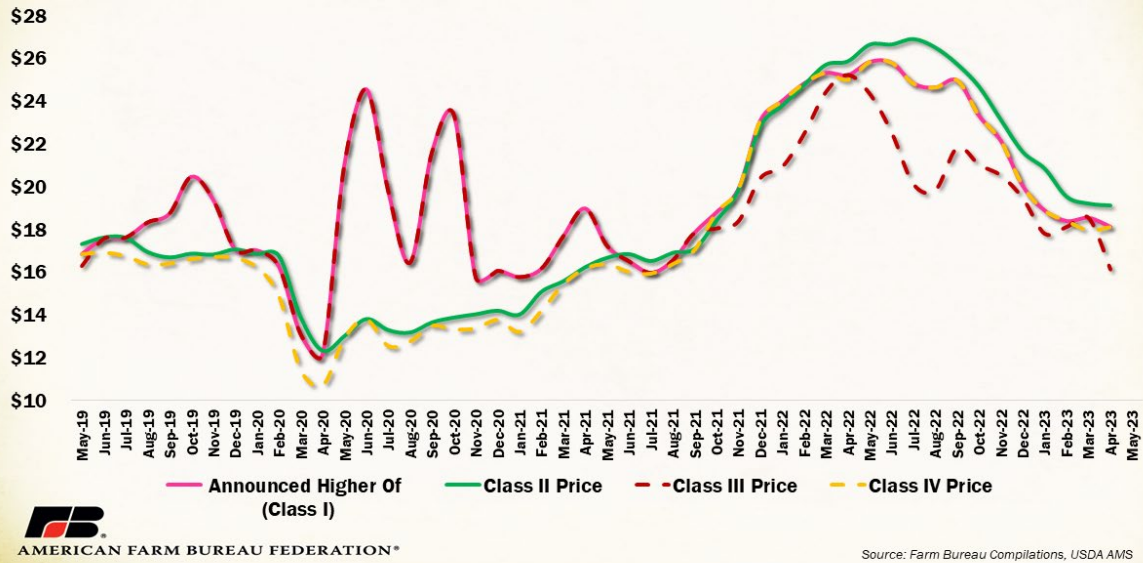


FIGURE 5: ADVANCED AVERAGE OF + \$0.74 VS. ANNOUNCED HIGHER OF
\$/CWT | Class Prices



Elimination of advanced pricing would not be expected to have a substantial impact on average Class I or overall producer prices, but it would increase average uniform prices in the FMMOs because periodic high manufacturing milk values would not be removed through pooling. During 2020, avoiding de-pooling would have retained billions of dollars in the FMMO pools, helping better maintain uniform prices among producers, rather than large differences between pooled and de-pooled milk values. This, of course, would be much more orderly marketing than what happened in the actual event.

Language:

Amend the preamble to 1000.50 as follows:

~~Class prices per hundredweight of milk containing 3.5 percent butterfat, and component prices, and advanced pricing factors shall be as follows. The prices and pricing factors described in paragraphs (a), (b), (c), (e), (f), and (g) of this section shall be based on a weighted average of the most recent weekly prices announced by the National Agricultural Statistical Service (NASS) before the 24th day of the month. These prices shall be announced on or before the 23rd day of the month and shall apply to milk received during the following month. The prices described in paragraphs (g) through (p) of this section shall be based on a weighted average for the preceding month of weekly prices announced by NASS AMS on or before the 5th day of the month and shall apply to milk received during the preceding month. The price described in paragraph (d) of this section shall be derived from the Class II skim milk price announced on or before the 23rd day of the month preceding the month to which it applies and the butterfat price announced on or before the 5th day of the month following the month to which it applies.~~

Strike 1000.50(q); amend 1000.50(b),(c), and (e), as follows:

(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 higher of the Class III skim milk price and the Class IV skim milk price-simple average of the advanced pricing factors computed in paragraph (q)(1) and (2) of this section rounded to the nearest cent, plus \$0.74 per hundredweight.

(c) Class I butterfat price. The Class I butterfat price per pound shall be the adjusted Class I differential specified in § 1000.52 divided by 100, plus the adjustments to Class I prices specified in §§ 1005.51(b), 1006.51(b) and 1007.51(b) divided by 100, plus the ~~advanced~~ butterfat price computed in paragraph ~~(q)(3)~~ (l) of this section.

...

(e) Class II skim milk price. The Class II skim milk price per hundredweight shall be the ~~advanced~~ Class IV skim milk price ~~computed in paragraph (q)(2) of this section~~ plus 70 cents.

9. Update the Class II differential with current drying costs

Proposal: The Class II differential was developed during order reform to reflect the cost of drying and rewetting milk, to reflect the higher value of Class II milk without incenting processors to dry and rewet (Class IV) milk for Class II uses. **AFBF accepts this logic and proposes to update the Class II differential to \$1.56.**

Some processors argue that powder is not rewetted for most uses, so that the (minimal) cost of rewetting is not an appropriate consideration for this calculation. For that reason, and for simplification, we propose to adopt only the cost of drying in setting the Class II differential. Ideally, this would be based on a recent mandatory and audited cost and yield survey; in the interim, however, this could be updated using the current make allowance for nonfat dry milk, together with the current nonfat solids yield factor and updated butterfat and nonfat solids tests for milk in the FMMOs. The cost of drying skim milk can be calculated then as:

$$\text{\$0.1678} \times \text{0.99} \times \text{9.4121} = \text{\$1.56}$$

or

$$\text{NDM make allowance} \times \text{lbs. NDM/lb. NFS} \times \text{avg. lbs. NFS/cwt. skim milk} = \text{cost of drying}$$

The 9.4121 factor is based on the 2022 average nonfat solids test in the FMMOs (9.03%), divided by the average skim milk test (100% - 4.06%). This relies on a butterfat test for all markets and a nonfat solids test for component markets; using the butterfat test for only component markets would raise the differential calculation, since the skim/butterfat markets have the lowest butterfat tests; so, this calculation is conservative.

Note: *The original 70-cent Class II differential was nominally based on the cost of drying condensed milk and rewetting it, presumably because dried and reconstituted Class IV milk substituted for Class II skim condensed milk first, and the differential should not be higher than the cost to convert that relatively standard Class II ingredient form into a Class IV form. Based on the last mandatory audited survey of nonfat dry milk manufacturing costs, by the California Department of Food and Agriculture, the energy costs of drying skim milk were about 3.5 cents per pound in 2016; given that the energy costs of manufacturing butter were about 1 cent per pound, we will assume that 2.5 cents of the ndm costs are direct energy costs of the drying process. Skim condensed milk contains about 3 times the skim solids as skim milk; so, producing a pound of ndm from skim condensed milk may require roughly a third of the direct energy. This suggests that the cost of producing a pound of ndm from skim condensed milk may be roughly 0.8 cents per pound lower than a make allowance calculated for drying skim milk, which would yield a Class II differential of \$1.49 per hundredweight.*

(See *Milk Component Tests by Order, Annual Summary 2022*, USDA, Agricultural Marketing Service, linked to at <https://www.ams.usda.gov/resources/marketing-order-statistics/producer-milk-components-order>; *California Manufacturing Cost Annual, 2016 Data*, California Department of Food and Agriculture, see: <https://www.cdfa.ca.gov/dairy/pdf/Annual/2017/ManufacturingCostAnnual2016Data.pdf>)

Need: This cost-based element of the Class II price formula is out of date, and no longer meets the purpose of incenting the availability of Class II milk, per USDA's logic at the time of order reform (64 FR 16104). The simple update, using the presumed cost of nonfat dry milk processing, achieves the original purpose of the Class II differential without incenting uneconomic drying of Class IV milk for price differences alone.

Impact: The impact of this change is to increase the minimum order value of Class II milk by 86 cents per hundredweight, increasing the average pool value in every market and reducing the likelihood of negative PPDs and attendant de-pooling. There were 14.2 billion pounds of Class II milk pooled in 2022; so that in a static analysis, the value of pooled milk would be increased by \$122 million. The \$1.56 differential is lower than the lowest Class I differential (\$1.60), so, combined with a return to the "higher-of" Class I price formula, maintains Class I prices above Class II in every month.

Language (including the elimination of advance pricing):

1000.50

...

(e) *Class II skim milk price.* The Class II skim milk price per hundredweight shall be the ~~advanced~~ Class IV skim milk price computed in paragraph (q)(2) of this section plus ~~70 cents~~ \$1.56.

...

(g) *Class II butterfat price.* The Class II butterfat price per pound shall be the butterfat price plus ~~\$0.0070~~ 156.

Notes: This change to the Class II differential should be made whether or not advanced pricing is eliminated for Class II skim milk.

Also, if automatic updates to the make allowance for nonfat dry milk are implemented through this hearing, the Class II differential should be updated in lockstep, with language referencing the make allowance and yield, however they may be incorporated into the Class IV milk and nonfat solids formula language. In addition, any one-time or regular updates to the component value of the Class IV milk price formula should be used to adjust the component test factor in the equation above.

10. Add 640-pound blocks to the Class III protein calculation and NDPSR survey

Proposal: AFBF proposes that 640-pound blocks be added to the cheddar cheese price calculation in the National Dairy Products Sales Report. This is consistent with dropping barrels from the survey (see above) and emphasizing blocks generally; however, it would also move the balance of blocks and barrels closer (but not close) to the actual market mix in the event that USDA decided not to remove barrels from the survey. No price adjustment is necessary to integrate these larger blocks into the survey, as every indication we have is that the two sizes are largely interchangeable in price, use, and storage.

Need: There has been a pronounced shift from 40-pound blocks to 640-pound blocks in the marketplace. Adding 640-pound blocks would provide a deeper volume to the survey immediately and would avoid the need for a hearing in the future simply to address the further dwindling of 40-pound block volume.

As NMPF outlines in its proposal, barrel cheese represents roughly 50% of the volume in the NDPSR but is used to set prices for only about 10% of cheese in the U.S. market. Divergence between block and barrel prices now creates a “cheddar” cheese price for use in the formulas that is not representative of the value of cheese.

Impact: We expect that the addition of 640-pound blocks to the survey will strengthen price discovery, avoid the potential for block manufacturers to switch between sizes to avoid and re-enter the price survey, and avoid a possible crisis of dwindling small blocks in the future. That is, a large and reliable survey volume will help avoid some sources of disorderly marketing.

A deeper survey will provide a stronger foundation for the Class III protein and skim milk price.

Language:

Add Section 1000.50(n)(1)(iii), as follows:

(iii) The U.S. average AMS survey price for 640-lb. block cheese reported by the Department for the month;

11. Add unsalted butter to the butterfat and protein calculation and NDPSR survey

Proposal: AFBF proposes adding unsalted butter to the butterfat and protein calculation. The growing volume of unsalted butter production and use in the U.S. market has meant that salted-only butter price collection in the NDPSR survey is increasingly unrepresentative of the value of U.S. butter.

Need: The NDPSR collects prices only for salted, 80% fat butter in 25-kilo and 68-lb. boxes. This only captures a small and declining share of U.S. butter production. Based on a comparison of the NDPSR

totals for a 52-week year and NASS dairy products annual reporting, butter in the NDPSR survey has fallen from 10.9% of total butter production in 2013 to 9.4% in 2022. We have every reason to believe that this trend will continue without the addition of unsalted butter. The rest of the world produces and consumes primarily unsalted butter and growing volumes of commodity unsalted butter are being used by American bakers and confectioners. Although unsalted butter was produced in small quantities in the U.S. at the time of federal order reform, its share of U.S. production and sales has grown very substantially since then and is projected to continue growing. The result of this growth is that a substantial volume of commodity butter is not included in a NDPSR survey and is increasingly underrepresented.

Impact: Incorporating the unsalted butter price into the FMMO butterfat formula will expand the base of the survey and make the survey price more representative of an evolving butter market. Collecting and publishing separate prices for salted and unsalted butter will allow for better market transparency and more orderly marketing of butter and milk. Anecdotal evidence suggests that unsalted butter is slightly more expensive than salted butter, but this may be a specialty premium that is disappearing as unsalted butter becomes more common.

Note: *Additional data will be needed for the hearing to verify the growth of unsalted butter in the U.S. market.*

Language:

(l) Butterfat price. The butterfat price per pound, rounded to the nearest one-hundredth cent, shall be the [weighted average of the U.S. average NASS-AMS AA salted and unsalted Butter survey prices](#) reported by the Department for the month, less 17.15 cents, with the result multiplied by 1.211.

12. Adjust make allowances for market balancers

Proposal: AFBF proposes adjusting make allowances for cooperatives and plants that balance the market. Make allowances are a reasonable way to provide compensation to plants that provide seasonal balancing services, based on slack capacity, measured by the difference in milk receiving between flush and short months. Two approaches are proposed, for consideration in the hearing.

First, an adjustment to make allowances in the short milk months, when plants are running below capacity, in order to partially compensate for the slack capacity, whose availability in the flush months is critical to seasonal balancing.

Second, an adjustment to make allowances are made throughout the year, in response to slack capacity during the previous short season, compared to flush season volumes.

Need: Make allowances, as they have generally been derived, often reflect the cost of processing for a plant running full all year round. The purpose of pooling milk values in the FMMOs is to share higher fluid milk values with balancing plants. Many manufacturing plants provide limited balancing or no balancing at all, running full every month. This puts true balancing plants at a disadvantage: because they are bearing the costs of maintaining slack capital and possibly less-than-fully utilized staff, they face greater costs per pound of product manufactured, particularly in short months.

Impact: A make allowance that is increased as the plant runs less than full would partially compensate seasonal balancing plants for slack capacity. The incentive to run low for a higher make allowance would

be limited by the low volume to which the make allowance was applied. The support of slack capacity during short months would, however, help incentivize plants to give up milk when it is most needed. The general support for balancing capacity is important to maintaining outlets for the seasonal flush and for orderly marketing.

Both of these pursue the same objective: supporting plants that provide true balancing. However, the market response and practical impact of both should be considered carefully before deciding on a specific approach, including a potential adjustment to the calculations proposed below.

AFBF intends to bring a more considered analysis to the hearing to better explore how plants would respond to these incentives. Of course, we also welcome USDA analysis to that end.

Language:

The make allowance for Class III and IV milk would be adjusted for any plant that receives substantially more milk in the flush season than the short season.

Alternative 1:

1000.50

...

(r) Balancing adjustment. For the months of August through December and provided that the pool plant operator requests such an adjustment, the prices of Class III and IV milk and components used in any pool plant, excluding diversions, may be adjusted by multiplying the make allowance number specified in sections (l),(m),(n), and (o) by a factor equal to the lesser of 1.5 and the following:

(1) the highest average monthly volume of producer milk received and processed at that plant over three consecutive months in the previous March through June, divided by

(2) the average monthly volume of milk received at that plant in the current month and previous month.

Alternative 2:

1000.50

...

(r) Balancing adjustment. For the months of January through December and provided that the pool plant operator requests such an adjustment, the prices of Class III and IV milk and components used in any pool plant, excluding diversions, may be adjusted by multiplying the make allowance number specified in sections (l),(m),(n), and (o) by a factor equal to the lesser of 1.5 and the following:

(1) the highest average monthly volume of producer milk received and processed at that plant over three consecutive months in the previous March through June, divided by

(2) the lowest average monthly volume of milk received at that plant over three consecutive months in the previous August through November.

13. Seasonal Class I differentials

Proposal: AFBF proposes that Class I differentials be adjusted to address seasonal differences in supply and demand. Just as there are geographic differences in the value of milk, so there are seasonal differences. Seasonal Class I pricing has been discussed for decades and, perhaps, held back primarily by the difficulty of calculations. Ideally, USDA could develop and implement seasonal Class I pricing rooted

in the analysis upon which geographic adjustments will be updated, although a rougher set of calculations could still improve seasonal balancing. By calculating location value for four quarters or twelve months, regulated milk prices can more accurately reflect the immediate market conditions across the country.

Need: In many markets, and particularly the Southeastern markets, the location value of milk can vary enormously from season to season. Milk supplies can be like an ocean, with movements ebbing and flowing in opposite directions depending on the month. Class I prices that are too high for the flush season can draw too much milk into a high Class I pool, without necessarily serving the market at all. Similarly, Class I prices that are too low in the late summer or early spring can fail to attract the basic needs of a market without balancing cooperatives bearing an undue burden. Seasonal Class I differentials can incent milk movement when and where it is actually appropriate, reduce pool riding and better supply short markets by setting the right price in the right place *at the right time*.

Impact: Effective seasonal Class I differentials will better reflect the actual market value of milk. This will better maintain and support milk supplies in deficit markets, and reduce the stress on balancing handlers, fluid handlers, and fluid retailers.

Language:

This would be implemented through three (or eleven) additional columns in the table in Section 1000.52, providing for quarterly (or monthly) differentials for each county, city, and parish.

Note: *This change will require substantial additional analysis and may require a reopening of the hearing at a later date.*

14. Extend 30-day limit to 45 days for nonfat dry milk in NDPSR

Proposal: AFBF proposes that the limit of 30 days between setting a price and shipping out the product be lifted to 45 days for nonfat dry milk in the NDPSR. This change may be best handled through the notice and comment rulemaking to amend 7 CFR 1170 to conform to FMMO changes made in this hearing. However, we believe that some discussion in this proceeding, including consideration in the preamble of the final decision, could provide a sounder basis for that eventual rule-making.

Need: A large share of nonfat dry milk and comparable skim milk powders manufactured in the U.S. are exported, and most of this ships more than 30 days after the price is set by the buyer and seller. The current NDPSR rules exclude products whose price was set more than 30 days before shipping. Some exporters believe that this is an unfair exclusion that leads them to face undue variation between the Class IV skim milk and nonfat solids price and their selling prices.

Impact: The extension of this limit would likely have a limited impact on market prices and producers but could encourage the marketing of nonfat dry milk on the world market.

- June 20, 2023