

UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

Re: Proposal to Establish a Federal Milk Marketing Order for California

Docket No. AO-15-0071

Hearing in Clovis and Fresno, California

September – November 2015

Reply Brief for National All-Jersey Inc.

National All-Jersey Inc. (NAJ) provided testimony and supporting documentation during the hearing held in Clovis and Fresno, California, and filed a post-hearing brief. Having reviewed the post-hearing briefs filed in conjunction with this hearing, NAJ is submitting this reply brief, which focuses on four topics.

Producer Price Differential (PPD)

In their post-hearing brief, the Cooperatives did not refute NAJ's testimony that a California Order should utilize the same Producer Price Differential (PPD) calculation and producer payment as the other six Federal Milk Marketing Orders (FMMOs) that are based on multiple component pricing (MCP). The existing MCP Orders calculate and pay producers the monthly PPD on a per hundredweight basis.

The Cooperatives' promulgation proposal included a provision that the Order's monthly PPD value should be distributed among the components of butterfat, protein and other solids according to their relative contribution to the Class III price during the previous fiscal year. Then producer pay prices for those three components would be adjusted each month by the amount of the PPD assigned to each component. Months with positive PPDs would adjust component values higher, and months with negative PPDs would adjust component values lower.

NAJ's PPD analysis presented during its testimony (Exhibit 82, Table 9) found that PPDs in a California Order would have been negative 43 out of the 72 months from 2009 through 2014, with an average PPD $-\$0.27/\text{cwt}$. The Cooperatives' PPD proposal would have lowered producer component values those 43 months, thus dis-incentivizing component production. NAJ's testimony (Exhibit 81) outlined numerous

reasons why the California dairy industry, producers, processors and consumers, would benefit from incentivizing component production, particularly protein. Higher protein milk results in:

1. Higher cheese yields
2. Higher protein whey, and thus higher yields of protein-standardized whey products
3. Higher yields of protein-standardized milk powders (skim milk powder and whole milk powder)
4. Less fortification needed to meet California's SNF standards for fluid milk.

Furthermore, the Cooperatives' PPD proposal would have the greatest impact on the highest component milk. Thus, producers that are doing the best job producing milk that has the highest value for the California dairy industry would be assessed the largest PPD penalty. This is counterproductive to building a more market-oriented dairy industry.

As noted earlier, the Cooperatives' post-hearing brief did not refute NAJ's PPD testimony, analysis or proposal that a California Order should utilize the same PPD process as the other MCP Orders. Therefore, if the Secretary recommends a FMMO be promulgated in California, the PPD should be implemented as it is in the other six multiple component pricing Orders, and the Cooperatives' PPD proposal should be rejected.

Mandatory Pooling

The post-hearing brief from Select Milk Producers addressed mandatory pooling. Select Milk Producers stated their position that if the Cooperatives' proposal for mandatory pooling of all manufacturing milk was recommended for a California Order, such a provision should be unique and limited to only California, just as each of the other FMMOs have unique pooling standards pertaining to diversion limits, touch base requirements and re-pooling milk that has been de-pooled milk in preceding months. The Cooperatives argue that mandatory pooling is required for a California Order because there will be little, if any, incentive for manufacturing milk to be pooled, given that PPDs will be negative most months.

The Select Milk Producers' brief referenced NAJ testimony pertaining to depooling milk in other FMMOs (Page 19 of Select's brief). NAJ testified to the fact that while other Orders did not require manufacturing milk to be pooled, each adopted provisions that limited how rapidly de-pooled milk could be re-pooled in subsequent months. NAJ's position is that strict re-pooling provisions could be effective in a California Order to incentivize manufacturing milk to be pooled.

While NAJ's analysis found PPDs will be negative most months, the relationship of Class III and Class IV prices to the Statistical Uniform Price drives the handlers' monthly pooling/de-pooling decision for Class III and Class IV independently of each other. Some months it is economically advantageous to pool Class III and de-pool Class IV. Other months the opposite is true, and still other months there is economic incentive to de-pool both Class III and IV.

To illustrate, Exhibit 9, Table 2 lists monthly Class and Component prices from January 2000 through August 2015. Looking at the subset of months included in NAJ's PPD analysis (2009 through 2014), the Class IV price was higher than the Class III price 41 of the 72 months. The Class III price was higher than the Class IV price 31 months. Given that Class III and Class IV utilization accounts for approximately 75% of milk pooled in California, it is reasonable to expect that when the Class III price is higher than Class IV, Class III will also be higher than the Statistical Uniform Price. By the same token, when the Class IV price is higher than Class III, the Class IV price will likely be higher than the Statistical Uniform Price. Those differences in prices provide very different economic incentives on whether to de-pool Class III or Class IV milk month to month. Therefore, just as with other Orders, if a California Order incorporates strict re-pooling provisions, when Class III and Class IV handlers are making their monthly pooling/de-pooling decisions, their decisions will need to be tempered with the prospect that subsequent months may have price relationships that are conducive to pooling. Being too aggressive with a de-pooling decision one month may lead to forgoing pool revenue in subsequent months should price relationships change. NAJ believes strict limitations on re-pooling milk after it has been de-pooled to be highly preferable to requiring mandatory pooling of all milk.

Prices for a California Order

The Dairy Institute of California's (DIC) proposal included a provision that a California Order use commodity price sources and component price formulas that would be unique to that Order. In its brief, Dairy Institute referenced NAJ's testimony that, "prices should be up to date", as support of DIC's proposal (Page 80). In its testimony, NAJ clearly stated its position in regards to regulated minimum pricing that would be unique to a California Order.

1. Establishing unique prices for California could lead to disorderly marketing as milk could be incentivized to move into or out of the Order due to regulated prices instead of market need, market value or marketing efficiency.

2. The issues of price discovery and make allowances may need to be updated, and perhaps even regionalized, but such changes should be done in concert with all FMMOs through a national hearing instead of on an individual Order basis.
3. If the Secretary recommends a FMMO for California which includes Class III and IV formulas specific to the Order, implementation of a Final Order should be delayed until a national hearing can be convened to afford all Orders the same consideration granted to California.

Modernize Rulemaking

The testimony and post-hearing brief from the Maine Dairy Industry Association (MDIA) recommended the Department adopt more modern rulemaking procedures and utilize informal rulemaking whenever possible. NAJ supports MDIA's recommendation.

Conclusions

The Cooperatives' PPD proposal is without economic merit, and, in fact is counter-productive to creating a more market-oriented dairy industry because it will dis-incentivize component production, particularly protein.

A California Order should not mandate pooling of manufacturing milk. Instead, the Order should follow the lead of other Orders and adopt strict re-pooling provisions for milk that has been de-pooled.

A California Order should not be structured with unique pricing, which could lead to dis-orderly marketing. The issues of price discovery and make allowances should be addressed via a national hearing.