

**STATEMENT OF ALISON L. KREBS**  
**LEPRINO FOODS COMPANY**  
**at the**  
**FEDERAL MILK MARKETING ORDER HEARING**  
**Docket No 23-J-0067; AMS-DA-23-0031**  
**Carmel, IN**  
**September 4, 2023**

**Introduction**

I am Alison Krebs, Director of Dairy and Trade Policy for Leprino Foods Company (Leprino), headquartered in Denver, Colorado. Our business address is 1830 West 38<sup>th</sup> Avenue, Denver, Colorado 80211. Leprino operates nine plants in the United States, manufacturing mozzarella cheese, whey products, and nonfat dry milk domestically, and marketing our products both domestically and internationally. All nine of the plants Leprino operates in the United States receive milk pooled in the Federal Milk Marketing Orders. Therefore, Leprino has a strong interest in the decision by USDA (“Department”) based on this hearing. For the record, Leprino also operates two plants in the UK, one in Ireland and one in Brazil, but most of our capacity is in the US.

**Expertise**

In my role as Director of Dairy and Trade Policy at Leprino Foods, I am responsible for developing the company’s policy positions and advocating those positions in appropriate forums, such as this hearing. Additionally, I am responsible for market analysis, dairy economics, and forecasting.

In addition to my current responsibilities at Leprino, I chair the Dairy and Economic Policy Committee for the Dairy Institute of California where I also serve on the Board of Directors and Executive Committee. I also serve on the Economic Policy Committee of the International Dairy Foods Association (“IDFA”) and the Policy Committee of the Wisconsin Cheesemakers Association (“WCMA”). These committees formulate their respective organizations’ positions as they relate to milk pricing policy.

My career has focused on food and agriculture since graduating with a degree in agricultural economics from the University of Wisconsin-Madison during which time I also worked on a dairy farm. Further education includes an MBA from Purdue University as well as a more recent masters in applied economics from the University of North Dakota. My professional experience has spanned animal health, commodity market analysis, agribusiness consulting, and market intelligence, with specific work in dairy, for organizations including Elanco Animal Health, CoBank, and the National Cattlemen’s Beef Association, prior to joining Leprino Foods in early-2020.

Contributing to the testimony and on the witness stand with me today is Sue Taylor, former VP of Dairy Economics and Policy for Leprino Foods. Sue has remained an “on-call” employee for Leprino since her retirement from full-time employment in 2020.

## **Testimony Principles**

### **Orderly Marketing**

My testimony not only aligns with the interests of Leprino Foods, but also closely adheres to important principles foundational to the Federal Milk Marketing Orders that are administered by the Department. I will begin my testimony by addressing four key principles on which Leprino's positions are based. First, I will discuss orderly marketing and the importance of minimum pricing, second, I will note the role of balancing supply and demand, third, I address regulation and markets for milk, and fourth, I will conclude with discussion on global competitiveness prior to discussing positions on specific proposals.

If milk prices are regulated, the concept of those prices being set at minimum levels is essential to the orderly marketing of milk. The key driver of the minimum pricing tenet is to ensure milk is priced at a market clearing level. Why does this matter? If this principle is violated, the market can end up with supplies that exceed the demand for milk – in other words, too much milk. This creates disorderly circumstances for the marketplace such as milk dumping, sustained below-order spot pricing, and co-op reblands reflecting their own manufacturing losses or the high cost of diverting surplus milk long distances to find available plant capacity. Symptoms such as these have become much more pronounced, particularly across the Upper Midwest, over the past several months (Figure 1). A broader example is the erosion of milk premiums over time (Figure 2). While other factors may have contributed, this deterioration is clearly associated with increasingly outdated make allowances and signals milk is no longer being priced appropriately across the regulated system.

An additional symptom of the potential for milk oversupply is the plethora of base-excess programs initiated as farm supplies have exceeded plant capacity. These have increased over time and are still in-place today. No doubt this has helped to reduce milk price volatility, but milk production now needs to be held in-check due to a dearth of processing capacity. Today's reality is the industry simply lacks the processing capacity to convert more milk into dairy products for Americans and for the rest of the world. While a level of investment in dairy processing is taking place within various regions and products, opportunities for US dairy are much more abundant and being lost because the regulated milk price often exceeds the market clearing value. In essence, the US industry is now resource-driven vs. market-driven. Only milk priced at market-clearing levels will drive adequate investment in dairy processing assets.

### **Balancing Supply and Demand in Federal Orders**

As a processor that buys milk to produce the dairy products to meet our customers' needs, and ultimately consumer demand, we closely analyze milk production and farm margin volatility. Simply put, without milk, Leprino Foods would fail. As is widely known, price volatility is a reality for any agricultural commodity. Specific to dairy, the existing federally regulated pricing system is designed to balance supply and demand at the farm level. It allows farms to benefit when times are good. In a similar vein, farms feel financial strain during difficult times. The system therefore signals farmers to produce more (or less) milk depending on dairy product demand. To moderate this farm-level margin risk, programs such as the Dairy Margin Coverage ("DMC") Program and Dairy Revenue Protection Program are available to support farmers through difficult times. For example, USDA has paid out nearly \$612 million in DMC payments during the first half of 2023.<sup>i</sup> In the meantime, it is important to note that Federal Order pricing policy is – and needs to be – about a longer-term view for the industry.

Manufacturers of Class III and IV products are on the flip side of the federal end-product pricing system. Processors receive a fixed allowance for converting milk into dairy products; this allowance remains unchanged regardless of market highs or lows. The biggest flaw to the current system, however, is that it is constraining capacity because the allowance for covering processing costs is now woefully outdated.

Current make allowances are based on 2006 cost data, and costs of processing have certainly changed across the 17 intervening years. I will discuss this in more depth in later testimony.

### **Regulation and Markets for Milk**

Beyond setting a minimum price for milk, regulation should facilitate farmers having markets for their milk. If sufficient processing capacity is not available within a reasonable distance to farms, transportation costs will make those farms uncompetitive. So, access to processing plants is important. For the industry to function efficiently, manufacturers must receive relevant compensation for the value they create in converting milk to dairy products. The business model must cover: the cost of processing, maintenance of existing plants, and, as needed, investment in new plants.

Consistent with principles of the current regulated milk pricing system, Leprino Foods believes regulated pricing policy alone should not put competitive entities with good business practices out of business. As such, regulation should not be used to run into the ground manufacturers who have invested in balancing assets that benefit the overall industry. Fair competition, not regulation, should determine players in the dairy marketplace.

### **Global Competitiveness**

The US dairy industry is now a full-fledged player in global dairy. Fully 18% of US milk solids equivalent is now sold overseas, nearly double the share from when a national Federal Order hearing was last held.<sup>ii</sup> While this growth in exports has been a boon for US dairy, exports have become such a large share that milk price policy is now about more than just the domestic US market and this broader perspective must be considered.

Care must be taken in updating milk pricing formulas to ensure US dairy remains competitive. Urgent action is needed to return the processing sector to financial health. Further, changes must incentivize efficient investment. If these necessities are addressed, the US industry will be poised to truly leverage its resources to become an even greater force in the global marketplace.

Given these broader comments, I will now move into testimony on specific proposals.

### **Proposal Positions**

#### **Opposition to Proposal 3: Removal of 500-Pound Barrels from the Class III Formula**

Leprino Foods Company opposes Proposal 3, put forth by the National Milk Producers Federation, to remove 500-pound barrel cheddar from the Class III formula. This proposal will both narrow the volume surveyed for price discovery and remove one of the most important milk balancing tools of the industry from a product perspective.

USDA stated in the February 7, 2013 Final Decision (p. 9275):<sup>iii</sup>

“...retaining the cheese barrel price in the protein price formula is necessary to ensure that the protein price is representative of the national cheese market. ... Eliminating the barrel price from the protein price formula would significantly and needlessly reduce the volume of cheese used in the Class III product price formula which could lead to protein prices that are not as representative of the national cheese market.”

Barrel volume is now more important today to the current milk price formula than it has been historically. Figure 3 shows the share of barrels in the National Dairy Products Sales Report (“NDPSR”) survey has

moved from representing less than half of survey cheese volume to now being the majority. Therefore, Proposal 3 seeks to remove over 50% of the volume represented in the survey, in direct conflict with the USDA's 2013 Final Decision.

Beyond its larger volume share, barrel cheddar continues to be a critical market-clearing format within the cheddar category, as demonstrated by its price volatility. Its prices can swing from a significant discount to blocks, to a premium over blocks, reflecting greater shifts in supply and demand than blocks. Removing barrels from the Class III cheese price formula removes the price that most closely reflects the supply and demand balance. Cheddar barrels are also storable and are produced and used by several buyers and sellers.

For as long as a wider spread to block price remains, barrel makers will be at a disadvantage in the marketplace as their milk cost will be higher relative to the price they receive for their product. Removal of cheddar barrels from the formulas would both shrink the survey volume and would likely result in greater production of cheddar blocks as an outlet to clear the market. This would likely add volatility to the block market, adding unnecessary stress to the US marketplace and making US cheese a less-attractive option for global buyers.

Dropping barrels from the survey would also create a presumption within the Class III formula that all cheese, including barrels, would then be priced off blocks. Again, in USDA's 2013 Final Decision (p. 9274), USDA noted that "Blocks and barrels have different supply and demand functions." So, the block and barrel markets are not expected to move in tandem, and forcing barrels to be priced off blocks could add dysfunction to the barrel market. This could decrease competitiveness for barrel makers as well as overprice the milk going into barrels, leading to disorderly marketing. Finally, as the Chicago Mercantile Exchange ("CME") is a private entity that operates beyond the scope of the Federal Order System, continuation of the CME spot barrel market could even further compound this confusion across the marketplace.

As a final note on the widening of the block/barrel spread that emerged beginning in 2017, it appears the market may be working to narrow the gap. An additional block plant came online in 2021, additional capacity is currently being ramped up in Texas, and more block capacity is being added in Kansas and South Dakota. The supply and demand balance between these two products will likely be facilitated by adequate updates to make allowances, as well.

As a result of each of the points I have stated above, adoption of Proposal 3 will be fraught with unintended consequences that will be distorting and risky to the industry, including a reduced volume of cheese in the survey from which to properly price milk. Accordingly, Leprino Foods respectfully requests that USDA reject NMPF's proposal 3.

#### **Opposition to Proposal 4: 640-Pound Blocks**

Leprino Foods Company opposes Proposal 4, put forth by the American Farm Bureau Federation, to add 640-pound block cheddar to the Class III formula. Although we are generally supportive of ensuring survey volume is robust, we are aware that others will be providing additional compelling testimony relative to the inappropriateness of adding 640-pound blocks to the commodity reference price calculation in the Class III formula.

Specifically, the 640-pound block market is largely a make-to-order market. The lack of equipment amongst buyers to handle 640s limits their sales to a narrow group of buyers. The balancing that occurs within the 640 market is through the cutting down of 640s into 40-pound blocks. Therefore, the balancing amongst 640 manufacturers is manifested in the 40-pound block cheddar market that is already embedded in the formula.

### **Opposition to Proposal 6: Mozzarella Cheese**

Leprino Foods Company opposes Proposal 6 put forth by California Dairy Campaign, which proposes to add mozzarella to the Class III protein price formula along with the broader suggestion to include virtually all dairy products in the calculation of regulated minimum prices. The proposal is flawed in numerous ways.

California Dairy Campaign's proposal and related testimony on this subject lack critical details, so it is difficult to interpret and evaluate. The proposal seeks creation of a survey for mozzarella prices with collection of data for moisture and fat composition. The proponent suggests that the mozzarella price should be combined with the surveyed cheddar prices based upon the national production of each in the prior year. Numerous errors and omissions in logic are embedded in the proposal.

#### Manufacturing Costs

The proposal does not recognize that the manufacturing cost of producing mozzarella is different than the manufacturing cost of cheddar. The proponents of Proposal 6 have not submitted any objective cost data. USDA stated in its letter dated July 24, 2023, to the proponents of Proposal 6 that "USDA does not currently have the legal authority to conduct a mandatory cost survey." Without cost data, the price data collected in Proposal 6 is worthless. While both mozzarella and cheddar can be produced in the same types of vats, the similarities end there. The manufacturing process beyond the vats differs significantly. Pasta filata mozzarella requires curd washing, heating, and mixing to achieve the product performance (such as stretch and no burning) desired in most uses of mozzarella. This requires additional equipment that is not used in cheddar manufacturing. Similarly, the pressed curd nature of cheddar production involves some equipment not used in mozzarella production. In addition to these differences, mozzarella yields differ from cheddar yields.

#### Product Composition

The proposal does not define the type of mozzarella to be surveyed or how the USDA should address the diversity of mozzarella cheese types. In contrast with the dominance of a single Standard of Identity for cheddar and the uniformity of its production, the mozzarella category is a diverse category with four distinct FDA Standards of Identity<sup>iv</sup> and a range of similar pasta filata products that are designed for a variety of food applications with wide ranging cook conditions and performance requirements. Performance in this range of conditions has been fine-tuned through years of research and development and the resulting cheese-make innovation. As a point of reference, given the diversity of product specifications, customizations, and other customer requirements, Leprino Foods produces nearly 400 separate pasta filata product codes.

In what appears to be an attempt to address the lack of uniformity in the mozzarella category, the proponent calls for collection of moisture and fat content in the mozzarella price survey but does not clarify how that data is to be used. Adjusting mozzarella prices based upon these parameters is

inconsistent with the commercial marketplace. The primary variation within cheddar barrels is the level of moisture in the cheddar. The value of barrels in processed cheese production is the solids content. The commercial marketplace recognizes that value equation by pricing barrel cheddar on a price-per-pound solid basis. This commercial marketplace practice is easily emulated by USDA by performing the same calculation to adjust the barrel price to a common moisture level (38%). The performance and functionality of mozzarella drives value within the mozzarella market. Mozzarella prices in the commercial marketplace are not mathematically adjusted based upon a price-per-pound solid basis, so a moisture-based price adjustment similar to that applied to cheddar barrels is not appropriate.

#### Product Form

The proposal fails to identify the form of mozzarella to be surveyed. Most mozzarella is sold in a form that already includes further manufacturing beyond the base bulk format. For example, mozzarella is often shredded by the first manufacturer. Additionally, mozzarella is often molded into smaller retail or food service sizes by the first manufacturer, rather than being sold in a bulk format and sold to a secondary manufacturer for further transformation. None of these formats represent bulk product appropriate for a minimum pricing system.

To provide some price data, the proponent references the delivered price from a USDA school lunch bid for string cheese to infer that mozzarella prices far exceed prices for bulk cheddar. Effectively, the string cheese price reported by USDA is a retail level price that embodies many costs beyond those of manufacturing. Further, string cheese represents a value-added form of mozzarella and requires additional equipment finely tuned to maintain dimension control. The string cheese specification associated with the quoted price is for one-ounce pieces in single-serve packaging, representing significantly more packaging than the minimal packaging associated with 40-pound blocks or 500-pound barrels. The price associated with the school lunch program is a delivered price to numerous locations for less-than-truckload quantities of product. The second price series included in the proponent's testimony is the delivered price for 5-6-pound loaves of mozzarella in mixed lots of 1,000 to 5,000 pounds (Dairy Market News). Rather than f.o.b. manufacturer price, it is delivered and in less-than-truckload quantities. Further, only an unweighted price range is provided. Finally, this product is typically used by independent pizzerias and does not represent bulk product and therefore cannot be interpreted as such. Further, this price series has been discredited as being based upon an outdated survey that is updated by changes in the weekly CME cheddar block price. Underlying assumptions incorporated into the base survey are not available, and thus the price series should be disregarded altogether.

#### Applying Overarching Principles to Classes III and IV

Class III and IV products include the market clearing commodity products that are critical to maintaining orderly marketing conditions within Federal Milk Marketing Orders. As such, the products that represent the market value of the milk in Classes III and IV must:

- represent the market clearing products within the respective categories,
- have clearly defined content specifications that facilitate matching products with their associated yields and costs of manufacturing,
- be in bulk form without value-added attributes or further processing,
- represent the value received by original manufacturers.

Therefore, product prices must represent manufacturers' value rather than distributor or retail values that incorporate additional costs in the supply chain beyond manufacturing.

#### Mozzarella Is Not Appropriate as a Class III Cheese Reference

Mozzarella cheese is not suitable as a cheese price reference for the purpose of regulated milk pricing. Further work to fill the data gaps that make Proposal 6 a non-starter in this proceeding is unwarranted. First, most mozzarella is not a market-clearing product. Most mozzarella is stored in refrigerated form and has a limited shelf life, limiting its role as a market balancer. Second, most mozzarella is not sold in bulk form. Significant volumes of mozzarella are manufactured into value-added forms, whether as shred, string, or smaller retail or foodservice loaves by the primary manufacturer. The volume of mozzarella production that is sold by the primary manufacturer in bulk format is comparatively small. This contrasts with cheddar cheese in which most shredding, cutting to retail or food service sizes, or conversion to other forms is performed by different companies than the original manufacturer. Third, the category is characterized by a lack of uniformity in compositional specifications and yields, making it difficult to accurately match prices with yields and manufacturing costs.

#### Cheddar Remains the Most Appropriate Class III Cheese Reference

Cheddar cheese remains the most appropriate representative cheese within the Class III formula because of several factors. First, cheddar is the cheese most often produced to clear the market of surplus milk, due to its storability. Use of cheddar prices is consistent with the need to set a market-clearing price within the regulated minimum milk pricing system. Second, large volumes of cheddar cheese are sold in bulk form, either as 40 pound or larger blocks or 500-pound barrels, providing price transparency for significant volumes of the base commodity. Third, a single product specification (21 C.F.R. § 133.113) and common manufacturing processes facilitate associating prices with yield and manufacturing cost factors related to the same product account for virtually all cheddar production.

#### Cheddar Is Representative of Broader Commodity Cheese Values

Bulk cheddar cheese remains representative of broader commodity cheese values. Margins for the most generic bulk forms of other cheeses are forced to converge with cheddar margins over time as companies seek profit opportunities by adjusting their capacity to produce the higher margin products.

Over the last several decades, many cheddar plants have been converted to mozzarella production where the profitability of mozzarella production exceeded that of cheddar cheese for sustained periods. Some companies maintain flexible plant capacity so that they may produce cheddar or mozzarella, depending upon comparative profit opportunities on a shorter-term basis. The ultimate result is that margins for basic mozzarella and cheddar converge over time.

Figure 1

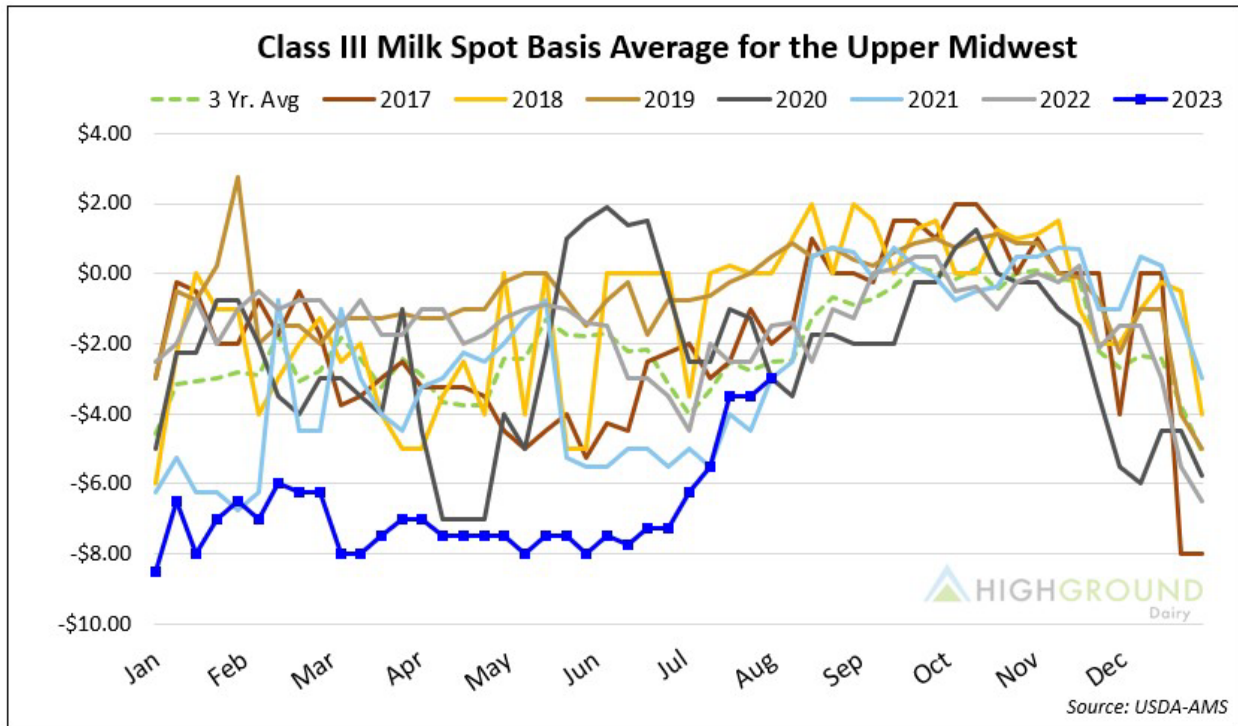


Figure 2

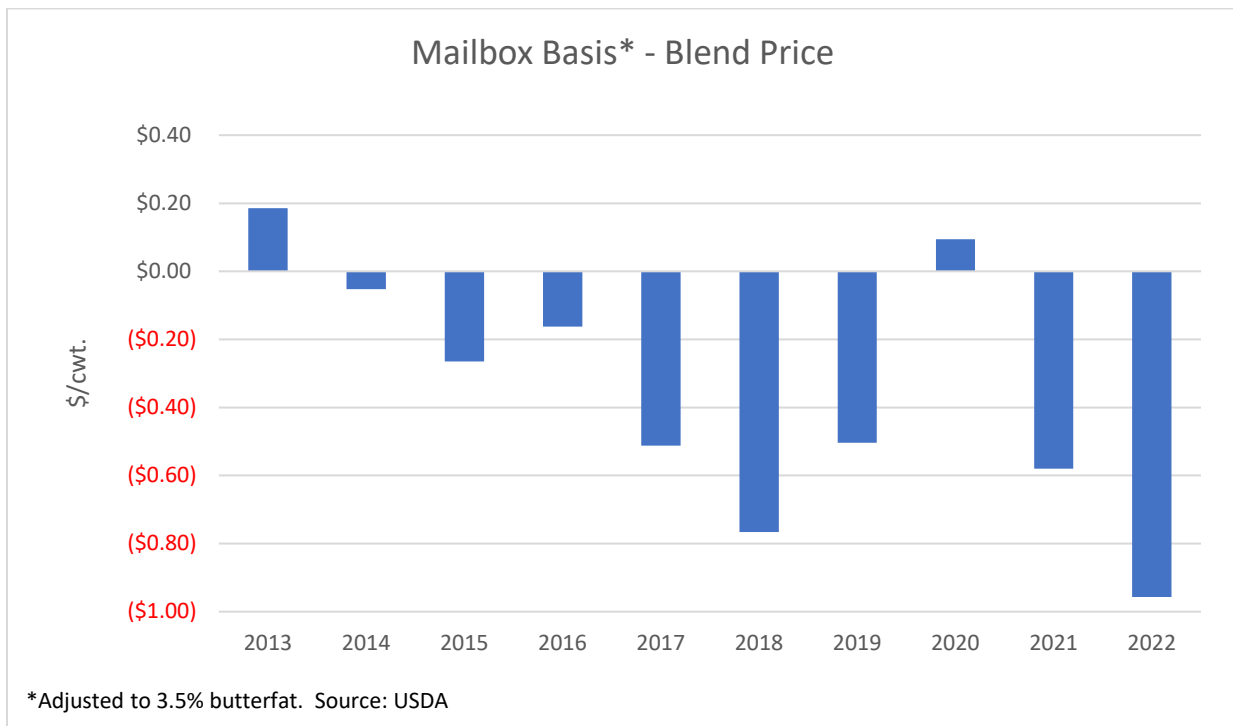
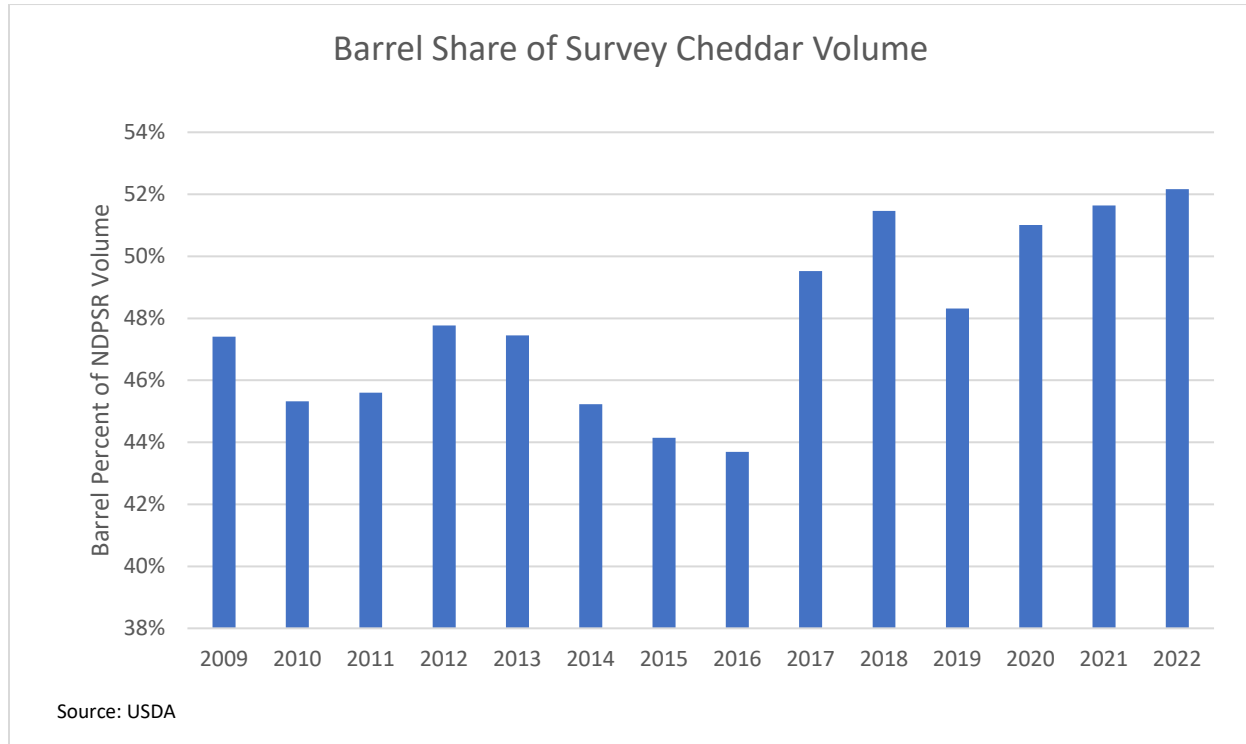




Figure 3



<sup>i</sup> <https://www.fsa.usda.gov/programs-and-services/dairy-margin-coverage-program/program-enrollment-information/index> (Data updated July 3, 2023).

<sup>ii</sup> U.S. Dairy Export Council: <https://www.usdec.org/research-and-data/market-information/top-charts-x1507>.

<sup>iii</sup> USDA AMS Final Decision, February 7, 2013: <https://www.regulations.gov/document/AMS-DA-07-0026-0025>; Federal Register Volume 78, Number 26.

<sup>iv</sup> Code of Federal Regulations, Part 133: Cheeses and Related Cheese Products: <https://www.ecfr.gov/current/title-21/chapter-I/subchapter-B/part-133> (133.1555-8).