

UNITED STATES DEPARTMENT OF AGRICULTURE  
BEFORE THE SECRETARY OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE

**In re:**

Milk in the Northeast and Other Marketing  
Areas

7 CFR Parts 1000 *et seq.*

Docket No. 23-J-0067;  
AMS-DA-23-0031

**CARMEL, INDIANA  
AUGUST 2023**

**TESTIMONY OF AURORA ORGANIC DAIRY, PART 1  
REGARDING NATIONAL HEARING ON  
FEDERAL MILK MARKETING ORDER PROPOSALS**

September 16, 2023

## **I. BACKGROUND**

### **A. PERSONAL BACKGROUND**

My name is Cammie Garofolo, and I am the Chief Financial Officer at Aurora Organic Dairy. I am responsible for accounting, information technology, risk, and FMMO reporting and compliance. I have been in the dairy industry for 17 years, and in the organic industry for 25 years. I have a Bachelor's Degree in Business Administration from the University of Missouri and a Master's Degree in Economics from the University of Colorado.

### **B. COMPANY BACKGROUND**

Aurora Organic Dairy is a vertically-integrated supplier of organic fluid milk and butter to national retailers. Aurora Dairy started as a conventional dairy producer in the mid-1970s. In 2003, we became Aurora Organic Dairy and converted all our farms to 100% organic production and began exclusively supplying the organic private label market. Today we own and operate four different dairy farms in Colorado and Texas. Our corporate headquarters address is 1919 14<sup>th</sup> Street, Suite 300, Boulder, CO. We also operate two extended shelf life / aseptic fluid milk processing plants, one in Colorado (pooled on the Central order) and the other in Missouri (partially regulated). Our products are sold in all 50 states.

## **II. UNIQUE ASPECTS OF THE ORGANIC FLUID MILK MARKET**

The organic dairy market is different than the conventional market. In 2022, approximately 55% of organic milk was utilized into Class I<sup>1</sup> as compared to 27% for the FMMOs. There was very little organic milk utilized into Class III and Class IV, whereas 64% of FMMO milk was utilized in these classes last year.<sup>2</sup>

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<sup>1</sup> As estimated by MIG's expert, Sally Keefe.

<sup>2</sup> *Market Summary and Utilization 2022 Annual Report*, U.S. Dep't of Agric., Agric. Mktg. Serv., <https://www.ams.usda.gov/sites/default/files/media/2022AnnualPriceandPoolReport.pdf> (last visited August 15, 2023).

As the organic milk category has developed since the Organic Foods Production Act (“OFPA”) of 1990, one of the fundamental challenges has been growing and balancing supply. Organic milk is legally different, segregated from conventional milk, and its legal requirements mean it is more costly to produce both at the farm and in a processing facility. For example, organic dairy cows must be fed a diet of 100% certified organic feed and graze on organic pastures. It takes three years to transition conventional land to organic crop production. This means organic milk is generally not produced unless a producer has a co-op buyer or a fixed contract at a premium that justifies the business decision to convert to organic production. As a result, organic processors have had to develop milk supplies with producers years into the future, or risk there would be no organic milk for growth. Conversely, the creation of organic milk years in advance also carries with it the risk of disposing surplus milk at an extraordinarily destructive loss due to the extra cost of producing it. Both organic processors and producers take a large risk that a sufficient future market will exist by entering into an organic contract. Thus, organic dairy farmers not only carry all of the same challenges and risks of conventional farmers, but they also carry the cost of organic certification and compliance, a more narrow subset of buyers in the market, and higher risks of disposing milk at an immense loss if the market does not exist. And the Federal Order system exacerbates these risks by depriving organic parties of equal access to risk management tools.

Aurora chose to integrate production and processing to manage these risks. By investing in our own farm production, we could ensure the supply we need would be available. By investing in our own processing, we could ensure access to the Class I manufacturing we needed. Still, these investments were not enough to meet the organic balancing challenge because of the lack of risk management tools available to conventional participants in the Federal Order system. For this reason, Aurora also invested significantly in extended shelf-life processing and product warehousing to enable internal balancing of production. We commonly hold finished product inventories - and the related working capital – equal to 14 – 21 days of sales or more to manage the above risks; far more than the 2 to 3 days most conventional HTST Class I processors carry.

For the organic supplies we source from contract producers, the contracted volumes are purchased on a highly regular basis. To assure these future supplies, we have also provided assistance to support the organic conversion and expansion of some of these producers. Under such contracts, producer and processor agree to make and purchase fixed weekly volumes, sometimes adjusted for the seasonality of production, which must be balanced through our product inventories. However, a contract organic producer outside of a co-op relationship typically has little or no way to provide a Class I processor priority or flexibility in shipped volumes. If they do not have a sufficient contract to sell all of their production, they either find another contract customer for their remaining supply or consider the extremely costly step of reducing their herd and their milk production.

Pricing for these contracts is based upon the cost of certified organic production and the competitive market for organic milk. These producers' milk checks are in no way related to classified pricing under the Federal Orders or driven by their Class I processor's obligation to the FMMO producer settlement fund. Although the final price for organic milk to regulated Class I processors includes the required obligation to the pool, it does not benefit the organic producer directly or through the intended risk management benefits.

Because organic milk is not legally interchangeable with conventionally produced milk, changes in conventional production volumes do not impact these balancing risks for organic producers and processors. Extra conventional milk cannot fulfill organic milk demand and any localized conventional milk deficit does not create economically viable uses for organic milk. This in mind, the treatment of organic milk and conventional milk as identical under the Federal Orders provides unequal risk management benefits to organic participants and sends incorrect pricing signals to conventional participants.

In sum, these investments in farm production, value added fluid milk processing and the related inventory management show that extremely significant financial resources are needed to balance the organic fluid milk supply chain.

### III. SUPPORT FOR MIG PROPOSALS

I am a member of the Milk Innovation Group (“MIG”) and support its proposals at this hearing. I am here today to testify on MIG’s Proposal 20.

#### A. Proposal 20: MIG’s Class I Differential

USDA should accept MIG’s Proposal 20 and reduce the current Class I differential from \$1.60 to \$0.

##### 1. It is not appropriate to include \$0.40 for Grade A status in the differential.

With respect to the Grade A component of the Class I differential, we do not see a reason to compensate producers effectively both in the Class III and IV formulas and again in the Class I differential for maintaining Grade A status. As a fluid milk processor, we cannot receive Grade B milk. I am not aware of any organic Grade B milk even available in the marketplace or used by any other FMMO regulated operation. Again, it is clearly nonsensical for organic milk processors to compensate conventional producers for a Grade A milk premium when we already require and compensate our organic producers at a premium to regulated minimum pricing for meeting the same Grade A requirement under contract. Including payment for Grade A status in the Class I differential is a double counting and must be eliminated.

##### 2. It is not appropriate to include \$0.60 for balancing in the differential.

With respect to the balancing component of the Class I differential, we bear all of our balancing costs as conventional and organic milk are not interchangeable and the FMMO system does not provide any mechanism for me to balance my organic milk supply. This is most glaringly obvious when we are short of organic milk – the FMMO has zero capability of fulfilling our extra needs. The so-called benefit for Class I processors of FMMOs is assuring a supply of fluid milk – FMMOs cannot and do not fulfill this mission as to organic milk.

As a processor of organic milk, we have to forecast demand long into the future and to have sufficient milk we have to err on the side of being long, not short. If we are short, there is nothing we or our producers can do about it because we cannot substitute conventional for organic

milk, there are no organic milk balancing plants with utilization to shift from other classes, and the lead time for additional organic milk supply is years long.

Because of this, we often are long and have to balance ourselves and utilize a variety of tactics:

- First and foremost, we balance by producing extended shelf life and aseptic products with long code dates. The code date on our products ranges from 65 to 240 days. On average, we carry about 14 days of sales in inventory to balance but this can increase to 25 days or more on certain products when we are balancing extra milk supply. A typical conventional Class I plant can commonly carry a small fraction of this inventory and successfully remain balanced.
- Our second tactic to balance is to divert some of our supply to be produced into storable organic milk powder, for which we must find our own markets. We pay a premium to process powder due to the segregation required for organic products and the size of the production run, which is small by conventional standards. We have no guarantees of access to conventional drying facilities. Often the cost of tolling and the milk hauling alone is more than conventional NFDM prices would yield.
- And as a last resort we dump milk or deliver for animal feed. The cost of a load of organic milk is approximately double that of conventional milk due to the higher cost of organic production.
- Selling organic milk into the conventional spot market is generally not an option for us because it would violate the supply commitments conventional processors and coops have and require a substantial and unsustainable discount to the lowest classified price.

Aurora has invested significant capital in our facilities to assist with balancing our milk supply. The capital cost for our extended shelf life processing and filling equipment was estimated to cost three times more than HTST equipment, and the cost for our aseptic processing and filling equipment was five times more than HTST equipment due to the complexity and sterilization needed to achieve the long shelf life. In addition, we have invested capital for 22,000 pallets of cold storage inventory balancing capacity within our two plants, which is not typical of an HTST fluid milk plant.

We do not take the position that the processor always carries the cost of balancing alone. Of course, our producers carry the cost of balancing in certain circumstances – a fact we know from our own experiences. We produce the majority of our milk supply from our own farms. And if our supply imbalance is extended, we will make changes to our farm operations to reduce supply. Some examples are that we will change the frequency of milking, adjusting rations, drying cows early, or reducing our herd by culling cows. All of these changes increase our costs to produce milk. Our contract producers have the same balancing risks at times.

However, the FMMO's currently assume that the producer always carries the cost of balancing, and that is not the case. As detailed above, Aurora often carries the expenses of balancing organic milk within its unique processing operations. For that reason, it is inaccurate and over-compensating the pool to compensate conventional producers \$0.60 per organic hundredweight of Class I processed for balancing expenses. The same is true for conventional Class I processors when their producer or coop negotiates the cost of balancing services into the farm gate milk price. Either way, the FMMOs must not skew the reality of the situation here, which is that "balancing costs" have no place in any minimum Class I differential.

**3. It is not appropriate to include \$0.60 for incentivizing Class I service in the differential.**

With respect to the incentive component of the Class I differential, we have been able to obtain a sufficient milk supply because we have invested the capital and taken the financial risk. We have built the dairies ourselves and we have provided support to others in developing organic supply for us. The FMMO system has not provided any incentive for attracting additional organic milk into Class I. In fact, the FMMO system creates an unnecessary burden on the organic fluid milk market, both for producers and processors because our substantial monthly contribution to the producer settlement fund goes nearly exclusively to the conventional market. Any more expense we pay into the FMMO system just means less capital available to invest in supply growth, product innovation, or balancing facilities. In fact, paying more across the board to producers does

not create market incentives for more production of organic milk which has historically been a growth segment within the fluid milk category. All it does is require organic processors to pay more money into a pool to be shared amongst conventional farmers. Such a scenario depletes resources and capital needed in the organic sector to support organic producers and operations. It also creates an incentive to produce more conventional milk, and since demand for conventional fluid milk is declining, it is sending the wrong market signal. This undoubtedly has contributed to the milk dumping we all hear about.

#### IV. CONCLUSION

The health of Class I is in jeopardy, and we must implement policy changes that will improve it, not hurt it. Annual Class I milk volume has declined 18% over the last ten years alone. Consumers have many different choices in store, and we want them to choose fluid milk, not non-dairy alternatives.

We must have a system that encourages innovation within fluid milk to meet evolving consumer tastes and to reverse the negative trend. But these innovations are discouraged by rules that treat legally different milks the same and fail to appropriately recognize the manufacturing investments necessary to create greater consumer choices.

DATED this 16<sup>th</sup> day of September, 2023.

By /s/ Cammie Garofolo  
CAMMIE GAROFOLO