Chip English (D.C. Bar No. 386572)
chipenglish@dwt.com
DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Suite 500 East
Washington, D.C. 20005
Telephone: 202-973-4200
Facsimile: 202-973-4499

Ashley L. Vulin (Oregon Bar No. 145454)
ashleyvulin@dwt.com
DAVIS WRIGHT TREMAINE LLP
560 SW 10th Avenue, Suite 700
Portland, Oregon 97205
Telephone: 503-241-2300
Facsimile: 503-778-5299

Attorneys for Fluid Milk Innovation Group

UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

In re: Milk in the Northeast and Other Marketing Areas	7 C.F.R. Parts 1000 *et seq.* Docket No. 23-J-0067; AMS-DA-23-0031

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW SUBMITTED BY MILK INNOVATION GROUP

Chip English
Ashley L. Vulin
1301 K Street NW
Suite 500 East
Washington, D.C. 20005

Attorneys for Milk Innovation Group

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main □ (202) 973-4499 fax

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main □ (202) 973-4499 fax

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main □ (202) 973-4499 fax

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main □ (202) 973-4499 fax

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DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main □ (202) 973-4499 fax

I. INTRODUCTION

This Brief of Proposed Findings of Fact and Conclusions of Law is submitted on behalf of the Milk Innovation Group ("MIG"). This matter comes before the United States Secretary of Agriculture upon the original requests of the International Dairy Foods Association ("IDFA"), Wisconsin Cheese Makers Association ("WCMA"), and National Milk Producers Federation ("NMPF"), and then related proposals from other interested parties.

The members of MIG are: Anderson Erickson Dairy Company ("AE"); Aurora Organic Dairy ("Aurora"); Crystal Creamery ("Crystal"); fairlife, llc ("fairlife"); Horizon Organic Dairy ("Horizon"); HP Hood LLC ("Hood"); Organic Valley|CROPP Cooperative ("OV|CROPP"); Shamrock Foods Company ("Shamrock"); Shehadey Family Foods, LLC ("Shehadey") (Producers Dairy Foods, Inc; Model Dairy, LLC; Umpqua Dairy Products Co.); and Turner Dairy Farms ("Turner"). MIG members, Anderson Erickson Dairy Company Turner Dairy Farms, Crystal Creamery, and Shehadey Family Foods are small businesses as defined by the Small Business Administration.[1] *See* Hearing Ex. 454 (MIG/AE Ex. 17), at 2 (Testimony of Warren Erickson); Hearing Ex. 271 (MIG/Turner Ex. 12), at 2 (Testimony of Chuck Turner); Hearing Ex. 267 (MIG/Crystal Ex. 13), at 2 (Testimony of Jacob Schuelke); and Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 2 (Testimony of Jed Ellis). Additionally, an estimated 99.6% of farmer members of OV|CROPP would qualify as small businesses. Hearing Ex. 472 (MIG/OV|CROPP 65), at 2 (Testimony of Dave Hardy); Hearing Tr. 11061:26-11062:2, Dave Hardy (October 19, 2023).[2]

[1] 13 C.F.R. § 121.201 (NAICS code 311511) (dairy products manufacturer is a "small business" if it has no more than 1,150 employees).

[2] 13 C.F.R. § 121.201 (NAICS code 112120) (dairy farm is a "small business" if it has under $3.75 million in average annual receipts).

DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

For the reasons described herein, MIG requests USDA adopt Proposals 15[3] and 20, and that USDA reject Proposals 1, 2, 13, 16, 17, 18, 19, and 21.

II. EXECUTIVE SUMMARY

In this United States Department of Agriculture ("USDA") Federal Milk Marketing Order ("FMMO") amendment proceeding, dairy farmer interests ask the Agricultural Marketing Service ("AMS") to further increase pool obligation burdens on Class I processors by amending certain sections in the FMMOs. USDA has authority, when appropriate, to act amend FMMOs to serve the public interest generally, to assure a fluid milk supply for consumers, and to stabilize milk markets for dairy farmers. USDA fulfills these public interest duties within the strict purposes of the Agricultural Marketing Agreement Act ("AMAA") and by relying on the guiding principles and precedent set by it in prior decisions applied to changed market conditions.

In the 25 years since FMMO Reform culminating in the rules published on April 2, 1999 ("FMMO Reform"),[4] the world, and in particular the U.S. dairy industry, has changed dramatically. As USDA-Agricultural Marketing Service ("AMS") approaches the monumental task before it after 11 weeks of hearings spread over 49 days, the paramount issue is that "modernization" of the 85 year-old New Deal program known as FMMOs cannot simply mean more of the same—or worse, a return to the past. NMPF and American Farm Bureau Federation ("AFBF") argue that modernization means raising minimum prices to Class I (and, as to AFBF, Class II) processors, focusing on factors not directly regulated by AMS, including increased farm production costs (captured indirectly in the Class III/IV formulas) and transportation costs (captured in the Class I price surface) since 1998, excluding any examination or concern for the health of Class I fluid sales. This simplistic, price enhancing approach ignores the elephant in the room – the declining Class I industry. NMPF and AFBF also assume that just because USDA *can*

[3] In the alternative, MIG requests USDA adopt Proposal 14.

[4] Milk in the New England and Other Marketing Areas, 64 Fed. Reg. 16026 (Apr. 2, 1999).

DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

raise minimum Class I prices, that it follows that USDA *should* raise those prices. They are wrong for many reasons.

First, under the Agricultural Marketing Agreement Act of 1937 ("AMAA") Congress charged USDA to set minimum prices at a level that will bring forth an adequate supply of milk for fluid use. With that in mind, and only with the possible exception of the three Southeastern FMMOs,[5] there is overwhelming evidence that there are abundant milk supplies for all uses, let alone just for Class I. USDA can lawfully employ the legal standard of "revenue neutrality," as preached by NMPF and AFBF. Moreover, even NMPF's economic expert, Dr. Scott Brown, concluded that no matter what action USDA takes, milk prices paid to dairy farmers will return to equilibrium at current levels over time. In exchange for this admittedly immaterial producer pay increase, NMPF is asking USDA to actively interfere with supply and demand market signals. Interference that, in the long-run, will harm farmers by encouraging milk production not called for by the marketplace (surplus that will end up in the lowest-priced class, pulling down prices with it) and hamstringing Class I's ability to grow and thrive. So, one must ask, why would USDA consider additional market disrupting amendments that can only serve to further destabilize both farmer pay prices and Class I sales?

Second, Class I prices at current levels (and certainly at higher levels) actually frustrate the service of the Class I marketplace, not support it. Given the significant decline in Class I consumption, the changes in order utilization, and the overall growth of manufacturing classes, Class I differentials no longer serve their original purpose of supporting service of the fluid marketplace. The current system makes Class I suppliers the ultimate losers, not the winners. Even producers testified that, under the current system, they have decreasing incentive to supply Class I processors. Adding more money to the pool cannot fix this issue with today's utilization levels. Instead, Class I processors need more ability to pay their suppliers directly. USDA needs

[5] *See infra* pp. 207-08.

DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

to recalibrate the balance between Class I pool obligations and over-order premiums by shifting to a more market-driven approach.

Third, as stated most succinctly by Dr. Mark Stephenson, a long-time Ph.D. economist specializing in dairy economics, today USDA is asked to solve "Class I problems" in a "Class III world." Simply put, USDA cannot conclude, as it long has and as presumed by Congress in 1937 with the passage of the AMAA, that Class I is the most "profitable" (*United States v. Rock Royal Co-op., Inc.*, 307 U.S. 533, 550 (1939)) use for milk. Dr. Stephenson's empirical analysis demonstrated that for large portions of the county, milk is more valuable when used for cheese (instead of fluid milk). Current FMMO pricing provisions are built upon the opposite assumption, and so must be reexamined.

Fourth, another major assumption underlying higher Class I prices is that consumer demand for fluid milk is inelastic. The newest and best evidence belies that assumption. Until 2023, no one had genuinely compared fluid milk elasticity with the vast array of consumer choices in beverages – juices, water and non-dairy drinks trading on milk's name. Dr. Oral Capps provides dramatic and compelling evidence that fluid milk demand is, in actuality, genuinely elastic. Adoption of NMPF and AFBF proposals will raise consumer prices, reduce fluid milk demand (creating more pressure on low margin fluid milk processor's use of plant capacity), **and** reduce pay prices to dairy farmers. This is a lose, lose, lose scenario. USDA must not adopt solutions that aggravate declines in the fluid milk segment of the dairy industry.

Fifth, as conclusively demonstrated by the International Dairy Foods Association in its Brief filed February 13, 2024, dairy farm costs of production are already implicitly recognized by USDA in setting minimum prices for Class III and Class IV. NMPF's attempts to introduce evidence about costs of production for Class I differentials attempts to double count the same costs already found in the ultimate Class I price.

Sixth, even if USDA were to consider farmer costs, increasing Class I prices will not result in long-term financial gains for dairy farmers. NMPF's own expert affirmed the very outcome

DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

MIG warns here if USDA were to maintain or even increase prices. As Dr. Brown concluded from his study, all of NMPF's proposals on Class I will raise Class I prices significantly and, in turn, raise blend prices in the short-term. Hearing Ex. 421 (NMPF Ex. 60), at 8 (Testimony of Scott Brown). But even Dr. Brown concluded that, if USDA adopts all five of NMPF's proposals, the "U.S. all milk prices are $0.09 per hundredweight higher in the first year of the analysis relative to baseline ***but moderate as milk production grows relative to the baseline***." *Id.* at 10 (emphasis added). This concession arises from the unavoidable fact that higher Class I prices will lead to more production, production that when used by the manufacturing classes will counteract the Class I price increases and depress farmer pay prices.

Seventh, export markets for the dairy industry barely existed in 1998; now 18% of U.S. milk is used for exported dairy products. When USDA raises Class I prices, fluid sales decline (even NMPF witness Dr. Harry Kaiser for NMPF agrees that fluid milk consumption will go down[6]), and then that milk not processed as Class I will most likely be Class IV. Given that Class IV makes up a significant portion of exports, that means U.S. fluid milk consumers are subsidizing exports and consumers outside U.S. This cannot be in the U.S. public interest under the AMAA for U.S. consumers to subsidize sales outside the U.S. This result also begs the question of whether raising Class I prices could violate U.S. trade obligations. NMPF has made no effort to prove otherwise.

Eighth, NMPF's drum beat demand for an immediate return to the so-called "higher-of" Class I pricing formula, ignores both that an equivalent compromise option exists and that the dairy industry as a whole, and Class I processors specifically, use commodity markets to hedge their price risk. The prevalence of hedging and risk management in the dairy market is a major change since FMMO Reform. A return to the past would interfere with this critical, nascent and

[6] It is worth noting that NMPF's expert on the elasticity of fluid milk demand, Dr. Harry Kaiser, did not consider the impact of lost consumption as to where milk would go and how the issue would affect uniform minimum pricing. Hearing Tr. 1664:20-23, Harry Kaiser (August 31, 2023).

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

growing market mechanism. USDA has no authority to use FMMO minimum prices to interfere with the marketplace beyond setting minimum prices that must still permit the market to operate.

Ninth, organic and extended shelf-life milks were barely registering back in the 1990s (the National Organic Program was established at the end of 2000 although the enabling statute dates to 1990). These specialty milks could not have been considered adequately by USDA during FMMO Reform. And these specialty processors simply do not fit into the rigid framework of Class I pricing for many reasons discussed herein. Unless USDA exempts or otherwise gives special treatment for organic and similarly-situated specialty milks, USDA cannot set general Class I prices at levels based upon assumptions that all milk is the same. This concern is especially acute here as the FMMO system cannot fulfill its basic duties to organic Class I plants. FMMOs do not have any performance standards or other incentives to deliver milk when needed that are applicable to and effective for organic milk. The uncontroverted hearing testimony is that organic dairy farmers are already paid well over the FMMO minimum prices and that the monthly pool obligation is simply a payment from the organic industry to the conventional market. The monthly pool obligation borne by organic Class I processors is money that cannot be paid to organic farmers and instead is shared in a pool where the majority of participants are conventional farmers whose milk is not interchangeable with organic milk. The FMMO system is a burden on organic Class I processors' ability to obtain fluid milk, not the other way around; in order to meet the AMAA's requirements, USDA must address the organic issue.

Significant market developments since FMMO Reform means USDA must take an modern, adaptive, and more market-driven approach to FMMOs. Modernization does not mean "raise prices" it instead means recognizing all the industry structural changes and adapting minimum pricing to those changes. When USDA applies all these changes, it should conclude that Class I prices should not be increased relative to the value of other uses of milk. Proposals 1, 2, 13, 16, 17, 18, 19, and 21 should be denied. Proposals 15 and 20 should be adopted.

DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

III. FINDINGS OF FACT

MIG includes in the arguments section of its briefing a multitude of facts and evidence from the multi-week hearing that USDA should consider and adopt in its rulemaking process. But MIG presents here a non-exclusive summary of key facts that USDA should adopt as the foundation of any policy determinations.

A. Summary Of Key Facts

USDA should adopt the following facts as true when setting FMMO policy from this hearing. For ease of reference, to support each contention, MIG includes citations to both record evidence and where such supporting record evidence can be found in the brief. However, given the interrelated nature of the facts here and extensive evidence introduced, MIG would also direct USDA to its brief more generally to support each of these facts.

- **Class I utilization has declined since USDA adopted FMMOs, and since USDA last considered national Class I prices during FMMO Reform.**
    - *See infra* pp. 150-52.
- **Class I consumption has declined since USDA adopted FMMOs, and since USDA last considered national Class I prices during FMMO Reform.**
    - *See infra* pp. 152-53.
- **Projections indicate Class I consumption will continue to decline.**
    - Hearing Tr. 1660:5-13, Harry Kaiser (August 31, 2023) (testifying that milk consumption amongst young people is "fairly significantly lower than it was in 2013. And that is the largest milk-consuming cohort, and . . . that is explaining part of the reason why . . . average milk consumption per capita for the whole population has declined."); *Id.* 1661:24-28 (the looming decline in consumption is compounded by the general presumption that fluid milk consumers lost at an early age are more difficult to regain).
    - Hearing Tr. 5964:2-22, Chuck Turner (September 28, 2023) (discussing MilkPEP data showing expected continued declines unless a new approach can be found).
- **Raising Class I prices will result in a net decline of Class I purchases and consumption.**
    - *See infra* pp. 19-32.

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

- Hearing Tr. 10973:2-4, Chuck Turner (January 18, 2024) ("[E]veryone's numbers say that increasing the milk price is going to decrease sales, so that's not controversial.").

- Hearing Tr. 10973:5-13, Chuck Turner (January 18, 2024) ("[T]he increased prices the last year and a half or two years actually caused our sales to go down volume-wise, and that people definitely traded down from gallons to half gallons.").

- Hearing Tr. 11145:24-26, Cammie Garofolo (January 18, 2024) ("[P]assing a penny along in any product to a retailer is not a simple thing.").

- Hearing Tr. 1661:21-23, Harry Kaiser (August 31, 2023) (Q" "[H]ow will higher prices bring more of those teens back to fluid dairy?" A: "It won't.").[7]

- Hearing Tr. 10902:2-6, Tim Kelly (January 17, 2024) ("Price increases reduces Class I demand, and certainly reduces profitability, and takes away from my ability to invest in the value-added items, which I think every dairy farmer wants me to continue to invest in.").

- **Class I plants are closing.**

  - Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 6-7 (Testimony of Jed Ellis) ("USDA ERS data shows the number of fluid milk plants decreasing from 2,216 in 1970, to 605 in 1990, and 332 in 2010. In the last four years, the two largest Class I bottlers have both filed bankruptcy"; also discussing that when Shehadey acquired the Dean Foods Model Dairy facility in Reno, the only other bidder intended to turn the plant into a parking lot).

  - Hearing Tr. 5964:2-22, Chuck Turner (September 28, 2023) (recounting how at a recent Pennsylvania conference, attendance by processors dropped from 35 to 4, with 40 suppliers trying to figure out how to market to that small group).

  - Hearing Tr. 3007:3-6, Dairy Farmer James Jacquier (September 11, 2023) ("We significantly lack processing in the Northeast. We significantly lack it. There's a lack of investment going on.").

  - Hearing Ex. 33 (USDA Ex. 33) (listing 264 distributing plants in 2010 and 216 distributing plants in 2023).

[7] In the same testimony, Dr. Kaiser agreed his testimony was that "fluid milk processors can absorb . . . the entirety of the increase in the price of milk by passing it on to retailers." Hearing Tr. 1666:2-6, Harry Kaiser (August 31, 2023). The inconsistencies in NMPF's picture of the broader Class I market is further illustrated by Dr. Kaiser's admission that, based on declining sales on fluid milk, retailers are likely to give up shelf space previously occupied by fluid milk products to competing beverages and that such loss "would be consumer driven." *Id.* 1667:15-26; *see also id.* 1668:16-19 (agreeing that when retailers' sales of fluid milk go down, retailers will fill shelves with more water or plant-based beverages).

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

- Hearing Ex. 47 (USDA Ex. 47) at 16 (listing 399 pool plants in 2000); Hearing Ex. 48 (USDA Ex. 48), at 16 (listing 354 pool plants in 2005); Hearing Ex. 49 (USDA Ex. 49), at 15 (listing 334 pool plants in 2010); Hearing Ex. 50 (USDA Ex. 50), at 15 (listing 312 pool plants in 2015); Hearing Ex. 51 (USDA Ex. 51) at 15 (listing 311 pool plants in 2020); Hearing Ex. 52 (USDA Ex. 52), at 14 listing (289 pool plants in 2022).

- **Of the Class I plants that remain, cooperatives own more Class I plants today than either proprietary or retailer owners.**

  - Hearing Ex. 443 (MIG Ex. 64C Corrected) (Testimony of Sally Keefe) (cooperatives own approximately 50% of Class I processing operations, compared with 30% owned by proprietary and 20% owned by retailer-captive).

- **Under the AMAA, cooperatives (including those that own Class I plants) are entitled to reblend the proceeds of their milk to their dairy farmers. Proprietary Class I processors regulated under the FMMO system must pay the full minimum price.**

  - Hearing Tr. 2561:15-2562:20, Christian Edmiston (September 7, 2023) (when reblending, Land O'Lakes is not actually required to pay the full price to farmers, and can reduce its actual payments to farmers to cover losses where the regulated price of milk is at a level which does not allow Land O'Lakes to operate its plant at a profit).

  - Hearing Tr. 5977:13-26, Chuck Turner (September 28, 2023) (testifying that he is personally aware that at least some farmers do receive less than the blend price when cooperatives reblend).

  - Hearing Ex. 271 (MIG/Turner Ex. 12), at 5 (Testimony of Chuck Turner) ("We are now competing with fluid milk plants owned by cooperatives that have the option of reblending to reduce volatility for their customers. The very cooperatives that own the fluid plants that I compete with are now proposing to raise Class I prices that will dictate the prices of their competitors, like me. As a small, family-owned business, this is difficult to compete with.").

  - Hearing Tr. 11273:22-25, Jacob Schuelke (January 19, 2024) ("Dairy farmers oftentimes share their milk checks with me from farms who ship to the other nine powder plants in the state. Based on those checks, you can infer that they are not paying Class IV for milk.").

  - Hearing Tr. 2348:4-7, Kristine Spadgenske (September 6, 2023) ("[T]he benefit of being the member of—a farmer member-owner—of a cooperative is that when there is depooling, DFA does pass that revenue back on to the dairy farmer.").

  - Hearing Ex. 481 (MIG/Shehadey Ex. 24A), at 7 (Testimony of Jed Ellis) ("These farmers have been very vocal about their true take-home pay and the amounts that

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have been deducted from their checks to cover cooperative administrative fees and, in their opinion, to help with the cost of building new manufacturing facilities. The deductions they say they face are substantial amounts of money. Similarly, we are paying significant over order premiums that we purchase milk from, so it is hard for us to reconcile the disparity between the amounts we pay and the net pay price the farmers receive."

- Hearing Tr. 7481:25-7482:1, George teVelde (October 6, 2023) ("Since then I have seen my own price occasionally go up when Class IV depools since it's such a heavily Class IV position, and they do pay somewhat of a premium for that. Of course, since it is a cooperative, they are not obligated to pay at all[.]").

- **The market power disparity between producers and processors that existed during the inception of FMMOs no longer exists today.**

  - Congressional Research Service, *Federal Milk Marketing Orders: An Overview*, at 2 (June 15, 2022) (When the FMMO system was established in the 1930s, local handlers were seen as having "asymmetric market power over producers that resulted in unfair buying practices.")[8]

  - Hearing Tr. 10932:11-15, Tim Kelly (January 18, 2024) (no disparity in market power today that justifies requiring Class I processor to pay market-wide balancing subsidies).

  - Hearing Tr. 9613:7, Ed Gallagher (December 5, 2023) (DFA is the largest Class I processor in the country—and they are a supplier).

- **Over-order premiums are an effective mechanism for negotiating prices above the federal minimum price and ensuring supply for the Class I marketplace.**

  - Milk in the New England and Other Marketing Areas; Decision on Proposed Amendments to Marketing Agreements and to Orders, 64 Fed. Reg. 16026, 16113 (Apr. 2, 1999) (under adopted Class I pricing structure, "over-order premiums will remain useful for allowing the market to find the final value of Class I milk").

  - Hearing Tr. 11316:5-19, Tim Doelman (January 19, 2024) (the over-order premium structure allows processors to "deal in real time with the marketplace.")

  - Hearing Tr. 6010:6-8, Chuck Turner (September 28, 2023) (Turner utilizes premiums to pay for differentiation).

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[8] Official notice was taken for Congressional Research Service, *Federal Milk Marketing Orders: An Overview* June 15, 2022. *See* Ruling: Official Notice Taken, Docket No. 23-J-0067; AMS-DA-23-0021, In re Milk in the Northeast and Other Marketing Areas (March 20, 2023); *see also* Hearing Ex. 508 (MIG Ex. 68).

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- Hearing Tr. 11316:5-19, Tim Doelman (January 19, 2024) (Manufacturers of value-added fluid milk products rely on over-order premiums to "help dictate what special attributes" they need in their milk.).

- Hearing Tr. 11276:2-6, Jacob Schuelke (January 19, 2024) (For example, in Southern California—which has lost almost 80% of its milk supply in 80 years—processors have adjusted from operating in a robust manufacturing sector to one that now imports milk from 100 miles away. Yet, "no one noticed, because over-order premiums work.").

- Hearing Ex. 501 (IDFA Ex. 65), at 2 (Testimony of Steve Galbraith) ("At times, we struggle to get milk to certain Saputo facilities that are not located in the traditional 'milk sheds.' The marketplace has a mechanism that helps us get milk to where we need it, when we need it by paying a larger over-order premium. The over-order premium is not promulgated nor implemented through regulatory means. . . . The free market and the use of over-order premiums will help bring our milk production closer to the demand.").

- Hearing Tr. 11572:11-27, Steve Galbraith (January 29, 2024) ("So the point is, why would we need to structurally increase [the Class I differential] when that [market-based over-order premiums] dynamic works?").

- **Over-order premiums ("OOPs") are common in the marketplace.**

  - Class I processors consistently affirmed that they pay over order premiums.

    - Hearing Tr. 10741:23-26, Warren Erickson (January 17, 2024) (affirming it pays over order premiums).

    - Hearing Ex. 457 (MIG/Hood Ex. 21), at 4 (Testimony of Michael Newell) ("Currently Hood pays over order premiums on all of our milk.").

    - Hearing Tr. 11226:24-11227:10, Jed Ellis (January 19, 2024) (Shehadey pays OOPs to every supplier, every day of the year. And these payments are in terms of dollars, not cents.).

    - Hearing Tr. 10919:26-10920:4, 10894:10-25, Tim Kelly (January 17, 2024) (Shamrock currently pays OOPs, in the range of $1.50 to $2.00; "It has not been hard for them [cooperatives] to collect over-order premiums in our market. Arizona, we are – they are the lone co-op, United Dairymen of Arizona. They are the only co-op. And I will tell you, in our last agreement, we have – we have seen increases as high as fourfold and – on the over-order premium. That's a lot of money.").

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- Hearing Tr. 11274:16-26, Jacob Schuelke (January 19, 2024) (Crystal pays its suppliers a base premium plus a quality premium on top of minimum Class I prices).

- Hearing Tr. 11331:23-25, 11326:23-11327:20, Tim Doelman (January 19, 2024) (fairlife pays its suppliers over-order premiums, accounting for food safety/quality, milk attributes, service, and balancing).

  - Cooperatives corroborated those statements.

    - Hearing Tr. 8038:10-15, 8040:5-25, Calvin Covington (October 11, 2023) (every agreement that Southeast Milk has contains an over-order premium).

    - Hearing Tr. 2694:15-16, Matt Johnson (September 7, 2023) (DCMA testified that it negotiates with processors to collect over-order premiums).

    - Hearing Tr. 8122:5-18, Robert VandenHeuvel (October 11, 2023) (100% of CDI agreements have an over-order premium, and the typical supply agreements range from two to four years).

- **Contrary to Class I, Classes III and IV utilization and consumption have grown since USDA adopted FMMOs and since USDA last considered Class I pricing formulas during FMMO Reform.**

  - Hearing Tr. 5687:27-5688:7, Sally Keefe (September 27, 2023); Hearing Ex. 265 (MIG Ex. 9B), at 2 (Testimony of Sally Keefe) (In 2000, Class III utilization was at 42.76%, and Class IV utilization was at 7.68%. In 2022, utilizations for Class III and Class IV rose to 53.94% and 9.63%, respectively.) (September 27, 2023).

  - Hearing Tr. 2465:27-2466:1, Peter Vitaliano (September 6, 2023) ("Cheese processing capacity is one aspect of the U.S. dairy industry where significant new assets are being added on a regular basis.").

  - Hearing Tr. 11259:18-24, Jacob Schuelke (January 19, 2024) (citing declining utilization of Class I in the marketplace and the increasing prominence of manufacturing classes in the marketplace as two contributing factors causing disincentive to service Class I).

  - Hearing Ex. 171 (NMPF Ex. 15), at 2 (Testimony of Paul Bauer) ("Since 2006, our production volume has increased 53% in cheese output to 2022.").

  - Hearing Ex. 252 (NMPF Ex. 87), at 2 (Testimony of Chris Kraft) ("Colorado's milk supply and cow numbers have increased considerably since 2005, but this growth occurred to supply a large cheese plant to which we have contract supply obligations.").

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- **Exports have also grown in recent years and now make up approximately 20% of milk use.**

    - Hearing Tr. 5687:27-5688:7, Sally Keefe (September 27, 2023).

    - Hearing Ex. 229 (NMPF Ex. 30), at 2 (Testimony of Peter Vitaliano); Hearing Tr. 4694:21-4695:7, Peter Vitaliano (September 19, 2023) (testifying that exports are fairly significant now, and that about 80% of exports are skim milk ingredient products (i.e., skim milk powder, nonfat dry milk, whey, and other ingredients used to reconstitute dairy products)).

    - Hearing Ex. 238 (NMPF Ex. 32), at 7 (Testimony of Sara Dorland) (the United States exported approximately 77% of all nonfat dry milk and skim milk powder produced, compared to 21% of cheese).

    - Hearing Tr. 5361:20-24, Sara Dorland (September 26, 2023) (demand from international markets is "typically reflected in our Class IV price.").

    - Hearing Tr. 2010:23-24, Mike Brown (September 5, 2023) ("Exports is becoming a bigger part of sales, which are volatile.").

    - *See infra* pp. 153-54.

- **As opposed to declining Class I sales, milk production has increased since FMMO Reform.**

    - Hearing Ex. 435 (IDFA Ex. 61), at 6-7 (Testimony of Joseph Balagtas) (Milk production since 2000 has grown by 37%.).

- **The market has more than a sufficient amount of farm milk for fluid use.[9]**

    - *See infra* pp. 185-87.

    - Milk in the Appalachian, Florida, and Southeast Marketing Areas, Recommended Decision, 88 Fed. Reg. 46016, 46027 (July 18, 2023) ("[t]he UMW [Upper

[9] The Southeastern FMMOs are an outlier, both in terms of supply and utilization. Those three orders have the highest Class I utilization amongst all FMMOs. Hearing Ex. 248 (NMPF Ex. 34), at 4 (Testimony of Calvin Covington). There were arguments they do not have an adequate supply of farm milk year-round to meet consumer fluid milk demand, and supplemental milk from other orders is procured to meet the demand. *Id.* at 3. These unique circumstances do not justify raising the Class I price nationally, however. Given the utilization, a smaller Class I price increase would meet the needs of the Southeastern FMMOs quickly. An overall Class I price increase affecting other markets would raise the price too high in the Southeastern orders, and potentially make it more difficult for those orders to attract and retain the milk needed.

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Midwest] order has abundant milk supplies locally to meet Class I demand, with a 2022 average Class I utilization rate of 7 percent.").

- Hearing Tr. 3441:9-10, Mark Stephenson (September 12, 2023) ("[T]here's plenty of milk available for Class I needs.").

- Milk in the New England and Other Marketing Areas; Decision on Proposed Amendments to Tentative Marketing Agreements and Orders, 58 Fed. Reg. 12634, 12646 (Mar. 9, 1993) (USDA has said "a reserve milk supply equal to 30 to 35 percent of the total milk in the market appears to be a reasonable reserve requirement.").

- Hearing Tr. 11350:1-6, Mike Brown (January 19, 2024). (if the reserve metric of 30% is used, the FMMO milk supply currently exceeds Class I needs).

- Hearing Tr. 3441:9-10, Mark Stephenson (September 12, 2023) ("[T]here's plenty of milk available for Class I needs.").

- Hearing Tr. 11350:9-14, Mike Brown (January 19, 2024) (current milk supply is "almost double the amount percentage-wise that you would need to meet [Class] I and [Class] II, and it is double if you include all milk, not just pooled milk.").

- Hearing Ex. 487 (MIG/fairlife Ex. 26), at 3 (Testimony of Tim Doelman) ("There is an adequate milk supply available for Class I needs. We have not had any issues serving the Class I milk.").

- Hearing Tr. 5828:10-13, Jacob Schuelke (September 28, 2023) ("I live in the Central Valley of California. From Modesto to Tulare is the largest and most dense milk shed on the entire planet. There is plenty of milk to go around.").

- Hearing Tr. 10969:25-27, Chuck Turner (January 18, 2024) (milk supply in Pennsylvania is "[a]bsolutely" sufficient to meet Turner's needs).

- Hearing Tr. 5097:19-25, Chris Hoeger (September 25, 2023) (Prairie Farms agrees that there is sufficient supplies of milk to meet fluid needs).

- Hearing Tr. 5042:28-5043:19, Craig Alexander (September 25, 2023) (Upstate Niagara similarly testified that there is currently a sufficient supply of milk for fluid use in the areas where it operates, and it has not heard of anyone else in Federal Order 1 currently having trouble obtaining a sufficient supply of milk for fluid use.)[10].

[10] Illustrating the current sufficiency of the fluid milk supply, the only example the Upstate Niagara witness could give was a call hearing back in the 1980s, and the witness admitted that it has been "quite some time" since a shortage occurred. Hearing Tr. 5044:3-7, Craig Alexander (September 25, 2023).

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- Hearing Tr. 6262:18-19, Sarah Lloyd (September 29, 2023) ("We have more and more milk. So we're losing a lot of farms, but we just have more and more milk.").

- Hearing Ex. 246 (FMMO 1 Request to Reduce Fall Month Shipping Percentages) (*see infra* pp. 199-202) (suppliers have recently asked to reduce the shipping percentage requirements).

- **Milk production at the farm level has outpaced processing capacity in many areas of the country.**

  - Hearing Tr. 10969:28-10970:15, Chuck Turner (January 18, 2024) ("[O]ur farmers can usually grow faster than we grow. So, you know, our real problem, you know, is more like slowing them down.").

  - Hearing Tr. 9619:1-5, Ed Gallagher (December 5, 2023) ("In general, Michigan's milk supply is greater than the demands of milk from milk plants in the state of Michigan, and so on a regular basis, milk from Michigan leaves . . . the state to meet demands in other parts of the United States, principally in Ohio.").

  - Hearing Tr. 6263:124-27, Dairy Farmer Sarah Lloyd (September 29, 2023) ("We need to curb overproduction, because what we're having is, we're producing all of this milk, it sometimes isn't finding a home in our different orders, and it's also glutting it out and pulling the prices down.").

- **Basic supply and demand principles mean that if the price of milk increases, production of farm milk will also increase.**

  - *See* Milk in the New England and Other Marketing Areas, 64 Fed. Reg. 16026, 16116 (Apr. 2, 1999) (discussing witness testimony that setting differentials at too high of a level would result in artificially induced overproduction).

  - Hearing Tr. 2612:15-17, Steve Schlangen (September 7, 2023) ("From a number of situations, I think around the country, you know, we had record milk prices last year, which always leads to more production.").

  - Hearing Tr. 3057:24, Christopher Wolf (September 11, 2023) (higher prices will incentivize farmers to produce more milk; longer term, farmers' willingness to produce milk is going to be dependent on being paid a price that will cause them to produce).

- **More milk production means more milk to powder and exports, milk uses which generally result in lower pay prices for farmers.**

  - Hearing Ex. 421 (NMPF Ex. 60), at 10 (Testimony of Scott Brown) ("Higher milk production increases dairy product production relative to the baseline and drives wholesale dairy product prices lower relative to the baseline. Lower dairy product

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prices reduce Class II through IV milk prices by $0.033 to $0.39 per hundredweight relative to the baseline.").

- Hearing Ex. 246, at 7 (FMMO 1 Request to Reduce Fall Month Shipping Percentages: "Class IV, the balancing class in the order is ever increasing due to higher milk production and ever decreasing Class I sales in the order. The figures for February 2018 indicate that the Class I volume was the lowest ever for the month and the Class IV volume among the highest in the month.").

- Hearing Tr. 1979:12-18, Christian Edmiston (September 5, 2023) (Land O'Lakes testified that "Class IV plays a bigger role in the clearing of milk that otherwise doesn't have a home in Class III").

- Hearing Ex. 421 (NMPF Ex. 60), at 10 (Testimony of Scott Brown) ("The average of the 500 stochastic outcomes shows that there are only small effects in producer milk prices and milk production, given the changes in federal order formulas assumed relative to current federal order provisions.").

- Hearing Ex. 462 (MIG/Shamrock Ex. 23), at 5 (Testimony of Tim Kelly) ("Price increases will stifle margins, limit innovation, and drive more milk to Class IV which will reduce the blended price to farmers.").

- Hearing Ex. 458 (MIG/Hood Ex. 21A), at 7 (Testimony of Michael Newell) ("As an industry, we need to strongly consider what will happen to the pool milk check if Class I utilization drops below 20%.").

- *See infra* pp. 159-60 for testimony from NMPF's expert affirming this fact.

- *See infra* pp. 205-06.

- **NMPF's Proposal 1, 2, and 19 would raise Class I prices for Class I processors.**

  - Hearing Ex. 421 (NMPF Ex. 60), at 9 (Testimony of Scott Brown).

  - *See generally*, Testimony of Sally Keefe.

  - *See infra* pp. 203-04.

- **Higher Class I prices would be passed on to consumers, and likely at rates even larger than the Class I price increase.**

  - *See infra* pp. 105-09.

  - Hearing Ex. 270 (MIG Ex. 11), at 6 (Testimony of Michael Newell) ("Retailers often will 'margin up' on manufacturers' price changes due to favoring specific retail price points like $3.99, $4.49, $4.99."); Hearing Tr. 5910:7-10, Michael

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Newell (September 28, 2023) (a $0.20 increase at the wholesale level could result in a $0.50 increase in price to consumers.).

- Hearing Tr. 5971:2-6, Chuck Turner (September 28, 2023) (explaining that when retailers have to raise prices due to price spikes, they oftentimes will not drop back down when the cost of milk goes down again).

- **Because of low Class I utilization, pooling obligations can no longer effectively incentivize service of the Class I market.**

  - *See infra* pp. 130-37.

  - *See infra* pp.179-194.

- **Given the change in milk utilization in the orders, Class I prices cannot influence or effectively address depooling.**

  - *See infra* pp. 130-37.

  - Hearing Tr. 5822:17-23, Jacob Schuelke (September 28, 2023) (raising the Class I price alone is not an effective way to address depooling in an order with California's utilization: "In orders with very high manufacturing utilization, the Class I price does not move the blend very well.").

- **The spread between Class III and IV is what primarily drives depooling.**

  - *See infra* pp. 130-34.

  - Hearing Ex. 76 (Edge Ex. 2), *see infra* pp. 132-34.

  - Hearing Ex. 291 (MIG Ex. 291), at 6 (Stephenson and Novakovic Paper) ("More to the point is the price spread between [Class III and Class IV], regardless of which one is higher."); *see infra* p. 132.

  - Hearing Tr. 10509:28-10510:3, Sally Keefe (January 16, 2024) ("Class prices and Class I prices are not – are not the right method for preventing – for preventing price inversions. Class I prices, that's not their role, that's not their job.").

  - Hearing Tr. 5824:7-12, Jacob Schuelke (September 28, 2023) ("So as much as I pick on depooling, I was a big depooler. I moved milk from Class IV to Class III because I made a lot of money doing it. And most importantly, I serviced the market. The market said: I need cheese, I don't need powder. So I shut my powder plant down, and I sold the milk to a cheese plant.").

  - Hearing Tr. 5824:13-23, Jacob Schuelke (September 28, 2023) ("What I want to highlight from this example is, because of pooling, the Class III farmer, the Class III price was 13.77, but the blend price was 15.24. So now the Class III farmer only

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paid 13.77, but because of pooling, they were able to pay their farmer 15.24. The spread between the blend and Class IV is now much smaller. There is a much lower incentive for me to shut down that cheese plant now and move milk to Class IV. As we increase the Class I price, that market signal to move milk from cheese to powder because even more and more muted.").

- **Class I processors utilize risk management, including hedging.**
    - *See infra* pp. 97-102.
- **Milk sale agreements and incentives to farmers are not changed monthly.**
    - Hearing Tr. 5025:16-28, Craig Alexander (September 25, 2023) (Upstate Niagara, as a seller, negotiates contracts annually or longer, and typically negotiates supply agreements annually); *id.* 5026:27-5027:1 (decisions about shifting where milk is sold to take place only once a year); *id.* 5028:22 (it takes farmers weeks to months to years to ramp up production, depending on the type of ramp up).
    - Hearing Tr. 5096:2-9, Chris Hoeger (September 25, 2023) (as a purchaser, Prairie Farms negotiates supply agreements annually, and some are done longer than annually); *id.* 5097:8-14 (Prairie Farms has been told by producers it is four to six months, if not longer, for them to react in any significant way to market signals).
    - Hearing Tr. 5845:25-5846:5, Jacob Schuelke (September 28, 2023) (Crystal Creamery negotiates its milk purchase agreements, when it purchases milk from manufacturers to give them access to the pool, on an annual basis).
- **If Class I prices are too high—and not "market minimums"—they will distort the marketplace.**
    - *See infra* pp. 157-62.
    - Hearing Ex. 451 (MIG Ex. 16 (Corrected)), at 15 (Testimony of Mark Stephenson) (**"Being above the market clearing price is a cardinal sin in minimum price regulation – which means it governs milk price regulation, too."** (emphasis in original)).
    - Hearing Ex. 487 (MIG/fairlife Ex. 26), at 4 (Testimony of Tim Doelman) ("Artificially enhancing prices ultimately results in the disorderly marketing of milk.").
    - Hearing Tr. 4708:3-6, Peter Vitaliano (September 19, 2023) ("Generally, it is in the interest of processors, whether they are a cooperative or not, to maximize their income. [T]hat's the kind of system that economists would . . . designate as a healthy industry.").

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- **Raising Class I prices will result in a decline of Class I volume—in other words, fluid milk is not inelastic.**
    - Given the importance of this fact, it is discussed at length below in the section that follows.

B. FMMO Assumptions on Elasticity of Demand for Fluid Milk No Longer Valid.

USDA historically primarily relied upon two significant predicates to justify imposing higher Class I regulated minimum pricing as part of FMMO's differentiated classified pricing system: (1) that milk used to produce packaged fluid milk products is more "profitable" than milk used to produce other products, *United States v. Rock Royal Co-op, Inc.*, 307 U.S. 533, 550 (1939); *Zuber v. Allen*, 396 U.S. 168, 172 (1969) ("Milk used in the consumer market has traditionally commanded a premium price, even though it is of no higher quality than milk used for manufacture."); and (2) that fluid milk sales are own-price demand inelastic such that higher regulated milk prices on Class I milk will nonetheless result in net revenue gains to dairy farmers even if consumers purchase less Class I milk (because the price increase will offset lost volume). *See, e.g.*, Milk in the New England and Other Marketing Areas, 64 Fed. Reg. 16026, 16102 (Apr. 2, 1999) ("This [FMMO classification] system allows a higher price to be applied to milk used for Class I uses due to inelastic demand for Class I products."). The hearing evidence demonstrated USDA can no longer make this assumption and must adjust milk pricing formulas accordingly.

MIG and others at the hearing rebutted the first proposition from the 1930's that fluid milk is the most profitable utilization; this proposition is simply incorrect today, *see infra* p. 169. The second proposition is rebutted here. **Based upon this hearing record and expert testimony, USDA's inescapable conclusion must be that consumer demand for milk is not inelastic.** This conclusion has profound impacts for FMMO policy and on any and all proposals that would increase Class I prices. Class I prices cannot be increased for the purpose of generating additional producer revenue, both because such an increase will come at the expense of Class I sales and

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when, in fact, the record evidence demonstrates that a Class I price increase will not generate significant additional producer revenue.

MIG's members know first-hand that the fluid milk industry's priority within consumer pocketbook preferences has changed dramatically since FMMO Reform. NMPF cannot explain away the real absolute and relative decreases in Class I sales and utilization as being unrelated to price. Indeed, the assumption about fluid milk's demand inelasticity rests on older studies that simply do not account for today's marketplace. Today, consumers can and do purchase a myriad of beverage products many in competition with and in lieu of fluid milk products. It is for this reason that in preparation for this hearing, MIG requested that USDA provide "[a]ny studies that USDA has conducted regarding the elasticity or inelasticity of demand for fluid milk, cheese, yogurt, ice cream, and butter." Hearing Ex. 14 (USDA Ex. 14), at 6. MIG made the same request with respect to "plant based dairy substitutes and different categories of value-added fluid milk, e.g. organic, grass-fed, A2, etc." *Id*. USDA's response in both instances was: "No studies conducted by AMS – Dairy Program." *Id*.

USDA and much of the industry have *assumed* for decades that fluid milk is own-price demand inelastic based upon old studies that do not consider the existence or impacts of many new competitive products; studies which processors rebutted on the record of this proceeding. The previous assumption that fluid milk is own-price demand elastic is of critical importance because, if true, it means that fluid milk price increases will not be offset by a reduction in volume of Class I milk consumed. Combined with assumed elastic manufactured use demand, this would mean that Class I milk revenue increases would exceed losses resulting from shifts to manufactured products. The net effect was assumed to be higher dairy farmer revenue, despite increased Class I prices. Hearing Ex. 435 (IDFA Ex. 61), at 13 (Testimony of Joe Balagtas). But as with so much else in the intervening 25 years since FMMO Reform, this critical underlying assumption is no longer true. Its absence hollows out the FMMO policy conclusion that Class I prices can be raised without negative consequences to dairy farmer revenue.

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

1. Development of a number of milk substitutes increases milk own-price elasticity.

Both Dr. Oral Capps (Texas A&M) and Dr. Joe Balagtas (Purdue) provided empirical, compelling, and dramatic testimony debunking the outdated elasticity assumptions. The prior studies reviewed by NMPF's expert Dr. Kaiser suffer from related flaws: (1) most are decades old; and (2) none consider the impacts of plant-based beverages, water, and juices on consumer demand. These flaws are critical because Drs. Capps and Balagtas both emphasized the significant impact that a greater number of substitutes for products has on any product's own-price elasticity. Hearing Ex. 387 (IDFA Ex. 53), at 15 (Testimony of Oral Capps); Hearing Ex. 435 (IDFA Ex. 61), at 14 (Testimony of Joe Balagtas). Dr. Balagtas testified to studies demonstrating significant growth of plant based beverages strategically placed in the same coolers as dairy milk: (1) the Mintel Group study "showed that sales of non-dairy milk grew by 67% between 2017 and 2022" with non-dairy milk in 2022 accounting for 17% of "milk" sales; and (2) Son and Lusk, using Nielsen scanner data from March 2018 to December 2022, estimated that "share of non-dairy milks grew by 19% from 12.9% in 2018 to 15.4% in 2022." Hearing Ex. 435 (IDFA Ex. 61), at 14. Further, Dr. Balagtas noted a 2023 published paper by Ghazaryan et al. ("I Say Milk, You Say Mylk") that tested "the relevance of nondairy milks in demand for milk, and concludes that '. . .nondairy milk products compete with dairy milk for consumers' budget allocated to milk.'" *Id*. (citation omitted). The inescapable conclusion is that competition for "consumers' budget allocated to milk" is a direct connection between the pricing and demand for those products. Past studies' failure to consider these substitutes means they underestimated the demand elasticity of milk. MIG does not necessarily criticize these studies as flawed in their time, as many fluid milk substitutes (especially plant-based products) developed a marketplace presence post-FMMO Reform.[11] However, given the undisputed testimony of the changed competitive landscape, these studies no longer provide a relevant or reliable basis for USDA to set FMMO policy today.

[11] For this reason, the repetitive reports to Congress, some of which are co-authored by Dr. Capps, are not relevant to and do not in fact contradict Dr. Capps' 2023 study because they necessarily were designed and

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Washington, D.C. 20005
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2. New, more comprehensive studies demonstrate fluid milk is demand elastic.

Dr. Capps, in his testimony, provides both the most recent study of the impacts for three time periods (pre-COVID, COVID, and post-COVID) and considers (for the first time) five different fluid milk product segments and also a number of fluid milk alternatives/substitutes. Dr. Capps relied on January 2017 through October 2023 Circana retail data for volume, dollar sales, average price per volume, and distribution points (market reach). Hearing Ex. 387 (IDFA Ex. 53), at 8 (Testimony of Oral Capps). Consistent with other recent studies, he divided the data into three time periods: (1) pre-COVID (January 8, 2018, to March 15, 2020); (2) COVID affected (June 28, 2020, to May 15, 2022); and (3) May 22, 2022, through August 13, 2023). *Id*. Dr. Capps estimates that the data he utilized covers "roughly 76% of the milk volume sold at retail outlets," and that this volume is representative of the market for purposes of studying own-price demand elasticity. *Id*. at 9.

Taking an approach consistent with the work of others from 2014 and 2018, *id*. at 10, Dr. Capps considered fluid milk category demand for five segments (conventional white, conventional flavored, organic, lactose-free, and health enhanced milks) and included "juices, bottled water, sports drinks, plant-based alternatives, and refrigerated yogurt." *Id.* Dr. Capps found that for the combined category (total milk) the own-price elastic was estimated to be -1.10 in the pre-COVID and -1.26 in the moving past COVID period—that is demand for total milk is elastic. *Id*. at 16. While some within USDA and the industry may find Dr. Capps' results startling, MIG's members' own real life sales experience, discussed below, are entirely consistent with the study results that find the pre-COVID and post-COVID demand for total milk to be own-price elastic.

Entirely independent of Dr. Capps, Dr. Joe Balagtas provided complementary and consistent support for Dr. Capps' conclusions. In addition to the important argument that the new

executed as static comparisons to past studies that did not and indeed could not include plant-based beverages. Hearing Ex. 386 (IDFA Ex. 52), at 1-2 (Testimony of Oral Capps).

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widespread availability of substitutes tend to increase demand elasticity of milk, Dr. Balagtas bolstered the conclusions of Dr. Capps' study with another 2023 study:

> I am aware of few studies that estimate milk demand with recent data, but those that do tend to find more elastic demand. Ghazaryan et al., (2023) use IRI scanner data from 2012 to 2017 to estimate demand for dairy and non-dairy milks. They estimate elasticities of demand for three categories of dairy milk (skim, reduced fat, and whole fat) and find in each case that demand is elastic.

Hearing Ex. 435 (IDFA Ex. 61), at 14 (Testimony of Joe Balagtas); *see also id.* at 15 (Dr. Balagtas' discussion of Lusk et al. (2023): 40% of respondents had tried soy-based and 47% had tried other plant-based milks in past 6 months and an additional 15% percent said that they were somewhat or very likely to try them if the price was the same as milk). Dr. Balagtas considered this evidence indicative of the milk substitutes' impact on fluid milk own-price elasticity.

NMPF presented a witness, Dr. Harry Kaiser, which argued that demand for fluid milk remained inelastic. However, Dr. Kaiser failed to perform any study of his own, and instead relied upon historical studies that suffer from the failures described above. Only *two* of Dr. Kaiser's cited *thirty-eight* studies were published since 2021. Hearing Ex. 115 (NMPF Ex. 48), at 4-5 (Testimony of Harry Kaiser). The list of Dr. Kaiser's studies dates back as far as 1964. *Id*. Not one of those studies addressed the issues of milk substitutes, and only a few addressed organic milk or different milkfat levels. Hearing Ex. 386 (IDFA Ex. 52), at 1 (Testimony of Oral Capps). Dr, Kaiser had not conducted any elasticity of demand studies since 2012, and his last report to Congress addressing elasticity was in 2011. Hearing Tr. 1641:15-1642:6, Harry Kaiser (August 31, 2023). He acknowledged that plant-based competitors developed after his most recent studies. Dr. Kaiser was unaware which plant-based beverages are the most popular. *Id*. 1652:11-1653:17.

Further undermining Dr. Kaiser's conclusions and as discussed above, Dr. Capps' results are consistent with another 2023 study that included an ERS economist (Andrea Carlson). "Ghazaryan, Bonanno, and Carlson (2023) estimated own-price elasticities to be -1.297 for skim milk, -1.666 for reduced fat milk, and -1.450 for whole milk." Hearing Ex. 386 (IDFA Ex. 52), at

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Washington, D.C. 20005
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11 (Testimony of Oral Capps). Moreover, the Ghazaryn, et al., 2023 study expressly notes the inadequacies of demand elasticity estimates for milk that do not consider plant-based beverage competition. The study concludes: "dairy and nondairy milk are not considered separate categories of products. Rather, consumers considered all six types of milk included in this study (skim, reduced-fat, whole-fat, soy, almond, and other nondairy milk) jointly when making a purchase decision." Hearing Ex. 390 (IDFA Ex. 56), at 291. Moreover, since prior AMS data used for elasticity analyses did not capture this competition from now acknowledged milk substitutes, failure to rely on this data (acknowledged within USDA by Dr. Carlson in the 2023 study that she co-authored) would miss significant elements of fluid milk competition. Hearing Tr. 9146:22-9152:13, Oral Capps (December 1, 2023).

Dr. Balagtas further tied the current market conditions in which "fluid milk consumption has been decline for multiple decades" to the functioning of the FMMO system, even assuming that fluid milk consumption were still demand-inelastic (disproved above):

> [E]ven under the assumption that fluid milk demand is inelastic, as Class I utilization rates fall, higher Class I prices have an increasingly small effect on average milk revenue. As noted earlier, Federal Milk Marketing Order Class I utilization fell from 38% in 2001 to 27% in 2022. Thus raising Class I prices is, increasingly, an ineffective way to raise average milk revenue.

Hearing Ex. 435 (IDFA Ex. 61), at 14 (Testimony of Joe Balagtas). In short, the FMMO record-low and falling Class I utilization means that the ability of higher Class I revenue to offset lower values in growing manufacturing utilization becomes attenuated and at some point, self-defeating. This self-defeating phenomenon is working against the professed AMAA mandate to bring forth an adequate supply of milk for fluid use:

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> Finally, it is important to note that Federal Milk Marketing Orders' objective of ensuring adequate supplies of fluid milk for consumers implies that encouraging consumption of fluid milk is a goal of the regulation. In the current market environment, with declining fluid milk consumption and an expanding assortment of non-dairy milks available to consumers contributing to more elastic demand for fluid milk, higher Class I differentials further discourage consumption of fluid milk in the United States. That is to say, higher Class I differentials undermine the objective of encouraging fluid milk consumption.

Id. at 15.

3. Recent studies have major implications for FMMO policy.

The testimony of Dr. Capps and Dr. Balagtas ought to be a clarion call to USDA and the dairy industry, particularly dairy farmers. NMPF and AFBF proposals to saddle the Class I segment of the dairy industry with higher costs (largely if not exclusively ostensibly made to provide a so-called "revenue neutral" package) would be a disaster if adopted. Dr. Scott Brown's assumptions underlying his analysis, Hearing Ex. 421 (NMPF Ex. 60), at 3 (Testimony of Scott Brown), rely on the older studies of demand elasticity which are both out of date generally and ignore the impacts of all the substitutes now dominating the dairy case. We have two inescapable conclusions: (1) NMPF's determination that farmers will make more money is wrong because it depends upon own-price elasticity assumptions that are no longer true; and (2) even relying on the old assumptions as to own-price demand elasticity, Dr. Brown concluded that NMPF's proposals would leave dairy farmers back close to the baseline within a few years. *Id*. at 5, 10, 20-21.

Moreover, while increasing costs to Class I handlers, placing more stress on their viability, and discouraging them from making new investments, NMPF's proposal will not increase dairy farmer revenue 6.8 to 7.6% as projected by Dr. Kaiser. Hearing Ex. 387 (IDFA Ex. 53), at 20 (Testimony of Oral Capps). Contrary to the analysis of Dr. Kaiser (Hearing Ex. 115 (NMPF Ex. 48)), Dr. Capps concludes that Proposal 19, which would increase the Class I price by 8.6%, would lead at best to a 2.1% increase in gross revenue for dairy farmers analyzing Class I only. Hearing

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Ex. 387 (IDFA Ex. 53), at 20.[12] In other words, the lower estimated Class I revenues are the results of already declining volumes accelerated by higher prices and perpetuated by lower resulting investment – a downward trending loop.

However, the analysis of impacts does not stop with only a Class I price impact analysis. Dr. Capps expressly acknowledged that neither he nor Dr. Kaiser had considered the impacts on Class III or IV prices from the milk no longer being sold for fluid use and needing to find a home in manufacturing uses. Hearing Tr. 9014:18-9015:18, Oral Capps (November 30, 2023). Dr. Balagtas, using both Dr. Kaiser's price transmission calculation (Hearing Ex. 115 (NMPF Ex. 48), at 3) and Dr. Capps' analysis (Hearing Ex. 387 (IDFA Ex. 53), at 20 (Testimony of Oral Capps)), first calculated that Proposal 19 alone would displace 2.2 billion pounds of milk. Hearing Ex. 435 (IDFA Ex. 61), at 17 (Testimony of Joe Balagtas). With this 2.2-billion-pound displacement in mind, he then applied his best professional expert estimates of available relevant demand elasticities for manufactured products, and, acknowledging a range of inelastic, mid-range or elastic scenarios, concluded that Proposal 19 would have from -$0.28/cwt to $0.12/cwt impact on the all milk price. That is to say, that there is no certainty that dairy farmers would benefit at all from the proposed increases to Class I prices, and if dairy farmers did benefit, the benefits are very small compared to the industry and consumer costs.

All of this runs counter to USDA's other AMAA mandate to act in the "public interest," 7 U.S.C. § 602, because consumers would be paying substantially more for their milk, but the overall impact on net revenue paid to dairy farmers could well be negative or at best simply far less than assumed by Dr. Kaiser, and especially far less than concluded would achieve revenue neutrality according to Dr. Brown. This inescapable reality reminds the industry—the market always wins. Even as NMPF seeks to artificially raise FMMO prices, and the very real burdens of those increases fall on Class I processors and, like water seeking the lowest point, the free

[12] Dr. Capps relied on Dr. Kaiser's price transmission calculation. Hearing Ex. 387 (IDFA Ex. 53), at 18 (Testimony of Oral Capps).

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market will find a way to equilibrium. Regulating in direct contravention to these supported economic conclusions means USDA risks further damage to the Class I marketplace for some sort of (very) short term bump in prices, but without any real return to farmers in the long run. *See* Hearing Ex. 453 (MIG Ex. 16B), at 8 (Testimony of Mark Stephenson) ("It is better to err on a somewhat too-low price than one that is too high—especially for fluid plants which cannot opt out of regulation.").

In summary, for the first time USDA has record evidence of several recent own-price demand elasticity studies for fluid milk that account for the real-world attributes of genuine substitutes. These studies all demonstrate that fluid milk sales are actually demand elastic. Dr. Capps' study supported by Dr. Balagtas' testimony and the other studies cited by each of them presents new, rigorous, and convincing evidence that USDA must start applying today. The implications reverberate throughout the FMMO system and the proposals before USDA. First, the dairy farmer mantra that USDA should raise fluid milk prices just because it can, is simply false. USDA cannot "whistle past the graveyard" given the decades long drop in Class I sales both in absolute and relative terms. Second, USDA's conclusion stated most recently in FMMO Reform that the "system allows a higher price to be applied to milk used for Class I uses due to inelastic demand for Class I products," Milk in the New England and Other Marketing Areas, 64 Fed. Reg. at 16102, is no longer valid. Third, USDA works against the public interest when it raises consumer prices on fluid milk 8.6% in exchange for, at best, only a modest increase in dairy farmer revenue and with very real risk of the opposite occurring. In short, USDA's entire Class I policy is predicated on 20th century information that is not valid in at the end of the first quarter of the 21st century. Everything that has been said and done in setting Class I FMMO policies with respect to Class I pricing and the conclusions reached as to the impacts of those policies about that pricing are no longer accurate.

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1301 K Street NW, Ste. 500 East
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4. Fluid milk processors' consistent experience affirms these studies.

These results do not surprise MIG members given the of decades of lower Class I utilization and the impacts of cost increases on them in competing with non-dairy substitutes is not abstract theory— is their everyday reality.[13] Moreover, that reality can and does have significant industry shocks (such as the Dean Foods bankruptcy) demonstrating by itself the lack of health in Class I— "[T]he average plant went for between $8 to $10 million . . . ." Hearing Tr. 11206:8-15, Jed Ellis (January 19, 2024). Unlike NMPF's parade of witnesses whose specialty is the procurement of raw milk, MIG's members and other fluid milk processors who appeared at this hearing, are actually in the everyday business of selling, or at least attempting to sell, packaged fluid milk to customers in an ever more challenging market environment. Without a customer to buy the milk, neither supply nor demand matters. And their testimony supports Drs. Capps and Balagtas' conclusions repeatedly.

As to the important issue of substitutes for dairy, Tim Kelly for Shamrock, Cammie Garofolo for Aurora, and Sally Keefe for MIG all expressly testified that plant-based products are direct competitors of fluid milk in the grocery store shelf space. Hearing Tr. 10935:6-11, 10946:9-11, Tim Kelly (January 18, 2024); Hearing Tr. 11141:8-16, Cammie Garofolo (January 18, 2024); Hearing Tr. 11599:16-23, Sally Keefe (January 29, 2024). Further, other MIG Class I processors testified that price elasticity exists for fluid milk and plays out in the real world. *See* Hearing Tr. 10743:17-28, Warren Erickson (January 17, 2024) ("I'm not an economist. You are going to ask for studies. I don't have any. But I have real experience that when the price goes up, people shop differently. When the Class I prices increase, you see less gallon sales, more half gallon sales. You see people downsizing. I can attest that – and I would attribute that to elasticity and the fact that the milk does struggle when you saddle it with increased costs."); Hearing Ex. 462 (MIG/Shamrock Ex. 23), at 4 (Testimony of Tim Kelly) ("Simply passing increases along to

[13] As for MIG fluid milk processors, they can only say, "We are shocked! Shocked to find that gambling is going on in here." Claude Raines (Best Supporting Actor) as Captain Renault in *Casablanca* (Best Picture 1942 – five years after the AMAA was adopted).

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consumers will, without a doubt, continue to decrease demand and consumption of Class I fluid milk."); Hearing Tr. 11031:14-28, Jay Luikart (January 18, 2024) (testifying that if Horizon Organic has to increase its prices, sales will go down and it will not be an insignificant amount); *and* Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 13 (Testimony of Shawna Nelson) (affirming that demand for milk is not price inelastic). Ms. Garofolo also provided evidence at how she observed real-world price impacts at her local Safeway, showing how low price milk resulted in an empty shelf. Hearing Tr. 11140:22-11141:7, Cammie Garofolo (January 18, 2024) ("How is milk not somewhat elastic if you sell gallons at $1.97 and the shelves are empty?").

Maple Hill Creamery took on the "ivory-tower" of "theoretical data" in testifying that in the real world "milk is not inelastic" providing real world examples:

> 30 days ago we ran a promotion. We dropped our price 7%. I saw a spike in my volume of 30%. When that promotion ended, the price went back up 7%, my volume dropped 30%. Right? It's the reason we run promotions. We know if we change price, volume will change. That's why we promote.
>
> We took a price increase, our last major price increase was in early 2022. When we took that price increase, our volumes fell. In fact, we had at least one retailer who came to us and said, we are going to take you off the shelf because your price is too high.

Jim Hau, Hearing Tr. 10043:1-11, 15-20 (December 7, 2023) (Maple Hill Creamery tried to take a price increase in 2019, "[b]ut the blowback on volume loss was so great that we had to reverse course and adjust our prices back – back down in order to keep our business. Milk is not inelastic.").

HP Hood also introduced empirical evidence that supports MIG's conclusion that increased prices negatively impact Class I sales. Hearing Ex. 457 (MIG/Hood Ex. 21), at 4-6 (Testimony of Michael Newell). Hood's Category Development Team utilized its Circana database subscription to analyze sales and found that with the price inflation in 2022, volume gallon sales declined significantly while the sales on the half gallon bump chart held up reasonably well. *Id.* The likely cause of this result is consumers opting for a lower unit price of a half-gallon in an effort to save

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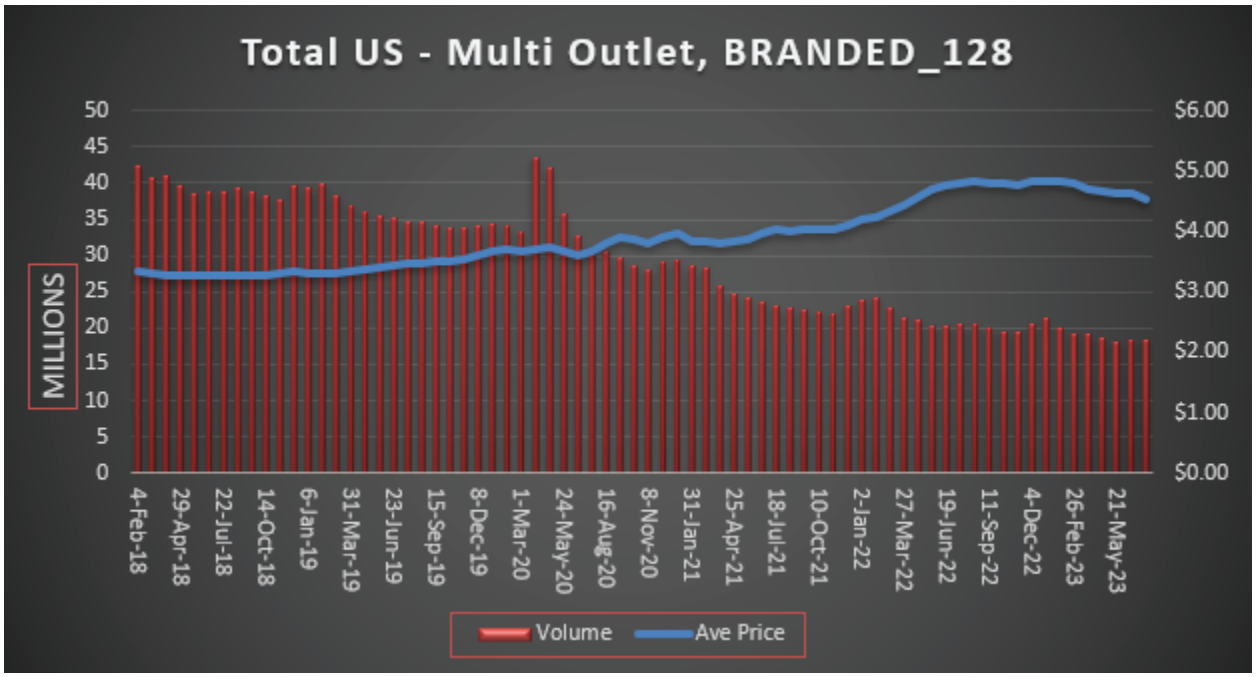
(202) 973-4200 main · (202) 973-4499 fax

money. Hood also examined volume sales data on more premium priced branded Gallon white fluid milk, which factored out lower-priced private label. The volume declines were even more drastic on this chart further demonstrating the price elasticity of milk. *Id.*



See also Hearing Tr. 10972:17-10973:13, Chuck Turner (January 18, 2024) ("[T]he increased prices the last year and a half or two years actually caused our sales to go down volume-wise, and . . . people definitely traded down from gallons to half gallons.").

USDA should be particularly concerned about branded sales, given that branded sales return higher profit margins for processors (and thus provide revenue that can be returned to farmers), and help lift milk as a category by keeping it from being seen as a pure, undifferentiated commodity. *Id.* 10973:14-20 (describing how Turner sells 100% branded products, making it a challenge to grow sales with grocery price inflation). If the market moves away from branded products, it pushes the market to the lowest cost and makes milk more of a pure commodity product with less reinvestment in innovation. Hearing Tr. 11208:8-11209:14, Jed Ellis (January 19, 2024). Branded products are where innovation is found in the Class I space: "And so if we can grow

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brand, if we can get brand to sell, it's more – you know, we can pay our suppliers more, we can pay our employees more, and we can grow Class I." *Id.*

> This volume decline in branded milk products in the face of higher prices does not bode well for independent dairy bottlers and points to further commoditization of the white fluid milk market as more consumers move from branded Class I products to private label. This trend favors co-operative owned bottlers as they are in a better cost position to win the private label bids of large retail customers as well as retailer-captive bottlers that are in business primarily to serve the retailers that own them.

Hearing Ex. 457 (MIG/Hood Ex. 21), at 6 (Testimony of Michael Newell).

And just as importantly for the industry, the inverse has also proven true: when prices on fluid milk products go down, processors can regain some of the losses. In other words, when prices decline sales will increase. *See* Hearing Tr. 10973:25-10974:10, Chuck Turner (January 18, 2024) (describing how sales declines from recent years moderated in the second half of last year when the Class I price came back to the mean). MIG established that price does matter and price increases drives consumers to change their shopping behavior. As HP Hood testified:

> As an industry, we cannot continue to ignore the increasing negative effect Class I price elasticity has on demand, and how rapidly demand will erode if we continue to push cost to the consumer.

Hearing Ex. 458 (MIG/Hood Ex. 21A), at 7 (Testimony of Michael Newell).

The direct correlation between pricing and Class I sales means USDA can help reverse the course of Class I sales by adopting Proposal 20 and reducing the Class I price. As Dr. Balagtas discussed, "current per capita milk consumption in 2019 was 0.49 cups per person per day, which is 29% lower than it was in 2000, and 21% lower than in 2010." Hearing Ex. 435 (IDFA Ex. 61), at 13 (Testimony of Joe Balagtas). The trend clearly accelerated over these two decades; *see also* Hearing Ex. 459 (MIG/HP Hood Ex. 21B), at 13 (Testimony of Michael Newell).

As Shehadey Family Foods testified: "The closure of processing plants across the country and the current state of fluid milk sales demonstrates that the current system is not serving the market reality we are facing." Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 6 (Testimony of Jed

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Ellis). The fluid milk industry cannot withstand further regulated minimum price increases in the face of more than adequate supply of milk for fluid use and these real world and agricultural economists' studies dramatically demonstrating that fluid milk is demand elastic. USDA must conclude that fluid milk is now own-price demand elastic and adjust long-standing FMMO policy accordingly. USDA should start this course-correction by rejecting NMPF 19 as well as Proposals 1 and 2, and adopting Proposal 20.

IV. USDA MUST REJECT NMPF'S AND AFBF'S PROPOSED AMENDMENTS BECAUSE THEY FAIL TO MEET THE NECESSARY LEGAL REQUIREMENTS.

USDA can only consider NMPF[14] and AFBF's Proposals on the merits if those proposals first meet the necessary legal requirements for adoption. However, opponents have failed to establish either that disorderly marketing exists as to the Class I market or that their proposals would address that disorder. Accordingly, USDA must reject NMPF's and AFBF's proposals.

A. NMPF Introduced No Evidence of Disorderly Marketing Sufficient to Justify any FMMO Amendment that Raises Class I Prices.

Not only has NMPF failed to substantively establish disorderly marketing (as discussed further in Sections VI-XI), but their arguments fail as a legal matter because they have never alleged the requisite disorderly marketing *within the fluid milk sector*. USDA may only amend Class I provisions of the FMMOs if it finds that disorderly marketing conditions exist with respect to that aspect of the industry. *See* 7 U.S.C. § 602(4) (instructing the Secretary to utilize the powers of the Act to "establish and maintain such orderly marketing conditions for [milk] as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices."). Specifically, before amending FMMO provisions, USDA has always required a showing of actual packaged fluid milk market failures, especially an inadequate supply of milk for fluid

[14] Reference to NMPF's proposals here extends to NAJ's Proposal 2, as it shares the same shortcomings as the similar NMPF Proposal 1.

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uses. NMPF failed to prove actual and substantial disruption resulting from any regulatory advantage or disruptive sales in the fluid milk market. Moreover, Class I utilization nationally is now so low that no one can seriously argue that there is an inadequate supply of milk for fluid uses outside the Southeastern orders. In March 2024, USDA implemented new regulations expressly designed to solve that regional issue. Further regulation now, especially on a national basis, is inappropriate and unnecessary.

1. AMAA declared policy focuses on fluid milk for packaged sales.

Both USDA and courts have correctly and continuously concluded that the AMAA's statutory requirement found in 7 U.S.C. § 608c(18) to "insure a sufficient quantity of pure and wholesome milk" expressly means *fluid packaged milk for packaged milk sales* ("fluid milk"). Milk in the New England and Other Marketing Areas, 64 Fed. Reg. 16026, 16070 (Apr. 2, 1999); Milk in the New England and Other Marketing Areas, 63 Fed. Reg. 4802, 4891-4900, 4907-4908, 4912 (Jan. 30, 1998). The historical context of the passage of the AMAA supports this interpretation. Milk sales competition during the Depression was the genesis for the chief mechanism for meeting the Declared Policy of the AMAA—setting a price for milk which is sufficient to call forth an adequate supply of pure and wholesome milk and being in the public interest. *Rock Royal*, 307 U.S. at 543; *H.P Hood & Sons, Inc. v. United States*, 307 U.S. 588, 605-606 (1939). In the 1920s and 1930s, U.S. dairy farmers produced surplus milk (otherwise dumped or used to produce non-fluid products such as cheese or butter) and pursued the more lucrative fluid market with this milk. It was this disruption to the fluid milk market that Congress sought to address with the passage of the AMAA. *Nebbia v. New York*, 291 U.S. 502, 517-518 (1934); *Rock Royal*, 307 U.S. at 550; *see also*, *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 523 (1935).

This Declared Policy of the AMAA—"to insure a sufficient quantity of pure and wholesome milk"—has become a USDA term of art after 80 years of agency application and interpretation. *Milk in the Chicago Marketing Area*, 52 Fed. Reg. 38240, Col. 3 (1987) ("[A] major purpose of the order program is to assure an adequate supply of pure and wholesome milk

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for the fluid market . . . ." (emphasis added)).[15] In the 1998 Proposed Rule during FMMO Reform, USDA expressly tied this concept to the legislative language of the "AMAA mandate." Milk in the New England and Other Marketing Areas, 63 Fed. Reg. at 4892 ("the AMAA mandate" 'to provide an adequate supply of milk' for fluid use."). Further findings by USDA during FMMO Reform most completely and repeatedly set out the necessity of tying Class I prices to the adequate supply of milk for fluid use requirement. *Id*. at 4892, 4894, 4896-4898, 4900; Milk in the New England and Other Marketing Areas, 64 Fed. Reg. at 16102 ("The purpose of the minimum Class differential is to generate enough revenue to assure that the fluid milk market is adequately supplied."); 64 Fed. Reg. at 16070 ("[M]arketing order provisions for both markets must provide for attracting an adequate supply of milk for fluid use."); Milk in California, 83 Fed. Reg. 14110, 14133, 14135 (Apr. 2, 2018) (discussing California FMMO provisions necessary or unnecessary "to ensure an adequate supply of milk for Class I use);" *see also*, Milk in the Rio Grande Valley and Certain Other Marketing Areas, 56 Fed. Reg. 42240, 42245 (Aug. 27, 1991); Milk in the Grand Basin and Lake Mead Marketing Areas, 53 Fed. Reg. 686, 698 (Jan. 11, 1988).

Only four months ago, USDA yet again reiterated this central thesis: "Ensuring Class I demand is met is essential to the FMMO system in meeting its objective of maintaining orderly marketing conditions." Milk in the Appalachian, Florida, and Southeast Marketing Areas, 88 Fed. Reg. 84038, 84050 (Dec. 1, 2023). In another recent statement, USDA responded on January 31, 2003 to Congressman Sherwood that the first objective of the FMMO program is "to assure an adequate supply of milk for the fluid market." Hearing Ex. 433 (IDFA Ex. 57), at 37 (Attachment A).

[15] However, if USDA were to take a different interpretation, the AMAA would control over that interpretation and courts would maintain their precedent here. Such a deviation in regulatory interpretation could also fall under further analysis and scrutiny depending on the outcome of currently-pending cases involving the *Chevron* deference standard. *Loper Bright Enters. v. Raimondo*, 143 S. Ct. 2429 (Mem) (May 1, 2023) (granting certiorari); *Relentless, Inc. v. Dep't of Commerce*, 144 S. Ct. 325 (Mem) (Oct. 13, 2023) (granting certiorari).

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1301 K Street NW, Ste. 500 East
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Likewise, the Supreme Court affirmed this reading of the AMAA early on in its existence:

> The problems concerned with the maintenance and distribution of an adequate supply of milk in metropolitan centers are well understood by producers and handlers. . . . Since all milk produced cannot find a ready market as ***fluid milk*** in flush periods, the surplus must move into cream, butter, cheese, milk powder and other more or less nonperishable products. . . . The market for fluid milk for use as a food beverage is the most profitable to the producer. Consequently, all producers strive for the ***fluid milk market***."

Rock Royal, 307 U.S. at 549-550 (emphasis added).

There, the Court concluded that competition among the existing suppliers of fluid milk resulted in extreme competition which engendered business practices that jeopardized "the quality and in the end the quantity" of the vital fluid milk supply. *Id.* at 550. Other courts have followed suit. *See generally*, *Borden v. Butz*, 544 F.2d 312, 316 (7th Cir. 1976) (where testimony was given indicating that the primary purpose of a fixed price "is to bring forth an adequate supply of pure and wholesome milk" for Borden's bottling operations of fluid milk); *see also Schepps Dairy v. Bergland,* 628 F.2d 11, 17 (D.C. Cir. 1979).

NMPF witness testimony similarly acknowledged that "FMMOs have two primary purposes as contained in the [AMAA]: 1) maintain orderly marketing conditions, and 2) protect the interest of the consumer by ensuring an adequate supply of milk for fluid consumption." Hearing Ex. 248 (NMPF Ex. 34), at 5 (Testimony of Calvin Covington). NMPF agreed at the hearing the "the Class I price is supposed to be set at a level that is sufficient to assure Class I processors of an adequate supply of milk for fluid milk purposes." Hearing Tr. 4700:25-4701:2, Peter Vitaliano (September 19, 2023); *see also* Hearing Ex. 238 (NMPF Ex. 32), at 3 (Testimony of Sara Dorland) (expressing the same).

Given this history and focus on destructive competition for Class I sales and since the highest classified price set by the Secretary is the fluid milk price, clearly the "sufficient quantity" referred to in the statute is a quantity of milk for fluid use. In addition, while other products use "pure and wholesome" milk, it is milk in the bottle which must, under all circumstances, be pure

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1301 K Street NW, Ste. 500 East
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and wholesome in order to best meet public interest. This declared policy cannot now be altered just to suit NMPF's "revenue neutral" needs in this proceeding.

2. When setting Class I minimum regulated prices USDA must ensure "Orderly Marketing" most importantly as to Class I.

Orderly (or "disorderly") marketing conditions sufficient to justify federal intervention is another term of art that USDA, that for over 80 years USDA interpretated as a substantial failure of the Class I markets, including pricing of Class I and an equitable sharing of that price with all the order's dairy farmers. With respect to the kind of disorderly marketing that supports the need for federal regulation of the fluid milk market, USDA has succinctly concluded that:

> The problems of unstable marketing encountered by producers in the proposed marketing area are not uncommon in ***fluid milk markets*** where there is no overall program for effectively regulating producer milk supplies.

Milk in Georgia Marketing Area, 34 Fed. Reg. 960, 962 (Jan. 22, 1969) (emphasis added); *Milk in Tampa Bay Marketing Area*, 30 Fed. Reg. 13143, 13144 (Oct. 15, 1965); *Milk in the Appalachian, Florida, and Southeast Marketing Areas*, 88 Fed. Reg. 84038, 84048 (Dec. 1, 2023) ("The AMAA further instructs the Secretary to maintain '. . . an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices.'" (quoting 7 U.S.C. § 602(4))).

USDA's emphasis on fluid milk market failure is consistent with the 1965 Farm Bill Amendments to the AMAA discussed in Section IV. These amendments *temporarily* provided express authority for USDA to adopt milk or milk product "marketing orders . . . limited in application to milk used for manufacturing." Pub. L. 89-321, Sec. 102 (1965). Thus, Congress found it necessary to include a specific provision addressing milk used for manufacturing, conveying that the statute as written would not apply to such milk. While that expired language could support regulation of milk based upon evidence of market failures outside the fluid milk market, USDA under the present AMAA lacks the authority to amend existing FMMOs with respect to Class I price levels relying on anything other than evidence of fluid milk market failures

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or disorderly marketing. Complaints that minimum regulated Class I prices are too low must be viewed in light of current, actual market conditions, including falling Class I utilization.

Recent USDA hearings continued this usage of "disorderly marketing" to apply to fluid milk markets. In FMMO Reform, USDA used the words "orderly" or "disorderly" a total of 27 times.[16] In every instance, the term is used to apply to determinations USDA made regarding Class I issues exclusively: for example, defining the consolidated markets based upon Class I route disposition, Class I pricing, establishing appropriate and real performance standards, transportation credits or allowances, and using the "higher of" pricing mechanism. *Not once* did USDA in FMMO Reform Decision use the term when discussing the appropriate replacement for the Basic Formula Price (i.e., Class III or Class IV price formulas).

Further, the current pricing and pooling structures only hold captive Class I processors—not manufacturing processors. Instead, manufacturing processors may opt in or out of the pool in accordance with the requirements in their particular order. USDA's policy here means that its focus on manufacturing classes can only reach so far as necessary to provide order to its regulation of Class I processors. Otherwise, USDA would be regulating Class I processors—who cannot leave the system, like their manufacturing counterparts—for the benefit of manufacturing processors. Neither the AMAA or USDA policy permits such regulation, which also would run in contravention to the Fifth Amendment's Takings Clause (*see infra* pp. 70-72).

USDA cannot now abandon or modify that long-held policy in order to justify NMPF's proposals without a sufficient legal rationale. Any change in this longstanding policy would be arbitrary and capacious. *Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 47-51 (1983); *see*, *F.C.C. v. Fox Television Stations, Inc.,* 556 U.S. 502, 535 (2009) (Justice Kennedy joined Justice Breyer's four Justice Dissent on central point here; "that

[16] The term also appears in the Order language 9 times in paragraphs 13 (producer milk definition) of all orders except Order 1. 7 C.F.R. §§ 1---.13. The term also appears once in the introduction of Appendix D (Identical Provisions Project). 64 Fed. Reg. at 16293, c.3.

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the agency must explain why 'it now reject[s] the consideration that led it to adopt that initial policy.'")

3. USDA may not rely upon *potential* disorderly marketing to raise Class I prices.

USDA has held that the "potential of creating disorderly marketing conditions" is insufficient to justify regulation even in the critical Class I context:

> Although the marketing of milk by producer-handlers has the potential of creating disorderly marketing conditions, it has not been found necessary to regulate fully this type of operation. . . .
>
> . . . .
>
> There is no evidence of market disorder as a result of competition between such producer-handlers and fully regulated handlers.

Milk in the Texas and Southwest Plains Marketing Areas, 54 Fed. Reg. 27179, 27182 (June 28, 1989); *see also* Milk in the Rio Grande Valley and Certain Other Marketing Areas, 56 Fed. Reg. at 42248. Potential or hypothetical claims of disorderly marketing are thus wholly insufficient as justifications for amending FMMOs. Given its own past decisions, USDA could not now rely on hypotheticals or potential disorderly market conditions to justify amending the FMMOs to increase Class I differentials. *Borden*, 544 F.2d at 317 (striking down USDA order increasing a Class I location differential because USDA had not proven an inadequate supply of milk and based the differential on speculative evidence). All of NMPF's claims that there may be the inability to provide milk to the fluid market and thus disorderly market conditions unless minimum FMMO prices are raised are legally deficient. Hearing Tr. 8211:10-13, Chris Hoeger (October 11, 2023) ("[I]f we can't keep [dairy farmers] competitive to serve the fluid markets in Florida, ***I think*** longer-term they could look for other alternatives." Hearing Tr. 8070:13-16, Calvin Covington (October 11, 2023) (emphasis added).

> [D]airy farmers are beginning to question, why are we doing this? Why are we hauling milk from our farms all this way to serve these Class I plants in cities when the money's not there? The difference in price doesn't pay to get us there. They are ***just questioning*** whether that's a sustainable system.

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Hearing Tr. 7253:3-8, Jeff Sims (October 5, 2023) (emphasis added); *see also id.* 7256:11-24 ("The other threat to Class I is the economic incentives aren't there and we take the milk someplace else. If the returns are better at a cheese plant, we don't bring it to Class I, ***there's the second threat***." (emphasis added)).[17] Critically, not a single Class I processor testified that it currently could not obtain sufficient milk supplies (*see infra* pp. 160-61). The testimony regarding processor desire to serve the Class I marketplace established that the current pricing system actually disincentivized service of the Class I marketplace because the differentials were *too high*. *See infra* pp. 181-191.

4. In adopting minimum prices, the AMAA and USDA policy always left room for the marketplace to operate.

Both USDA and courts have held that the FMMO system must properly incorporate and rely upon market forces in setting prices—thus, the presence or lack thereof of over-order premiums does not establish disorder. In fact, the lack of any space for the market to operate above minimum prices indicates that FMMO prices are not "minimum" and are the cause of the disorder.

In its Tentative Final Decision to set make allowances in 2008, USDA rejected arguments that make allowances must ensure all farmer production costs are covered:

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

[17] Even if NMPF points to shortages in specific geographic areas, milk production decrease in a single area does not necessarily reflect an overall decrease because milk could instead be going to a nearby region. *Compare, e.g.*, Hearing Exs. 53-58 (USDA Exs. 53-58) (purportedly showing a decrease in milk in Michigan from 2015 to 2022), *with* Hearing Ex. 261 (USDA Ex. 61) (revealing regional milk supplies remained steady in this window, but that more Michigan milk was likely being pooled as received at a pool plant in Indiana).

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Milk in the Northeast and Other Marketing Areas, 73 Fed. Reg. 35306, 35324 (June 20, 2008).

When rejecting a challenge by farmers to these same make allowances, the D.C. Circuit Court held that the Secretary correctly concluded that "market mechanisms" would sufficiently cover producer costs. *Ark. Dairy Co-op Ass'n, Inc. v. U.S. Dep't of Agric.*, 573 F.3d 815, 832 (D.C. Cir. 2009) ("In sum, the Secretary considered the costs to producers, but reasoned that those costs could be recouped through ***market mechanisms***."). Additionally, over order premiums have been an inherent part of the FMMO system for decades. *Farmers Union Milk Mktg. Coop. v. Yeutter*, 930 F.2d 466, 468-69 (6th Cir. 1991) ("One more detail of the regulatory scheme is necessary to complete the picture. Although the AMAA mandates a minimum price, it does not mandate a maximum price. Handlers cannot pay less than the blend price, but they are allowed to pay as much as they want. In times of relative scarcity, handlers can and do negotiate premiums, known as 'over-order' prices, for the sale of the milk. . . . ***Thus, market forces are allowed to intrude on this regime*** . . . ." (emphasis added)).

Here, NMPF witnesses routinely asserted that they prefer USDA set minimum prices at levels above where the free market would generate. *See infra* p. 160. By NMPF's own admission, adoption of its proposals (particularly Proposal 19) would require Class I processors to pay prices above those generated by market forces.

B. USDA Lacks the Legal Authority to Adopt NMPF and AFBF's Proposals.

The AMAA only allows USDA to amend the FMMOs if there is evidence of actual disorderly marketing such as an inadequate supply of milk for fluid use, and then to amend the FMMOs in a way that sets <u>minimum</u> prices and will best serve the public interest by ensuring a sufficient supply of fluid milk.

Congress passed the original AMAA in 1937 (which reenacted the Agricultural Adjustment of 1933 ("AAA")). Pursuant to 7 U.S.C. § 608c(18):

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> The Secretary of Agriculture, prior to prescribing any term in any marketing agreement or order, ***or amendment thereto***, relating to milk or its products, if such term is to fix ***minimum prices*** to be paid to producers or associations of producers, or prior to modifying the price fixed in any such term, shall ascertain the parity prices of such commodities. . . . Whenever the Secretary finds, upon the basis of the evidence adduced at the hearing required by section 608b of this title or this section, as the case may be, that the parity prices of such commodities are not reasonable in view of the price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk and its products in the marketing area to which the contemplated agreement, order, or amendment relates, ***he shall fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk, and be in the public interest***.

The AMAA has been subject to extensive agency interpretation and court review defining the scope, range and extent of USDA authority. These interpretations make clear that the AMAA requires setting only minimum prices as justified by economic evidence. *See Zuber*, 396 U.S. 168 (striking down the Massachusetts-Rhode Island Order's nearby differentials as not being authorized economically justified adjustments to uniform price requirement required by 7 U.S.C. § 608c(5)(B)); *Lehigh Valley Coop. Farmers, Inc. v. United States*, 370 U.S. 76 (1962) (striking down compensatory payments to producer settlement fund from partially regulated Class I handlers as being an unlawful trade barrier prohibited by 7 U.S.C. § 608c(5)(G)).

1. USDA may only set *minimum* Class I prices.

By its plain language the AMAA only allows USDA to set minimum prices:

> In the case of milk and its products, orders issued pursuant to this section shall contain one or more of the following terms and conditions . . . .
>
> > (A) Classifying milk in accordance with the form in which or the purpose for which it is used, and fixing, or providing a method for fixing, ***minimum prices for each such use classification*** which all handlers shall pay.

7 U.S.C § 608c(5)(A) (emphasis added); *see also Stark v. Wickard*, 321 U.S. 288, 290 (1944) ("The immediate object of the Act is to fix minimum prices for the sale of milk by producers to handlers."); *White Eagle Coop. Ass'n v. Conner*, 553 F.3d 467, 470–71 (7th Cir. 2009) ("As we shall explain more precisely in the following paragraphs, the provisions attempt to promote orderly

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milk-marketing by maintaining ***minimum prices*** for producers and limiting the competitive effects of excess supply of Grade A milk." (emphasis added)). USDA may not set prices at price enhancing levels, but must keep prices at their minimum level.

The hearing evidence establishes that prices are currently enhanced, and certainly would be more so if USDA adopts opponent's price increasing proposals. NMPF's argument that costs have increased in recent years fails to establish that USDA must make changes to the regulations in order to ensure they continue to generate *minimum* prices. Market conditions have changed dramatically since FMMO Reform, and evidence at the hearing establishes that Class I prices are higher than the market can bear. *See infra* pp. 150-194.

Further, USDA can no longer assume, as was true at the time FMMOs were adopted, that Class I products drive the dairy marketplace. In the 1930's, manufactured dairy products were a much smaller segment of the market and oftentimes manufactured only with an eye towards utilizing surplus milk. *Rock Royal*, 307 U.S. at 550 ("Since all milk produced cannot find a ready market as fluid milk in flush periods, the surplus must move into cream, butter, cheese, milk powder and other more or less nonperishable products. . . . The market for fluid milk for use as a food beverage is the most profitable to the producer. Consequently, all producers strive for the fluid milk market."). Instead, today there is no evidence that fluid milk is more profitable when used in a fluid beverage. In fact, there is evidence that in large parts of the country milk is now more valuable when used to produce cheese. Hearing Ex. 453 (MIG Ex. 16B), at 17-20 (Testimony of Mark Stephenson).

Likewise, the intense competition amongst producers for the most lucrative Class I sales drove a lot of the disorderly marketing FMMOs were designed to address. *See Rock Royal*, 307 U.S. at 550, ("Since these producers are numerous enough to keep up a volume of fluid milk for New York distribution beyond ordinary requirements, cut-throat competition even among them would threaten the quality and in the end the quantity of fluid milk deemed suitable for New York

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consumption."). Again, now testimony made clear that Class I sales are not the coveted sales, but instead could be detrimental to farmers. *See infra* pp. 134-35, 187-91.

2. *Zuber* requires that USDA justify FMMO amendment's contribution to fluid milk orderly marketing or economic benefits for Class I processors.

In *Zuber*, the Supreme Court considered USDA's decision to merge four sub-markets and readopted for the Massachusetts-Rhode Island Order "nearby differentials," which were adjustments to the uniform price paid to dairy farmers in favor of dairy farmers who were located closer to the cities and the Class I handlers. The nearby producers argued that they would have enjoyed price or competitive benefits for sales of milk due to their proximity to cities and handlers, and so the FMMO regulations should compensate them for the same. The Court summarized the effect of the program: "The deduction for differential payments withheld for the benefit of nearby producers reduces the uniform 'blended' price to those producers ineligible to collect this particular adjustment." *Zuber*, 396 U.S. at 178 (citing 7 C.F.R. § 1001.72 (1969)). Unlike the organic issues discussed, *infra* pp. 47-72, in which organic dairy farmers provide value through a production method that can and should be categorized as a production or market differential under 7 U.S.C. § 608c(5), the nearby dairy farmers in *Zuber*, did not qualify as providing a genuine economic benefit.

The Court rejected the attempts by certain producers to obtain regulatory protection for profits not generated by the free market and unnecessary to ensure orderly marketing:

> Nearby producers now seek the best of both worlds. Having achieved the security that comes with regulation, they seek under a regulatory umbrella to appropriate monopoly profits that were never secure in the unregulated market.

Id. at 181. The Court went on to base its holding on a narrow interpretation of the AMAA. *Id.* The Court concluded that Congress intended and did "confine the boundaries of the Secretary's delegated authority." *Id.* at 183 & n. 16.

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> The statute before us does not contain a mandate phrased in broad and permissive terms. Congress has spoken with particularity and provided specifically enumerated differentials, which negatives the conclusion that it was thinking only in terms of historical considerations.

Id.

Importantly the Court observed that each of the specifically enumerated adjustments to uniform prices of the kind relied upon by USDA to justify the nearby differentials—"volume," "grade or quality," "location," and "production"—"all of which compensate or reward the producer for providing an economic service or benefit to the handler." *Id.* at 183-84; *see*, organic discussion, *infra* pp. 47-72. The Court concluded that the specific and "permissible adjustments are limited to compensation for rendering economic service." *Zuber*, 396 U.S. at 188.[18] The Court found that the nearby differentials, "do not fall in this category" especially as the Secretary and the nearby farmers failed to advance "any economic justification for these differential payments." *Id.* In light of the fact that the Court could not discern any economic benefit to the handlers, it affirmed the lower court's conclusion that, "if there is any economic benefit here, producers should receive their compensation directly from the handlers and not out of the marketwide pool." *Id.* at 190. The Court also rejected the familiar threats of petitioners that they could exit the marketplace without the credits:

> While petitioners argue that the differential is a necessary inducement to keep the nearby farmers in business, the record does not reveal that the Secretary acted out of concern that the nearby farmers would quit the market, nor is there any evidence demonstrating the present necessity for nearby producers. In an era where efficient transportation is available this may be of nominal concern.

Id. at 190-91.

U.S. Supreme Court repeatedly and specifically emphasized this conclusion and judicial interpretation that USDA have economic justifications for its amendments. "There is no

[18] The Court also recognized and found that statutorily authorized adjustments under 7 U.S.C. § 608c(5)(B) are only "permissible," meaning discretionary and not mandatory.

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suggestion in the findings, nor have the parties explained, how the present [nearby] differential contributes to the broad, general purpose of eliminating crippling competition." *Id.* at 193. "This Court has been slow to attribute to Congress an intent to compensate for inefficient allocation of economic resources. *Cf.* [*W. Ohio Gas Co. v. Pub. Utilities Comm'n*, 294 U.S. 63, 72 (1935)]." *Id.* at 190. "[N]or is there any evidence demonstrating the present necessity for nearby producers." *Id.* And finally, the issue "is whether the provisions are authorized by the statute. The Secretary's order is devoid of any economic justification and relies solely on the historical factor of the nearby producer's favorable share of the fluid use market." *Id.* at 188 n.25.

Here, NMPF aims to extract additional value from Class I processors without identifying any benefit the system provides in exchange. Today, Class I processors have all of the milk needed to meet fluid needs. The manufacturing classes make up the bulk of raw milk use, including for exports. Raising Class I prices serves no end to the marketplace. Instead, NMPF seeks to raise Class I prices because it is the only "easy" way for producers to extract more value from the FMMO system to counteract unavoidable make allowance adjustments. Hearing Tr. 10935:25-10936:4, Tim Kelly (January 18, 2024) ("I truly believe that National Milk's proposals are looking at the top of that iceberg, and it's very small. . . . [T]hey are looking at [decreases from make allowance proposals] and saying 'Just throw it on Class I.'").

Further, proponents seeking price regulation must present "their best economic case to the price-setting agency." *Tenoco Oil Co. v. Dep't of Consumer Affairs*, 876 F. 2d 1013, 1027-28 (1st Cir. 1989) (gasoline wholesale price regulation).[19] A palpable dearth of evidence exists, however, on a number of key aspects of NMPF's proposals: for example, that Class I processors receive components at the levels proposed; that Class I processors are not hedging; that there is an insufficient supply of milk for fluid use; that farmers uniformly provide balancing services; or that

[19] Under the Administrative Procedures Act ("APA"), proponents have the burden of proof for any proposals put forth. 5 U.S.C. § 556(d) ("Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof.").

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there is any need to incentivize service of the fluid milk market via higher Class I pool obligations. While NMPF managed to introduce many pages of tables, charts, and testimony, when one strips these exhibits of their self-serving conclusions and down to the data that serves as the meat and bones supporting these arguments, there is little left. Likewise, AFBF failed to support their proposals, particularly in regards to the Class II differential. Neither party met their burden of production.[20] The record, in fact, *contradicts* many of the provisions and policies for which NMPF and AFBF are advocating.

The AMAA and federal courts prohibit such an unwarranted price grab.

3. *Lehigh* precludes the trade barriers imposed by the AFBF Proposal 21.

The Supreme Court's ruling in *Lehigh Valley Cooperative Farmers, Inc. v. United States*, 370 U.S. 76 (1962) prohibits USDA from raising the Class II differential to bar Class I processors equal access to the Class II marketplace. In *Lehigh*, the U.S. Supreme Court exhaustively reviewed 7 U.S.C. § 608c(5)(G) after fluid milk processors challenged the validity of a provision in the New York-New Jersey FMMO for compensatory payments on non-pool milk sold in the marketing area by outside handlers.[21] This statutory provision read:

> No marketing agreement or order applicable to milk or its products in any marketing area shall prohibit or in any manner limit, in the case of the products of milk, the marketing in that area of a milk or milk product thereof produced in any production area in the United States.

Id. at 91. Under the provision in dispute, a handler who brought outside fluid milk into the area would have to pay the pool producers through the producer-settlement fund an amount equal to the difference between the minimum prices for the highest and lowest use classification prevailing

[20] As USDA has noted, "It is left to the discretion of the trier of fact to determine whether or not a negative inference will be drawn from the failure to present any specific piece of evidence under one party's exclusive control." Milk in California;, 83 Fed. Reg. 14110, 14147 (Apr. 2, 2018).

[21] At the time, 23 FMMOs included a provision as found unlawful in *Lehigh*. *Lehigh*, 370 U.S. at 83 & n.9.

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in the area. The Court concluded that, "In effect, therefore, the nonpool milk is forced to subsidize the pool milk and insulate the pool milk from the competitive impact caused by the entry of outside milk." *Id.* at 90.

In striking down the compensatory payments at issue, the Court held that this provision "encompasses *economic trade barriers* of the kind effected by the subsidies called for by this 'compensatory payment' provision." *Id.* at 97 (emphasis added). Therefore, the Order set up an economic trade barrier specifically prohibited by 7 U.S.C. § 608c(5)(G). Here, AFBF's Proposal 21 would create regulatory burdens and costs for Class I processors making Class II products that a stand-alone Class II processor does not have. *See infra* pp. 236-38. This disparate regulatory treatment would occur despite the two entities making *the exact same product*. These burdens constitute anticompetitive barriers because the Class I processor would not have the same options to avoid the pool and the increased Class II differential. USDA must reject the proposal for this reason.

C. USDA Cannot Adopt Proposals Increasing Class I Prices Until it Resolves Organic Milk Issues.

This FMMO amendatory proceeding presents USDA with its first real opportunity to genuinely grapple with the existence and growth of certified organic milk. While demonstrably, legally distinct from conventional milk, the FMMO system treats organic milk as being identical to conventional milk. When USDA last reviewed Class I pricing during FMMO Reform, certified organic ("organic") milk was, at best, a nascent afterthought. While the Organic Food Production Act "OFPA" was enacted in 1990, 7 U.S.C. §§ 6501-22 (1990), the enabling regulations were not adopted until the end of 2000, after FMMO Reform was already complete. National Organic Program, 65 Fed. Reg. 80548 (Dec. 21, 2000). Nonetheless, Horizon Organic submitted a proposal during FMMO Reform seeking differential treatment of organic milk under the FMMOs. USDA briefly discussed and rejected the proposal as premature. Milk in the New England and Other Marketing Areas, 64 Fed. Reg. at 16128-29 ("[I]t would be inappropriate at this time to exempt

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

organic milk from pooling or to provide any other type of special treatment for it."). Organic's distinct legal status, as well its growth and marketplace differentiation from conventional milk in the intervening twenty-five years, now requires USDA to fully vet the issue of organic milk. USDA no longer can justifiably give identical treatment to organic and conventional milk within the FMMO system.

However, when MIG presented USDA with the opportunity to hear this perspective from the organic dairy industry in the form of MIG Proposal 6, USDA declined to include that proposal in the Hearing Notice. Hearing Ex. 60 (MIG Ex. 1). USDA further rejected MIG's objection to this refusal to consider the treatment of organic milk. *Id.*; Order Denying Requests to Consider Additional Proposals at Hearing (Dec. 11, 2023). USDA's approach has myriad of problems: organic has grown substantially since FMMO Reform; organic milk is legally distinct from conventional milk; organic milk costs significantly more to produce; organic handlers incur substantial and significantly different supply chain costs than conventional handlers; and as FMMOs are incapable of bringing forth an adequate supply of organic milk, organic dairy farmers and handlers cannot receive the Class I *quid quo pro* for higher minimum regulated prices, including especially the requirement to equalize with the producer-settlement funds.

Given this absolute and basic failure by FMMOs to fulfill their primary directive with respect to the organic dairy segment, USDA cannot add to organic's financial burdens by adopting any proposal that would result in an increase in Class I prices. USDA cannot increase handler obligations to producer settlement funds that provide no benefit to the organic milk segment. As such, USDA must reject Proposal 1, 2, and 19. Doing otherwise would be disorderly with respect to both the organic segment (because organic pays for FMMO services it cannot receive) and the conventional segment (because those payments from organic send the wrong market signal to the conventional segment) and the market as a whole and would violate the declared policy of the AMAA, Hearing Ex. 473 (MIG/OV|CROPP Ex. 22), at 9 (Testimony of Shawna Nelson); Hearing

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Washington, D.C. 20005
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Ex. 471 (MIG/Danone Ex. 20B), at 7 (Testimony of Jay Luikart); it also would constitute a takings without compensation, *Horne v. Dep't of Agriculture*, 576 U.S. 350, 361 (2015).

1. The AMAA Requires FMMOs to Account for Organic Milk.

a. Organic dairy has grown since FMMO Reform.

The adoption of OFPA and the creation of implementing regulations that established the National Organic Program ("NOP") set in motion the creation of a vibrant stream of USDA certified organic agricultural products. In 2006, the first year for which AMS data is available, organic fluid milk was about 2% of the total fluid milk (Class I) sales. *Estimated Total U.S. Sales of Fluid Milk Products January – December 2006, with Comparisons*, https://mymarketnews.ams.usda.gov/filerepo/sites/default/files/3358/2006-12- 30/340611/inareasls_ytd2006%20REVISED.pdf. But AMS data shows that in 2023 organic fluid milk volume had grown to about 7% of total Class I volume. Agricultural Marketing Serv., *Estimated Fluid Milk Products Sales Report* (Feb. 20, 2024), https://mymarketnews.ams.usda.gov/filerepo/sites/default/files/3358/2023-12-11/804317/ams_3358_00056.pdf. USDA certified organic milk is a relatively new, but growing, product category that is entirely distinguished from conventional milk by AMS. However, the FMMOs do not address this distinction, or the challenges presented for organic dairy farmers, processors, and consumers.

Organic milk utilization is quite different from that of the FMMOs as a whole, with organic both the Class I and Class II utilizations double that of conventional dairy. Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 6 (Testimony of Shawna Nelson). The table below compares the utilization of organic milk by class to total FMMO utilization.

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(202) 973-4200 main · (202) 973-4499 fax

Table 1 Organic & FMMO Total Milk Utilization by Class				
	I	II	III	IV
Organic[1]	55%	20%	15%	10%
FMMO Total[2]	27%	9%	54%	10%

> However, despite organic milk being disproportionately represented in the FMMO system due to the high Class I utilization, it makes up smaller piece of the overall milk production in the US. In 2022, U.S. farms produced 226.6 billion pounds of milk with the 151.6 billion pounds pooled on the Federal Orders. Of this amount, only 41 billion pounds is classified as Class I. And of this 41 billion pounds, only 5 billion pounds are estimated to be organic. This means of the 226.6 billion pounds of milk produced in the United States, only 2.2% is Class I organic.

Id. (footnotes omitted).

These changes and differences in production and utilization have significant implications for FMMO policy as discussed below.

b. Organic milk's legally distinct status from conventional milk, with its much higher cost of production, makes it a bad fit for regulation under FMMOs.

While USDA, through AMS, administers both the FMMOs and the NOP, the two programs are separate and distinct. The two programs operate pursuant to wholly separate enabling statutes (AMAA and OFPA) and regulations (7 C.F.R. Parts 1000-1131 and Part 205).

Since the NOP did not exist until after the completion of FMMO Reform, it was impossible for AMS operating the FMMOs ("Dairy Programs") to understand or know how real, concrete, stringent, science-backed, and costly it is to produce organic milk on farms and process it for sale to consumers. In FMMO Reform USDA only noted that different costs "*may* be associated with producing organic milk." Milk in the New England, 64 Fed. Reg. at 16129. Moreover, Dairy Programs likely lacked the details, discussed below, to comprehend just how different organic milk is from conventional milk. Thus, any decision made in 1999 could not account for the need to make lawful adjustments to uniform prices permitted under the AMAA for "market, and

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production differentials customarily applied by the handlers subject to such order." 7 U.S.C. § 608c(5)(A); *Zuber*, 396 U.S. at 183 ("The congressional purpose is further illuminated by the character of the other statutory differentials for 'volume' 'grade or quality,' 'location,' and 'production," all of which *compensate or reward the producer for providing an economic service of benefit to the handler*." (emphasis added)). Fortunately, MIG provided that detailed and uncontradicted record evidence in this proceeding.

Dr. Juan Velez testified extensively about the NOP program and its application to organic dairy farming, and his unimpeachable credentials support USDA giving careful consideration to his testimony.[22] Dr. Velez is a doctor of veterinary medicine, has a master of science, and is a diplomate of the American College of Theriogenology. Hearing Tr. 11164:17-19, Juan Velez (January 18, 2024). He has extensive experience in the dairy industry both in the United States and Columbia, including herd health programs, training, and organic herd health protocols dating back to the 1980s. *Id*. 11165:18-11166:10. Dr. Velez also has experience with conventional and organic production. *Id*. 11166:11-14. He worked for nine years on clinic reproduction, protocols, and training thus getting involved in management. *Id*. 11166:15-17.

> [S]ince 2004, when Aurora Organic was created, by becoming 100% organic company, I started getting involved in management, and my role evolved from managing the farms to what my title is today of chief agricultural officer. Today, that entails four farms, ten milking parlors, about 20,000 acres under my control, approximately 26,000 cows, and 15,000 heifers . . . .

Id. 11166:17-23.

Dr. Velez is also "deeply involved in research and academia" and is "a co-author of more than 20 scientific papers related to health and well-being in organic cows." *Id*. 11166:25-28. He is co-founder and past president of the Dairy Cattle Welfare Council. *Id*. 11167:4-6. And he remains personally and directly involved with cows: "I still have that passion. . . . I still walk the

[22] Notably, opponents failed to introduce any testimony, let alone evidence from an expert like Dr. Velez, to oppose his testimony.

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cows. I still go to the pens. I still go to the pastures. I still have direct interaction with them." *Id*. 11167:7-10.

Dr. Velez summarized the key differences between conventional and organic production:

> My most important task today, and I really appreciate the invitation and the opportunity to be able to explain to the group and be part of this hearing, is to show the real differences that exist between organic milk production and conventional milk production. It is obvious to some of those of us who are in the organic business, but it is not that obvious to people on the outside of the organic business. Sometimes it is misinterpreted as organic is just no use of BST, for example.
>
> But I want to explain that there's some key differences. Organic is highly regulated by the United States Department of Agriculture under the [Agricultural Marketing Service] that developed the program called NOP, or National Organic Program. It's federally regulated, and the standards are very comprehensive. My intention is not to go through the standards, of course. My intention is just to portray the key differences that have a significant impact on the cost of organic milk production.
>
> But there are three components of it: You have to feed the cows certified organic feed; you have some strict grazing requirements; and you have some limitations on what you can use for cow care.

Id. 11167:13-11168:7. Many farmer witnesses testified consistent with Dr. Velez's testimony regarding the differences between organic and conventional milk production. *See* Hearing Tr. 2878-2890, LeAnna Compagna (September 8, 2023); 4133-4148, Steve Pierson (September 15, 2023); 4168-4178, Stephanie Alexandre (September 15, 2023); 6192-6203, Joe Borgerding (September 29, 2023); 7420-7432, Lauren Perkins (October 6, 2023); 7445-7460, Johnny Painter (October 6, 2023); 11057-11077, Dave Hardy (January 18, 2024); 11163-11177, Dr. Juan Velez (January 18, 2024).

Unlike conventional feed, organic feed requires: (a) land must transition over three years from conventional to organic; (b) no use of synthetic fertilizers, no pesticides, herbicides or GMO seed; (c) distinct boundaries and buffer zones; and (d) crop rotation. Hearing Ex. 479 (MIG Ex. 66), at 4 (Testimony of Juan Velez). Conventional dairy has no grazing requirements. But for organic dairy herds, cows must graze a minimum of 120 days during a defined grazing season, and

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at least thirty percent of the Dry Matter Intake Demand ("DMID") must come from that grazing, and all animals older than 6 months of age must graze. *Id.* at 5. The NOP also regulates the actual care of cows. The organic dairy herd health requirements include a prohibition of unapproved synthetics, no hormones, no pesticides, no antibiotics (similar to feed). The management plan must include use of preventive health practices which may not restrict the use of a prohibited substance in order to preserve organic status of the animal, and an animal must be removed from the organic herd if treated with a prohibited substance. *Id*. at 6.

Dr. Velez also explained in detail the impacts of the organic regulations on the differences between conventional and organic reproduction. The reproduction tools that have increased twenty-one-day pregnancy rates from fourteen to fifteen percent to twenty-five to thirty percent for conventional are not available to organic. "We still have to do old-fashioned heat detection." Hearing Tr. 11169:19-11170:2, Juan Velez (January 18, 2024). Conventional tools shorten the calving interval meaning that "cows on . . . average [in] a herd will stay fewer average days in milk in the lactation cycle, where they are more efficient in converting feed to milk." *Id*. 11170:8-13. There is thus real science backing up the differences in production between conventional and organic.

These rules for organic versus conventional production all come with real and substantial cost differences for organic dairy farming versus conventional: (1) milk production per cow is substantially lower for organic than conventional; (2) feed and labor costs are higher than conventional production; (3) operational costs are higher than conventional production; and (4) herd replacements are more expensive together with higher disposal rates of replacements. Hearing Ex. 479 (MIG Ex. 66), at 13 (Testimony of Dr. Juan Velez). In summary, organic faces "significantly higher cost per cwt" than conventional from lower production per cow, higher feed cost per cow, higher labor cost per cow, higher maintenance cost per cow, and higher replacement cost per cow. *Id*.

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USDA must conclude that organic milk production is different from conventional milk production and that those differences translate to real and significantly higher costs to produce organic milk than its conventional counterpart.

c. Producer payments for organic milk are higher and structured differently than FMMO conventional milk.

Not surprisingly, the significant higher costs of production and the lengthy transition period from conventional to organic status results in very significant differences between farmer pay prices for conventional and certified organic milk: (1) organic dairy farmers are paid by handlers not based upon utilization, but are instead generally paid one price for being organic; (2) organic uses fixed price contracts and agreements that are generally longer than a year and longer than conventional milk contracts; and (3) organic prices paid are higher than FMMO minimum Class I prices (even without considering utilization). This analysis does not account, as discussed below, for the handler producer settlement fund pooling obligations.

OV|CROPP Cooperative provided public data with respect to the organic milk price comparisons to conventional milk:

> Organic milk also maintains higher pricing for farmers compared to non-organic milk. As an example, using the latest USDA NASS Certified Organic Survey there was a reported 5,196,491,771 pounds of organic milk annually produced with a national production value of $1,632,652,318. This results in an average organic price of $31.42 per hundredweight.
>
> Comparatively, in 2023 the average regulated minimum price has been $18.758 and Class I prices have been $21.869, which is 43.33% and 30.4%, respectively below organic milk prices from the previous year. The fact is organic milk today, and historically, has always satisfied, and often far exceeded, the FMMO tenet that farmers received at least a minimum regulated minimum uniform price for farm milk.

Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 6-7 (Testimony of Shawna Nelson) (citing USDA NASS, Certified Organic Survey 2021 Summary (Dec. 2022)).

David Hardy, an organic dairy farmer member of CROPP Cooperative, testified that their dairy farmers state as to FMMO pricing, "that's not how my monthly milk price is determined."

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Hearing Ex. 472 (MIG Ex. 65), at 3. Further, "many farmers come to CROPP Cooperative because" "they are seeking organic price premiums for their farm milk that are historically substantially higher than conventional milk." *Id*. Finally, the "cooperative provides stability in its base organic milk price." *Id*. The price does not often change. *Id*.; *see also* Hearing Ex. 475 (MIG/OV|CROPP Ex. 22B), at 8-9 (Testimony of Shawna Nelson) (farmer pay price set above regulated minimum prices annually based upon "[n]eeds of the farmer membership," "[a]bility of the co-op to meet sales targets and manage inventories," and "[c]ost of goods and co-op operations.").

Danone testified that these differences are quite substantial:

> Most importantly, organic milk producers receive a premium over traditional fluid milk. Moreover, that premium is paid as a single, unified price, not a classified price based on use. So, essentially, classified pricing is irrelevant as to organic milk. The farm gate milk price for organic milk is about $34 per hundredweight. This is significantly higher than both the FMMO regulated minimum Class I and uniform prices.

Hearing Ex. 469 (MIG/Danone Ex. 20 (Corrected)), at 4 (Testimony of Jay Luikart).

Aurora corroborated the testimony of others in the organic industry:

> 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.

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> 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.

Hearing Ex. 476 (MIG/Aurora Ex. 18), at 4 (Testimony of Cammie Garofolo).[23]

Aurora Organic Dairy further testified that unlike conventional milk, the organic handler pays the hauling cost, not the dairy farmer. "Organic farmer income is not affected by decisions regarding which plant receives their milk, nor by transportation cost increases." Hearing Ex. 478 (MIG/Aurora Ex. 18B), at 14 (Testimony of Cammie Garofolo).

USDA must conclude that in order for producers of organic milk to economically exist and comply with the legal requirements of the NOP rules, they must be compensated for very different and much greater costs than conventionally produced milk. As such, the current producer price mechanisms of the FMMO are in no way a rational basis for pricing organic milk for producers or the handlers who buy it.

d. Because FMMO treat organic milk identically, organic milk generates disorderly payments to the producer settlement fund.

Payments to organic dairy farmers are entirely disassociated with the fact that FMMOs treat organic Class I milk as if it were conventional and further require Class I handlers to incur

[23] USDA asked Horizon why organic "didn't have the ability to take into account these Federal Order regulations." Hearing Tr. 11046:20-22, Jay Luikart (January 18, 2024). Sally Keefe responded in detail on January 29. Hearing Ex. 503 (MIG Ex. 67), at 9-10 (for example, explaining that the organic milk price is not a premium over conventional but rather is determined by organic inputs and practices; "Organic production costs are not only higher than conventional but also do not necessarily track with conventional."). For example, conventional feed drives conventional milk pay prices (including for Classes III and IV), but organic feed is a wholly separate market. Further, without Class I having the same legal right and benefits as manufactured milk classes to forward contract, no Class I handler, whether organic or conventional, can contract around the FMMO requirement to equalize with the producer settlement fund. If the question presumes that organic handlers could contract with organic dairy farmers to subtract from the organic dairy farmers' pay price the value of those producer settlement fund payments, that would defeat all the benefits that organic industry is trying to afford to organic dairy farmers. *See, e.g.*, Hearing Ex. 475 (MIG/OV|CROPP Ex. 22B), at 8-9 (Testimony of Shawna Nelson).

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pool obligations to the various order producer settlement funds. These payments are simply a transfer of money from the organic value chain to PSF shared by conventional farmers, in which organic farmers do not share because their price (and costs) already significantly exceed the overall minimum price obligation. This payment obligation imposes significant costs on both organic dairy farmers and handlers both because of its size and its variability.

These higher payments to dairy farmers do not consider the fact that FMMOs further require Class I handlers to incur pool obligations to the various order producer settlement funds. For organic, these payments are simply a transfer of money from organic to mostly conventional since the payments to the organic farmers already significantly exceed the overall minimum price obligation. This payment obligation imposes significant costs on both organic dairy farmers and handlers both because of its size and its variability:

OV|CROPP testified extensively regarding this problem using NMPF 19 as an example of how much worse the producer settlement pool obligation problem would get:

> Proposal 19 represents the greatest risk of all of the non-MIG industry proposals pending at this hearing. When applied to our volumes and utilization of organic milk, Proposal 19 would exacerbate OV|CROPP's already high and unpredictable pooling obligations. While the full impact is difficult to fully anticipate, we conservatively estimate that if adopted Proposal 19 would create a 30 percent increase in our co-op's annual pooling obligations.
>
> For our organic fluid milk business, the increased Class I differentials have no bearing on where our organic milk is processed, packaged and sold.

Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 9 (Testimony of Shawna Nelson). The OV|CROPP witness further testified that Class I differential adjusted location pricing is disconnected from the cooperative's milk supply strategies and unusually long routes. She then demonstrated with a chart the detachment from the pooling obligation variability and their Class I utilization:

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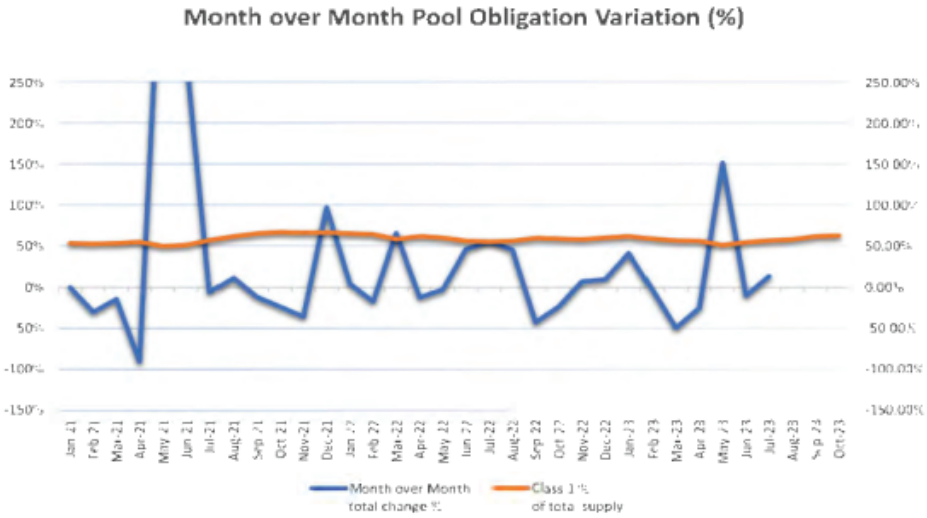
> The blue line charts the percentage change month to month of OV|CROPP's monthly pool obligations. The orange line charts OV|CROPP's monthly Class I utilization of milk as a percent of total supply. As you can see, OV|CROPP maintains a steady Class I utilization with no regard for the changes in the pool obligation.
>
> 
>
>
> Variation in pooling obligations, and associated location adjustments differential, should theoretically inform where milk would be best placed for conventional participants. That is, in fact, the justification for their existence. But as the chart above shows these regulatory signals have no discernable influence on Class I utilization for our organic milk over the last 3 years – utilization that remains remarkably consistent despite pooling obligations and variability.

Id. at 10.

The OV|CROPP witness noted that the cooperative's pool obligation rose approximately 475% over this time period with no shortage of organic milk, natural disaster, government shutdown or other condition that drove that pool bill. *Id.* at 11. "The impact of the dissonant regulation on our business cannot be overstated." *Id*. Because OV|CROPP is a cooperative, it is organic dairy farmers who bear these costs that benefit their conventional counterparts.

And significantly higher producer payroll and pool payments issues are not the whole story. Organic milk must be transported by organic-dedicated haulers. Hearing Ex. 469 (MIG/Danone Ex. 20 (Corrected)), at 4 (Testimony of Jay Luikart). Organic milk must be segregated from

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conventional milk at the processing facility. 7 C.F.R. § 205.272(a). Other supply chain costs are higher with many organic farmers being smaller farms. Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 8 (Testimony of Shawna Nelson). OV|CROPP has unique "milk movement and . . . assembly of milk destined for bottling or manufacturing." *Id.* at 7. Its average route "that serves a Class I facility, has 7 farm stops and is on average 262 milk (nationwide)." *Id*. And even that is not always the norm—some routes have "as many as 23 farm stops and a handful of routes that are more than 800 miles from the Class I facility." *Id*. Moreover, as discussed in greater detail below with respect to the lack of interchangeability of conventional and organic milk, organic processors incur significant supply chain and balancing costs not borne by the conventional industry. *See e.g.*, Hearing Ex. 478 (MIG/Aurora Ex. 18B), at 6, 8-9 (Testimony of Cammie Garofolo).

USDA must conclude that organic dairy farmers are paid more and on substantially different contractual terms for their milk than their conventional counterparts. Further, MIG established that organic handlers also incur other supply chain and balancing costs inconsistent with the FMMOs Class I differentials and, more generally, the requirements to meet the minimum pricing requirements by equalizing with the FMMO producer settlement funds.

e. Conventional and certified organic milk are not interchangeable.

Conventional milk cannot legally be marketed as certified organic milk. 7 C.F.R. §§ 205.100, 205.305, 205.310. As testified to by Alexandre Family Farm:

> We can't use conventional pool milk at our creamery. The benefit of a milk supply supported by the pooling formula is not valid when there are no organic raw milk prices tied to pool pricing. Organic raw milk producer prices are independent of the pool and are primarily long-term contracts with organic processors and cooperatives. The FMMO system does not balance for us because of the extreme loss of selling organic milk into the conventional market.

Hearing Ex. 209 (Ex. Alexandre_DF), at 3 (Testimony of Stephanie Alexandre).

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While nothing in federal law prohibits organic milk from being marketed as conventional milk, economic and practical realities make that a rare and insignificant occurrence within FMMOs. Testimony from organic handlers described the many different ways in which organic handlers (in partnership with many parties, including their dairy farmers) seek to balance organic supply and demand with insignificant sales into the conventional market being the last resort.

OV|CROPP explained the multi-step process it goes through (often due to plant disruptions outside of its control) that results in the rare circumstance of organic milk being sold as conventional. OV|CROPP has a current target of 98.85% of its milk going into organic. OV|CROPP first makes every effort to sell the milk as organic. This includes inventory management, balancing, and other supply chain management. OV|CROPP reaches out to customers, to see if bulk milk sales or other opportunities exist from the milk. Then, if it has no other options, it considers the conventional market. But as noted, these organic sales are not typically driven by supply management issues, but by processing disruptions—a plant breaking down, weather challenges, etc. Additionally, the 1.15% of milk not utilized as organic includes milk that must be dumped or otherwise not used due to quality or temperature issues. Hearing Tr. 11105:12-11106:11, Shawna Nelson (January 18, 2024).

Aurora Organic Dairy also detailed the myriad of ways in which it balances its own supplies incurring substantial expenses and capital investments. Hearing Ex. 478 (MIG/Aurora Ex. 18B), at 6-8 (Testimony of Cammie Garofolo). Moreover, the balancing risk for organic is high due to the lack of interchangeability. *Id*. at 6. The FMMO system provides no mechanism for organic processors to receive milk from FMMOs. *Id*. at 7. Aurora has invested significant capital to balance its supply through ESL processing (e.g., long code dates of 65 to 240 days) and storage. *Id*. at 7-8. In addition, Aurora produces organic powder at an incremental cost and value loss, adjusts farm management practices including collaborating with its farmer partners, and dumps or sends milk to animal feed. *Id*. at 8.

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The balancing solutions for organic are quite expensive with ESL processing and filling equipment costing three times more than HTST; aseptic processing and filling equipment costing five times more than HTST; and 22,000 pallets of cold storage. *Id*. at 9.

> To give you some sense of the scale of how much inventory we carry, this particular facility holds 2.5 million gallons of milk. If you unloaded all the pallets, loaded them on trucks, and lined the trucks up on the highway, end to end to end, they would cover seven and a half miles. So it is a significant amount of product that we carry all the time.
>
> The other place that we have invested is in our processing facilities, in our ESL and our aseptic lines. ESL processing equipment costs three times more than an HTST line, and an aseptic processing and filling line costs five times more than an HTST line. So there's significant capital tied up into being able to achieve those extended shelf lives, which give us flexibility when we're needing to balance fluctuations and supply versus demand.

Hearing Tr. 11132:17-11133:4, Cammie Garofolo (January 18, 2024); Hearing Ex. 478 (MIG/Aurora Ex. 18B), at 9 (Testimony of Cammie Garofolo).

Danone also supported this last resort proposition:

> Q. And if Danone finds itself with a surplus of milk, how does it manage that side of balancing?
>
> A. So the first -- the first thing we do is find a home for it in our finished goods. It's the most cost effective way for us. We have paid a lot of money for this milk. It is liquid gold. We got to put it into our products. If we cannot do that for some reason, we would potentially utilize a -- you know, within Danone, a different product that could be conventional and downgrade the milk. But it is very, very expensive, so we try to avoid that as much as possible and we make it as rare as we possibly can.
>
> Q. And do you ever sell it on the open market?
>
> A. It could be possible. It's not -- not frequent. We -- we don't want to do that at all, if possible.
>
> Q. And if you did, do you typically sell it as organic milk first and conventional milk second, or how does that --
>
> A. We would try organic, if possible. If that's not possible, then we would sell it as conventional.

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> Q. And you said is -- does that occur with some frequency or is that quite rare?
>
> A. We would like it to be rare. That's the intention. It's usually centered around a, you know, maintenance downtime at a plant or something like that where we have got a reason why we have to move milk.

Hearing Tr. 11025:24-11026:21, Jay Luikart (January 18, 2024).

Aurora Organic concludes that while sales to the conventional market are theoretically possible, "it is just not a viable outlet." Hearing Tr. 11131:20-11132:1, Cammie Garofolo (January 18, 2024):

> I know the question has come up from -- in this hearing about how much organic milk gets balanced into the conventional market. And in our case I looked back over the last ten years, and we have sold into the conventional market .4% of our milk supply. And when we have done so, it's been into either Class III or Class IV. And it's been at a price no higher than the Class III or Class IV, and often there have been times where it's been lower.
>
> The conventional market for us is just not a viable outlet. If we have milk to go into -- and we try to go into the conventional market at a spot -- in the spot market, often we find that the buyer that can take it is so far away that the cost to haul it doesn't even make it worth it to send it, so it is better for us almost to dump it than to pay as much or more to haul it there than what we're going to get paid. So we really focus on balancing within our own footprint a lot. And anybody that you talk to at Aurora can tell you the "B" word comes up every day.

Hearing Tr. 11131:17-11132:10, Cammie Garofolo (January 18, 2024). The ability to maybe obtain a Class III or Class IV price naturally leaves out the fact that Aurora pays the hauling costs and so it eats that loss as well. In short, the exceptionally rare circumstance of organic milk balancing on the conventional market serves only as a red herring likely to be raised by opponents who wish to keep the organic processor payments to the pool within the FMMO system.

Finally, there is no evidence that consumers of organic milk will substitute conventional milk for organic milk if organic milk is not available:

> Q. Yes. I mean, when you -- when you -- a consumer of organic milk, if it's not available on the shelf, what do they purchase?

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> A. It varies. Today I would say that many of them will purchase a plant-based beverage. They -- most often people switch in to organic milk from conventional milk. But they don't necessarily go back to conventional when organic is not available.

Hearing Tr. 11599:16-23, Sally Keefe (January 29, 2024); *see also* Hearing Tr. 11141:8-11142:14, Cammie Garofolo (January 18, 2024) (discussion of inability of organic milk to compete with plant-based products); Hearing Tr. 10935:6-11, Tim Kelly (January 18, 2024) ("Look at the shelf space that is given to the plant-based alternative beverages, and that's who I'm really competing with . . . ."). USDA must conclude that organic milk shortages will not be balanced by consumers using the conventional market. Opponents to MIG introduced no record evidence to the contrary.

Finally, if and when USDA does take up the issue of the proper treatment of organic milk within FMMOs, there are a number of ways to address any organic milk that could mitigate any potential for adverse impacts on the conventional dairy farmers. For example, USDA could choose to only regulate organic milk marketed as conventional. USDA could treat any such milk as "other source milk" or under some similar rule that limits a certified organic handler's use of any FMMO exemption if such a condition is found to have occurred.[24] Moreover, market administrators already have the ability to address handler reporting under 7 C.F.R. § 1000.25(c)(6). The answer is not to ignore the problem.

USDA must conclude that conventional and organic milk are not interchangeable.

f. FMMOs cannot fulfill the declared policy of the AMAA when regulating organic milk.

The consequences that conventional milk cannot be marketed as organic milk obviously means FMMOs are incapable of their basic underlying purpose to bring forth an adequate supply of organic milk for fluid use. And yet that basic premise is the *quid quo pro* that FMMOs

[24] Without conceding that an organic handler's 2021 termination of under a hundred organic farmers would fall under this rubric, MIG acknowledges that issue which would best be determined and addressed within the framework of any differential treatment for organic milk. Hearing Tr. 11037:14-11038:26, Jay Luikart (January 18, 2024).

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purportedly provide to Class I handlers in exchange for being the captive class of milk that is always required to pool their milk. As stated by Aurora Organic's witness:

> And lastly, in terms of the incentives, there's -- again, there's not really any -- the price surface, so the pricing mechanisms in the FMMO system don't provide any incentives to really attract any additional organic milk into Class I. It doesn't encourage it to shift between classes, and it doesn't encourage new supply.

Hearing Tr. 11128:15-20, Cammie Garofolo (January 18, 2024).

No increase in the level of performance standards would incentivize the production of one drop of organic milk available to organic handlers not already produced. And worse, adoption of Proposals 1, 2, or 19 would simply increase the amount of money organic handlers pay to the producer settlement funds. The Class I proposals open in this proceeding can only work to the disadvantage of organic handlers, as well as organic farmers, who would see more monies diverted to the conventional market.

Returning to the balancing issue, organic's risk management for balancing is also adversely impacted by this asymmetric issue of paying a price while not receiving the promised service:

> 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.

Hearing Ex. 476 (MIG/Aurora Ex. 18), at 4 (Testimony Cammie Garofolo).

This disconnect between AMAA policy and the inability to bring forth organic milk would only be compounded by adoption of Proposal 19, whether or not USDA relies solely on the USSDS model or NMPF's Class I differential machinations because the USDSS does not take into account organic milk production, processing or consumption. Hearing Tr. 6996:20-6997:7, 7046:26-28, Chuck Nicholson (October 4, 2023) (discussion of how organic milk is not treated any differently

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than conventional in the model); *see also* Hearing Tr. 10200:23-10201:4, Mark Stephenson (December 7, 2023) (discussion of one aggregated category of Class I products including organic in the model); Hearing Tr. 10473:18-27, Sally Keefe (January 16, 2024) (discussion of model's treatment of specialty milk including organic). As discussed by Aurora Organic's witness there are multiple flaws when addressing organic and Class I issues in this hearing: (1) as discussed, *supra* pp. 13-15, there is an adequate supply of milk for fluid use, but in particular that plainly exists in Colorado, Hearing Tr. 11134:8-13, Cammie Garofolo (January 18, 2024); Hearing Ex. 477 (MIG/Aurora Ex. 18A), at 6-7 Tables 1-2 (Testimony of Cammie Garofolo); (2) the proposed increased based upon increased hauling costs would charge organic milk twice for hauling since organic handlers pay the haul from the farm, Hearing Tr. 11134:14-20, Cammie Garofolo (January 18, 2024); and the organic supply chain is different from the conventional market such that the neither the USDSS model nor NMPF 19 properly account for the production, processing and consumption of organic milk.

> I want to show you how the organic supply chain is different, in particular and in the context of the University of Wisconsin model, which is being used to set the price surface. The organic supply chain is very different, and I'm going to show you in our case how different it is versus what the model assumes happens. And I think that's something that we have to be very mindful of when we are setting policy based on the model to organic products.

Hearing Tr. 11134:21-11135:1, Cammie Garofolo (January 18, 2024).

> So I want to talk a little bit about the model. The model, I understand, has a lot of inputs and is very rigorous in many aspects. But I think that there's one important aspect that is missing, and it's concerning when we're using it to set policy. And that is the assumptions that it makes in regards to organic supply chains, and mine in particular.

Id. 11137:20-26.

The Aurora Organic witness then discussed Figures 1 and 2 on Hearing Exhibit 478 (MIG/Aurora Ex. 18B), at 15 which examined Aurora's plant locations, milk supply and sales distribution all of which are different from those assumed by the USDSS model and NMPF:

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FIGURE 1
Excerpt from Dr. Nicholson Figure 5. Milk Assembly at Fluid Plants and Packaged Milk Flows (small USDSS model), May 2021 (Exhibit 302)

> [Figure 1] is just a snapshot of the area of the United States where my two plants reside. And you can see on the left I've got a red circle. That little triangle is our Platteville plant. And on the right side, the triangle with the red circle is our Columbia, Missouri, plant.
>
> Now, the way that these lines work, the orange lines are the assumptions about where the milk is shipped from that plant, and the green lines are the assumptions on the raw milk flows.
>
> So if you look at my Platteville plant, you will see that there is green lines actually leaving where my plant is moving south. That's because my plant is in Weld County, which is, I think, 60% – I have to look in my testimony – I think it is 60% of the cows in Colorado are in Weld County. So the milk supply is almost – is very concentrated in Weld County, and it is actually moving out of the county, not in.
>
> The orange lines are the assumptions as to where my plant distributes. So it assumes that I'm reaching as far as Western Nebraska, Southern Wyoming, and Eastern Colorado.
>
> And if you look over to the Columbia plant, you can see that it assumes my milk supply is coming from Southern Iowa, and I'm hitting St. Louis.

Id. 11137:27-11138:23.

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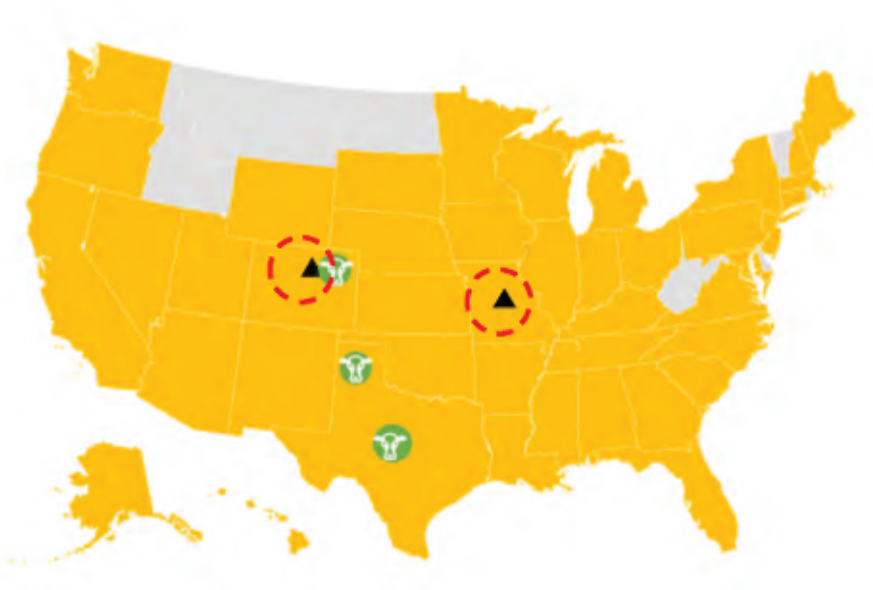
FIGURE 2
Aurora Organic Dairy Milk Production and Processing Footprint and Packaged Milk Flows, 2023



> So now if you look at the map [Figure 2], the orange states are where I distribute – I ship milk out of my two plants. And you can see my two plants are circled in red, and the green dots are where my dairy farms are that are supplying the majority of my milk. So you can see that my milk supply is traveling a much longer distance to my plant, and my packaged milk, my finished goods, are going much farther and much wider.

Id. 11138:24-11139:3. The Aurora witness went on to explain that Aurora's distribution includes Alaska and Hawaii and that Figure 2 show that it is competing nationally against processors and not just in Colorado or Missouri as the USDSS model and NMPF suggest. The Aurora witness then discussed the problems and risks of using a one-size fits all approach for Class I differentials:

> And I think this is very concerning because we're looking to set policy for organic products based on this, because we are being grouped in with everything else, without being considered that we're different.

Id. 11139:12-15.

The Aurora Organic witness further concludes that based upon OV|CROPP's testimony, OV|CROPP's supply chain is very similar to Aurora's. *Id*. 11139:16-21; Hearing Ex. 475

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(MIG/OV|CROPP Ex. 22B), at 3 (Testimony of Shawna Nelson); Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 8 map 1 (Testimony of Shawna Nelson). Crystal's Humboldt, California facility is primarily organic and faces the same fundamentally flawed supply chain issues based upon erroneous estimates of milk movements in Northern California. Hearing Ex. 485 (MIG/Crystal Ex. 19A), at 3-4 (Testimony of Jacob Schuelke).

USDA cannot solve a dilemma inspired by NMPF's proposals to raise Class I prices across the board without accounting for the issues raised by including organic milk in the FMMOs. Organic milk simply does not fit neatly, if at all, within the existing regulatory framework. Raising Class I prices on organic milk with all of these counter arguments would itself lead to disorderly marketing—the most obvious being that Class I organic handlers would face increased producer settlement fund obligations without any commensurate benefit. The FMMOs do not and cannot encourage one drop of organic milk to be delivered to more organic fluid needs and organic handlers pay the haul that is embedded in Class I differentials.

Moreover, OV|CROPP also testified that adoption of NMPF 19 could lead to inefficient movements of organic milk.

> Review of the 13 fluid plants across the U.S. where we process, and package fluid milk shows a multi-million dollar annual increase in our pooling obligations when compared against a previous baseline. The demonstratable impact of this portion of the Class I differential functions akin to a tax that we have no ability offset or mitigate fully. Instead, our only option would be to reconsider our milk shipments and routes to see if there are more advantageous approaches under the regulations, when balanced with increased costs such inefficient movements would incent. Federal regulations should not contradict market forces in such a way.

Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 11 (Testimony of Shawna Nelson); *see id*. at 12 tbl.2. USDA regulation should prevent, not encourage that result.

The AMAA provides alternatives to FMMO uniform prices through consideration of "market" or "production" differentials, but USDA has failed to adopt such differentiated prices for organic. 7 U.S.C. § 608c(5)(A). USDA exacerbated this problem by its refusal, over MIG's

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objection, to hear MIG Proposal 6. MIG's Proposal would have at least provided an option for organic milk that would have removed this threshold issue and allowed USDA to consider more generally changes to Class I prices. But with the problem now unresolvable in this proceeding, the only option USDA has which would not create disorderly marketing in organic milk is to deny all proposals which would increase Class I prices at least until organic milk can be appropriately recognized and treated under terms and conditions that also protect the conventional market, should such conditions turn out to be warranted.

g. Increasing organic Class I prices for handlers of organic milk would be disorderly.

The foregoing discussion demonstrates that both the existing FMMO pricing and pooling of organic milk and any increases to Class I pricing proposed at this hearing are disorderly:

- The system does nothing to incentivize the production or delivery of organic milk. Hearing Ex. 471 (MIG/Danone Ex. 20B), at 7 (Testimony of Jay Luikart);
- The system sends the "wrong signals to the market." Hearing Ex. 469 (MIG/Danone Ex. 20 (Corrected)), at 4-5 (Testimony of Jay Luikart);
- "By increasing the conventional price, organic farmers' pool payments promote increased production of conventional milk, while that very milk cannot be used for organic dairy products." Hearing Ex. 473 (MIG/OV|CROPP Ex. 22 (Corrected)), at 9 (Testimony of Shawna Nelson);
- "Organic milk markets are disconnected from the conventional market and yet organic milk pays into the FMMO pools without drawing any benefit (especially no ability to raise shipping percentages to get more organic milk)." Hearing Ex. 485 (MIG/Crystal Ex. 19A), at 5 (Testimony of Jacob Schuelke); and
- Organic milk's payments to the pools increases the blend price paid to "non-organic producers. By increasing the conventional price, organic farmers' pool payments promote increased production of conventional milk, while that very milk cannot be used for organic dairy products. This is simply unfair." And that is disorderly. Hearing Ex. 473 (MIG/OV|CROPP Ex. 22 (Corrected)), at 9 (Testimony of Shawna Nelson).

Based upon this for now unsolved conundrum, USDA must reject Proposals 1, 2, and 19.

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2. Any Increase in Class I Obligations to the FMMO Program Would Constitute a Takings for Which Organic Handlers Must Receive Compensation Under the Supreme Court's Ruling in *Horne v. USDA.*

Failure to address the organic issues within the FMMOs risks invalidating the proposed regulations leading to Class I price increases. Even if valid under the AMAA, the existing (and certainly any increased) Class I prices charged on organic milk under the FMMOs must be able to withstand a Tucker Act claim for an unconstitutional takings without compensation. 28 U.S.C. § 1491 (2024). In a recent court challenge regarding USDA's raisin marketing program, similarly promulgated under the AMAA, the Supreme Court ruled that USDA cannot take a handlers' property without handlers receiving just compensation under the U.S. Constitution's Takings Clause. *Horne v. Dep't of Agriculture*, 576 U.S. 350 (2015) (a decision post-dating FMMO Reform and not previously available for USDA to consider with respect to increasing Class I prices on organic milk, resulting in increased payments to the producer settlement funds). The raisin program previously required raisin handlers to withhold and turn over to AMS a certain quantity of raisins, to be held in reserve. AMS then would sell the raisins domestically or internationally, or otherwise dispose of them in a manner consistent with the programs' aims of managing an orderly market. A raisin handler, the Horne family, objected to the requirement as in violation of the Fifth Amendment and an unlawful taking.

The Ninth Circuit concluded that the Government here imposed a condition (the reserve requirement) in exchange for a Government benefit (an orderly raisin market). And just as a landowner was free to avoid the government condition by forgoing a permit, so too the Hornes could avoid the reserve requirement by "planting different crops." *Id.* at 357. Under that analysis, that court found that the reserve requirement was a proportional response to the Government's interest in ensuring an orderly raisin market, and not a taking under the Fifth Amendment.

The Supreme Court rejected this argument and reversed, holding unequivocally that, "[s]elling produce in interstate commerce, although certainly subject to reasonable government regulation, is … not a special governmental benefit that the Government may hold hostage, to be

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ransomed by the waiver of constitutional protection." *Id.* at 366. Likewise, the Court rejected the argument by the government that "general regulatory activity such as enforcement of quality standards can constitute just compensation for a specific physical taking." *Id.* at 368.

As applied here under FMMOs, at a minimum the organic dairy industry has a valid Tucker Act claim. USDA cannot justify any increase of Class I prices when such increases provide no commensurate benefit in return to organic dairy farmers and organic handlers.[25] Maple Hill Creamery, speaking for itself as a small business and its 120 small business dairy farmer patrons, expressed the frustration that would be imposed by "a potential 80% increase in the pooling" fees "on our business with 0 benefits to our stakeholders and will do nothing to increase pay prices to our farmers" and no impact on the availability of milk from those farms with the risk that pay prices will go down. Hearing Ex. 432 (Ex. Hau-DF1), at 6 (Testimony of Jim Hau).

To the extent that the organic dairy industry receives market information, auditing, and other services from USDA or the market administrators for which it does receive benefits, that is separately accounted and paid for by producers and handlers under the program assessments. *See e.g.*, 7 C.F.R. § 1001.85. Moreover, USDA cannot successfully assert a defense that the taking is really for the benefit of private parties and not the government when the producer settlement funds are held by USDA only for equalization of payment to dairy farmers. Such an argument was extinguished, if it ever existed at all, in *Kelo v. City of New London*, 545 U.S. 469, 477 (2005) (confirming that an eminent domain taking for private development nonetheless required the government to compensate the real property owner); *see also Cedar Point Nursery v. Hassid*, 594 U.S. 139, 148 (2021) (U.S. Supreme Court case following Horne discussing the government's "appropriat[ion] of private property for itself *or a third party*" (emphasis added)).

[25] MIG does not waive conceded that this argument is limited only to the organic segment; it can apply more broadly to all Class I handlers, especially as Crystal Creamery cogently argued, as FMMO regulation leads to independent dairy farmers shipping to Class I handlers worse not better off. *See infra* pp. 134-35, 187-191.

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This issue is aptly summarized by OV|CROPP: "It is said that FMMOs is a program for dairy farmers – however, it is certainly not a program for organic dairy farmers." Hearing Ex. 473 (MIG/OV|CROPP Ex. 22 (Corrected)), at 13 (Testimony of Shawna Nelson). USDA has had multiple opportunities to address organic milk's FMMO issues. It simply can no longer ignore that historical FMMO pricing regulations no longer meet their statutory aims in the new marketplace of organic milk. USDA cannot have it both ways. Either USDA must treat organic differently in the FMMOs from conventional milk or USDA must, using taxpayer dollars, compensate organic handlers and organic dairy farmers for the taking of monies paid to the producer settlement funds.

V. OBJECTIONS

A. USDA Must Reject AFBF's Request for Emergency Status.

On February 22, 2024, USDA received a post-hearing letter that is neither a brief, nor a request for conclusions of fact, making it an impermissible ex parte communication. 7 C.F.R. § 900.16. Accordingly, MIG and IDFA submitted an objection on March 7, 2024. Although USDA has posted it to the website, it is still objectionable, especially as it purports to provide factual material other than that adduced at the hearing. 7 C.F.R. § 900.9(b). Both Chief Administrative Law Judge Strother and Administrative Law Judge Clifton accepted the AFBF and MIG and IDFA submissions as argument. MIG attaches the MIG and IDFA submission as Exhibit 1 hereto and incorporates it by reference. In addition, as noted in footnote 1 in the MIG and IDFA submission, the substantive arguments responding to AFBF's improper submission are made in this Brief and Proposed Findings of Fact and Conclusions of Law. *See infra* pp. 137-45.

B. Other Objections.

MIG preserves all of its objections raised at the hearing. 7 C.F.R. 900.8(d)(2). Additionally, MIG preserves its prior objections regarding USDA refusal to consider two of MIG's proposals: MIG Proposal 5 (addressing ESL Shrink) and MIG Proposal 6 (a partial exemption

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from FMMOs pricing regulations of certified organic milk), as detailed in MIG's Objection to USDA submitted on August 23, 2023 (MIG Ex. 1, Hearing Ex. 60).

VI. USDA SHOULD REJECT PROPOSALS 1 AND 2

Proposals 1 and 2 would increase the protein and other solids component factors in the minimum price formula for Class III skim milk and the nonfat solids component factor in the Class IV skim milk minimum price formula. These changes, in turn, would increase the Class I and Class II skim milk prices. USDA should reject Proposals 1 and 2[26] because they rely on erroneous assumptions about the value of and actual component levels in milk used as Class I.

MIG directly proved, including with the only empirical record evidence specific to Class I processors, the following: 1) consumers do not value additional components in their fluid milk, and 2) Class I processors do not actually receive components at the levels in the Proposal 1 and 2 skim component formula factors. NMPF failed to cite *any* studies or research in support of their skim component factors having any value (let alone a specific value to wholesale customers and fluid milk consumers). Further, MIG submitted comprehensive and reliable data of *actual* component levels of milk receipts, and this data contradicted NMPF's primary support for its proposal. Finally, NMPF failed to establish any disorderly marketing conditions with the current component factors.

While Proposals 1 and 2 purport to modify the component factors in the Class III and IV formulas, USDA must conclude that the actual result of the proposals is really just an attempt to increase Class I prices and, in turn, producer prices. USDA should not accept as true NMPF's professed intention that their package of proposals, inclusive of Proposals 1 and 2 is "designed to be revenue neutral." NMPF's proposals which seek to increase Class I prices are clearly not

[26] NMPF and NAJ each submitted proposals with identical component levels, but differing by the mechanisms by which they update the proposals over time. MIG's criticisms apply equally to both proposals, and (unless explicitly stated otherwise), for ease of reference, MIG will refer to "NMPF" or "NMPF's proposal" to include both Proposals 1 and 2.

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standing of their own accord, but designed to counterbalance proposed adjustments in make allowances which would decrease farmer prices. As discussed above in the Executive Summary, *supra* p. 3, this is not a legitimate basis to increase Class I prices under the AMAA. Thus, USDA must reject both milk composition proposals.

A. Class I Cannot Derive Additional Value from Higher Components, so Proposals 1 and 2 Would Amount to an Unjustified Price Increase on Class I Milk.

If either of the milk composition proposals were adopted, from a minimum regulated price perspective, Class I handlers would have to pay an additional ***$240 million*** for their milk annually—a substantial increased cost for which they will receive no benefit. Hearing Tr. 968:13-21, Mike Brown (August 28, 2023). NMPF's narrow focus on whether there is value in components confuses the issue, which should focus on whether there is an *additional value to Class I* in the increase from the current component factors to the proposed. As made clear from the evidence at the hearing, once milk components meet the necessary standard of identify for fluid milk products Class I processors cannot generate any additional value from the higher components. For a processor to be able to label its product as containing protein above the standard of identity, processors would need to be able to be guaranteed to reliably receive milk with 3.51% protein on a skim basis. Hearing Ex. 458 (MIG/Hood Ex. 21), at 4 (Testimony of Michael Newell). With Proposals 1 and 2 setting protein at 3.39% on a skim basis, producers have no incentive to meet that higher standard and processors will be unable to capture additional value (if any) from higher protein content on their label. *Id.* Thus, USDA has no justification for increasing the skim formula component factors and thereby raising Class I prices

1. In contrast to Class III and IV processors, Class I processors cannot generate value from components (other than butterfat).

Class I plants do not derive value from any components other than butterfat, which is already separately accounted for at its actual levels. Hearing Tr. 1128:5-9, Wendy Landry (August 29, 2023) (noting there is "no advantage to having a higher protein level")); *see also* Hearing Ex.

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111 (MIG Ex. 5), at 7 (Testimony of Sally Keefe). Proposals 1 and 2 presume that components in fluid milk used for Class I products have the same value as components in milk used for Class III and Class IV products, which is not the case. *See id.* NMPF conceded that only manufacturing classes can realize the value of increased component levels. Hearing Tr. 189:5-15, Peter Vitaliano (August 23, 2023) (When milk has increased components, "the value of those components are realized when that milk is manufactured into Class III or Class IV products."). The component levels of milk packaged as fluid milk has no impact on the volume of milk produced. Hearing Tr. 437:3-8, Calvin Covington (August 24, 2023) ("[Y]ou don't get any more gallons of milk . . . used for fluid regardless of those component levels."). In contrast, a Class III plant could take the higher levels of protein or solids and produce a larger volume of cheese—thereby creating value and revenue from the higher components.

Raising Class I prices due to skim component formula factor increases, as Proposals 1 and 2 seek to do, would take more money from Class I that it cannot recover in the market. *Id.*; Hearing Ex. 105 (MIG/Shehadey Ex. 4), at 3 (Testimony of Jed Ellis) ("Shehadey Family Foods would not be able to pass along to the market this increased cost from Proposals 1 and 2."). In the words of Class I handlers:

> These proposals raise the component levels on the basis that there is additional value in milk with higher components. But there is no way in the manufacturing process for Class I processors, like Hood, to "capture" that value of higher components.

Hearing Ex. 102 (MIG/Hood Ex. 3), at 8 (Testimony of Wendy Landry).

> Class I processors like us can't standardize these components, so there is no way to capture them and use them in another way or get more final product from the raw milk. To re-emphasize that point, the costing and pricing models that our largest retailers use to price the Class I milk they buy from us are only based on Skim and Butterfat, and therefore they do not directly pay for other components nor ask for component levels.

Hearing Ex. 105 (MIG/Shehadey Ex. 4), at 3 (Testimony of Jed Ellis).

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The result of the Proposals would be both predictable and imbalanced—yet again, the FMMO captive Class I processors would face minimum regulated prices that do not reflect market realities, while other competitors for the same raw milk (including manufacturers) would pay for it based on the components they actually received. This disparity both harms Class I processors' ability to ensure a sufficient supply of fluid milk and consumers' ability to continue to afford fresh, wholesome milk.

2. Federal law setting the fluid milk standard of identity prohibits processors from utilizing components to increase yield.

Class I processors cannot and will not capture any additional value or yield from increased components because federal regulations for the fluid milk standard of identity limit the modification of packaged fluid milk to adding or removing butterfat. USDA should use the standard of identity as a guidepost for evaluating which component levels are relevant to the Class I market. This approach accounts for the other legal limitations on Class I processors, the reasonable expectations of consumers, and the economic realities of the marketplace. Hearing Tr. 966:1-6, Mike Brown (August 29, 2023) (higher protein levels do not result in higher yield of Class I products "[b]ecause of standards of identity," which processors cannot adjust).

The federal standard of identity for milk only permits standardization of the milk by removing or adding milkfat and/or adding milk solids: "Milk may have been adjusted by separating part of the milkfat therefrom, or by adding thereto, cream, concentrated milk, dry whole milk, skim milk, concentrated skim milk, or nonfat dry milk." 21 C.F.R. § 131.110(a). This standard sets limits on what Class I processors can do to raw milk they receive. The only way to modify milk by removing something is removing milkfat. *See* Hearing Ex. 102 (MIG/Hood Ex. 3), at 7 (Testimony of Wendy Landry); *see also id.* at 8 ("The way milk is processed in our Class I facilities there is no way to extract, separate, or reduce the components if the levels are higher than needed."). Otherwise, fluid milk product manufacturers may only add to milk, and may only do so by fortifying with cream, nonfat dry milk, or similar products. *See id.* at 7.

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The fact that the standard of identity for milk expressly permits only separation of butterfat is especially instructive on this value proposition. In standardizing milk to specific butterfat levels, fluid milk processors can use the excess cream in Class II products or sell the cream to others thereby realizing that value. Hearing Tr. 454:3-12, Calvin Covington (August 24, 2023). This explains why in all FMMOs USDA prices both skim and butterfat. But the same is simply not true with respect to protein and nonfat solids. Class I processors must comply with the standard of identity, meaning it will be impossible for them to capture additional value from higher components. No amount of innovation or processing efficiencies can change the standard of identity for milk. USDA must not burden Class I processors with competing obligations between complying with federal standard of identity regulations and trying to capture the value necessary to meet the FMMO pricing regulations.

Class I handlers in California face even more financial unfairness given their state's fortification standard. This standard requires that fluid milk be fortified with nonfat solids at a level above the federal standard. To meet the California standard, processors buy additional solids to add to fluid milks in the form of condensed milk or nonfat dry milk. Hearing Tr. 5811:1-9, Jacob Schuelke (September 28, 2023). This requirement has not, generally, translated to other markets, as California Class I handlers have not been successful in selling higher-protein fluid milk products for a higher price because of protein levels on a mass level. *Id.* 5811:10-19; Hearing Tr. 1186:2-22, Jed Ellis (August 29, 2023) (no customer outside of California has ever requested Shehadey's California fortified milk with higher protein). Without measurable benefits, California processors are paying twice for components. As California Class I processors described:

> [O]ur primary objection [to Proposals 1 and 2] is that the components we receive now . . . are well below the new proposed standard. So due to the California fortification standard, I would have to pay twice for these products: One, I would buy the products to get up to the level that I paid for, and then, next buy them again to get to the California finished product standard.

Hearing Tr. 11283:10-23, Jacob Schuelke (January 19, 2024).

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3. Customers and consumers have not recognized any additional value in higher-component traditional fluid milk and neither has USDA.

Proposals 1 and 2 rest on the assumption that consumers recognize and find greater value in products with higher component levels. But USDA has long recognized both that consumers do not place higher value on higher protein milk and that the standard of identity prevents the removal and sale of protein. When USDA first adopted MCP pricing in the then Great Basin and Lake Mead FMMOs, it expressly noted this lack of value for Class I proposition:

> While protein content was seen to be critical in establishing the value of milk used in cheese, there was no evidence that protein content has any effect on the value of fluid milk products at all. On the contrary, there appears to be general agreement that consumers are not willing to pay more for fluid milk with a higher-than-average protein content than they are for low-protein milk. Handlers cannot easily remove protein from fluid milk products to add it to products in which it would have value, and it is illegal for them to add water to milk to reduce its protein content. Therefore, handlers obtain no discernable difference in economic benefit from the various levels of protein contained in milk used in fluid milk products, and there is no justification for requiring them to pay for such milk according to its protein content.

Milk in the Great Basin and Lake Mead Marketing Areas, 53 Fed. Reg. 686, 702 (January 11, 1988). USDA has never in the intervening 35 years found otherwise. USDA should thus reject Proposals 1 and 2 on this ground alone.

NMPF failed to enter into the record any study or research supporting their assertion that USDA should reverse this policy because consumers now attribute any measurable value to traditional milk for its protein, other solids, and solids nonfat content. Hearing Tr. 453:12-23, Calvin Covington (August 24, 2023). They have "not done supermarket pricing surveys" and do not know what percentage of milk sold nationally is marketed on the basis of higher protein levels. Hearing Tr. 191:4-13, Peter Vitaliano (August 23, 2023). In fact, testimony at the hearing, detailed below, established that consumer expectations (and the marketing practices developed in response to those expectations) for fluid milk products are based only on butterfat levels.[27]

[27] While certain innovative products have found success with utilizing the components in unique ways—for example, fairlife and Lactaid—the FMMO regulations apply uniformly to all milk. First, these entities have utilized technology and innovation to generate additional value and consumer demand. Certainly, the

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Washington, D.C. 20005
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MIG members who operate Class I plants are the industry participants who are undoubtedly most focused on customer and consumer desires and expectations for fluid milk. And these processors confirmed that they do not market traditional fluid milk products based on the skim components:

> In my experience, I also have never had a customer express any demand or desire for any other components except butterfat. To be honest, I am not sure most of Hood's customers know what nonfat solids or other solids even are (let alone have a demand for them). And I am confident that the average consumer purchasing our products does not know what solids and other solids are. And if there is no demand by retailers for components, there is no way for Hood to raise its prices to customers based on higher component levels.

Hearing Ex. 102 (MIG/Hood Ex. 3), at 9-10 (Testimony of Wendy Landry).

> As a Class I handler, having an increased level of non-fat solids, protein and other solids is of no value to us or our customers are it does not increase the amount of volume of product we can bottle. Retailers do not pay Class I manufacturers based on component tests, but only on which item they are purchasing at a fixed price. I can tell you that Shehadey Family Foods would not be able to pass along to the market this increased cost from Proposals 1 and 2.

Hearing Ex. 105 (MIG/Shehadey Ex. 4), at 3 (Testimony of Jed Ellis). *See also* Hearing Ex. 465 (MIG/AE Ex. 17B), at 6 (Testimony of Warren Erickson) (no customer has ever asked AE for more protein or nonfat solids in AE's Class I products).

If the skim components had value to traditional fluid milk consumers, Class I would be making attempts to capture that revenue. But fluid milk consumers do not expect fluid milk products to reference specific levels of nonfat solids, protein, or other solids. Hearing Tr. 1411:6-

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regulations would not require that all traditional milk become specialty milk based on components. Short of that, these success stories in the industry are just that—success stories, not baselines for regulations. And any fluid milk products touting increases in skim components must either undertake significant investment in technologies like ultrafiltration to concentrate proteins and other solids in the milk, or add solids. Hearing Ex. 111 (MIG Ex. 5), at 6 (Testimony of Sally Keefe); Hearing Tr. 1430:13-20, Sally Keefe (August 30, 2023). The market also has not responded uniformly to protein-enhanced products. Hood sells a protein-enhanced Lactaid fluid product, but after three years on the market it accounts for less than 1.8% of Lactaid fluid sales. Hearing Ex. 458 (MIG/Hood Ex. 21), at 5 (Testimony of Michael Newell). Even plant-based beverages have not seen a boost from touting "high protein" content. *Id.*

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17, Sally Keefe (August 30, 2023) (nutrition facts based on federal composition standard are "what consumers see and expect."). Proposals 1 and 2 risk sending inaccurate signals to producers, incentivizing them to invest in practices that raise components that will have no use to Class I processors. Hearing Ex. 105 (MIG/Shehadey Ex. 4), at 3 (Testimony of Jed Ellis) ("[R]aising component levels for Class I also unfairly pressures farmers to invest money and resources into raising components when the Class I fluid market does not require them to do so" and "we wouldn't want our suppliers to be spending this money to raise their component levels when we can't use them.").

B. Class I Plants Do Not Consistently Receive the Component Levels in Proposals 1 and 2.

NMPF's proposed increases in the Class III and Class IV skim price formula component factors, would in turn raise the Class I price (as the Class I skim price formula incorporates the two manufacturing skim prices). First, even the FMMO data relied upon by NMPF shows that the proposals would set components at higher levels than processors uniformly receive. But more importantly, in order to raise Class I prices on the basis of increased components, NMPF had to establish as a predicate that ***Class I processors*** themselves ***actually received those components***. They failed to do so. Evidence presented at the hearing establishes that the component values received by Class I vary geographically and throughout the year or within seasons.[28]

1. FMMO component data does not support the component factors in Proposals 1 and 2.

Both NMPF and NAJ rely on annual average FMMO data for 2022 found in Hearing Exhibit 18 (USDA Ex. 18) for the Proposal 1 and 2 component factors. Hearing Exhibit 17 (USDA Ex. 17) and Hearing Exhibit 44 (USDA Ex. 44) provide the underlying monthly data for Hearing Exhibit 18 (USDA Ex. 8). MIG's review of the underlying monthly data shows variation

[28] And as established above, even if Class I processors are sometimes receiving higher levels than reflected in the formula factors, Class I processors cannot convert those higher component levels into any increased value for either the processors themselves or producers.

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seasonally and geographically. Hearing Ex. 112 (MIG Ex. 5A), at 1-3 (Charts 1-3 below). This variability demonstrates that using a national average (albeit weighted) is a flawed baseline for determining the component factors in the *minimum* skim price formulas.

The proposed factors clearly overstate the component levels for several of the MCP FMMOs for much of the year. Indeed, with respect to protein and nonfat solids, for Order 1 during 2022, the component values only achieved the proposal levels in one month for each—January for nonfat solids and December for protein. And, for other solids during 2022, Order 51 does not have even one month that reaches the proposed component factor. The skim component levels are not available for the four non-MCP orders. However, butterfat levels for all 11 orders are known. As shown in Hearing Exhibit 112 (MIG Ex. 5A), at 4 (see Chart 4 below) butterfat is lower in the four non-MCP orders than the other seven. Given that butterfat and skim components are highly correlated and move together, the butterfat data suggests that the proposed component factors also overstate the levels of protein, other solids, and nonfat solids in the non-MCP orders. Hearing Ex. 98 (IDFA Ex. 4), at 24-26 & tbl.4 (Testimony of Mike Brown).

It would be disorderly to determine component factors for the minimum price using annual average component levels for most but not all FMMO milk. With respect to fluid use, it would be disorderly to use component factors in the Class I price formulas based on component levels in all producer milk versus that which was received at pool distributing plants. Further, it would be disorderly for producers especially in the non-MCP orders to be paid for components they do not produce. Doing so would artificially enhance minimum milk prices for both (1) the lower component orders and (2) the lower component seasons.

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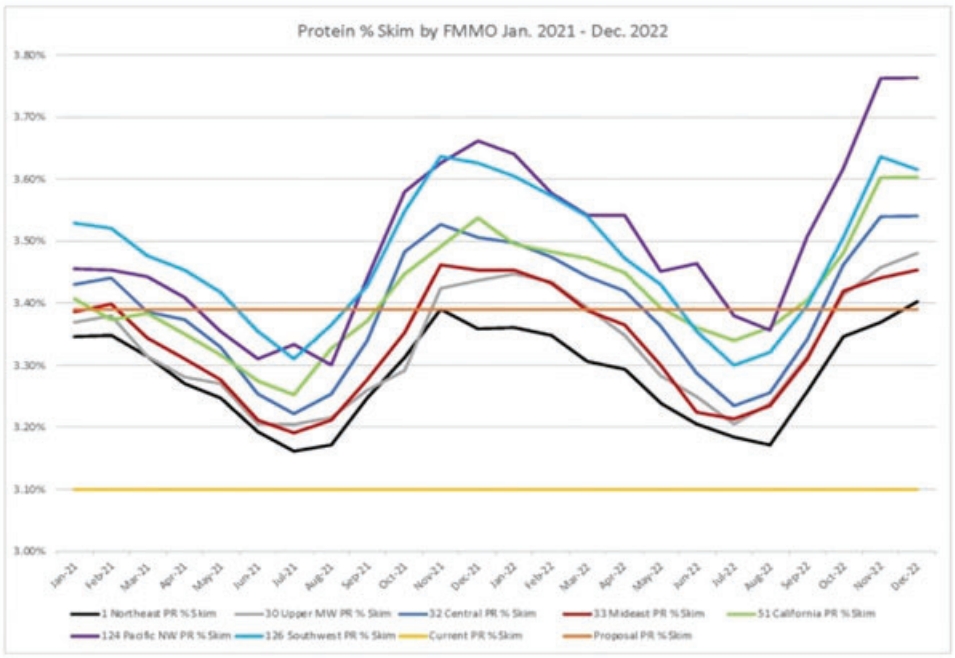
Exhibit MIG - 5A



Data Source: USDA Exhibit 17 Component Tests in Producer Milk by Order

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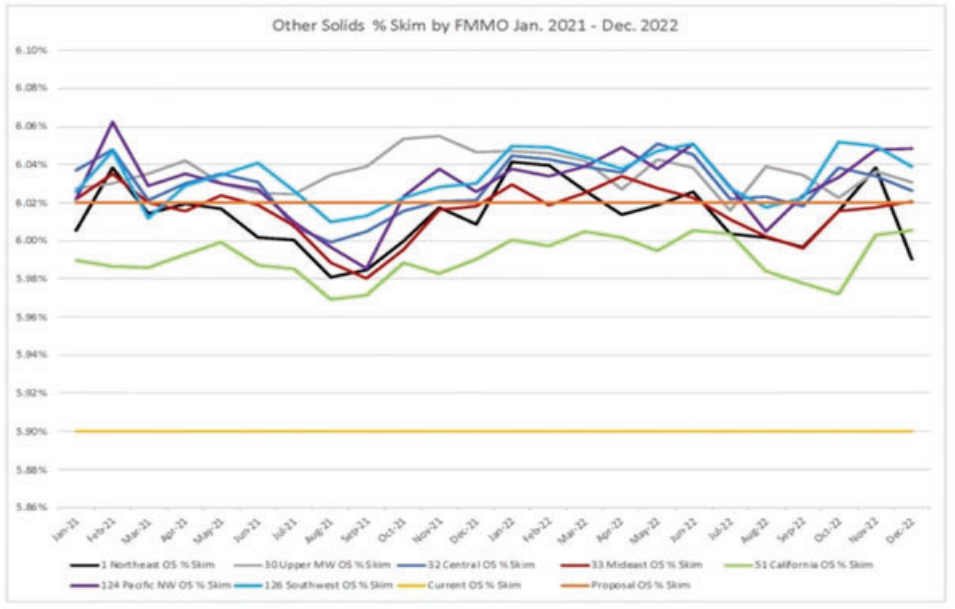
Exhibit MIG - 5A



Data Source: USDA Exhibit 17 Component Tests in Producer Milk by Order

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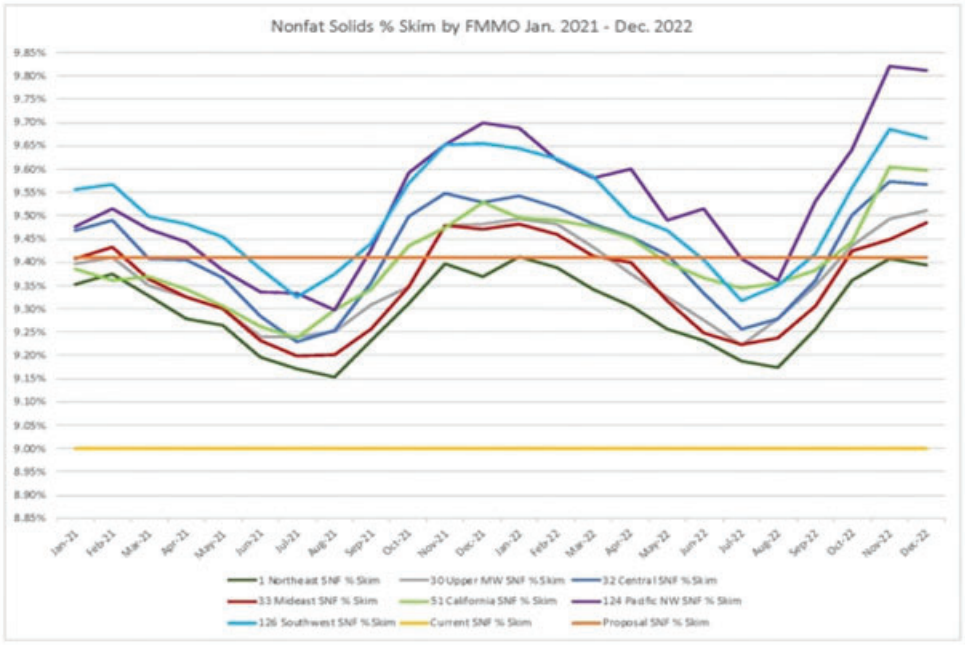
Exhibit MIG - 5A



Data Source: USDA Exhibit 17 Component Tests in Producer Milk by Order

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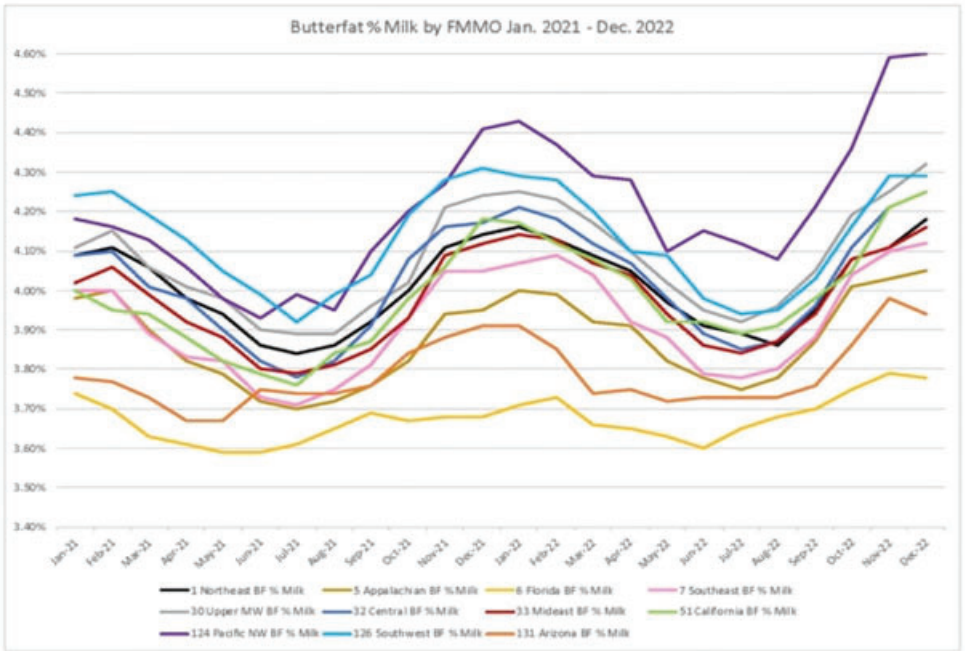
Exhibit MIG - 5A



Data Source: USDA Exhibit 17 Component Tests in Producer Milk by Order

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2. Class I plants do not receive components at the levels in Proposals 1 and 2.

NMPF and NAJ failed to present any analysis of the component values actually received by Class I. MIG's survey of component levels *actually received* by Class I plants—the only such analysis introduced at the hearing—directly contradicts the factual assumptions underpinning Proposals 1 and 2. The fluid milk plant receipt survey data presents a pattern of inconsistent component levels, varying from plant to plant, order to order, and seasonally within each order. *See* Hearing Ex. 111 (MIG Ex. 5), at 6 (Testimony of Sally Keefe). From the overall pattern of inconsistent levels, three major takeaways emerge:

- **Class I plants routinely receive component levels below the average level for the order**, *see id.*
- **Class I plants routinely receive component levels below the Proposal 1 and 2 component factors**, *see id.* Most of the fluid milk plants surveyed received components below the skim milk component factors in the Proposals. Given the inconsistency of component levels, the severity and frequency of this shortcoming varied. *See id*; *see also* Hearing Ex. 112 (MIG Ex. 5A), at 25-27.
- **The component levels vary remarkably seasonally and geographically**, *see* Hearing Ex. 111 (MIG Ex. 5), at 6. Seasonal variation means that even if there are months that Class I plants are receiving higher levels of components, there are also months Class I plants are receiving components closer to the current factors. But even in the months with the highest actual values, the plants surveyed usually received milk with component levels below the proposed factors. *See id.; see also* Hearing Tr. 1126:14-1127:20, Wendy Landry (August 29, 2023).

Ms. Keefe's analysis presents illustrative examples of how the Proposals 1 and 2 component factors would burden Class I processors, wholesale customers, and, ultimately, retail consumers. In Order 1, for the months of August 2021 and August 2022, the Class I survey and the Order 1 protein values were both approximately 3.17%—well below the 3.39% protein factor found in Proposals 1 and 2. *See* Hearing Ex. 112 (MIG Ex. 5A), at 5. Under Proposals 1 and 2, a FMMOs would obligate the Class I plant to pay a price based upon the 3.39% protein factor *even though the plant actually only obtained 3.17%.* Such a result could hardly be called a minimum regulated price when it is artificially inflated above actual components received.

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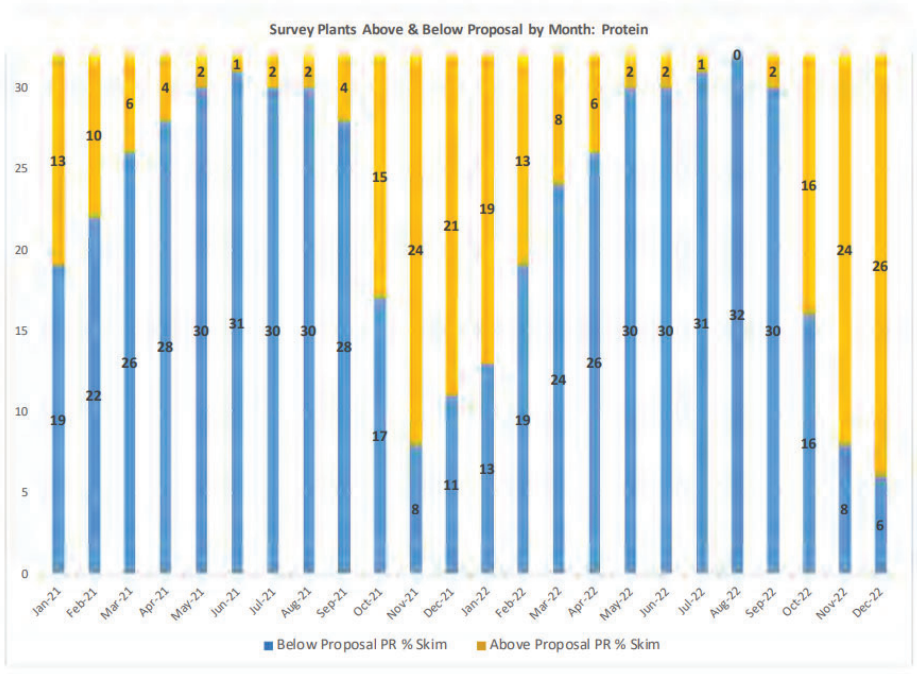
This pattern was repeated for the 32 survey plants for protein, other solids, and nonfat solids across the 24-month period. As shown in Hearing Exhibit 341 (MIG Ex. 5B), in most months more than half of the surveyed plants did not receive milk with component levels that reach the proposed factors (see Table 1 below and figure of Protein, by example from Ex. 341, at 1).

Table 1
Survey Plants Above and Below Proposal 1 and 2 Component Factors

Skim Component	Months with 17-24 Plants Below Proposals 1 & 2	Months with 0-16 Plants Below Proposals 1 & 2
Protein	18 (75%)	6 (25%)
Other Solids	20 (83%)	4 (17%)
Nonfat Solids	20 (83%)	4 (17%)
Source: Hearing Ex. 341 (MIG Ex. 5B), at 1-3.		

Exhibit MIG - 5B



Data Source: Fluid Milk Plant Survey
*Per AMS request; See also Exhibit 112 p. 25

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NAJ also did not introduce any evidence to the contrary—thus the record stands unchallenged that Class I processors are *not* receiving components at Proposal 1 and 2 levels. And given the significant cooperative-owned Class I processing, NMPF certainly could have presented its own data on this point. Likewise, it could have undertaken an industry-wide study, akin to what was done by Dr. Stephenson for make allowances. Instead, NMPF and NAJ relied on consolidated, and in the case of non-MCP orders, incomplete, data. USDA data lacks the necessary specificity to support their proposals. NMPF failed to meet their burden of proof here.

3. Undisputed testimony from Class I processors in opposition to Proposals 1 and 2 corroborates that Class I processors receive component levels below the proposals.

Testimony from Class I plant operators resoundingly and consistently affirmed Ms. Keefe's conclusions. HP Hood, a MIG member, does not consistently receive producer milk at Class I plants with skim components at the proposed factors. *See* Hearing Ex. 102 (MIG/Hood Ex. 3), at 3 (Testimony of Wendy Landry). At its nine Class I fluid milk plants for the 24-month period from January 2021 to December 2022, HP Hood received skim component levels below the proposed factors the vast majority of the time—specifically, HP Hood received below the proposed levels in 83% of months for protein; in 72% of months for other solids; and 86% of months for nonfat solids. *Id*. at 4.

HP Hood is not alone. In 2021 and 2022 combined, Shehadey Family Foods, a MIG member, purchased 2.5 billion pounds of producer milk. Hearing Ex. 105 (MIG/Shehadey Ex. 4), at 4 (Testimony of Jed Ellis). On monthly averages, only 17.6 % of that milk met or exceeded the protein component factor in Proposal 1. *Id*. During the same period, Shehadey received other solids at levels lower than the proposed factor over 90% of the time. *Id.* at 5. The same is true for the nonfat solids components actually received by Shehadey, with over 90% of the nonfat solids components received falling below the Proposal 1 and 2 factor. *Id.*

As for seasonal and geographic variations, HP Hood's levels on the minimum and maximum reflect Ms. Keefe's takeaway. Hearing Ex. 102 (MIG/Hood Ex. 3), at 6 (Testimony of

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Wendy Landry). Seasonal variations align with the realities of milk production in that cows produce higher component milk in the winter months, and lower component milk in the summer months. *Id.* Even in the high points of seasonal variations—the high component winter months—processors still received components below the Proposal factors. Hearing Tr. 1126:14-1127:20, Wendy Landry (August 29, 2023). The component values of HP Hood's milk receipts support that the current skim price formula component factors are at the appropriate level. Hearing Ex. 102 (MIG/Hood Ex. 3), at 4 (Testimony of Wendy Landry). Due to the locations of their supply, some of HP Hood's plants are routinely on the lower end of their component levels. *Id.* at 6. NMPF also appear to recognize the seasonal and geographic variation of component levels, noting that "it clearly varies seasonally, more so in some orders than others." Hearing Tr. 270:9-13, Peter Vitaliano (August 24, 2023).

Saputo also testified about its inability to achieve in the relevant time period the component levels that Proposals 1 and 2 would establish. This was especially true as to its three plants in the non-MCP orders. Hearing Ex. 113 (IDFA Ex. 24), at 4 (Testimony of Steve Galbraith). Saputo, in order to make its Class II products, must add condensed skim milk—meaning that adoption of Proposal 1 and 2 would mean paying for "ghost solids" and then paying a second time for the condensed skim milk. *Id.* at 2. This result would be disorderly.

Other factors outside of processors control can impact component levels. As NMPF acknowledged, major feed challenges could result in a dip in components in any given year. Hearing Tr. 502:12-20, Calvin Covington (August 25, 2023) (noting that "feed quality has a major impact on component levels" and that a major feed challenge could result in a dip in components). In fact, NMPF testified that "[w]ith today's rapid advances in genomics, biotechnology, and nutrition along with the potential of weather events that could impact the next year's feed supply, ***it is possible to have unexpectedly large differences in milk components from one year to the next."*** Hearing Ex. 64, (NMPF Ex. 2), at 10 (Testimony of Calvin Covington) (emphasis added).

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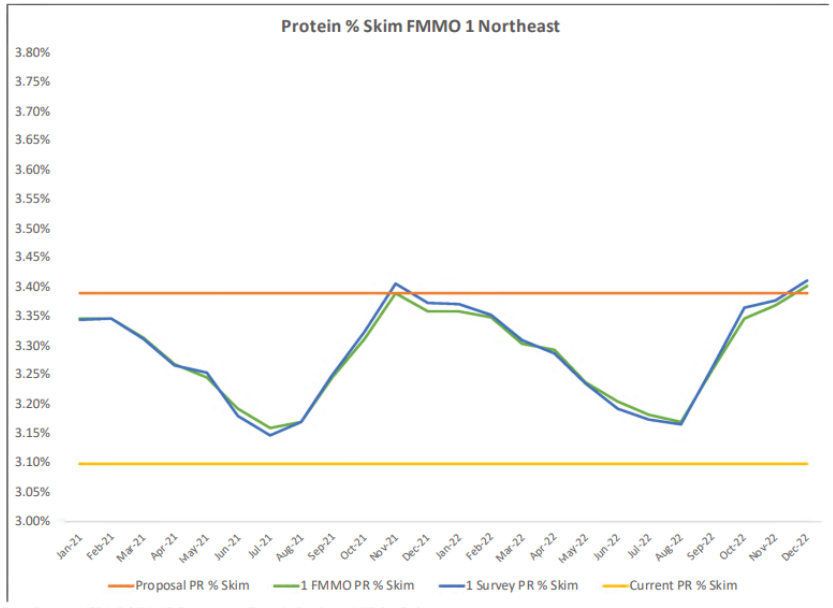
4. Proposals 1 and 2 enhance prices when they establish component factors above the levels actually received by Class I.

The broad purpose of marketing orders—to establish a minimum price—requires that USDA look at the minimum component levels so as not to risk price enhancement. Ms. Keefe's analysis establishes that the Proposal skim component factors are not minimum component values actually received and are instead meaningfully higher. NMPF claims that looking at the lowest month for the lowest Order—in other words, the minimum levels—would underprice milk for other orders and other months. Hearing Tr. 562:4-16, Eric Metzger (August 25, 2023). But given that premiums and other market forces are available as effective mechanisms for producers to obtain a price greater than the FMMO regulated minimum, the minimum component levels geographically and temporally must be used to determine the component factors for the minimum price. By example, visually, one cannot ignore that Proposals 1 and 2 would be price enhancing nearly all the time for protein in FMMO 1. Hearing Ex. 341 (MIG Ex. 5B) at 5 (Testimony of Sally Keefe). The other orders suffer from similar issues.

Exhibit MIG - 5A



Data Source: USDA Exhibit 17 Component Tests in Producer Milk by Order; Fluid Milk Plant Survey

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USDA must carefully weigh the impact of these proposals on Class I processors—an impact that the processors cannot avoid by depooling, selling their product to a different buyer, or voting out a federal order (options all other industry participants have when they face economic challenges due to FMMO regulations). For example, for Shamrock alone, Proposals 1 and 2 will increase their cost between $0.60 and $0.75 per cwt in the market orders. Hearing Ex. 463 (MIG/Shamrock Ex. 23A), at 3 (Testimony of Tim Kelly). And as Order 131 is a butterfat skim order, Shamrock's suppliers would not even be paid on the components that NMPF is proposing to be adopted by USDA. Hearing Tr. 10891:6-16, Tim Kelly (January 17, 2024). USDA should avoid enhancing prices when they have such a significant impact on Class I.

5. The fact that Class I processors receive, at times, skim components higher than the current formula factors does not support changing them.

NMPF and NAJ did not introduce a single piece of evidence that current skim component formula factors were causing disorderly marketing. With FMMO regulations, the question is not, "what are the current component levels?"[29] Rather, it is, "do we need to change the regulation component levels in order to cure disorderly marketing and ensure a sufficient supply of fluid milk?" And the answer is a clear "no." Just because the levels are higher than they once were does not mean that the *formula factors* should be changed.

Current component levels do not cause disorderly marketing—Class I processors are receiving the components they need (or extra) and consumers are not clamoring for more skim components in their milk products. Hearing Tr. 1188:12-23, Jed Ellis (August 29, 2023) (receiving milk with components at or slightly above the current factors has not resulted in any difference in ability to market milk to customers). The current regulations generate sufficient milk for fluid use and there is no disorderly competition to access the fluid milk market. Non-fluid milk utilization drove component increases (as discussed further below). Component increases in recent years are

[29] And if the goal were to accurately reflect component levels in the marketplace, the levels should be lower, at the federal standard of identity level for Class I products.

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more or less irrelevant to Class I. In fact, despite increases in components over the last 20 years, fluid milk has been on a downward trajectory. Hearing Ex. 111 (MIG Ex. 5), at 6 (Testimony of Sally Keefe); Hearing Tr. 453:3-7, Calvin Covington (August 24, 2023) ("Fluid milk consumption continues to go down . . . .").

NMPF vaguely threatened that: "[f]ailing to adjust the skim milk component factors used to calculate the Class I skim milk value in all FMMOs . . . has, is, and will continue to create marketing challenges . . . . The out-of-date skim milk component factors mean today's FMMO class prices fail to reflect the true value of skim milk . . . ." Hearing Ex. 64 (NMPF Ex. 2), at 4 (Testimony of Calvin Covington). But NMPF never specifies what these "marketing challenges" are, nor what "value" the components create for Class I processors. Moreover, NMPF's argument that there has been a narrowing of pricing between Class I and other classes wholly ignores the fact that in the 25 years since FMMO Reform, the relative values of milk used to produce manufactured products and fluid milk have changed. FMMOs should not increase the spread between Class I and Class III or IV when components of value to those classes increase while those same components have no value to fluid milk processors, wholesaler, or consumers. While MIG acknowledges that Class I processors are, on average, receiving higher levels of components than historically, that does not mean that USDA needs to change the component factors to require a higher Class I obligation to the pool. USDA operates a minimum uniform milk pricing regulatory program, not a market milk price regulatory program.

6. Economic signals outside Class I drove increases in skim components.

NMPF has testified that: "[d]airy farmers have responded and continue to respond positively to economic signals to increase skim milk component levels. Continuous improvements in genetics, nutrition, and dairy farm management have and continue to enable dairy farmers to increase milk component levels." Hearing Ex. 64 (NMPF Ex. 2), at 3 (Testimony of Calvin Covington). But Class I processors have never asked for, nor incentivized, increases in skim components. In fact, higher components can actually cause manufacturing problems for Class I

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processors. Hearing Tr. 11285:16-20, Jacob Schuelke (January 19, 2024) ("as components increase and finished product target levels stay the same, it gets harder and harder to process them," and fluid processor costs go up).

Neither Class I processors nor Class I customers drove the increase in components in recent years. Rather, one culprit of those increases is the very issue MIG continues to raise here—overproduction of milk. In recent years, more cooperatives have put in place base plans, which limit the amount of milk a particular supplier can ship. Hearing Tr. 11287:11-17, Jacob Schuelke (January 19, 2024). With limits on volume, producers can only increase returns by increasing component levels within that same volume. *Id.* 11283:17-11288:1. And that is exactly what they have done. *Id.* Raising Class I prices does not solve the problem of overproduction of milk, it only exacerbates it.

USDA has no economic justification to burden Class I with further costs for features they do not want, cannot use, and from which they will not generate money. The fact that other market factors have played a role in farmers wanting to increase components is completely irrelevant to Class I processors.

C. Proposals 1 and 2 Would Create Disorderly Marketing by Unfairly Impacting Some Market Participants and Further Incentivizing Strategic Targeting of High-Component Milk to Non-Class I Processors and Certain Regions.

The practical effect of Proposals 1 and 2 would be to exacerbate the existing incentive in the FMMO system that directs components not to Class I plants, but to manufacturing plants, particularly those in MCP orders. Hearing Tr. 286:8-287:18, Calvin Covington (August 24, 2023) ("They [producers] would have a tendency to send their . . . higher testing milk to Class III uses, yes."). Rational actors in MCP orders have an incentive to deliver higher solids milk to Class III and Class IV plants because they receive specific compensation for higher components in those orders.

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NMPF and NAJ do not dispute this reality. Hearing Tr. 559:8-15, Eric Metzger (August 25, 2023) (Q: "[R]ational actors in multiple . . . component pricing orders, have an incentive to provide higher protein or solids milk to Class III and IV plants, correct? There is a financial incentive to do so, right?" A: "Correct."); Hearing Tr. at 286:8-19, Calvin Covington (August 24, 2023) (Q: In MCP orders, "[the] rational cooperative is going to send [their] high SNF milk to Class III, correct?" A: "You would expect that to occur, yes." Q: "And send the lower SNF to the Class I, correct?" A: "Yes."). In contrast, if USDA raises the skim component formula factors, producers will receive higher payments via the pool regardless of the actual component level of the milk sent to a specific Class I handler. Thus, rational producer actors moving milk will continue to gather the guaranteed money from the pool by sending Class I the lowest component milk possible and then maximizing returns by directing as much high component milk as possible to non-fluid uses.

Note, as long as regulations align with the practice, MIG does not criticize this targeting of high component milk as a failure of the FMMO system—it is actually a win-win for all involved. Higher component milk *should* go to manufacturing processors who can utilize those components and create value for everyone in the supply chain. It would be disorderly to try to force that high component milk out of its highest and best use and to Class I fluid processors. But this efficient operation of the system also requires that Class I processors not be forced to subsidize this high-component milk that is directed to other uses.

A further disorderly outcome of the proposals would be that Class I processors, the only captive mandatory participants in the FMMO system, would be forced to pay for component levels regardless of what they actually receive, as discussed above. In contrast, manufacturing processors only must pay for those components actually received when they choose to be subject to FMMO regulation. This situation would disadvantage Class I processors vis-à-vis the manufacturing class, and make it even more difficult for Class I processors to attract milk.

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Even within the Class I market, in terms of both benefit and burden, Proposals 1 and 2 set markedly different stages on which proprietary processors and cooperatives will operate. Proposals 1 and 2 would unfairly burden proprietary processors. Cooperatives can allocate their milk to their own plants and competitor customer plants according to whichever option will generate the highest value based on the components—essentially equipping cooperatives with a handbook to minimize their risk and maximize their benefits. Hearing Tr. 11204:23-11205:7, Jed Ellis (January 19, 2024) ("[Cooperatives] can determine . . . the historical component test to determine which [milk] should go to a cheese plant, which should go to a butter plant, which should go to a milk processing facility. You know, they just have those abilities to dictate which milk goes where. [Proprietary processors] just order the milk.").

Just as Proposals 1 and 2 would have disorderly impacts on Class I processors, they also would do so with respect to producers in MCP and non-MCP orders. Further, Proposal 1 would result in farmers in MCP orders with component levels less than the average being paid less than all farmers in the four non-MCP orders. Hearing Tr. 186:2-8, Peter Vitaliano (August 23, 2023) (Q: "All of the farmers in the MCP orders with component levels less than the average will be being paid for their milk less than all of the farmers in the four fat skim orders, correct?" A: "That is correct."). And in non-MCP orders, which will remain as-is unless someone petitions otherwise, actual component levels are meaningfully less than in MCP orders. *Id.* 179:4-13 (rather than unilaterally extending a pricing system into these four orders, USDA should rely on the decision by producers in those orders to move to MCP if desired).

D. NMPF And NAJ Cannot Support Their Proposed Mechanisms for Periodic Updating to the Component Factors.

NMPF and NAJ included automatic updating functions in their proposals, meaning periodic reviews of components levels would result in changes to the component factors in the price formulas. And as testified to by NMPF; "[a]ll signs point to future increases in milk component levels." Hearing Ex. 64 (NMPF Ex. 2), at 4 (Testimony of Calvin Covington). But

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the updating functions suffer from the same shortcomings discussed above. Were USDA to adopt Proposals 1 and/or 2, it would continue just compound all the failures in the record evidence and legal bases discussed above by automatically updating the components without requiring a proponent to first prove such an update is needed (i.e., necessary to ensure a sufficient supply of fluid milk and/or orderly marketing). While MIG is not against automatic updates in certain situations, here, where the parties greatly disagree about the value (not just the level) of components, such an update would bypass the critical hearing process over an issue that is in such dispute. *See id*. at 9 (NMPF proposed the updating procedure "[t]o prevent future misalignments in the skim milk component factors, ***and to avoid returning to an administrative hearing***" (emphasis added)). USDA must reject NMPF and NAJ's Proposals 1 and 2 in total.

E. If USDA Proposes to Adopt Modified Component Formula Factors, MIG Does Not Object to Delayed Implementation.

If USDA does accept any version of Proposals 1 and 2, MIG does not object to the requested 12-month delayed implementation. However, as discussed further in the following Section VII, USDA's accommodation of *producer* risk management needs must be coupled with similar consideration for *processor* risk management needs.

VII. USDA SHOULD ADOPT PROPOSAL 15

In favorably considering and then adopting Proposal 15, USDA has the opportunity with respect to the issue of the base Class I skim price to give multiple parties what they want: Class I processors need to manage risk, and NMPF desires "revenue neutrality" compared to an old formula. But before it can make any changes, USDA must start with the initial necessary question prompting any FMMO change: is the current "average of" formula resulting in disorderly marketing? While MIG maintains the answer is "no," USDA should consider what *is* working about the current policy and how to adjust it to best serve all market participants. In doing so, USDA will see that the "average of" portion of the current formula works exactly as intended—tracking Class III and IV prices (the market has sufficient milk for both fluid and manufacturing

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uses and there is not disorderly competition for fluid market access), while allowing Class I processors to manage risk.

In review, opponents of Proposal 15 only have an issue with the current formula, the fixed $0.74 adjuster; however, NMPF's proposed solution gets rid of a more effective formula only on the basis of this adjuster. Further, NMPF's proposal does not fix the "problem" of higher returns to farmers. As concluded by NMPF's own expert, if USDA adopts NMPF's Proposal 13, "[t]he longer-term effect of this scenario [returning to the higher of] moderates the effect on the U.S. all milk price as milk production expands by 0.1 billion pounds. U.S. all milk prices are only $0.01 to $0.02 per hundredweight higher longer term." Hearing Ex. 421 (NMPF Ex. 60), at 8 (Testimony of Scott Brown). In other words, NMPF is asking USDA to return to a failed policy that would have ***significant negative impacts on Class I and the entire dairy industry,*** all in exchange for the ***potential*** of higher returns to farmers that are ***"only $0.01 to $0.02"*** per cwt. USDA should outright reject this nonsensical request.

MIG's Proposal 15 addresses the fixed $0.74 adjuster, replacing it with a rolling adjuster that tracks the "higher of" averaged over time. Returns to farmers will be equivalent, over time, to what they would have been under the "higher of." MIG's formula has no "asymmetrical risk." In fact, NMPF even endorsed a similar "average of" approach as recently as late 2021, when it stated on its website:

> NMPF supports a proposal to recalculate the current $0.74/cwt every two years using the average of monthly differences between the higher-of, and the average-of, advanced Class III and IV prices during the prior 24 months, with the current mover serving as the floor. This preserves the mover predictability that processors sought while addressing the asymmetrical risk borne unfairly by farmers under the Class I pricing formula."

Hearing Ex. 236 (IDFA Ex. 236) (a page on its website NMPF deleted ahead of the hearing).

USDA should not consider a full return to the past base Class I skim milk price formula when 1) Congress, in amending the AMAA, clearly directed USDA to ensure Class I has the opportunity to manage risk; 2) the bulk of the formula is working successfully as intended; and 3)

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industry has developed a more than fair alternative. Rather, USDA should endorse a policy that encourages a healthier Class I sector and a healthier dairy industry through adoption of Proposal 15.[30]

A. Proposal 15 Description and Regulatory Language.

MIG proposes an "average of" base Class I skim milk price formula with a rolling adjuster. *See* Hearing Ex. 263 (MIG Ex. 9), at 7-8 (Testimony of Sally Keefe) (regulatory language). MIG proposes updating the adjuster monthly using a 24-month look back period with a 12-month lag, i.e., the preceding 13-to-36-month period. Proposal 15 amends 7 C.F.R. § 1000.50(b) as follows. Additions are in italics font. Deletions are strikethrough font.

§ 1000.50 Class prices, component prices, and advanced pricing factors.

> (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 simple average of the advanced pricing factors computed in paragraph (q)(1) and (2) of this section rounded to the nearest cent, plus *the Class I skim price adjuster rounded to the nearest cent* ~~*$0.74 per hundredweight*~~*.*
>
> > *(1) Class I skim price adjuster. The Class I skim price adjuster per hundredweight shall be a 24-month simple average of the difference between the higher of the advanced pricing factors computed in paragraph (q)(1) and (2) and the simple average of same for the preceding 13 to 36 month period.*
> >
> > *(2) The skim price adjuster shall change monthly.*

Id.

[30] MIG also supports Proposal 14 as an alternative to Proposal 15.

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B. Class I Processors Use Risk Management Options and Must Retain This Critical Tool for the Marketplace to Encourage Orderly Marketing.

USDA should continue its current policy of ensuring that Class I processors, like all other segments of the dairy industry, can effectively manage their price risk. Utilizing a form of the "average of" formula (with adjustments to the element that is the source of NMPF's objections) ensures Class I processors can continue to offer their customers stable prices and reduce risks for this struggling fluid dairy sector.

1. A significant portion of Class I processors use risk management tools.

Contrary to some opponents' assertions, Class I processors are, in fact, using risk management tools—multiple processor witnesses testified to this fact.

One of the key risk management tools is hedging. Hedging is the practice of securing a future price for a commodity now. Hearing Ex. 273 (MIG/fairlife Ex. 10), at 2 (Testimony of Tim Doelman). Hedging is not about obtaining a better price or "beating the market." Hedging is not gambling. Hearing Ex. 274 (MIG/fairlife Ex. 10A), at 4 (Testimony of Tim Doelman). Rather, hedging is about reducing risk by creating financial stability for both the buyer and the seller. Hearing Ex. 273 (MIG/fairlife Ex. 10), at 2 (Testimony of Tim Doelman). Hedging has transactional costs that must be considered when deciding if hedging brings economic advantages to a company. Hearing Tr. 6025:1-3, Tim Doelman (September 28, 2023).

Three MIG Class I processors, fairlife, HP Hood, and Shamrock, have active hedging programs developed after the current "average of" formula was adopted. Hearing Ex. 273 (MIG Ex. 10), at 4 (Testimony of Tim Doelman); Ex. 270 (MIG/Hood Ex. 11), at 4-5 (Testimony of Michael Newell); Hearing Tr. 10892:23-10893:6, Tim Kelly (January 17, 2024); Hearing Tr. 10940:10-28, Tim Kelly (January 18, 2024). fairlife began its hedging program in 2019, as soon as it was feasible after the move to the "average of." Hearing Tr. 6027:6-15, Tim Doelman (September 28, 2023). It expects that next year, it will be hedging as much as eighty percent of its milk. *Id.* 6050:12-18.

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HP Hood (which has five ESL Class I plants) utilizes futures contracts to fix the cost of a portion of the milk it utilizes for Lactaid (its best-selling ESL Class I product) to create a level of predictability on the cost of the milk ingredients. Hearing Ex. 270 (MIG/Hood Ex. 11), at 4 (Testimony of Michael Newell). Shamrock, like Hood, has ESL sales which it already hedges for its ESL customers, including food service. Hearing Tr. 10892:23-10893:6, Tim Kelly (January 17, 2024); Hearing Tr. 10940:10-28, Tim Kelly (January 18, 2024). AE hedged its HTST milk over the course of several years when a group of customers wanted long-term fixed prices (but does not currently have any open hedges). Hearing Tr. 10733:22-25, 10770:25-10771:13, Warren Erickson (January 17, 2024).

Industry cannot ignore that ESL fluid milk products, including fairlife and Lactaid, have seen significant growth in recent years. *See* Hearing Tr. 6019:3-11, Tim Doelman (September 28, 2023) (testifying that fairlife just celebrated surpassing the billion-dollar brand mark); Hearing Tr. 5926:4-22, Michael Newell, (September 28, 2023) (testifying to the steady growth of Lactaid over the last 20 years). Hedging aligns smoothly with the sales structure for ESL products, another growing segment of the industry. Hearing Tr. 5695:20-5696:6, Sally Keefe (September 27, 2023); Hearing Tr. 6039:12-6040:8, Tim Doelman (September 28, 2023). Of course, this growth cannot be attributed solely to a stable price strategy, but it shows that stable prices (and using hedging to minimize risk in setting stable prices) matter in today's marketplace.

Two other significant Class I processors also testified that they are actively hedging. Nestlé already has in place one of, if not the, most robust hedging program, especially for its flavored milk processed at its facility in Anderson, Indiana. Nestlé purchases $200 million of raw milk annually in the United States, 80-90% of which goes into its Class I Nesquik product. Nestlé hedges 100% of those purchases. Hearing Tr. 5517:28-5518:18, Kim Greenbaum (September 26, 2023). Additionally, Schreiber hedges millions of pounds of milk annually, including the milk it purchases for Class I use. While Class I is a relatively small share of its purchases, Schreiber's

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risk management program allows it to offer fixed prices on ESL and aseptic products to its customers. Hearing Tr. 5434:19-5436:25, 5486:20-5487:4, Chris Herlache (September 26, 2023).

Moreover, fluid milk customers are or have adopted risk management strategies for their purchases. Kroger, in its capacity as a large grocery store chain, actively engages in risk management of Class I branded products such as fairlife, Lactaid, and Nesquik. Hearing Tr. 6354:23-6355:18, Mike Brown (October 2, 2023). End use customers (such as a large chain of coffee shops) who tried and failed to use hedging strategies on Class I prior to the formula change in 2019 now hedge. Hearing Tr. 6358:22-6359:20, Mike Brown (October 2, 2023). And Hood also concludes that food service customers likely have pent up demand for the benefits of these programs. Ex. 270 (MIG/Hood Ex. 11), at 6 (Testimony of Michael Newell). These risk management practices have become more prevalent and successful since the formula change in 2019. Hearing Tr. 6140:14-6141:20, 6174:10-23, Mike Brown (September 29, 2023).

Testimony also supported that in the future, more processors intend to utilize these risk management tools. While the pandemic created a proliferation of supply chain challenges for manufacturers, which likely slowly adoption of risk management opportunities, Hood is already using and exploring new ways to implement them. Ex. 270 (MIG/Hood Ex. 11), at 4-5 (Testimony of Michael Newell). Crystal Creamery currently hedges its ice cream contracts and wants to begin hedging in the Class I space. Hearing Tr. 5861:8-17, Jacob Schuelke (September 28, 2023).[31] Likewise, Turner Dairy intends to look into starting a hedging program for Class I and already uses butter futures to hedge or protect its cost on cream products. Ex. 271 (MIG/Turner Ex. 12), at 4 (Testimony of Chuck Turner). Industry has also responded to the increased interest in hedging the hearing created, including a recent IDFA presentation on hedging. Ex. 468, MIG/Turner Ex.

[31] The fact that Class I processors hedge their non-Class I products where possible supports that they will adopt more Class I hedging strategies as they become more ubiquitous. *See* Hearing Tr. 6044:11-15, Tim Doelman (September 28, 2023) (testifying about hedging the Class IV product used in fairlife's Class I products).

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25B, at 10 (Testimony of Chuck Turner). And as more processors are able to depend on and utilize risk management, the market liquidity will increase and, thus, be more effective. *See* Ex. 273 (MIG/fairlife Ex. 10), at 3-4 (Testimony of Tim Doelman).

The fact that Class I processors have not universally adopted risk management programs does not support disregarding their importance. Not every company will be able to utilize risk management to the same degree and at the same time. To date, primarily specialty milk processors have utilized risk management—all sectors that have seen growth in comparison to the 40-year history of negative sale growth in conventional HTST. Hearing Tr. 5832:25-5833:4, Jacob Schuelke (September 28, 2023). These sectors have historically utilized more fixed pricing, meaning hedging can be more easily adopted. Hearing Tr. 5695:20-5696:6, Sally Keefe (September 27, 2023). While HTST customers, like grocery stores, have become accustomed to the monthly fluctuations of pass-through pricing, other HTST customers, like school lunch programs or USDA feeding programs, would benefit significantly from more price certainty. Hearing Tr. 5813:12-5814:1, Jacob Schuelke (September 28, 2023); Hearing Tr. 5969:7-5970:4, Chuck Turner (September 28, 2023) (explaining why it is difficult to predict prices for schools a year in advance, and also difficult to change prices for ongoing school contracts when that typically coincides with bids for the next year's contract).

Additionally, setting up hedging programs takes time and resources. Even with the extension services educating Class III processors on hedging, it took time for the marketplace and the CME to adopt Class III hedging programs. Hearing Tr. 5811:22-5812:11, Jacob Schuelke (September 28, 2023). Mr. Schuelke, an MBA with significant risk management experience (including at the extension office), estimates it will take the Class I marketplace about ten years before hedging can be well understood and more widely adopted. *Id.* 5814:14-21. Companies need time to figure out how that the cost and the benefits integrate into their business plan. Hearing Tr. 6027:16-24, Tim Doelman (September 28, 2023) (testifying that fairlife started with hedging about ten percent of its milk the first year, then twenty percent, and so forth; "you walk before you

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run"). Even NMPF's own expert witness testified that setting up risk management programs can take, at the shortest, three to nine months. Hearing Tr. 4956:13-16, Sara Dorland (September 20, 2023).

The industry has also had only a relatively short window in which processors could consider adopting risk management strategies, and now have little incentive to invest in developing hedging programs until there is more certainty that Class I will retain the use of the same risk management tools available to everyone else. Congress adopted the current base Class I skim formula in the 2018 Farm Bill and it became effective in May 2019. Hearing Tr. 5693:11-21, Sally Keefe (September 27, 2023). By early 2021, significant voices within the producer community requested a reversion to the higher of. *Id.* Thus, USDA had the "average of" formula in place for *less than two years* before opponents started their public campaign against it—*with the formula in place for less than one year before the pandemic hit* and companies had to rapidly shift all resources to navigating the challenges that event brought. This timing understandably slowed the adoption of risk management. Hearing Ex. 270 (MIG/Hood Ex. 11), at 4-5 (Testimony of Michael Newell). Additionally, given the regulatory uncertainty around the base Class I skim price, Class I processors may have rightly determined to await the outcome of this hearing before investing resources in putting together a risk management program. A clear pronouncement from USDA in support of risk management opportunities for Class I processors will go a long way in encouraging its use, to the benefit of the entire dairy industry.

USDA must critically consider that Class I processors did not request a change that would uniformly result in lower prices—just the opposite. Neither proposed formula gives a clear benefit to Class I processors in terms of the overall Class I price. Risk management ability is the only meaningful difference. Class I processors have foregone all other options they could have put forth for the base Class I skim price (i.e., formulas that would have lowered the Class I price) in order to support a revenue neutral formula that protects risk management. MIG hopes USDA and opponents consider why Class I processors so strongly advocate for the preservation of an "average

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of" formula over the "higher of" when both result in a similar cost to processors—that alone makes clear the importance of risk management to Class I processors. Class I genuinely needs this opportunity, especially since it is the one segment of the dairy industry that is failing, and everyone else already has these risk management tools available to them. *Id.*

2. The AMAA requires the Secretary to establish FMMOs that support avoiding unreasonable fluctuations in prices and Proposal 15 best meets that policy goal.

The authorizing legislation for FMMOs directs the Secretary of Agriculture to establish marketing orders that will "provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing season ***to avoid unreasonable fluctuations in supplies and prices***." 7 U.S.C. § 602(4) (emphasis added). USDA previously identified a need to "reduce volatility in milk prices" (Milk in the New England and Other Marketing Areas, 64 Fed. Reg. 16026, 16094 (Apr. 2, 1999)) as a policy goal of the base Class I skim price. The average of plus lookback adjuster is far more stable than a month-to-month "higher of" price. *See* Hearing Ex. 264 (MIG Ex. 9A) (Testimony of Sally Keefe). Proposal 15 reduces price fluctuations in two ways: first, the Proposal 15 formula generates a more stable price than utilizing Proposal 13's "higher of" formula; and second, processors and their customers experience fewer price fluctuations when Class I processors can manage their risk.

a. Proposal 15 generates more stable prices for Class I processors.

Using the "average of" Class III and IV skim milk prices (as opposed to the "higher of") helps reduce volatility in Class I milk prices. Hearing Exhibit 264 (MIG Ex. 9A) shows the base Class I skim milk price by month under the current formula as well as Proposals 15 and 13. Table 1 below summarizes the monthly prices for the 5-year 2018 to 2022 period calculated using the current, Proposal 15, and Proposal 13 formulas. The volatility as measured by the range and standard deviation are less for both the current and Proposal 15 average of formula versus the Proposal 13 higher of formula.

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Table 1 Base Class I Skim Milk Monthly Price Formula Comparison for 2018 to 2022 (60 months)			
	Current: Average of Plus $0.74 Adjuster	**Proposal 15: Average of Plus Rolling Adjuster**	**Proposal 13: Higher of**
Minimum	$5.86 (Mar. '18)	$5.91 (Mar. '18)	$5.38 (Mar. '18)
Maximum	$15.66 (Jun. '22)	$16.58 (Jun. '22)	$20.07 (Dec. '20)
Range	$9.80	$10.67	$14.69
Average	$9.99	$10.10	$10.36
Std. Deviation	$2.64	$2.88	$3.46
Source: Hearing Ex. 264 (MIG Ex. 9A)			

Whereas in times of relative market calm, both "average of" and "higher of" formulas generate fairly similar prices, Proposal 15 provides the stability when the marketplace needs it the most—during unexpected market swings. *See id.* at 3 (showing differences in prices in 2020). And even though the AMAA does not specifically provide for "hedging," a base Class I skim formula that supports hedging helps serve the enumerated purposes of the Act (like many other features of FMMO's, including, for example, make allowances). Hearing Tr. 5945:4-5946:4, Michael Newell (September 28, 2023).

Dr. Marin Bozic also recounted Jordan Clark's master's thesis paper, supervised by Dr. Bozic, where Mr. Clark concluded the following:

- "We find that between January 2000 and December 2017, average uniform prices for each Federal Milk Marketing Order would have differed by less than $0.01/cwt when comparing the previous and current Class I pricing formulas."

- "We also find that uniform prices are more volatile in federal milk marketing orders with the highest Class I utilizations, and had the newly reformed [average of] pricing formula been in place, would have reduced volatility in all FMMOs between 2000 and 2017."

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- "We also find that the basis risk of varying hedging strategies is significantly reduced under the reformed [average of] formula as compared to the previous formula."

Hearing Ex. 289 (Edge Ex. 6), at 2 (Testimony of Marin Bozic) (quoting Jordan Clark, Quantifying Impacts of Class I Milk Price Formula Reform: A Study of FMMO Uniform Milk Price Volatility and Class I Milk Hedging (October 2019) (Master's thesis, University of Minnesota), https://conservancy.umn.edu/bitstream/handle/11299/243054/Clark_umn_0130M_20777.pdf.

An unstable price has the greatest impacts on Class I processors, fundamentally undermining the FMMO's charge to ensure a sufficient supply of fluid milk for American consumers and an orderly marketplace. *See* 7 U.S.C. § 602(4). NMPF's own expert testified that the FMMO Class I price is more volatile than the retail price for whole milk, and so either processors or retailers are not passing along those price swings to consumers. Hearing Tr. 5272:13-23, Sara Dorland (September 26, 2023). More price stability in a processor's number one input cost—raw milk—allows processors to undertake long-term planning, reliably develop plant capacity, and invest capital in processing that has more certainty in creating a return on that investment. Hearing Ex. 273 (MIG/fairlife Ex. 10), at 3 (Testimony of Tim Doelman); Hearing Tr. 6046:1-11, Tim Doelman (September 28, 2023); *see also* Hearing Tr. 5934:28-5935:11, Michael Newell (September 28, 2023); Hearing Tr. 6463:25-6463:13, Marin Bozic (October 2, 2023) (more stable prices increases investment in Class I).

Consistent, predictable pricing supports innovative and short-term offerings, like the brownie batter milk developed by Turner Dairy. Hearing Tr. 5957:10-5960:2, Chuck Turner (September 28, 2023). Given the state of Class I and the need for innovation; stable, predictable prices can play a helpful role. As testified to by Chuck Turner:

> One problem with the "higher of" formula, in addition to incompatibility with hedging, was that the Class I price went up with every spike in butter, cheese or powder markets. But short-term changes in those product prices have no bearing on the actual Class I market. So we were left having to raise our prices to cover cost, but with no reasonable or market-based explanation to offer our customers. These resultant spikes in the cost of fluid milk definitely hurt milk sales over the 18 years that the higher of formula was used.

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Hearing Ex. 271 (MIG/Turner Ex. 12), at 4 (Testimony of Chuck Turner).

In other words, even if no Class I processors were using risk management, Proposal 15's formula generates a more stable price than Proposal 13.

b. When Class I processors can manage risk, they support the growth of fluid milk sales by stabilizing their prices.

Given the declining utilization share for Class I and the downward trends in per capita consumption, hedging provides an incredibly needed and valuable tool to manage price risk. Hearing Tr. 5692:1-11, Sally Keefe (September 27, 2023). If Class I can better manage its risk, then it can both better plan for its own costs and also offer more stable prices to consumers. *Id.* The very purpose of risk management and hedging is to minimize losses and support long-term planning. Undoubtedly, Class I could use the benefits offered by risk management.

Value-added fluid milk products (e.g., organic, high-protein, lactose-reduced) have adopted stable pricing strategies, and this price stability has been an important part of the success of this segment. Hearing Tr. 11094:21-23, Chris Dahl (January 18, 2024) (organic milk, which utilizes stable prices, is one of the few growing Class I sectors). These growing segments rely upon price stability. Hearing Tr. 5695:20-5696:6, Sally Keefe (September 27, 2023); Hearing Tr. 5959:23-5960:2, Chuck Turner (September 28, 2023); Hearing Ex. 273 (MIG Ex. 10), at 6 (Testimony of Tim Doelman) ("As companies work to create value in the fluid milk space, price certainty becomes more important."). Price stability and consistency is one of the features that farmers look forward to when moving into the organic system. Hearing Tr. 11024:8-15, Jay Luikart (January 18, 2024). Likewise, OV|CROPP testified to providing a more stable pay price than the FMMO system offers. Hearing Ex. 475 (MIG Ex. 22B), at 10 (Testimony of Shawna Nelson). While this is more nuanced than just pricing, having stable pricing is a key component of this marketplace. In fact, this need extends to any branded product. As NMPF's expert testified, "[a] processor that buys Class I milk and sells a branded product with a national pricing program (fixed price) may have risk" that would benefit from risk management. Hearing Ex. 238 (NMPF

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Ex. 32), at 10 (Testimony of Sara Dorland). Undoubtedly, all farmers and market participants would be served by more stable prices, and USDA should ensure the FMMO system supports stability for the conventional and HTST marketplace, too.

Dairy's top competitors, including plant-based milk substitutes, juices, and other non-dairy beverages, are frequently able to set consistent prices. *Id.* 5694:15-26; *see* Hearing Ex. 275 (IDFA 37), at 7-8 (Testimony of Mike Brown) ("Retailers demand—and receive—1-to-2 year pricing contracts with supplies on most, if not all of the alternative beverages to milk that compete in the dairy case or the coffee shop."). To compete, fluid milk must find a way to offer more price stability. Hearing Tr. 5692:1-11, Sally Keefe (September 27, 2023); Hearing Ex. 275 (IDFA 37), at 7-8 (Testimony of Mike Brown); *see also* Ex. 270, MIG Ex. 11, at 5 (Michael Newell Testimony) ("I noted above our use of hedging to help execute annual marketing and trade promotional plans for Lactaid. This is the same go-to-market approach that Hood uses for plant-based products and our competitors use for Value Added Milk and plant-based products."); Hearing Tr. 10905:16-10906:7, Tim Kelly (January 17, 2024) (given the increase in plant-based beverage competitors to milk, which have stable prices, stable pricing has become more important for milk sales).

MIG anticipates that opponents will argue that Class I processors cannot prove that price stability and the ability to hedge directly correlate with increased sales of Class I products—however, MIG and other witnesses clearly established that price stability serves an important role (among many other facets of marketing and sales) in encouraging sales. Hearing Tr. 5507:3-11, Kimberly Greenbaum (September 26, 2023) (explaining that offering stable pricing makes Nestlé more competitive in the hyper-competitive ready-to-drink market). Further, no single factor in any industry, or under the FMMOs, can alone change Class I sales. Instead, companies holistically examine the multitude of factors that support brand success and growth. Risk management and price stability undoubtedly serve to support these strategies, making them all the more important to Class I processors who have been fighting an uphill battle in recent years. *Id.* 5515:18-23 ("The

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change to the average-of allowed us to hedge that Class I price, and we have been able to limit the risk to the beverage business which owns Nesquik, and that has allowed that brand to grow over the past three years, where we were not seeing a growth pattern on that particular brand.").

c. Proposal 15 serves the industry as a whole by creating stability at multiple levels.

Not only is reducing price volatility a directive the Secretary must follow and a benefit to Class I processors, but price stability serves the entire dairy industry at every level.

First, processors' customers value stable prices, particularly institutional customers (school lunch programs, USDA feeding programs), food service, and restaurants. Hearing Tr. 5813:12-5814:13, Jacob Schuelke (September 28, 2023); Hearing Tr. 10940:22-28, Tim Kelly (January 18, 2024) ("[W]ithin our customer base we have foodservice customers that are really looking for a stable price. I think I even stated yesterday where they have menu boards that can cost millions of dollars to change, so they are asking us to reduce risk for them."). Having stable prices allows retailers to build marketing and promotional programs around dairy products. Hearing Tr. 6039:25-6040:5, Tim Doelman (September 28, 2023). One MIG witness, fairlife, testified that its retail customers are frequently looking to set prices out for six to twelve months. Hearing Ex. 273 (MIG/fairlife Ex. 10), at 3 (Testimony of Tim Doelman). Price changes for fairlife's customers rarely happen more than once per year. Hearing Ex. 274 (MIG/fairlife Ex. 10A), at 9 (Testimony of Tim Doelman). Likewise, for HP Hood, annual marketing and trade plans for ESL fluid milk products are rigorously developed and wholesale price changes take place infrequently (over the past ten years the average is less than annually). Hearing Ex. 270 (MIG/Hood Ex. 11), at 3 (Testimony of Michael Newell). And particularly for grocers using milk as a loss leader, while the grocer wants the milk to be cheap enough to incent visits to the store, "once [customers] are in the store, you don't really want them to buy a lot of milk." Hearing Tr. 6464:19-6465:2, Marin Bozic (October 2, 2023). Hedging options help grocers protect their margins on milk so they can fully encourage milk purchases while remaining profitable on those sales. *Id.*

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Price stability will also encourage more dairy purchases. Imagine a national restaurant chain considering developing a new dessert—prices must remain set and inputs need to track. That restaurant chain is significantly more likely to consider using milk as an ingredient if it can rely upon a more stable price—an outcome that undoubtedly benefits the entire dairy industry, including farmers. *See id.* at 6.

Additionally, HP Hood sees an opportunity to utilize Class I hedging to be more competitive in overseas markets. *Id.* at 5. Before the 2019 change, HP Hood sold ESL milk in overseas markets from its Sacramento plant, but as a result of price volatility, Hood and its milk suppliers lost a business relationship with an international distributor which equated to about 750,000 gallons per year. With an active hedging program, Hood could have worked with this distributor to reduce their price risk and possibly preserve the business. *Id.*

Second, the same is true for ultimate consumers—price stability is a desirable trait for consumers, particularly for products that they are buying routinely. Hearing Tr. 5695:2-10, Sally Keefe (September 27, 2023). "Anything we can do to facilitate marketing our product successfully to the end consumer will help the industry in large." Hearing Tr. 6040:21-23, Tim Doelman (September 28, 2023). MIG even presented evidence that price stability can support lower prices for consumers. "Retailers often will 'margin up' on manufacturers' price changes due to favoring specific retail price points like $3.99, $4.49, $4.99." Hearing Ex. 270 (MIG Ex. 11), at 6 (Testimony of Michael Newell). So, a $0.20 increase at the wholesale level could result in a $0.50 increase in price to consumers. Hearing Tr. 5910:7-10, Michael Newell (September 28, 2023). Further, the less predictable the price, the higher the likelihood of more frequent price changes, the more opportunities retailers will have to build added margin into their retail prices. That harms the market as a whole—including, and especially, the consumer. Hearing Ex. 270 (MIG Ex. 11), at 6 (Testimony of Michael Newell); Hearing Tr. 5971:2-6, Chuck Turner (September 28, 2023) (explaining that when retailers have to raise prices due to price spikes, they oftentimes will not drop back down when the cost of milk goes down again).

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Finally, price stability on the sell side allows processors to give better price stability on the buy side—meaning farmers receive more stable prices. Hearing Ex. 273 (MIG Ex. 10), at 3 (Testimony of Tim Doelman). This stability means that farmers will not experience price volatility to as high of a degree as they would under the "higher of"—a benefit to farmers and processors. Additionally, the Proposal 15 formula generates more stable minimum prices for farmers. While farmers will not see the significant "high" swings when Class III or IV surges, they also will not be hit as hard by rapid "low" swings when they contract. NMPF's witnesses testified that they believed more volatility was on the horizon for the dairy industry. *See* Hearing Tr. 5195:25-28, Calvin Covington (September 25, 2023) ("But in my opinion, going forward, I think we're going to be—going to see more volatility in prices. We're going to see greater spreads between Class III and IV prices."). Should this market prediction come true, price stability will be even more critical to farmers.

3. Congress, USDA, and even NMPF have all previously endorsed the policy of ensuring Class I opportunities for utilizing risk management.

Congress established policy that FMMO's account for Class I risk management opportunities and USDA must continue that policy. In Section 1403 of the Agriculture Improvement Act of 2018, Congress amended the AMAA. Consistent with the longstanding statutory requirement that the Secretary implement orders that help avoid price fluctuations, this amendment established Class I risk management as a policy consideration USDA must implement in FMMOs by revising the provision related to determining the monthly Class I skim milk price. Agriculture Improvement Act of 2018, Pub. L. 115-334, 132 Stat. 4490 (2018 Farm Bill) § 1403(a). USDA cannot now adopt a different policy, as the statutory incorporation of risk management opportunities preempts any potential current or former USDA policy that failed to consider these tools. Statutes control over regulations and regulatory policy. *Children's Health Defense v. F.C.C.*, 25 F.4th 1045, 1052 n.5 (D.C. Cir. 2022) ("[A] regulation can no more preempt a federal statute than a federal statute could preempt a provision in the Constitution.").

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In fact, consistent with this statute, USDA affirmed the policy of supporting risk management when adopting the current formula. When USDA adopted the current base Class I skim milk price formula, it recognized the critical policy goal of ensuring that Class I processors had access to risk management tools.

> The dairy industry has calculated that applying the "higher of" provisions to skim milk prices has returned a price $0.74 per hundredweight above the average of the two factors since the pricing formulas were implemented in 2000 [and] the inclusion of the $0.74 in the calculation should make the change roughly revenue neutral. At the same time, it is anticipated that using the average of the Class III and Class IV advanced pricing factors in the Class I skim milk price formula will allow handlers to better manage volatility in monthly Class I skim milk prices using Class III milk and Class IV milk futures and options. Until now, uncertainty about which Class price will end up being higher each month has made effective hedging difficult.

Federal Milk Marketing Orders—Amending the Class I Skim Milk Price Formula, 84 Fed. Reg. 8590, 8591 (Mar. 11, 2019). USDA also noted how important these tools were to small businesses. *Id.* ("Amending the Class I skim milk price provisions may help small businesses better utilize currently available risk management tools.").

USDA would be reversing its own previously established policy based upon Congress amending the AMAA, if it now moved back to the "higher of." During this hearing, questions were asked whether the AMAA as originally enacted in 1937 could have (and thus, did today) contemplate hedging within the declared policy of the Act. That question must, however, be considered in light of the AMAA as amended *today*. And the 2018 Farm Bill, which permanently amended the AMAA, expressly was made for one and only one reason—to facilitate risk management. Congress and USDA made it abundantly clear that hedging is a valid policy concern, and a necessary consideration for USDA in adopting any FMMO regulatory amendments.

Moreover, NMPF itself acknowledged this express need for hedging in the process to adopt the current formula. *See* Hearing Ex. 232 (IDFA Ex. 45), at 2; Hearing Tr. 4807:28-4808:18, Peter Vitaliano (September 20, 2023) (testifying that the goal at the time of requesting a move to the

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average of was "[t]o make Class I prices more hedgeable."). NMPF originally supported the "average of" formula on the basis that it supported Class I hedging. Hearing Ex. 236 (IDFA Ex. 236).

The importance of risk management has grown since FMMO Reform, further supporting why it is now a key consideration for USDA. To operate in the sophisticated marketplace of today's dairy industry and on the same footing as other dairy processors, Class I processors must have the ability to manage risk. Other classes took time to develop hedging programs, even with the active support of extension offices, and Class I should be given the same opportunity. Hearing Tr. 5811:20-5012:11, Jacob Schuelke (September 28, 2023). To be on equal footing to their competitors (i.e., cooperatives who also own fluid milk plants or manufacturing class processors), USDA should ensure that *all* processors have the ability to manage risk.

Producers utilize risk management in their own operations, reinforcing the ubiquitousness of this feature in modern agricultural markets. As stated by one farmer:

> ***Risk management is an extremely important part of our business.*** We use several different tactics to try to minimize large price fluctuations and its effect on our bottom line. We use a combination of fixed pricing in both classes of milk along with Dairy Revenue Protection (DRP) and, at times, Target Blend pricing that is offered through DFA Risk Management. We tend to protect profitable pricing as far ahead as I can have feed contracted. This can range from 3 months to up to 18 months ahead depending on the futures price, and my desire for risk.

Hearing Ex. 148 (DFA Ex. 2), at 3 (Testimony of Eric Palla) (emphasis added).

The hearing testimony from farmers consistently emphasized their need for and use of risk management.

- Hearing Ex. 167 (Edge Ex. 5), at 1 (Testimony of Justin Peterson) ("***Utilizing risk management when you can is paramount.*** We utilize risk management tools when we can on our farm, including DRP, DMC, futures contracts, options and hedge-to-arrive contracts. If any of our risk management tools were to be suspended for any amount of time, we would risk significant financial exposure for our business." (emphasis added)).

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- Hearing Ex. 262 (Edge Ex. 11), at 3 (Testimony of Lucas Sjostrom) ("I believe DRP, LGM-Dairy, and CME Group-type hedging is more important for farms like mine than ever before—farms that fit the definition of a small business for the purpose of this program.").

- Hearing Ex. 149 (DFA Ex. 1), at 2-3 (Testimony of Paul Windenmuller) ("***We are diversified and use several different tools for managing milk price risk.*** The federal government's Dairy Margin Coverage is an important mainstay of our risk management strategy, but it is not the only tool we use. We also use Dairy Revenue Protection (DRP) and forward contract prices up to 16 months in advance. We have used both Class III and Class IV forward contracts to try to stabilize our pay price." (emphasis added)).

- Hearing Tr. 5199:27-5200:3, Calvin Covington (September 25, 2023) (SMI witness testified that when he worked at the cooperative, they would forward contract feed.).

- Hearing Tr. 622:24-26, Soluma Schwoeppe (August 25, 2023) ("We forward-contract soybean meal. We forward-contract our protein base mix. And we forward-contract fuel.").

- Hearing Ex. 205 (Edge Ex. 9) (Testimony of Amy Penterman) ("***One key aspect of economic sustainability is effectively managing our price risk, as market prices can fluctuate significantly in short periods of time.*** Our farm, and other farms like it, need effective tools to ensure a certain amount of price certainty." (emphasis added)).

- Hearing Ex. 210 (Edge Ex. 7) (Testimony of Nicole Barlass) ("Risk management is an important part of how modern dairy farms operate, as milk prices and costs can fluctuate up and down.").

- Hearing Ex. 136 (NMPF Ex. 81), at 3 (Testimony of Karl Wedemeyer) ("Part of this strategy is to have forward contracts for milk at various price points and for various lengths of time out into the future to hedge price risk. ***There will be times when I have milk forward contracted for up to a year in advance.***" (emphasis added)).

Additionally, the significant portion of farmer witnesses testified to using USDA-sponsored programs that mitigate risk, including Dairy Revenue Protection and Dairy Margin Coverage.

- Hearing Tr. 1587:7-21, Kevin Krentz (August 31, 2023) (discussing Dairy Revenue Protection, tracking CME prices, and locking in margins ahead of time).

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- Hearing Tr. 1874:6-15, Josh Tranel (September 1, 2023) (Tranel Family Farms uses "some risk management tools on our input side of our dairy, so example, for fuel or cropping needs. And we also use crop insurance and some other programs that are offered by the USDA.").

- Hearing Tr. 1916:18-20, Kristopher Scheider (September 1, 2023) ("[I]n reference to risk management, we utilize DMC and DRP.").

- Hearing Tr. 2948:12-14, Matt Hoff (September 8, 2023) ("I use the DMC, and I have used the DRP quite extensively. Before that I actually used the futures market some.").

- Hearing Tr. 2907:27-28, Evan Hillian (September 8, 2023) ("[W]e do use Dairy Margin Coverage and Dairy Revenue Protection as well.").

- Hearing Tr. 4176:17-22, Stephanie Alexandre(September 15, 2023) ("We greatly appreciate the Dairy Margin Coverage[.]").

- Hearing Tr. 5390:11, Chris Kraft (September 26, 2023) ("We use DRP a lot, extensively.").

- Hearing Tr. 6391:15-20, David Pool (October 2, 2023) ("[T]he DMC for a dairy my size is critical. I think it's a very, very good program. It's utilized by a lot of dairy farmers in my area because our average farm, I think, is 125 cows in our geographical area, so the DMC is spot on for them. I also use Class I mover hedging, and monitor the DRP very closely.").

NMPF's own arguments on risk management in support of Proposal 1 also support USDA's consideration of that factor in MIG's Proposal 15. For its Proposal 1, NMPF urged USDA to delay the implementation of that proposal by twelve months in order to account for hedging programs currently in place. Hearing Ex. 64 (NMPF Ex. 2), at 9 (Testimony of Calvin Covington), ("Both dairy farmers and handlers use risk management programs, and this delay will allow most transactions placed prior to updating the skim milk component factors be completed."); *see also id.* at 10 ("With today's rapid advances in genomics, biotechnology, and nutrition along with the potential of weather events that could impact the next year's feed supply, it is possible to have unexpectedly large differences in milk components from one year to the next. Plus the three-year average allows dairy farmers and handlers using risk management tools to better anticipate potential future changes."); *and* Hearing Tr. 1313:4-9, Ed Gallagher (August 30, 2023) ("Failure

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to recognize that change and delay the change, we're asking for a 12-month delay in its implementation, will create financial harm to dairy farmers, milk plants, end users, and others who entered into risk management transactions prior to the knowledge of the change and the timing of it."). The fact that farmers are asking for delayed implementation of certain outcomes of this hearing in order to account for their hedged positions affirms that risk management is critical and indeed, as discussed above, a valid and important policy consideration under the AMAA. USDA should not act to protect risk management options only for certain sectors of the dairy industry and ignore it in others.

The Chicago Mercantile Exchange even attended the hearing, underscoring the importance of risk management in the dairy industry today. The CME Group witness, Anne Krema, explained:

> Commodities futures and options markets are essential to producers, processors, retailers, and consumers to help manage price risk throughout the supply chain. CME dairy futures and options serve as hedge tools for physical market participants, allowing them to lock in either sale or purchase prices for milk or dairy products.

Hearing Ex. 78 (CME Group 1), at 1 (Testimony of Anne Krema). The growth in the number of dairy commodities and average open interest clearing shows the importance of risk management for the dairy industry today.

> CME Group has been able to expand our dairy risk management complex from one commodity in 1996, to now offering products on seven different dairy commodities. Average open interest, or the average amount of open positions held on a daily basis, equated to over 37 billion pounds of product across futures and options in 2022 compared to just over 2 billion pounds of product in 2000.

Id.

Finally, any implication that the "average of" may impair some dairy farmers from hedging because depooling adds risk ignores that depooling can and will occur regardless of the Class I skim milk price formula and is simply yet another way in which the depooling boogeyman is used to adversely affect Class I processors. If depooling is a problem (which MIG does not concede it is), then USDA should address depooling directly and not through artificial mechanisms that

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cannot and will not solve the problems of depooling. Blaming Class I for depooling, when it is the captive class through minimum price regulation, is akin to drawing water from an empty well.

4. An "average of" calculation must be the heart of the base Class I skim milk price in order for the pricing formula to support hedging.

Class I market participants cannot effectively hedge their price risk under the "higher of" formula. The overwhelming and mathematically backed evidence at the hearing supports the conclusion that the "higher of" formula cannot be hedged. *See* Hearing Ex. 244 (Edge Ex. 244), at 563 (Newton & Thraen, 2013, Road Block to Risk Management) ("The basis exposure prevents Class III and IV milk futures from directly managing the milk price and limits potential risk reduction and revenue stability for fluid milk participants. Removing these roadblocks to risk management would provide avenues for farm processor retailer profitability in an increasing volatile market."); Hearing Ex. 273 (MIG/fairlife Ex. 10A), at 5-7 (Testimony of Tim Doelman) (hedging was not feasible under the "higher of"); Hearing Tr. 5929:26-28, Michael Newell (September 28, 2023) (HP Hood did not hedge Class I prior to 2019); Hearing Tr. 6358:22-6359:6, Mike Brown (October 2, 2023) (hedging by end use customers is more prevalent and more successful under the "average of").

As demonstrated in the example by fairlife at the hearing, the failure to predict which of the two prices will be the applicable price under the "higher of"—Class III or IV—means processors and producers have no way to develop an effective hedge because they either have to purely guess which class to hedge (which would make it a gamble, not a hedge), or they have to hedge both classes (offsetting the financial benefit of hedging because they then will be left holding an irrelevant hedge). Hearing Ex. 274 (MIG/fairlife Ex. 10A), at 5-7 (Testimony of Tim Doelman); Hearing Tr. 5921:5-14, Michael Newell (September 28, 2023).

Instead, under the average of, a Class I processor can buy fifty percent Class III contracts and fifty percent Class IV contracts of the same volume during the relevant time period. Hearing Ex. 273 (MIG/fairlife Ex. 10), at 4 (Testimony of Tim Doelman); Hearing Ex. 274 (MIG/fairlife

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Ex. 10A), at 5-7 (Testimony of Tim Doelman). Specifically, a Class I processor that wants to hedge its sale price buys a futures/options contract for the solids (powder or cheese) and the fat (butterfat) on the CME. Hearing Ex. 270 (MIG/Hood Ex. 11), at 4 (Testimony of Michael Newell). The processor knows with certainty that each commodity will make up fifty percent of the base Class I skim price. Then the Class I processor can set its own price to its customers based on that hedged price.[32] That way, no matter how the underlying manufacturing commodities prices change, the processor has a locked in price and can honor the set price it gave its customer.

MIG does not dispute that over-the-counter ("OTC") Class I custom hedges could exist, or that some industry participants may have utilized such contracts when the "higher of" was in place. But what was subject to significant, and robustly supported, testimony is that such OTC hedges are not a feasible option for the industry as a whole. Hearing Tr. 6441:12-6442:25, Marin Bozic (October 2, 2023); *id.* 6476:4-12 (stating that he "strongly disagree[s]" with NMPF's expert Ms. Dorland's conclusion that there can be industrywide hedging using OTC contracts under the "higher of"). Dr. Bozic testified that an OTC hedge for Class I under the "higher-of" would be $0.30/cwt, meaning "[e]ven if hedging instruments are technically available, it would just not be economically feasible." *Id.* 6436:19-6538:3. In contrast, a CME futures contract could be around $0.03/cwt. *Id.* 6538:13. "There is a reason why almost no witness in this hearing said that [an OTC hedge] was their regular practice prior to 2019." *Id.* Tr. 6439:1-3.

USDA should disregard the testimony of the sole witness who testified in support of the ability to hedge under the higher-of formula—NMPF's expert witness, Sara Dorland. Critically, ***NMPF's own witnesses disagreed with Ms. Dorland***, testifying that the "average of" is easier to hedge. *See* Hearing Tr. 4784:19-20, Peter Vitaliano (September 20, 2023) ("We do not disagree

[32] NMPF's counsel implied during cross-examination that Class I processors actively hedging have now created a liquid Class I hedging market. But as clarified by Tim Doelman, Class I processors do not hedge Class I milk or Class I prices—they hedge Class III and IV milk as those are the pricing inputs for the Class I price. Hearing Tr. 6053:27-6054:9, 6074:5-16, Tim Doelman (September 28, 2023).

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that – that the current mover is more hedgeable . . . ."). Ms. Dorland admits that the majority of the dairy industry disagrees with her conclusions that hedges are equally effective (or ineffective) under the "average of" as the "higher of." *See* Hearing Tr. 5290:27-5291:21, Sara Dorland (September 26, 2023) (Q: "[Y]our statement is, at that time [that the formula switched to the "average of"], everyone, despite thinking this would help hedging, they were all wrong?" A: "Yes. It's common. The industry does that often, unfortunately.").

First, NMPF's expert lacked any support for her criticisms of the success of hedges under the "average of" formula. She incorrectly asserted that the adjuster in MIG's Proposal 15 and IDFA's Proposal 14 could not be hedged because it changes every month—entirely ignoring that this adjuster will be known in advance every month. *See* Hearing Tr. 5291:25-5292:28, Sara Dorland (September 26, 2023). She also tried to argue that, under the "average of plus adjuster," processors would be unable to predict, and thus hedge, their pool obligation. Hearing Tr. 4933:23-4934:7, Sara Dorland (September 20, 2023). MIG does not disagree, but not one witness testified that what processors were trying to hedge was the pool obligation—rather, they are hedging the respective announced prices for Classes III and IV.[33] *See supra*, p. 116 note 32. A company managing risk does not care what the actual class prices are, rather just that they can lock in a certain price ahead of time. Hearing Tr. 6071:26-6072:10, Tim Doelman (September 28, 2023). Disproving a hedging method *no one wants to use* does not add anything substantive to this record. NMPF's expert also claimed that because of depooling, Class I prices would be unhedgeable under the "average of." But depooling does not create complexity or even impact the processor's ability to lock in a price ahead of time. *Contra*, Hearing Tr. 5364:2-5365:4, Sara Dorland (September 26, 2023). Ms. Dorland's testimony was also riddled with mathematical errors, undercutting the reliability of such complex testimony. *See* Hearing Tr. 4962:8-18, Sara Dorland (September 20, 2023) (for example, an incorrect skim conversion and the missing producer price differential).

[33] "[T]rying to hedge the producer settlement fund obligation is a fruitless task" because you would have to predict the utilization for the entire order. Hearing Tr. 5767:16-18, Sally Keefe (September 27, 2023).

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Finally, one of Ms. Dorland's key examples of a hedge was for an organic processor, an example she later disclaimed as likely irrelevant because she did not know if anyone in the industry had even done such a hedge.[34]

On the other side of the coin, Ms. Dorland failed to establish that industry could effectively hedge Class I risk under the "higher of." The best method Ms. Dorland was able to testify to was the utilization of a bespoke, custom hedge. *Id.* 4951:18-22 ("[I]f I want something that's cookie cutter, Class I may be more challenging to hedge. But if I can work with somebody who will actually devise a program that works for me, I have no issues with Class I."). Dr. Bozic's hedge effectiveness analysis showed that a Class I hedging program under the "higher of" "would have major difficulties achieving" hedge accounting status. Hearing Ex. 297 (Edge 15 Corrected), at 4-6 and 12-17, (Testimony of Marin Bozic). MIG witnesses agreed that theoretically, one could purchase a custom Class I contract using the over-the-counter market. Hearing Ex. 270 (MIG Ex. 11), at 4 (Testimony of Michael Newell). However, multiple witnesses from different entities appearing at the hearing agreed that such "custom" hedges bear unacceptable basis risk, as well as are prohibitively expensive. *Id.* at 5; *see also* Hearing Tr. 5905:18-23, Michael Newell (September 28, 2023); Hearing Tr. 6436:23-6438:17, Marin Bozic (October 2, 2023).

C. The "Average Of Plus Rolling Adjuster" Formula Best Supports FMMO Policy of Ensuring an Orderly Market and a Sufficient Supply of Milk for Fluid Use.

The "average of" formula is working as intended, with the exception of the fixed $0.74 adjuster; thus, USDA should *only* change the portion of the formula that needs adjustment. MIG cannot decipher what logic supports NMPF's opposition to Class I's ability to hedge when win-win formulas like Proposal 15 exist: i.e., formulas that return equivalent revenue to farmers *and*

[34] Referring to Hearing Exhibit 251, (NMPF Ex. 32C), Sara Dorland corrected, "[O]bviously you have an issue with the methodology. If I could strike this entire spreadsheet from the record, I would, because it's a crazy little hypothetical that I truly don't know if anybody in the industry is actually using." Hearing Tr. 5307:4-8 (September 26, 2023).

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allow Class I to manage risk. **NMPF's own expert affirmed that MIG's Proposal 15 would return roughly equal revenue to farmers as a return to the "higher of"—and even more revenue, in some years.** Emotion and familiarity, by NMPF's own admission, appear to drive farmer's desire to return to the "higher of"—undoubtedly, though, USDA cannot consider such factors when setting federal regulations for a multi-billion dollar industry.[35] But even more importantly, while MIG went to great lengths to develop a proposal that would be attractive to producers, USDA should not consider revenue neutrality as a standalone policy consideration when setting FMMO prices.[36]

To the extent that NMPF argues USDA's reasoning for adopting the "higher of" during FMMO Reform supports rejecting Proposal 15 and adopting their Proposal 13 (*see* Hearing Tr. 229 (NMPF Ex. 30), at 4 (Testimony of Peter Vitaliano)), that reasoning is preempted by Congress' statute implementing the "average of" plus adjuster as well as USDA's own implementing regulations. *Compare* Milk in the New England and Other Marketing Areas, 64 Fed. Reg. 16026 (April 2, 1999) *with* 7 U.S.C. § 608c(5)(A) *and* Federal Milk Marketing Orders—Amending the Class I Skim Milk Price Formula, 84 Fed. Reg. 8590 (Mar. 11, 2019).

Furthermore, USDA cannot ignore the significant, multiple, and compelling changes to the U.S. dairy industry since making its FMMO Reform policy decisions in 1999, changes which have in many instances resulted in significant and growing challenges for the Class I segment of the dairy industry. Simply put, the FMMO policy behind the "higher of" must be revisited after 25

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[35] "[T]he higher-of is the one that dairy farmers are most comfortable with, most trusting of, and we think that would be – you know, we would be content to return to the higher-of as opposed to something that was more complicated.", Hearing Tr. 4700:16-20, Peter Vitaliano (September 19, 2023); Hearing Tr. 5157:13-22, Cal Covington (September 25, 2023) ("But I can tell you just based upon the feedback I received from dairy farmers, they are – they want the higher-of back. That's the one they are comfortable with. . . . [The current formula] hurt them in the pocketbook, and so they are very suspicious of anything other than going back to the higher-of.").

[36] Revenue generated to dairy farmers can be related to ensuring a sufficient supply of fluid milk. But with declining Class I utilization and milk production growth, as established *infra* pp. 136-37, revenue cannot be the driving factor for the base Class I skim price.

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years of change in the marketplace. Given the significant market changes and dynamics including the development of plant-based competitors that have occurred since 1999, the same policy reasons that supported using a "higher of" formula at FMMO Reform now support using an "average of" formula. *See contra*, Hearing Ex. 245 (NMPF Ex. 31) (Testimony of Craig Alexander).

1. MIG's "average of" formula generates the most accurate pricing signals for dairy producers.

The "average of plus rolling adjuster" best reflects the overall manufacturing marketplace on a timeframe most relevant for producers to respond to market signals. For clarity, MIG provides a narrative and a mathematical example below of how Proposal 15 would work in practice if adopted:

A. For each prior month, calculate the "higher of" the advanced Class III or IV skim price (in other words, the pre-May 2019 method).

B. For each prior month, calculate the "average of" the advanced Class III and IV skim price (in other words, the post-May 2019 method, without the $0.74).

C. Calculate the difference between (A) and (B).

D. Monthly, calculate the adjuster by averaging (C) for the preceding 13-to-36-month period (this is the "Rolling Adjuster" with a 24 month look back period with a 12-month lag). For example, if this were in place for January 2024, the Rolling Adjuster would be the average of (C) for January 2021 to December 2022. And then the Rolling Adjuster for February 2024 would be the average of (C) for February 2021 to January 2023. And so on.

E. Monthly, average the Class III and IV advanced skim prices for that month and add (D) (the Rolling Adjuster).

Calculating as an example, assuming Proposal 15 had been in place, the base Class I skim price for January 2017:

1. Adjuster = $0.95

    a. Average of difference between "higher of" and "average of" for January 2014 to December 2015, as found in the third to last column.

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2. Average of advanced skim milk pricing factors = $8.34

    a. Average of the January 2017 Class III pricing factor ($9.61) and the Class IV pricing factor ($7.07)

3. Proposal 15 base Class I skim milk price: $9.29

    a. Add the Average and Adjuster: $8.34 + $0.95

Hearing Ex. 263 (MIG Ex. 9), at 7 (Testimony of Sally Keefe). This formula generates not only appropriate financial returns (particularly in comparison to the "higher of"), but tracks the most appropriate market signals.

a. MIG's Proposal results in similar returns to farmers as the "higher of."

MIG's Proposal 15 returns roughly the same amount of money to farmers as NMPF's Proposal 13. *Id.* at 4. NMPF's own witnesses agreed, conceding that MIG's Proposal 15 would have, in certain years, generated ***more money*** for farmers than NMPF's Proposal 13. Hearing Ex. 241 (NMPF Ex. 103), at 11 (Testimony of Sara Dorland). The two prices converge even more as they are viewed over time. Hearing Ex. 263 (MIG Ex. 9), at 3 (Testimony of Sally Keefe). Specifically, looking at 2021 and 2022, Proposal 15 and Proposal 13 return very similar amounts to farmers. And when those returns are averaged over 5, 10, or 20 years, they converge to similar amounts. That means the pricing signals sent by the "average of plus rolling adjuster" and the "higher of" are going to be very similar.

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Comparison of Monthly Average Base Class I Skim Milk Prices ($/cwt)			
Year(s)	**Current**	**Proposal 15**	**Proposal 13**
2018	$6.56	$6.54	$6.23
2019	$8.40	$8.29	$8.31
2020	$11.13	$10.89	$12.89
2021	$10.83	$10.86	$10.75
2022	$13.03	$13.94	$13.64
2018 – 2022 (5 yr.)	$9.99	$10.10	$10.36
2013 – 2022 (10 yr.)	$10.23	$10.30	$10.41
2008 – 2022 (15 yr.)	$10.37	$10.40	$10.51
2003 – 2022 (20 yr.)	$10.05	$10.07	$10.15
Notes: The advanced Class III and IV skim milk pricing factors used for this analysis are from Exhibit 15 "Announcement of Advanced Prices and Pricing Factors - January 2000 - August 2023."			

The one year where the price formulas would have generated meaningfully divergent prices is 2020—but USDA should not use that obviously anomalous year as the basis for setting policy. The Food Box Program, while well intended and needed for other reasons, greatly distorted FMMO pricing. No witness testified to any factor that could so greatly impact FMMO prices than that type of global crisis coupled with government intervention. Undoubtedly, should another worldwide disruption occur, both regulators and the industry have the benefit of learning from 2020 and future policy will likely be crafted to avoid such impacts. Given the fragility of the Class I fluid milk industry, Class I should not be blamed or made to pay the price for these price spreads over which it had no control or influence.

NMPF's expert testified that, in comparison to the current "average of" formula, "[t]he longer-term effect of this scenario [returning to the higher of] moderates the effect on the U.S. all milk price as milk production expands by 0.1 billion pounds. U.S. all milk prices are only $0.01

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to $0.02 per hundredweight higher longer term." Hearing Ex. 421 (NMPF Ex. 60), at 8 (Testimony of Scott Brown). NMPF witnesses affirmed this conclusion, admitting that their Proposal 13 will only have a "modest positive impact" on the average pay price received by producers. Hearing Tr. 4727:6-11, Peter Vitaliano (September 19, 2023). Critically, no NMPF witness compared the "higher of" to MIG's "average of plus rolling adjuster" formula—so NMPF failed to even evaluate if MIG's Proposal will actually do better for farmers in the future than the "higher of." From the overall testimony, there is no evidence that Proposal 15 results in any net revenue differences from the "higher of." Yet NMPF still believes that a potential positive impact outweighs the need for a declining Class I market to try to mitigate its risk. *Id.* 4731:10-28 ("So on balance, life is full of trade-offs, and this is one trade-off that our decision-makers have decided, you know, dictates that we go back to the higher-of."). USDA should not accept such a cavalier attitude towards the only captive participant in the FMMO system.

Dairy farmer support of Proposal 13 and the "higher of" appears to be a misunderstanding of the proposals—that the "higher of" would return more money to farmers than Proposal 15 (or 14). While NMPF's expert testified that a short-term adjustment could raise the base Class I skim price by $0.48 in comparison to the current formula, that would translate into only an $0.06/cwt increase in milk prices for farmers for the first year. Hearing Ex. 422 (NMPF Ex. 60A), at 13 (Testimony of Scott Brown). And given the economic consequences of the short-term higher prices, the long-term increase would be only $0.01 to $0.02 (again, only in comparison to the current formula). *Id.* Instead, farmers appeared to be misinformed about the outcome of NMPF's Proposal 13, repeatedly testifying that they supported the "higher of" because it will return more money to farmers. For example:

- Jennifer Lawrence, Hearing Ex. 281 (NMPF Ex. 78), at 4 ("Using the 'higher of' the most currently calculated advanced Class III or Class IV skim milk price in the Class I mover formula will ensure the dollars will come from the marketplace as originally intended.").

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- Doug Chapin, Hearing Ex. 135 (NMPF Ex. 76), at 1 ("I don't know of any tools accessible to the average dairyman that can address [Class 1] pricing today. The best tool would be the higher of mover so that producers know that they won't have to risk a negative basis in Class 1 pricing.").

- Gerben Leyendekeer (Hearing Ex. 122 (NMPF Ex. 64), at 1) ("Dairy farmers left a large amount of money on the table with the previous change following the 2018 Farm Bill.").

- Kristopher Scheider, Hearing Tr. 1911:1-6 (September 1, 2023) (Hearing Ex. 123 (NMPF Ex. 69), at 1-2) ("Our dairy farmers would benefit greatly by reverting back to the original higher-of Class III/IV pricing method. This loss of value for our products has greatly impacted our members' profitability, especially during the volatile markets and continual increases in input costs.").

- Brian Rexing, Hearing Tr. 2365:10-14 (September 6, 2023) ("I think [the higher of] is simpler, and I think it's, you know, it's provided us a better price. You know, dairy farming is not a race, it is a marathon. And I think it's something that gives us more stability in pricing our milk.").

- Sieste Tollenaar, Hearing Ex. 208 (DFA Ex. 5), at 3 ("I'm not sure how [the change to average of plus 74 cents] worked out for them other than our dairy's blend price has been lower due to the change. This experiment has failed for dairy farmers, and it would benefit farmers to immediately fix the mover and return to revenue my blend price on a monthly basis.").

See also Hearing Ex. 248 (NMPF Ex. 34), at 2 (Testimony of Calvin Covington). And with NMPF failing to compare their Proposal 13 to the alternatives proposed by MIG and IDFA, none of the farmer witnesses had the benefit of knowing ahead of the hearing that these alternatives were going to be right in line with the historical "higher of" calculation.

Finally, the adjuster portion of the base Class I skim price plays a very small role in the overall Class I price. *See* Hearing Ex. 265 (MIG Ex. 9B), at 5 (Testimony of Sally Keefe):

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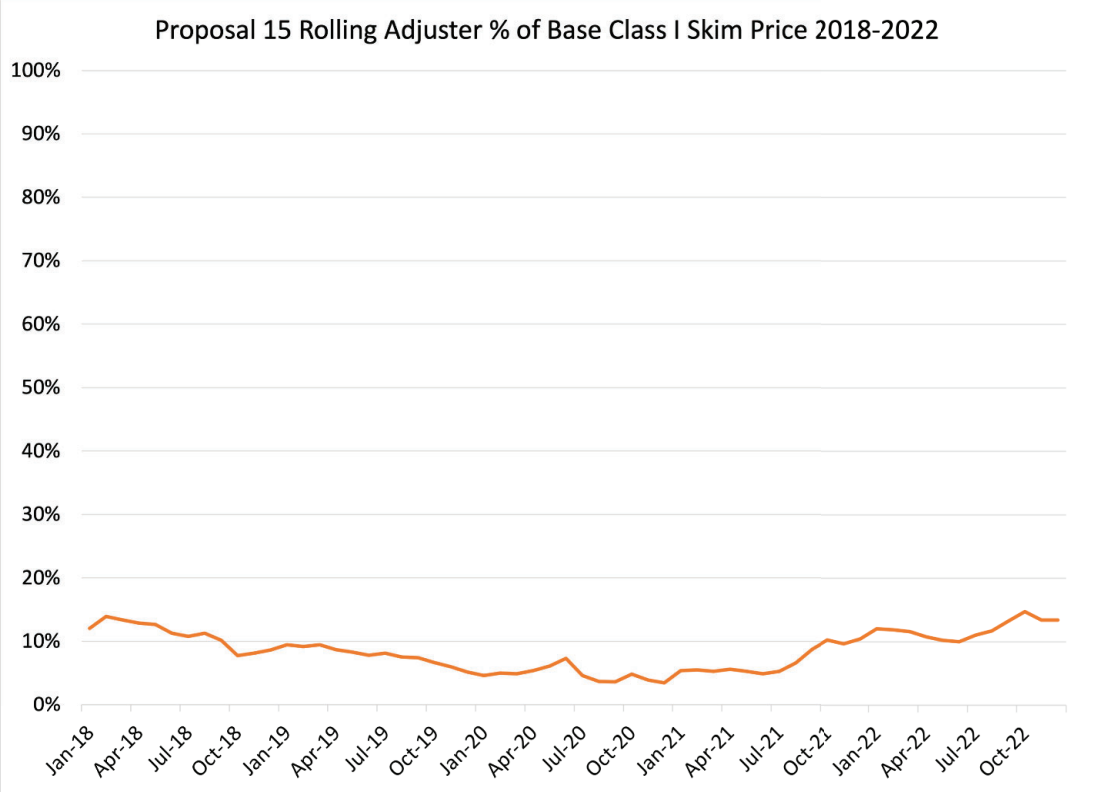

To the extent producer objections focus on the formula for the adjuster (as opposed to the "average" portion, which has worked as intended), that is really an objection to the tail, not the dog.

In fact, *NMPF* even publicly endorsed a modified "average of" approach as fair to farmers:

> NMPF supports a proposal to recalculate the current $0.74/cwt every two years using the average of monthly differences between the higher-of, and the average-of, advanced Class III and IV prices during the prior 24 months, with the current mover serving as the floor. This preserves the mover predictability that processors sought while addressing the asymmetrical risk borne unfairly by farmers under the Class I pricing formula.

Hearing Ex. 236 (IDFA Ex. 236), at 1 (a page on its website NMPF dubiously deleted ahead of the hearing, forcing it to be recovered through historical archives). NMPF also included on this website a chart showing that replacing the $0.74/cwt fixed adjuster with a biennial reset adjuster "offers farmers fair pricing." *Id.* at 2. NMPF did not move away from this position until October 2022. Hearing Tr. 4777:28-4778:1, Peter Vitaliano (September 20, 2023). For whatever reason,

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the NMPF economic policy committee "decisively rejected the average . . . , and the feeling in the room . . . was nothing besides returning to the higher -of would even be entertained . . . ." *Id.* 4778:19-27.

Yet throughout the hearing, NMPF failed to explain this shift in position. NMPF has repeatedly stated that the intention of both Class I milk buyers and dairy farmers sellers to the "average of" was to be revenue neutral and to accommodate buyers' desires to better manage their price risk without harming the sellers. Hearing Ex. 275 (IDFA Ex. 37), at 32, Attachment A (Testimony of Mike Brown). ***MIG's Proposal 15 meets these jointly enumerated goals,*** and USDA should adopt it accordingly.

b. MIG's Proposal 15 sends market signals to farmers on the relevant, year-long timeframe upon which farmers would want to respond to market signals.

Unlike the "higher of's" rapid, monthly swings, MIG's average of plus rolling adjuster more accurately reflects the marketplace that dairy farmers will respond to—**the broader market shifts that occur over a year-plus period**. Hearing Tr. 5967:2-9, Chuck Turner (September 28, 2023) (farmers look to the long-term market signals). As testified to by many processors and producers, milk marketing decisions are not made or changed monthly.

NMPF's criticisms regarding the timing of the pricing signals of MIG and IDFA's proposals are factually wrong. One of their key errors, reiterated by NMPF expert Sara Dorland, was her misconception that dairy farmers will react to pricing signals month to month. Hearing Tr. 5300:20-5301:12, 5362:2-6, Sara Dorland (September 26, 2023). MIG's witnesses established that dairy contracts operate on much longer time frames. Shehadey typically negotiates OOPs on two-year contracts. Hearing Tr. 11245:6-14, Jed Ellis (January 19, 2024). Shamrock negotiates contracts typically every two to five years. Hearing Tr. 10920:21-26, Tim Kelly (January 18, 2024). Likewise, fairlife's cooperative contracts typically last two to five years, sometimes one year on the short side. Hearing Tr. 11317:18-26, Tim Doelman (January 19, 2024). Turner

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negotiates its premiums long-term, "every couple of years." Hearing Tr. 11002:16-26, Chuck Turner (January 18, 2024).

Even NMPF's witnesses repeatedly testified to exactly the opposite of Ms. Dorland's conclusion, affirming that dairy farmers will need months or years to make production changes:

- Upstate Niagara Cooperative testified that, as a seller, it negotiates contracts annually or longer (setting aside some handshake agreements). As a buyer, it negotiates supply agreements "typically annually." Hearing Tr. 5025:16-28, Craig Alexander (September 25, 2023). It is only about once a year that they would make a decision to shift who they sell their milk to. *Id.* 5026:27-5027:1.

- Prairie Farms also testified that, as a purchaser, it negotiates supply agreements annually, and some are done longer than annual. Hearing Tr. 5096:2-9, Chris Hoeger (September 25, 2023) (note, they also have handshake agreements)

- Likewise, according to Upstate Niagara, it takes farmers weeks to months to years to ramp up production, depending on the type of ramp up. Hearing Tr. 5028:2-22, Craig Alexander (September 25, 2023).

- Prairie Farms has been told by producers it is four to six months, if not longer, for them to react in any significant way to market signals. Hearing Tr. 5097:8-14, Chris Hoeger (September 25, 2023).

- The SMI witness also agreed that, "[M]ilk is going to move to where it gets the greatest return. . . . [I]t might not happen overnight because of contracts, logistics, other things, but over time, milk's going to move to its highest value." Hearing Tr. 5190:18-22, Calvin Covington (September 25, 2023).

A producer who sells his milk to a fluid processor will not, under normal market practices, switch to a Class III processor one month due to FMMO prices and back again the next month. Standard industry terms would never permit this practice, nor would market participants want to live in such a chaotic market. Instead, these decisions are made on annual, or even longer, time frames. And practically, farmers would not base customer decisions on a single months' prices (regardless of when that "signal" is sent)—instead, farmers would want to have the assurance that a switch reflects broader market shifts that will translate to returns. To incentivize milk movement to the right classes and peg value accordingly, USDA must consider "value" in the broader marketplace, not on a month-to-month timeframe. The base Class I skim price will better track

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value if it incorporates the immediate average of Classes III and IV, and then a wider view lookback adjuster.

NMFP also agreed that, with respect to supply, we do not want producers responding to single-month pricing signals. Hearing Tr. 5035:23-26, Craig Alexander (September 25, 2023) (considering, for example, that the Class III skim milk pricing factor dropped roughly $10 from December 2020 to January 2021, see Hearing Ex. 15 (USDA Ex. 15)). Moreover, in today's marketplace, monthly differences between what Class I prices under different skim formulas cannot realistically impact producer pay prices when one considers (a) wider Class III and IV price spread and (b) declining Class I utilization. There simply is not a meaningful difference in most FMMOs.

Additionally, MIG's adjuster updates monthly to reflect the pricing differences in Class III and IV from the precise period twelve to thirty-six months prior. Because the adjuster is updating monthly (as opposed to static, like the current formula), it will remain "live" and reflective of the market. Incorporating a two-year time frame allows dairy farmers to respond to the marketwide trends and the direction of sales, not a single month's anomalous price. And because of the twelve-month interval between the source prices for the adjuster and when it applies to the formula, the adjuster price is predictable. This interval means a producer could anticipate the impact of the adjuster's price on Class I prices one year out and have the time to make changes in production accordingly.

c. MIG's Proposal 15 best reflects the "value" of Class I milk in comparison to manufacturing class milk.

Any "average of" formula (current, MIG, IDFA) would do better tracking the industry than a "higher of" formula, as the "average of" includes both Class III & IV at all times.

As the Class III and IV prices change, so will the base Class I skim price under Proposal 15. It will effectively reflect whether manufacturing classes are generating more or less value from milk. The other factors of the Class I price, including the advanced butterfat pricing factor,

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will send similar signals. The question of whether milk is more valuable to Class III or Class IV is irrelevant when one is considering the competition between Class I and manufacturing classes as a whole. Under Proposal 15, the base Class I skim price will shift monthly to track the manufacturing marketplace.

Opponents blatantly mischaracterize MIG's proposal when they criticize that it only reimburses farmers "after the fact." *See, e.g.*, Hearing Ex. 248 (NMPF Ex. 34), at 5 (Testimony of Cal Covington); Hearing Ex. 238 (NMPF Ex. 32), at 15 (Testimony of Sara Dorland). First, processors pay producers monthly, the full amount, under MIG's Proposal 15. Hearing Tr. 6037:15-22, Tim Doelman (September 28, 2023). The formula accounts for trends in pricing differences in determining what that amount should be, but the payments happen in real time. Second, the Class I pricing formula does not "reimburse" farmers, it reflects the minimum value necessary to ensure a sufficient supply of fluid milk. Third, the adjuster better fulfills the purposes and needs of the base Class I skim price by using a historical "higher of" calculation—farmers receive more consistent prices. While farmers may not experience the wild up swings, *they also will not experience the wild down swings*.

In fact, NMPF proposed a similar time frame in its Proposal 1 on components, which includes a mechanism to automatically update the Class III and IV skim formula component factors every three years. NMPF argues in that proposal, "[u]pdating every three years and using a three-year average smooths out unexpected 'ups or downs' in component averages." Hearing Ex. 64 (NMPF Ex. 2), at 10 (Testimony of Cal Covington). If producers endorse changes to component factors on a three-year average, it seems they should be equally compensated by changes to the base Class I skim price on a similar three-year window.

2. MIG's specific adjuster best corrects the current $0.74 fixed adjuster.

MIG's adjuster incorporates the "higher of" comparison, in an effort to capture the Class III / IV market spread while aiming to ensure farmers receive approximately the same return as under the higher of formula. Proposal 15 uses a rolling adjuster, calculated as a 24-month moving

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average of the Class III/IV higher of difference. Hearing Ex. 273 (MIG/fairlife Ex. 10), at 5 (Testimony of Tim Doelman). Another important point of MIG's proposal is that the rolling adjuster has a twelve-month lag to ensure market participants can secure futures at least 12 months into the future. *Id.* Without the 12-month lag, a processor would not be able to purchase futures and have price certainty because the Class III/IV adjuster calculation would not be fully known. *Id.*

For example, imagine on January 1, 2024, a processor wants to hedge its milk for June 2024—six months out so that it can agree to a fixed sale price for milk for that month. That processor can buy fifty percent Class III and fifty percent Class IV hedges, but will also need to account for the adjuster. Because of the twelve-month lag, in January 2024 the processor will know what the adjuster will be in June 2024 because the prices setting the adjuster already exist: the difference in Class III and IV from June 2021 to May 2023 (all data available before January 2024, when the processor develops the hedge). Without the twelve-month lag, the lookback for the June 2024 adjuster would be for prices June 2022 to May 2024; meaning that in *January* 2024 the processor would have six months' worth of prices it does not know.[37] This uncertainty adds risk, defeating the purpose of hedging.

This rolling, monthly adjustment best aligns with USDA standards and industry practice of calculating and releasing the Class I price each month, but softening the extreme month-to-month swings. It also is preferable over an annual adjuster, which only will update once a year and could cause a significant, one-time shift (as opposed to gradual changes from a dynamic monthly adjuster). While MIG supports IDFA's Proposal 14 as an alternative to Proposal 15, MIG prefers an adjuster that follows the market and not one with a price floor. Such floors risk

[37] This knowledge of the adjuster is why the current fixed $0.74 adjuster supports hedging, and why IDFA's Proposal 14 fixed floor adjuster also supports hedging. The actual amount of the adjuster does not impact hedging, all that matters is that the adjuster is known in advance. Hearing Tr. 6071:26-6072:10, Tim Doelman (September 28, 2023).

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becoming artificially price enhancing. And like other FMMO formulas that involve multiple mathematical steps, MIG's Proposal 19 can be run as any automatic formula using USDA's current systems.

3. Given utilization levels across orders, changes to the Class I price cannot meaningfully impact depooling—nor should they.

As established at the hearing, due to changes in utilization and market conditions, the Class I price cannot be used to address price inversions and depooling. USDA may not raise Class I prices on the basis that doing so will compel more pool participation not only because pool participation is not a valid program goal on its own, but also because ***it will not work***. Hearing Ex. 267 (MIG/Crystal Ex. 13); Hearing Ex. 268 (MIG/Crystal Ex. 13A) (Testimony of Jacob Schuelke). And while the evidence does not establish that the "higher of" will result in higher prices than MIG's Proposal 15, to the extent such a conclusion is made, it still does not support rejecting a proposal that uses the "average of," like MIG's Proposal 15.

MIG witness Jacob Schuelke with Crystal Creamery demonstrated through a pooling example (an example that was never rebutted or otherwise criticized by opponents) that USDA cannot use the Class I price to meaningfully impact depooling.

		Calfiornia Pool July 2023 With Class IV Fully Pooled						
		Lbs	Price					
	1	349,270,582	$ 19.42	$ 30.00	$ 37.00	$ 40.00	$ 45.00	$ 47.50
	2	111,057,544	$ 19.12	$ 19.12	$ 19.12	$ 19.12	$ 19.12	$ 19.12
	3	1,468,531,570	$ 13.77	$ 13.77	$ 13.77	$ 13.77	$ 13.77	$ 13.77
	4	1,400,000,000	$ 18.26	$ 18.26	$ 18.26	$ 18.26	$ 18.26	$ 18.26
Weighted Average / Blend		3,328,859,696	$ 16.43	$ 17.54	$ 18.27	$ 18.59	$ 19.11	$ 19.38

Hearing Ex. 268 (MIG/Crystal Ex. 13A), at 8 (Testimony of Jacob Schuelke). As demonstrated in this example using real pool prices from July 2023 in the California Order 51, USDA would have to increase the Class I price from $19.42 to $47.50 for the order to incentivize both manufacturing classes to remain pooled. *Id.* This increase equates to an additional **$61 million** paid by Class I into the pool and an increase to consumers of **$1.67 per gallon** just for the month of this example. *Id.* at 7. This absurd price increase, which the marketplace would never support,

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lays bare how diminishing Class I utilization means the Class I price cannot be a tool for influencing pool participation. Neither NMPF nor any other participant introduced any compelling empirical evidence that raising the Class I price can support pool participation. And NMPF has not demonstrated that moving to the "higher of" will generate prices at a level that would impact pooling. *Id.* at 10. **Given the indisputable changes in the dairy industry, USDA must conclude that pooling can no longer be a policy consideration when making changes to the Class I price formula.**

Even NMPF admitted that USDA cannot regulate the conditions that lead to depooling:

> Q. And so what are the market conditions that drive Class III and IV apart?
>
> A. Basically, the supply and demand for Class III and Class IV products, and how they intersect and how they may differ.
>
> Q. So does USDA regulate the supply and demand for Class III and IV products?
>
> A. No.
>
> Q. Okay. So USDA can't control the conditions that could lead to the spread between III and IV?
>
> A. No.
>
> . . . .
>
> Q. Does raising the Class I minimum price change the supply and demand factors or market conditions that drive III and IV apart?
>
> A. Generally[,] [n]o.

Hearing Tr. 4711:10-20, 4712:13-16, Peter Vitaliano (September 19, 2023); *see also* Hearing Tr. 5106:2-6, Chris Hoeger (September 25, 2023) (admitting that he can only show some *correlation* between negative PPD's and the shift to the average-of, but does not actually know if there is any *causation*); *see also* Hearing Tr. 6495:12-15, Marin Bozic (October 2, 2023) (no pending proposal can reduce the spread between Class III and IV).

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A multitude of factors cause depooling and negative PPDs, but respected dairy economists who testified, including Dr. Mark Stephenson and Dr. Marin Bozic, agreed Class I does not drive these results. *See* Hearing Ex. 291 (MIG Ex. 291) (Dr. Mark Stephenson & Dr. Andrew Novakovic, *Making Sense of Your Milk Price in the Pandemic Economy: Negative PPDs, Depooling, and Reblending*, Dairy Markets & Policy (June 26, 2020)). In this paper, Drs. Stephenson and Novakovic considered what factors impacted pricing during the pandemic swings, looking at 1) the FMMO PPD and depooling of Class III milk; 2) the spread between Classes III and IV and its impact on the Class I price; and 3) cooperative reblending of returns. They found that each of these factors contributed to pricing impacts during the pandemic, oftentimes pushing them down or up in extreme ways.

And as negative PPD's are the negative outcome of depooling (and the result producers are most concerned about), understanding that other factors drive these PPD's is critical to ensuring proper FMMO policy. As concluded by Dr. Bozic and Dr. Wolf in their recently published academic article (and which cited to Drs. Stephenson and Novakovic), the primary drivers of negative PPD's were depooling, declining Class I utilization, rising component tests, advanced prices, and the spread between cheese and milk powder prices (i.e., the difference between Classes III and IV). Hearing Ex. 76 (Edge Ex. 2) (Marin Bozic & Christopher Wolf, *Negative Producer Price Differentials in Federal Milk Marketing Orders: Explanation, Implications, and Policy Options*, J. Dairy Sci. (2022)). This paper, reviewed by two anonymous peer reviewers, experts reviewers, and by the editor of the Journal of Dairy Science prior to its publication (Hearing Tr. 6450:18-22, Marin Bozic (October 2, 2023)), concluded that the "average of" base Class I skim formula did not alone (or even primarily) cause depooling.

> Looking at all of these diagrams [in Exhibit 76], for the life of me I cannot find convincing evidence that Class I reform [adopting the "average of"] caused depooling. Did it cause slightly negative PPD that would have been negative already in some months? Yes.
>
> Did it cause depooling? Draw your own conclusions. I – I would have a hard time agreeing with that statement.

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Id. 6459:2-9. The main drivers of depooling in the examined months are the Class III/IV spread and advanced pricing. *Id.* 6496:14-21.

Even NMPF member Calvin Covington referred to Dr. Bozic's paper when asked to identify the causes of depooling. *See* Hearing Tr. 5184:9-26 (September 25, 2023) (when asked about the causes of depooling, answered "I'll refer you to . . . a document, research paper referred to . . . And Dr. Bozic was one of the authors. And it broke down all the things that did impact or cause depooling. . . . I would refer you to that."). Depooling is (much) more complex than just Class price inversions. NMPF's expert's claims otherwise fail. *See* Hearing Tr. 4939:14-19, 4939:26-4940:1, Sara Dorland (September 20, 2023) (Q: "Are you claiming that extended period of depooling would not have happened were it not for average-of?" A: "That is correct." . . . . Q: "Have you done any research that would suggest how much milk would have been depooled if we had higher of in either 2020 or 2022?" A: "I have not.").

Also depooling is a feature, not a bug, of the FMMO system. Depooling is often economically rational, and occurred with regularity before and after the change to the base Class I skim formula. Hearing Ex. 265 (MIG Ex. 9B), at 3 (Testimony of Sally Keefe); Hearing Ex. 76 (Edge Ex. 2), at 438 (Drs. Wolf and Bozic Article; "Orderly marketing must also include incentives to direct milk to dairy products where the milk adds the most value."). Processors and farmers best serve the market when they respond to demand and FMMO minimum prices to depool and reallocate milk accordingly. Hearing Tr. 5824:7-12, Jacob Schuelke (September 28, 2023) ("So as much as I pick on depooling, [when I worked at a powder plant] I was a big depooler. I moved milk from Class IV to Class III because I made a lot of money doing it. And most importantly, I serviced the market. The market said: I need cheese, I don't need powder. So I shut my powder plant down, and I sold the milk to a cheese plant."). Depooled milk is not dumped, it is sold and provides a return to producers.

Depooling is a response to critical market signals with which USDA should not interfere. *See* Milk in California, 82 Fed. Reg. 10634, 10669 (February 14, 2017) ("While the proponents

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claim a negative PPD is confusing, this decision finds that distributing the PPD through the component prices would distort market signals to producers. As in the current FMMOs, a negative PPD in the California FMMO would inform producers that component values are rising rapidly. Regulated FMMO prices should not block those market signals."). When a Class III or IV price exceeds the Class I price, that is the market sending a signal that milk is valued more highly for cheese and powder in that particular moment. Hearing Tr. 5691:18-25, Sally Keefe (September 27, 2023). Preventing depooling through artificial price machinations within the FMMO system creates disorderly marketing for the dairy marketplace as a whole as when participants do not receive accurate pricing signals.

4. Class I handlers can better compete for milk supplies by freeing up capital to use for over order premiums, not suffering from higher pool obligations.

Finally, returning to the "higher of" will not help Class I handlers in competing for a milk supply. In fact, the opposite is true—a higher pool obligation detracts from the resources Class I plants have available to actually incentivize service of the plants. Again, MIG witness Jacob Schuelke with Crystal Creamery laid bare how Class I processors and suppliers are actually the biggest losers when Class I prices increase. Hearing Ex. 268 (MIG/Crystal Ex. 13A), at 9 (Testimony of Jacob Schuelke). Given the low Class I utilization, requiring Class I to add more money to the pool (whether on the basis of Class III or IV price spikes or otherwise) no longer helps Class I processors attract milk. Hearing Tr. 5966:10-23, Chuck Turner (September 28, 2023) (spikes in the Class III or IV prices do not impact a processor's ability to acquire sufficient milk supplies). Instead, it would be an increased sunk cost that means Class I processors have less money to pay their suppliers and Class I suppliers never get the benefits obtainable by depooling. This disadvantage has led to farms that exclusively supply Class I plants to go out of business. Hearing Tr. 11260:14-11262:9, Jacob Schulke (January 19, 2024).

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	Cheese Depool Month			Powder Depool Month			Average	
Class I Mover	Current Formula	Higher Of			Current Formula	Higher Of	Current Formula	Higher Of
Class III	$ 20.00	$ 20.00		Class III	$ 15.00	$ 15.00	$ 17.50	$ 17.50
Class IV	$ 15.00	$ 15.00		Class IV	$ 20.00	$ 20.00	$ 17.50	$ 17.50
Class I	$ 19.94	$ 21.70		Class I	$ 19.94	$ 21.70	$ 19.94	$ 21.70
	Utilization				Utilization			
Class III	0%	0%		Class III	90%	90%	45%	45%
Class IV	90%	90%		Class IV	0%	0%	45%	45%
Class I	10%	10%		Class I	10%	10%	10%	10%
Blend	$ 15.49	$ 15.67		Blend	$ 15.49	$ 15.67	$ 15.49	$ 15.67
Pay Price				Pay Price				
Class III	$ 20.00	$ 20.00		Class III	$ 15.49	$ 15.67	$ 17.75	$ 17.84
Class IV	$ 15.49	$ 15.67		Class IV	$ 20.00	$ 20.00	$ 17.75	$ 17.84
Class I	$ 15.49	$ 15.67		Class I	$ 15.49	$ 15.67	$ 15.49	$ 15.67

A farmer witness also recounted his personal experiences with this phenomena, culminating with his deciding not to ship to a Class I plant any longer because the losses were unsustainable. George teVelde, Hearing Tr. 7480:6-7482:8 (October 6, 2023). As he stated:

> I left my Class I plant in 2020, and it had to do with the fact that under the new Federal Order, Class I plants were forever and always part of the pool. We were always getting paid the pool price. Other classes could pool and depool at will in the new Federal Order, it seemed, which left me at the Class I plant with either the pool price or a price lower than other dairymen who were shipping to a plant that had depooled. So we were either being paid the price everyone else is or something less.
>
> And to me that was not an acceptable way to market milk. I approached my creamery about this, but our Federal Order Administrator in the area assured us that there was really no way around the situation. So in early 2020, this was actually before the pandemic hit, I approached my creamery and told them that I intended to leave because of this issue.
>
> . . . .
>
> But I'm retelling this story, I was asked to tell this – my – this story of events surrounding my leaving them because of the penalty that a dairyman in the Federal Order is being subject to by being at a Class I plant, always and forever being in the pool or being paid less than other depooled dairies.

Id.

USDA has never endorsed NMPF's frequently repeated mantra of "Class I price supremacy," likely because this framework is a complete mischaracterization of the FMMO

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system. First, the FMMO system does not create value, it redistributes value created by the market. Hearing Tr. 4969:7-14, Sara Dorland (September 20, 2023) (Q: "[I]s the pool's purpose to create revenue or merely distribute revenue?" A: "I don't believe the pool's purpose is to create revenue." Q: "The pool's purpose is to provide a mechanism for uniformly distributing the minimum value of milk used for Class I products, correct?" A: "Sounds about right."). Second, for depooling, the comparison between the class prices is wholly irrelevant. The difference between the blend price and the class prices, not prices between the classes, drives pooling decision-making. Hearing Tr. 5817:10-20, Jacob Schuelke (September 28, 2023). Finally, the difference between an announced class price and what a depooled manufacturer actually pays also has no bearing on the proposal. NMPF's criticism that Proposal 15 would generate "two prices" is really a criticism of an inherent feature of FMMOs: that there are regulated (minimum) prices and non-regulated (market) prices. Hearing Tr. 5363:10-23, Sara Dorland (September 26, 2023).

The only justification for setting the Class I price as the highest price is if the high price is necessary in order to incentivize service of the fluid milk market—a fact MIG clearly disproved and for which NMPF offered no empirical evidence. For example, NMPF's expert Sara Dorland stated, "Class I milk price primacy is vital to attract milk to the pool each month." Hearing Ex. 238 (NMPF Ex. 32), at 9. But she failed to connect the two key dots here: first, that a higher Class I price will actually attract milk to the pool each month, and second, that attracting milk to the pool means Class I processors are better served. *See* Hearing Tr. 5360:5-5363:15, Sara Dorland (September 26, 2023). Further, Ms. Dorland even agreed that the objective of FMMOs is only to draw milk into the pool if the producer is participating in and servicing the Class I marketplace. *See* Hearing Tr. 4970:11-23, Sara Dorland (September 20, 2023). And as made clear above, the marketplace is currently sufficiently served using an "average of" formula.

For these reasons, USDA should adopt Proposal 15.

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VIII. USDA SHOULD REJECT PROPOSALS 13, 16, 17, AND 18.

The reasons why USDA should adopt Proposal 15 also demonstrate why USDA should reject proposals 13, 16, 17, and 18. Therefore, MIG opposes the three "higher of" proposals (13, 17, and 18) as they would severely limit risk management opportunities for Class I processors.

In addition, like NMPF and IDFA, MIG opposes any proposal that would eliminate advanced pricing for Class I and Class II skim as further negatively impacting those market segments. Thus, MIG also opposes the three "eliminate advanced pricing" proposals for the base Class I formula (16, 17, and 18).

A. NMPF's Desire to Return to the "Higher Of" Is Unnecessary, Not Supported by the Facts, and Would Result in Disorderly Marketing.

As an initial matter, the industry has already acknowledged that the "higher of" does not work—return to this failed formula will be a return to disorderly marketing. USDA should support moving the industry forward and adopting a policy that fits the needs of everyone, not reverting to an outdated policy just because it is familiar or subject to significant emotional reactions. The base Class I skim formula must be set based on sound economic policy and verified evidence. To be blunt, what the industry really needs is education on the issue, not a knee-jerk return to failed "higher of" policy.

1. The "average of plus $0.74" formula currently in place has not caused disorderly marketing.

Farmers' concern is <u>not</u> about the "average of" in the current formula, it is the fixed $0.74/cwt addition. The "average of" portion of the formula is not causing any disorderly marketing—in fact, *it is the portion of the current formula that fixed* the disorderly marketing that occurred under the "higher of." Had the "higher of" been in place during the Food Box Program price runs, the resulting prices would have devastated Class I processors. Hearing Tr. 6005:3-19, Chuck Turner (September 28, 2023) ("I cannot imagine if Class I prices followed that $3 cheese price through the roof in the second half of 2020, and, you know, we're sitting there without all of our foodservice business and trying to make boxes, and . . . it would have just – it would have been

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devastating to – to our whole industry . . . ."). Not one witness testified that those prices would have been warranted by the market, or that the marketplace (and especially consumers) could have endured those prices. Prices were still high for Class I processors during that time, but were manageable. In other words, the "average of" formula did its job—it accurately transmitted the value of milk for Class III and IV manufacturing uses to the base Class I skim milk price while minimizing (though not fully preventing) rapid price swings. USDA should not disregard effective policy in the "average of," but focus on the part that farmers are really concerned about—the fixed adjuster.

MIG's Proposal 15 addresses the adjuster, with a new formula that allows farmers to have unlimited upside potential while still tracking prices using a similar "higher of" formula in the adjuster. NMPF's only enumerated complaint was limited to the "asymmetrical risk" of the $0.74 adjuster and "losses" in farmer revenue.[38] But any issues of price asymmetry are eliminated under Proposal 15—farmers will get all of the benefit of an increase in manufacturing prices and then a tempering of the impact of decreases in the same. And the sheer fact that one formula results in lower prices than another formula does not make it disorderly—particularly when the evidence shows that all fluid milk markets were sufficiently serviced during that period and subsequently. But if farmers want revenue neutrality (without getting into whether or not USDA can or should properly consider "revenue neutrality" as a valid USDA consideration), MIG's proposal achieves that aim.

NMPF also claimed that "cumulative" losses from the "average of" formula are $941.1 million through July 2023. Hearing Ex. 229 (NMPF Ex. 30), at 6 (Testimony of Peter Vitaliano).[39]

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[38] Notably, MIG does not concede that price asymmetry or lower prices are "disorderly." As FMMO prices are minimum prices, the prices will necessarily have limitations.

[39] Additionally, NMPF's use of "cumulative" losses as opposed to the monthly analysis is a misleading perspective on the information—essentially, carrying a few months of pandemic price swings forward to justify the formula change.

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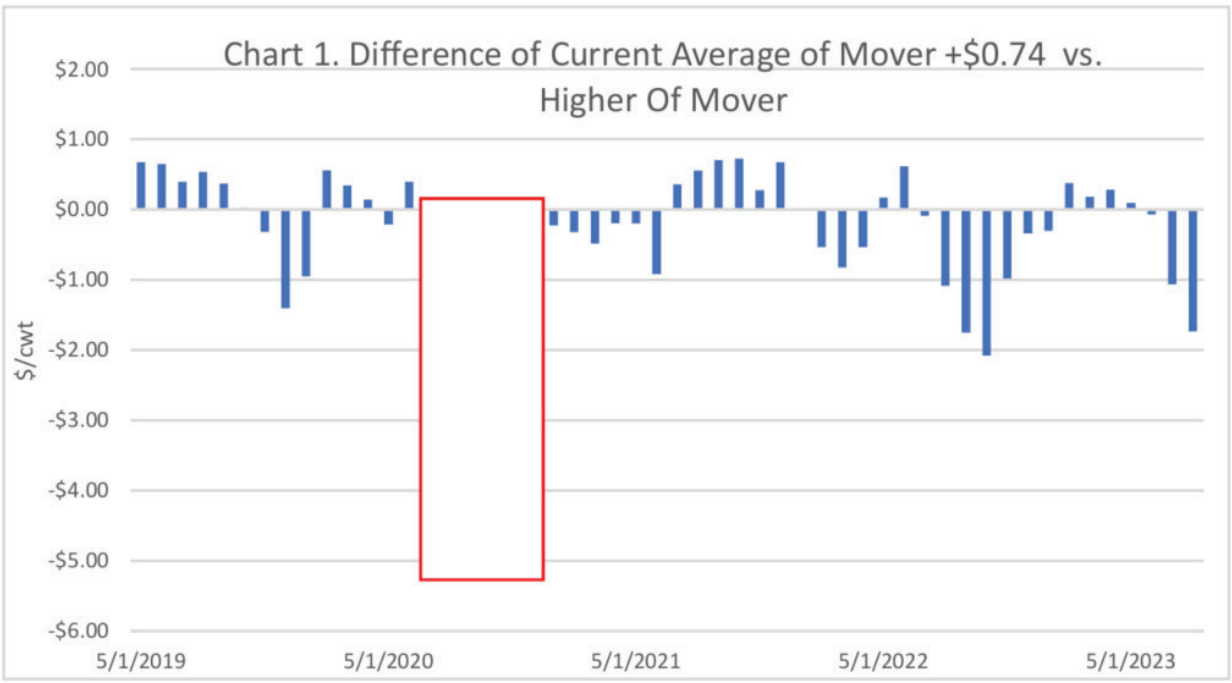
But even if USDA were to consider this alternative outcome a "loss" (which it should not), the overwhelming majority of those hypothetical losses were from a single, anomalous time period—the six months in 2020 impacted by COVID and the USDA Food Box program. Using NMPF's own chart to visually demonstrate this point; when you exclude those months, the mover largely bounced equitably between positive and negative for farmers and processors (Hearing Ex. 245 (NMPF Ex. 31), at 5, with modification to exclude six months in 2020).



And by NMPF's own testimony, farmers were *better off* under the current formula for many of the months, including collecting over $100 million more than the "higher of" in the first five months the current formula was in place. Hearing Ex. 229 (NMPF Ex. 30), at 7 (Testimony of Peter Vitaliano); Hearing Tr. 4722:22-24, Peter Vitaliano (September 19, 2023) ("The first year after it was in place, I was thinking, hey, we made a good deal here."); Hearing Tr. 4753:9-23, Peter Vitaliano (September 20, 2023) (in the first five months, the amount paid to farmers in the form of minimum Class I milk prices under the current formula reached "about a maximum of $100 million plus."). How can it be that the formula was not disorderly when *processors* were

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worse off, but became disorderly only when *farmers* no longer had the advantageous market conditions?

Critically, despite admitting that the purpose of the Class I price is to ensure a sufficient supply of milk for fluid uses, NMPF introduced no evidence that the "average of" caused such problems. Rather, their focus was only on hypothetical money they wished the FMMO system had generated for farmers:

> Q: So the issue that arose under the average-of was not that there were insufficient supplies of milk for fluid use, it was that producers made less money than they would have made under a different calculation, correct?
>
> A: There was an issue with producers receiving less money, that they clearly identified as disorderly marketing. I cannot speak to whether or not fluid milk processors did not have a problem with attracting adequate milk supplies.

Hearing Tr. 4705:5-13, Peter Vitaliano (September 19, 2023).

NMPF stakes out an untenable position, though, because not only does it fail to introduce *any* evidence of a shortage of milk for fluid use during the relevant time period the "average of" was in place, but it maintains that had the proper "higher of" formula been in place, consumers would have paid nearly **one billion dollars** more for their fluid milk products. But ***the AMAA does not give farmers a blank check to use federal regulations to extract money from consumers, especially when there is already a sufficient supply of milk for fluid use.***

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> Q: And had the formula not been changed, Class I processors would have owed $941 million more to the pool than they would have otherwise?
>
> A: In that same arithmetic analysis – analytical framework, yes.
>
> Q: And where would Class I processors have gotten nearly a billion dollars to put into the pool during this time period?
>
> A: They would have gotten that from – basically from the marketplace . . . .
>
> Q: So the billion dollars would have come from consumers, ultimately?
>
> A: Yes.

Hearing Tr. 4714:18-4715:7, Peter Vitaliano (September 19, 2023); *see also* Hearing Ex. 248 (NMPF Ex. 34), at 2 (Testimony of Calvin Covington) ("Dairy farmers, in these three FFMOs, appreciate their fellow taxpayers providing partial reimbursement of the loss through the Pandemic Market Volatility Assistance Program. However, the revenue should have come directly from FMMO pricing provisions, and the marketplace, as the FMMO system intended.").

2. Returning to the "higher of" formula would result in disorderly marketing.

NMPF's expert's testimony (Dr. Brown) supports MIG's contention that the "higher of" will result in disorderly marketing. Dr. Brown testified that larger spreads between Classes III and IV will lead to higher prices under the "higher of" than an "average of" formula. Hearing Ex. 421 (NMPF Ex. 60), at 8 (Testimony of Scott Brown) ("In some outcomes where Class III milk prices and Class IV milk prices are the most different, the higher of formula results in the highest Class I mover price."). These higher Class I prices will raise the uniform price, meaning under the higher of, it is more likely the lower-priced manufacturing class of the two will remain in the pool. But in that situation, FMMOs should *not* be raising the uniform price paid out to the lower-priced manufacturing class. That compensation overvalues the lower-priced manufacturing class in the marketplace, meaning the FMMO draws milk to a lower-value class instead of going to the higher-performing class. *See* Hearing Tr. 5824:13-28, Jacob Schuelke (September 28, 2023). The

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"average of" can help move milk between the manufacturing classes as the market needs. *Id.* 5831:15. In other words, using the "higher of" in a more volatile marketplace will result in disorderly marketing by distorting the necessary market signals about where milk is most valuable at certain points in time.

Additionally, if USDA does agree with NMPF's (wholly unsupported) position that the "higher of" will draw more milk into the pool to serve Class I, then USDA must also conclude such an effect is disorderly given the current marketplace. The orders are designed to ensure processors have sufficient milk supplies for fluid use, but not so much that the order is drawing milk away from Class III or IV when a manufacturing use would be the highest and best value for the milk. *See* Hearing Tr. 5689:10-21, Sally Keefe (September 27, 2023). Class I does not need more milk, and FMMOs should not be disrupting the market to pull milk for fluid utilization.

Additionally, in the short term, the "higher of" will cause dairy farmers to respond to market signals by producing more milk. NMPF has failed to establish that the marketplace currently needs nationwide increases in milk production. In fact, it establishes the opposite. And if there is an increase in milk production, that will depress the Class III and IV prices: "The Class III and IV milk prices are lower in the first year of the analysis as dairy farmers increase milk supplies slightly in response to the higher all milk price." Hearing Ex. 421 (NMPF Ex. 60), at 8 (Testimony of Scott Brown).

While it is true that the market functioned for nearly 20 years under the "higher of," given the massive declines in Class I sales during that time period, one cannot conclude it was functioning well. And the industry changes, including adoption of risk management tools for Class I discussed above, undergone in the last five years under the "average of" would be swiftly lost by a policy change adopting Proposals 13, 17, or 18.

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3. Producers have no "losses" from the current version of the formula – and even if they did, USDA has compensated producers with over one billion dollars to make up for those losses.

The current formula did not result in farmer "losses" any more than a "loss" can be claimed by any party related to infinite variations of regulations that USDA could have adopted but did not. Hearing Tr. 5724:2-11, Sally Keefe (September 27, 2023) ("[T]he thing with any of these price formulas is, that's just it, they are the price formula. . . . [T]he difference wasn't paid by anybody to anybody. It's – it is a formula difference. . . . a spreadsheet difference."). These amounts are merely calculated, hypothetical gains, which also do not take into account: 1) producers who benefited from higher manufacturing prices during these windows; and 2) what other market changes might have come into play if this one factor were different (that could have helped or hurt producers). As owners of Class III plants, cooperatives undoubtedly benefited from the high cheese prices during the pandemic, benefits that were not included in the calculation of regulated minimum price "losses" presented at the hearing. Hearing Tr. 4822:3-7, Peter Vitaliano (September 20, 2023). And as sellers of milk to Class III plants, farmers also would have benefited from the high Class III prices during the pandemic, benefits also not included in the loss calculation. *See* Hearing Tr. 4823:24-4824:3, Peter Vitaliano (September 20, 2023). But unwinding these benefits to claim a "loss" is a task far more complex than anyone accomplished at this hearing.

Most importantly, farmers have received significant government assistance since 2020, targeted specifically at any perceived "losses" from confluence of the new higher of formula and the USDA's pandemic response programs. USDA has provided over $2 billion to dairy for pandemic recovery over the last three years. Hearing Ex. 234 (USDA Press Release: "USDA Announces Improvements to the Dairy Safety Net and New Pandemic Market Volatility Assistance Program.").

NMPF testified that a significant portion of this pandemic assistance was specifically targeted to any alleged impacts by the change in formula. Administered by AMS, the Pandemic

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Market Volatility Assistance Program (PMVAP) provided $360 million to dairy producers. Hearing Ex. 231 (USDA Information Sheet: "Pandemic Market Volatility Assistance Program for Dairy"). The PMVAP payment formula targeted FMMO producer milk impacted by depooling associated with the 2020 food box program impact on cheese markets. Hearing Ex. 234, at 2 ("The payment rate will vary by region based on the actual losses on pooled milk related to price volatility."). NMPF testified to receiving these payments in exchange for "losses" caused by the current formula. Hearing Tr. 4715:20-4716:12, Peter Vitaliano (September 19, 2023) ("[PMVAP payments] were due to the pandemic market volatility, in other words, the volatility created by the pandemic which was, in terms of the severe underperformance of the current mover compared to the higher-of, was due to a great extent to the extensive Farmers to Families Food Box – as I recall, Farmers to Family Food Box Program that – that basically purchased very large quantities of cheese, compared to Class IV products, and created that – that severe separation of Class III and Class IV prices.").

In other words, despite NMPF repeatedly claiming that these assistance payments only partially compensated farmers for the change in the base Class I skim formula (Hearing Tr. 4715:20-24, Peter Vitaliano (September 19, 2023)), during the relevant time period, USDA paid farmers hundreds of millions of dollars. To the extent that this one-time anomaly in the marketplace negatively impacted farmers, they have more than been made whole by the American taxpayers.

1. Revenue neutrality is not a valid policy consideration without evidence to establish revenue neutrality is necessary to ensure a sufficient supply of fluid milk.

The price neutrality feature of the current average of formula was a *political* compromise made in order to gather the necessary support for a *legislative* change. But in setting regulations based on the evidence and law applicable to this hearing, USDA must consider neutrality only in light of what is necessary to fulfill the tenets of the AMAA.

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Market evolution makes it highly unlikely that any current FMMO regulation can remain "revenue neutral" over a long period of time. The dairy marketplace will change and prices along with it—that is the nature of a minimum pricing system meant to reflect the marketplace. Setting any formula based on ensuring farmers receive the same revenue as some other, hypothetical formula means that farmers will, in perpetuity, have a basis to seek revision of the regulations anytime they experience a dip in prices. And it would also beg the question, would processors be given the same rights, to pursue regulatory changes anytime prices swing upward and away from "neutral" from a processor perspective?

B. MIG Opposes Proposals 16, 17, and 18 Because Advanced Pricing is Critical to Class I Processors and Customers.

Advanced pricing for Class I remains critical for a dominant share of the fluid market. Currently, both the skim milk and butterfat prices are advanced, meaning that the price for each month is announced before the start of that month. Hearing Ex. 503 (MIG Ex. 67), at 8 (Testimony of Sally Keefe). USDA should not get rid of this pricing approach because retailers of fluid milk expect and demand to know their prices in advance. Advanced pricing is very well accepted on the HTST side of the business. Hearing Tr. 5916:9-14, Michael Newell (September 28, 2023).

Prior regulations did not fully incorporate advanced pricing for Class I until FMMO Reform. USDA rightfully abandoned the prior approach because of the disorder it caused. Currently, Class I prices are on announced on or before the 23rd day of the prior month, computed using the most current two weeks of commodity survey price data available. Hearing Ex. 503 (MIG Ex. 67), at 8 (Testimony of Sally Keefe). In 1972, the FMMOs were amended to establish advanced pricing of the skim milk portion of Class I. The decision stated:

> The rapidly changing structure of the milk distribution industry throughout the United States makes it desirable that handlers be notified at reasonable period in advance of changes in the price they must pay for Class I milk.

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Milk in the Boston Regional and Certain Other Marketing Areas, 37 Fed. Reg. 1388, 1389 (Jan. 28, 1972). While some advocated for also advancing the Class I butterfat differential, that change was not made then. Specifically, the decision noted:

> The Class I butterfat differential changes infrequently. This is because the Chicago butter price quotations, which are strongly influenced by the prices paid for butter by the Government under the price support program, do not vary significantly from month to month. Consequently, there is no compelling need to advance the Class I butterfat differential announcement in connection with the adoption of advance Class I pricing.

Id. at 1390.

At the time of FMMO Reform, the butterfat differential for the preceding month was still announced on or before the fifth day of the current month. As testified to by other witnesses, this lack of advanced pricing for the butterfat differential was burdensome for the industry. Hearing Tr. 10735:1-3, Warren Erickson (January 17, 2024) ("I'm a proponent of advanced pricing. I have lived in an era of non-advanced pricing, and it's—it's very cumbersome."); Hearing Tr. 10987:11-18, Chuck Turner (January 18, 2024) ("I have been here long enough to remember the days before advanced pricing and trying to work with the state-regulated milk system on – without advanced pricing, and it – I can tell you for sure it will be a catastrophe to live without advanced pricing."). To address that issue, during FMMO Reform, USDA aligned the timing for the Class I butterfat and skim prices. With respect to Class I, the FMMO Reform final decision stated:

> Announcement of Class I butterfat and skim milk prices in advance ***eliminates current problems*** caused by calculating the butterfat differential after the month for which it is effective. Handlers will have true advance Class I pricing.

Milk in the New England and Other Marketing Areas, 64 Fed. Reg. 16026, 16095 (April 2, 1999) (emphasis added).

Multiple witnesses, including those for MIG, IDFA, and NMPF, have noted throughout this proceeding that advanced pricing remains important for Class I handlers today. Preserving Class I advanced pricing remains critical given long-standing standard terms of trade with retailers

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for traditional white jug milk. Hearing Ex. 463 (MIG/Shamrock Ex. 23A), at 4 (Testimony of Tim Kelly). Advanced pricing underpins the standard terms of trade for traditional HTST segment of Class I fluid milk. Hearing Ex. 463 (MIG Ex. 67), at 9. Eliminating advanced pricing will further burden Class I sales given customers' familiarity with advanced pricing. Hearing Ex. 455 (MIG/AE Ex. 17A), at 4 (Testimony of Warren Erickson) ("Given the trajectory of fluid milk sales in this country, we should not be adding difficulty and complication to our customers' ability to purchase fluid milk."); *see also* Hearing Ex. 458 (MIG/Hood Ex. 21), at 5 (Testimony of Michael Newell) (the current system is "quite orderly and transparent" and "[e]liminating advanced pricing would create a much more chaotic market and could harm bottlers who are operating labor-intensive businesses on very tight margins."). With the likelihood of increased volatility, that makes advanced pricing even more important. Hearing Tr. 10987:5-10988:5, Chuck Turner (January 18, 2024) ("I have seen the volatility in Class II butterfat this year, and it's – it's not pretty. And we just couldn't live without advanced pricing. . . . [W]e should be looking at doing more pricing in advance and not less.").

One of the few areas of unity between MIG, IDFA, and NMPF is that USDA policy should continue to support advanced pricing. *See* Hearing Ex. 263 (MIG Ex. 9), at 8 (Testimony of Sally Keefe) ("Advance[d] pricing for Class I remains critical for a dominant share of the fluid market both because retailers expect and demand knowing their prices in advance and because the current ability to hedge is still relatively new."); Hearing Ex. 296 (NMPF Ex. 104), at 6 (Testimony of Calvin Covington) ("Advanced pricing has served the fluid dairy industry well for many years. This hearing shows there are FMMO provisions where processors and producers have differences of opinion. Advanced pricing is one FMMO provision that most fluid milk processors and those cooperatives who supply fluid milk to these processors largely agree on."); Hearing Ex. 275 (IDFA Ex. 32), at 22-23 (Testimony of Mike Brown) (Advanced pricing "is an important part of the marketing planning for customers of fluid milk, particularly grocery stores, who use the advanced price as part of their marketing efforts for the following month. Not knowing that price of course

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increases uncertainty. Increased uncertainty of cost generally will lead to higher prices to protect an uncertain margin."); *id.* at 25 (if advanced pricing were eliminated, "all Class I handlers would always have to price their milk at a time they did not yet know their raw milk costs" and "could not use [hedging] to mitigate the pricing risks created by the use of actual versus advanced Class III and IV prices to set Class I.").

While elimination of advanced pricing can be more manageable if a company hedges the price, FMMOs should only be designed to permit and encourage hedging, not require it. The fluid milk industry, and especially traditional fluid milk retail customers, are not yet using hedging sufficiently to permit a regulatory change that would rely heavily on hedging. Hearing Ex. 263 (Ex. MIG 9), at 8 (Testimony of Sally Keefe); Hearing Tr. 6080:7-6081:16, Tim Doelman (September 28, 2023). Additionally, hedging has transaction costs, and the Class I marketplace should not be compelled to take on those costs immediately. Instead, USDA must first give the industry robust time to adopt and integrate hedging strategies, before even consideration of eliminating advanced pricing can occur.

With respect to Proposal 16, MIG is also concerned about pricing Class I solely off Class III as this would be a significant departure from the current practice and completely divorce fluid milk supply and demand from Class IV. Some cooperatives testified that Class IV remains the ultimate balancing utilization. Hearing Tr. 4869:25-28, Rob Vandenheuvel (September 20, 2023) ("[P]redominantly across the country, Class IV is managed by farmer-owned cooperatives, and it's—while I won't say its exclusive use in the marketplace, but a very significant use is for balancing purposes."). As such, one cannot ignore that segment entirely when setting Class I prices. Proposals 15 and 14 remain the better solutions.

Finally, AFBF Proposal 18 would also eliminate advanced pricing for the skim milk portion of Class II. For the same reasons that advanced pricing must be retained for Class I, MIG urges USDA to reject this proposal.

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IX. USDA SHOULD ADOPT PROPOSAL 20

USDA's adoption of Proposal 20 would help realign Class I differential pricing with the statutory purposes of the AMAA—to set minimum regulated prices at a level sufficient to bring forth an adequate supply of fluid milk, provide orderly marketing, and be in the public interest. In the 25 years since FMMO Reform, significant industry and consumer changes drove the Class I milk market in an increasingly perilous, if not disastrous position. These developments must not be ignored, or the Class I segment sacrificed, for so-called producer revenue neutrality solely because Class I cannot opt out of the FMMO system. No evidence supports USDA maintaining Class I prices at current levels (let alone increasing them), and especially not as some sort of counterbalance to increasing make allowances. Simply put, ***USDA can no longer balance the costs of the FMMO minimum regulated prices on an increasingly shrinking market segment.***

Critically, the issue before USDA is not whether costs exist related to the market categories enumerated below (Grade A, balancing, incentive) or even what these costs are in total. Rather, the question is if Class I processors *alone* should bear some degree of *additional costs in those categories*, on top of the market-clearing Class III and IV prices that make up the base Class I skim price, in order to ensure service of the Class I market. Milk in the New England and Other Marketing Areas, 64 Fed. Reg. 16026,16102 (Apr. 2, 1999) ("The purpose of the minimum Class I differential is to generate enough revenue to assure that the fluid market is adequately supplied."). In other words, do Class I processors have to pay *the entire marketplace's* balancing costs (or Grade A costs or an incentive) in order to attract sufficient milk? The clear answer to these questions is, "no."

The current base $1.60 Class I differential is no longer justified or necessary to meet the goals of the AMAA and must be eliminated.

A. Statutory Authorization and Longstanding USDA Policy Require an Economically-Justified, Minimum Class I Differential.

Under the AMAA, the Class I differentials' purpose must be ensuring service to the Class I marketplace and supporting orderly marketing conditions. *See* 7 U.S.C. § 602(4) (instructing the

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Secretary to utilize the powers of the Act to "establish and maintain such orderly marketing conditions for [milk] as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices."); *see also* Congressional Research Service, *Federal Milk Marketing Orders: An Overview*, at 2 (June 15, 2022), https://crsreports.congress.gov/product/pdf/R/R45044/5 (one of the main objectives of FMMOs are to "promote orderly marketing conditions in *fluid milk markets*."). Accordingly, the AMAA charges the Secretary with establishing minimum prices under Federal Milk Marketing Orders that apply to handlers of fluid milk. As the sole captive processing class in FMMOs, USDA must give particular consideration to the impacts of FMMOs on the Class I marketplace.

Without doubt, the change in Class I utilization since the Secretary established FMMOs means that the old FMMO tools cannot and will not work to accomplish the same aims they may have previously. Fluid milk used to represent two-thirds of FMMO utilization, and USDA built the FMMO's structure to address both the problems and solutions for fluid milk processing and consumption. Hearing Ex. 447 (MIG Ex. 15), at 7 (Testimony of Sally Keefe). Today, less than one-third of FMMO utilization is Class I and less than 20% of all usage is fluid milk. Hearing Ex. 489 (IDFA Ex. 64), at 3 (Testimony of Mike Brown). The below chart lays bare the stark decline.

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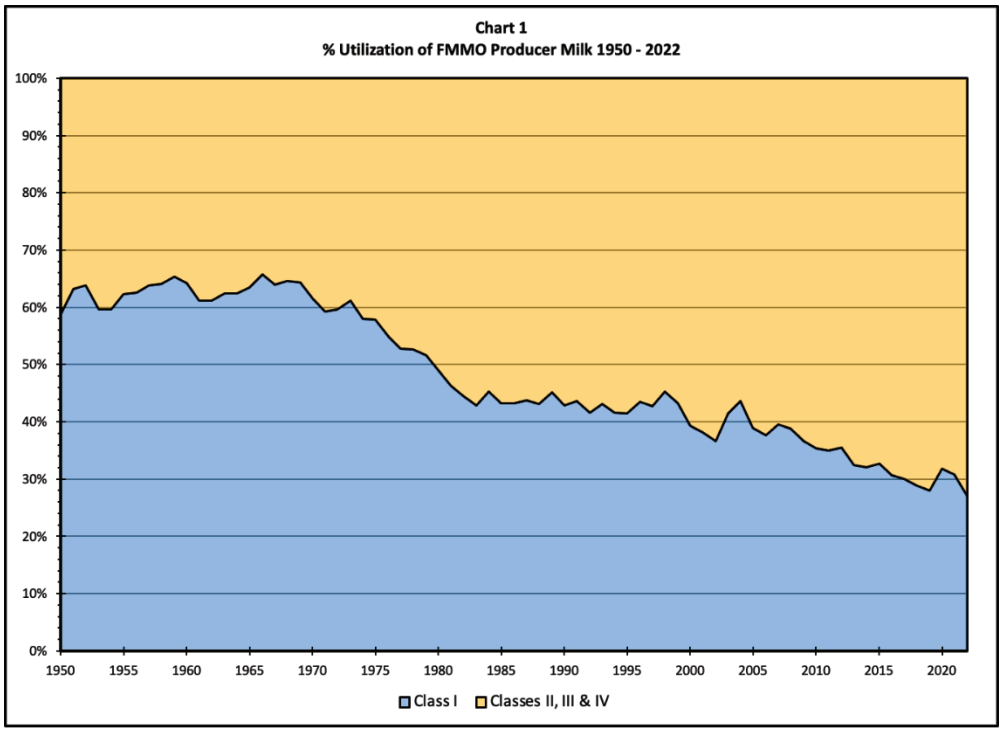

Hearing Ex. 447 (MIG Ex. 15), at 7 (Testimony of Sally Keefe) (using USDA data); Hearing Tr. 10501:27-10502:3, Sally Keefe (January 16, 2024) (notably, this chart overstates the overall Class I milk in the marketplace, as Class I is overrepresented in pool milk).

Not only is Class I utilization down as an overall percentage of FMMO pooled milk, but actual fluid milk sales are also in decline. *See* Hearing Ex. 459 (MIG/HP Hood Ex. 21B), at 13 (Testimony of Michael Newell) (citing USDA ERS, https://www.ers.usda.gov/webdocs/DataFiles/48685/pcconsp_1_.xlsx?v=2763.4).

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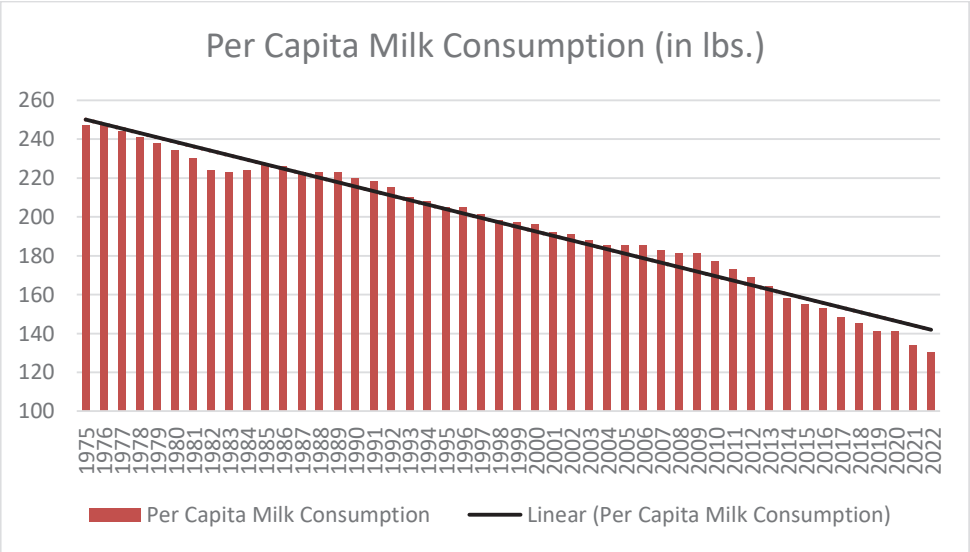
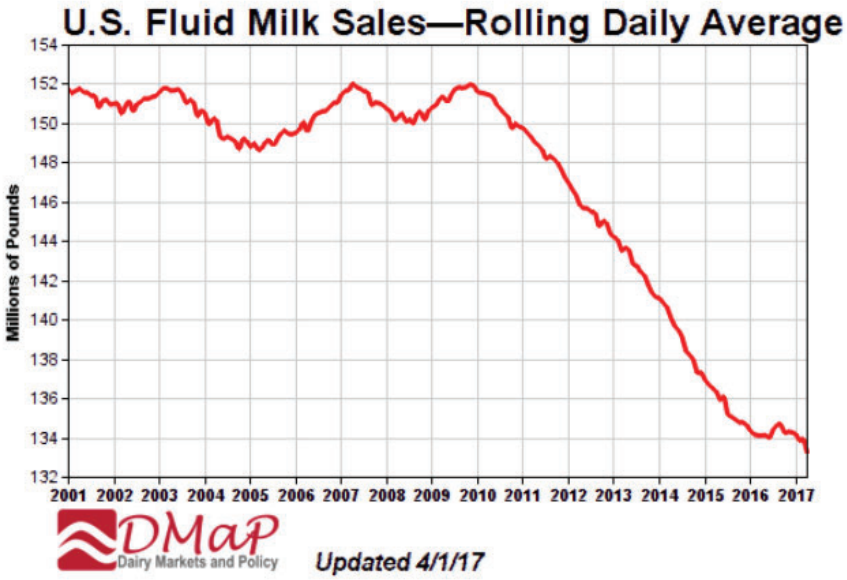


See id.



Hearing Ex. 435 (IDFA Ex. 61), at 9 (Testimony of Joseph Balagtas). In other words, the Class I market is shrinking both as a portion of the overall dairy market, but also in absolute terms. Hearing Tr. 10502:4-16, Sally Keefe (January 16, 2024).

Fundamental supply and demand principles dictate that as Class I needs less milk, the price for milk should go down, and then production would decrease in response. Instead, in this same

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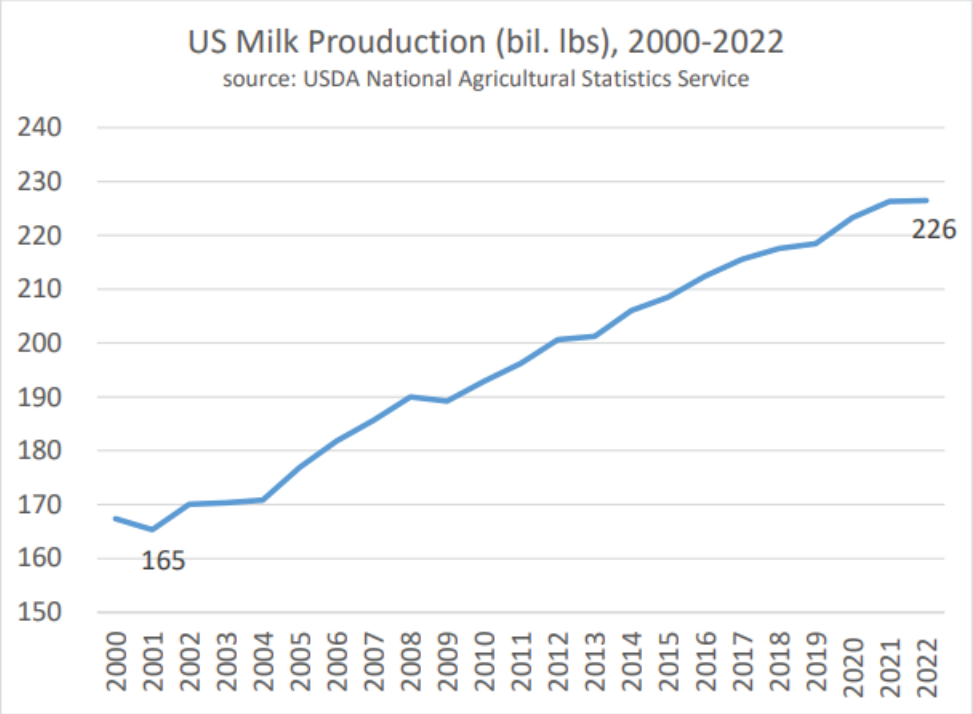
time period, milk production at the farm level *increased*. *Id.* 10502:17-24. Milk production since 2000 has grown by thirty-seven percent. Hearing Ex. 435 (IDFA Ex. 61), at 6-7 (Testimony of Joseph Balagtas). So, the world we live in today has *more* milk than it had at FMMO Reform, but Class I needs *less* of that milk in order to meet fluid needs.

Figure 1. U.S. Milk Production, 2000-2022 (bil. lbs)



Id.

In contrast to the decline in Class I consumption and utilization, the market has seen a significant increase in the consumption of manufactured food products (primarily cheeses and powders). Hearing Tr. 11259:4-9, Jacob Schuelke (January 19, 2024). In fact, manufactured dairy products are the primary use of farm milk today. Ex. 44 (USDA 44) (Producer Milk Components by Class and Order - January 2008 - April 2023). Additionally, the volume of milk that goes into exports now has grown significantly, particularly for powder (a product that oftentimes is the balancing option for surplus milk). **The dairy industry now exports more milk than it sells in**

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Class I. Hearing Tr. 4696:21-23, Peter Vitaliano (September 19, 2023) (in the last two years, "I estimate we exported more milk solids than we consumed milk solids domestically in fluid milk products," around 18% of sales); *see also* Hearing Tr. 10989:8-27, Chuck Turner (January 18, 2024).

This growth in the manufacturing classes and growth in milk production impacts utilization in a way that calls into question the fundamental underpinnings of the Class I differential. While USDA has previously concluded that a certain level of Class I prices over manufactured prices was either justified by the intrinsic value of milk for fluid use or a need to ensure service of the Class I marketplace, neither of those justifications holds today. Hearing Ex. 432 (Ex. Hau 001), at 5 ("We do not see logic in justification for the current Class I price differential even remaining at $1.60, given current supplies of fluid milk."). And as discussed, *supra* pp. 19-32, today the own-price demand for fluid milk is elastic further undercutting any justification for prices to be increased. As stated succinctly by Dr. Stephenson: "[T]here are some of things that just need to be changed. As I mentioned, . . . it's a fluid milk solution and a manufacturing world." Hearing Tr. 10631:8-10, Mark Stephenson (January 16, 2024).

B. History of the Current Class I Differential.

During FMMO Reform 25 years ago, USDA developed and implemented the current Class I pricing structure. Hearing Ex. 447 (MIG Ex. 15), at 2 (Testimony of Sally Keefe). At that time, USDA established the base Class I differential at $1.60 per cwt, along with county-level location adjustments. *Id.* at 2-3.[40] Currently, the effective Class I differential ranges from $1.60 to $6.00 per cwt. It has four parts:

> (1) $0.40 compensation for Grade A status,
>
> (2) $0.60 for the marketing/balancing costs incurred in supplying the Class I market,

[40] The majority of the Class I price comes from the base Class I skim portion of the formula. The differentials make up a smaller portion of the overall price. Hearing Tr. 10498:10-14, Sally Keefe (January 16, 2024).

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(3) $0.60 to incentivize producers to supply milk for fluid use, and

(4) $0.00 to $4.40 county-level location adjustment.

Hearing Tr. 10498:15-10499:4, Sally Keefe (January 16, 2024).

USDA aimed to establish the Class I price differential at the "***lowest value necessary***" to ensure sufficient milk supply for fluid use. USDA acknowledged the concern that setting the Class I differential at too high of a level would "be an incentive to overproduce for fluid needs." Specifically:

> The $1.60 minimum differential level proposed is perceived to be ***the lowest value necessary*** under present supply and demand conditions to maintain stable and viable pools of milk for Class I use in markets that are predominantly manufacturing oriented. Applying this minimum differential to each of the three low pricing areas will ensure that low utilization and surplus markets will have similar differentials. However, having a larger portion of Class I value pooled could mute price signals to producers more than prices determined strictly by market forces. If the blend price exceeds the marginal value of milk in manufacturing, there would be an incentive to overproduce for fluid needs.

Milk in the New England and Other Marketing Areas, 63 Fed. Reg. 4802, 4909 (Jan. 30, 1998) (emphasis added).

Of this $1.60 in the Class I differential, USDA concluded that $0.40 reflected the costs to producers of maintaining Grade A milk status:

> First, a portion of the Class I differential must reflect the value associated with maintaining Grade A milk supplies since this is the only milk available for fluid use. Originally the differential needed to be established at a level that would encourage conversion from Grade B to Grade A status. With approximately 96 percent of all milk already converted to Grade A, this value now needs to reflect the cost of maintaining Grade A milk supplies. Although it may be difficult to quantify the cost to maintain Grade A status, there are specific associated costs, as described below.
>
> . . . Often, this will require additional labor, resource, and utility expenses. It has been estimated that this value may be worth approximately $0.40 per hundredweight.

Id. at 4907-08.

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USDA also found during FMMO Reform that this $1.60 included $0.60 for the marketing/balancing costs incurred in supplying the Class I market:

> Traditionally, the additional portion of the Class I differential reflects the marketing costs incurred in supplying the Class I market. These marketing costs include such things as seasonal and daily reserve balancing of milk supplies, transportation to more distant processing plants, shrinkage, administrative costs, and opportunity or "give-up" charges at manufacturing milk plants that service the fluid Class I markets. This value has typically represented approximately $0.60 per hundredweight.

Id.

Finally, USDA determined the remaining $0.60 constituted necessary compensation to incentivize producers at the time to supply milk for fluid use, rather than manufacturing purposes.

> Option 1A presumes that the [proposed] minimum Class I differential is no longer adequate to ensure a sufficient supply of milk due to the competitive nature of the manufacturing facilities in this region. Thus, Option 1A establishes an additional competitive factor into the development of the base zone Class I differential. Option 1A values this competitive factor to be worth about $0.60 per hundredweight. This value reflects approximately two-thirds of the actual competitive costs incurred by fluid plants to simply compete with manufacturing plants for a supply of milk.

Id. at 4909.

This base Class I $1.60 differential is the starting point of the adjusted Class I differentials found in 7 C.F.R. § 1000.52, with county location adjustments applied on top of that. Hearing Ex. 447 (MIG Ex. 15), at 4 (Testimony of Sally Keefe). USDA intended the county level adjustments to reflect the differing location values in milk. *Id.*

Since Federal FMMO Reform (with the exception of the three southeastern Orders), USDA has not updated the underlying structure of the Class I differential, despite the significant shift in FMMO utilization. *Id.* This basic apportionment of the Class I differential has been affirmed without reconsideration since its establishment, including impliedly with USDA's adoption of the California FMMO, found at 7 C.F.R. pt. 51. *See also* Hearing on Promulgation of a Federal Milk Marketing Order in California, Ex. 70 ("Testimony of Dennis Schad"), at 30-32,

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https://www.ams.usda.gov/sites/default/files/media/Dairy%20Exhibit%2070_Redacted.pdf. However, affirmation via the California order was driven by a desire for national uniformity, not from careful reconsideration of the components of the Class I differential. Hearing Ex. 447 (MIG Ex. 15), at 4-5 (Testimony of Sally Keefe). The time is ripe for a dissection of this policy and evaluation of its usefulness in today's world.

C. Current, Elevated Class I Prices Cause Disorderly Marketing.

Class I differentials are supposed to be minimum regulated prices. *See id.*; Hearing Tr. 10499:22-10500:10, Sally Keefe (January 16, 2024). USDA does not intend for Class I differentials to be price enhancing. *See, e.g.*, Hearing Ex. 214 (IDFA Ex. 6), Attachment A (September 17, 2012, AMS Deputy Administrator for Dairy Programs Dana Coale letter responding to a FMMO hearing request: "the Federal Milk Marketing Order (FMMO) program is not designed to be a price or income support program since it is not authorized to establish minimum prices above the relative market value of the products of milk."). When Class I prices are too high, they are not minimum prices and will cause disorderly marketing. Hearing Ex. 453 (MIG Ex. 16B), at 8 (Testimony of Mark Stephenson) ("This is also a signal that markets are not clearing and may suggest a disorderly marketing condition and a need to lower the product price."). Artificially enhanced Class I prices can attract additional supply into the market overall, which then winds up not being used in Class I but instead in manufacturing classes (which are lower priced). Hearing Tr. 10500:11-20, Sally Keefe (January 16, 2024). USDA explicitly recognized this risk during FMMO Reform: "If the blend price exceeds the marginal value of milk in manufacturing, there would be an incentive to overproduce for fluid needs." Milk in the New England and Other Marketing Areas, 63 Fed. Reg. at 4909. Extensive evidence at the hearing verified that these harms are happening today.

In other words, USDA has long established that the FMMO system would constitute a balance between the minimum Class I price and the marketplace (via OOPs). MIG's Proposal 20

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does not ask USDA to change this policy; instead, it merely asks that USDA reconsider this balance in light of the significant market shifts since FMMO Reform.

> I understand that this is an underlying criticism of Class I differentials – the query being, if over order premiums are going to drive milk movement, why have Class I differentials at all? This is a valid question for USDA to ask itself at this juncture in our industry. We are in a different world than 100 years ago, than even 20 years ago. It is appropriate that USDA continue to question and scrutinize whether the tools used in the past are appropriate for today.

Hearing Ex. 488 (MIG/fairlife Ex. 26A), at 3-4 (Testimony of Tim Doelman).

The undisputed evidence establishes that the price needed to attract milk for fluid use today is going to be lower than it was during FMMO Reform. Hearing Tr. 10503:2-7, Sally Keefe (January 16, 2024). As described further below, the current price results in overproduction of milk, challenges the fluid milk segment's ability to innovate, and ultimately acts a disincentive to service the Class I marketplace. Hearing Tr. 11324:6-11, Tim Doelman (January 19, 2024) (calling the pricing regulations complicated and for a "need to look at it in earnest to figure out how we can simplify it and enable more innovation in this space."); *id.* 11341:18-20 ("But there is a lack of innovation in the space because there's so many rules around how it's going to be priced."). Class I's recognition of these ongoing harms explains the overwhelming support from this sector for Proposal 20.[41]

NMPF's own expert affirmed the very outcome MIG warns here if USDA were to maintain or even increase prices. As Dr. Brown concluded from his study, all of NMPF's proposals will raise Class I prices significantly and, in turn, raise blend prices in the short-term. Hearing Ex. 421

[41] The overwhelming testimony from Proprietary Class I processors, including processors who were not MIG members, supported Proposal 20. *See* Hearing Ex. 329 (Lamers Ex. 1) and Hearing Ex. 330 (Lamers 1A) (Testimony of Mark Lamers) (Lamers Dairy testifying in support of Proposal 20); Hearing Ex. 425 (United Dairy Ex. 1) (Testimony of Joe Carson) (United Dairy testifying in support of Proposal 20); Hearing Ex. 432 (Ex. Hau-001) (Testimony of Jim Hau) (Maple Hill Creamery testifying in support of Proposal 20). While some processors did not address Proposal 20 specifically, not one proprietary Class I processor spoke in opposition to Proposal 20.

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(NMPF Ex. 60), at 6-10. But even Dr. Brown concluded that, if USDA adopts all five of NMPF's proposals, the "U.S. all milk prices are $0.09 per hundredweight higher in the first year of the analysis relative to baseline ***but moderate as milk production grows relative to the baseline***." *Id.* at 10 (emphasis added).[42] Given the current level of Class I utilization in the FMMO system and in total nationwide, this is a compelling argument that NMPF's proposals would lead to ever greater overproduction relative to fluid needs.

If USDA relieves Class I from these market-distorting regulatory burdens, the marketplace will operate more efficiently and orderly. Over order premiums can and should have an important role to play when USDA regulates at minimum price levels. In FMMO Reform, USDA affirmed that minimum prices should be set at a level to permit OOPs and the market to operate. Milk in the New England and Other Marketing Areas, 63 Fed. Reg. at 4907, 4910, 4912-4913 ("to provide a more market-oriented structure that allows dairy farmers and processors freedom to negotiate fluid milk price levels.") *see also* Milk in the New England and Other Marketing Areas, 64 Fed. Reg. at 16037. Evidence established that the OOP tool currently operates effectively within the marketplace and processor/producer commonly utilize it in their relationships. Hearing Tr. 9967:17-21, Joe Carson (December 6, 2023) ("There's probably situations where there's too much milk in some parts of the country and too many consumers in other parts of the country. But through what has been traditionally the market premium, over-order premium system, you know, it's been able to handle that situation."). MIG members routinely testified to paying OOPs. *See* Hearing Ex. 454 (MIG/AE Ex. 17), at 4 (Testimony of Warren Erickson) (AE pays OOPs to its suppliers); *see also* Hearing Tr. 10783:16- 22, Michael Newell (January 17, 2024) (Hood pays its suppliers handling charges that include the cost of balancing); Hearing Ex. 462 (MIG/Shamrock

[42] Hearing Exhibit 46 (USDA Ex. 46) bears no persuasive value here, because it oversimplifies the impact of the Class I price and utilization on the pool. As Dr. Brown concluded, changes in the Class I price will result in changes in the Class III and IV markets that will ultimately return the uniform to its current equilibrium.

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Ex. 23), at 3 (Testimony of Tim Kelly) (Shamrock's cooperative supplier charges an OOP to Shamrock); Hearing Tr. 10967:8-13, 11001:26-11002:15, Chuck Turner (January 18, 2024) (Turner pays a quality premium to its suppliers and a seasonal or market-based premium). Likewise, NMPF witnesses repeatedly affirmed that they are able to obtain over order premiums in the marketplace. *See supra* p. 12.

To the extent that NMPF members repeated (contrary to the evidence that they uniformly received OOPs) that OOPs are more difficult to obtain today than previously, that evidence *supports* MIG's contention that prices today are not *minimum* prices, but are enhanced. When USDA sets minimum prices, the marketplace will and should operate at some level above those prices for a significant amount of the time. When the marketplace does not sustain prices above the minimum (i.e., when OOPs are not abundant), the minimum price holds the actual market price higher than warranted. Hearing Ex. 453 (MIG Ex. 16B), at 8 (Testimony of Mark Stephenson). The market can and will operate efficiently without FMMO interference. Hearing Tr. 11314:28-11315:2, Tim Doelman (January 19, 2024) ("[G]ood negotiations between partners and competitive players will ultimately get the pricing right, and at the end, the consumer will benefit the most.").

No evidence at the hearing established that the reduction of the base Class I differential to zero would result in a loss of sufficient milk for fluid use. *See supra* pp. 13-15. And critically, "people who care the most about making sure that they have enough milk for their bottling needs . . . are Class I processors, and so if they were concerned that this change [adopting Proposal 20] would lead to a shortage of supply for them, MIG would not have proposed it." Hearing Tr. 10532:12-17, Sally Keefe (January 16, 2024). Consider that not a single Class I processor testified that either 1) they are having trouble getting sufficient milk supplies today, or 2) that they would be concerned about procuring sufficient milk supplies if USDA eliminated the $1.60 base

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differential.[43] In fact, Dr. Stephenson notes that removing the $1.60 base Class I differential from the pool obligation may better align the size of large pools of milk under the FMMOs, thus restoring value to the dairy farmers actually serving the Class I market. Hearing Ex. 453 (MIG Ex. 16B), at 22.

Additionally, Proposal 20 addresses the increasingly burdensome nature of the pool obligation on Class I processors. The pool obligation, a regulatorily mandated cost, has become increasingly volatile and now constitutes a larger portion of the milk costs processors must pay, for which they can take no action to either extract value or reduce the obligation (unlike other liabilities the companies face). Hearing Tr. 11027:2-11028:1, Jay Luikart (January 18, 2024). Not only can Class I processors not avoid, or even mitigate, their pool obligations, but the month-to-month variations remain unpredictable and significant. As OV|CROPP testified to, it routinely sees swings of over fifty percent in its monthly pool obligations. Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 10-11 (Testimony of Shawna Nelson) (see chart at page p. 50). Imagine any other business where one of your core expenses swings so wildly month to month, yet you receive no discernable return from those swings.

USDA does not act in the public interest when it maintains artificially high prices. Hearing Tr. 10579:23-10580:20, Sally Keefe (January 16, 2024) (explaining that in addition to unsupported, enhanced Class I prices hurting producers by causing overstimulation of milk that goes into lower classes and depressing the price, enhanced prices hurt consumers when the retail price is artificially high); Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 6 (Testimony of Jed Ellis) ("If milk prices go up, what will that cost the federal government? What will that do to school milk? It will cost the federal government a lot of money (or risk losing this critical source of

[43] The only evidence of actual, rather than anticipated, supply issues is in the southeastern Orders which USDA recently addressed via transportation and delivery credit changes that became effective March 1, 2024 (and which no NMPF or opponent witness could show would remain a problem after USDA's recent proposed amendments go into effect).

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consumption and opportunity for getting nutritious products to our youth).”). Differentials at too high a level result in artificially induced overproduction while reducing fluid milk consumption by consumers (a risk raised in comments even during FMMO Reform, Milk in the New England and Other Marketing Areas, 64 Fed. Reg. at 16116), to say nothing of the artificial Class I production induced by including 7% of Class I milk that is organic. The current price-enhancing nature of the Class I prices also means that the U.S. customer now must pay more for their milk in order to compensate suppliers for the surplus from the over-stimulation of milk (excess milk production that is increasingly sold abroad). Certainly, having the U.S. taxpayer subsidize milk exports is not in the U.S.’s public interest. Hearing Tr. 10989:8-27, Chuck Turner (January 18, 2024).

D. MIG’s Proposal 20 Corrects the Disorderly Marketing Caused by Current, Enhanced Prices.

Thus, MIG proposes the appropriate and economically justified base Class I differential of $0.00, adjusted for the county specific locations using the current Class I price surface. Reducing the Class I pool obligation by adopting Proposal 20 addresses this ongoing disorderly marketing.

MIG members uniformly seek regulatory changes that provide greater support to their direct suppliers (whether independent farmers or cooperatives). *See, e.g.*, Hearing Tr. 10970:25-10971:10, Chuck Turner (January 18, 2024). These Class I processors know that, in this new marketplace, **the best way to ensure a sufficient supply of milk for fluid is to support those farmers actually shipping to Class I.** Proposal 20 will allow Class I processors to redirect money to their direct suppliers, to investments, or any multitude of ways that they can innovate and invigorate the Class I marketplace. Hearing Tr. 10510:19-10511:1, Sally Keefe (January 16, 2024). MIG members maintain that the FMMO system will support a healthier dairy marketplace if more money for services goes to directly compensate the suppliers providing those services. Hearing Tr. 10513:6-16, Sally Keefe (January 16, 2024):

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- "What I would like to do is pay our producers, the dairy farmers who ship milk to Turner Dairy, more to keep them in business by making the highest quality milk close to our plant while also covering our costs to balance our milk supply." Hearing Ex. 466 (MIG/Turner Ex. 25), at 4 (Testimony of Chuck Turner).

- "Likewise, if the issue here is farmer pay, then the only direct way Shehadey Family Foods can address that is to be able to pay more money to our direct ship farmers. In order to free up the resources needed to do that, we need to lighten the economic burden of the FMMO system. And if we want to support independent farmers, having this flexibility is particularly important, because it allows us to tailor a milk procurement strategy to better meet both our needs and the direct shippers' needs – as well as, and most importantly, allows us together to better serve customers." Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 7-8 (Testimony of Jed Ellis).

- "The only way for that $0.60 to incentivize service of the organic Class I market is to allow entities like ours to redirect those funds towards actually growing the Class I market—in particular, by redirecting back to the very farmers that service Class I bottlers." Hearing Ex. 472 (MIG Ex. 22), at 13 (Testimony of Shawna Nelson).

- "[I]f we had that $1.60, we would first use it to expand supply and support our farmers, and we would use it to create opportunities to sell more milk, which also benefits farmers." Hearing Tr. 11146:1-4, Cammie Garofolo (January 18, 2024).

The industry no longer sees the sort of destructive competition for Class I sales that prompted the creation of FMMOs nearly 100 years ago precisely because there is so much milk produced relative to Class I needs and manufacturing uses are ascendent. Hearing Ex. 453 (MIG Ex. 16B), at 23 (Testimony of Mark Stephenson). Likewise, no disparity in market power exists today that justifies requiring Class I processors to pay market-wide subsidies to the pool. Hearing Tr. 10932:11-15, Tim Kelly (January 18, 2024). Instead, the inverse is true—the FMMO system disincentivizes service of the Class I marketplace when it ties up too much of the payment to Class I suppliers in the shared pool. USDA must recognize this change and the reality of the world today and fulfill the purposes of the AMAA by reducing the pool obligation of Class I suppliers.

MIG anticipates that opponents will argue that MIG's efforts to relieve part of its pool obligation, with the intent to redirect those funds to innovation and supporting milk suppliers directly, runs afoul of the AMAA's goal of uniform prices. Hearing Tr. 10811:20-28, Michael Newell (January 17, 2024). First, any such argument defies the regulatory and economic reality.

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The AMAA's use of the word "uniform" already contemplates that farmers will actually receive non-uniform prices. These include OOPs (which are and have been routine in the industry for years) and cooperatives reblending, as well as non-FMMO prices paid to farmers by handlers who depool. Today, especially with opportunistic pooling and depooling permitted under the AMAA, dairy farmers routinely are paid non-uniform prices almost always to the detriment of the dairy farmers actually serving the fluid market. Hearing Ex. 486 (MIG/Crystal Ex. 19B), at 3-4 (Testimony of Jacob Schuelke); Hearing Tr. 11258:14-11259:5, Jacob Schuelke (January 19, 2024) (concluding that there is a lack of equal contribution). Moreover, when opportunistic pooling occurs, the dairy farmers actually serving the Class I plants are still incurring the costs of service, but the blend price paid deprives them of the value contributed by handlers while spreading out that payment to all dairy farmers regardless of service to the market. There simply are not uniform prices paid to dairy farmers today. Second, MIG does not propose a policy change here, rather a reevaluation of the level necessary for the Class I pool obligation. Hearing Tr. 10831:6-23, Michael Newell (January 17, 2024). USDA can and should routinely evaluate the amount in the base Class I differential price, and adjusting the same merely continues USDA's current approach to differentials.

MIG's proposal would amend 7 C.F.R. § 1000.52, adjusted Class I differentials, as shown in Hearing Exhibit 449 (MIG Ex. 15B). MIG's Proposal 20 adjusts the Class I differential for each county/parish/city listed to $1.60 lower than current. Proposal 20 addresses the three portions of the base Class I differential: $0.40 for Grade A costs, $0.60 for balancing costs, and $0.60 for incentive to service the Class I marketplace. These changes improve the disorderly marketing described above.

1. USDA must eliminate the Grade A $0.40 portion of the Class I differential.

Historically, the $0.40 Grade A compensation mattered given that the cost of maintaining Grade A status was unique to producers supplying Class I processors. Hearing Ex. 447 (MIG Ex.

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15) (Testimony of Sally Keefe), at 5. Decades ago, the market had significant amounts of Grade B milk, and Class III and Class IV products were oftentimes made with Grade B milk. Grade B milk has declined from approximately 40% to less than 1% today. Hearing Ex. 453 (MIG Ex. 16B), at 2-3 and 23 (Testimony of Mark Stephenson). But now nearly all (at least 99% of milk) is Grade A, and Class III and IV products are made with Grade A milk. *Id.*; Hearing Ex. 448 (MIG Ex. 15A), at 5, 7, 11 (USDA NASS, *Milk Production, Disposition, and Income 2022 Summary* (April 2023)). "Maintenance of Grade A status is no longer a Class I issue – it is an industry-wide standard." Hearing Ex. 451 (MIG Ex. 16 (Corrected)), at 17 (Testimony of Mark Stephenson).

First, as a threshold issue, even if USDA were to determine Class I must compensate farmers for Grade A status costs, ***they are already doing so in the form of the base Class I skim price***. Given that Class III and IV prices are intended to be market clearing, they account for the cost of achieving and maintaining Grade A status on the farm. Hearing Tr. 10505:13-16, Sally Keefe (January 16, 2024). Since all pool milk must be Grade A and Class I is less than 30% of all pooled milk, by definition the remaining 70% of milk used by manufacturing classes is also Grade A.[44] Given that make allowances and price discovery ensure that the Class III and IV prices are market-clearing, the cost of serving the Grade A market is embedded within those market-clearing prices for the manufacturing classes. Sally Keefe Testimony, Hearing Tr. 10505:13 - 16 (January 16, 2024). Including this cost in the base Class I skim price *and* the Class I differential is a "double dip," and not justified under the AAMA.

Second, and an entirely independent basis upon which USDA should accept MIG's proposal, extensive evidence established that being Grade A is no longer a Class I issue, but an industry-wide standard; Grade B milk plays no meaningful role in the marketplace today. AE has never heard of Grade B milk in any conversations with suppliers. Hearing Ex. 454 (MIG/AE Ex.

[44] In order to participate in the pool, a supplier must be Grade A. "If a dairy farmer loses producer status under the order in this part (except as a result of a temporary loss of Grade A approval) . . . ." 7 C.F.R. §§ 1032.13(d)(1).

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17), at 3 (Testimony of Warren Erickson). According to the State of Iowa Agriculture Department, as of August 1, 2023, there are 741 permitted dairy farms in the State of Iowa. *Id.* Of those, only 7 farms are Grade B, and none of those farms have milk pooled on a Federal Order. So over 99% of the dairy farms in Iowa are Grade A (and if this were computed as a percentage of pounds of milk produced the number would be even higher), and NASS reports show that 100% of the farm milk marketed is Grade A. *Id.* Looking to another state, Wisconsin (considered a powerhouse in dairy processing and cheese production and producing over 31 billion pounds of milk in 2022) affirms this conclusion. In August 2023 in Wisconsin, the state had 5,360 Grade A licensed dairy farms, compared to only 493 Grade B licensed dairy farms (producing less than one percent of the milk). Hearing Ex. 473 (MIG/OV|CROPP Ex. 22 (Corrected)), at 9-10 (Testimony of Shawna Nelson) (citing *Wisconsin Milk Cow Herds by Type of Milk Produced* (Aug. 1, 2023), https://www.nass.usda.gov/Statistics_by_State/Wisconsin/Publications/Dairy/2023/WI-DairyHerd-08-23.pdf)).

Likewise, the Shamrock witness testified that he is not aware of any farmer, particularly in FMMO 131, that has or is producing Grade B milk. Hearing Ex. 462 (MIG/Shamrock Ex. 23), at 3 (Testimony of Tim Kelly). Multiple other MIG witnesses affirmed this reality in their markets. Hearing Tr. 10963:17-10964:5, Chuck Turner (January 18, 2024) (testifying that while grade B milk used to be common in Pennsylvania, he would not even know where to find a load of Grade B milk today); Hearing Tr. 11021:27-11022:6, Jay Luikart (January 18, 2024) (same); Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 4-5 (Testimony of Jed Ellis) (same). NASS reports that for milk marketed by producers in California and Oregon, 97% and 100% (respectively) is fluid grade (i.e., Grade A). Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 5 (Testimony of Jed Ellis) (citing USDA NASS, *Milk Production, Disposition, and Income 2022 Summary,* at 11 (April 2023)).

Dr. Stephenson, agreed, concluding that there is no need to compensate dairy farmers for conversion to or maintenance of Grade A status; it is an industry standard for all milk. Production qualities have been and are paid for through voluntary premiums. The Grade A part of the base

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Class I differential simply has lost all meaning. Hearing Ex. 453, MIG Ex. 16B, at 10 (Testimony of Mark Stephenson). Therefore, he concludes that Grade A conversion or maintenance costs are no longer relevant as a justification for any portion of the $1.60 base Class differential.

Notably, not one self-described "Grade B" producer testified at the hearing, nor was there meaningful testimony from a Grade A producer that he or she would revert to Grade B status at the loss of this $0.40 in the base Class I differential. With herd health and farm quality directly tied to milk production, farmers lack financial incentive to revert to Grade B status given the impacts it would have on production and profitability. *See* Hearing Tr. 11270:4-22, Jacob Schuelke (January 19, 2024). MIG also established the reality of disinterest in Grade B milk with the real-world example of California's Grade B designation. California has a financial obligation (quota) on Grade A milk that remains in place today, meaning farmers have a $0.40/cwt economic incentive to not be Grade A. Hearing Ex. 484 (MIG/Crystal Ex. 19), at 7-8 (Testimony of Jed Ellis). In response, several manufacturers built their procurement strategies around that, aiming to utilize Grade B milk and avoid the quota payment. This approach was abandoned, though:

> However, in the past couple of years even those manufacturers stopped taking in Grade B milk because it made their cream, condensed, UF, and spot milk unmarketable to such a degree that they could not function in our Grade A environment. They had to eliminate receiving Grade B milk despite California's $0.40/cwt. subsidy.

Id. Even with *affirmative economic incentive* to maintain Grade B status administratively, it was not viable for the California dairy producers; NMPF has presented no evidence it would otherwise be viable (let alone preferable) in the rest of the country, either. Hearing Tr. 8150:2-8152:22, Rob Vandenheuvel (October 11, 2023) (in 2023 there is no active solicitation of Grade B milk, and the vast majority of cheese manufacturers require their supply to be Grade A).

Manufacturing classes now, as a market standard, contract for and use Grade A milk. OV|CROPP testified that for the milk it sold to buyers who process Class II and III, "it is standard expectation and typically within contractual clauses the milk will be Grade A." Hearing Ex. 473

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(MIG/OV|CROPP Ex. 22 (Corrected)), at 10 (Testimony of Shawna Nelson). Shehadey also does not accept any Grade B milk for its non-Class I products. Hearing Tr. 111201:6-8 (Testimony of Jed Ellis) (January 19, 2024). Multiple large cheese manufacturers testified that they do not receive Grade B milk; indeed, at least two of those stopped receiving any Grade B milk just in the last eight years. Hearing Tr. 3868:10-15, Wes Eveland (September 14, 2023) ("About two years ago . . . we [Hilmar] went all to Grade A. We no longer accept Grade B."); Hearing Tr. 3977:7-8, Alison Krebs (September 14, 2023) (Leprino does not accept Grade B milk); Hearing Tr. 4056:2-7, Terry Brockman (September 15, 2023) (as to Grade B "[w]e [Saputo] stopped probably in 2015 or 2016"). Even cooperatives have driven the change that Grade A status is universally expected for all milk. For example, all of SMI's farmer-members are required to be Grade A in order to remain a member of that cooperative. Hearing Tr. 5176:3-10, Cal Covington (September 25, 2023).

Exports also played a role in establishing Grade A milk as market standard, as exported products like NFDM, butter and cheese must all be Grade A or made with Grade A milk. Hearing Ex. 451 (MIG 16 (Corrected)), at 17 (Testimony of Mark Stephenson) ("[I]n order to service the manufactured products export market (which most farms need to be able to do), milk must be Grade A."). Exports have dramatically increased since FMMO Reform and this change must be considered by AMS. Milk market standards changed since the Final Decision implementing FMMO Reform.

While opponents have attempted to reframe this issue as one about the cost of Grade A status, USDA has only ever considered this factor to the extent that being Grade A was a standard unique only to Class I use. MIG's position is not that there are no costs associated with maintaining Grade A status, but rather that being Grade A is an industry-wide standard now and not a unique feature that must be met only for Class I suppliers. Hearing Tr. 10505:5-12, Sally Keefe (January 16, 2024). In other words, the issue is not "is there a cost to being Grade A," but rather "does Class I alone need to pay money into the pool in order to ensure there is sufficient Grade A milk

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for fluid processing?" The answer is clearly "no." USDA no longer needs to include the $0.40 in the Class I differential in order to ensure the marketplace has sufficient Grade A milk to meet fluid needs—the industry has taken care of that need.

The fact that certain Class I processors (or any other type of processor) may have quality requirements in excess of Grade A standards is neither here nor there for this proposal. NMPF never alleged (or could prove) Class I processors have uniform extra quality standards. And Class I processors already pay incentives or premiums for these standards, on a processor-by-processor basis. *See* Hearing Tr. 10740:10-17, Warren Erickson (January 17, 2024). Dr. Stephenson also took this issue on directly noting that other voluntary premiums (e.g., rBST free) have been and are used to incentivize milk production qualities. Hearing Ex. 453 (MIG Ex. 16B), at 10 (Testimony of Mark Stephenson); Hearing Tr. 10617:7-10618:2, Mark Stephenson (January 16, 2024) (rBST premiums were paid until farms no longer used it and the premium is no longer available; low somatic cell count milk is another example so milk quality is improved; "[t]he opportunity of moving on to using premiums for other purposes is now available. That's no longer a strong incentive in the marketplace. **They have become commodified.**" (emphasis added)). Once the underlying Grade A requirements are met, there is no policy justification for the government to mandate these others as part of a minimum regulated price. Hearing Ex. 433 (IDFA Ex. 57), at 34 (Testimony of Mike Brown). Moreover, almost all these alleged additional costs are not specific to Class I. *See, e.g.*, Hearing Ex. 310 (NMPF Ex. 37), at 7 (Testimony of Jeff Simms).

2. USDA must eliminate the balancing $0.60 portion of the Class I Differential.

USDA should not include balancing costs in the base Class I differential for two primary reasons: first, dairy producers do not all bear balancing costs alone, especially as a number of Class I companies have made significant infrastructure investments in their operations to perform balancing, and nor do dairy farmers all bear the same balancing costs for the system; and second,

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the FMMO system as a whole no longer provides balancing to Class I processors in general due to the growth of the manufactured milk classes.

As USDA's FMMO Reform stated balancing justification for the $1.60 base Class I differential, again multiple industry changes undermine the need for any such requirement because a pool-wide expense is no longer efficient or consistent with orderly marketing. Hearing Ex. 453 (MIG Ex. 16B), at 11 (Testimony of Mark Stephenson). Mark Stephenson found that cooperatives and dairy farmers are able to negotiate successful incentives to reduce the need for balancing or pay for it. Further consistent with the testimony of Aurora Organic Dairy, fluid plants have changed their behavior by investing in balancing infrastructure. *Id*.; Hearing Tr. 11132:11-11134:3, Cammie Garofolo (January 18, 2024). He also emphasized that "[a] high proportion of manufactured milk often no longer serves a balancing function. [A] shift mean[ing] there is more than an adequate supply of milk." Hearing Ex. 453 (MIG Ex. 16B), at 11 (Testimony of Mark Stephenson). This testimony is entirely consistent with NMPF member testimony that many of their manufacturing plants (both Class III and IV) are demand plants that do not function as genuine balancing operations, and with MIG member testimony detailed below.

a. Producers do not have identical balancing costs for all processors all of the time.

Like Grade A milk, market efforts at balancing have also changed over the last 25 years since the FMMO Reform. Hearing Ex. 447 (MIG Ex. 15), at 6 (Testimony of Sally Keefe); Hearing Tr. 10566:2-6, Sally Keefe (January 16, 2024) ("I think that the way in which balancing costs are incurred throughout the market has changed a lot since FMMO Reform. I don't necessarily think that they have gone down. I think it's a question of who's paying them when."); Hearing Ex. 451 (MIG 16 (Corrected)), at 8 (Testimony of Mark Stephenson) (historical justifications "no longer exist for making the balancing expense a pool-wide obligation."). Market balancing costs do not belong in the regulated minimum price because market balancing costs are not always borne by producers and/or cooperatives. The $0.60 that USDA built into the base

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differential assumes that balancing is happening all the time, in the same way, by the same people, and at the same cost; but the evidence demonstrates that balancing activities, costs, and the party bearing those costs vary relationship by relationship. Hearing Tr. 10538:1-10, Sally Keefe (January 16, 2024). Sometimes producers bear these costs, but other times processors bear them. Hearing Ex. 447 (MIG Ex. 15), at 6 (Testimony of Sally Keefe); Hearing Tr. 10506:18-27, Sally Keefe (January 16, 2024); Hearing Tr. 10930:22-27, Tim Kelly (January 18, 2024) (testifying that there are costs of balancing at the farm level and at the processor level).

Processor-borne balancing costs have become a significant portion of industry-wide balancing efforts, and represent real expenses for processors. These costs can range from low, around $0.25/cwt, to dollars per hundredweight. Hearing Tr. 10537:20-28, Sally Keefe (January 16, 2024); *see also* Hearing Tr. 10741:1-3, Warren Erickson (January 17, 2024) (testifying that everyday delivery balancing charges can range from $0.045 to $0.65/cwt). Yet the FMMO system fails to recognize this investment, assuming that every supplier in the FMMO system provides every processor in the FMMO system $0.60/cwt of balancing. Not one piece of evidence at the hearing supports this conclusion.

Processors balance in a variety of ways, and carry the costs for those balancing services. Many processors testified to receiving all milk from certain suppliers, which means the processor bears the burden of balancing that supplier's milk flow. Hearing Tr. 11130:10-25, Cammie Garofolo (January 18, 2024) ("[W]e also have contracts where we take all of the supply that the producer is producing. So the majority of the balancing risk is falling on us."). This arrangement is common with independent suppliers and direct shipments from farmers to Class I plants (as opposed to shipments from a balancing plant to Class I). Turner Dairy accepts all of the milk produced by the 32 independent suppliers shipping to it, meaning it bears significant balancing expenses for those suppliers. Hearing Tr. 10964:6-24, Chuck Turner (January 18, 2024) (also affirming that Turner's suppliers ship exclusively to Turner); Hearing Ex. 457 (MIG/Hood Ex. 21), at 4 (Testimony of Michael Newell) ("Currently Hood bears some of the cost of balancing its

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milk supply as we receive all Class I milk directly from the farms, not balancing plants. We also pay most of our co-ops a handling charge to cover the cost of balancing."); Hearing Tr. 11044:12-14, Jay Luikart (January 18, 2024) (Danone also accepts all of the milk produced by some of its shippers).

Processors also testified to running plants every day (even on weekends) so that it can receive a regular supply of milk—another balancing function. Cooperative incentives for even day receiving and weekend receiving have successfully shifted the processor marketplace towards making that practice more commonplace, demonstrating "that market incentives work." Hearing Ex. 451 (MIG Ex. 16 (Corrected)), at 8 (Testimony of Mark Stephenson). Hood runs most of its plants twenty-four hour a day, seven days a week so that they can do "even day" receiving. Hearing Tr. 10782:18-28, Michael Newell (January 17, 2024); Hearing Tr. 10507:3-11, Sally Keefe (January 16, 2024); Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 5 ("We have added additional silos and have raw milk receiving staff onsite seven days a week to receive raw milk, even on days our facilities do not even manufacture."). Hood can receive universal receiving credits from cooperatives (essentially, a reduction in the OOP) in exchange for that even day receiving schedule. Hearing Tr. 10782:18-28, Michael Newell (January 17, 2024). Hood carries administrative and labor costs in order to operate twenty-four hours a day, seven days a week. Hearing Tr. 10783:3-15, Michael Newell (January 17, 2024). Likewise, fairlife receives milk 365 days a year and carries costs to do so. Hearing Ex. 487 (MIG/fairlife Ex. 26), at 3 (Testimony of Tim Doelman) ("At fairlife, we run our facilities 24-7-365. Our goal is to receive milk as evenly as possible, similar to a cheese plant. Running our plant every day of the year requires significant personnel expenditures.").

Balancing arrangements can also be processor-specific. Crystal Creamery balances its own milk supply using its powder plant. Hearing Tr. 5848:1-9, Jacob Schuelke (September 28, 2023).

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> We have invested heavily into powder manufacturing and our costs of production for that are much higher than current make allowances. We are able to sustain these losses because we use the powder plant to balance our milk supply and that does two things. First it enables us to have a direct ship program and second it enables us to enter into steady milk volume contracts with handlers that are at a lower premium rate because they don't have variable commitments. Because of our powder plant we are a buyer of spot milk, almost never a seller.

Hearing Ex. 484 (MIG/Crystal Ex. 19), at 8 (Testimony of Jacob Schuelke)

Shehadey has worked specifically with its suppliers to reduce variability in daily milk receipts to help with balancing. Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 5 (Testimony of Jed Ellis). Danone testified to balancing milk supplies through its production network, "where there's multiple lines that we can work with and run production or flex the lines." Hearing Tr. 11021:7-20, Jay Luikart (January 18, 2024). AE balances internally by adding raw milk storage so it can avoid the additional balancing costs charged by suppliers. Hearing Ex. 454 (MIG/AE Ex. 17), at 4 (Testimony of Warren Erickson).

Further, Class I processors' investments in expensive ESL processing lines supports their ability to carry inventory, a critical balancing activity. Hearing Ex. 457 (MIG/Hood Ex. 21), at 4 (Testimony of Michael Newell); see also Hearing Ex. 489 (MIG/fairlife Ex. 26), at 3 (Testimony of Tim Doelman) ("We have very high capital costs associated with ESL and aseptic production. The high-cost equipment allows for long shelf-life products enabling us to receive milk more evenly compared to a fluid milk plant."). For example, Hood has invested significantly in ESL facilities, including more processing capacity and automated storage and retrieval systems (ASRS), all of which are geared towards balancing efforts. Hood can get anywhere from 70 to 120-day shelf life for its ESL products. Hearing Tr. 10824:1-3, Michael Newell (January 17, 2024); *see also* Hearing Tr. 11045:11-15, Jay Luikart (January 18, 2024) (Danone has a similar shelf life for ESL products, in the 70 to 90-day range). Shamrock testified it can get 70 days for carton ESL products and 100 to 130 days for bottled products. Hearing Tr. 10937:20-25, Tim Kelly (January 18, 2024).

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Having a longer shelf-life allows processors to manage the supply chain to account for balancing needs. *Id.* 10944:3-5January (describing how Shamrock turns over its cold room for HTST products about every 30 hours, but ESL only every 30 to 60 days); Hearing Tr. 11021:7-20, Jay Luikart (January 18, 2024) (also describing using ESL products and their longer shelf life to balance). Aurora testified that, with its ESL and aseptic products, it can carry 14 days of sales in inventory to balance, increasing to 25 days on certain products when necessary. Hearing Ex. 476 (MIG/Aurora Ex. 18), at 6 (Testimony of Cammie Garofolo); see also Hearing Tr. 11132:11-16, Cammie Garofolo (January 18, 2023) (describing how Aurora's storage facility can hold 12,000 pallets, equating to 2.5 million gallons of milk). In addition to more generally supporting supply chain flexibility with longer shelf-life products, ESL facilities can manage seasonal balancing by, for example, producing eggnog in August to ship in late September or October. Hearing Tr. 10808:18-27, Michael Newell (January 17, 2024).

Class I processors have to make significant investments in ESL facilities, and the FMMO system should recognize the value those bring to balancing. On August 31, 2023, Hood announced that it is investing $120 million in an expansion of its Batavia facility. This investment includes two additional receiving bays and two additional milk silos, which also will support balancing efforts. Hearing Ex. 457 (MIG/Hood Ex. 21), at 4 (Testimony of Michael Newell). While an HTST filler may cost around $5 to $7 million for an HTST business, a comparable ESL line would be closer to $35 to $40 million. Hearing Tr. 10944:13-20, Tim Kelly (January 18, 2024).

Finally, organic milk sales in particular do not meet historical balancing assumptions.

> Because organic dairy requires strict segregation and adherence to the National Organic Program standards, companies involved in the commerce of organic dairy are under immense pressure to achieve nearly perfect utilization of organic milk. These companies, including us [OV|CROPP], assume almost all balancing functions (and accompanying expenses) to ensure the milk and dairy products maintain certified organic status and can be marketed customers as certified organic.

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Hearing Ex. 473 (MIG/OV|CROPP Ex. 22 (Corrected)), at 10 (Testimony of Shawna Nelson). Requirements of segregation means that organic processors will also pay a premium to process organic powder during surplus events. Hearing Ex. 476 (MIG/Aurora Ex. 18), at 6 (Testimony of Cammie Garofolo). As an organic milk powder processor, Crystal Creamery confirmed this price disparity. Hearing Ex. 484 (MIG/Crystal Ex. 19), at 9 (Testimony of Jed Ellis).

> [T]here are very limited manufacturing uses where they [organic suppliers] can get an organic premium. Crystal's Humboldt facility is the primary organic balancing plant for the west coast. We charge four times the NFDM standard make allowance for balancing. Organic handlers routinely pay this because it is better than spot sales into the conventional market. In summary organic farms are paying $0.60/cwt for balancing in these formulas and then they routinely pay $6.00/cwt or more for real balancing services.

Id.

MIG of course acknowledges that suppliers also provide balancing. Hearing Ex. 476 (MIG/Aurora Ex. 18), at 7 (Testimony of Cammie Garofolo) (describing how Aurora's own farms balance milk supply through adjusting frequency of milking, rations, drying cows, or herd culling). Processors, though, often pay OOPs for those balancing services. *See also* Hearing Ex. 487 (MIG/fairlife Ex. 26), at 3 (Testimony of Tim Doelman) ("When our actual suppliers bear some portion of the balancing cost, we negotiate that expense and pay them for it via the over-order premium."). For example, Shamrock's cooperative supplier charges an OOP of up to $0.75/cwt when Shamrock fails to meet their forecasted demand to account for "balancing" and milk supply management. Hearing Ex. 462 (MIG/Shamrock Ex. 23), at 3 (Testimony of Tim Kelly); *see also* Hearing Tr. 10783:16-22, Michael Newell (January 17, 2024) (Hood pays its suppliers handling charges that include the cost of balancing). AE testified that their suppliers balance their milk supply for them, but AE pays an OOP for that arrangement. Hearing Ex. 454 (MIG/AE Ex. 17), at 4 (Testimony of Warren Erickson). When AE purchases milk to balance its supply needs, that milk is more expensive as they are paying for balancing services. *Id.* Specifically, its supplier charges AE a premium for milk loads not purchased each of the 7 days a week, a premium that

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can change but is currently more than the $0.60 built into the Class I differential. *Id.* That means that Class I processors are effectively paying for balancing twice, once diluted through the pool payment and then a second time via OOPs to the producers actually supplying the milk to fluid plants. *See* Hearing Tr. 10966:3-21, Chuck Turner (January 18, 2024). Just like the Grade A issue, USDA should not require this duplicative cost of Class I processors.

This individualized approach in who bears the balancing costs exists not only generally throughout the industry, but even internally at operations. For example, as AE also testified, for some suppliers it receives all of their milk and for others, it orders on a weekly basis. Hearing Tr. 10757:16-23, Warren Erickson (January 17, 2024). In an orderly marketplace, AE pays less to the supplier who gets to ship all of its milk to AE (because AE balances that supply) and AE pays more to the supplier from whom it orders on a weekly basis (because that supplier balances its own supply). *Id.* 10758:9-14 (as AE testified it, in fact, does). But if AE must pay this balancing cost to the pool, these two suppliers receive the same balancing payment in the blend despite bearing very different balancing costs. Undoubtedly, this outcome is disorderly. *See* also Hearing Tr. 10783:23-10784:8, Michael Newell (January 17, 2024) (balancing activity "really varies by supplier").

Shehadey's suppliers all handle balancing costs somewhat differently, and those costs can shift between Shehadey and the supplier depending on the week. "Currently all three of the cooperatives that we source raw milk from charge an additional premium for raw milk balancing. In order to reduce this premium and receive a credit for balancing, we must receive milk evenly throughout each week." Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 5-6 (Testimony of Jed Ellis). But only two of Shehadey's three cooperative suppliers offer these universal receiving credits. Hearing Tr. 11239:13-20, Jed Ellis (January 19, 2024).

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> One cooperative gives the most reduction based on lowest variation from the daily average per week. Another cooperative uses the lowest days receipt per week multiplied by number of days to determine how much milk is eligible for reduced price. We aim to qualify for these credits whenever possible – and when we do not, we pay for this balancing cost outside of the FMMO system.

Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 5-6 (Testimony of Jed Ellis). "As a result of this, we bear the cost burden for balancing raw milk and have, and will continue to make, significant investments to improve our balancing capabilities." *Id.*

Balancing costs between a supplier and processor can even vary within that individual relationship. Shamrock testified that its balancing OOP paid to its cooperative changes based on the accuracy of Shamrock's forecasts. Hearing Ex. 463 (MIG/Shamrock Ex. 23), at 3-4 (Testimony of Tim Kelly).

> [I]f Shamrock's investments in forecasting its needs accurately are successful, then the producer does not have the same balancing costs. But if Shamrock's needs change in unexpected ways, then the producer is bearing more of that cost and is charging Shamrock Foods Company a commensurate expense for providing that service. The FMMO assumes that the producer is bearing this cost in every instance, and that is not true.

Id.

For Shehadey, its suppliers enforce balancing through a set process for Shehadey's order process.

> We are required by our cooperative suppliers to place our milk orders days in advance with minimal changes allowed to these orders. Shehadey Family Foods provides quarterly forecasts. We then order milk a week in advance in line with the forecasts. Each week, we are only allowed to cancel a small portion of our orders (about 3%), and we rarely use even that minimum exception.

Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 5 (Testimony of Jed Ellis). These examples demonstrate why USDA cannot regulate the cost of balancing on an industry-wide basis.

Given that suppliers also sell milk to manufacturing processors, balancing costs for suppliers generally are not necessarily specific just to Class I processors. *See* Hearing Tr. 10830:11-27, Michael Newell (January 17, 2024). Critically, and as will be discussed further

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below, not one opposition witness proposed quantitative evidence regarding the ongoing balancing costs today borne by suppliers that are specific to Class I. In the face of the lack of that record evidence, and the overwhelming evidence from processors that processors are bearing more and more of the balancing costs and Class I needs can be met without Class I supporting balancing for the entire pool, USDA must remove it from the minimum Class I differential price.

Perhaps most critically here, the current formula hurts not only Class I processors, but also the Class I suppliers who are actually bearing balancing costs because low Class I utilization means those suppliers receive very little of the $0.60 in their blend price. *See* Hearing Tr. 10567:23-10568:9, Sally Keefe (January 16, 2024). Ms. Keefe discussed an example in cross-examination of a supplier of a Class I plant in an order with thirty percent utilization. Imagine that supplier had $0.60/cwt in balancing costs. Within the order, the supplier will only receive $0.18 of those balancing costs via the blend price. The remaining $0.42 is distributed to other suppliers where seventy percent of the total supplier milk is not even servicing a Class I plant. In those situations, if the Class I supplier negotiates to have the cost of their balancing covered, the Class I processor would be paying $1.02/cwt for balancing in order to receive only $0.60/cwt in balancing services. If the Class I processor understandably cannot bear such a high balancing cost in light of the return, it may have to pay an OOP to that supplier that is less than the missing $0.42. So then that direct Class I supplier is left with some portion of its $0.60/cwt balancing costs not covered by the transaction (while other suppliers have collected money in the blend price for balancing services never provided to a Class I plant). This scenario results in disorderly marketing for both the processor (who is paying twice for the same balancing costs) and the supplier (who may not receive reimbursement for the balancing costs provided given the dilution through the pool).

Like with the cost of maintaining Grade A status, MIG anticipates that opponents will argue that MIG has not established the actual cost of balancing in the marketplace. *See, e.g.,* Hearing Tr. 10747:19-10748:2, Warren Erickson (January 17, 2024); Hearing Tr. 10809:14-21, Michael

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Newell (January 17, 2024).[45] But like their opposition to Grade A, these questions were mere misdirection from the sole relevant question: should Class I processors pay into the pool a market-wide $0.60/cwt for general balancing costs when MIG has clearly established that balancing costs vary throughout the marketplace and opponents put forth no compelling evidence of a level of universal, producer-borne balancing costs? The clear answer is no. Notably, not one opposition witness at the hearing presented any empirical evidence of the current average costs of balancing are borne *universally* by producers or that they are $0.60/cwt.[46] Thus, USDA has no evidence upon which it could continue to premise a $0.60 base pool obligation from Class I and extensive evidence that it does not belong in the base Class I price at all. While balancing may have historically been more uniform, for example, not shipping milk on weekends, the industry has caught up and developed ways to deal with the both the daily, weekly, month, and seasonal variations in fluid processor demand and the every day nature of milk production.

b. The FMMO system does not balance Class I needs because of changed utilization and the market demand for manufactured dairy products.

Additionally, the FMMO system as a whole no longer performs a balancing service for Class I processors because manufacturing class products no longer are merely balancing activities but industries that run at full capacity and manage their own milk supply. "Manufactured milk, traditionally seen as more of a balancing role, is now a majority of the milk use in most regions." Hearing Ex. 451 (MIG Ex. 16 (Corrected)), at 8 (Testimony of Mark Stephenson); *see, e.g.*, Hearing Tr. 3117:6-12, Catherine de Ronde (September 11, 2023) ("It is worth noting that our

[45] Notably, no supplier testified as to what their total balancing costs are, or that they could not get that specific amount covered via the combination of the blend price and OOPs. *See also* Hearing Tr. 11204:14-17, Jed Ellis (January 19, 2024) (no supplier has ever told Shehadey it was unable to get sufficient payments from Shehadey to balance its supplies).

[46] NMPF's failure to establish that the $0.60 still exists as an industry-wide balancing cost is a shortcoming both for their opposition to MIG's Proposal 20, but also missing, necessary support for their own Proposal 19 (discussed further below).

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West Springfield facility has a long history of balancing milk in Federal Order 1. In recent years, as the Northeast has become long in milk and Class I utilization has decreased, this dynamic has shifted. Today, West Springfield often runs at full capacity."); Hearing Tr. 9366:5, Brad Parks (December 4, 2023) (describing Michigan Milk's plant in Constantine Michigan, which "used to be a butter powder plant. We have actually converted that now to a demand plant . . . . We no longer balance."); Hearing Tr. 7871:14-16, Eric Erba (October 10, 2023) (New Wilmington cheese plant is running at full capacity.). Given that manufacturing classes no longer serve to balance Class I supplies, the FMMO system cannot demand a pool-wide balancing payment from Class I processors alone.

Of course, manufacturing processors may have more flexibility in timing and supply chain and, therefore, may be able to take surplus milk at negotiated prices. But these sales are entirely independent of any compensation provided by the FMMO system, and instead driven by the free marketplace. For example, Turner Dairy will ship milk to a manufacturing plant during summer and school holidays, but it is very expensive for Turner Dairy Farms and their producers. Hearing Ex. 466 (MIG/Turner Ex. 25), at 4 (Testimony of Chuck Turner).

> We pay for it by subsidizing hauling rates for diverting milk to a cheese plant or by doing the hauling ourselves with our own tank trucks for transfers from our raw milk silos. Our producers pay for it in their hauling rates while the milk haulers cope with the risk of long wait times keeping them from getting back for the next days' work. So, we are directly outside the FMMO system paying for our balancing costs in addition to paying for balancing that portion of the Class I base differential that is supposed to compensate for balancing.

Id. Turner affirmed that, generally, it balances its supply outside of the FMMO system. "The FMMO system does not help us balance our milk supply with our bottling requirements. All of our milk comes from independent producers. Most of them are within an hour's drive to our east in Armstrong, Cambria, Indiana, and Westmoreland counties of Pennsylvania." *Id.* In other words, the FMMO system no longer serves to "entice" manufacturing facilities to exist in order to ensure balancing options for the fluid market.

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This shift can be seen as a positive development for the industry – increased demand for products like cheese and yogurt means that those processors operate at the forefront of the dairy industry, not as a balancing afterthought. But because of this change, manufacturing processors do not exist solely (or even primarily) to "balance" Class I needs. With Classes II, III, and IV making up ***roughly eighty percent*** of the marketplace in comparison to ***twenty percent of Class I milk***, USDA must conclude that the manufactured milk classes operate for their own benefit and not as balancers to Class I. Hearing Ex. 489 (IDFA Ex. 64), at 3 (Testimony of Mike Brown).

3. USDA must eliminate the incentive to serve the Class I market $0.60 portion of the Class I differential.

Finally, the presumption that Class I must pay a pool-wide "incentive" in order to attract milk for fluid use from manufacturing use no longer holds in today's marketplace. Hearing Ex. 447 (MIG Ex. 15), at 7 (Testimony of Sally Keefe). At FMMO Reform, USDA concluded that "due to the competitive nature of the manufacturing facilities in this region" Class I processors must pay an additional $0.60/cwt into the pool "to simply compete with manufacturing plants for a supply of milk." Milk in the New England and Other Marketing Areas, Proposed Rule and Opportunity to File Comments, 63 Fed. Reg. 4802, 4907-08 (Jan. 30, 1998). MIG questioned whether this reality still held, and found it does not withstand scrutiny.

MIG approached this factor by analyzing what level, if any, of monetary incentive is necessary to attract milk from manufacturing use to fluid use. MIG asked Dr. Mark Stephenson to use the U.S. Dairy Sector Simulator model to evaluate the value of the milk for fluid use relative to manufacturing use. Hearing Ex. 447 (MIG Ex. 15), at 7-8 (Testimony of Sally Keefe). Dr. Stephenson found that the national average of this simulation was *a negative number*. Hearing Ex. 453 (MIG Ex. 16B), at 20 (Testimony of Mark Stephenson); Hearing Ex. 490 (MIG Ex. 16C), at 4 (Testimony of Mark Stephenson).[47] In other words, this research demonstrated that, at a

[47] After questions from USDA, Dr. Stephenson identified an error in his original data set. He pulled the correct data, re-ran his analysis, and his conclusions remained unchanged. "The corrected data does not

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national level, fluid milk plants have no need to compel the production of more milk in order to ensure a sufficient supply of fluid milk. Therefore, the fluid incentive embedded in the Class I differential is not cost justified and should be eliminated.

Dr. Mark Stephenson, with more than 30 years of expert testimony in FMMO proceedings, testified to MIG Proposal 20.[48] Hearing Ex. 453 (MIG Ex. 16B) (Testimony of Mark Stephenson). Consistent with other IDFA and MIG testimony in this hearing, he confirmed that the dairy industry has evolved significantly from the conditions that existed in the 1940's from a system conceived to solve fluid milk problems when fluid milk sold as Class I was both the most important and dominant use of dairy farmer milk. Today, Class I is less than eighteen percent of all milk in the United States. Those 20th Century conditions are now totally different. "Manufacturing uses are now ascendant" and fluid milk used for bottling is hardly dominant. *Id*. at 23.

Dr. Stephenson spent the bulk of his MIG Proposal 20 testimony discussing the incentive to serve the Class I market element of the $1.60 base Class I differential. This incentive piece "has been identified as the cost to move milk (largely via diversion) from manufacturers to fluid plants when it is needed." *Id*. at 12. Dr. Stephenson is "not persuaded that this is still a factor" because Class I cannot be considered separately from the rest of the market. With manufacturing uses now dominant "the FMMOS are functioning as a fluid-based system in a manufacturing-dominant world." *Id*. at 23. USDA and industry under the FMMOs are trying to solve for remaining Class I issues in a Class III and IV world. Dr. Stephenson concludes that this mismatch of using old solutions in a different industry explains "many of the issues being raised at this hearing. Handler

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change my prior conclusions regarding the lack of need to a nationwide 'incentive' to attract milk for fluid use." Hearing Ex. 490 (MIG Ex. 16C), at 4 (Testimony of Mark Stephenson).

[48] Dr. Stephenson appeared repeatedly in this proceeding, testifying about Make Allowances, the USDSS model and MIG Proposal 20. Hearing Ex. 176 (Stephenson Ex. 1); Hearing Ex. 438 (Stephenson Ex. 2); Hearing Ex. 451 (MIG Ex. 16 (Corrected)); Hearing Ex. 452 (MIG Ex. 16A). USDA and industry clearly recognize the long-term expertise that Dr. Stephenson brings to these proceedings, and his testimony should carry significant weight.

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actions, such as de-pooling, are more of a symptom of the underlying problems than the problems themself." *Id*. at 23.

Moreover, pooling of Class I differentials attracts more milk to most orders than is necessary for fluid needs. *Id*. at 25. This dilutes the pool so that in reality when it comes to this incentive function Class I plants "may have to pay twice – once to the pool and the second time as a premium." *Id*. at 12. His conclusion (diverging only partially from MIG's proposal to eliminate the $1.60 entirely) is that if the $1.60 is still "necessary to ensure service to Class I plants" that it would be more effective for the Class I handlers to still be required to pay it, but pay it to the suppliers directly and not the pool. *Id*. at 13. Unfortunately, USDA declined to consider a MIG proposal which would have aligned with this concept. As such, MIG Proposal 20 is the option on the table. Dr. Stephenson's analysis thus supports MIG Proposal 20.

Dr. Stephenson further demonstrated that the USDSS model can instruct us not only as to location values for the next hundredweight of fluid milk, but also provide us "an idea of the relative value of milk used in different types of plants." *Id*. at 14-16. The model can thus tell us the relative value of milk delivered to a fluid plant versus a cheese plant located across the road. Dr. Stephenson thus used the USDSS model to generate a map reflecting the differences in the marginal value of milk in Class I minus Class III at such hypothetical next-door plants. Hearing Ex. 492 (MIG Ex. 16E) (Testimony of Mark Stephenson). In a huge swath of the United States, the model tells us that it is more valuable to the dairy industry as a whole (that is cost saving) to have milk in a cheese plant rather than a fluid plant. Hearing Ex. 453 (MIG Ex. 16B), at 20 (Testimony of Mark Stephenson). In the red colored regions in the corrected figure at Hearing Exhibit 492 (as in the original Figure 3 in Hearing Exhibit 453), "cheese plants in the [red] area [would be] unwilling to give up milk unless you compensated them for their opportunity costs **which are greater than the fluid plant's marginal cost of milk.**" *Id.* at 18. In other words, a fluid plant paying money into the producer settlement fund for the purpose of procuring milk will have to pay more than that diluted pool value to attract milk.

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Further demonstrating the disorderly nature of the current differentials, Dr. Stephenson created a box and whisker chart showing the disparate values of shadow prices between the orders. *See* Hearing Ex. 493 (MIG Ex. 16F) (Testimony of Mark Stephenson). This chart shows that in some orders (for example, in Florida), the Class I shadow price is much higher overall than the Class III shadow prices (meaning milk is more valuable for fluid use). But in other orders (for example, in Arizona), the Class III shadow price is much higher overall than the Class I shadow price (meaning milk is more valuable for Class III use). "In relatively surplus regions like the Central Order and the Upper Midwest Order, the value of milk in cheese plants is of greater value than it is in a fluid plant in those orders." Hearing Ex. 490 (MIG Ex. 16C), at 4 (Testimony of Mark Stephenson). Yet despite this relationship, Class I alone is forced to pay into the pool to incentivize milk it does not need, while Class III can either draw from the pool or opt out.

This outcome is disorderly—Class I plants cannot succeed in this situation as the FMMOs fail in the AMAA mandate to assure the supply of milk for fluid use. Those fluid plants must pay twice for the milk, and by definition according to Dr. Stephenson overpay for that milk as the value of the milk exceeds their marginal costs.

Dr. Stephenson's suggested solution would be to have the fluid plants pay the required $1.60 base Class I differential directly to the farmers or cooperatives supplying their plants. USDA cannot in 2024 ignore that the new market dynamic that milk used for manufactured dairy products is now ascendent use. USDA must factor this significant market change into the equation because milk used for manufacturing uses, just like fluid milk, has a value that varies geographically. No matter what the FMMO regulations attempt to do, Class III uses can and will out compete for a milk supply—that is unless Class I handlers are able to direct a portion of their mandated minimum regulated prices to their suppliers. Dr. Stephenson further opines that his solution may result in financially heathier pools as non-performing milk chooses not to pool resulting in a more sustainable Class I utilization in heavy manufacturing regions—leading to a "level needed to balance fluid needs." Hearing Ex. 453 (MIG Ex. 16B), at 22 (Testimony of Mark Stephenson).

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Most importantly, Dr. Stephenson concludes that the justifications for the $1.60 base Class I differential are no longer valid. If USDA is genuinely concerned about modernizing the FMMO regulatory program, adopting MIG Proposal 20 would be the best way to start.

Processors affirmed Dr. Stephenson's conclusions with real world experience and testified that they currently have no problems acquiring the milk they need. *See* Ex. 466 (MIG/Turner Ex. 25), at 5 (Testimony of Chuck Turner) ("Mark Stephenson's study on demand for milk Class III versus Class I confirms the reality we see month in and month out. It reflects the world we live in. The dairy farmers who ship to us do not do so because of any incentive created by the FMMO pool – it is a geographic issue as we are one of the best and most reliable buyers in Western PA."). For example:

> There is currently an abundance of milk available and further incentives should not be included in the Class I Differential related to attracting milk. Clearly it is not the case that there has never been a shortage, and I would never say so. But supply shortages are becoming rarer and are always addressed by over order premiums.

Hearing Ex. 454 (MIG/AE Ex. 17), at 5 (Testimony of Warren Erickson).

> [I]n my three decades of experience, there have only been a couple of times where the milk supply has been tight. In these limited instances, we were able to manage the demand with our co-op.

Hearing Ex. 462 (MIG/Shamrock Ex. 23), at 4 (Testimony of Tim Kelly).

> Q: "And is the milk supply in Pennsylvania sufficient to meet Turner's needs?"
>
> A: "Absolutely. . . . We're . . . blessed that we're – we have been able to grow our fluid milk sales most years. But I would tell you our farmers can usually grow faster than we grow. So, you know, our real problem is – you know, is more like slowing them down."

Hearing Tr. 10969:25-27, 10969:4-8, Chuck Turner (January 18, 2024).

> We can get the milk we need. We work with the suppliers, and if we have times of expansion, we have been able to work with them over time to solve our needs and then adjust as needed.

Hearing Tr. 11025: 10-15, Jay Luikart (January 18, 2024).

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> Shehadey Family Foods has had no issues finding an adequate supply of raw milk at all facilities. . . . For each of the last three years, multiple cooperatives have reached out and offered raw milk exactly at the Statistical Uniform Price due to oversupply during the spring and fall seasons."

Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 6 (Testimony of Jed Ellis).

> We have not had an issue at our [fairlife] facilities sourcing milk for Class I, nor Class II. There is an ample supply of milk in the marketplace.

Hearing Tr. 11315: 6-8, Tim Doelman (January 19, 2024).

For long-term milk sale arrangements, processors testified that *relationships* attract milk to their plants—not the FMMO pool. Hearing Tr. 10742:1-17, Warren Erickson (January 17, 2024); Hearing Tr. 10968:11-28, Chuck Turner (January 18, 2024) (affirming that relationships and partnerships drive producer choices; "when shipping to a family-owned company and to somebody whose brand is out there, they are really proud. We're actually proud of each other's successes."). Processors made clear that the FMMO system did not play a role in ensuring service of the Class I market. Hearing Ex. 484 (MIG/Crystal Ex. 19), at 7 (Testimony of Jed Ellis) ("[B]ase differentials do not move milk. In our system there are only three ways to move milk and those are: 1) over order premiums, 2) location adjustments, and 3) credits."); Hearing Ex. 466 (MIG/Turner Ex. 25), at 5-6 (Testimony of Chuck Turner) ("A general payment into the pool to be distributed amongst all producers does nothing to support Turner's relationship with our high-quality, independent suppliers – in fact, it just leaves us with less money to pay our suppliers.").

And if processors have a short-term need for milk, they attract that milk through purchasing on the spot market not a more generalized incentive through the FMMO system. Hearing Tr. 10787:10-15, Michael Newell (January 17, 2024). However, processor needs for spot loads are the exception, not the norm. Hearing Tr. 10904:25-10905:10, Tim Kelly (January 17, 2024) ("[There are] times where it could get tight [during humid weather], I will admit that. . . . [A]nd we work with our co-op and our farm to – to manage that. But it's typically a two-week period of time."). Notably, one processor testified it has not ever had to make a spot purchase for raw milk

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outside of its agreements with its suppliers. Hearing Tr. 11205:18-27 (Testimony of Jed Ellis) (January 19, 2024).

In tandem with relationships, physical proximity plays an important role, too. Shehadey has worked to ensure its largest facility purchases milk from an average of 26 miles from the facility, "and a sizeable portion from the Shehadey family farm that is 13 miles away. With location proximity, our efforts to help receive milk evenly, and paying for delivery, there is already more than enough incentive to supply raw milk to Shehadey's facilities." Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 8 (Testimony of Jed Ellis).

In fact, as described *supra* pp. 130-37, due to changes in utilization and the declines in Class I sales, the FMMO system now disincentivizes service of Class I processors. While Class I differentials used to be a tool that ensured service of the Class I marketplace (including consumers), given changes to utilization and fluid milk sales, the higher a Class I processors' pool obligation, the less money available to directly compensate the actual Class I supplier. Hearing Ex. 453 (MIG Ex. 16B), at 24-25 (Testimony of Mark Stephenson). Even NMPF witnesses testified to Class I no longer being the attractive option it used to be for suppliers. Hearing Tr. 9365:26-9366:4, Brad Parks (December 4, 2023) ("I have a concern that serving the Class I market, yes, milk is getting everywhere it needs to today, but we sit in our offices, in our meetings, and look at other opportunities that would better serve our members. And I got to tell you, serving a Class I plant is falling down the list of options very rapidly."); Hearing Tr. 6874:16-20, Peter Vitaliano (October 4, 2023) ("[O]ur members are telling us that the return they are getting from supplying Class I milk, which is expensive, is not returning enough revenue given all of the costs that they are incurring to do it.").

Other, independent data corroborates Dr. Stephenson's conclusion that Class I does not always represent the most desirable buyer for farm milk. A recent analysis done by Ever.Ag and presented by Phil Plourd at the 2023 California Creamery Operators Association meeting looked at the average blend pay price generated by FMMO's. From 1970 to 2000 (the time of FMMO

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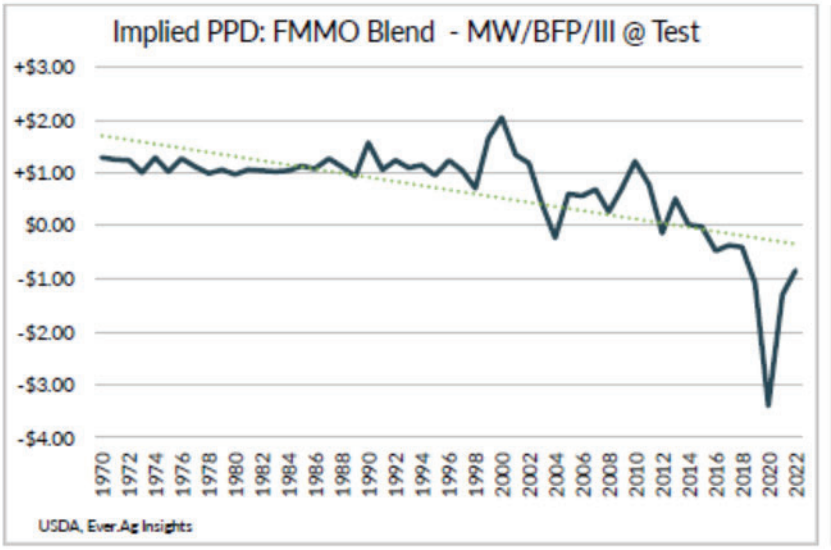
Reform), a producer shipping to Class I would still be better off by around $1.00/cwt shipping to a Class I plant than to a manufacturing plant. Hearing Tr. 11258:4-24, Jacob Schuelke (January 19, 2024). This advantage held even when the manufacturing plant could depool. But what this study found was that, over the past twenty-four years, this advantage shifted. The study found that for over the past five years, farmers in the FMMO system would be better off with a contract selling milk into a cheese plant for Class III *minus* $1.00 cwt rather than shipping to a Class I plant and receiving the FMMO blend price. Hearing Ex. 484 (MIG/Crystal Ex. 19), at 3-4 (Testimony of Jacob Schuelke). Once the blend price dropped below zero in the chart below, suppliers lost the incentive to ship to a Class I plant. Hearing Tr. 11259:10-17, Jacob Schuelke (January 19, 2024). As explained in detail above, the drivers of this result are the declining Class I sales coupled with a growing manufacturing base (as the system is no longer able to generate enough dollars to spread in the same way across the manufacturing base). *Id.* 11259:4-9. All evidence points to likely continuation of this trend. *See id.* 11260:6-13; *see also supra* pp. 150-54.

Figure 1



Hearing Ex. 484 (MIG/Crystal Ex. 19), at 4 (Testimony of Jacob Schuelke).

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But the answer here is not to force Class I processors to pay more into the pool, in fact, the answer is just the opposite—USDA needs to lessen the pool burden on Class I processors and suppliers. *Id.* "Because Class I is no longer the dominant use, being able to directly compensate your actual suppliers as opposed to having an incentive diluted through the pool is, in the view of our members, an essential change." Hearing Tr. 10508:7-11, Sally Keefe (January 16, 2024). And even if Class I sales steady or increase, the expected growth in manufacturing classes means Class I utilization is likely to remain low. *Id.* 10508:21-10509:8.

Crystal Creamery presented a pooling example to further affirm this reality. Hearing Ex. 484 (MIG/Crystal Ex. 19), at 5 (Testimony of Jacob Schuelke); Hearing Tr. 8118:27-8119:14, Robert Vandenheuvel (October 11, 2023) (notably, the CDI witness testified that he saw this analysis and did not disagree with it). As this example shows, each month the Class I supplier (at best) ties for "last place" (i.e., the producer receiving the lowest price). And if you average the Class I processor's experience in each of these two months, you can see that their pay price falls below that of the Class III or IV supplier. "The heaviest burden is placed on direct ship dairy farms and that is not what anyone originally intended in this system." Hearing Ex. 484 (MIG/Crystal Ex. 19), at 6 (Testimony of Jacob Schuelke)

Figure 2

$1.70 Differential Class I Plant Example

	Cheese Depool Month			**Powder Depool Month**			**Average**	
	Perception	Reality		Perception	Reality		Perception	Reality
Class III	$ 20.00	$ 20.00	Class III	$ 15.00	$ 15.00		$ 17.50	$ 17.50
Class IV	$ 15.00	$ 15.00	Class IV	$ 20.00	$ 20.00		$ 17.50	$ 17.50
Class I	$ 19.94	$ 19.94	Class I	$ 19.94	$ 19.94		$ 19.94	$ 19.94
	Utilization			Utilization				
Class III	45%	0%	Class III	45%	90%		45%	45%
Class IV	45%	90%	Class IV	45%	0%		45%	45%
Class I	10%	10%	Class I	10%	10%		10%	10%
Blend	$ 17.74	$ 15.49	Blend	$ 17.74	$ 15.49		$ 17.74	$ 15.49
Pay Price			Pay Price					
Class III	$ 17.74	$ 20.00	Class III	$ 17.74	$ 15.49		$ 17.74	$ 17.75
Class IV	$ 17.74	$ 15.49	Class IV	$ 17.74	$ 20.00		$ 17.74	$ 17.75
Class I	$ 17.74	$ 15.49	Class I	$ 17.74	$ 15.49		$ 17.74	$ 15.49

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Id. at 5.

Further, Crystal offered personal experience regarding the challenges Class I suppliers face and the emotional closure of Crystal's farm:

> How much more can we afford to take from organic and direct ship farmers to write an endless stream of MA checks to other industry participants? Unfortunately for Crystal Creamery we cannot offer up anymore. If it were just a few months ago I would also be able to testify here as an operator of a dairy farm in California that lasted for over 80 years and five generations of ownership but sadly that has come to an end. This is not the outcome of poor general markets or mismanagement but the outcome of a government mandated system that over the last five years has forcibly made us the lowest paid dairymen in the order. Without the ability to depool (like other classes), without the ability to reblend (like cooperatives) and without the ability to direct payments from the pool to the farm (because of FMMOs), Crystal was unable to pay prices high enough to keep our own dairy farm viable. This was an ongoing loss that could not be sustained and the difficult decision had to be made. In the last two years we have lost over half of our direct shippers to handlers that receive economic benefits from depooling.

Id.

Not only did Crystal Creamery have to close its own dairy farm, it also was unable to sell the dairy farm with the Class I contract attached.

> That milk contract was the best contract in the state… It had no caps. You could make as much milk as you want and you were guaranteed the blend price. So when we put this farm for sale on the market, what do you think happened? Every single farmer in the area knew what that contract was and they passed on the facility.

Hearing Tr. 11261: 20-11262:8, Jacob Schuelke (January 19, 2024). The farm still sits vacant, and will likely be bulldozed. *Id.*

A farmer witness reiterated a similar experience. George teVelde recounted his personal experiences with this phenomena, culminating with his deciding not to ship to a Class I plant any longer because the losses were unsustainable. Hearing Tr. 7480:6-7482:8, George teVelde (October 6, 2023). As he stated:

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> I left my Class I plant in 2020, and it had to do with the fact that under the new Federal Order, Class I plants were forever and always part of the pool. We were always getting paid the pool price. Other classes could pool and depool at will in the new Federal Order, it seemed, which left me at the Class I plant with either the pool price or a price lower than other dairymen who were shipping to a plant that had depooled. So we were either being paid the price everyone else is or something less.
>
> And to me that was not an acceptable way to market milk. I approached my creamery about this, but our Federal Order Administrator in the area assured us that there was really no way around the situation. So in early 2020, this was actually before the pandemic hit, I approached my creamery and told them that I intended to leave because of this issue.
>
> . . . .
>
> But I'm retelling this story, I was asked to tell this – my – this story of events surrounding my leaving them because of the penalty that a dairyman in the Federal Order is being subject to by being at a Class I plant, always and forever being in the pool or being paid less than other depooled dairies.

Id.

Additionally, as described in *supra* pp. 63-69, the FMMOs do nothing to incentivize the service of the organic Class I marketplace. Hearing Ex. 473 (MIG/OV|CROPP Ex. 22), at 12 (Testimony of Shawna Nelson) ("Gaining sufficient supplies of organic milk for fluid use is not predicated on some incentive element in the base Class I differential. Really our ability to procure sufficient milk supplies has nothing to do with FMMOs."). Reducing Class I members' pool obligations will also support innovation for organic producers and their processors. *See* Hearing Ex. 469 (MIG/Danone Ex. 20), at 5 (Testimony of Jay Luikart) ("Because of these differences [between organic and conventional milk], Danone must pay into an FMMO system that provides no resources back to our producer partners. Last year, these payments totaled $13 million, which reduced the amount of capital that could be directed to other more direct ways of supporting our supply chain, business infrastructure, payments to farmer partners, or investments to improve the viability of the business.").

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Heeding this call for innovation is critical to future of the fluid milk sector. MIG's members include some of the leaders in fluid milk innovation. Hearing Ex. 462 (MIG/Shamrock Ex. 23), at 4 (Testimony of Tim Kelly) ("Shamrock has been considered an innovator in the milk space and has relentlessly invested in products, facilities, and technologies to continue to expand fluid milk's relevance, drive consumption, and grow demand for milk. Future investment in innovation across the entire industry is critical in stimulating demand for Class I products."). But as Chuck Turner recounted, white milk is currently the "Great White Tundra, because it's cold, white, and nothing ever changes." Hearing Tr. 5988:5-7, Chuck Turner (September 28, 2023). The fluid milk sector must find a new way to move forward if it expects to reverse the trends of the recent years, and its success is vital to the entire dairy industry.

E. The Solution for the Failing Class I Market Is Less Regulation.

Albert Einstein is often credited with having distilled this sentiment: the definition of insanity is doing the same thing over and over again but expecting different results. The current system is not working and leaving it in place will leave Class I on its current downward trajectory. Even worse, the package of NMPF proposals would *increase* Class I prices relative to manufacturing products prices and hasten the devastating decline of fluid milk sales.

The world and the dairy industry have changed since FMMO Reform 25 years ago. No one in dairy is served by ignoring today's reality. USDA should recognize that:

- Grade A milk is industry standard and should not be considered in determining a base Class I differential;
- Balancing is now paid for both by processors directly through plant, warehouse, and inventory investments and through direct payments to suppliers; and
- For significant regions of the country, milk is more valuable to the overall system if used to manufacture cheese than as packaged fluid milk.

Given the volume of total milk in relation to fluid utilization, the $1.60 base Class I differential is not necessary on a national, market-wide basis. It is instead counterproductive and

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market distorting. It leads to fluid milk processors paying for the same services twice – once through the regulated minimum and then again directly to their cooperatives/producers. No one in dairy, producer and processor alike, benefits from an ever-shrinking Class I market. Maintaining high levels of regulation is both unnecessarily expensive and will likely lead to further erosion of Class I sales. We need a new vision and new approaches. "[I]f you can remove some restrictions, you are going to allow the opportunity for innovation." Hearing Tr. 11342:1-3 (Testimony of Tim Doelman) (January 19, 2024).

As made clear by Anderson Erickson in its testimony:

> As a very small company, our very ability to survive is at stake with these discussions. If Class I Differentials do not reflect current realities, it puts us at a competitive disadvantage with other consumer options. Certainly, the cooperatives have the ability to shift funds (primarily through reblending but there are other methods also) to avoid the direct effect of Class I Differentials. There are plenty of other options for consumers that do not have archaic pricing methodologies and are not dairy based. These would include water, all manner of other "milk" products that contain no dairy whatsoever, protein-enhanced workout drinks, and other options available. In order to be able to compete, we must alleviate the current burdens in place on companies like AE under the FMMO system.

Hearing Ex. 454 (MIG/AE Ex. 17), at 5-6 (Testimony of Warren Erickson).

And HP Hood shared these sentiments:

> Failure to relieve Class I prices (or, to raise them) will continue to put pressure on the already declining Class I market and accelerate the decline in Class I volume. Declining volume will put greater financial pressures on Class I processors and could lead to additional bankruptcies of Class I processors. This situation would favor the Co-op owned Class I plants and, to a lesser extent Producer-Handlers.

Hearing Ex. 457 (MIG/Hood Ex. 21), at 4 (Testimony of Michael Newell)

Processing milk within the FMMO system should, at best, be a benefit to processors, and, at worst, a neutral administrative requirement. If the purpose of FMMOs is merely to ensure the sharing of milk proceeds amongst producers, rather than enhance the price of milk producers must receive, then producers would be agnostic to its impacts. But that is not the case. FMMOs

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currently create a significant regulatory barrier and weigh heavily on those Class I processors who have no remedy. Hearing Ex. 466 (MIG/Turner Ex. 25), at 4 (Testimony of Chuck Turner) ("Given Turner's location, the costs of the FMMO system can put as at a particular disadvantage to those not carrying those same regulatory burdens.").

It is far past the time for the base Class I differential to be reconsidered in light of market changes, including the exploding growth of dairy beverage alternatives, the ongoing precipitous decreases in both absolute volume and per capita fluid milk consumption, and the substantial growth of non-fluid dairy products often sold in the export market. The three elements making up the base Class I differential (Grade A costs, balancing, and incentive to pull milk from manufacturing) are no longer applicable in 2024—all these factors have changed dramatically since FMMO Reform. They actually cause or contribute to disorderly marketing rather than solving it. They should be eliminated.

USDA should adopt MIG Proposal 20.

X. USDA SHOULD REJECT PROPOSAL 19

NMPF's Proposal 19 bears two fatal flaws: first, it raises Class I prices when all evidence supports the contrary; and second, NMPF took an inconsistent, unsupported, and at times, seemingly self-serving, approach to determining the proposed Class I differentials. Weeks of testimony at the hearing laid bare that NMPF had no logical or consistent organizing principles behind its Proposal 19. ***The factual and logical failings of Proposal 19 ensure a federal judge would reject any regulation based on this proposal as arbitrary and capricious.*** *United States v. Abbotts Dairies Div. of Fairmont Foods Co.*, 315 F. Supp. 517 (E.D. PA 1970); *discussed and aff'd in Abbotts Dairies Div. of Fairmont Foods, Inc. v. Butz*, 584 F.2d 12 (3rd Cir. 1978) (finding lack of substantial record evidence means USDA decision was arbitrary and capricious); *Lehigh Valley Farmers v. Block*, 829 F.2d 409, 414 (3rd Cir. 1987) (striking down USDA regulation expanding then Order 2 marketing area to include central Pennsylvania as lacking substantial record evidence); *Fairmont Foods Co. v. Hardin*, 442 F.2d 762, 769-770 (D.C. Cir. 1971) (holding

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Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

certain price differentials invalid where there was no substantial evidence of economic service to handlers). USDA must reject this proposal.

If USDA does not address and update Class I prices (for instance, as proposed in MIG Proposal 20), the fluid milk segment of the dairy industry will remain in the same cycle it is stuck in now—with Class I prices propping up FMMO market-wide pools, but excess milk dragging them down so that the ultimate prices to farmers servicing the Class I market continue to remain below desired levels. Critically, even if raising the Class I prices did not impact milk production, the impact a price increase would have on decreasing Class I volumes means that (unless farmers produce less milk than they are today in response to these price changes) the milk no longer needed by Class I would increase the volume of excess milk that will have to clear through the manufacturing classes. Hearing Tr. 10961:2-18 (Testimony of Chuck Turner) (January 18, 2024). Thus, even in a "best case scenario," excess milk will be pushed to the manufacturing classes, countering the gains to farmers through raising Class I prices. At every turn, Proposal 19 results in a bad outcome for every participant in the dairy industry—from farmers to processors to consumers.

A. Given Current Market Conditions, USDA Should Not Raise Class I Differentials.

USDA must conclude that today the supply of milk in the United States more than meets fluid needs. Milk production has never been higher while Class I utilization rates are very low. Class I sales are falling both in absolute and per capita terms. USDA must not rely on speculative or generalized assertions that milk may be in short supply as that is insufficient grounds to increase Class I differentials. *Borden v. Butz*, 544 F.2d 312, 317 (7th Cir. 1976) (holding that an increased Class I location differential was not supported by record evidence given existence of adequate supply of milk and lack of non-speculative testimony to the contrary). Any increase in the Class I differentials will lead to even more stress on the Class I segment with higher prices to consumers

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Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

leading to fewer sales. And dairy farmers will not see the purported benefits of NMPF 19. The proposal, in short, is a disaster in the making. It should be denied.

1. Class I processors do not need more milk in the marketplace to satisfy fluid plant and consumer needs, so USDA has no basis to raise Class I prices.

Given the current state of the marketplace—with decreasing demand for fluid milk coupled with increasing raw milk production at the farm level—USDA lacks the justification necessary to raise Class I prices.[49] These higher prices will incentivize more milk production, and USDA has no basis to incentivize further milk production. Hearing Ex. 488 (MIG/fairlife Ex. 26A), at 2 (Testimony of Tim Doelman) ("There is no indication that more robust government intervention is needed in order to ensure the industry meets national fluid milk demands."). Raising milk prices will only further disrupt the market's ability to find supply and demand balance. "If [FMMO minimum] milk pricing is insufficient to cover the cost to produce and move milk, the market will respond accordingly by utilizing a number of mechanisms to keep supply and demand in balance; such as adjusting over order premiums and/or implementing fuel surcharges." Hearing Ex. 458 (MIG/Hood Ex. 21), at 6 (Michael Newell Testimony).

MIG details extensively in this brief the abundance of milk on the market and that fluid needs are currently met without any price increase. *See supra* pp. 13-15. As USDA itself concluded in its recent order on the Southeastern credits: "The UMW [Upper Midwest] order has abundant milk supplies locally to meet Class I demand, with a 2022 average Class I utilization rate of 7 percent." Milk in the Appalachian, Florida, and Southeast Marketing Areas, Recommended Decision, 88 Fed. Reg. 46016, 46027 (July 18, 2023) (USDA rejected an alternative proposal for assembly credits on this basis). NMPF failed to establish otherwise; NMPF witnesses only made

[49] NMPF's Proposal 19 must also be rejected because it impacts organic processors and producers without any commensurate benefit to them. *See supra* pp. 47-72. "Proposal 19 would increase the spread between manufacturing prices and Class I prices, resulting in larger producer settlement obligations by organic handlers like Danone with no commensurate benefit." Hearing Ex. 470 (MIG/Danone Ex. 20A), at 4 (Testimony of Jay Luikart).

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vague references to the potential for a shortage of milk for fluid needs contradicted by their own testimony. For instance, Prairie Farms acknowledged that there are Class I plant closings in the Central Order; further he admitted that there is plenty of milk, much of it going to products other than fluid milk, and still they are seeking higher Class I differentials. Hearing Tr. 8296:21-8297:11, Chris Hoeger (November 27, 2023).

But (outside of the three southeastern orders, something already recently addressed by USDA) NMPF presented no specific evidence that a shortage was currently occurring that would justify raising minimum regulated prices. NMPF even admitted that the current combination of minimum prices and over order premiums are moving milk today to areas of demand, even areas with high hauling costs. *See, e.g.*, Hearing Tr. 8125:21-8126:8, Rob Vandenheuvel (October 11, 2023) (when asked how milk is able to move into Los Angeles today given the current cost structure, the CDI witness responded, "it's making it there today through a combination of the base price and over-order premiums). And cooperatives cannot argue that the rest of the country reflects the Southeastern orders, as USDA has already recently concluded otherwise: "As documented in this hearing record, the market conditions in the southeastern region are vastly different than other regions of the country;" and "The hearing record clearly demonstrates the unique supply/demand imbalance in the southeast region. Similar market conditions do not exist in the eight FMMOs outside the region. Consequently, the marketing conditions of the southeastern warrant unique provisions to ensure Class I demand is met." Milk in the Appalachian, Florida, and Southeast Marketing Areas, Recommended Decision, 88 Fed. Reg. 46016, 46027, 46031 (July 18, 2023) (USDA rejected an alternative proposal for assembly credits on this basis).

When asked "in which Federal Orders is the increased cost of moving milk threatening the reliability of milk supplies in Class I," NMPF only identified Texas. Hearing Tr. 6870:10-6871:22, Peter Vitaliano (October 4, 2023) ("[T]he availability of manufacturing plants near the areas of milk supply is growing, and the availability of milk supplies closer to the fluid milk consuming areas is declining. . . . therefore, hauling distances from where the milk is produced to where it's

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needed for Class I use are increasing."). But this testimony fails to support any claim that there is an actual insufficient supply of milk for fluid needs in Texas or elsewhere. At best it supports MIG's assertions that Class I pool dollars are so diluted as to make the FMMO system a barrier to getting milk delivered to fluid milk plants. Taken to its logical conclusion, the Texas example would mean that if milk production was so high that Class I utilization was only one percent because manufacturing uses absorbed the other ninety-nice percent, NMPF would still insist on USDA increasing the Class I differentials in Texas. Moreover, NMPF then had to admit that no one has ever called for a hearing in Order 126, nor has anyone has sought to change performance standards. *Id.* 6872:2-6873:1, Peter Vitaliano (October 4, 2023). And not one Texas Class I processor testified at the hearing as to be being left short on milk.

One NMPF witness claimed that processors he spoke with preferred having higher federal order minimum prices, despite the fact that every Class I processor who testified advocated for the opposite. *See* Hearing Tr. 8022: 9-28, Calvin Covington (October 11, 2023) (admitting that he was unsure if any of those processors would testify at the hearing and that he **had no evidence to support the contention**). USDA cannot rely on this testimony.

USDA's own data supports this conclusion that there is more than sufficient farm milk in the market to meet fluid needs. For example, Exhibits 53 to 58 show milk production grew substantially from 2000 to 2022, while at the same time Class I sales declined. In the volumes of data USDA provided for this hearing, one cannot find any evidence that farm milk volumes are unable to keep pace with fluid milk needs.

In fact, evidence shows that in certain orders, producers have sought to lower performance standards and Class I shipping obligations. Rather than pulling more milk into the pool, pooling standards and shipping percentages have only been relaxed in recent years—in other words, producers and/or processors have requested (and MA's have granted these requests) to lower the amount of milk that must physically serve Class I.

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Exhibit 39 summarizes adjustments in performance standards since 2010. Hearing Ex. 39 (USDA 39). In Order 1, performance standards have been reduced *every single year* from 2013 to present. Likewise, performance standards were reduced in Orders 30, 33, 124, and 131 in the last 13 years. As seen in Exhibit 40, which compiles the requests for these reductions, a decline in Class I utilization and sales was frequently cited as the reason a reduction was needed. *See, e.g.*:

> In their 2021 petition, Queensboro cited declining Class I sales, a decline in the number of Class I customers seeking to purchase milk for Class I usage, and a comment that they, as a long-standing participant of the Northeast dairy industry, were unaware of any instances where Class I needs have not been covered.

Hearing Ex. 40, at 6 (July 21, 2021, letter from Shawn M. Boockoff, Market Administrator, to Pool Handlers on the Northeast Order). Other USDA records show similar requests and representations:

> Class I sales are decreasing every year and the number of viable Class I dealers is decreasing as well. Producer milk is more than sufficient to meet Class I demand as Class I utilization declines almost every year.

Id. at 17.

> Class I sales declined from 2010 to 2011 by 3.0% and from 2011 to 2012 by an additional 2.7%. This decline continued in 2013 with Class 1 volumes setting new lows. In fact, in 2013 Class I volume was the lowest ever.

Id. at 18 (same).

> We believe that [macro trends supporting 2013 reduction in shipping percentages] are continuing and past year's reduction by the Market Administrator had no adverse effect on our producers. **All of our industry contacts informed us that Class I needs were met**.

Id. (emphasis added) (same).

> **In the last few years only one customer has called upon us to sell milk and we immediately complied. We also have not heard of any other instances where Class I needs have not been covered.**

Id. at 17 (same) (emphasis added).

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> Cayuga Marketing LLC, a cooperative handler in the Northeast Order, "underscored their support of the reduction by presenting data that compared relatively stable and then declining Class I utilization against producer milk available. **They state the results show that producer milk is more than sufficient to meet Class I demand given Class I utilization has fallen precipitously since 2010.**

Id. at 6, 7 (emphasis added) (July 21, 2021, letter from Shawn M. Boockoff, Market Administrator, to Pool Handlers on the Northeast Order, summarizing June 25, 2021, letter from Cayuga Marketing to Shawn M. Boockoff, Market Administrator, Northeast Marketing Order).

> Thus, the cumulative Class I demand for the September to November timeframe as a percent of producer milk available decreased by a total of 14.25%, or approximately 1.4% per annum.

Id. at 13 (June 25, 2021, letter from Cayuga Marketing to Shawn M. Boockoff, Market Administrator, Northeast Marketing Order).

> Monthly pool statistics continue to present a picture of declining Class I utilization for the Northeast Order.

Id. at 7 (July 21, 2021, letter from Shawn M. Boockoff, Market Administrator, to Pool Handlers on the Northeast Order).

> In 2020, Class I utilization for the September through November period was 24.7 percent below the same period during the first year of the Northeast Order in 2000, showing how much less Class I has been utilized in recent years compared to when the Order's shipping provisions were first adopted.

Id. at 8 (same).

> Upstate Niagara Cooperative commented "that as COVID-19 restrictions are lifted, there appears to be **a return to a pattern of a downward trend in Class I milk sales**.

Id. at 7 (emphasis added) (same).

> The request (from Cooperative Regions of Organic Producer Pools) stated "**that with Class I sales dropping, the handler has 'struggled to meet this requirement without changing routes and moving milk around.'**"

Id. at 31 (emphasis added) (July 1, 2022, letter from Lisa K. Wyatt, Market Administrator to Pool Handlers–Pacific Northwest Federal Milk Marketing Order).

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The MA offices granted these requests and reduced the performance standards. Hearing Ex. 40 at 10 (July 21, 2021 letter from Shawn M. Boockoff, Market Administrator, to Pool Handlers on the Northeast Order) ("After reviewing a variety of Northeast Order statistical data related to total pool volume, class utilization changes over time, fluid sales reports for the Order, and recent industry dynamics, together with comments submitted by parties responding to the call for comments on Queensboro's request, a reduction in the shipping percentage under Section 1001.7(c)(2) of the Northeast Order from 20 to 10 percent for the three months of September, October, and November of 2021, is approved."); *id.* at 31, 34, 38, and 45. Even NMPF's expert economist testified that she is not aware of any order where a Class I processor asked to increase performance standards to pull more milk into the FMMO system. Hearing Tr. 4982:19-22, Sara Dorland (September 20, 2023). Additionally, evidence in the record also established that surplus milk supplies have led to milk being dumped. Hearing Tr. 2612:1-9, Steve Schlangen (September 7, 2023) (when asked about whether there was milk being dumped in the Upper Midwest, answering "Yes, there was. And if there's one thing that makes a dairy farmer sick, it's going through all the work and it—the money to produce that milk, knowing there's starving people around the world, and we have to run it down the drain, because that is the most economical answer to do with that milk at the time.") (emphasis applied).; *and* Hearing Ex. 246 (FMMO 1 Request to Reduce Fall Month Shipping Percentages), at 7 ("In addition to this year [2022] as in other recent years in the Northeast, milk and skim milk will have to be dumped due to lack of plant capacity.").

Finally, the Pacific Northwest Market Administrator proactively invited comments to extend the reduction in percentages in that order, noting that "[t]he Market Administrator received comments each year requesting a review of the marketing conditions annually to determine if the conditions that existed when the reduction was granted still exist" and that "each subsequent year [since the original proposed action in 2019] a request for comments was issued and a continued revision was granted through June 30 of 2021, 2022, and 2023." *Id.* at 33 (May 17, 2023 letter

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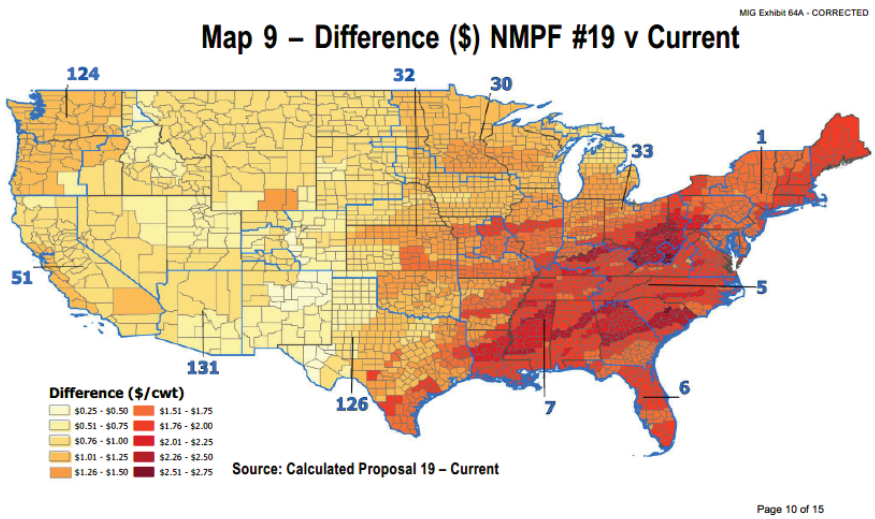
from Lisa K. Wyatt, Market Administrator, to Pool Handlers—Pacific Northwest Federal Milk Marketing Order).

USDA must conclude that this evidence of the repeated need to reduce (with no requests to ever increase) FMMO performance standards is *prima facie* evidence that there is more than an adequate supply of milk for fluid milk needs. And this evidence contradicts NMPF's speculative and vague assertions about future potential shortages.

2. Raising Class I differentials will cause disorderly marketing by decreasing Class I sales and aggravating the challenges faced by the already-struggling Class I sector.

Proposal 19 would harm Class I processors by establishing significant, damaging price increases on Class I. As Ms. Keefe testified to at the hearing, considering the data on a nationwide map shows the meaningful impact Proposal 19 will would have if adopted. Hearing Ex. 440 (MIG EX. 64), at 6 (Testimony of Sally Keefe); Hearing Ex. 441 (MIG EX. 64A), at 10 and 11 (Testimony of Sally Keefe).



On Map 9, which reflects the absolute dollar change between Proposal 19 and the current differentials: Class I differentials would increase within a large range from $0.25 – $0.35 in 19 counties in Colorado, Idaho, and New Mexico to a high of $2.55 – $2.70 in eight counties found in Georgia, Kentucky, South Carolina, and West Virginia. Proposal 19 would effectuate a change

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of 10 – 15% in 18 counties in Colorado and New Mexico to 120% (and higher) in 15 counties in Kentucky, Ohio, and West Virginia.

MIG cannot overstate the significance of the impact Proposal 19 would have on Class I processors if it were adopted. One Class I processor described it as "devastating." Hearing Tr.10982:1 – 3 (Testimony of Chuck Turner) (January 18, 2024). Shamrock's differential would increase over $2.50/cwt or $0.22 / gallon (with a 62% increase in the differential in Virginia). Hearing Tr. 10895:27 – 10896:4 (Testimony of Tim Kelly) (January 17, 2024); *see also* Hearing Tr. 10974:27 – 10975:14 (Testimony of Chuck Turner) (January 18, 2024) (describing how the differential for Turner's plant *doubles* under the NMPF proposal). For organic cooperative OV|CROPP, "Proposal 19 represents the greatest risk of all of the non-MIG industry proposals pending at this hearing. When applied to our volumes and utilization of organic milk, Proposal 19 would exacerbate OV|CROPP's already high and unpredictable pooling obligations. While the full impact is difficult to fully anticipate, we conservatively estimate that **if adopted Proposal 19 would create a 30 percent increase in our co-op's annual pooling obligations**." Hearing Exhibit 474 (MIG 22A), at 9 (Shawna Nelson) (emphasis added).

The data supports this real-world experience. Exhibit 443 lists 198 of the 3,108 counties in the 48-contintental states that have fluid plants located in them. This data includes the plants in each county, the current and Proposal 19 Class I differentials, the University of Wisconsin USDSS model estimates, and comparison calculations. For the 255 plants listed, Exhibit 443 not only shows the extremely large Class I differential increases NMPF has proposed, it also demonstrates that Proposal 19 does not equitably update Class I differentials.

By and large, NMPF proposes very large increases from the current Class I differentials at most fluid plants. The range of the increases for Proposal 19 from the current Class I differentials is also wide: $0.35 per cwt (DFA Creamland in Bernalillo County, New Mexico) to $2.50 per cwt (United in Kanawha County, West Virginia) over current levels. Summarized in Table 1 below, 80% of fluid plants are in counties where Proposal 19 would increase the Class I differential by at

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least $1.00 per cwt. And there are 139 fluid plants facing a proposed increase of $1.50 or more from NMPF's proposal.

What matters to the industry are the differentials in the counties where fluid plants are located. There are 255 fluid plants identified by MIG and listed in MIG's Exhibit 64C. They are located in 198 different counties. What MIG's evidence shows is that the impact of Proposal 19 on these 198 counties with 255 plants is significant. Table 1 below (distilled from the data in MIG EX. 64C) shows that 80% of plants would experience at least a $1.00 /cwt increase. Over 50% of plants would experience an increase of greater than $1.50/cwt. In other words, the impacts of Proposal 19 on Class I processors are immense.

And while NMPF increases the Class I differentials across the board, the increases are not consistent across the country. For example, at the low end Proposal 19 increases Bernalillo County, New Mexico (DFA Creamland) by only 15%. In contrast, NMPF 19 increases Belmont County, Ohio (United) by 120%.[50]

Table 1
Increase Proposal 19 – Current for Fluid Plants ($/cwt)

Increase Range	Counties	% Counties	Plants	% Plants
$0.35 to $0.49	1	1%	1	0%
$0.50 to $0.99	30	15%	50	20%
$1.00 to $1.49	53	27%	65	25%
$1.50 to $1.99	98	49%	120	47%
$2.00 to $2.50	16	8%	19	7%
Total	198	100%	255	100%

Source: Exhibit 443 (MIG EX. 64C Fluid Plant County Comparison CORRECTED.xlsx), Difference Proposal 19 – Current (column O).

[50] Exhibit 443 (MIG 64C Fluid Plant County Comparison CORRECTED.xlsx), % Change Proposal 19 v UoW Avg (column R).

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3. Proposal 19 will not improve farmers' financial positions in the long-term, and could actually reduce farmer pay.

Proposal 19 will not only be devastating to processors, but it will ultimately work to the disadvantage of farmers, too. Experts agreed that the price increase on Class I products caused by Proposal 19 will result in a decline in purchases of these products. While the experts disagree on the degree to which Class I consumption will decline, all agree that Class I cannot withstand Proposal 19 without losing sales volume. *See supra* pp. 19-32 for discussion of fluid milk own-price elasticity; *see also* Hearing Ex. 458 (MIG/Hood Ex. 21A), at 7 (Testimony of Michael Newell) (the increased differential will most likely result in accelerating the rate of decline in fluid milk sales we are already experiencing). Earlier in the hearing Dr. Capps testified he projects the demand impact of the 4.3% cost increase of Proposal 19 equates to a -6.6% volume loss. *See supra* p. 26. This volume loss will only accelerate the Class I volume loss in future years. Loss of Class I sales means lost income for farmers. And if Class I loses sales, farmers will either have to produce less milk or sell that milk to lower-priced classes. Hearing Tr. 10902:7 – 28 (Tim Kelly Testimony (January 17, 2024). Higher fluid milk prices could push more consumers to consider plant-based beverages as a more price competitive and fungible alternative, and there is no evidence that those customers will return to dairy once lost. This loss of valuable fluid market share hurts everyone.

Higher fluid milk retail prices will dampen innovation and development of new fluid milk products. Mr. Doelman shared a concerning experience, where the FMMO system's onerous pricing obligations meant a newly developed product originally made with 90% milk was eventually formulated with only 48% milk so that it could be Class IV. Hearing Tr. 11321:9 – 26 (Tim Doelman) (January 19, 2024). This real-world example means that the dairy industry has lost a potential innovative and market-growing product, consumers have lost out on a new source of healthy milk, and producers received a lower pay price – the FMMO system meets not one of its enumerated policy goals when these events occur.

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Raising Class I prices could also mean fewer Class I processors remain in business—resulting in even fewer homes for the increasing milk supply. For Hood, with multiple plants in regions where Proposal 19 raises Class I differentials, this could cause them to review our operations and potentially consolidate plants. Hearing Ex. 457 (MIG/Hood Ex. 21), at 11 (Michael Newell Testimony); *see also* Hearing Ex. 480 (MIG/Shehadey Ex. 24), at 6 *and* Hearing Ex. 483 (MIG/Shehadey Ex. 24B), at 4 (Testimony of Jed Ellis) (discussing Dean Foods bankruptcy); Hearing Tr. 11319: 1 – 25 (Tim Doelman) (January 19, 2024) (Proposal 19 would incentivize processors like fairlife to reconsider plant locations (like a currently-contemplated plant in Rochester, New York) only because of the impact of the regulatory price.)).

4. USDA should not update Class I differentials until the three southeastern orders have adjusted to the impacts of USDA's recent final rule.

From the first days of this hearing, the milk deficit in the three southeastern federal milk marketing orders (Appalachian (5), Florida, (6), and Southeast (7)) has been the basis for much of the discussion revolving around NMPF's proposals (1, 13, and 19) that seek to increase in various ways Class I prices. Hearing Ex. 440 (MIG EX. 64), at 15 (Testimony of Sally Keefe); Hearing Ex. 342 (NMPF 44), at 5 (Calvin Covington). But given USDA's recent consideration of that deficit, and the recently adopted changes to address it, risks duplication[51]—and thus, price-enhancement—in the three southeastern orders. Hearing Ex. 440 (MIG EX. 64), at 15 (Testimony of Sally Keefe).

With respect to transportation credits, USDA's final decision to amend the Appalachian and Southeast orders increases them. *Id.* The final decision also establishes distributing plant delivery credits to provide transportation cost assistance to handlers for the local southeastern milk supply. The transportation credits ("TC") and distributing plant delivery credits ("DPDC") effectively enhance the Class I price in the three southeastern orders as summarized below (*id.*):

[51] The transportation & delivery credit changes were effective 3/1/24. Final Rule is 89 FR 6401 (Feb. 1, 2024).

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1301 K Street NW, Ste. 500 East
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Current vs. Pending Transportation and Distributing Plant Delivery Credits			
FMMO	**Current**	**Pending**	**Increase**
Appalachian (5) TC + DPDC ($/cwt)	$0.07	$0.90	$0.83
Florida (6) TC + DPDC ($/cwt)	-	$0.85	$0.85
Southeast (7) TC + DPDC ($/cwt)	$0.30	$1.10	$0.80

Given the high Class I utilization on the three southeastern orders, any changes to the Class I price would have more of an effect on the overall pool than in other orders with lower Class I utilization. Hearing Tr. 8014: 9-23 (Calvin Covington) (October 11, 2023). While the pending final rule may not fully address the deficit in these three orders,[52] it certainly will have an impact, an impact that is not yet known. But Proposal 19 does not consider the pending transportation and delivery credit increases at all. So NMPF cannot say whether its Proposal 19 differentials will "overshoot the mark" in these orders. Any change meant to address deficits in that region must take into account these recent developments, but NMPF has made no effort to do so. Hearing Ex. 440 (MIG EX. 64), at 15 (Testimony of Sally Keefe). Given that the pending change will support service of the fluid market in the southeast and that even today the market is finding its needs met, USDA should reject any proposal to raise differentials in that region until the impacts of these changes are understood. *Id.*

B. NMPF Failed to Provide Specific or Compelling Justification for a Base of $1.60 (or $2.20) For Its Proposed Class I Differentials.

NMPF proposed changing the Class I differentials, including the base amount, so it bears the burden of establishing and supporting this base.

NMPF agreed at the start of its testimony that its model run used the current base Class I differential of $1.60. Hearing Tr. 6850:13-17, Peter Vitaliano (October 4, 2023). Then later in its

[52] MIG does not concede there is a shortage in this region. Dr. Balagtas concluded that there is an adequate supply of milk in the southeast. According to his testimony, utilization rates may not tell the whole story. Instead, he concluded that inadequate supplies of fluid milk would be linked to unreasonably high retail milk prices – and he found just the opposite. Thus, higher Class I differentials beyond what USDA has already done through the recent Southeast hearing are not justified. Hearing Ex. 435, IDFA Ex. 61 at 12-13 (Joe Balagtas).

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own process, after the final model run, NMPF concluded that the lowest differential should be $2.20, "based on several cost factors." Hearing Tr. 6851:14-21, Peter Vitaliano (October 4, 2023). Dr. Nicholson had no information on and was not consulted on how NMPF set this $2.20 base. Hearing Tr. 7040:20-7041:10, Chuck Nicholson (October 4, 2023). When asked if transportation costs were included in any way in the $2.20 base, NMPF witness Peter Vitaliano answered, "our feeling was transportation costs were properly covered in the spatial differences that were solved for… in the University of Wisconsin Model." Hearing Tr. 6852:12-24, Peter Vitaliano (October 4, 2023). When pushed further, Dr. Vitaliano deferred to Jeff Sims and Eric Erba as the best witnesses to testify on the $2.20. Hearing Tr. 6854:19-6855:7, Peter Vitaliano (October 4, 2023).

Mr. Sims at first ascribed the $2.20 to being that amount necessary to prevent inversions of manufactured and Class I prices. Hearing Tr. 7592:24-7593:4, Jeffrey Sims (October 9, 2023). But NMPF used this same justification for their Proposals 1 and 3, meaning these proposals are duplicative. Hearing Ex. 64 (NMPF Ex. 2), at 2-7 (Testimony of Calvin Covington); Hearing Tr. 7702:20-7703:2, Jeffrey Sims (October 9, 2023); Hearing Ex. 433 (IDFA Ex. 57), at 20-23 & Attachment C (Testimony of Mike Brown) (where IDFA debunks this entire concept).[53]

Mr. Sims then went on to testify that the $2.20 was also, allegedly, made up of the various factors discussed in MIG's Proposal 20: that balancing (Hearing Tr. 7601:1-7602:18, Jeff Sims (October 9, 2023)), price alignment (*id.* at 7635:11-12), and the Grade A/Grade B question (*id.* at

[53] More importantly, even assuming the inversion argument remains relevant in light of the IDFA testimony, price inversions are entirely consistent with Dr. Stephenson's testimony on MIG Proposal 20, infra, that for vast swaths of the United States today milk is more valuable used as cheese rather than fluid milk. And Dr. Stephenson concludes, as corroborated by MIG witnesses, that simply sharing that value in the pool is counterproductive. Hearing Ex. 453 (MIG Ex. 16B), at 17-21 (Testimony of Mark Stephenson). In addition, Mr. Sims based his inversion assertion on his view that depooling is a disorderly marketing condition. Hearing Tr. 7522:20-7527:27, Jeff Sims (October 9, 2023). But USDA has already concluded that FMMOs should not interfere with these types of market signals, including things like depooling or negative PPDs. See Milk in California, 82 Fed. Reg. 10634, 10669 (February 14, 2017). And to the extent USDA does aim to limit depooling, Crystal Creamery demonstrated, *supra* pp. 188-91, the futility of raising Class I prices to prevent depooling.

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7635:12-13) support the $2.20. However, he confessed that the $2.20 that NMPF discusses is not a base Class I differential at all, but rather a "minimum." *Id.* 7605:17-25.

Dr. Erba more candidly than Mr. Sims acknowledged that $2.20 in NMPF 19 was not approached the same way as the $1.60 base Class I differential "used by USDA in Federal Order reform." Hearing Tr. 7849:11-7850:1, Eric Erba (October 10, 2023). His view of the so-called $2.20 was that the NMPF for the colored-pencil crews—"Everybody started with the USDSS results at $1.60 per hundredweight added in, as we requested. . . . Most of them came back and said, we can make this work with no adjustments with the $1.60." *Id.* 7850:23-7851:1. But, as that didn't work for everyone, "price alignment doesn't work," so they came up with $2.20 for some areas. *Id.* 7851:2-9. "But that $2.20 was not applied universally, only in the areas with price alignment issues." *Id.* 7851:9-11. When pressed for more information or clarification, Dr. Erba declined to comment. *Id.* 7851:12-18.

Despite early representations regarding their approach to the Class I differentials, NMPF has not cogently or consistently changed the base amount of the differential nationwide from $1.60 to $2.20. Hearing Ex. 440 (MIG Ex. 64), at 3-4 (Testimony of Sally Keefe). Instead, NMPF utilized the $1.60 in some areas (for example, North Carolina and Michigan) and, in other areas used a base level of $2.20 (for example, Minnesota and California where milk is most abundant). *Id.*

> Q. And that minimum price, National Milk proposes to raise across the board to $2.20, correct?
>
> A. Yes.

Hearing Tr. 7289:4-8, Jeff Sims (October 5, 2023)

> Q. Is it true today, in the current system established by Federal Order reform, that there is a minimum of $1.60 that was then added on to the price surface?
>
> A. I believe that may be true.
>
> Q. Okay. Is it true that that is not the case in National Milk Producers' results?

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> A. Some of the regions used the $1.60. The $0.60 that went from $1.60 to 2.20 was added as a result of the regional work.

Id. 7291:15-24.

After Mr. Sims deferred further to the regional committees, Rob Vandenheuvel testified that:

> We don't have any proposal, we don't have any counties in Proposal 19 that are lower than $2.20, so that's what we support as the lowest. We don't call it a base differential, and it wasn't constructed as such. But we're not proposing any number that is tied to those calculations.

Hearing Tr. 8158:13-18, Rob Vandenheuvel (October 11, 2023).

Thus, not only does NMPF fail to justify the original $1.60, but it also cannot explain the new $0.60 to get to $2.20 (in some area). For DFA in Colorado, CDI in California, and Darigold in the Pacific Northwest, they ultimately relied upon the justification of price alignment to institute the $2.20, especially "alignment" with the Upper Midwest, despite these western regions having plenty of milk. Hearing Ex. 407 (NMPF Ex. 54), at 5 (Testimony of Ed Gallagher); Hearing Ex. 345 (NMPF Ex. 39), at 3 (Testimony of Rob Vandenheuvel); Hearing Ex. 397 (NMPF Ex. 47), at 2 (Testimony of Monty Schilter). And the $2.20 was repeatedly referred to as a "new minimum" alongside the $1.60 base price in other areas—so we are still left asking, "*what is the base Class I differential*?" Hearing Ex. 440 (MIG Ex. 64), at 4 (Testimony of Sally Keefe).

The base Class I differential must be made up of specific amounts—for example, USDA's prior determination that Class I processors must compensate costs for maintaining Grade A costs status so that farmers did not revert to Grade B status and that these costs were calculated to be $0.40/cwt. Reexamining this factor, NMPF has not put forth a clear statement or justification for whether or not it still considers the Grade A maintenance costs to make up $0.40 of the $1.60. Hearing Ex. 440 (MIG Ex. 64), at 4 (Testimony of Sally Keefe); *see supra,* pp. 150-195. As discussed in MIG's support of MIG Proposal 20, NMPF has not and cannot establish that there is any real risk that farmers will revert to Grade B status in such significant numbers without the

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$0.40 support that fluid milk supplies will run dry. The same shortcomings apply to the rest of NMPF's base Class I differential. Hearing Ex. 440 (MIG Ex. 64), at 4 (Testimony of Sally Keefe).

Without knowing the specific amounts that make up NMPF's proposed base Class I price, USDA cannot adopt it. NMPF never harmonized its scattered references to transportation costs to establish a specific $__/cwt cost allocation. NMPF presented no compelling evidence that such transportation costs were uniform among producers, or that they would remain stable. NMPF never established a specific $__/cwt cost of balancing, that all producer bore balancing costs, that all producers bore the same balancing costs, and why balancing costs should still be included in the base given the extensive balancing services no provided by Class I.

NMPF's sole specific testimony on these factors fails to meet the standard for setting the Class I differential. NMPF witness Calvin Covington did estimate SMI had a balancing cost of $1.33/cwt, but did not calculate that cost as part of developing Proposal 19 (only in response to hearing some questions at the hearing), nor did any NMPF witness testify that producers outside of Florida or nationwide had this same balancing cost. Hearing Tr. 8051:8-8052:4, Calvin Covington (October 11, 2023). And Dr. Erba estimated the costs of Grade A compliance were around $1.40, but never established that these costs were Class I-specific or universal in the industry. Hearing Tr. 7839:1-3, Eric Erba (Oct. 10, 2023) ("[T]he estimated ongoing cost of maintaining a Grade A license is $1.46 per hundredweight"). And finally, when presented with these costs and how they do not, in fact, add up to the proposed $2.20, NMPF had no response.

> Q: Now, if we take Dr. Erba's $1.40-ish for Grade A and Mr. Covington's testimony about the cost of balancing they incur at SMI, we're over $2.50, and we haven't even started to talk about the cost to attract milk to the market. And I don't think National Milk or its members have put on any other numbers to help us quantify what that base is. Do you have – CDI have an opinion on what those three buckets add up to?
>
> A: No.

Hearing Tr. 8159:5-15, Rob Vandenheuvel (October 11, 2023).

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In other words, NMPF's presentation lacked the basic information necessary for USDA to continue the base Class I differential at $1.60, or to increase it to $2.20. These constantly shifting sands of vague and unsubstantiated bases for raising the Class I price surface to a minimum of $2.20, especially in the milk abundant west, lack any foundation to support reasoned or rational rulemaking by USDA. USDA must reject Proposal 19.

C. NMPF's Proposal 19 Lacks Reliable Support for its County-Specific Class I Differentials.

At every turn, Proposal 19 revealed itself to be an inconsistent and unprincipled mish-mash of NMPF member opinions.

When asked if the regional committees followed any central principles for their changes to the USDSS, NMPF witness Dr. Vitaliano failed to identify one and only stated that the committee members "understood" the principles as they had "done this sort of thing before" (despite the last national Class I differential updates taking place 24 years ago):

> The central principles were basically understood, you know, by the folks – the task force members that were specifically going to work on that in their regions. And they were made based – you know, by people who had done this sort of thing before. I can't tell you exactly which – which process and procedures they used for [this], but the people involved had experience with this, and so they kind of knew what was involved.

Hearing Tr. 6858:12-21, Peter Vitaliano (October 4, 2023).

When asked if there was someone in charge of the committees, NMPF again equivocated.

> Mr. Jeff Sims was formally the chair of the Class I surface working group, but there was no, you know, master plan. There was basically – it was primarily, you know, getting – getting the folks to get the work done and putting their individual expertise in. . . . It was a rather decentralized process."

Id. 6859:4-17. Then NMPF utilized an "anchor city" process that preceded the completion of the modeling, Hearing Tr. 7278:7-11, Jeff Sims (October 5, 2023), but provided no unifying principle for the anchor cities. For example, Mr. Stout, who testified extensively about Colorado (where the anchor city of Denver is located) stated "I was never given a definition of anchor city." Hearing

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Tr. 9305:20, Steve Stout (December 1, 2023). Then the treatment of minimum prices and transportation costs varied among committees and regions (as discussed further below).

Parsing NMPF's approach betrays that it disregarded every touchstone of reliability and consistency:

1) Did NMPF follow the USDSS model estimates? NO.

2) Did NMPF mostly follow the USDSS model estimates? NO.

3) Were NMPF's deviations from the model minor, an occasional nickel, dime or quarter? NO.

4) Were NMPF's deviations equally applied to proprietary processors as to NMPF's cooperative-member owned plants? NO.

Rather than present a principled, objective, and justified map, NMPF put forth a proposal riddled with inconsistencies and apparent bias. As a matter of principle and policy, USDA should reject a proposal that lacks the objective, economic backbone necessary to fairly support all participants in this billion-dollar industry.

1. NMPF did not follow the USDSS model estimates.

Despite initially claiming that the USDSS results formed the backbone of NMPF's Proposal 19, NMPF instead utilized a series of committee and individual viewpoints to set the differentials. NMPF's failure to follow the model estimates, invoking them in certain jurisdictions and essentially ignoring them in others, has resulted in a wildly disparate level of differentials across the country. In significant areas, NMPF did not follow the model *in a single instance*. Hearing Ex. 440 (MIG Ex. 64), at 4 (Testimony of Sally Keefe).

Extensive testimony from both stewards of the model made clear that the thousands and thousands of data point from the USDSS objectively account for nearly all relevant considerations for determining minimum prices. *See* Hearing Tr. 6971:26- 6978:25, Chuck Nicholson (October 4, 2023). The USDSS accounts for the primary drivers of spatial milk value: milk production centers (farmers), milk composition, milk processing demand centers (plants), milk consumption

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demand centers (consumers/population), and transportation costs. *Id.*; *see also* Hearing Ex. 302 (NMPF Ex. 36), at 29 (Testimony of Chuck Nicholson). It even goes so far as to account for the cost of tires, minimum wage, and state-specific weight limits on roads. Hearing Ex. 438 (Stephenson Ex. 2), at 2 (Testimony of Mark Stephenson) (the model accounts for a "vehicle fleet (active and reserve trucks), fuel, oil, tire and interest rate costs per unit etc. It also accounts for overhead and maintenance for the fleet." It includes individual truck values "such as how many axles (tires), types of fuels, unloaded and loaded milage, insurance, fees, etc."). The model assembles various routes, what kinds of trucks can use those routes, distances from the trucking company to the farm, numbers of farms on a route, time and distance data, tolls and fees and employee overhead. *Id*. The USDSS samples small and large truck haulers, assemble routes from multiple small farms to single tankers, look at short and long routes from farms to plants, examine hauls of intermediate products such as cream and skim milk, and look at multiple distribution costs from plants to population centers—all resulting in non-linear functions of hauling costs per miles. *Id*. at 3. Dr. Stephenson elaborated further on the extensive data input into the model and its careful and impartial processing of that data into a spatial analysis. *See generally id.* **The model has around 250,000 constraints and millions of variables.** Hearing Tr. 6979:26-6980:8, Chuck Nicholson (October 4, 2023). It is hard to imagine anything more detailed, comprehensive and impartial. ***And yet NMPF proposes disregarding this objective, mathematically-driven solution for the personal beliefs of a few self-interested industry participants.***

Of course, the USDSS is a model, and thus a simplification of reality. Hearing Ex. 440 (MIG Ex. 64), at 4-5 (Testimony of Sally Keefe). Dr. Nicholson testified that the model does not consider factors like competitive relationships, geographic barriers (like mountains), or traffic. Hearing Tr. 7043:23-7045:8, Chuck Nicholson (October 4, 2023). It is not a perfect, omniscient system, and by its operator's own statements warrants continued updating and improving. But the USDSS is the most precise and sophisticated model for the relative spatial value of milk that is known to me or has been introduced at this hearing. USDA has used the USDSS in the past to

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develop Class I differentials. *Id.* And the respect for the expertise of its creators can be summed up by the fact that NMPF, IDFA, and MIG all separately engaged Dr. Stephenson for information created and used at this hearing. *Id.* Deviations from the model must be well-supported, minimal, and necessary—NMPF's deviations are none of these things.

NMPF first had Dr. Nicholson run the USDSS model in the spring of 2022. Hearing Tr. 6844:19-23, Peter Vitaliano (October 4, 2023). NMPF originally concluded that the model results "were a relatively good representation of what our specialists, with all of their local knowledge, understood might be . . . a reasonable current Class I differential surface." *Id.* 6846:5-15. NMPF provided some updated plant information for a second and third run, but otherwise did not provide the University of Wisconsin with any further information to add to the model.

> Q: Other than the plants that were closed or closing, or the plants that were planned or you thought would open, . . . did you, for the third iteration, provide the University of Wisconsin with any information about the art?
>
> A: No, because we understood particularly by the third run, what the model could do, which was amazing, all the detail it could do . . . . Because we had a very good idea of what the model could and what the model couldn't do, and we were planning to, and preparing for, and did, apply that institutional knowledge that the model was not able to take into account.

Id. 6848:26-6849:15. But despite having and taking opportunities to confer with the model's experts regarding plants, NMPF failed to confirm that the justifications for their proposed deviations were not already accounted for in the model (or that they were reasonable in light of what the model already calculated). NMPF then submitted a proposal that bears little resemblance to the USDSS results.

MIG's expert's extensive and considered analysis of Proposal 19 and the USDSS laid bare NMPF's disregard for the results. The USDSS model estimates can be found in Hearing Exhibits 300 and 301. MIG expert Sally Keefe created maps comparing the current differentials, the model minimum differentials, and NMPF's Proposal 19 differentials. *Compare* Hearing Ex. 441 (MIG Ex. 64A (Corrected)), at 2, 3, 4 (Testimony of Sally Keefe). Unlike the smooth gradient change

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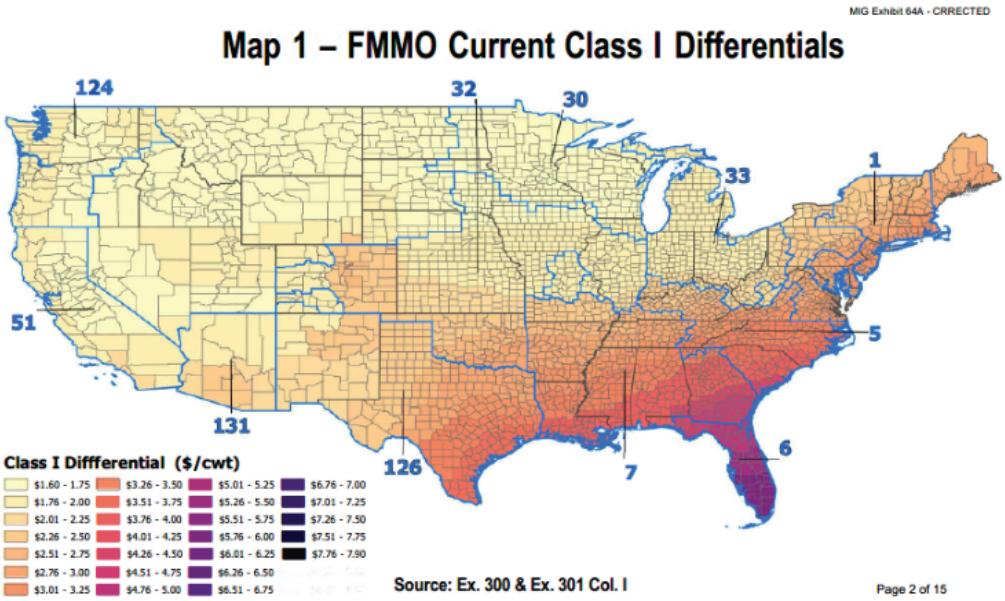
of the current and model differentials, NMPF's Proposal 19 has artificial ridges (or "cliffs") where prices change more dramatically between neighboring counties than the model estimates advise. Hearing Ex. 440 (MIG Ex. 64), at 6 (Testimony of Sally Keefe). Price disparities at borders create incentive for disorderly marketing. These areas demand careful consideration. *Id.*



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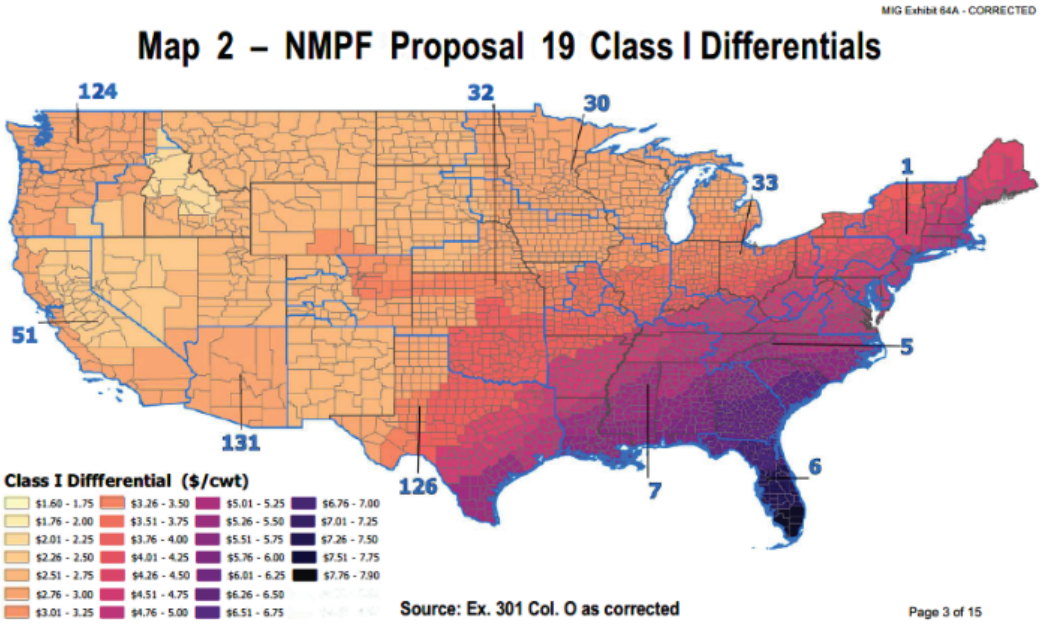

2. NMPF made significant deviations from the USDSS model.

While NMPF claims that "NMPF's final Class I recommendations *deviated somewhat* from the model results due to a variety of real-world milk movement considerations . . . ." (Hearing Ex. 299 (NMPF Ex. 35), at 6 (Testimony of Peter Vitaliano) (emphasis added)), the deviations are in fact numerous and substantial. Proposal 19 varies considerably both absolutely and relatively from the average USDSS 2021 model estimates, NMPF's purported starting point.

MIG presented comprehensive testimony that conveyed the degree of NMPF's deviations from the model. *See* Hearing Ex. 441 (MIG Ex. 64A (Corrected)), at 8 (Testimony of Sally Keefe). As shown below, NMPF's differences from the model average strangely grew as the map moved toward the milk-heavy west.

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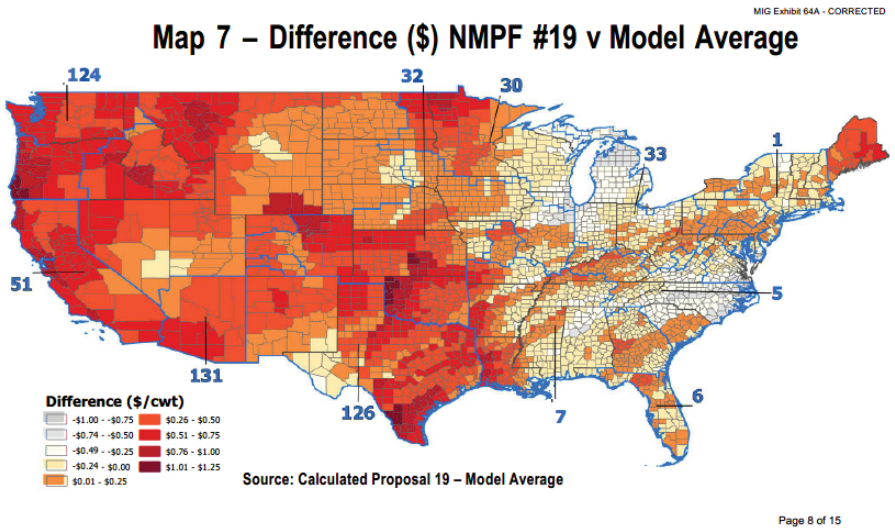

Another way to consider this testimony is by looking at the actual dollar deviations for counties with fluid plants—an exercise that again emphasizes the high degree of deviation. As shown in Hearing Exhibit 443, for counties with fluid plants, Proposal 19 ranges from $0.70 per cwt less than the model average (Pleasant View in Lake County, Indiana) to $1.05 per cwt greater than it (Kroger in Reno County, Kansas). Summarized in Table 2 below, of the 198 counties with fluid plants listed in Exhibit 443, Proposal 19 diverges from the model average by more than plus or minus $0.25 per cwt in 73 counties. There are 103 fluid plants in those 73 counties. This is just over 40% of the 255 plants listed in Exhibit 443. Dr. Stephenson's professional judgment as to adjustments that would supersede the model is that they would be in the range of "**nickels, dimes, or possibly quarters over small areas**." Hearing Tr. 10200:18-22, Mark Stephenson (December 7, 2023) (emphasis added). But NMPF adjusts **41% of plants** by an amount larger than $0.25 from the USDSS average.

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Table 2 Difference Proposal 19 – Model Average for Fluid Plants ($/cwt)				
Difference Range	**Counties**	**% Counties**	**Plants**	**% Plants**
-$0.70 to -$0.26	14	7%	17	7%
-$0.25 to -$0.01	41	21%	48	19%
$0.00	20	10%	21	8%
$0.01 to $0.25	64	32%	83	33%
$0.26 to $1.05	59	30%	86	34%
Total	198	100%	255	100%
Source: Exhibit 443 (MIG Ex. 64C (Corrected)), col. Q (Difference Proposal 19 – UoW Avg).				

MIG also presented NMPF's deviations on a relative basis (in comparison to the pure dollar deviations considered above). On a relative basis Proposal 19 also varies considerably from the model average. Very little rhyme or reason can be gleaned from Proposal 19 when considering it from this viewpoint, too. Looking at the specific outliers here, those deviations range from going 18% below the model average (Pleasant View in Lake County, Indiana) to 55% above the model average (Darigold and DFA MeadowGold in Ada County, Idaho).[54]

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[54] Hearing Ex. 443 (MIG 64C (Corrected)), col. R (% Change Proposal 19 v UoW Avg).

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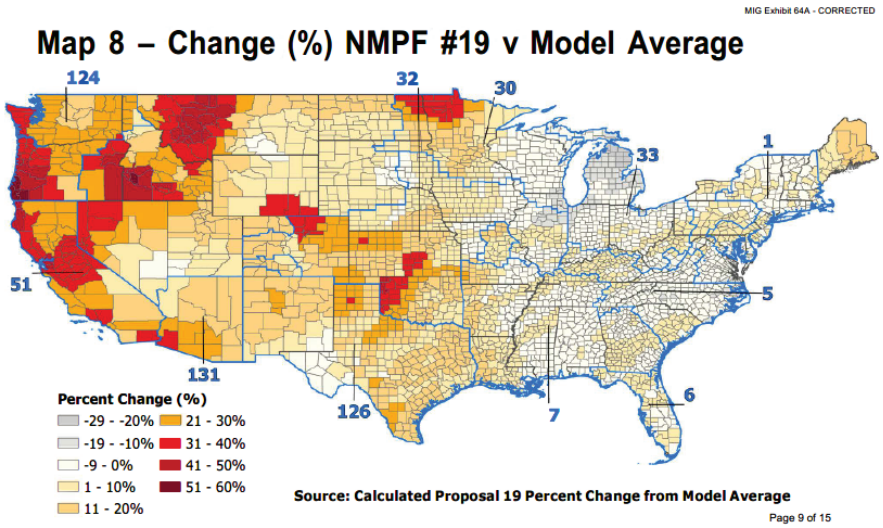

Hearing Ex. 441 (MIG Ex. 64A (Corrected)), at 9.

Looking at the numbers themselves also demonstrates that the Class I differential increases are often disconnected from what the model suggests an efficient market would do in these areas. Hearing Ex. 440 (MIG Ex. 64), at 13 (Testimony of Sally Keefe). For example, NMPF's proposed Class I differentials in the California (51) and Pacific Northwest (124) orders are more than $0.60 above the model average. *Id.*; *see also* Hearing Ex. 441 (MIG Ex. 64A), at 12 tbl.1 (Testimony of Sally Keefe). Similarly, the changes in the Central (32), Southwest (126), and Arizona (131) orders are remarkably higher than the model average on an absolute basis. But none of these areas are known or generally believed to be milk deficit. Hearing Ex. 440 (MIG Ex. 64), at 13 (Testimony of Sally Keefe).

NMPF's approach varied between the orders and lead to different degrees of deviation from the model estimates between the orders. This variation between the orders is concerning and would be arbitrary and capricious if adopted. Given that there are 3,108 counties in 11 different FMMOs, understanding the impact of the proposed increases in Class I differentials requires peeling the onion on a large data set. *Id.* at 7. Ms. Keefe summarized the data broken down by order in Hearing Exhibit 441 (MIG Ex. 64A), at 13 Table 2, which is from Hearing Exhibits 300 and 301, using box and whisker plots. These plots are found on page 15, Chart 1, of Hearing

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Exhibit 441 (MIG Ex. 64A (Corrected)). They demonstrate the substantial size of the proposed increases.

Finally, NMPF's use of a model average, instead of the model minimum, also undercuts its proposal. Dr. Nicholson testified that model minimum would be more appropriate. Hearing Ex. 302 (NMPF Ex. 36), at 29 (Testimony of Chuck Nicholson) ("There could be a danger in elevating Class I differentials to mimic the October solution values as flush season milk may be over-valued. However, it might be rational to consider an increase of existing Class I differentials to something like the USDSS May values, with a seasonal adjuster to the area previously noted."). Dr. Stephenson also testified that a minimum regulated price system would more appropriately use the model minimum rather than the model average or maximum. Hearing Tr. 10638:24-10639:18, Mark Stephenson (January 16, 2024). Setting the value at the average, instead of the minimum, will over-value milk by meaningful amounts in the spring. In comparing the model average to the spring estimates, using the average has little impact in some areas but big impact in others. Hearing Ex. 440 (MIG Ex. 64), at 8 (Testimony of Sally Keefe). There are 551 counties where fall is $0.50 to $1.00 above spring, found in the following states: AL, AR, FL, GA, IL, IN, KY, MO, NC, OH, SC, TN, VA, WV. *Id.* For example, Broward County, Collier County, and Miami-Dade County, all in Florida, have $1.00 difference in their spring and fall Class I differentials. *Id.* Using the average in these counties will over-value milk by meaningful amounts in the spring. *Id.* This difference matters because NMPF's Proposal 19 would end up enhancing prices during the spring flush. *Id.*

3. NMPF failed to justify the deviations from the USDSS.

Rather than utilize the USDSS model estimates, NMPF came up with a wholly different price surface (as demonstrated above). Critically, the USDSS takes into account the important variables that drive the spatial value of milk, and NMPF duplicates these very data points in many of its justifications for deviating from the model ("double counting" certain data points when convenient). *Id.* at 5. NMPF failed to consult with either Dr. Nicholson or Dr. Stephenson

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regarding the deviations from the USDSS. Hearing Tr. 6992:6-9, Chuck Nicholson (October 4, 2023). Had they done so, undoubtedly the majority of NMPF's justifications for the deviations would have been pointed out as already accounted for in the model. And nearly as problematic as the degree of deviation is the convoluted process NMPF went through to justify these deviations.

a. NMPF methodology lacks reliability.

First, NMPF began using "anchor cities" to establish a "baseline" across the country. Hearing Ex. 310 (NMPF Ex. 37), at 22 (Testimony of Jeff Sims). NMPF's use of "anchor cities" itself is not necessarily bad, but they do not appear to have been uniformly identified or deployed. Hearing Ex. 440 (MIG Ex. 64), at 7 (Testimony of Sally Keefe). Considering the locations NMPF selected, it is difficult (if not impossible) to tease out a unifying principle. *Id.* NMPF identified no coherent principle as to why it used anchor cities like the borough of Sharpsville (population appx. 4,300) along with metropolitan Los Angeles and the small city of Yuma, AZ (population appx. 93,000) as well as the metropolis of Chicago. *Id.* Nor is it clear why two Arizona cities were included but not one city in the Northeast or the Pacific Northwest. *Id.*

Then NMPF takes wholly different approaches for setting differentials with each of these anchor cities. NMPF *increased* western cities (Phoenix, Yuma, Los Angeles, and San Francisco) $0.60 to $0.80 from the model average, which is a 25 to 38% increase from the USDSS. In contrast, NMPF *decreased* Chicago and Asheville, NC by $0.60 and $0.30, respectively, from the USDSS average (a 16% and 5% decrease). *Id.*; Hearing Ex. 442 (MIG Ex. 64B) (Testimony of Sally Keefe). And then still other cities (Kansas City, MO and Winchester, VA) NMPF follows the USDSS average without change. Hearing Ex. 440 (MIG Ex. 64), at 7-8 (Testimony of Sally Keefe).

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NMPF Anchor City	State	Current	UofW v3 Average	Proposal #19	Difference Proposal #19 – Current	% Change Proposal #19 v Current	Difference Proposal 19 v UoW Avg	% Change Proposal 19 v UoW Avg
Phoenix	AZ	$2.35	$2.40	$3.00	$0.65	28%	$0.60	25%
Yuma	AZ	$2.10	$2.15	$2.90	$0.80	38%	$0.75	35%
Los Angeles	CA	$2.10	$2.25	$3.00	$0.90	43%	$0.75	33%
San Francisco	CA	$1.80	$2.10	$2.90	$1.10	61%	$0.80	38%
Denver	CO	$2.55	$2.50	$3.30	$0.75	29%	$0.80	32%
Chicago	IL	$1.80	$3.70	$3.10	$1.30	72%	-$0.60	-16%
Indianapolis	IN	$2.00	$3.75	$3.70	$1.70	85%	-$0.05	-1%
Dubuque	IA	$1.75	$3.15	$3.00	$1.25	71%	-$0.15	-5%
Winchester	KY	$2.60	$4.45	$4.60	$2.00	77%	$0.15	3%
Kansas City	MO	$2.00	$3.35	$3.35	$1.35	68%	$0.00	0%
St. Louis	MO	$2.00	$3.75	$3.70	$1.70	85%	-$0.05	-1%
Asheville	NC	$3.40	$5.70	$5.40	$2.00	59%	-$0.30	-5%
Norman	OK	$2.60	$3.50	$3.85	$1.25	48%	$0.35	10%
Sharpsville	PA	$2.10	$4.20	$4.00	$1.90	90%	-$0.20	-5%
Nashville	TN	$2.90	$4.85	$4.85	$1.95	67%	$0.00	0%
Amarillo	TX	$2.40	$2.25	$3.00	$0.60	25%	$0.75	33%
Winchester	VA	$2.80	$4.50	$4.50	$1.70	61%	$0.00	0%
Charleston	WV	$2.20	$4.70	$4.70	$2.50	114%	$0.00	0%

Source: Hearing Ex. 442 (MIG EX. 64B) (Testimony of Sally Keefe)

NMPF then established small regional committees to evaluate these "anchor cities" and the USDSS results and make changes as deemed appropriate.[55] The regional committees had no central principles, but instead relied upon its members who just "understood" what to do. Hearing Tr. 6858:12-21, Peter Vitaliano (October 4, 2023).

[55] Although notably, one of the lead members of the Florida regional committee said they were not even formal committees. Hearing Tr. 8024:17-22, Calvin Covington (October 11, 2023) (Q: "And what committee were you on?" A: "Well that is a good question. I wouldn't quite call them committees. We were given tasks. That's the way I would call it. . . . And the task I was given to start with was my input on Class I differentials for Florida.").

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NMPF did not invite a number of cooperatives to participate in this "art" process, including organic cooperative OV|CROPP. Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 5 (Testimony of Shawna Nelson). NMPF also did not invite Select Milk Producers or Edge Cooperative to participate. Hearing Tr. 6862:17-6863:13, Peter Vitaliano (October 4, 2023). While NMPF failed to invite any proprietary processors to participate in the regional committees that developed Proposal 19, it also appeared that it failed to invite any independent dairy farmers. *See* Hearing Tr. 10977:2-15, Chuck Turner (January 18, 2024); Hearing Tr. 6864:16-27, Peter Vitaliano (October 4, 2023) ("We [NMPF] felt we had all the expertise we needed."). MIG does not argue that every industry participant must be consulted before a proposal. But when a party, like NMPF, puts forth a proposal based primarily on individual and personalized knowledge without having sufficient or sufficiently diverse sources for such knowledge, USDA must consider the development process and who it excluded. Hearing Ex. 455 (MIG/AE Ex. 17A), at 6-7 ("The influence of ALL of our major competitors on the NMPF proposal without any input from other NMPF nonmembers is troubling in the least.").

b. NMPF made inconsistent and (at times) contradictory deviations from the USDSS.

Then, following this novel approach of anchor cities and regional committees, NMPF proceeded to employ a number of varied and at times contradictory justifications to support raising Class I prices.

NMPF again relied upon the vague concept of "alignment" to raise certain county differentials (in addition to using "alignment" as a justification for raising the base Class I differential). But even with the low Class I utilization in the Upper Midwest, NMPF still proposed increasing the Class I differential in Minneapolis by $1.30/cwt on the basis of "price alignment." Hearing Tr. 6904:16-27, Peter Vitaliano (October 4, 2023) ("The justification is basically the purpose of price alignment. We had to look – each county, particularly counties with a – with a city, or you know, milk plants in them, had to be aligned with those in other areas, and that was

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one of the overriding considerations in coming up with our proposed differentials."). In comparison to this increase in the milk-heavy Midwest, where NMPF raised the differential from the model average, in Miami-Dade County in Florida (where NMPF repeatedly stated milk supplies were tight), NMPF used the model average. Again, NMPF relied upon that vague phrase "price alignment." *Id.* 6906:24-6907:7 ("We felt that the model results for Miami-Dade were adequate for the purpose of price alignment, all of the purposes we looked at for which we commissioned the model and made adjustments to it.").

NMPF doubled down on using its price alignment concept when the witnesses for western parts of the United States proposed increasing Class I differentials in Colorado and California in significant part based upon the increases in the Upper Midwest. The witness for CDI admitted that California currently does not suffer from any disorderly marketing conditions, but that USDA should still raise Class I prices in California because NMPF was also proposing raising prices in other regions. Hearing Tr. 8133:12-27, Rob Vandenheuvel (October 11, 2023).

Another primary justification NMPF proffered was transportation costs. NMPF's own witnesses admitted that the USDSS took into transportation costs, but then it sought to rely upon increased transportation costs to raise Class I prices from the model estimates. As originally testified to by Dr. Vitaliano, the model accounted for transportation costs: "[T]he primary impact of transportation costs in the National Milk recommendation in Proposal 19 came from the model, which is based upon the road network, the fuel costs, labor costs, and the like." Hearing Tr. 6869:3-11, Peter Vitaliano (October 4, 2023); *see also generally* Hearing Ex. 438 (Stephenson Ex. 2) (Testimony of Mark Stephenson). But then NMPF went on to introduce extensive evidence on purported increases in milk hauling costs. *See, e.g.*, Hearing Ex. 309 (NMPF Ex. 49) (Testimony of Stephen Zaler). However, this evidence is wholly irrelevant to setting Class I differentials here because the USDSS already takes into account milk hauling costs, and in far greater detail than any NMPF witness. *See, e.g.*, Hearing Ex. 310 (NMPF Ex. 37), at 8-19 (Testimony of Jeff Sims). Nor did NMPF ever establish a specific national rate or hauling expense that justified the across-

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the-board increases. In fact, NMPF could not even do that at a local level. Hearing Tr. 8124:25-8125:6, Rob Vandenheuvel (October 11, 2023) (admitting there is not specific correlation between hauling costs and why NMPF recommended a specific differential). And NMPF witnesses also testified to passing along a fuel rate to their suppliers, meaning this factor is already addressed outside of the FMMO system. Hearing Tr. 8122:20-8123:8, Rob Vandenheuvel (October 11, 2023); *see also* Hearing Tr. 10786:13-16, Michael Newell (January 17, 2024) (Hood also pays fuel surcharges outside of the FMMO minimum price.).

NMPF also relied upon traffic as a reason to deviate from the model in some areas, but in other instances ignored major and well-known traffic conditions in making or not making adjustments. For instance, for the I-95 corridor in the Middle Atlantic, NMPF equalized a number of locations despite traffic congestion. Hearing Tr. 8427:12-8429:19 (Testimony of Mike John) (November 28, 2023). Yet, the notorious California Grapevine limitations were apparently not sufficient to adjust the model in Southern California where a NMPF member owns operations. Hearing Tr. 8138:19-8139:18, Rob Vandenheuvel (October 11, 2023); Hearing Tr. 8681:27-8682:5, Johnny Hiromoto (November 29, 2023). In another instance, Dr. Erba had thought that traffic would justify relative increase for Chicago, but others thought the Class I differential there should be lower, and the Chicago differential was ultimately set at $0.60 below the model average. Hearing Tr. 7867: 23-28, Eric Erba (October 10, 2023).

NMPF's also pointed to the need for "stair-stepping" the movement of milk are, but these arguments are, at base, arguments for USDA to codify in regulations business advantages for cooperatives. Moving their milk to different markets should not be something USDA should require Class I processors to subsidize. For example, AE built up a local, independent milk supply in the Iowa area. AE (and its independent, local suppliers) should not be required to ensure cooperative milk in that same area gets moved down south. Hearing Tr. 10737:26-10738:4, Warren Erickson (January 17, 2024) ("So when I built up – when AE built up an independent milk

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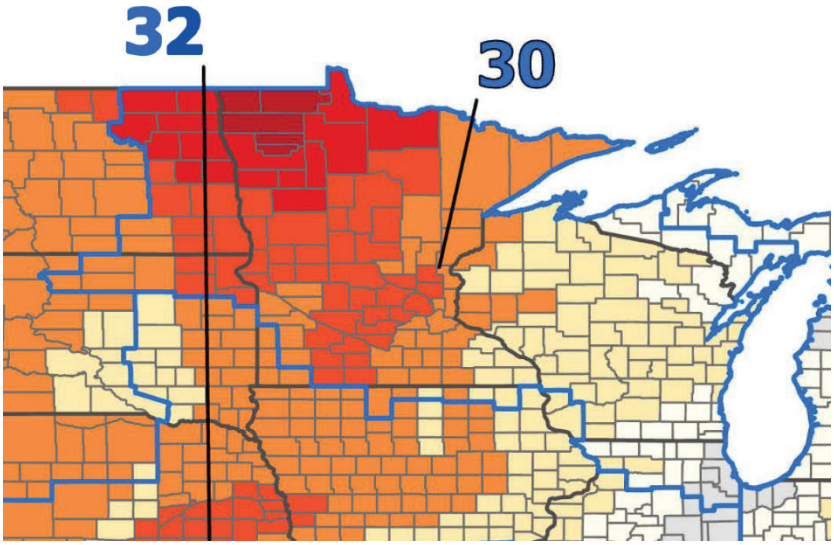
supply, we did that on our own volition, and we made our own partners, and we don't think we should be asked to pay for a cooperative business model that wouldn't service us.").

NMPF's individualized treatment of areas means it had to introduce evidence to support every deviation from the model – it failed to do so. For example, the Upper Midwest (30) only has a $0.10 deviation from the model on the average. Hearing Ex. 440 (MIG Ex. 64), at 14 (Testimony of Sally Keefe). But Minnesota has large increases from the model average. Looking at an excerpt of Map 7 from Hearing Exhibit 441, it is clear that different approaches were taken even within the same order for neighboring states, both of which have significant milksheds, as well as dairy product processing and manufacturing. *Id.* But one cannot tell from the record why NMPF treated each of these counties in such a different manner. This question could be posed to any number of county-level changes that NMPF did not specifically address at the hearing. Thus USDA lacks the necessary record to adopt NMPF's proposal.



4. NMPF's deviations appear to be self-serving for cooperatives; USDA must not codify such unfair competition in regulation.

Cooperatives are themselves significant Class I processors today, and so any proposal that creates "winners" and "losers" between processors on the justification of supporting suppliers must be given exceptional scrutiny for the veracity of the supporting evidence and the objectivity of its

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application. Cooperative-owned plants make up over 50% of the Class I manufacturing volume today and are significant Class I processors. Hearing Ex. 443 (MIG Ex. 64C (Corrected)) (Testimony of Sally Keefe) (Class I plant ownership breaks down to approximately 50% cooperative, 30% proprietary, and 20% retailer captive); Hearing Tr. 9613:7, Ed Gallagher (December 5, 2023) (DFA is the largest Class I processor in the country—and they are a supplier). This significant shift from FMMO Reform means the competitive landscape must be carefully examined anew.

Examples abound of self-interested deviations from the USDSS model estimates by Proposal 19's proponents. AE described NMPF's variations from the model, which gave a cooperative-owned competitor a $0.10 advantage in the Kansas City area. Hearing Tr. 10737:4-12, Warren Erickson (January 17, 2024) ("All of which makes a big difference for AE. When you are talking about $0.10 a hundred[weight], that can make a very big difference on the street and when you are competing with customers."). For Turner Dairy, NMPF adjusted the USDSS results to give itself a $0.30/cwt advantage to a DFA plant over Turner, equating to $0.026 per gallon. Hearing Ex. 468 (MIG/Turner Ex. 25B), at 6 (Testimony of Chuck Turner). This amount matters. *Id.* Other MIG members presented extensively regarding how their own plants were seemingly given less favorable treatment under Proposal 19 than cooperative competitors. Rather than recount all of that testimony in the brief, MIG requests USDA review and consider those comparisons within the testimony. *See, e.g.*, Hearing Exs. 447 (MIG Ex. 15), at 9-10 (Testimony of Sally Keefe); 451 (MIG Ex. 16 (Corrected)), at 17-19 (Testimony of Mark Stephenson); 455 (MIG/AE Ex. 17A), at 29-30 (Testimony of Warren Erickson); 477 (MIG/Aurora Ex. 18A), at 4-12 (Testimony of Cammie Garofolo); 485 (MIG/Crystal Ex. 19A), at 9-12 (Testimony of Jacob Schuelke); 470 (MIG/Danone Ex. 20A), at 4-7 (Testimony of Jay Luikart); 458 (MIG/Hood Ex. 21A), at 6-11 (Testimony of Michael Newell); 474 (MIG/OV|CROPP Ex. 22A), at 5-14 (Testimony of Shawna Nelson); 463 (MIG/Shamrock Ex. 23A), at 4-5 (Testimony of Timothy Kelly); 481 (MIG/Shehadey Ex. 24A), at 3-7 (Testimony of Jed Ellis); 467 (MIG/Turner Ex. 25A),

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at 5-7 (Testimony of Chuck Turner); 488 (MIG/fairlife Ex. 26A), at 2-4 (Testimony of Tim Doelman).

But by way of example, consider the below six counties in Table 3 below, all located in relatively close geographic proximity and who compete for the same milk supplies. These six counties are in southern Virginia and northern North Carolina. For the three counties with proprietary plants (Augusta VA, Caroline VA, and Lynchburg VA) Proposal 19 either follows the USDSS or makes more modest reductions to the USDSS average ($0.05 and $0.10). In contrast, for the three counties where cooperative-owned plants are located, NMPF 19 makes drastic reductions to the USDSS model estimate Class I differential. Specifically, Newport News VA, Forsyth NC, and Guilford NC, Proposal 19 are $0.55, $0.45, and $0.40 below the average, respectively. Hearing Ex. 359 (NMPF Ex. 41), at 5-7 (Testimony of Mike John). NMPF relied upon the justification that following the model results would result in "unwarranted changes in competitive relationships."

Table 3
Class I Differential Comparison
FMMO 5 North Carolina & Virginia Selected Plants ($/cwt)

Fluid Plant(s)	County, State	Current	Model Average	Proposal 19	Difference 19 – Avg.
Shamrock	Augusta, VA	$2.90	$4.70	$4.70	$0.00
Homestead	Caroline, VA	$3.10	$5.10	$5.00	-$0.10
Kroger Westover	Lynchburg, VA	$3.20	$5.05	$5.00	-$0.05
MD-VA Marva Maid	Newport News, VA	$3.20	$5.55	$5.00	-$0.55
DFA Dairy Fresh	Forsyth, NC	$3.40	$5.65	$5.20	-$0.45
DFA Dairy Fresh, Homeland, MD-VA Hunter Farms	Guilford, NC	$3.40	$5.60	$5.20	-$0.40
Source: Exhibit 443 (MIG EX. 64C (Corrected)).					

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These failures are not limited to Order 5. To demonstrate, MIG presents an example from each order to demonstrate the questionable nature of the proposed differential treatment. By no means are these the only counties with problems or the only questions USDA should ask, but rather an example of the endless issues presented by NMPF's flawed proposal and the natural hurdles any regulations based on this proposal would have to face if presented to the judiciary.

- **FMMO 1 (Northeast):** Why is NMPF artificially pricing milk so that it stays in Maine when the model concludes the milk should be flowing south?
    - Cumberland County, ME (DFA Oakhurst, Hood Portland): + $0.35 above model
    - Merrimack County, NH (Hood Concord): + $0.15 above model
    - Hampden County, MA (Hood Agawam): equals model
    - Norfolk County, MA (DFA Garelick): –$0.15 below model

- **FMMO 6 (Florida) & FMMO 131 (Arizona):** Why are Florida counties, with their need for milk, so close to model average while Arizona, with an abundant milk supply, is so much higher than the modeling?
    - Polk, FL (New Dairy, Borden; Publix): -$0.05 below model
    - Miami-Dade, FL (Mcarthur Next): $0.00 equal to model
    - Orange FL (DFA TG Lee): +$0.05 above model
    - Maricopa , AZ (Danzeisen; fairlife; Kroger; Safeway; Shamrock): +$0.65 above model
    - Yuma, AZ (GH; Sarah Farms): $0.80 above model

- **FMMO 7 (Southeast):** Why did NMPF treat the similar counties differently, including going below the model average in an area of the country allegedly low on fluid milk supplies?
    - Layfayette, LA (New Dairy, Borden): +$0.40 above model
    - Hammond, LA (PF Eastside Jersey): –$0.10 below model

- **FMMO 30 (Upper Midwest):** Why is NMPF pricing milk so differently east and west of the Mississippi River when these areas are close geographically and the USDSS already accounted for supply and demand issues?
    - Kane, IL (Oberweis): -$0.40 below model
    - Winnebago, IL (Prairie Farms): -$0.25 below model
    - Ozaukee, WI (DFA Kemps): -$0.20 below model
    - Outagamie, WI (Lamers): -$0.10 below model
    - Ramsey, MN (DFA St Paul Beverage): +$0.25 above model
    - Hennepin, MN (DFA Kemps): +$0.35 above model
    - Cass, ND (DFA Kemps): +$0.45 above model

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- **FMMO 32 (Central):** Why raise Plymouth and Polk Counties above the model when NMPF reduced Dubuque by $0.15? And why raise proprietary Class I handler AE the most?
    - Dubuque County, IA (Prairie Farms): –$0.15 below model
    - Jackson County, MO (Hiland): equals model
    - Plymouth County, IA (DFA-Dean, Le Mars): +$0.15 above model
    - Polk County, IA (Anderson-Erickson): +$0.20 above model

- **FMMO 32 (Central):** Why do these counties need such significant deviations from the model? And why the different deviations when the Hiland plant is in downtown Wichita while Kroger's plant is at the rural-suburban interface?
    - Kroger Hutchinson (Reno County, KS): +$1.05 above model
    - Hiland Wichita (Sedgwick, KS): +$0.90 above model

- **FMMO 32 (Central):** Why did NMPF raise the Colorado differential such a significant amount when there is an abundance of milk in the area, and without accounting for the impact of significant organic supplies and processing? See the testimony from the Aurora witness, below.
    - Arapahoe County, CO (DFA Meadow Gold): +$0.75 above model
    - Denver County, CO (Kroger and Safeway): +0.80 above model
    - Weld County, CO (Aurora): +$0.85 above model

> So first I'd like to talk a little bit about Colorado. I know there was a lot of testimony earlier in the hearing about Colorado. So what I want to do is, I took the analysis that Steve Stout from DFA prepared, where he was looking at the milk supply in Colorado and the milk – the consumer demand for fluid milk in Colorado and was showing how much or how little milk was going to be available in Colorado and why there needed to be an additional adjustment to the model results for the differential in Colorado.
>
> And what I want to show is that if you break down the milk supply in Colorado and the demand in Colorado, and you take into account our organic supplies and our organic consumers, which are different, that there's more than enough milk in Colorado to not only meet the organic supply but also the conventional supply when you factor out the organic, which Aurora has covered.
>
> . . . .
>
> And what you can see is that organic milk supply during this timeframe increased 164%, conventional organic supply – or conventional supply increased 60%, and the overall Colorado supply was 64%. So organic contributed significantly to the increase in milk supply in Colorado over this timeframe.

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> And then if you break down what's happening in demand, which is on the right side of the table, you will see that organic beverage demand increased 68%, whereas conventional beverage demand decreased 11%.
>
> So even though there was a large increase in both conventional supply and organic supply, and there are other demands on the conventional supply in the state, there's still a lot of milk in the state, and in particular, with the increase in organic in terms of fluid milk demand, there's plenty of milk in the state to meet both organic and conventional.
>
> . . . .
>
> Now, while on principle I don't think policy should be set around a private contract [like DFA's contractual obligation in Colorado], I wanted to show that it doesn't actually matter. If you take out the organic demand, which Aurora has supplied, there's – and you look at what DFA claims that they have left that's available for fluid – to meet fluid demand, there's still more than enough milk available in the state. So I don't think the economic conditions in the state warrant any type of increase in the Class I differential to attract more milk into the state.

Cammie Garofolo, Hearing Tr. 11134:21-1117:1 (January 18, 2024).

- **FMMO 33 (Mideast):** Why did NMPF increase differentials in counties with proprietary fluid plants the most?
    - NMPF made more adjustments below the model average in the Mideast than in any other FMMO. All eight of the fluid plants facing a proposed increase of 100% or greater versus current for Proposal 19 are in FMMO 33 and all eight are proprietary.

- **FMMO 51 (California):** Given that cow populations in California are heavily concentrated in the Central Valley and those totals have not changed in recent years (see Hearing Ex. 481 (MIG/Shehadey Ex. 24A), at 3 – 4 (map below) and Hearing Ex. 483 (Testimony of Jed Ellis), why is NMPF proposing one of the largest increases in California in the most milk-heavy county?
    - Solano County, CA (Producers Fairfield): +$0.90 above model
    - Most other counties, CA: +$0.60 above model

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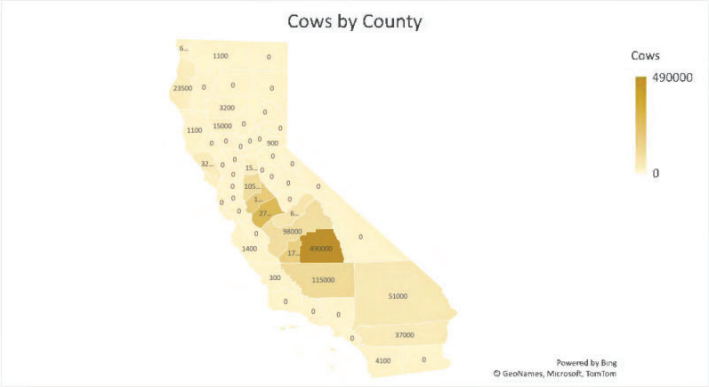

- **FMMO 124 (Pacific Northwest)**
  - NMPF appears to completely ignore the USDSS model estimates, despite Washington and Oregon having heavy contrast between population centers (Seattle, Portland) and rural areas (Yakima, central Oregon).

- **FMMO 126 (Southwest):** DFA's Creamland plant in Albuquerque, New Mexico (Beralillo County) has the lowest percent increase versus current of all the fluid plants listed in Exhibit 443—why?

As shown, NMPF's deviations often work, coincidently or not, to NMPF member plant advantages over proprietary Class I plants. With the fragile state of the Class I market, USDA should not permit this kind of result. If existing competitive relationships between Class I plants are a factor for consideration, then USDA must carefully and impartially determine those changes. For instance, both Turner Dairy and United Dairy noted the competitive disadvantages that adoption of NMPF 19 would establish to their detriment. Hearing Tr. 9940:20-26, Joe Carson (December 6, 2023) ("United Dairy's costs increase compared to every other competitor plant in our region. . . . United Dairy's three plants would receive the highest increases in the country. This proposal is unfair and blatantly gives an advantage to our competitors."); Hearing Tr. 10974:13-10976:21, Chuck Turner (January 18, 2024) (NMPF 19 provides a $0.30 swing against Turner in favor of DFA plant in Sharpsville, PA, and that is without even getting into the harm that the proposal causes Turner Dairy in competing for milk in Western PA with unregulated handlers). Nothing in the record supports these kinds of competitive harms being visited on two small family owned businesses.

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That said, MIG members do not ask USDA to ensure they have the same prices as competitors or cooperative-owned plants, only that USDA not impose different regulatory burdens on these competitors through adoption of the flawed Proposal 19. *See* Hearing Tr. 10753:1-11, Warren Erickson (January 17, 2024); Hearing Tr. 10833:2-28, Michael Newell (January 17, 2024); Hearing Tr. 10906:8-22, Tim Kelly (January 17, 2024) ("If it's an even playing field, I'm willing to compete. I'm willing to do my best. I'm willing to make substantial investments in our business, substantial investments to drive down costs, increase efficiencies. But when it's an unfair playing field, which I already experience within depooling plants, it makes it very difficult to go out and compete against like items."). In other words, MIG members' concern with maintaining competitive relationships does not mean Class I processors need to have certainty about prices offered by competitors, it means that their competitors should not have a government-sanctioned advantage through the Class I differentials and the marketplace should control in certain spaces.

USDA must rejected NMPF's highly flawed Proposal 19, both because it fails to meet the legal and factual requirements for setting billion dollar regulatory policy, but also because it only harms the dairy industry as a whole.

XI. USDA SHOULD REJECT PROPOSAL 21

In one of the notable instances of alignment among NMPF, IDFA, and MIG, all three strongly oppose the adoption of Proposal 21. This unified opposition highlights the significant defects in this Proposal to raise Class II differentials.

A. Class I and Class II are Uniquely Linked.

The adoption of any Class II-specific proposal will significantly impact fluid processors because of the ways in which Class I and Class II are linked. The link between Class I and II is largely out of a fluid processor's control—consumer preferences for skim, 1% lowfat, 2% reduced fat, and whole milk determine the relatively low butterfat utilization of Class I fluid milk. Hearing Ex. 503 (MIG Ex. 67), at 3 (Testimony of Sally Keefe). As such, Class I products inherently have excess cream that must either be processed or sold. Class I processors use the excess cream in a

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variety of ways, including both bottling Class II fluid creams and producing Class II products such as cottage cheese, sour cream, yogurt, and ice cream mix. Hearing Ex. 503 (MIG Ex. 67), at 2-3 (Testimony of Sally Keefe). Numerous Class I processors testified to making Class II products at their plants, including Turner Dairy, HP Hood, Anderson Erickson, Shamrock, OV, Aurora, Shehadey, Crystal, and fairlife. Hearing Tr. 10999:8-13 (Testimony of Chuck Turner) (January 18, 2024); Hearing Ex. 458 (MIG/Hood Ex. 21A), at 12 (Testimony of Michael Newell); Hearing Tr. 10738:7-25, Warren Erickson (January 17, 2024); Hearing Tr. 10900:12-28, Tim Kelly (January 17, 2024); Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 15-16 (Testimony of Shawna Nelson); Hearing Ex. 477 (MIG/Auora Ex. 18A) (Testimony of Cammie Garofolo), at 12; Hearing Ex. 485 (MIG/Shehadey 24A) (Testimony of Jed Ellis); Hearing Ex. 485 (MIG/Crystal 19A) (Jacob Schuelke); Hearing Ex. 488 (MIG/fairlife 26A) (Testimony of Tim Doelman).

Additionally cream, a Class II product, must be made with fluid milk given its standard of identity. Hearing Ex. 463 (MIG Ex. 23A), at 5 (Testimony of Tim Kelly) ("Many of [the Class II] products have FDA standards of identity that mandate the product be made with the fluid milk and cream."). Given that cream processors must use fluid milk, Proposal 21 constitutes a mere money grab from these FMMO-captive processors:

> Shamrock's Class II utilization occurs in our fully-regulated pool distributing plants. An increase in the Class II differential would increase our producer settlement fund pool obligations. Our Class II utilization is mostly fluid creams. Many of these products have FDA standards of identity that mandate the product be made with the fluid milk and cream. We cannot formulate our way around Class II differential increase. Increasing the Class II differential will increase retail pricing to the consumer and thus drive down the demand.

Hearing Ex. 463 (MIG/Shamrock Ex. 23A), at 5 (Testimony of Tim Kelly); *see also* Hearing Tr. 10900:12-28, Tim Kelly (January 17, 2024) (affirming that, because Shamrock follows the standards of identity for fluid creams, would not be able to reformulate its Class II cream products); *see also* Hearing Ex. 477 (MIG/Aurora Ex. 18A), at 12 (Testimony of Cammie Garofolo) ("Like many ESL operators, Aurora produces Class II fluid creams. These products are not formulated in

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Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

the same manner as cultured Class II items or ice cream mix. Any increase in the Class II differential, simply increases the producer settlement fund obligation.").

Class II products are also the "catch-all" category for dairy products without an otherwise enumerated class. Class II milk includes any use which is not explicitly Class I, III, or IV. *See* 7 C.F.R. § 1000.40(b)(2)(ix) (providing that Class II includes skim milk and butterfat used for "[a]ny product not otherwise specified in this section."); Hearing Ex. 503 (MIG Ex. 67), at 3 (Testimony of Sally Keefe). This categorization means Class II products are best poised for any beverage-based innovation (like fairlife, coffee creamers, kefir, etc.). Stifling Class II products through increased differentials will only further burden attempts to innovate dairy products and grow the industry.

Proposal 21's impacts are significant. "If Proposal 21 is advanced, we anticipate an increase of an estimated 3.5 percent in our annual pooling obligations for the Class II products we have manufactured and market for the cooperative." Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 16 (Testimony of Shawna Nelson); "Any increase in the Class II differential, simply increases the producer settlement fund obligation." Hearing Ex. 477 (MIG/Aurora Ex. 18A), at 12 (Testimony of Cammie Garofolo). "[T]hat $0.86 of additional cost is just that to us. We have no ability to avoid it, and that is why we're in opposition to Proposal 21." Hearing Tr. 10738:23-25, Warren Erickson (January 17, 2024). In the current environment (and for the many reasons argued above), the outcome is the opposite of what should happen from this hearing: Class I pool obligations should be going *down*, not up.

B. Proposal 21 Would Unfairly Disadvantage Class I Processors Making Class II Products Vis-À-Vis Stand-Alone Class II Processors.

Proposal 21 would disadvantage Class I processors that also make Class II products at their facilities in comparison to standalone Class II processor competitors. Standalone Class II manufacturers are more prevalent today than they were historically. Hearing Ex. 503 (MIG Ex. 67), at 3 (Testimony of Sally Keefe); Hearing Tr. 11364:10-13, Mike Brown (January 19, 2024)

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

("[A]s we all know, there's more and more of those large Class II standalone plants being built."). Under Proposal 21, standalone Class II processors would be able to depool when economically rational, while Class I processors with Class II manufacturing would always be subject to pooling. Hearing Ex. 503 (MIG Ex. 67), at 4 (Testimony of Sally Keefe). Adoption of Proposal 21 would not change Class I's mandatory participation in the pool for all products, including Class II (when thresholds are met). A fluid plant making Class II products that meets the threshold for regulation as pool distributing plants—typically, 25% or more Class I utilization and at least 25% of Class I sales—would be subject to pooling *at all times* for *all of its milk*, not just the Class I utilization. *Id.* at 4-5.

For a Class I bottler like HP Hood, it would be nearly impossible to de-pool so the additional costs associated with the increased differential will be absorbed into the finished good pricing. Hearing Ex. 458 (MIG/Hood Ex. 21A), at 12 (Testimony of Michael Newell); Hearing Tr. 11277:7-10, Jacob Schuelke (January 19, 2024) (Q: "Because Crystal is a Class I facility, is Crystal able to depool any of its Class II milk?" A: "No, we are not."). Doubling the differential may cause retail and foodservice demand to decrease due to additional costs, which would ultimately push more cream and solids to Class III or Class IV plants. With limited balancing plants in certain areas of the country, such as New England, Proposal 21 could result in significant disorderly market conditions. Hearing Ex. 458 (MIG/Hood Ex. 21A), at 12 (Testimony of Michael Newell).

AE makes Class II products, including yogurt, cottage cheese, sour cream, and whipping cream. AE cannot depool the milk used for these products given its Class I operations, but AE competes with specialized Class II plants in the area, plants that could depool and avoid the onerous increases under Proposal 21. Warren Erickson, Hearing Tr. 10738:7-25 (January 17, 2024). Shamrock's similar situation means Proposal 21 would disadvantage Shamrock vis-à-vis stand-alone Class II competitors, despite the companies making the same products. Hearing Tr. 10900:12-28, Tim Kelly (January 17, 2024) ("Particularly in Arizona, we do have a competitor

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

that would be a non-pooled operation in culture."). Shehadey, which makes Class II products, opposes Proposal 21 precisely because of this competitive disadvantage: "So Proposal 21 would impact those that pool. . . . For those that are non-pooled facilities, wouldn't – wouldn't bear the same increase. And so you are taking two facilities that make the exact same product, now one of them has to pay more and one of them doesn't." Hearing Tr. 11221:3-13, Jed Ellis (January 19, 2024).

CROPP Cooperative also makes Class II fluid creams at its Class I bottling facilities but would not be able to depool that milk. This reality would put the company at a disadvantage to competitors. Hearing Ex. 474 (MIG/OV|CROPP Ex. 22A), at 15-16 (Testimony of Shawna Nelson) ("By the nature of our business, with the aforementioned dairy processors, we would ultimately have no ability to de-pool milk for Class II products while other Class II market participants might deploy this strategy when classified pricing conditions are favorable for such an option. . . . Proposal 21 in our view creates an unlevel playing field among Class II manufacturers which will translate to a unlevel playing field among milk handlers and their farmer patrons.").

C. Proposal 21 Will Cause Disorderly Marketing by Incentivizing Processors to Use Solids in Place of Fresh Farm Milk.

Proposal 21 would more than double the Class II differential, and thus create incentives to utilize powder in place of fresh fluid milk. Class II milk "is not the only option for people making most Class II products." Hearing Tr. 11373:7-12, Mike Brown (January 19, 2024). As such, setting the price too high will result in movement away from fresh farm milk towards other products, like powder. *Id.* The permanent cost increases in Proposal 21 may decrease the demand for Class II skim solids by encouraging low-cost raw material optimization of non-fat dry milk powder, whey and/or buttermilk in place of the Class II skim solids. Hearing Ex. 458 (MIG/Hood Ex. 21A), at 12 (Testimony of Michael Newell). Turner is one of the owners of Titusville Dairy, which makes cottage cheese, sour creams, and ice cream mix. The ice cream mix is distributed

DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

widely, beyond the region, and so to be competitive Turner would have to weigh making its products with powder instead of farm milk. Hearing Tr. 10986:6-10987:3, Chuck Turner (January 18, 2024).

It does not serve the supplier, the processor, the consumer, or the environment for regulations to artificially incentivize the use of rewetting solids over fresh farm milk.

> Re-wetting powder when perfectly good fresh milk is available is a practice that only takes place in America and only takes place because of this pricing differential which is being debated today and enforced by the government. The practice of re-wetting powder offers low returns to the dairyman for two reasons. First the milk used is purchased from the farmer at lower Class IV prices. Second there are a number of large stand-alone Class II plants that don't have Class I utilization, meaning they can freely depool. Raising the differential will lead to more depooling which will be to the further detriment of the remaining Class I farmers forced into the pool.

Hearing Ex. 485 (MIG/Crystal Ex. 19A), at 9 (Testimony of Jacob Schuelke). A shift to more powder use will also lower blend prices over time, as there is a lower payment to the farmer when processors use Class IV products instead of fluid. Hearing Tr. 11277:19-27 (Testimony of Jacob Schuelke) (January 19, 2024) (if a manufacturer is "buying Class IV milk, drying it, and then rewetting it instead of just using it fresh out of the cow, there's a lower payment to the farmer and a lot of wasted costs, which are environmentally unsound."); Hearing Tr. 11374:5-7, Mike Brown (January 19, 2024) ("[B]ecause it's a lower value milk that replaces the Class II, we think overall it could very well lower the average blend price for a farmer.").

> [I]f you start increasing Class II, absolutely people will look more to just use Class IV, and that's a huge negative for the industry.

Hearing Tr. 11320:19-21, Tim Doelman (January 19, 2024).

> My competitors are all using class IV powders for Class II like products. It's cheaper, more convenient, and easier to manage. USDA should reject Proposal 21, a proposal that will only incentivize and reward use of powder.

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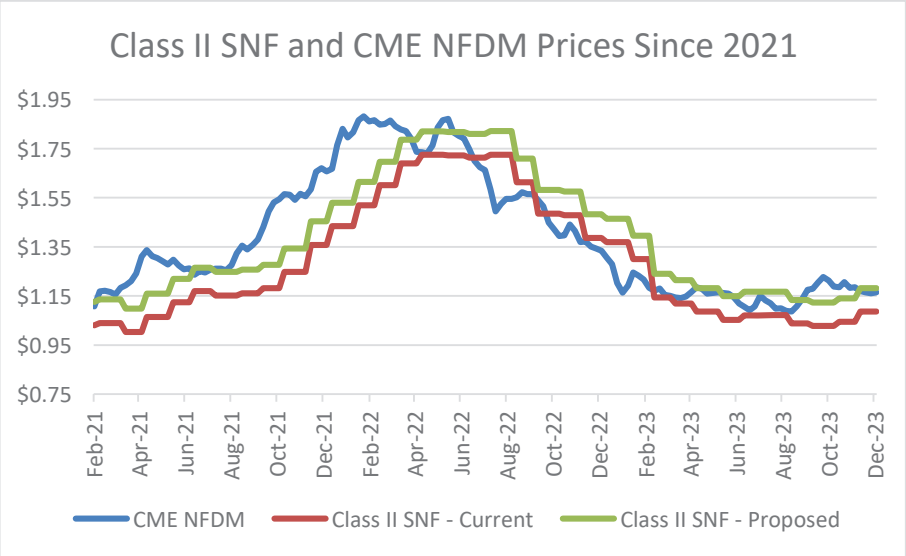
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

> I already pay a significant premium for Class II given that fairlife uses fresh milk for its products. We believe using fresh milk results in a superior products because the milk doesn't undergo the extra processing and storage. We also think it makes a more attractive product for consumers, helping drive – or at least retain – consumers in the world of dairy. Higher Class II differentials would push us towards powder use.
>
> It's not good for the dairy industry to push ourselves and other competitors to dry powders that can be purchased from around the world versus fresh milk produced here in the US. It is also not good for consumers or the environment. It is extra energy consumed, packaging wasted, and product aged and degraded. Ultimately, the higher costs will be passed onto the consumer who will look to alternative products or simply buy less milk. That is bad for everyone in the industry.

Hearing Ex. 488 (MIG/fairlife Ex. 26A), at 4-5 (Testimony of Tim Doelman).

As demonstrated by MIG, "Under the current formula the CME weekly average was lower than the current months Class II SNF price 20.5% (32 out of 156 weeks) of the time, however under the proposed formula the CME NFDM price would have been lower than the Class II price 50.6% (79 out of 156 weeks) of the time." Hearing Ex. 485 (MIG/Crystal Ex. 19A), at 11 (Testimony of Jacob Schuelke). In other words, when making Class II products today it makes sense to use powder over fluid milk only 20% of the time. But if Proposal 21 were adopted, that would increase to 50% of the time, meaning processors will have to make difficult decisions about reorienting milk procurement. Hearing Tr. 11282: 3-17, Jacob Schuelke (January 19, 2024).



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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

And as a result, the displaced skim will be pushed to a Class III or Class IV plant, incurring additional freight costs and potentially lowering over-order premiums—which would be completely at odds with AFBF's reasoning regarding Proposal 21. Hearing Ex. 458 (MIG/Hood Ex. 21A), at 12 (Testimony of Michael Newell); Hearing Tr. 10270:16-21, Tim Galloway (December 8, 2023) ("There are many fewer manufacturers of nonfat dry milk at a scale than there are ice cream mix manufacturers. So that, to me, is disorderly marketing, because you are moving dry ingredients or concentrated butterfat over tremendous distances when it can be used right from local milk in your own market.").

And while the Class II marketplace already has some volatility and depooling, Proposal 21 would increase that volatility. As the U.S. has increased powder exports, global factors have driven volatility in the Class IV market. Hearing Tr. 11279:20-11280:7 (Testimony of Jacob Schuelke) (January 19, 2024). Forcing Class II processors to reconsider use of powder versus fresh farm milk for product manufacturing will not serve orderly marketing goals.

"Lastly this is truly awful for the environment. Drying perfectly good milk only to re-wet it is a complete waste of natural gas, water, and milk because of plant loss. This is in no way in the public interest, and the government should not be encouraging it with the policies that they set forth today." Hearing Ex. 485 (MIG/Crystal Ex. 19A), at 12 (Jacob Schuelke). Proposal 21 would create a market "counter-productive to the basic purpose of the Federal Order program." Hearing Ex. 499 (NMPF Ex. 113), at 1 (Testimony of Carl Rasch). USDA should reject Proposal 21, to the benefit of producers, fluid processors, and consumers alike.

XII. CONCLUSION

If USDA wants to move the industry forward, address the problems in Class I, and ensure it does not exacerbate an already difficult situation for the fluid market, it must adopt Proposals 15 and 20 and reject Proposals 1, 2, 13, 16, 17, 18, 19, and 21. Three concluding quotes from MIG members and from Mike Sumners (dairy farmer) best summarize the problems facing industry and USDA and point the way to improving the dire situation for Class I, dairy farmers and consumers,

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Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

Aurora spoke to the need to revitalize the system so as to support and encourage Class I growth that can benefit farmers, processors and give consumers what they want:

> Class I volume has declined 18% over the last ten years alone. I'm not talking about per capita, I'm talking about absolute volume. There is less class [I] milk out there being sold. There's less – and if we continue to reduce the Class I volume… there's going to be less money for farmers. There just is…
>
> I think the way to win is we've got to encourage innovation, and we've got to look and see what consumers want, and we've got to create a system that supports and encourages us to create products that consumers want so we can grow the industry and support the farmer.
>
> Consumers have a lot of choices, and we want them to choose us, not non-dairy, not plant-based beverages, not any of the other stuff. We want them to choose milk. And if we continue to raise prices, then they are not going to choose milk, they are going to choose something else, because we're going to lose in that game.

Hearing Tr. 11142:8 – 11143:26 (Testimony of Cammie Garofolo) (January 18, 2024).

Turner Dairy supports innovation by removing regulatory hurdles so that product differentiation rather than a race to the bottom on costs and pricing can lift industry up:

> Michael Porter, of the Harvard Business School, is famous for his work on business strategy. Porter says that there are really only two strategies for businesses to be successful in the broader market: a low cost or low price strategy and a differentiation strategy. In the first case, a low cost strategy, an organization gets its product to market at a lower cost than its competitors is able to and is, therefore, able to sell profitably at a low price. With a differentiation strategy, on the other hand, the organization needs to add value in the form of features and benefits to its product so that it is able to sell profitably at a higher price.
>
> Over the past several decades, industry and regulatory roadblocks have made it very difficult to succeed with a differentiation strategy for fluid milk. . . .
>
> . . . .
>
> . . . We cannot stand the idea that someone would market milk that's better, in any way, than the milk the rest of us market. The key to all of the above, of course, is the Federal Milk Marketing Order system where all dairy farmers in an order area get the same exact price for their milk regardless of what it is used for or how it is marketed.

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1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

> At Turner Dairy Farms we attempt to be profitable by executing a differentiation strategy and I can tell you that it's not easy. We bear the costs of participation in the FMMO system which not only isn't helpful to our efforts but rather is an obstacle. We pay into the pool for Class I but still pay quality premiums directly to our producers to get the caliber and milk quality we are looking for. We pay into the pool but still have to use our own tank trucks to haul surplus milk from our silos or subsidize milk haulers to divert surplus milk.
>
> Going back to Porter, if we give up on differentiation strategies, we are left with only a low price strategy. And the only way to win the low price strategy in this industry is to grow – and grow big. The dairy industry needs to find a way to support small farmers and small processors, but we are setting them up for failure with today's FMMO system. Are we willing to try something different?
>
> There are about 330 million people in this country. Every one of us thinks that we are special and should eat and drink food and beverages that are special. We need to make milk special if we are going to reverse the continuing decline in fluid milk sales. To do that we need to remove the regulatory obstacles currently in place that act as a bulwark against innovation. It probably won't happen during my career at Turner Dairy but I have hope that milk sales will start to grow again for the next generation of my family.

Hearing Ex. 271 (MIG 12), at 5-7 (Testimony of Chuck Turner).

fairlife spoke to the need to create opportunities rather than misalignment of priorities due to regulation:

> Proposals 19 and 21 artificially disrupt plant locations by creating geographic winners and losers. The marketplace, not regulations, should be what dictates the location of plants. Trying to filter marketplace signals through a static government program creates significant opportunity misalignment with reality.

Hearing Ex. 488 (MIG/fairlife Ex. 26A), at 4 (Testimony of Tim Doelman).

And finally, Trihope Dairy noted the necessity of USDA to do what is best for the industry:

> I am concerned that Federal Orders have long since gotten to the point where they end up creating winners and losers rather than dealing with the real issues. For that reason, it has been very hard to listen to much of this proceeding. Instead of letting markets and economics work, everyone seems to have a plan for how to make the system work for their benefit. I don't envy USDA who has a job to do – but USDA should not pick sides and instead needs to do what is best for the industry.

Hearing Ex. 431 (Trihope Dairy Ex. 1), at 2 (Testimony of Mike Sumners).

DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

MIG expresses its thanks and appreciation to USDA and all hearing participants for the opportunity to present these important issues for consideration. MIG requests USDA adopt Proposals 15 and 20 and move FMMOs forward to the benefit of all participants in the dairy industry.

DATED this 1st day of April, 2024.

DAVIS WRIGHT TREMAINE LLP

By */s/ Chip English*
Chip M. English, D.C. Bar No. 386572
chipenglish@dwt.com
Telephone: 202-973-4200

/s/ Ashley Vulin
Ashley L. Vulin, Oregon Bar No. 145454
ashleyvulin@dwt.com
Telephone: 503-778-5493

Attorneys for Fluid Milk Innovation Group

DAVIS WRIGHT TREMAINE LLP
1301 K Street NW, Ste. 500 East
Washington, D.C. 20005
(202) 973-4200 main · (202) 973-4499 fax

ATTACHMENT 1

UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

In re: Milk in the Northeast and Other Marketing Areas	AO Docket No. 23-J-0067; AMS-DA-23-0031

Ruling ACCEPTING as ARGUMENT the 2024 Feb 23 and Mar 8 Filings

This Ruling concerns the Hearing on proposed amendments to pricing formulas in all 11 Federal Milk Marketing Orders ("FMMOs"), filed as Docket No. 23-J-0067; AMS-DA-23-0031, In re: Milk in the Northeast and Other Marketing Areas.

The emergency relief requested in the February 23, 2024 filing by the American Farm Bureau Federation and National Farmers Union will be addressed NOT by the Administrative Law Judges but by Secretary Vilsack.

Administrative Law Judges remain responsible for rulings and orders until certification of the transcript is issued, which will be soon after March 22, 2024. Administrative Law Judges stopped taking evidence when the Hearing ENDED, on January 30, 2024.

The Response filed by the Milk Innovation Group and International Dairy Foods Association on March 8, 2024 asks that the Request for Emergency Return to "Higher-of" Class I Mover" filed on February 23, 2024 be rejected. Among other objections, the Response calls attention to a sentence in the Request, in the next-to-the last paragraph, that may rely on information not in evidence when the Hearing ended.

We find value in the arguments presented in

the REQUEST of the American Farm Bureau Federation and National Farmers Union filed with the USDA Hearing Clerk on February 23, 2024 (copy attached); and

the RESPONSE of the Milk Innovation Group and the International Dairy Foods Association filed with the USDA Hearing Clerk on March 8, 2024 (copy attached).

Accordingly, we ACCEPT as ARGUMENT (NOT evidence) these 2024 February 23 and March 8 filings.

We suggest that the parties include these filings in their filings that are due by April 1, 2024.

We request that the USDA Agricultural Marketing Service post this Ruling with attachments on

the USDA / AMS webpage at

https://www.ams.usda.gov/rules-regulations/moa/dairy/hearings/national-fmmo-pricing-hearing

The most efficient way to file with the Hearing Clerk is to attach a document to an email and send to SM.OHA.HearingClerks@usda.gov, or to FAX the document to 1-844-325-6940 if you prefer. The Hearing Clerk's information can also be found on the USDA / AMS webpage and on the last page of this order.

To meet the deadlines for filing with the Hearing Clerk, filings must be RECEIVED by the Hearing Clerk by 4:30 pm Eastern on the due date.

Copies of this "Ruling ACCEPTING as ARGUMENT the 2024 Feb 23 and Mar 8 Filings" shall be sent by the Hearing Clerk to each of the parties.

Issued at Washington, D.C.,
this 11th day of March 2024

CHANNING STROTHER
Digitally signed by CHANNING STROTHER
Date: 2024.03.11 16:19:25 -04'00'

Channing D. Strother
Chief Administrative Law Judge

Digitally signed by Jill S Clifton
Date: 2024.03.11 14:08:06 -04'00'

Jill S. Clifton
Administrative Law Judge

Attached:

the REQUEST of the American Farm Bureau Federation and National Farmers Union filed with the USDA Hearing Clerk on February 23, 2024; and

the RESPONSE of the Milk Innovation Group and the International Dairy Foods Association filed with the USDA Hearing Clerk on March 8, 2024.

Hearing Clerk
United States Department of Agriculture
Stop 9203, South Building, Room 1031-S
1400 Independence Ave SW
Washington, DC 20250-9203
Phone: 1-202-720-4443
Fax: 1-844-325-6940
sm.oha.HearingClerks@usda.gov

ATTACHMENT 1

February 22, 2024

The Honorable Thomas J. Vilsack
Secretary, U.S. Department of Agriculture
200A Whitten Building
1400 Independence Avenue, S.W.
Washington, D.C. 20250

Docket: 23-J-0067

RE: Request for Emergency Return to "Higher-of" Class I Mover

Dear Secretary Vilsack,

On behalf of our members across the country, we thank you for the U.S. Department of Agriculture's continuing effort to provide price stability and transparency to dairy farmers. U.S. dairy farm families face many challenges as they make their critical contribution to the well-being of our nation.

One of those challenges is the ongoing milk price spreads that have substantially lowered farmer milk prices under the current "average of" Class I mover formula. The American Farm Bureau Federation and National Farmers Union request that you address this challenge by issuing an interim final decision in the current federal milk marketing order hearing process that returns the Class I mover formula to the "higher-of" the Class III or IV calculations, as it was before the 2018 farm bill.

The 2018 farm bill included a provision that swapped the higher-of the advanced Class III or IV skim milk price formula for the simple average-of advanced Class III and IV skim milk formulas plus 74 cents. This was intended to produce a roughly equal long-term Class I milk price. This statutory change was made at the request of dairy processors and dairy cooperatives and was intended as a revenue-neutral way to improve risk management opportunities for beverage milk.

The current formula was based on a quick legislative decision and not based on a hearing record of demonstrated need; it has also not turned out to be revenue neutral for dairy farmers. A return to the "higher-of" is supported by the record in the current hearing, as well as by the rulemaking at the time it was first established in 2000.

Disruptive market conditions during the recent pandemic exposed and exacerbated a temporary but serious shortage of block cheddar cheese production. This led to very high Class III values, a huge imbalance between Class III and Class IV prices, and over $700 million in Class I revenue losses to producers in the 11 federal order pools in 2020 alone resulting from the "average-of plus" Class I mover. This, along with the delay associated with advanced pricing, resulted in manufacturing milk prices higher than the market blends, leading to massive de-pooling of producer milk by manufacturing plants to capture those higher market prices. These large negative producer price differentials created significant disparities among the milk checks of different groups of farmers. These losses in pool value have continued through 2023 and into

2024, as Class IV prices have become the driver of the dairy market and the gap between Class III and Class IV prices has flipped, but remained large, with no end in sight. As of December 2023, cumulative pool losses have surpassed $1 billion since the formula went into effect in May 2019, including pool losses of $50 million in November 2023 and $38 million in December of 2023. Dairy farmers with pooled milk face ongoing threats of decreased milk checks linked to the current Class I mover formula.

The members of both our organizations, through our respective grassroots policy development processes, have unanimously expressed the high priority they put on a speedy return to the "higher-of" Class I mover.

AFBF policy states: "*(G)iven the circumstances of the Class I mover changes in the 2018 farm bill, we support returning to the Class I milk mover formula to the higher-of Class III or IV in the most expedient manner possible.*"

A special order of business adopted by the delegates at the 2023 National Farmers Union Convention supports the immediate return to a Class I pricing formula based on the higher-of Class III or Class VI.

In a forum held in Kansas City in October 2022 to address federal milk marketing order issues, the recommendation with greatest support from the 300-dairy farmer-majority participants was for a return to the "higher-of" Class I formula.

The FMMO hearing process has completed only step 5 of a 12-step process before changes would potentially go into effect for our dairy farmers. With about $55 million in Class I losses related to the current Class I formula in January 2024 alone, each additional month without a change poses a threat to dairy farmers' livelihoods. An interim final decision could speed implementation of this change by six months or more.

We understand that USDA is undertaking a comprehensive process of amending federal orders; however, dairy farmers remain stuck with current pricing regulations until USDA publishes a final rule. Current market dynamics underscore the need for expedited return to the "higher-of" Class I mover. The current Class I mover was a well-intentioned but misguided policy that has reduced dairy farmer income. Emergency implementation of the "higher-of" Class I mover formula will staunch persistent losses associated with a policy that has left dairy farmers struggling to make ends meet.

Sincerely,

Zippy Duvall
President, American Farm Bureau Federation

Rob Larew
President, National Farmers Union

Davis Wright Tremaine LLP

ATTACHMENT 2

Charles M. English, Jr.
202.973.4272 tel
202.973.4499 fax
chipenglish@dwt.com

Ashley L. Vulin
503-778-5493 tel
503-276-5793 fax
ashleyvulin@dwt.com

Docket: 23-J-0067

March 7, 2024

Via Email and US Mail
SM.OHA.HearingClerks@usda.gov
FMMOHearing@usda.gov

The Honorable Jill S. Clifton
Administrative Law Judge
The Honorable Thomas J. Vilsack
Secretary, U.S. Department of Agriculture
200A Whitten Building
1400 Independence Avenue, SW
Washington, D.C. 20250-0225

Re: Procedural Objection to AFBF's and NFU's Request for Emergency Return to "Higher-of" Class I Mover

The Milk Innovation Group (MIG) reiterates its objections to American Farm Bureau Federations' (AFBF's) and National Farmer's Union's (NFU's) attempt to circumvent both the established regulations and the hearing process in its request for emergency consideration of the change to the base Class I skim formula.

First, AFBF's February 22 post-hearing letter is neither a brief, nor a request for conclusions of fact, making it an impermissible ex parte communication. *See* 7 C.F.R. §900.16. USDA's regulations permit the filing of "proposed findings and conclusions, and written arguments or briefs, based upon the evidence received at the hearing…"; "[f]actual material other than that adduced at the hearing … shall not be alluded to therein, and, in any case, shall not be considered…" 7 C.F.R. §900.9(b).[1] AFBF's letter is clearly the latter. For example, AFBF alleges that there were, "… about $55 million in Class I losses related to the current Class I formula in January 2024 alone…;" but the hearing closed on January 30, 2024, meaning this fact was not and could not have been introduced into the record.

USDA should reject the letter entirely. Otherwise, other participants will be left to conclude they must not only submit the proper formal briefs, but also advocate for new requests during the post-hearing period of the rulemaking process. The briefing stage should remain an organized filing process, not a chaotic letter writing campaign.

[1] MIG intentionally limits this response to the procedural shortcomings of AFBF's request. The merits will be addressed in the proper form of a post-hearing brief and conclusions of fact.

Second, AFBF's request for emergency status is procedurally deficient. Such a request must be made at the outset of any hearing process. *See* 7 C.F.R. §900.4 (aptly entitled, "Institution of proceeding"). Pursuant to 7 C.F.R. §900.4(a), a hearing can proceed on an expedited schedule only if the Administrator determines "than an emergency exists which requires a shorter period of notice." A request for emergency would have required a shorter notice period, and such emergency status would need to be included in that notice. Without such, other interested parties do not have due process notice of the fact that the proceeding is taking place under expedited rules.

Third, USDA has just concluded the 49-day on the record rulemaking proceeding that expressly includes this issue. Pursuant to the AMAA (7 U.S.C. § 608c16(C)(iii)) and implementing regulations, as well as the announcement by the Administrative Law Judge who presides over the hearing, April 1 is the established briefing deadline for the parties to address the Proposals that were the subject of the hearing, including the various proposals relating to the base Class I skim formula. The AFBF letter ignores that deadline and does not seek a modification of that briefing schedule. The rules of practice expressly provide that any recommended decision must be prepared *after* the period allowed for the filing of briefs. 7 C.F.R. § 900.12(a). The Secretary would violate the parties' due process rights if he were to act inconsistent with that schedule and before all interested parties were able to file their briefs, especially since the Secretary has not provided in the Notice of Hearing or otherwise advance notice of such a deviation. *See generally*, 5 U.S.C. § 556.

Finally, to be clear, MIG expects that various parties, including AFBF, will be submitting post-hearing briefs and conclusions of fact that may address some of the positions contained in AFBF's letter. MIG clearly makes no objection to that advocacy, but rather requests affirmation of the Department's commitment to proper due process by not considering AFBF's February 22 letter. The volume of evidence and complexity of issues at the hearing, coupled with the diverse views of the various participants, counsels that the full hearing process must be followed in this matter.

We have been authorized by the International Dairy Foods Association to state that it joins in the positions stated in this letter.

Respectfully submitted,

Davis Wright Tremaine LLP

Charles M. English, Jr.

Ashley L. Vulin

cc:
Dana Coale (dana.coale@usda.gov)
Erin Taylor (erin.taylor@usda.gov)
Brian Hill (brian.hill1@usda.gov)
Steven Rosenbaum (srosenbaum@cov.com)
Mike Brown (mbrown@idfa.org)
Nicole Hancock (nicole.hancock@stoel.com)
Bradley Prowant (Bradley.prowant@stoel.com
Roger Cryan (rogerc@fb.org)
Danny Munch (dmunch@fb.org)
John Vetne (johnvetne@gmail.com)
Marin Bozic (marin@bozic.io)
Lucas Sjostrom (lucas@mnmilk.org)
Daniel Smith (dsmith@gmavt.net)
Ryan Miltner (ryan@miltner-reed.com)

CERTIFICATE OF SERVICE

Milk in the Northeast and Other Marketing Areas
Docket No.: 23-J-0067

Having personal knowledge of the foregoing, I declare under penalty of perjury that the information herein is true and correct, and this is to certify that a copy of the RULING ACCEPTING AS ARGUMENT THE 2024 FEB 23 AND MAR 8 FILINGS and ATTACHMENTS has been furnished and was served upon the following parties by electronic mail on March 12, 2024 by the following:

USDA (OGC)
Brian Hill, OGC
Brian.Hill1@usda.gov
Michelle McMurtray, OGC
Michelle.McMurtray@usda.gov
Donna Erwin, OGC
Donna.Erwin@usda.gov
Carla Wagner, OGC
Carla.Wagner@usda.gov

USDA (AMS) Dairy Programs
Dana H. Coale, Deputy Administrator
Dana.Coale@usda.gov
Erin Taylor, Director Order Formulation and Enforcement Division
Erin.Taylor@usda.gov

AMS - FMMO Hearing
FMMOHearing@usda.gov

USDA (OSEC)
Katharine Ferguson
Katharine.Ferguson@usda.gov

Lucas S. Sjostrom, Executive Director
Minnesota Milk Producers Association
P.O. Box 65
Brooten, MN 56316
E-mail: lucas@mnmilk.org

Mike Stranz, Vice President of Advocacy
National Farmers Union
20 F Street NW, Suite 300
Washington, DC 20001
E-mail: mstranz@nfudc.org

Erick Metzger, General Manager
National All-Jersey, Inc.
6486 East Main Street
Reynoldsburg, OH 43068
E-mail: emetzger@usjersey.com

Mike Brown, Chief Economist
International Dairy Foods Association
1250 H Street, NW, Suite 900
Washington, DC 20005
E-mail: mbrown@idfa.org

Counsel for National All-Jersey, Inc.
John H. Vetne
E-mail: johnvetne@gmail.com

Wendy M. Yoviene
Baker, Donelson, Berman, Caldwell, & Berkowitz PC
901 K Street, NW, Suite 900
Washington, DC 20001
E-mail: wyoviene@bakerdonelson.com

Counsel for National Milk Producers Federation
Stoel Rives LLP
101 S. Capitol Blvd., Suite 1900
Boise, ID 83702
Bradley R. Prowant
E-mail: bradley.prowant@stoel.com
Nicole C. Hancock
E-mail: nicole.hancock@stoel.com

Counsel for International Dairy Foods Association
Steven J. Rosenbaum
Covington & Burling LLP
1201 Pennsylvania Avenue, NW
Washington, DC 20004
E-mail: srosenbaum@cov.com

Counsel for Select Milk Producers, Inc.
Ryan K. Miltner
The Miltner Law Firm, LLC
100 North Main Street
P.O. Box 477
New Knoxville, OH 45871
E-mail: ryan@miltnerlawfirm.com
ryan@miltner-reed.com

American Farm Bureau Federation
600 Maryland Avenue SW, Suite 1000W
Washington, DC 20024
Sam Kieffer
E-mail: sk@fb.org
Roger Cryan
E-mail: rogerc@fb.org
Danny Munch
E-mail: dmunch@fb.org
Erin M. Anthony
E-mail: erin@fb.org
Mike Tomko
E-mail: miket@fb.org

Counsel for Milk Innovations Group
Davis Wright Tremaine LLP
920 Fifth Avenue, Suite 3300
Seattle, WA 98104
Charles M. English, Jr.
E-mail: chipenenglish@dwt.com
Ashley L. Vulin
E-mail: ashleyvulin@dwt.com
Grace Bulger
E-mail: gracebulger@dwt.com

Daniel Smith
E-mail: dsmith@gmavt.net

Marin Bozic
E-mail: marin@bozic.io

E-mail: sleperjp@gmail.com

Respectfully Submitted,

_____
Wanda Mosby, Legal Assistant
USDA/Office of Administrative Law Judges
Hearing Clerk's Office, Room 1031-S
1400 Independence Ave., SW
Washington, DC 20250-9203

CERTIFICATE OF SERVICE

I hereby certify that on the date set forth below I served a copy of the foregoing MILK INNOVATION GROUP'S BRIEF OF PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW on:

Hearing Clerk
United States Department of Agriculture
Stop 9203, South Building, Room 1031-S
1400 Independence Ave. SW
Washington, DC 20250-9203
Telephone: 1-202-720-4443
Fax: 1-844-325-6940
Email: SM.OHA.HearingClerks@usda.gov

AMS – FMMO HEARING
FMMOHearing@usda.gov

USDA OSEC
Katharine Ferguson
Katharine.Ferguson@usda.gov

USDA (OGC) – Electronic Mail
Brian Hill, OGC
brian.hill1@usda.gov
Michelle McMurtray, OGC
michelle.mcmurtray@usda.gov
Donna Erwin, OGC
donna.erwin@usda.gov
Carla Wagner, OGC
Carla.wagner@usda.gov

USDA (AMS) Dairy Programs – Electronic Mail
Dana H. Coale, Deputy Administrator
dana.coale@usda.gov
Erin Taylor, Director Order Formulation and Enforcement Division
erin.taylor@usda.gov

National All-Jersey, Inc.
Erick Metzger, General Manager
6486 East Main Street
Reynoldsburg, OH 43068
Email: emetzger@usjersey.com

Edge Dairy Farmer Coop
Marin Bozic
marin@bozic.io

Minnesota Milk Producers Association
Lucas S. Sjostrom, Executive Director
Email: lucas@mnmilk.org

National Farmers Union
Mike Stranz, Vice President of Advocacy
Email: mstranz@nfudc.org

Lamers Dairy, Inc.
Mark Lamers
N410 Speel School Road
Appleton, WI 54915
Email: mark.lamers@lamersdairyinc.com

American Farm Bureau Federation
Sam Kieffer
Email: sk@fb.org
Roger Cryan
Email: rogerc@fb.org
Danny Munch
dmunch@fb.org
Erin M. Anthony
Email: erin@fb.org
Mike Tomko
Email: miket@fb.org

Counsel for National All-Jersey, Inc.
John H. Vetne
Email: johnvetne@gmail.com
Wendy M. Yoviene
Baker, Donelson, Berman, Caldwell, & Berkowitz PC
901 K Street, NW, Suite 900
Washington, DC 20001
Email: wyoviene@bakerdonelson.com

Counsel for National Milk Producers Federation
Nicole C. Hancock
Bradley R. Prowant
Stoel Rives LLP
101 S. Capitol Blvd., Ste. 1900
Boise, ID 83702
Email: Bradley.prowant@stoel.com
Email: Nicole.hancock@stoel.com

Counsel for International Dairy Foods Association
Steven J. Rosenbaum
Covington & Burling LLP
1201 Pennsylvania Avenue, NW
Washington, DC 20004
Email: srosenbauam@cov.com

Counsel for Select Milk Producers, Inc.
Ryan Miltner, Esq.
The Miltner Law Firm, LLC
100 North Main Street
PO Box 477
New Knoxville, OH 45871
Email: ryan@miltnerlawfirm.com

Dated this 1st day of April, 2024.

DAVIS WRIGHT TREMAINE LLP

By */s/ Ashley Vulin*
Chip M. English, D.C. Bar No. 386572
chipenglish@dwt.com
Ashley L. Vulin, Oregon Bar No. 145454
ashleyvulin@dwt.com

Attorneys for Fluid Milk Innovation Group

CERTIFICATE OF SERVICE

Milk in the Northeast and Other Marketing Areas
Docket No.: 23-J-0067

Having personal knowledge of the foregoing, I declare under penalty of perjury that the information herein is true and correct, and this is to certify that a copy of the PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW AND CONCLUSIONS OF LAW SUBMITTED BY MILK INNOVATION GROUP has been furnished and was served by electronic mail upon the following parties on April 2, 2024 by the following:

USDA (OGC)
Brian Hill, OGC
Brian.Hill1@usda.gov
Michelle McMurtray, OGC
Michelle.McMurtray@usda.gov
Donna Erwin, OGC
Donna.Erwin@usda.gov
Carla Wagner, OGC
Carla.Wagner@usda.gov

USDA (AMS) Dairy Programs
Dana H. Coale, Deputy Administrator
Dana.Coale@usda.gov
Erin Taylor, Director Order Formulation and Enforcement Division
Erin.Taylor@usda.gov

AMS - FMMO Hearing
FMMOHearing@usda.gov

USDA (OSEC)
Katharine Ferguson
Katharine.Ferguson@usda.gov

Lucas S. Sjostrom, Executive Director
Minnesota Milk Producers Association
P.O. Box 65
Brooten, MN 56316
E-mail: lucas@mnmilk.org

Mike Stranz, Vice President of Advocacy
National Farmers Union
20 F Street NW, Suite 300
Washington, DC 20001
E-mail: mstranz@nfudc.org

Erick Metzger, General Manager
National All-Jersey, Inc.
6486 East Main Street
Reynoldsburg, OH 43068
E-mail: emetzger@usjersey.com

Counsel for New Dairy Opco, LLC
Counsel for Milk Innovations Group
Davis Wright Tremaine LLP
920 Fifth Avenue, Suite 3300
Seattle, WA 98104
Charles M. English, Jr.
E-mail: chipenglish@dwt.com
Ashley L. Vulin
E-mail: ashleyvulin@dwt.com
Grace Bulger
E-mail: gracebulger@dwt.com

John H. Vetne
E-mail: johnvetne@gmail.com

Counsel for National All-Jersey, Inc.
Wendy M. Yoviene
Baker, Donelson, Berman, Caldwell, & Berkowitz PC
901 K Street, NW, Suite 900
Washington, DC 20001
E-mail: wyoviene@bakerdonelson.com

Mark Lamers
Lamers Dairy, Inc.
N410 Speel School Rd.
Appleton, WI 54915
E-mail: mark.lamers@lamersdairyinc.com

Peter Vitaliano
National Milk Producers Federation
2107 Wilson Blvd., Suite 600
Arlington, VA 22201
E-mail: pvitaliano@nmpf.org

Counsel for National Milk Producers Federation
Stoel Rives LLP
101 S. Capitol Blvd., Suite 1900
Boise, ID 83702
Bradley R. Prowant
E-mail: bradley.prowant@stoel.com
Nicole C. Hancock
E-mail: nicole.hancock@stoel.com

Marvin Beshore
Johnson, Duffie, Stewart & Weidner
301 Market Street,
P.O. Box 109
Lemoyne, PA 17043
E-mail: embeshore@johnsonduffie.com

Mike Brown, Chief Economist
International Dairy Foods Association
1250 H Street, NW, Suite 900
Washington, DC 20005
E-mail: mbrown@idfa.org

Counsel for International Dairy Foods Association
Steven J. Rosenbaum
Covington & Burling LLP
1201 Pennsylvania Avenue, NW
Washington, DC 20004
E-mail: srosenbaum@cov.com

Counsel for Select Milk Producers, Inc.
Ryan K. Miltner
The Miltner Law Firm, LLC
100 North Main Street
P.O. Box 477
New Knoxville, OH 45871
E-mail: ryan@miltnerlawfirm.com
ryan@miltner-reed.com

Counsel to Dairy Cooperative Marketing Association, Inc.
John A. St. Peter
Dempsey Law Firm, LLP
10 Forest Avenue, Suite 200
Fond du Lac, WI 54935
E-mail: jsp@dempseylaw.com

American Farm Bureau Federation
600 Maryland Avenue SW, Suite 1000W
Washington, DC 20024
Sam Kieffer
E-mail: sk@fb.org
Roger Cryan
E-mail: rogerc@fb.org
Danny Munch
E-mail: dmunch@fb.org
Erin M. Anthony
E-mail: erin@fb.org
Mike Tomko
E-mail: miket@fb.org

Alison L. Krebs
Director, Dairy and Trade Policy
Leprino Foods Company
1830 W. 38th Avenue
Denver, CO 80211
E-mail: akrebs@leprinofoods.com

Marin Bozic
Edge Dairy Farmer Coop
E-mail: marin@bozic.io

Daniel Smith
E-mail: dsmith@gmavt.net
dsmith@dairycompact.org

Jim Sleper
Sleper Consulting, LLC
E-mail: sleperjp@gmail.com

Respectfully Submitted,

WANDA MOSBY
Digitally signed by WANDA MOSBY
Date: 2024.04.02 16:01:22 -04'00'

Wanda Mosby, Legal Assistant
USDA/Office of Administrative Law Judges
Hearing Clerk's Office, Room 1031-S
1400 Independence Ave., SW
Washington, DC 20250-9203