**United States Department of Agriculture**
**Before The Secretary of Agriculture**

**In re: [Docket No. 23 – J – 0067; AMS-DA-23-0031]**
**Milk in the Northeast and Other Marketing Areas**

**Hearing beginning August 23, 2023**

**Testimony Presented By:**

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My name is Calvin Covington. This testimony is presented in support of **Proposal 13: Restore the original Federal Order Reform Class I skim milk Mover as proposed by National Milk Producers Federation (NMPF).** This testimony is presented on behalf of Southeast Milk, Inc. (SMI), a long-time member of NMPF.

My off-farm career in the dairy industry covers 50 years, working with dairy farmers and their organizations. This work includes preparing proposals for and presenting testimony at many federal milk marketing order (FMMO) hearings over the past five decades. I retired from SMI as their CEO in 2010, but remain involved in the dairy industry, particularly, in the areas of milk pricing and federal order regulations. Since leaving full-time employment with SMI, my association with the cooperative continues, including serving as their Interim CEO most recently in 2022, and representing the cooperative on FMMO and dairy policy issues. This includes serving as a member of the NMPF federal order task force which developed this and the other proposals presented at this hearing.

SMI is a Capper-Volstead cooperative and a pool handler in the Florida and Southeast FMMOs. SMI is responsible for supplying all the raw milk needs for four pool distributing plants located in the Florida FMMO and one pool distributing plant in the Southeast FMMO.

As of June 30, 2023, SMI's membership consists of 114 dairy farmer members who own and operate 119 Grade A dairy farms. SMI estimates 93 of these members meet the Regulatory Flexibility Act's definition of a small business.

SMI extends its appreciation to the Secretary of Agriculture and the Dairy Division staff for holding this hearing.

My testimony will focus on the challenges resulting from, the use of the "average of" versus the "higher of" in calculating the Class I Mover skim milk price, for dairy farmers marketing milk under the Appalachian, Florida, and Southeast FMMOs.

Implemented in May 2019, the “average of” has lowered revenue to dairy farmers compared to using the “higher of” to calculate the Class I Mover skim milk value. The revenue loss occurs when the difference between the advanced Class III skim and Class IV skim milk prices exceeds $1.48 per cwt. From May 2019 through June 2023, the “average of” decreased revenue to the three Southeastern FMMO producer pools by $192,371,500. See Table one. This revenue decline was a direct result of calculating the Class I Mover skim milk price using the “average of” versus the “higher of.”

The use of the “average of” has decreased revenue to FMMO pools, including the Appalachian, Florida and Southeast FMMOs. This in turn has lowered the blend or uniform milk price. As shown in Table one, and using data from May 2019 to June 2023, the Appalachian FMMO’s blend price was reduced by $0.38 per cwt., the Florida FMMO’s blend price was reduced by $0.41 per cwt., and the Southeast FMMO’s blend price was reduced by $0.36 per cwt. This is a significant and unexpected reduction in dairy farmer revenue from a milk price formula change that was intended to be revenue neutral.

**Table one. “Average of” Impact on Class I Skim Revenue and Blend Prices in the Appalachian, Florida, and Southeast FMMOs (May 2019 – June 2023)**

| Federal Order | Class I Skim ($) | Producer Milk (lbs.) | Blend Price ($/cwt.) |
|---|---|---|---|
| | | | |
| Appalachian | ($84,105,095) | 22,251,402,670 | ($0.38) |
| Florida | ($42,807,322) | 10,320,455,747 | ($0.41) |
| Southeast | ($65,459,084) | 18,205,082,074 | ($0.36) |
| | | | |
| Total | ($192,371,500) | 50,776,941,121 | ($0.38) |

**Source: Published market administrator data for the Appalachian, Florida, and Southeast FMMOs.**

Dairy farmers, in these three FMMOs, 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 is intended. If the “higher of” pricing remained in place, these inconsistencies would not have occurred. Taxpayers should not be required to cover the losses. The Pandemic Market Volatility Assistance Program was a one-time program. It will not be around in the coming years to save dairy farmers from the unintended lowered pricing that occurs by using the “average of” pricing mechanism.

The negative financial impact of the “average of” was not limited to just a few months. During the 50-month period from May 2019 to June 2023, the “average of” lowered the Class I Mover skim milk price, in 27 months, compared to what would have been paid had the “higher of” pricing been utilized. The “average of” was lower than the “higher of” two (2) months in 2019, eight (8) months in 2020, six (6) months in 2021, nine (9) months in 2022, and two (2) months in 2023 as of June. The “average of” lowered revenue to dairy farmers before and after the coronavirus pandemic.

The negative financial impact of the "average of" was not solely due to the Class III skim Mover over $1.48 per cwt. higher than the Class IV skim Mover. It was also due to the Class IV skim Mover $1.48 per cwt. higher than the Class III skim Mover. From May 2019 to June 2023, the negative financial impact occurred in sixteen (16) months due to the Class III skim milk value exceeding Class IV by over $1.48 per cwt., and eleven (11) months when Class IV exceeded Class III by $1.48 per cwt.

More recently, both the June and July 2023 Class I Movers are lower due to the use of the "average of" calculation compared to the "higher of" calculation. The July 2023 Class I Mover skim milk price was announced at $7.88 per cwt. Using the "higher of" the July Class I Mover skim milk value would be $8.94 per cwt., $1.06 per cwt. higher than the actual price.

Worse yet, the "average of" lowered revenue to dairy farmers at a time when dairy farm margins are extremely low. The July gross margin calculated under USDA's Dairy Margin Coverage Program was only $3.52 per cwt. This is $6.40 per cwt. lower than the margin in July of last year. It is the lowest margin in the history of the program. The "average of" calculation is reducing dairy farmer milk prices during a financially challenging time for dairy farmers.

Further, the "average of" calculation plus $0.74 per cwt. limits any recovery of losses when there is wide variation between the advanced Class III and IV skim prices. The "average of" can only exceed the "higher of" by $0.74 per cwt. On the other hand, there is no cap on how much the "average of" can fall below the "higher of." In December 2020, the "average of" was $5.19 per cwt. lower compared to the "higher of" calculation. In October 2022, the Class I Mover skim value was $2.08 per cwt. lower, than the "higher of" calculation. The "average of" inadvertently and unnecessarily places more risk on dairy farmers, and the downside risk is greater than the upside risk.

To date, the largest reduction in FMMO revenue, resulting from the "average of" was in calendar year 2020. The Appalachian FMMO blend price was reduced by $1.28 per cwt., the Florida FMMO blend price was lowered by $1.37 per cwt., and the Southeast FMMO blend price was $1.16 per cwt. lower. At the time, dairy farmers were not assured they would receive any reimbursement for the losses sustained, due to the blend price reduction. Such a large reduction in blend price was the tipping point for some dairy farmers to exit the dairy farming business. Such farm exits further reduced the milk supply in an already milk deficit marketing area.

Granted, a partial reimbursement was received for 2020 losses. However, it was not until 2021 and 2022 before partial loss payments were received, long after the time when dairy farmers had to pay their bills. This was a one-time remedy, and there is no guarantee of a future such remedy if this occurs again.

The Appalachian, Florida, and Southeast FMMOs do not have an adequate supply of farm milk year-round to meet consumer fluid milk demand. Supplemental milk is purchased outside of the three orders to meet demand. The "average of" calculation, resulting in lower blend prices, makes attracting supplemental milk more challenging.

The three Southeastern FMMOs have the highest Class I utilization among all FMMOs. In 2022, the three Southeastern FMMOs combined for a Class I utilization of 73.7% compared to 23.1% for the other eight FMMOs. The higher Class I utilization results in higher blend prices in the three Southeastern FMMOs than for all other FMMOs. A higher blend price helps procure needed supplemental milk to meet fluid demand.

Due to their higher Class I utilization and the incorporation of the "average of," the three Southeastern FMMOs experienced a larger reduction in blend prices compared to the other FMMOs. This narrows the difference in blend prices between the Southeastern FMMOs and the other FMMOs, including those which have historically been a source of supplemental milk. It requires more money, beyond FMMO blend prices, to attract the supplemental milk needed to meet fluid demand. Dairy farmers, through their cooperatives, purchase most of the supplemental milk needed in the Appalachian, Florida, and Southeast FMMOs which reduces dairy farmers' milk checks.

Although my testimony focuses on the Southeastern FMMOs, the "average of" creates challenges for all Class I handlers in all FMMOs. Milk handlers compete for the same milk for different uses. As the Secretary of Agriculture pointed out in the 2000 federal order reform decision, the Class I price should exceed Class III and IV prices. This is to ensure an adequate supply of milk for fluid use. This is a primary reason why "higher of" was implemented back in 2000.

The Secretary of Agriculture understood what would happen by using an average of the manufacturing milk prices versus the highest manufacturing milk price in establishing the Class I price. The 2000 reform final decision emphasized that using an average of manufacturing milk prices to establish a Class I price makes it more difficult for Class I handlers to procure milk from plants with the higher-valued manufactured product.

The Secretary further pointed out the use of the "higher of" in the Class I formula makes it more difficult for milk needed for Class I to remain at manufacturing plants. Using an "average" of two milk classes (III and IV) results in occasional difficulties for those supplying the fluid milk market to compete with those supplying the manufacturing milk market. The Class I price established by using the "average of" approach may not be high enough to attract milk for fluid use.

FMMOs need to heed the 2000 federal order reform decision and its rationale, and return to the "higher of" in calculating the Class I Mover.

FMMOs have two primary purposes as contained in the Agricultural Marketing Agreement Act of 1937: 1) maintain orderly marketing conditions and 2) protect the interest of the consumer by ensuring an adequate supply of milk for fluid consumption.

Using the "average of" versus the "higher of" makes it more difficult for FMMOs to meet those two purposes. Previous witnesses have testified how the "average of" creates the opportunity for depooling, thus leading to disorderly marketing conditions.

Other hearing proposals related to the Class I Mover skim milk price, include an "adjustor" added to the advance or announced Class III and/or Class IV skim milk prices. SMI appreciates the submitters of these other proposals recognizing the challenge with the current "average of" method, and wanting to make a correction. However, these other proposals, call for revenue losses to dairy farmers resulting from the "average of," paid back to dairy farmers after the fact. Being paid "after the fact" creates challenges for dairy farmers.

Generally, dairy farmers must pay their labor costs bi-weekly. Most other expenses are paid monthly, or upon receipt of the product purchased. Dairy farmers need the revenue from milk sales now, not after the bills are past due.

"Adjusting" the Class I Mover in later months to compensate for losses resulting from using an "average of," creates challenges. Dairy farmers may not be compensated at all, or not equitably compensated. Dairy farmers may have exited the business before receiving the adjustment. In some cases, the dollar difference between the "average of" and "higher of" may be the determining factor in their milking cows or not. The milk volume of some dairy farmers may be more or less, when the adjustment shows up in their milk check compared to the volume produced when the loss occurred.

Providing dairy farmers with the proper economic signal is vitally important. Making the adjustment "after the fact" could occur at a time when milk supply greatly exceeds milk demand. The economic signal at the time the adjustment is paid, may need to be to produce less milk. However, the "adjustor" added to the Class I Mover may be providing a different economic signal. On the other hand, at the time when the spread between the advanced Class III and IV skim values is large, could be a time when milk was needed. The "average of" can fail to provide the proper economic signal.

It is good to see other dairy organizations recognizing the challenges in the current "average of" method and their desire to correct it. However, the other proposals cannot improve on the "higher of" as the method to calculate the Class I Mover skim milk price.

In summary, the "average of" has lowered dairy farmer revenue compared to the "higher of." The economic loss has been greater in FMMOs without an adequate supply of farm milk needed for fluid milk consumption.

Southeast Milk, Inc. expresses its appreciation to the Secretary of Agriculture and the Dairy Division for holding this hearing. We strongly encourage the Secretary to recommend the adoption of Proposal 3: Return to the "higher of" in calculating the Class I Mover. This is needed to promote orderly marketing of milk, and help ensure consumers have an adequate supply of fluid milk for consumption.

Respectfully submitted,

Calvin Covington
On behalf of Southeast Milk, Inc.
Southeast Milk, Inc.