THE UNITED STATES DEPARTMENT OF AGRICULTURE

AGRICULTURAL MARKETING SERVICE

In re: Milk in the Northeast and Other Marketing Areas	Doc. No. 23-J-0067 AMS-DA-23-0031

NATIONAL MILK PRODUCERS FEDERATION'S

POST-HEARING BRIEF

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I. INTRODUCTION

A. Modernizing the Uniform Pricing Provisions of the Federal Milk Marketing Orders.

The federal milk marketing order ("FMMO")[1] system needs modernization. Aspects of the uniform pricing provisions, such as skim milk component levels and most Class I differentials (which impacts the producer price surface), have not been updated since Federal Order Reform, 64 Fed. Reg. 16026-16296 (Apr. 2, 1999) (herein "Order Reform" or "Federal Order Reform"), and have become archaic. Other aspects, such as make allowances and the Class I Mover,[2] need revision to reflect market realities and support and protect producer prices and producer profitability. Through great effort and expense, the National Milk Producers' Federation ("NMPF") led the modernization movement and aptly supported five amendments for the Secretary's consideration during a hearing that lasted 49 days, with 153 witnesses testifying and 511 exhibits accepted into the record. While many potential regulatory revisions are being considered, the five amendments proposed by NMPF will help re-establish and "maintain such orderly marketing conditions…in the interests of producers." 7 U.S.C. § 602(4).

Indeed, NMPF is best situated to know and recommend amendments to the uniform pricing provisions, 7 C.F.R. §§ 1000.50-1000.52, based on the national milk marketing and processing footprint and knowledge of the dairy industry and FMMOs held by its cooperative members. NMPF is the voice of America's dairy farmers; it has 25 dairy marketing cooperative members that comprise approximately two-thirds of the commercial dairy farmers in the United States. NMPF's member cooperatives reflect both geographic and product mix diversity of the dairy

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[1] The abbreviation "FMMO" will be used broadly to refer to: the milk pricing regulations, specific marketing areas, and to the regulatory system established by the Agricultural Marketing Agreement Act and the attendant policy objectives.
[2] "Class I Mover" (sometimes referred to as "Mover") is defined in the Proposed Findings of Fact for Proposal 13. *See infra* at 141.

industry, provide the majority of raw milk to pool distributing plants, and process approximately half of the Class I milk pooled under FMMOs and distributed on routes within the 11 FMMOs. Additionally, NMPF's cooperative members have significant Class II, Class III, and Class IV manufacturing operations and manufacture a majority of United States produced butter and nonfat dried milk products. Its members cooperatives write the milk checks for more than 70 percent of the milk produced in the United States. Simply, NMPF understands the dairy industry better than any other proponent and is in the best position to offer FMMO pricing amendments that benefit the entire United States dairy industry.

B. NMPF Represents the Interests of Producers; Those Opposing Modernization Do Not.

Ten industry stakeholders presented evidence at the hearing.

Only one stakeholder represented the majority of dairy farmers and the majority of processing in the United States: NMPF. NMPF has been the unifying voice of America's dairy farmers on Capitol Hill and with government agencies since 1916. Focusing on federal issues, NMPF uses its unique resources to enhance and promote the economic well-being of dairy farmers and their cooperatives through coordinated industry efforts.

The International Dairy Foods Association ("IDFA") represents a portion of the dairy manufacturing and marketing industry of the United States. IDFA has an expansive membership that includes multinational companies, United States regional companies, and smaller single plant companies. IDFA, which is somewhat opaque about its membership, claims to represent 90 percent of dairy manufacturing in the United States—although, with the recent membership withdrawal of some of the United States' largest dairy cooperatives, this statistic is in question. [3]

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[3] A number of large dairy cooperatives with processing and manufacturing operations left IDFA's membership over IDFA's FMMO modernization policy initiatives including their stance on the

The Wisconsin Cheese Makers Association ("WCMA") is a policy advocate for dairy manufacturers and processors and, specifically, cheesemakers, butter makers, and whey processors. WCMA membership includes more than 650 companies.

The Milk Innovation Group ("MIG") is a group of fluid processors and manufacturers formed specifically for this hearing. Its members are Anderson Erickson Dairy Co., Inc.; Aurora Organic Dairy; Crystal Creamery; Danone North America; fairlife; HP Hood LLC; Organic Valley/CROPP Cooperative; Shamrock Foods Company; Shehadey Family Foods, LLC (Producers Dairy Foods, Inc.; Model Dairy, LLC; Umpqua Dairy Products Co.); and Turner Dairy Farms. The two largest fluid processors—Dairy Farmers of America ("DFA") and Prairie Farms Dairy ("Prairie Farms")—are NMPF members, not members of MIG, and only support NMPF's proposals, as do other NMPF Class I processors.

Select Milk Producers, Inc. ("Select") is a cooperative of 115 dairy farms based in Texas, New Mexico, and the Midwest. Select produces over nine billion pounds of milk annually.

American Farm Bureau Federation ("AFBF") is a grassroots national policy advocate for farmers, ranchers, and rural communities founded in 1919. AFBF has members in more than 2,800 counties in the United States. Those members set the policy agenda for AFBF. While recently active in national dairy policy discussions, AFBF does not own or operate milk plants and AFBF does not write milk checks for dairy farmers.

National All-Jersey Inc. ("NAJ") is an organization with the stated purpose of promoting the increased production and sale of milk and milk products produced by the Jersey cattle breed. NAJ also promotes Jersey cattle and represents the interests of breeders of Jersey cattle. NAJ does

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Class I mover and the level of increase in make allowances that were harmful to producer prices and detrimental to the United States dairy industry.

not own or operate milk plants and does not write milk checks for dairy farmers.

California Dairy Campaign ("CDC") is an organization of California dairy producers with a stated goal of achieving an equitable dairy system that will return to dairy producers a price that is fair, based on the cost of production and return on investment and management. CDC does not own or operate milk plants and does not write milk checks for dairy farmers.

Lamars Dairy, Inc. ("Lamars") is a family owned and operated dairy processing plant located in Appleton, Wisconsin. Lamars is primarily a fluid processor.

Edge Dairy Farmer Cooperative ("Edge") is a verification cooperative. Edge's other primary service provided to its members is representation in advocating for dairy policy. Edge does not own or operate milk plants and does not write milk checks for dairy farmers.

C. The AMAA and FMMOs Are Intended to Benefit Producers.

The Agricultural Marketing Agreement Act ("AMAA"), 7 U.S.C. §§ 601-627, grants the Secretary of Agriculture ("Secretary") authority to issue orders "setting the minimum prices that handlers (those who process dairy products) must pay to producers (dairy farmers) for their milk products." *Block v. Cmty. Nutrition Inst.*, 467 U.S. 340, 341–42 (1984) (citing 7 U.S.C. § 608c). "To be sure, the general purpose sections of the [AMAA] allude to general consumer interests,"[4] but "the principal purposes…are to raise the price of agricultural products and to establish an orderly system for marketing them." *Id*. at 346-47; *see also St. Albans Co-op. Creamery, Inc. v. Glickman* ("*St. Albans*"), 68 F. Supp. 2d 380, 387 (D. Vt. 1999) ("The [*Block*] Court further emphasized that the purpose of the AMAA was to protect the producers of milk, but not the general public."). More specifically, "[t]he 'essential purpose [of this milk market order scheme is] to raise

[4] For example, Section 602(2) of the AMAA references "protect[ing] the interest of the consumer," but the rest of Section 602(2) makes clear this protection is regarding "parity" pricing, by referencing Section 602(1), which has not been utilized for milk in nearly 40 years.

producer prices," *Block*, 467 U.S. at 342 (second set of brackets in original) (quoting S. Rep. No. 1011, 74th Cong., 1st Sess., 3 (1935)), "and thereby to ensure that the benefits and burdens of the milk market are fairly and proportionately shared by all dairy farmers." *Id*. (citing *Nebbia v. New York*, 291 U. S. 502, 517-18 (1934)).

To accomplish these aims, the AMAA directs broad policy considerations to all marketing orders: "to establish and maintain such orderly marketing conditions…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." 7 U.S.C. § 602(4). However, the AMAA also directs specific requirements and considerations for *milk* marketing orders: handler price uniformity, 7 U.S.C. § 608c(5)(A); producer price uniformity, 7 U.S.C. § 608c(5)(B)(ii); consideration of the "price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk or its products in the marketing area to which the contemplated marketing agreement, order, or amendment relates," 7 U.S.C. § 608c(18); *see also St. Albans*, 68 F. Supp. 2d at 389 ("[c]hanges in milk prices require consideration of regional differences in economic factors such as feed and transportation costs"); and, if parity pricing is not reasonable, "insur[ing] a sufficient quantity of pure and wholesome milk, and be[ing] in the public interest." 7 U.S.C. § 608c(18).

Within the statutory framework and authority granted by the AMAA lies discretion for the Secretary to issues orders and amendments as necessary to achieve the primary aim of the AMAA: raise producer prices. *Block*, 467 U.S. at 342; *Farmers Union Milk Mktg. Co-op v. Yeutter*, 930 F.2d 466, 474 (6th Cir. 1991) ("We have recognized that the primary purpose of the scheme is to raise the general level of producer prices by authorizing the Secretary of Agriculture...to issue orders that regulate milk prices in given geographical market areas…." (internal quotation marks and citation omitted)). How the Secretary accomplishes his Congressionally mandated aim is not defined. Importantly and necessarily, the Secretary has shown an ability to change and adapt to market realities over time. For example, with Order Reform, 64 Fed. Reg. 16026-16296, the Secretary changed the entire pricing methodologies of the FMMO system by moving away from the Minnesota-Wisconsin ("M-W") surveyed price series and its Basic Formula Price ("BFP") to the use of end-product pricing formulas. The ability to adapt is critical to issuing appropriate regulations that will be accepted by the producer community. *See* 7 U.S.C. § 608c(9)(B). NMPF's Proposals 1, 3, 13 and 19 seek to both modernize long-held pricing regulations and to support stronger producer milk prices. NMPF's Proposal 7, to modestly increase make allowances, is a necessary change and is offered after careful consideration of the financial impact on milk manufacturers and producers. NMPF's balanced approach both offers manufacturers some cost relief but also limits its negative consequences to producer milk prices and their underlying impact on producer profitability.

While some of NMPF's opposition suggest NMPF's proposals are not in perfect alignment with past rulemaking, whether and to what extent the Secretary previously considered an amendment similar to the proposals in this hearing is not binding. Nor should it be. NMPF's motivation for modernizing the FMMO system is to update pricing methodologies to reflect the dairy industry today. The last time many of the pricing provisions under consideration were amended, as part of Order Reform, the Secretary significantly deviated from long held FMMO norms. In forming a final rule for this hearing, the Secretary should not hesitate, as he has not before, to depart from historical norms or considerations when those no longer reflect the current landscape of the dairy industry. This is because the Secretary's decision is ultimately not graded by his adherence to past rulemaking but by adherence to his Congressionally granted authority:

the AMAA is intended to raise producer prices. *Block*, 467 U.S. at 342.

D. NMPF Represents the Interests of about 18,000 Small Business Dairy Farmers and the NMPF Proposals Are in Those Producers' Interests.

NMPF represents about two-thirds of the small business dairy farmers in the United States. The Secretary and USDA must consider the effect amendments to the FMMOs will, potentially, have on small business. 5 U.S.C. §§ 603, 604. For dairy farmers, any farm with a gross revenue of $3,750,000 or less constitutes a small business. 13 C.F.R. § 121.201. A large majority of the small entities affected by FMMOs are dairy farmers. (Ex. 299 at 9 [Testimony of Dr. Peter Vitaliano].) At Order Reform, USDA estimate 96 percent of the producers in the United States were small businesses. 64 Fed. Reg. 16026, 16034. As recently as 2019, USDA estimated that figure to be 98 percent. 84 Fed. Reg. 8590, 8591 (Mar. 11, 2019). Whereas, only 54 percent of handler plants were considered to be small businesses. *Id*.

Yet, it cannot be ignored that increasingly most of the milk produced in the United States is coming from fewer farms. Many dairy farmers are choosing between exiting the industry or expansion through consolidation. For example, in four of the 11 FMMOs, average herd sizes are over 1,500 cows. (Ex. 299 at 10 [Testimony of Dr. Peter Vitaliano].) It is increasingly difficult for small dairy farmers, which is the vast majority of America's dairy farmers, to remain profitable under the current pricing regime.

NMPF presented a package of five proposals that collectively do not unduly burden or disproportionately impact small businesses. Were NMPF's proposals adopted, all changes to the prices of individual dairy products and to the FMMO prices resulting from these proposals (and therefore to the uniform prices received by dairy farmers in individual orders and regions) will be limited to those necessary to reflect changes in the costs of manufacturing those products, changes in the costs of supplying milk to processors of those products, changes in the value of the milk supplied by producers to those processors, or other changes necessary to more closely align the regulated minimum value of milk with the market value of the products from which it is produced, as translated by the FMMO product price formulas. (Ex. 299 at 10 [Testimony of Dr. Peter Vitaliano].)

Dr. Scott Brown, dairy economist for the nonpartisan Rural and Farm Finance Policy Analysis Center at the University of Missouri, analyzes the economic impacts of federal dairy policy for Congress and other dairy stakeholders. Dr. Brown concluded that adoption of any one proposal would result in a modest positive (Proposals 1, 3, 13, and 19) or meaningful negative change (Proposal 7) in the United States all milk price in the first year that moderates over time. (Ex. 421 at 10 [Testimony of Dr. Scott Brown].) In some cases, adoption of multiple proposals will offset each other and their impact on the United States all milk prices. (Ex. 421 at 10 [Testimony of Dr. Scott Brown].) Adoption of all five NMPF proposals would result in "U.S. all milk prices [being] $0.09 per hundredweight higher in the first year of the analysis relative to the baseline but moderate as milk production grows relative to the baseline." (Ex. 421 at 10 [Testimony of Dr. Scott Brown].) Thus, NMPF's proposals—1, 3, 7, 13, and 19—are in the interests of small dairy farmers, on average across the United States, because they give them a small increase in the all milk price.

E. Record Evidence Admitted But Not Within the Scope of This Hearing Should Not Be Considered.

USDA received 40 proposed amendments to the FMMOs by industry stakeholders. USDA issued a Notice of Hearing ("Notice") that invited evidence on 21 of those proposals. 88 Fed. Reg. 47396-47399 (July 24, 2023). That is, only 21 of the 40 proposals were within the scope of the hearing as defined by the Notice: "evidence on proposals to amend the pricing formulas in the 11 [FMMOs]," by which the Secretary meant amendments to the uniform pricing formulas. *See* 7

C.F.R. §§ 1000.50, 1000.52; *see also* USDA, Letter in Reply to MIG's Proposals, at 1-2 (June 24, 2023), https://www.ams.usda.gov/rules-regulations/moa/dairy/petitions ("The Secretary has determined the hearing will be limited in scope to amendments directly impacting ***the uniform pricing formulas*** used in FMMOs." (emphasis added)). Formal rulemaking is permitted whenever the Secretary "has reason to believe that the issuance of an order will tend to effectuate the declared policy of [the AMAA]." 7 U.S.C. § 608c(3). "The proceeding shall be instituted by filing the Notice of Hearing with the hearing clerk. The notice of hearing…***shall define the scope of the hearing***...." 7 C.F.R. § 900.4(a) (emphasis added); *see also* 7 U.S.C. § 608c(17)(B)(i) (mandating the Secretary promulgate supplemental rules of practices "to define guidelines and timeframes for the rulemaking process relating to amendments to orders"). The Secretary or Administrator of the Agricultural Marketing Service ("AMS") has discretion when setting the substantive scope in a notice of hearing. 7 C.F.R. § 900.4(a). A proposal may be denied if it "will not tend to effectuate the declared policy of the act, or…for other proper reasons a hearing should not be held on the proposal...." 7 C.F.R. § 900.3(a).

Most proponents whose proposals were not within the scope of the hearing omitted presentation of evidence in support of those out-of-scope proposals. At least one industry stakeholder—MIG—forged ahead and repeatedly presented "evidence" on its out-of-scope proposals related to special treatment for organic and ESL fluid products. ***All "evidence" presented by MIG on proposals outside the scope of this hearing should be categorically and summarily rejected and ignored***.

Presenting information outside the scope of the notice of hearing is procedurally improper. 7 C.F.R. § 900.8(c)(2) ("Evidence shall then be received with respect to the matters specified in the notice of the hearing…."). MIG weaved its improper information in with its opposition and support of various proposals to avoid a clear opportunity for other stakeholders to object. When the Secretary reviews the record, that evidence should be ignored. Additionally, the purpose of a notice of hearing is to provide notice. When a stakeholder presents information outside of the scope of the hearing, it defeats the purpose of the notice and leaves other proponents without an ability to respond. There is now a record of MIG's improperly presented information, and because it was outside the scope of the hearing, it went unrebutted. Had MIG's rejected proposals been part of the Notice, there are likely stakeholders who would have opposed those proposals and presented evidence in opposition. Allowing irrelevant and immaterial evidence—clearly aimed at rejected and out-of-scope proposals—to be part of this decision would give industry stakeholders a basis on which to challenge the Secretary's final rule.

II. SUMMARY OF ARGUMENT

Multi-family generational dairy farmer, Brittany Nickerson- Thurlow, summarized best the critical nature of this modernization hearing:

> Without our farms, there are no processors, there are no check-off organizations, there are no Federal Orders, and the economic impact to suppliers, employees, and rural economies is lost. The farms are who feeds this supply chain from top to bottom and from left to right. Our farms should have the opportunity to thrive just as much as anyone in that chain, but that role has been reversed or at minimum highly compromised. The [F]ederal [O]rder was established to provide an orderly market for Class I milk. Without significant changes in the dairy industry, especially in updating the pricing formulas in Federal orders, we will have more dairy farm attrition.

(Ex. 266 at 3 [Testimony of Brittany Nickerson- Thurlow].) NMPF offers five proposals to amend outdated and disorderly regulations in the uniform pricing provisions of FMMOs. *See* 7 C.F.R. §§ 1000.50, 1000.52. The net effect of adopting NMPF's proposals will be a regulatory environment that reflects the current dairy industry, protection of dairy farmers' profitability, and adherence to the policy goals of the AMAA and FMMOs.

III. PROPOSAL 1 SHOULD BE ADOPTED: THE BASE VALUE OF A HUNDREDWEIGHT OF SKIM MILK, AS ANNOUNCED FOR ALL CLASSES, SHOULD BE UPDATED TO REFLECT THE AVERAGE COMPONENTS OF PRODUCER MILK TODAY.

PROPOSED FINDINGS OF FACT

A. The "Standard" Component Factors in the Skim Pricing Formulas Are Out-of-Date and Inaccurate.

1. The uniform formulas for the price of skim milk in all classes for all current FMMOs are in 7 C.F.R. §§ 1000.50(b) (Class I skim milk price); 1000.50(e) (Class II); 1000.50(i) (Class III); and 1000.50(k) (Class IV). Those formulas uniformly assume component levels in producer milk of 3.1 pounds of protein, 5.9 pounds of other solids, and 9.0 pounds of nonfat solids. *See* 7 C.F.R. § 1000.50(i) and (k).

2. Seven of the 11 FMMOs use multiple component pricing ("MCP") for payment to producers: 1, 30, 32, 33, 51, 124, and 126 (herein the "MCP FMMOs"). *See* 7 C.F.R. §§ 1001.60, 1030.60, 1032.60, 1033.60, 1051.60, 1124.60, 1126.60; (Ex. 62 at 4; Tr. 158:3-9 [Testimony of Dr. Peter Vitaliano]; Ex. 64 at 2; Tr. 405:4-15 [Testimony of Calvin Covington].)

3. In the MCP FMMOs, producers are paid for all their skim milk production based on milk components. (Ex. 64 at 2; Tr. 158:16-19 [Testimony of Calvin Covington].) Handlers, on the other hand, pay for Class III skim milk based on the pounds of protein and other solids contained in the skim milk and Class II and IV skim milk based on the nonfat solids content; however, handlers pay for Class I skim milk based on volume. (Ex. 64 at 2; Tr. 158:19-22 [Testimony of Calvin Covington].)

4. Today, the dairy farmers in the MCP FMMOs collectively produce almost 90 percent of the milk under the FMMO system. (Ex. 62 at 4; Tr. 158:3-5 [Testimony of Dr. Peter Vitaliano]; Ex. 64 at 2; Tr. 405:10-12 [Testimony of Calvin Covington] (noting these seven FMMOs accounted for 89 percent of producer milk in 2022).) The majority of the milk in these

orders is used in Classes II, III, and IV (sometimes referred to as the “manufacturing classes”). (Ex. 64 at 2; Tr. 405:12-15 [Testimony of Calvin Covington].)

5. The other four FMMOs—5, 6, 7, and 131—use skim-butterfat pricing (herein, the “non-MCP FMMOs”). Handlers pay for skim milk in all four classes on a hundredweight basis, regardless of the components contained in the skim milk. (Ex. 64 at 2; Tr. 405:23-26 [Testimony of Calvin Covington].)

6. As noted above, the formulas implemented with Federal Order Reform use “standard” component factors for skim milk pricing in all classes. These factors are intended to be reflective of the value, which is derived from components, of skim milk. To calculate the Class III Skim Milk Price and the Advanced Class III Skim Milk Price, “standard” component factors of 3.1 percent for protein and 5.9 percent for other solids are used. 7 C.F.R. §§ 1000.50(i), (q)(1). Adding the protein and other solids value results in the 9.0 percent nonfat solids, which is the “standard” component factor used in the Class II and Class IV skim milk prices and the Advanced Class IV Skim Milk Price. 7 C.F.R. §§ 1000.50(e), (k), (q)(2); (Ex. 62 at 4; Tr. 156:12-15, 157:16-23 [Testimony of Dr. Peter Vitaliano]).

7. The “standard” component factors were intended to approximate the average pounds of protein, other solids, and nonfat solids contained in one hundred pounds of producer skim milk at the time. (Ex. 64 at 4; Tr. 408:9-12 [Testimony of Calvin Covington].) These factors were not based on the actual composition of producer skim milk at the time of Order Reform, but rather on the standard practice of quoting announced prices at 3.5 percent butterfat. (Ex. 62 at 4; Tr. 157:24-158:1 [Testimony of Dr. Peter Vitaliano].)

8. The uniform MCP formulas created by Federal Order Reform were premised upon the costs and realities of milk production and dairy product manufacturing which prevailed at that

time—i.e., 2000. (Ex. 62 at 2, 4; Tr. 151:28-152:10, 156:11-157:1 [Testimony of Dr. Peter Vitaliano].)

9. However, the United States dairy industry has undergone dynamic structural change since 2000, such that the "standard" component factors are no longer reflective of the value of skim milk. (Ex. 62 at 2; Tr. 153:3-5 [Testimony of Dr. Peter Vitaliano].) Yet, the product price formulas ("PPFs") in FMMOs have remained static since 2000. (Ex. 62 at 2; Tr. 153:5-7 [Testimony of Dr. Peter Vitaliano].)

10. During that same time, dairy farmers have responded to the uniform MCP pricing formulas by significantly increasing the levels of components in the milk they produce. (Ex. 62 at 4; Tr. 158:5-9 [Testimony of Dr. Peter Vitaliano].) Continuous improvements in genetics, nutrition, and dairy farm management have and continue to enable dairy farmers to increase milk component levels. (Ex. 64 at 3; Tr. 406:4-7 [Testimony of Calvin Covington].)

11. As shown by the yearly average testing data collected by Market Administrators since 2000, component levels have steadily increased since Federal Order Reform.

Table 2. Annual Average Pounds of Protein, Other Solids, and Nonfat Solids Contained in One Hundred Pounds of Producer Skim Milk in FMMOs with Protein and Others Solids Component Tests. (2000-2022)

Year	Protein	Other Solids	Nonfat Solids
2000	3.13	5.91	9.04
2001	3.14	5.91	9.05
2002	3.14	5.92	9.06
2003	3.14	5.92	9.06
2004	3.16	5.92	9.08
2005	3.15	5.93	9.08
2006	3.16	5.93	9.09
2007	3.17	5.93	9.10
2008	3.17	5.93	9.10
2009	3.17	5.93	9.10
2010	3.17	5.95	9.12
2011	3.20	5.96	9.16
2012	3.21	5.97	9.18
2013	3.24	5.97	9.21
2014	3.24	5.96	9.20
2015	3.24	5.97	9.21
2016	3.24	5.97	9.21
2017	3.26	5.98	9.24
2018	3.28	5.99	9.27
2019	3.29	6.00	9.29
2020	3.30	6.01	9.31
2021	3.35	6.01	9.36
2022	3.39	6.02	9.41

(Ex. 64 at 5 [Testimony of Calvin Covington] (citing Market Administrator reports); *see* Ex. 17.)

12. Additionally, higher butterfat also increases the component content of skim milk because there are fewer pounds of skim milk in a given hundredweight of producer milk and thus the components become a larger percentage of the total. (Ex. 62 at 4; Tr. 156:19-26 [Testimony of Dr. Peter Vitaliano].) Based on data from USDA's National Agricultural Statistics Service ("NASS") and USDA's Economic Research Service (ERS), the average nonfat solids content of producer skim milk in the United States rose from 9.05 percent in 2000 to 9.41 percent in 2022. (Ex. 62 at 4; Tr. 156:26-157:1 [Testimony of Dr. Peter Vitaliano].)

13. "[D]espite obvious and well-documented increases in the dairy components" the "standard" component factors have not been updated. (Ex. 77 at 1; Tr. 702:28-703:3 [Testimony of Chris Hoeger].)

14. As a result, in the MCP FMMOs, the price difference between the Class I skim milk price and skim milk prices for Classes II, III, and IV have narrowed and skim milk prices have

increased relative to the non-MCP FMMOs. (Ex. 62 at 5; Tr. 158:22-27 [Testimony of Dr. Peter Vitaliano]; Ex. 64 at 4; Tr. 407:9-12 [Testimony of Calvin Covington].)

15. In the non-MCP FMMOs, producers have been increasingly underpaid for the true value of all their skim milk because the manufacturing classes in non-MCP FMMOs have not increased as actual component levels have increased. (Ex. 62 at 5; Tr. 158:28-159:2 [Testimony of Dr. Peter Vitaliano]; Ex. 64 at 4; Tr. 407:12-16 [Testimony of Calvin Covington].)

16. And in all orders, the increase in component levels has resulted in producers being increasingly underpaid for the true value of their skim milk used in Class I. (Ex. 62 at 5 [Testimony of Dr. Peter Vitaliano]; Ex. 64 at 4; Tr. 159:2-4 [Testimony of Calvin Covington].)

17. These inequities are because the "standard" component factors have remained static. Skim milk containing higher protein and other solids levels do not increase the Class I skim price, which is based on volume regardless of the component levels. Whereas manufacturing class prices increase as component levels rise and therefore narrow the gap with the Class I price. (Ex. 62 at 5; Tr. 159:10-21 [Testimony of Dr. Peter Vitaliano].)

18. By not increasing the Class I skim price commensurate with the other Classes, the producer price differential ("PPD") is reduced. As producer component levels increase without additional revenue from Class I skim (to increase the PPD), the difference between prices for Classes II, III, and IV milk versus the respective blend price narrows, which results in price inversions, leading to depooling, and resulting in disorderly marketing. (Ex. 64 at 4, 7; Tr. 408:18-24 [Testimony of Calvin Covington].)

19. For example, the "standard" component factors contributed an average of -$0.14 per hundredweight to PPDs during 2020. (Ex. 72 at 5; Tr. 528:5-7 [Testimony of Erick Metzger].)

20. Further, for the month of April 2023 in FMMO 32, properly recognizing

components at current levels would have resulted in an additional $1,874,755 in producer revenue added to the pool. The PPD would have increased $0.12 per hundredweight. Similarly, for May 2023, $2,190,925 would have been added to the pool and the PPD would have increased $0.16 per hundredweight. (Ex. 77 at 2; Tr. 704:13-27 [Testimony of Chris Hoeger].)

21. For that same time period in FMMO 32, using the component factors in Proposal 1 would have inferred total component pounds closer to reality than the totals inferred by the current "standard" component factors set over 20 years ago.

May-23	Fat	Protein	Other Solids	Non Fat Solids
Class I	7,695,710	11,633,532	20,969,034	32,602,566

	Class IV	Class III		
	Current formula Calculated			
	Non Fat Solids	Protein	Other Solids	
	31,298,933	10,780,744	20,518,189	31,298,933

	Class IV	Class III		
	Proposed formula Calculated			
	Non Fat Solids	Protein	Other Solids	
	32,724,772	11,789,264	20,935,508	32,724,772

(Ex. 77 at 3; Tr. 705:27-706:10 [Testimony of Chris Hoeger].)

22. Updating the "standard" component factors used in the Class I skim milk price formulas will help address low or negative PPDs, encourage participation in the pool, and reduce disorderly marketing in MCP FMMOs. (Ex. 77 at 3; Tr. 706:21-28 [Testimony of Chris Hoeger].)

23. The outdated "standard" component factors also significantly impact three milk-deficit non-MCP FMMOs—5, 6, and 7—because those Orders attempt to supplement milk supplies from MCP FMMOs where the incentive to move milk away from manufacturing classes to these milk deficit areas has decreased. (Ex. 62 at 5; Tr. 159:24-160:8 [Testimony of Dr. Peter

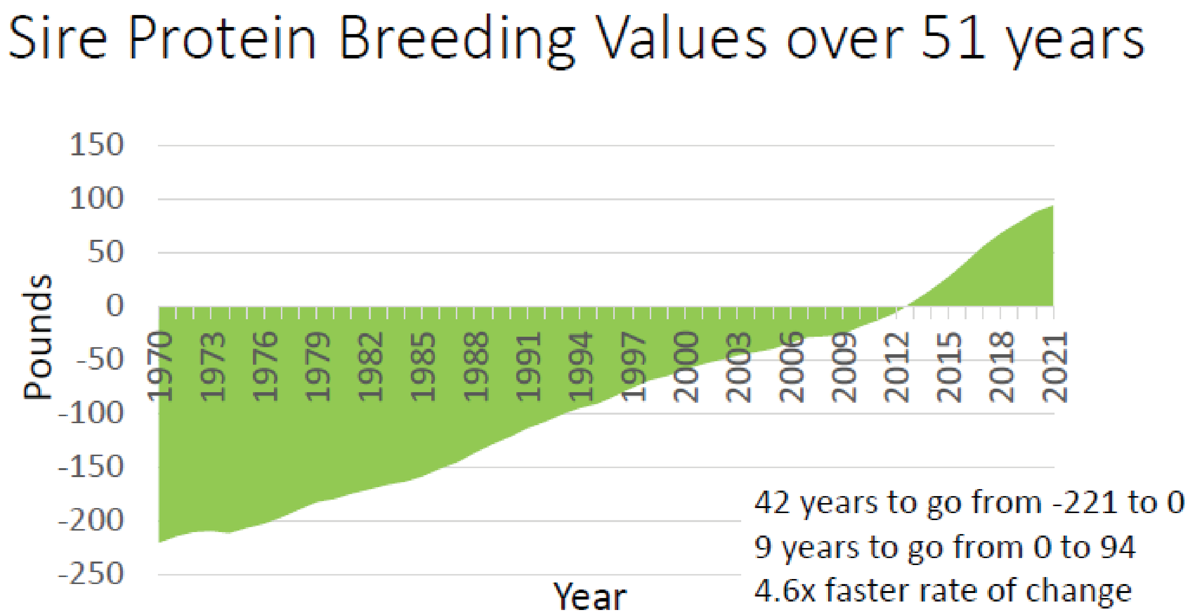
Vitaliano].) Particularly, supplemental milk in the Appalachian and Southeast FMMOs is procured from marketing areas with MCP. The higher relative value of skim milk in MCP FMMOs increases the cost of this additional supplemental milk. (Ex. 64 at 8; Tr. 413:28-414:5 [Testimony of Calvin Covington].) Worse, most supplemental milk is procured by dairy cooperatives, which results in dairy farmers paying increased expenses and seeing a lower mailbox price. (Ex. 64 at 8; Tr. 414:9-11[Testimony of Calvin Covington].) Put another way, "[t]he skim and butterfat pricing used in FMMOs 5 and 7 compete poorly with the component values available in the MCP orders." (Ex. 77 at 4; Tr. 709:24-26 [Testimony of Chris Hoeger].)

24. These problems will persist and magnify as the adoption of genomics in dairy cattle selection continue increasing milk component levels. (Ex. 64 at 4; Tr. 406:20-22 [Testimony of Calvin Covington].) Dairy farmers continuously improve dairy cattle nutrition, cow comfort, and dairy farm management, all of which increase milk components. (Ex. 64 at 4; Tr. 406:24-26 [Testimony of Calvin Covington].)

25. Moreover, changes in component levels are occurring at an accelerating pace. (Ex. 96 at 2, 4; Ex. 97 at 7-8, 20; Tr. 925:13-926:-8, 934:11-24 [Testimony of Dr. Mike Van Amburgh].) Changes in genomics and other reproductive technologies are enhancing the capacity for increased components faster than nutritionists can learn to meet the updated nutrient requirements. (Ex. 96 at 2, 4; Ex. 97 at 7-8, 20; Tr. 925:13-926:8, 934:11-24 [Testimony of Dr. Mike Van Amburgh].) Cows are not currently being fed to meet their capabilities for components. (Ex. 96 at 2, 4; Ex. 97 at 7-8, 20; Tr. 925:13-926:8, 934:11-24 [Testimony of Dr. Mike Van Amburgh].) Simply put, "[a]ll signs point to future increases in milk component levels." (Ex. 64 at 4; Tr. 406:28-407:1 [Testimony of Calvin Covington].)

26. For example, since 2012, protein breeding values increased 4.6 times faster than

from 1970 to 2012:



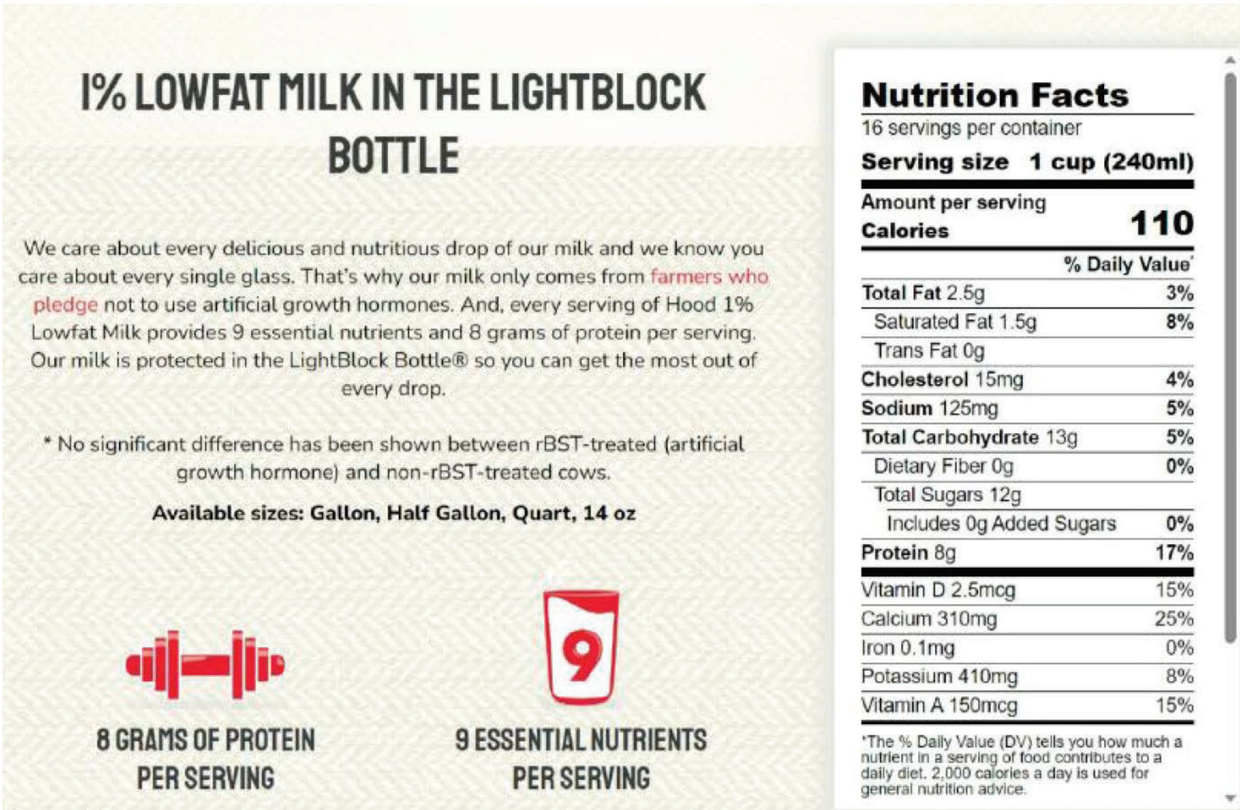
(Ex. 97 at 8; Tr. 926:3-13 [Testimony of Dr. Mike Van Amburgh].)

27. Based on current rates of increase, there is no projected "top line" level at which components will plateau. (Tr. 940:25-28 [Testimony of Dr. Mike Van Amburgh].)

28. Indeed, certain Class I handlers receive milk with skim components in excess of the current FMMO fixed factors 100 percent of the time. (Ex. 106 at 6; Tr. 1202:20-1203:13 [Testimony of Jed Ellis].) Those handlers do not deny they want to pay for what they are receiving. (Tr. 1201:13-1202:1 [Testimony of Jed Ellis].)

29. But handlers are not paying for those increased component levels despite advertising the benefits of components to boost sales. (*See, e.g.*, Tr. 1137:6-8 [Testimony of Wendy Landry]; Tr. 6049:11-24 [Testimony of Tim Doelman].) Handlers advertise increased components because the value of milk is derived from component levels; the greater the level of components, the greater the value of the milk. (Ex. 64 at 7; Tr. 412:26-27 [Testimony of Calvin Covington]); (Tr. 564:25-565:13 [Testimony of Erick Metzger].)

30. In the following label, eight grams of protein in a cup of milk is the equivalent of 3.3 percent protein—higher than the protein test used to determine Class I skim milk prices and more in line with our proposed increase.



(Ex. 104.)

31. In sum, higher component levels have value in the competitive manufacturing dairy market, and the competitive value of milk is the base price from which Class I values are determined. (Ex. 385 at 3; Tr. 8858:3-8 [Testimony of Geoff Vanden Heuvel].) Class I markets have their own pricing dynamics unique to the Class I market, and the FMMOs establish a differential value for Class I over and above the competitive value of milk for manufacturing. (Ex. 385 at 3; Tr. 8858:8-11 [Testimony of Geoff Vanden Heuvel].) Increasing the components to reflect reality properly recognizes the current average value of producer milk used for manufactured dairy products. (Ex. 385 at 3; Tr. 8858:12-15 [Testimony of Geoff Vanden Heuvel].)

In turn, this increased value must be recognized as the base competitive value used to establish the Class I price. (Ex. 385 at 3; Tr. 8858:15-17 [Testimony of Geoff Vanden Heuvel].)

32. Accordingly, the skim milk components' weighted averages in 2022 are appropriate figures to which to update the "standard" component factors:

a. Protein: 3.39 pounds per one hundred pounds of Class III skim milk;

b. Other Solids: 6.02 pounds per one hundred pounds of Class III skim milk;

c. Nonfat Solids: 9.41 pounds per one hundred pounds of Class IV skim milk.

(Ex. 64 at 8; Tr. 414:18-28 [Testimony of Calvin Covington].)

B. A Mechanism for Future Changes to the "Standard" Component Factors Should Be Implemented.

33. To prevent future misalignments of the "standard" component factors and to avoid the need for a formal rulemaking hearing every time components increase, an updating procedure is necessary. Proposal 1 offers the following procedure:

> (1) by February 28th of the third year beginning one year after the announcement of a change of skim milk factors, AMS shall calculate the weighted average of component pounds (protein, other solids, nonfat solids) in one hundred pounds of FMMO producer skim milk for the three previous calendar years;
>
> (2) if the calculated nonfat solids calculation differs by the nonfat solids factor in effect by 0.07 percentage points or more, then update the factors for protein, other solids, and nonfat solids to the corresponding calculated values;
>
> (3) the updated factors would be announced no later than five (5) days after the calculation;
>
> (4) implementation of the updated factors would be effective the first day of March of the following year;
>
> (5) if the calculation does not exceed the 0.07 percentage point threshold, repeat this procedure in the following year, using the weighted average for the three preceding calendar years;

> (6) continue this procedure in subsequent years, until the 0.07 threshold is exceeded, and the skim milk component factors are updated, accordingly;
>
> (7) if the factors are updated, repeat the procedure after three years.

(Ex. 64 at 9; Tr. 415:12-416:8 [Testimony of Calvin Covington].)

34. The 0.07 factor is based on the historical change in nonfat solids levels, which, as the sum of protein and other solids, is representative of all skim components. (Ex. 64 at 10; Tr. 417:15-17 [Testimony of Calvin Covington].)

35. Indeed, if this proposal had been implemented as a part of Federal Order Reform, three updates would have occurred over the past 10 years. (Ex. 64 at 10; Tr. 417:17-20 [Testimony of Calvin Covington].)

36. Updating every three years and using a three-year weighted average smooths out unexpected "ups or downs" in component averages and allows dairy farmers and handlers using risk management tools to better anticipate potential future changes. (Ex. 64 at 10; Tr. 417:5-14 [Testimony of Calvin Covington].)

C. To Avoid Unnecessary Disruption and Harm to Producers, the Change to the "Standard" Component Factors Should Be Delayed 12 Months.

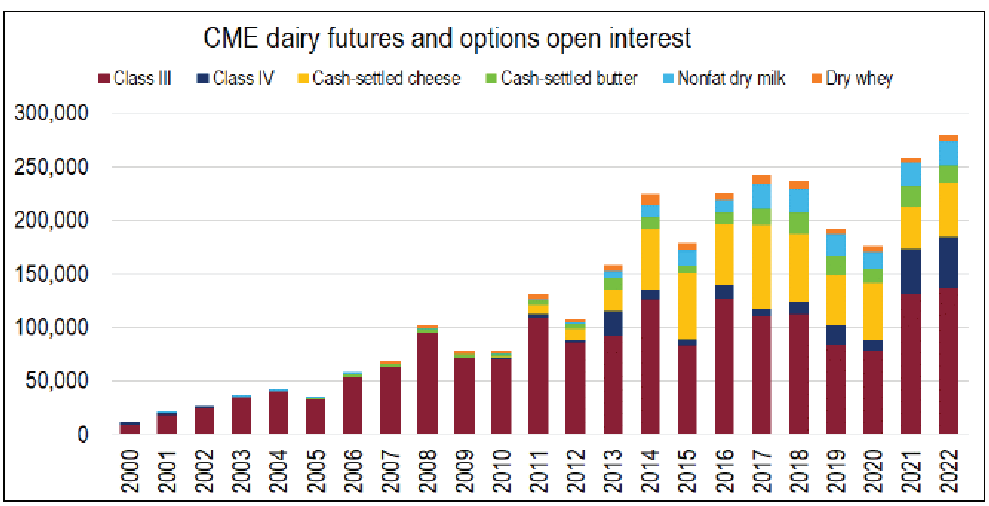
37. Delayed implementation of updated "standard" component factors is necessary because of dairy farmers' use of risk management programs. This delay will allow most transactions placed prior to updating the "standard" component factors to be completed. (Ex. 64 at 9; Tr. 415:1-7 [Testimony of Calvin Covington].)

38. Because dairy farmers cannot know their milk check price until after they have produced their milk and because of the volatility in milk prices, producers have increasingly used risk management over the last 20 years. (Ex. 109 at 2; Tr. 1315:8-1316:1 [Testimony of Edward Gallagher].)

39. Producers do this in part because they incur significant debt. (Ex. 109 at 3; Tr. 1316:17-22 [Testimony of Edward Gallagher].) Producers can use risk management to lock-in a milk price or ensure a floor price for their milk. This assures producers sufficient cash flow to pay costs—most significantly feed costs. (Ex. 109 at 3; Tr. 1316:23-1317:7 [Testimony of Edward Gallagher].)

40. The Chicago Mercantile Exchange ("CME") offers futures and options contracts as means for producers to manage price risk. (Ex. 78 at 1, 3, 5; Tr. 730:26-731:11; 736:5-16; 737:2-19 [Testimony of Anne Krema].) Since inception of milk futures and options in 1996, CME has expanded its dairy risk management complex. (Ex. 78 at 1, 3, 5; Tr. 730:26-731:11; 736:5-16; 737:2-19 [Testimony of Anne Krema].) In 2022, CME had an average daily open interest—i.e., the average amount of open positions daily—of 37 billion pounds or 269,354 contracts. (Ex. 78 at 1, 3, 5; Tr. 730:26-731:11; 736:5-16; 737:2-19 [Testimony of Anne Krema].) While CME lists futures and options for 24 consecutive months, most of the open interest is in the first 12 months. (Ex. 78 at 1, 3, 5; Tr. 730:26-731:11; 736:5-16; 737:2-19 [Testimony of Anne Krema].)

41. Since Federal Order Reform, use of risk management, or hedging, on the CME has grown significantly. (Ex. 109 at 5; Tr. 1319:26-1320:17 [Testimony of Edward Gallagher].)



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42. Understanding how risk management operates is important to evaluate how a regulatory change may impact producers. Dairy futures products are all financially settled—meaning a price reference is used for final settlement—using underlying USDA published pricing references. (Ex. 78 at 2; Tr. 733:20-28 [Testimony of Anne Krema].) For example, the prices at which Class III and IV milk futures are settled are based on the FMMO formulas and the prices for dairy products are based on a monthly weighted average of product prices from the National Dairy Products Sales Report ("NDPSR"). (Ex. 78 at 2; Tr. 734:18-23 [Testimony of Anne Krema].)

43. In addition, CME provides an outlet for firms that offer "over-the-counter" transactions and serves as a reference for prices offered to producers through Dairy Revenue Protection ("DRP")—a form of insurance to protect producers against price fluctuations. (Ex. 78 at 7; Tr. 741:11-21 [Testimony of Anne Krema]); USDA, Risk Management Agency Fact Sheet, Dairy Revenue Protection (Apr. 2019), https://www.rma.usda.gov/en/Fact-Sheets/National-Fact-Sheets/Dairy-Revenue-Protection. DRP debuted in October 2019 and has been embraced by many producers, with 2022 coverage nearing 25 percent of the industry. (Ex. 109 at 7; Tr. 1322:27-1323:15 [Testimony of Edward Gallagher].)

44. Market participants entered current open interests based on assumptions about the current FMMO price formulas. (Ex. 78 at 2; Tr. 734:23-25 [Testimony of Anne Krema].) As a result, immediately changing aspects of the pricing formulas of the FMMOs could have a material impact on the risk management solutions for the dairy industry. (Ex. 78 at 2; Tr. 734:23-25 [Testimony of Anne Krema].)

45. If Proposal 1 were adopted immediately, dairy farmers who have already entered into futures transactions or Dairy Revenue Protection Insurance transactions would see a negative

outcome on their transactions' settlements because the regulatory change would increase the settlement price at the producers' cost and result in unexpectedly worse hedge results. (Ex. 109 at 2, 12 [Testimony of Edward Gallagher]).

46. Edward Gallagher, President of DFA Risk Management a business unit of DFA, estimates 35-45 percent of the United States milk supply is hedged. (Ex. 109 at 7, 9; Tr. 1323:23-1324:1 [Testimony of Edward Gallagher].) He further testified that close to 100 percent of DFA's farmer-owners use some form of risk management tool when Dairy Margin Coverage ("DMC") is included. (Tr. 1350:17-1351:3 [Testimony of Edward Gallagher].). Nonetheless, producers are still somewhat uncertain about using CME futures and options to protect against milk price declines and support their families and farms. (Ex. 109 at 7, 9 [Testimony of Edward Gallagher].)

47. Making changes that impact settlement values on contracts with significant open interest could result in lost confidence in the CME dairy markets and reduce or eliminate participation, which would reduce opportunity for risk management in the dairy industry. (Ex. 78 at 7; Tr. 740:11-17 [Testimony of Anne Krema].)

48. Generally, when material changes are made to contract specifications for agricultural commodities traded on the CME, the changes are either applied on contracts without open interest or are communicated to market participants with sufficient notice that settlements will not be disrupted. (Ex. 78 at 6, 8; Tr. 738:14-19, 742:13-18 [Testimony of Anne Krema].) However, the occurrence of this national hearing, 88 Fed. Reg. 47396, does not provide notice to the market participants, it only provides uncertainty until a final rule is issued. (Ex. 78 at 6, 8; Tr. 738:14-19, 742:3-6 [Testimony of Anne Krema].)

49. Thus, the risk of immediate implementation of updated "standard" component factors is that producers' basis—the difference between the price being hedged and the price the

producer expects to receive—will be "cannibalized" by the change in components, making existing hedges ineffective. (Ex. 109 at 12-13; Tr. 1359:26-1360:8 [Testimony of Edward Gallagher].)

50. At least half of the dairy farmers who testified in support of Proposal 1 stated that they used risk management solutions, demonstrating how commonplace these tools have become among farmers. (Ex. 136 at 3 [Testimony of Karl Wedemeyer]; Ex. 137 at 3 [Testimony of Kristine Spadgenske]; Ex. 138 at 2-3 [Testimony of Brian Rexing]; Ex. 148 at 2-3 [Testimony of Eric Palla]; Ex. 149 at 2-3 [Testimony of Paul Windemuller].)

D. Producers Support Changing the Component Levels in the Skim Milk Formulas.

51. At least 10 producers testified in support of updating the "standard" component factors. Indiana producer Somula Schwoeppe is a fourth-generation dairy farmer. Her plans to continue improving her farm are on hold until the financial outlook for component pricing and better milk pricing overall are more secure. For her, improving components is necessary to staying competitive: "[E]verything we do has to get better every day to stay competitive." (Tr. 621:2-3 [Testimony of Somula Schwoeppe].) As a result, her component levels regularly exceed the average value of the FMMO 5 uniform price. Ms. Schwoeppe supports updating the skim milk pricing provisions to reflect the current levels of components in milk. (Ex. 74 at 2-3; Tr. 613:11-614:2, 615:7-11 [Testimony of Somula Schwoeppe].)

52. Michigan producer Ken Nobis has a long-standing research relationship with Michigan State University, which has allowed him to see how embracing new technology can lead to improvements in milk components. Mr. Nobis utilizes cow comfort, genomics, and high-quality nutrition—at significant costs—to improve the components of his milk. However, despite increasing his components through these expensive measures, there remains an imbalance in pool revenue due to Class I skim not reflecting modern-day component levels, which lowers Class I producer revenue and dilutes the PPD. Mr. Nobis supports updating the skim milk pricing

provisions to reflect the current levels of components in milk and keeping dairy farmers in a more financially viable position to continue to produce. (Ex. 108 at 1-3; Tr. 1286:22-27, 1290:9-1292:18, 1293:14-1294:2, 1294:22-25 [Testimony of Ken Nobis].)

53. Ohio producer Karl Wedemeyer's 2022 average protein level exceeded the "standard" component factor in the Class III skim formula by 0.7 percentage points (i.e., 3.8 percent versus 3.1 percent). The components in Mr. Wedemeyer's milk have increased by 2.5 percent since 2018, and he seeks to increase the components every year through feeding strategies. He supports updating the components in the skim milk pricing formulas and regularly updating the components in the future. Mr. Wedemeyer is also active in risk management. He forward-contracts for milk at various price points and accordingly supports a 12-month implementation lag to avoid a loss of income from locking in a lower milk price in advance of the formula change which would settle to a higher price based the proposed updated formulas. (Ex. 136 at 3; Tr. 2327:22-27, 2328:10-2329:5, 2329:21-23 [Testimony of Karl Wedemeyer].)

54. Minnesota producer Kristine Spadgenske supports updating the "standard" component factors in the skim milk pricing formulas. The components in her milk have steadily increased since 2013, and she expects the components will continue to rise. She further supports delayed implementation. Ms. Spadgenske utilizes risk management because her farm has been unable to ride the recent highs and lows of milk prices associated with increased costs and shrinking profit margin. (Ex. 137 at 3; Tr. 2341:3-2342:9 [Testimony of Kristine Spadgenske].)

55. Indiana producer Brian Rexing supports updating the "standard" component factors in the skim milk pricing formulas. The components in his milk have steadily risen as he reacts to market signals. He further supports delayed implementation because he utilizes risk management strategies to lock-in costs and pay prices. (Ex. 138 at 2-3; Tr. 2355:27-2356:23, 2357:1-15

[Testimony of Brian Rexing].)

56. New Mexico producer Eric Palla supports updating the "standard" component factors in the skim milk pricing formulas. The components in his milk have risen steadily since 2017 as a result of: (1) the increasing speed of genetic improvement, (2) nutritional science, and (3) cross breeding. His 2022 milk tests averaged 3.23 percent protein, up from 3.11 percent in 2017. Further, risk management is an "extremely important" aspect of Mr. Palla's dairy business, and he utilizes fixed pricing, DRP, and target blend pricing through DFA. As a result, Mr. Palla supports delayed implementation to protect his risk management interests. (Ex. 148 at 2-3; Tr. 2635:17-2636:5, 2636:13-19, 2637:2-10 [Testimony of Eric Palla].)

57. Michigan producer Paul Windemuller supports updating the "standard" component factors in the skim milk pricing formulas because it "just makes sense…given the on-farm progress toward higher milk components." Since 2018, Mr. Windemuller's milk components have steadily increased, with a 2023 year-to-date average of 3.2 percent, up from 3.02 percent in 2018 percent protein. Increasing components is an integral part of maintaining profitability and aligning with market demands. Further, Mr. Windemuller supports delayed implementation because he forward-contracts milk prices up to 16 months in advance. (Ex. 149 at 2-3; Tr. 2678:6-10, 2678:18-22, 2679:4-10 [Testimony of Paul Windemuller].)

58. Georgia producer Matt Johnson supports updating the "standard" component factors in the skim milk pricing formulas. The components in his milk have increased by 3.5 percent since 2021, with his 2022 average protein level at 3.18 percent. He expects his component levels will continue to rise given advances with farm management. Mr. Johnson also supports delayed implementation because it is important to the success of his risk management strategy. (Ex. 150 at 3; Tr. 2689:27-2690:20 [Testimony of Matt Johnson].)

59. Missouri producer Sean Cornelius is a dairy nutritionist in addition to a dairy farmer. For him, "updating the component factors is straightforward" because "herds today…routinely produce much higher solids counts," and advances in cow nutrition "will continue to propel dairy cow performance." (Ex. 162 at 4; Tr. 2896:11-25 [Testimony of Sean Cornelius].)

60. Kentucky producer H.H. Barlow is an independent dairy farmer. Mr. Barlow supports updating the "standard" component factors in the skim milk pricing formulas. High protein and solids milk is where potential growth exists because consumers are willing to pay a higher price for higher component milk, such as fairlife. Mr. Barlow's average annual protein over the last three years was 3.7 percent—0.6 points higher than the current protein level in the Class III skim formula. If Mr. Barlow were in an order that paid on protein, he estimates he would have realized an additional $8,500 annually. (Ex. 269 at 4; Tr. 5880:14-5881:5 [Testimony of H.H. Barlow].)

ARGUMENT

E. Proposal 1 Corrects Inaccuracies in the Skim Milk Price Formulas: Update "Standard" Component Factors with a Twelve-Month Implementation Lag and a Procedure for Automatic Updates.

1. The Average Components in Producer Skim Milk Have Increased Since the Adoption of "Standard" Component Factors During Federal Order Reform in 2000.

In response to Congressional directive, Federal Order Reform consolidated FMMOs (to 11) and made uniform many order provisions. *See* 7 C.F.R. part 1000. Multiple orders already used MCP at the time of Federal Order Reform, but the order provisions were not uniform. Those consolidated orders that had previously used MCP maintained MCP, which prices milk used by handlers in Classes II, III, and IV based on components, while those orders without MCP maintained pricing to handlers based on the volume of milk and pounds of butterfat used in each class. At the same time, in all FMMOs post-Order Reform, the Secretary established uniform skim milk prices for all classes, incorporating "standard" component factors in the formulas for each hundredweight of skim milk: 3.1 pounds of protein, 5.9 pounds of other solids, and 9.0 pounds of total nonfat solids. 64 Fed. Reg. 16026, 16096; *see also* 7 C.F.R. § 1000.50(f), (i), (k), (q).

In the intervening 23 years, significant advances have been made in animal genetics, farm management and cow nutrition which render the "standard" component factors inaccurate. NMPF proposes a technical correction raising the "standard" component factors specified in the Class III and IV skim milk formulas (and incorporated into the Class I and II skim milk formulas) to track reality. Specifically, NMPF proposes adopting the skim milk component weighted averages from 2022 USDA AMS data:

a. Protein: 3.39 pounds per one hundred pounds of Class III skim milk;

b. Other Solids: 6.02 pounds per one hundred pounds of Class III skim milk;

c. Nonfat Solids: 9.41 pounds per one hundred pounds of Class IV skim milk.

(*See* Ex. 64 at 8 [Testimony of Calvin Covington].)

a. The Order Reform skim milk price formulas were constructed to be reflective of the content of the skim portion of producer milk.

Prior to the implementation of MCP in any FMMOs, which began in the 1980s, the value of skim milk for manufacturing uses was established based of the competitive value (the "M-W price") of a volume (a hundredweight) of skim for manufacturing and its later modification as the BFP. By default, this tracked payments for milk at the then produced levels of protein and nonfat solids and incorporated those skim component tests into the Class I price and other class prices for all FMMOs. This per-hundredweight manufacturing value was also the base value of a hundredweight of skim for Class I use. Federal Order reform expanded the reach of MCP in the FMMOs and eliminated the use of the BFP. Thus, a new means of determining the value of skim milk had to be identified. The solution was an end-product pricing system which derives the value of the components in milk from the price of the products (cheese, butter, dry whey powder, and nonfat dry milk powder) produced from the milk, less a make allowance reflecting the cost of conversion of the raw milk into the manufactured products and multiplied by a yield factor for the product from the component. Then, the value of a hundredweight of skim milk is calculated by pricing the pounds of the nonfat components in a hundredweight of producer skim milk of average components.

The "standard" component factors used in the new skim milk price formulas were intended to reflect the average pounds of protein, other solids, and nonfat solids contained in one hundred pounds of producer skim milk at the time of Order Reform. (Ex. 64 at 4; Tr. 408:9-12 [Testimony of Calvin Covington].) The "standard" component factors were not based on the actual composition of producer skim milk at the time. (Ex. 62 at 4; Tr. 157:24-158:1 [Testimony of Dr. Peter Vitaliano].) Rather, the Secretary intended to maintain continuity with the prior BFP that end product pricing replaced. 64 Fed. Reg. 16026, 16096. While the end product pricing formulas will yield changes in the values of each pound of the milk components based on supply and demand prices for the manufactured products, the "standard" component factors set in the skim milk formulas are immutable.

The "standard" component factors were set at 3.1 pounds of protein, 5.9 pounds of other solids, and 9.0 pounds of nonfat solids per hundredweight of producer milk. In 2022, the components in the average hundredweight of producer skim milk in the FMMOs are 3.39 pounds of protein and 6.02 pounds of other solids. Proposal 1 puts forth a mere update to the accuracy of the skim milk price formulas by updating the "standard" component factors in a hundredweight of skim milk, adjusting the price to handlers for the orders and classes where milk continues to be priced on volume.

This update is in accord with what the Secretary found in Order Reform: that the Class I base price—i.e., the Mover—is based on to the value of the average hundredweight of producer skim milk used for Class III or IV manufacturing. The prices are calculated by taking the price of the Class III or IV skim solids multiplied by the pounds of those solids, which are the static "standard" component factors. *See* 7 C.F.R. § 1000.50(b). Proposal 1 simply updates that calculation to the volume of solids in the average hundredweight of producer skim milk in 2022 versus the volume of solids in the average hundredweight in 2000. (Ex. 18; Ex. 62 at 4; Tr. 156:23-157:1 [Testimony of Dr. Peter Vitaliano].)

At least 10 producers testified in support of Proposal 1, and many testified how their components have changed to be in excess of the current "standard" component factors. For example: producer Karl Wedemeyer's 2022 protein level was 3.8 percent; producer Eric Palla's 2022 protein level was 3.23 percent; producer Paul Windemuller's 2022 protein level was 3.2 percent; producer Matt Johnson's 2022 protein level was 3.18 percent; and producer H.H. Barlow's average protein level over the last three years was 3.7 percent. All producers testified they are constantly enacting changes on their farms to raise their component levels to stay competitive, and those changes come with significant costs. Moreover, a Class I handler testified that they receive milk with skim components in excess of the current "standard" component factors ***100 percent of the time***. (Ex. 106 at 6; Tr. 1202:20-1203:13 [Testimony of Jed Ellis].)

Indeed, the data collected and reported by the USDA demonstrates that component levels have risen since Federal Order Reform without leveling-off. Calvin Covington of Southeast Milk Inc. testified that, based on USDA data, component levels have steadily increased since Federal Order Reform, with protein increasing from 3.02 percent to 3.25 percent and other solids increasing from 5.69 percent to 5.78 percent. At the same time, butterfat has also increased from 3.69 percent to 4.06 percent. Recognizing these component changes will help producers financially.

> Q. And for those Class I markets, do you believe that there is going to be an effect for them as well?
>
> A. Yeah. Well, if the proposal – National Milk's proposal increases skim milk component levels, it will increase the price of – it will increase the Class I skim mover, which increases the Class I price in Federal Milk Marketing Orders. And so if we add more dollars to the Federal Order pools by increasing the skim – the Class I skim milk value and orders in the – in the skim/butterfat market orders, if we add more skim dollars there, it will increase the uniform blend price. And then in orders for multiple component pricing, it will increase the producer price differential.
>
> Q. Okay. So even for the dairy farmers, they – you believe that they would benefit even for their Class I sales?
>
> A. Well, I'm going to say it is more than believe. ***If you add revenue to the Federal Order pool, you are going to increase returns to dairy farmers.***

(Tr. 424:19-425:9 [Testimony of Calvin Covington] (emphasis added).)

In addition to producer and handler testimony and USDA data evidencing higher component levels today versus 2000, Cornell professor Dr. Mike Van Amburgh testified component levels are increasing at an accelerating rate. Changes in geonomics and other reproductive technologies are enhancing the capacity for increased components faster than nutritionists can learn to meet the updated nutrient requirements. Cows are not currently meeting their capabilities for components, which means there is still an unknown amount of room for growth. Nonetheless, because of advances in farm management and nutrition, the rise in components, while still not meeting full-potential, are occurring at a historic pace. For example, since 2012, protein breeding values increase 4.6 times faster than from 1970 to 2012. Based on current rates of increase, there is no projected "top line" level at which components will stall.

Components will continue to rise for the foreseeable future.

Yet, even the data from the USDA—showing an upward trend line in component levels–does not tell the whole story. First, the data reported by USDA is only for pooled milk. Increased components hold value for the manufacturing classes, which often do not pool. It can be safely assumed that depooled milk likely has *higher* components because the incentive to depool is highest when the components are high; if pooled on an MCP FMMO, increased component values increase the possibility of paying into the pool. Thus, the competitive value of a hundredweight of skim milk to manufacturing classes is likely higher than any available data would suggest. Second, in addition to increases in nonfat solids, producers have significantly increased butterfat percentages. As the butterfat increases in milk, then the percentage of milk that is skim decreases and thus even if only butterfat rises, nonfat skim solids also rise. (Ex. 62 at 4; Tr. 156:19-157:6 [Testimony of Dr. Peter Vitaliano].) While the skim formulas obviously do not utilize butterfat, producers' conscious decision to increase butterfat also increase the nonfat component levels.

Because average component levels in a hundredweight of skim milk have undeniably increased since 2000 and the "standard" component factors are no longer accurate, Proposal 1 should be adopted to update the skim milk formulas with current conditions in the dairy industry.

b. The value of milk is derived from its components.

Updating the "standard" component factors in the skim formulas for all classes is important to reflect the fundamental reality that milk derives its value from its components. Specifically, the value of skim milk in Classes II, III, and IV manufactured dairy products is derived from the products which the nonfat components yield, and in Class I, the nutrition those components provide differentiates milk from competing products such as water.

> Q. Do you believe that skim milk solids have a value in Class I?
>
> A. Yes. Yeah. Skim milk solids have a value in Class I or fluid milk.

> Q. And how does that work?
>
> A. Well, people don't buy milk just for colored water. You know, ***it's the solids in milk that give its nutritional value. That's the reason people – people buy – buy milk***. That's the reason why FDA, in some individual states, set minimum solids nonfat standards for – for milk. It gives it value. I mean, why would you drink milk if it didn't have nutritional value?

(Tr. 425:14-425:25 [Testimony of Calvin Covington] (emphasis added).) Consequently, the base value of skim milk in all classes is the value reflected in its components, accurately quantified.

Likewise, producers that testified in support of Proposal 1 noted they must raise their component levels to remain competitive in the market. Class I processors openly recognize the value that solids in milk provides; Class I processors advertise more protein in the milk they sell than that for which they pay producers. While Class I processors receive a premium price for higher solids (Tr. 6049:11-24 [Testimony of Tim Doelman]), producers are relegated to the static "standard" component factors in the skim milk formulas. 7 C.F.R. § 1000.50(b). Despite recognizing financial gain from producers' higher component values, Class I processors are reluctant to pay producers any more than required, and predictably oppose Proposal 1. But processors are not buying water; they admit to receiving a benefit from the solids in milk. Without an update to the "standard" component factors, processors will continue to receive a windfall from producers' labor and investment. Therefore, the "standard" component factors should be increased to reflect contemporary levels and compensate dairy farmers accordingly.

As proprietary Class I handlers push to pay dairy farmers as little as possible for their milk, dairy farmers are incurring increased costs to raise the components in their milk. Multiple witnesses testified to elevated requirements by handlers for milk. For their part, dairy farmers responded to economic signals of the MCP FMMOs—and demands by handlers—by investing and significantly increasing protein and other solids levels in the skim portion of milk through genetics, cow comfort, and better nutrition—i.e., cost of feeds. These costs are significant. Yet, the product being produced from these added costs is not accurately reflected in the FMMOs that price the product. To accurately reflect the value of milk, which is derived from its components, in the FMMOs, the "standard" component factors of the skim formulas should be updated in accordance with Proposal 1.

2. There Is Misalignment Between Class I and Classes II, III, and IV Because the "Standard" Component Factors Are Inaccurate.

In all FMMOs, the increase in component levels has resulted in producers being increasingly underpaid for the true value of their skim milk used in Class I in all orders and in all classes in the skim/fat orders. In the MCP FMMOs, the prices paid producers for milk used for manufacturing increase as component levels increase. However, the Class I skim value, (and the announced Class II, III, and IV skim values), remains stagnant because of the "standard" component factors. Thus, as producers have increased protein and other solids component levels, the price difference between the Class I skim milk price and skim milk prices for Classes II, III, and IV have decreased because Class II, III and IV in multiple component orders reflect the full component value of milk and Class I does not. In this way, these, inaccurate "standard" component factors increase the possibility of price inversions, which, in turn, increases depooling. This will become more pronounced in the future as producer protein and nonfat tests continue to increase. In the non-MCP FMMOs, producers have been increasingly underpaid for the true value of their skim milk in all classes because the manufacturing class prices in non-MCP FMMOs have not increased as component levels have increased. Additionally, the skim/fat FMMOs must pay more for supplemental milk to compete with the increased components in the adjacent MCP FMMOs.

In MCP FMMOs, because the value of Class I skim milk is suppressed by the inaccurate component factors, the PPD is being reduced and producers are being harmed. As pooled component tests increase, more dollars are paid out on all the pooled milk components. But with no commensurate revenue from Class I skim given the outdated "standard" component factors, the revenue left to pay the PPD is diluted. For example, in FMMO 32 for the months of April and May 2023, properly recognizing components at current levels would have resulted in an additional $1,874,755 and $2,190,925, respectively, in producer revenue added to the pool. The PPD would have increased $0.12 and $0.16, respectively, per hundredweight. This inequitable situation must be remedied through an amendment to the "standard" component factors to reflect reality.

Adopting Proposal 1 has myriad benefits. Foremost, the FMMO system will operate in a more orderly fashion. Increasing the component levels in the skim formulas will increase the Class I Mover—i.e., the Class I base price—which will affect Class I price. This in turn will widen the gap between Class I and the manufacturing classes to be more proportional to that originally intended when the Secretary adopted MCP in Order Reform. The result will be higher producer prices, more stable supply to Class I, and increased PPDs. Updating milk component factors decreases price inversions and depooling. The non-MCP FMMOs will also benefit because the Class I price will better align with manufacturing prices and those FMMOs will be more competitive in attracting supplemental milk. Proposal 1 should be adopted.

3. Delayed Implementation and a Procedure for Routine Updates of the "Standard" Component Factors Are in the Best Interests of Producers.

a. Delayed implementation is necessary to protect producers' risk management positions.

Because producers milk prices have become increasingly volatile, producers have increasingly turned to risk management since Order Reform. With Proposal 1, NMPF requests that changes to the "standard" component factors be delayed by 12 months to provide adequate notice to milk price risk management users and allow settlement of most of the transactions entered prior to knowledge of the change to runoff and occur before the new component standards are implemented.[5]

Dairy farmer and manufacturer (not Class I) hedging is a significant practice in the dairy industry and has grown appreciably since 2000. The number of daily open positions on the CME has swelled from less than 25,000 in 2000 to nearly 270,000 in 2022. He indicated it is a substantial advantage to US dairy product exporters when competing for sales with other leading dairy exporting countries. The advantage exists because of the robust and highly used CME Group futures and options market that is tremendously more mature than similar markets in Europe and Singapore – that is used by New Zealand. President of Risk Management for DFA, Edward Gallagher, testified an estimated 35-45% of the United States milk supply is hedged. Informing that estimate, he further testified that nearly 100% of DFA's 11,000 member-owners utilize some form of risk management. DRP debuted in October 2019 and has been embraced by many producers, with 2022 coverage nearing 25% of the industry. In short, a significant and growing number of producers utilize risk management today; whereas, few did at the time of Federal Order Reform. Any change must account for this reality.

Dairy farmers that hedged will be harmed if implementation is not delayed. The delay is necessary to provide time for hedge transactions entered into before knowledge of the change to settle before the change is implemented. Whether using CME or DRP, a producer entered that transaction based on the market and regulatory conditions as they existed at that time—i.e., with "standard" component factors in the skim pricing formulas at their current level. Additionally, an important aspect of risk management is how positions are settled. Dairy futures products are all financially settled—meaning a price reference is used for final settlement—using underlying

[5] MIG, one of the primary opponents to changing component levels, does not oppose delayed implementation.

USDA published pricing references.

When making hedge decisions, dairy farmers choose their futures price for the hedge based in part on their expectation of their milk price basis, which combined give them an expected total blend price at their expected full components. Class III futures and Dairy Revenue Protection Insurance settles against the USDA announced Class III prices. Consider a hypothetical where a producer hedges against a Class III price of $17.08 per hundredweight. (*See* Ex. 109 at 11 [Testimony of Edward Gallagher].) A producer hedging their milk price would sell a futures contract (i.e., take a short position in the futures market) to protect their milk price from declining. With a short futures contract, a decline in price results in a profit on the futures transaction and provides income to make up for the decline in the milk price when selling their milk to a handler. If a producer hedges their Class III price at $17.90 per hundredweight and the settlement price is $17.08 per hundredweight, their futures contract would result in a gain of $17.90 per hundredweight minus the settlement price of $17.08 per hundredweight, or $0.82 per hundredweight. For the month, the producer would receive a Class III price of $17.08 per hundredweight, the announced Class III price, from their handler. The $17.08 per hundredweight handler Class III price plus their $0.82 per hundredweight futures profit equals $17.90 per hundredweight —the milk price they were expecting. This example however ignores the value of their actual component tests which will be higher than the standard component tests and are an important element of their handler pay price.

Following on with the hedging example, a dairy with a 3.27% protein test and a 5.81% other solids test would have a non-fat solids component basis of $0.82 per hundredweight over a Class III price at standard tests. (*See* Ex. 109 at 13 [Testimony of Edward Gallagher].) A producer choosing to hedge at the Class III futures price of $17.08 per hundredweight is expecting a full component price, assuming their components are 3.5% butterfat, 3.27% protein and 5.81% other solids, to be $17.90 per hundredweight, which is the standard test Class III price plus $0.82 per hundredweight of additional component value per hundredweight. In this example, the producer chooses to hedge at a $17.08 per hundredweight Class III futures price because the full component price of $17.90 per hundredweight covers their costs and leaves them with a profit on their milk. Because they are aware of the standard components and their own usual components, this basis amount will be generally stable.

If the announced Class III settlement milk price is $17.08 per hundredweight, the short Class III futures contract will not have a gain or loss, the handler will pay a standard Class III price of $17.08 per hundredweight plus the $0.82 per hundredweight of component basis, on component tests that exceed the standard tests of the announced Class III milk price that is used as the settlement price, or $17.90 per hundredweight. However, if between the futures transaction and the announcement of the Class III price for the month that was hedged, the skim component tests used to determine the Class III price are increased to 3.27% protein and 5.81% other solids, the producer would not achieve their expected milk price. Instead, the Class III settlement price would be $17.90 per hundredweight, which would be $0.82 per hundredweight higher than the Class III futures transaction, resulting in a loss on the futures contract of $0.82 per hundredweight. The handler would pay the producer the new standard test Class III price of $17.90 per hundredweight. However, since the new standard tests are the same as the producer's component test, there would be zero value of the additional component basis. This results in the producer netting $17.08 per hundredweight which is the $17.90 announced Class III price minus the $0.82 per hundredweight loss on the hedge and without any additional payment for higher component values beyond the standard components. per hundredweight. This is below the expected milk price of $17.90 and would likely result in a loss on producing the milk instead of a profit. This loss occurs because the expected component basis was absorbed into the new standard component test announced Class III price. The loss would be unexpected and solely a result of the regulatory change. As a result, any changes to the formulas will negatively impact the expected outcomes and the effectiveness of the risk management transactions entered before knowledge of the changes or knowledge of the effective dates of the changes.

To protect producers that utilize risk management, updating the "standard" component factors should be delayed 12 months. This would enable producers to calculate their new expected basis from any component values they achieve above the new standard component values before executing hedge transactions for their future production and without worry and economically harmful risk of a lower and unprofitable outcome due to the regulatory change. Most producers testified to using some form of risk management. Numerous producers—Karl Wedemeyer, Kristine Spadgenske, Brian Rexing, Eric Palla, Paul Windemuller, and Matt Johnson—testified in support of delayed implementation to protect their risk management strategies. Edward Gallagher testified that without a delayed implementation, the "basis" these producers have in their risk management positions will be cannibalized by changes to the "standard" component factors. For its part, the USDA has considered "phased-in" approaches when, absent the phased-in approach, there is the potential for significant economic impact on producers. *See, e.g.*, 63 Fed. Reg. 4802, 4827 (Jan. 30, 1998). Given the potential for producers to lose some or all of the benefit of their hedging strategy and their basis in a particular transaction, delayed implementation is necessary to avoid significant financial harm to many producers.

b. Automatic updates are necessary to ensure the "standard" component factors track with reality on the farm.

In addition to delaying implementation, a procedure for periodically updating the "standard" component factors should be adopted. A balance must be struck between changing too often (e.g., annually) and not often enough (e.g., every 20 years). Proposal 1 puts forth a simple procedure that will change components as often as every three years to prevent class misalignment problems associated with outdated "standard" component factors and avoid the need for formal rulemaking to change the component levels:

(1) by February 28th of the third year beginning one year after the announcement of a change of skim milk factors, AMS shall calculate the weighted average of component pounds (protein, other solids, nonfat solids) in one hundred pounds of FMMO producer skim milk for the three previous calendar years;

(2) if the result of the nonfat solids calculation differs by the nonfat solids factor in effect by 0.07 percentage points or more, then update the factors for protein, other solids, and nonfat solids to the corresponding calculated values;

(3) the updated factors would be announced no later than five (5) days after the calculation;

(4) implementation of the updated factors would be effective the first day of March of the following year;[6]

(5) if the calculation does not exceed the 0.07 percentage point threshold, repeat this procedure in the following year, using the weighted average for the three preceding calendar years;

(6) continue this procedure in subsequent years, until the 0.07 percentage point threshold is exceeded, and the skim milk component factors are updated,

[6] The implementation date need not be the first day of March. NMPF is willing to accept any implementation date if it maintains the lag to account for producers' risk management strategies.

accordingly; and

(7) if the factors are updated, repeat the procedure after three years.

This procedure can be placed into the regulations and conducted without additional administrative burden. USDA AMS already tabulates component levels. When those nonfat solids levels change—up or down—by more than 0.07 percentage points over a three-year weighted average period, a change to the skim formula would occur. The 0.07 percentage point threshold is based on historical changes in the nonfat solids levels and represent a significant enough deviation in component levels to warrant a change to the formulas. Implementing a multi-year weighted average threshold avoids minor "nuisance" changes that do not meaningfully impact prices and avoids changing prices in a way that overvalues or undervalues components. (Tr. 501:1-13 [Testimony of Calvin Covington].) With rapid advances in genomics, biotechnology, and nutrition complicated by weather events that could impact feed supply, it is possible to have unexpectedly large differences from one year to the next. Further, a change cannot occur more often than every three years, which will avoid volatility and confusion through more frequent changes. Finally, the date of change will be known at a point in the future to protect the risk management strategies of producers.

The need for a self-executing procedure that occurs at regular intervals is the same as the need for updating the "standard" component factors in this hearing: component levels continue to rise but the "standard" component factors in the skim milk pricing formulas remain stagnant. As testified to by Dr. Van Amburgh, there is no projected "top line" at which components will level; components will continue to rise for the foreseeable future. Producers recognize the value of milk is in its components and that the market is demanding higher component milk. No producer testified that he or she is maintaining the status quo. All producers are constantly reinvesting in their farms to improve efficiency through genetics, farm management, cow comfort, and improved nutrition. The FMMO formulas should reflect this reality and do so without the need for protracted formal rulemaking. A procedure for automatically updating the "standard" component factors in the skim milk pricing formulas should be adopted.

4. NMPF Opposes the Annual Updates in Proposal 2.

NMPF supports Proposal 2, submitted by NAJ, except to the extent it proposes annual updates to the "standard" component factors in the skim milk pricing formulas. NMPF agrees with NAJ's testimony that the "standard" component factors are inaccurate and, as a result, have caused price inversions in 2021 and 2022. (*See* Ex. 67 [Testimony of Erick Metzger] (showing Class III/I price inversion in 2021 and Class IV/I price inversion in 2022). However, NMPF does not support annual updates to the "standard" component factors for the reasons in support of using a three-year weighted average. A three-year weighted average provides greater stability and accuracy than annual updates. As NAJ admitted, Proposal 2 has the potential to overvalue milk, and NAJ framed this as a choice between overvaluing a little or undervaluing a lot. (Tr. 543:12-545:6 [Testimony of Erick Metzger].) However, that is not a choice that needs to be made by the Secretary if Proposal 1 is adopted. By limiting changes of "standard" component factors to a periodic basis and relying on three-year weighted averages, Proposal 1 is more likely to produce accurate component values and avoid disruption from frequent changes. Accordingly, annual updates should not be implemented.

5. Opponents to Proposal 1 Rely on Fallacies and Equivocation.

Opposition to Proposal 1—primarily advanced by IDFA and MIG—relies on mischaracterization and improper reframing of what Proposal 1 is intended to accomplish and how it would operate in practice. Before addressing the opposition's arguments with particularity, it is important to set out how the "standard" component factors in the skim milk pricing formulas operate.

The purpose of the "standard" component factors is to convert component prices, derived from end-product pricing, into Class II, III, and IV skim milk prices per hundredweight. Skim milk prices per hundredweight are needed to calculate the Class I Mover and the published Class II, III, and IV prices. The basic premise for a Class I price is the competitive value of milk for manufacturing plus the Class I differential. The component levels in the skim formulas were not intended to designate a minimum component level that all milk must meet; the purpose is to convert component prices into the average value of producer milk for manufacturing, which is also the base price for Class I.

It is undeniable that skim milk component levels have increased significantly since 2000. Producer and handler testimony and USDA data all confirm this reality. As a result, higher component levels have increased the actual price of manufacturing milk at test. With the Class I skim milk price still calculated based on the "standard" component factors implemented in 2000, the Class I price is no longer based on the competitive value of milk for manufacturing plus the Class I differential. Rather, it is now based on a lower, outdated, manufacturing milk price. Updating the "standard" component factors restores the proper, and effective, value of average producer milk in all classes in skim/fat orders and the proper base price for Class I skim in all orders.

With this proper lens in place, the opposition's arguments can be quickly dispatched as baseless. The opposition, focusing on Class I, argues they are unable to recoup the value from higher "standard" component factors in the skim formulas through yield or otherwise. This is fallacious for two reasons.

First, the purpose of the skim milk formulas is to accurately quantify the value of skim milk, a value which in the end-product pricing system is derived from the value of the nonfat components. The formulas are not intended to compensate handlers for what they can receive for milk in the consumer market or for "yield" of Class I products. There is no basis in the AMAA or the uniform pricing provisions to support a position that the base Class I skim price should be set based on handlers' ability to market a particular volume based on the price handlers pay for milk or realize a particular amount of yield in relation to the components. Indeed, handlers have no objection to how the base price is calculated currently. (Tr. 1164:24-26 [Testimony of Wendy Landry].)

Second, handlers are already receiving the proposed "standard" component factors in Proposal 1. Some handlers receive milk with skim components exceeding the current FMMO fixed factors 100 percent of the time. (Ex. 106 at 6; Tr. 1202:20-1203:13 [Testimony of Jed Ellis].) The advanced Class I skim price allows Class I handlers to set their prices to consumers with full knowledge of input costs. Despite claiming handlers want to pay for what they are receiving (Tr. 1201:13-1202:1 [Testimony of Jed Ellis]), the opposition's true, thinly-veiled, objection is to the Secretary erasing their windfall from avoiding paying for components they are already receiving. Updating the "standard" component factors to reflect reality brings the skim milk pricing formulas into accord with the true competitive value of milk for manufacturing purposes, which is the basis for setting a Class I price.

While not specifically targeted at the "standard" component factors, the opposition argues the country is "awash" in milk and thus any proposal that increases Class I prices is unnecessary. The opposition's "awash" theory fails to account for regional differences and commercial relationships that dominate the dairy industry. This is more fully addressed in the discussion on Proposal 19. *See infra* at 186-330. However, this argument also fundamentally misunderstands the purpose of the "standard" component factors—which is to convert component prices into the average value of manufacturing milk, which is the base Class I price—and the intent of Proposal 1—which is to update the "standard" component factors to reflect reality. The opposition's arguments are a distraction to avoid the truth: IDFA and MIG have no principled basis to oppose Proposal 1 other than wanting to keep prices down at the expense of the dairy farmers.

To that end, opponents have not proposed an alternative formulation for the skim milk pricing formulas, different "standard" component factors, or an alternative to using the value of solids. The opposition admits components are trending upward and certain handlers receive milk with skim components exceeding the current FMMO fixed factors 100 percent of the time. (Tr. 1202:20-1203:13; Tr. 1205:7-10 [Testimony of Jed Ellis]; *see also* Tr. 1085:1-2 [Testimony of Mike Brown] ("And we're not denying components have an increase, it's the degree.").) The opposition also recognizes the basic premise for a Class I price is the manufacturing milk price plus the Class I differential (*see, e.g.*, Tr. 1148:13-18 [Testimony of Wendy Landry] (recognizing Class I price is based on its best alternative use in manufacturing)) and is not arguing to decouple the link between Class I and manufacturing classes. (Tr. 1088:21-1089:4 [Testimony of Mike Brown].) Put another way, the opposition to Proposal 1 commits an absurdity by recognizing the basic purpose of the "standard" component factors, and that the "standard" component factors are not at the same level as during Federal Order Reform, but still opposing Proposal 1.

Several opponents of Proposal 1 presented data, either from their own processing operations (*see e.g.*, Tr. 1122-1129 [Testimony of Wendy Landry]; Tr. 1187-1193, [Testimony of Jed Ellis]), or from a survey of processing operations (Tr. 1380-1405 [Testimony of Sally Keefe]), purporting to demonstrate that milk solids in milk received for processing often do not meet the levels called for in Proposal 1. These claims all use data for the 24-month period January 2021 through December 2022, but compare that data to a standard that would not initially come into effect until at least 2026 under Proposal 1, with similar implementation lags under the Proposal's recommended procedure for future updates. Since there is uniform agreement that skim components in milk will continue to increase in the future, proponents' analyses are a temporal equivocation and are therefore invalid and should be disregarded.

Importantly, the opposition avoids what Proposal 1 will *not* do. Proposal 1 does not give any Class I handler a competitive advantage over another (because the change will affect all Class I handlers uniformly) and does not change that Class I handlers pay for skim milk based on quantity. *See, e.g.*, 7 C.F.R. § 1032.60(a); *see also* 7 U.S.C. § 608c(5)(A) (handler price uniformity); 7 C.F.R. § 1000.50(q) (using components to value Class III and IV). Nor is Proposal 1 intended to establish a minimum component level that producers must meet (though, in fact, producers are meeting it because the market demands it). Nor does Proposal 1 require processors to add solids to their milk (Tr. 1154:26 [Testimony of Wendy Landry].0 While the opposition attempted to frame the "standard" component factors in the skim milk pricing formulas as "minimum levels," the formulas do not currently operate that way and Proposal 1 does not seek otherwise. The opposition relies on equivocation because the opposition to Proposal 1 is baseless. The only principle adhered to by the opposition is that it wants lower prices for Class I handlers by maintaining inaccurate "standard" component factors in the skim milk pricing formulas. This, of course, reduces the prices producers receive, which directly contradicts the purpose of the AMAA, and cannot be condoned by the Secretary. The Secretary should adopt Proposal 1.

IV. PROPOSAL 3 SHOULD BE ADOPTED: FORTY-POUND CHEDDAR BLOCKS SET THE BASE PRICE FOR THE CHEESE MARKET AND SHOULD BE THE SOLE COMPONENT IN THE PROTEIN PRICE FORMULA.

PROPOSED FINDINGS OF FACT

A. The Secretary Incorporated Barrels into the Protein Price Formula to Add Volume to the Block Price and Synthetically Adjusted the Barrel Price to the Block Price.

1. The Class III milk price is derived from calculations of component prices for protein, butterfat, and other solids. *See* 7 C.F.R. § 1000.50(h). The protein component price formula references two survey price series for cheddar cheese: 40-pound block yellow cheddar ("Block" or "Blocks") cheese price ("Block Price") and the 500-pound moisture-adjusted barrel cheddar cheese ("Barrel" or "Barrels") price ("Barrel Price"). (Ex. 114 at 4; Tr. 1485:27-1486:7 [Testimony of Dr. Peter Vitaliano]); *see also* 7 C.F.R. § 1000.50(n)(1)(i), (ii).

2. The protein price calculation begins with a weighted average of the Block Price and the moisture-adjusted Barrel Price plus $0.03 per pound.[7] (Ex. 114 at 4; Tr. 1486:8-11 [Testimony of Dr. Peter Vitaliano]); *see also* 7 C.F.R. § 1000.50(n)(1). The averages are weighted by sales volumes reported to AMS and published in the NDPSR. (Ex. 114 at 4; Tr. 1486:11-15 [Testimony of Dr. Peter Vitaliano]); *see also* 7 C.F.R. § 1000.50(n)(1).

3. The $0.03 difference between the Block Price and the Barrel Price represents the cost of processing difference between the two products. (Ex. 114 at 4; Tr. 1487:10-15 [Testimony of Dr. Peter Vitaliano] (quoting 64 Fed. Reg. 16026, 16098); Ex. 126 at 2; Tr. 1935:14-18 [Testimony of Christian Edmiston].)

4. The original intent was to put the Blocks and Barrels on equal price terms, which

[7] The protein price calculation is completed by subtracting a make allowance (i.e., a partial offset for the cost of processing) and multiplying by yield factors (i.e., the pounds of cheese that can be made from one pound of a component). *See* 7 C.F.R. § 1000.50(n)(2), (3).

meant no major impacts to producers or processors of barrels. (Ex. 126 at 2; Tr. 1935: 18-20 [Testimony of Christian Edmiston].) Since that time, the Barrel Price has become increasingly more distant from the Block Price and the $0.03 addition to barrels is not enough to cover the delta between the two. (Ex. 126 at 2; Tr. 1935: 21-24 [Testimony of Christian Edmiston].)

5. Historically, using both Block and Barrel Prices in the Class III pricing formula effectively increased the volume of cheddar cheese reported in the NDPSR. (Ex. 114 at 4-5; Tr. 1487:16-18 [Testimony of Dr. Peter Vitaliano].) The original intent with using the Barrel Price to determine the protein price was to bolster the volume of Blocks on the survey; hence why the Barrel Price was adjusted to resemble the Block Price. Effectively, the formula assumes Blocks and Barrels are the same product in different packaging. (Ex. 114 at 6; Tr. 1490:4-20 [Testimony of Dr. Peter Vitaliano]; Ex. 126 at 2; Tr. 1935:14-20 [Testimony of Christian Edmiston]; Ex. 117 at 5; Tr. 1618:20-1619:3 [Testimony of Darin Hanson] ("The [Barrel Price was] adjusted by $0.03 per pound and adjusted for moisture to arrive at a synthetic [Block]-equivalent price"); Ex. 119 at 1; Tr. 1777:19-25 [Testimony of Paul Bauer] ("The original concept to include the [Barrel Price] in the Class III price calculation was to get more input tonnage for use in estimating the most accurate pricing of cheese sales into the market. The [Barrel Price] incorporated adjustments to . . . get to a synthetic [Block Price].").)

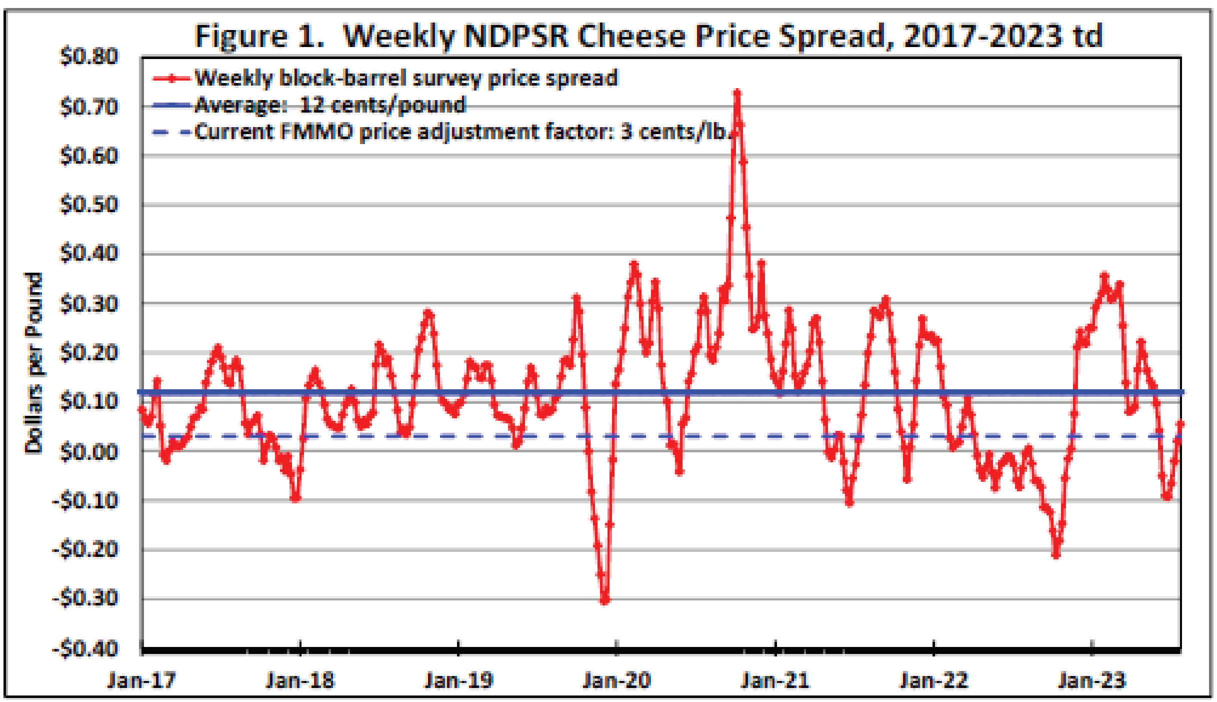
6. Whereas Blocks have robust markets and many uses, Barrels are singularly focused on processed cheese, a market driven by a few processors and purchasers. (Ex. 119 at 2; Tr. 1778:19-22 [Testimony of Paul Bauer].)

7. The inclusion of both the Block Price and Barrel Price was reasonable because the prices were highly correlated. (Ex. 117 at 5; Tr. 1618:20-24 [Testimony of Darin Hanson].)

8. From 2000 to 2016, the spread between Block Price and Barrel Price in the NDPSR remained close to the assumed $0.03 per pound. (Ex. 114 at 4-5; Tr. 1487:10-18 [Testimony of Dr. Peter Vitaliano].)

B. The Volatile Spread Between the Block Price and Synthetic Barrel Price Undervalues the Class III Price.

9. Since 2017, however, prices have been more volatile. From January 2017 through July 2023, the Block Price/Barrel Price spread in the NDPSR ranged from -$0.305 per pound (meaning that barrel prices were higher than block prices) to $0.727 per pound. (Ex. 114 at 4-5; Tr. 1487:18-1488:2 [Testimony of Dr. Peter Vitaliano].)



(Ex. 114 at 5; Tr. 1488:7-17 [Testimony of Dr. Peter Vitaliano].)

10. As a yearly average, the NDPSR Block Price/Barrel Price spread averaged $0.01 from 2000 to 2016 and $0.11 from 2017 to 2022. (Ex. 117 at 7; Tr. 1619:20-1620:2 [Testimony of Darin Hanson].)

Table 4: NDPSR (NASS) Block and Barrel Spread History

Year	NDPSR Block Minus Barrel Spread
2000	$ 0.03
2001	$ 0.01
2002	$ 0.02
2003	$ 0.02
2004	$ 0.01
2005	$ 0.02
2006	$ 0.00
2007	$ (0.01)
2008	$ (0.00)
2009	$ 0.02
2010	$ 0.01
2011	$ (0.01)
2012	$ 0.01
2013	$ 0.02
2014	$ 0.01
2015	$ 0.01
2016	$ (0.01)
2017	$ 0.07
2018	$ 0.12
2019	$ 0.08
2020	$ 0.27
2021	$ 0.14
2022	$ 0.01
2000-2016 Avg	**$ 0.01**
2017-2022 Avg	**$ 0.11**

(Ex. 117 at 7 [Testimony of Darin Hanson].)

11. Without volatility in this price spread, the flaws in the Class III pricing formula structure were not evident. The departure of the historically stable price relationship between Block and Barrel has become evident since 2017 and has created financial impacts on producers. (Ex. 126 at 2; Tr. 1935:25-1936:4 [Testimony of Christian Edmiston].)

12. Now, the smaller statistical information captured by including the Barrel Price results in skewing, rather than making more accurate, the actual cheese prices in the market because of this small market report that can be entirely disconnected from the rest of the cheese market. (Ex. 119 at 2; Tr. 1778:22-27 [Testimony of Paul Bauer].)

13. The increased spread between Block Price and Barrel Price has caused instability in the cheese market and reduced revenue for dairy farmers because the Barrel Price is playing a disproportionately large role in the setting of the Class III price compared to its role in the market. (Ex. 114 at 5; Tr. 1489:18-28 [Testimony of Dr. Peter Vitaliano].)

14. Most cheese sold in the United States utilizes the CME Block price as a pricing index. Approximately 90 percent of the natural cheese produced in the United States is priced in this fashion. While the CME also has a Barrel price, that price is not used as an index for the sale of cheese products other than Barrels. (Ex. 114 at 5; Tr. 1488:18-1489:2 [Testimony of Dr. Peter Vitaliano]; Ex. 117 at 8-9; Tr. 1620:14-24 [Testimony of Darin Hanson].)

15. "[O]nly a very small fraction of cheese [is] priced off of [Barrel]." (Ex. 126 at 1; Tr. 1934:20-24 [Testimony of Christian Edmiston].) The CME Barrel price was used to price only about 9 percent of total domestically produced natural cheeses during calendar year 2022, including Barrels themselves. (Ex. 114 at 5; Tr. 1489:3-7 [Testimony of Dr. Peter Vitaliano]; *see also* Ex. 141.)

Exhibit NMPF - 6A

	CY 2022 Volume		Priced by Blocks	Priced by Barrels
	mil. lb.	*%*	*mil. lb.*	*mil. lb.*
NATURAL CHEESE	**13,816**	**100%**		
AMERICAN, CHEDDAR:	3,964	**29%**		
40# & 640# CHEDDAR BLOCKS	2,764	**20%**		
500# CHEDDAR BARRELS	1,200	**9%**		
NDPSR 40# BLOCKS (48% of NDPSR)	643	**5%**	643	
NDPSR 500# BARRELS (52% of NDPSR)	701	**5%**		701
NON-NDPSR CHEDDAR:	2,619	**19%**	2,121	499
OTHER AMERICAN	1,677	**12%**	1,677	
BLUE & GORGONZOLA	92	**1%**	92	
BRICK	1.5	**0.01%**	1.5	
CREAM & NEUFCHATEL	1,130	**8%**	1,130	
FETA	141	**1%**	141	
GOUDA	62	**0.4%**	62	
HISPANIC	386	**3%**	386	
ITALIAN, HARD, PARMESAN & SIMILARS	494	**4%**	494	
ITALIAN, HARD, PROVOLONE & SIMILARS	383	**3%**	383	
ITALIAN, HARD, ROMANO & SIMILARS	57	**0.4%**	57	
ITALIAN, OTHER	95	**1%**	95	
ITALIAN, SOFT, MOZZARELLA	4,628	**33%**	4,628	
MUENSTER	192	**1%**	192	
OTHER	163	**1%**	163	
SWISS (Priced by a Class III-based formula)	351	**3%**	168	183
TOTAL	**13,816**		**12,433**	**1,383**
Source: USDA/NASS, AMS/NDPSR	**100%**		**90%**	**10%**

16. Thus, the ratio of Blocks on the NDPSR versus Barrels on the NDPSR is not representative of cheese pricing in the United States. Yet, the protein price within the Class III formula is weighted nearly equally between the Block Price and Barrel Price. Consequently, when the Block Price is well above the Barrel Price, as has mostly been the case since 2017, the result is a Class III milk price that is artificially lower because of the over-representation of Barrel. (Ex. 126 at 1; Tr. 1934:18-1935:2 [Testimony of Christian Edmiston].)

17. The Class III milk price has been undervalued because the proportion of Barrels used in the protein price calculation is significantly overstated relative to the total volume of commodity cheese priced using the Barrel market as an index. (Ex. 117 at 2; Tr. 1616:10-14 [Testimony of Darin Hanson].)

18. Since 2017, Barrels have been selling at a significant discount compared to Blocks. The resulting impact in the Class III price has cost dairy producers around two billion dollars in lost revenue. And this impact is understated because of the significant depooling of Class III in 2020 and 2021. (Ex. 117 at 2-3; Tr. 1616:18-28 [Testimony of Darin Hanson].)

Table 1: Block/Barrel Spread Impact to Dairy Producers

Year	Class III Annual Milk Pounds	Class I Annual Milk Pounds	Class I Pounds Driven by Class III	Class III Plus Class I Pounds	Converted to cwt	NDPSR Block Barrel Spread	Spread Minus $0.03/lb	Converted to cwt Impact	$ Impact to Dairy Producers
2017	55,897,144,585	40,654,709,100	37,236,216,602	93,133,361,187	931,333,612	$ 0.07	$ 0.04	$ 0.17	$ 158,500,097
2018	61,583,657,246	40,944,720,574	33,708,732,204	95,292,389,450	952,923,895	$ 0.12	$ 0.09	$ 0.42	$ 397,608,766
2019	64,190,876,175	43,881,688,527	28,848,885,587	93,039,761,762	930,397,618	$ 0.08	$ 0.05	$ 0.24	$ 218,844,406
2020	32,903,300,887	43,766,303,983	21,883,151,992	54,786,452,879	547,864,529	$ 0.27	$ 0.24	$ 1.16	$ 632,801,428
2021	37,560,263,627	42,127,249,523	21,063,624,762	58,623,888,389	586,238,884	$ 0.14	$ 0.11	$ 0.51	$ 297,472,559
2022	81,785,483,605	40,986,267,286	20,493,133,643	102,278,617,248	1,022,786,172	$ 0.01	$ (0.02)	$ (0.10)	$ (101,759,894)
2023	42,243,929,390	20,038,946,961	10,019,473,481	52,263,402,871	522,634,029	$ 0.19	$ 0.16	$ 0.78	$ 408,939,822
Total									**$ 2,012,407,184**

*The table shows the impact on dairy producer revenue of actual block/barrel spread versus if the spread was $0.03/lb spread (as used in the Class III formula) during 2017-2023 (June). Calculations based on total Class III milk volume plus Class I volume impacted by the Class III price. Since 05/2019 this volume is half of the Class I volume. Prior to 05/2019, the volume included are the months where Class III was the 'higher of' price of the Class III and IV. Based on Class III pricing formulas, every

(Ex. 117 at 3 [Testimony of Darin Hanson].)

19. The disparity is also harming producers whose milk goes towards manufacturing Barrels. Since 2017, Ellsworth Cooperative Creamery ("Ellsworth") producers, whose milk goes towards Barrels, have received $0.84 per hundredweight less than their counterpart cooperatives

without a barrel operation. (Ex. 119 at 4; Tr. 1780:6-13 [Testimony of Paul Bauer].)

C. Blocks and Barrels Are Not Interchangeable Products.

20. Blocks and Barrels are no longer essentially the same product. (Ex. 114 at 6; Tr. 1490:18-20 [Testimony of Dr. Peter Vitaliano]; Ex. 117 at 6, 9; Tr. 1619:4-7 [Testimony of Darin Hanson] ("With the price spread between [Block] and [Barrel] becoming less predictable with larger price difference swings, [Barrel] can no longer be used to represent a synthetic [Block] equivalent price. . . .") and Tr. 1621:19-21 ("The two forms of cheddar cheese are not interchangeable products and have developed into different and distinct markets. . . .").)

21. The volume of Blocks reported on the NDPSR has grown by more than 334,400,000 pounds since 2000. The continued growth in NDPSR Block demand and growing capacity of Block sales volume renders the original reason behind including Barrels in the protein price invalid. (Ex. 132 at 3-4; Tr. 2138:2-10 [Testimony of Emma Downing Reynolds].)

22. Blocks and Barrels cannot be substituted at an equal exchange. White cheddar packaged in Barrels is almost exclusively used in the production of process cheese. Restaurants and fast-food outlets are the primary purchasers of processed cheese. Because the current standard for processed cheese is Barrels of ungraded USDA white cheddar, a Block of yellow cheese cannot be substituted easily. The color in the Block would make some substitutions impossible, and the moisture differences would change the recipes and ingredient statements of some process cheese. Thus, a complete substitution between Barrel and Block would not be possible or acceptable for most of the process cheese manufacturers and process cheese buyers. (Ex. 119 at 5; Tr. 1780:24-1781:10 [Testimony of Paul Bauer].)

23. Today, including the Barrel Price is doing the opposite of that which was intended; inclusion of the Barrel Price is creating disorderly marketing in FMMOs by artificially pulling down prices that do not correlate to the actual market, resulting in a reduced Class III price.

(Ex. 119 at 1; Tr. 1777:26-1778:3 [Testimony of Paul Bauer].)

24. Eliminating the Barrel Price from the protein price, and thus Class III price, formula will benefit dairy farmers. (Ex. 114 at 6; Tr. 1490:26-1491:18 [Testimony of Dr. Peter Vitaliano].) When the Block Price exceeds the Barrel Price, Barrel plants struggle to maintain profitability with a regulated milk price based on the weighted average of Block and Barrel. (Ex. 126 at 1; Tr. 1935:3-8 [Testimony of Christian Edmiston].) Producers either absorb this financial impact through direct ownership of the plant via a cooperative, or through lower milk prices paid to producers by a plant in areas outside FMMOs. (Ex. 126 at 1; Tr. 1935:8-12 [Testimony of Christian Edmiston].)

D. The Barrel Price Should Be Eliminated from the Protein Price Calculation.

25. The Block Price and Barrel Price are no longer highly correlated and inclusion of Barrel in the protein price is inappropriate. (Ex. 117 at 6; Tr. 1619:4-9 [Testimony of Darin Hanson].)

26. Eliminating the Barrel Price in the protein price formula will result in pool values that more accurately reflect the value of milk used to produce cheese because the Class III price will be based entirely on the index that prices between 75 percent to 90 percent of cheese without inclusion of an index that prices 9 percent of cheese. (Ex. 114 at 6; Tr. 1490:26-1491:2 [Testimony of Dr. Peter Vitaliano]; Ex. 117 at 8; Tr. 1620:21-1621:5 [Testimony of Darin Hanson]; Ex. 119 at 6; Tr. 1782:2-12 [Testimony of Paul Bauer].)

27. Eliminating the Barrel Price will increase the Class III price. (Ex. 114 at 6; Tr. 1491:15-18 [Testimony of Dr. Peter Vitaliano].) For example, without the Barrel price, from 2017 to 2022, the Class III price would have increased by $0.41 per hundredweight. (Ex. 114 at 6; Tr. 1491:19-27 [Testimony of Dr. Peter Vitaliano].)

28. Eliminating the Barrel Price will provide more meaningful risk management

opportunities for producers because risk management tools are built around Block. (Ex. 114 at 6; Tr. 1491:8-14 [Testimony of Dr. Peter Vitaliano]; Ex. 117 at 9; Tr. 1622:6-8 [Testimony of Darin Hanson].)

29. Without the Barrel Price, there will still be adequate survey volume for accurate price discovery. Approximately 69 percent of cheddar cheese is in the form of Blocks (i.e., 40 pounds) or 640-pound blocks. Reported volumes of Block represent 16 percent of total cheddar cheese production. For comparison, the NDPSR weekly butter survey represents 9 percent of butter production, and that price is the only commodity product price used in the butterfat formula. Moreover, the protein price formula is the only component formula that relies on two products. (Ex. 114 at 6; Tr. 1491:28-1492:5 [Testimony of Dr. Peter Vitaliano]; Ex. 126 at 2; Tr. 1936:7-11 [Testimony of Christian Edmiston] ("Price discovery will not be impacted"); Ex. 117 at 4, 8; Tr. 1618:13-19, 1620:10-13 [Testimony of Darin Hanson].)

30. Further, when a single price series is used to calculate a component price—such as protein—the cost of milk will be highly correlated with the price of the finished product. However, because the protein price is based on reported prices received from sales of both Blocks and Barrels, processor profitability, which impacts cooperatives that process cheese, will fluctuate if the spread between Blocks and Barrels is highly variable. Since 2017, the price spread between Blocks and Barrels has been extremely variable, resulting in earnings volatility. Barrel manufacturers have been paying high milk costs relative to the prices received for Barrels. Block manufacturers have faced financial uncertainty when the price spread shifts dramatically over time. (Ex. 117 at 3-4; Tr. 1617:10-24 [Testimony of Darin Hanson].)

31. Attempting to proportionally utilize Blocks and Barrels based on the percentage of cheese priced off those products will exacerbate the problem for producers whose milk goes toward

barrel manufacturing. (Ex. 119 at 7; Tr. 1782:25-1783:6 [Testimony of Paul Bauer].)

E. Producers Support Elimination of the Barrel Price from the Protein Price Calculation in the Class III Price Formula.

32. Land O'Lakes ("LOL") supports removal of Barrels from the protein price formula. (Ex. 126 at 2; Tr. 1936:24-27 [Testimony of Christian Edmiston].)

33. Ellsworth supports removal of Barrels from the protein price formula. (Ex. 119 at 7-8; Tr. 1783:7-10 [Testimony of Paul Bauer].)

34. DFA supports removal of Barrels from the protein price formula. (Ex. 132 at 1; Tr. 2135:9-15 [Testimony of Emma Downing Reynolds].)

35. Wisconsin producer Kristopher Scheider, along with his cooperative Foremost Farms ("FF"), supports elimination of Barrels from the protein price formula because the spread between the Block Price and Barrel Price is causing the Class III price to be undervalued. This is a detriment to the dairy industry because it harms both producers and manufacturers trying to capitalize on the true value of dairy products. Mr. Scheider astutely noted: "Trying to price off the barrel v[ersu]s block market would be the same as pricing one acre of farmland for commodity production vs one acre of farmland for real estate development. Neither belongs in the same category but both are tied to pricing." (Ex. 125 at 2; Tr. 1911:7-1912:8 [Testimony of Kristopher Scheider].)

36. Wisconsin producer Evan Hillan, along with his cooperative LOL, supports elimination of Barrels from the protein price formula because the inclusion of Barrels compresses the margins for Barrel manufacturers, which is in turn felt by cooperatives that invest in Barrel plants. (Ex. 163 at 1-2; Tr. 2902:16-19, 2903:13-18 [Testimony of Evan Hillan].)

ARGUMENT

F. Proposal 3 Recognizes Market Reality and Brings Uniformity in Commodity Pricing: Eliminate Use of Barrels in the Class III Protein Price Formula.

The natural cheese market overwhelmingly uses Blocks as an index for pricing. Appropriately, Blocks are included in the protein price formula that figures heavily into the Class III price. As a pricing index for a vast majority of the natural cheese sold in the United States, Blocks are a natural representative of the Class III marketplace. Inappropriately, the protein price formula also relies on the survey price for Barrels. Worse, the protein price formula weighs Blocks and Barrels nearly evenly despite Barrels barely playing a role in how prices are set for other cheese products. As a result, significant and unpredictable price fluctuations have become common in the last six years, and the protein price formula is no longer representative of how Class III product prices are established in free and open interactions. *See* 64 Fed. Reg. 16026, 16094. Simply, Class III is being undervalued, and dairy farmers are being underpaid. To remedy this volatility, the unnecessary Barrels should be eliminated from the protein price formula. The protein price should be determined only by reference to Blocks. NMPF's proposed amendment to 7 C.F.R. § 1000.50(n) should be adopted. (*See* Ex. 114 at 11; Tr. 1493:5-27 [Testimony of Dr. Peter Vitaliano] (providing proposed amendments to 7 C.F.R. § 1000.50(n)).)

1. The Historical Justification for Including Barrels in the Protein Price Is No Longer Valid.

The AMAA directs the Secretary, through the powers conferred, to "maintain such orderly marketing conditions…to avoid unreasonable fluctuations in supplies and prices." 7 U.S.C. § 602(4). The protein price formula fails this basic tenant of the AMAA. Significant volatility exists in the protein price, and thus the Class III price, because of the inclusion of Barrels. Since 2017, at times, the Block Price has been considerably higher than the Barrel Price, which has resulted in the Class III price being artificially lowered based on a cloistered minority of the cheese market—Barrels. The problems caused by the spread between the Block Price and Barrel Price only afflicts one component price: protein. The protein price formula should be simplified. Like other component prices, the protein formula should be based on one commodity product—Blocks. This will result in a formula that is more representative of the market, more in accord with the initial aims of component pricing and follows the mandate of the AMAA.

Understanding the historical context of the protein price formula is important to understanding its current construction and why change is necessary. When evaluating a replacement for BFP in Order Reform, USDA articulated several criteria: "(a) [s]tability and predictability; (b) simplicity, uniformity, and transparency; (c) sound economics—e.g., consistency with market conditions; and (d) reduced regulation." 64 Fed. Reg. 16026, 16091. USDA replaced BFP with MCP by reasoning "[t]he price handlers can afford to pay for milk is determined by the price for which the finished product can be sold. Therefore, a pricing system that translates finished product prices to a price for raw milk results in a representative raw milk price for both producers and handlers." *Id.* at 16092. MCP relies on formulas that determine the value of components based on commodity product prices because product prices "established in a relatively free and open interaction between supply and demand directly translate the value of the finished products to the value of milk and its components." *Id.* at 16094.

Thus, the premise of PPFs is simple: "Because milk used in manufactured products obtains its value from the components of milk, it is the components that should be priced; particularly butterfat and protein…." *Id.* at 16092. The prices of components are derived by starting with commodity product prices determined by USDA survey (originally, NASS; now, NDPSR). *See id.* at 16093. The survey does not capture all products in a given class, but, rather, a commodity that is representative of the class. For protein, which figures heavily into the Class III price, the commodity is cheddar cheese, specifically, Blocks and Barrels. *See* 7 C.F.R. § 1000.50(i), (n)(1); *see also* 63 Fed. Reg. 4802, 4885 ("The proposed Class III and Class IV formulas are computed from product prices representing the use of milk in each class. That is, the Class III price would be derived from the value of cheese....").

Protein is the most complicated of the component price formulas. *Compare* 7 C.F.R. § 1000.50(n) (protein) *with id.* § 1000.50(l) (butterfat), (m) (nonfat solids), (o) (other solids). While no other component has more than a one-step computation, the protein price formula, broadly, follows three steps:

> (1) Compute a weighted average of the amounts described in paragraphs (n)(1)(i) and (ii) of this section:
>
> > (i) The U.S. average NASS survey price for 40–lb. block cheese reported by the Department for the month; and
> >
> > (ii) The U.S. average NASS survey price for 500–pound barrel cheddar cheese (38 percent moisture) reported by the Department for the month plus 3 cents;
>
> (2) Subtract 20.03 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by 1.383;
>
> (3) Add to the amount computed pursuant to paragraph (n)(2) of this section an amount computed as follows:
>
> > (i) Subtract 20.03 cents from the price computed pursuant to paragraph (n)(1) of this section and multiply the result by 1.572; and
> >
> > (ii) Subtract 0.9 times the butterfat price computed pursuant to paragraph (l) of this section from the amount computed pursuant to paragraph (n)(3)(i) of this section; and
> >
> > (iii) Multiply the amount computed pursuant to paragraph (n)(3)(ii) of this section by 1.17.

7 C.F.R. § 1000.50(n). However, as shown by the language of the regulation, the three steps are complex, and Subsections (n)(1) and (n)(3) have multiple constituent parts. Much of the complexity in the protein price formula arises from the inclusion of Barrels. Unlike the other

components in milk—butterfat, nonfat solids, other solids—that are determined through use of one surveyed commodity price, protein relies on two commodity survey prices—Blocks and Barrels. *Compare* 7 C.F.R. § 1000.50(n)(1) *with id.* § 1000.50(l) (butterfat price based on AA butter survey price), (m) (nonfat solids price based on nonfat dry milk survey price), (o) (other solids price based on dry whey survey price).

In Order Reform, USDA provided a brief justification for inclusion of Blocks ***and*** Barrels:

> Including both block and barrel cheese in the price computation increases the sample size by about 150 percent, ***giving a better representation of the cheese market***. Since the make allowance of $0.1702 is for block cheese, the barrel cheese price must be adjusted to account for the difference in cost for making block versus barrel cheese. The three cents that is added to the barrel cheese price is generally considered to be the industry standard cost difference between processing barrel cheese and processing block cheese.

64 Fed. Reg. 16026, 16098 (emphasis added). In 2008, USDA briefly revisited the topic after Northwest Dairy Association ("NDA") and DFA proposed elimination of Barrels from the protein price formula. 73 Fed. Reg. 35306, 35328 (June 20, 2008). However, at that hearing, NDA abandoned the proposal by not putting forth any supportive evidence or testimony, and DFA expressly reversed its position to oppose the proposal. *Id.*; (Tr. 2006:24-2007:13 [Testimony of Mike Brown].) With a record devoid of reasons to remove Barrels from the protein price formula, the Secretary kept it with a similar justification as that proclaimed in Order Reform.

> This decision finds that retaining the cheese barrel price in the protein price formula is ***necessary to ensure that the protein price is representative of the national cheese market***. The Class III product-product price formula needs to be as ***reasonably representative of the market for cheese*** that determines the value of milk. Record evidence reveals that barrel production in the NASS survey is often in excess of 50 percent of the total cheese volume surveyed. Eliminating the barrel price from the protein price formula would significantly and ***needlessly reduce*** the volume of cheese used in the Class III product price formula which could lead to protein prices that are not as ***representative of the national cheese market***. Accordingly, Proposal 13 is not adopted.

73 Fed. Reg. 35306, 35328 (emphasis added).

The volume justification for Barrels has lost its potency. The inclusion of the Barrel Price for the sake of volume only made sense if the Barrel Price and Block Price moved in tandem in the marketplace. (Tr. 1722:23-1723:1 [Testimony of Darin Hanson] ("I think the important aspect there is those two series move together. And…the spread was fairly consistent. It was predictable. I mean, I don't remember looking at the spread back ten years ago, but now, today, I have to report the spread every day to my boss, who is the CEO, because it has that much of an impact on the business.").) Since 2017, the spread between the Block Price and the Barrel Price has become substantial and unpredictable. For example, when the Block Price exceeds the Barrel Price, Barrel plants struggle to maintain profitability with a regulated milk price based on the weighted average of Blocks and Barrels. (Ex. 126 at 1; Tr. 1935:3-8 [Testimony of Christian Edmiston].) Thus, the elimination of Barrels is no longer "needless" because Barrels are no longer "representative of the national cheese market." Barrels now skew the protein, and Class III, price—to the detriment of producers—by playing an outsized role in how the price is determined compared with how the market treats Barrels. Removal of Barrels is necessary to maintain a protein price formula that is reasonably representative of the Class III market.

2. The Market Relies on Blocks, Not Barrels, to Price Class III Products; the Products Are Not Interchangeable

The cheese price factor of the protein price (i.e., Blocks and Barrels) figures heavily into the Class III price. Given commodities dictate a large percentage of the class price, "[i]t is important that the product-price formulas reflect current market conditions, not market conditions that may be possible but not widely achieved or not reflective of general industry wide conditions." 73 Fed. Reg. 35306, 35327. "Cheese…compete[s] in a national marketplace and as such the prices established under the Class III…product-pricing formula[ ] need[s] to be reflective of marketing conditions that directly affect determining the minimum value of raw milk." *Id.* at 35325. Yet, Barrels do not reflect market conditions for cheese but continue to play an outsized role in setting Class III prices.

To understand why Barrels do not reflect cheese market conditions, it is important to understand the distinctions between Blocks and Barrels.

> Q. Okay. Can you – can you help us understand what the difference is between the cheddar market and the barrels?
>
> A. The markets and, like, where the products get used?
>
> Q. How the products get used, what the differences are between the two, cheddar block and barrels, yeah.
>
> A. Yeah. The block products, you get a lot of use in cut-and-wrap type applications. They put it in shred-type products. They can be cubed. So they get put into a lot of retail and foodservice types of products that use natural cheese. Either barrel prices – or barrel products – barrel – barrels go into processed cheese products, where they get combined with other types of ingredients to give the processed cheese sort of functionality. And that can be used for a quite a few different products, from sauces to, you know, cheese slices and things like that.
>
> Q. And would you consider them to be interchangeable products?
>
> A. They can be on the fringe, but if prices get really, really wide, let's say blocks are much lower than barrels, you are going to see blocks go into processed cheese applications, just because there is an economic incentive to do so. But then you get into labor challenges and things like that.
>
> Q. Can you tell me about what those – what you mean by labor challenges?
>
> A. Well, I mean a lot of cut-and-wrap and processed – block processors are very automated, and, you know, if – if you are using blocks in a processing cheese application, you are going to have to physically pick up those blocks and take them out of the boxes and put them on the production lines, versus with barrels, they have more of an automated process.

(Tr. 1624:26-1626:3 [Testimony of Darin Hanson].) Put another way, Blocks and Barrels are not interchangeable.

The Secretary attempted to synthetically equate Barrels to Blocks in Order Reform, 64 Fed. Reg. 16026, 16098 ("[T]he barrel cheese price must be adjusted to account for the difference in cost for making block versus barrel cheese"), but the products are not interchangeable. (Tr. 1741:27-1742:3 [Testimony of Darin Hanson]; Tr. 2004:12-2004:24 [Testimony of Mike Brown] ("Q. And is it your opinion that barrel and block products are interchangeable? A. No. They are not.").) Barrels cannot be converted into Blocks, and Blocks cannot be converted into Barrels. (Tr. 1738:23-1739:1 [Testimony of Darin Hanson].) Barrels cannot be made using a Block manufacturing line, and Blocks cannot be made using a Barrel manufacturing line. (Tr. 1956:3-1957:5 [Testimony of Christian Edmiston].) And because cheese plants attempt to run at full capacity at all times—i.e., cheese is a demand product now versus during Order Reform when more slack capacity existed—there is limited flexibility for those plants that may try to produce both Barrels and Blocks. (Tr. 1956:3-1957:5 [Testimony of Christian Edmiston].) Of those that can produce both, since 2017, the trend has been towards producing Blocks. (Tr. 2011:10-2011:27 [Testimony of Mike Brown].)

In addition to being distinct products, Blocks and Barrels serve different functions in the market. The CME contains a market for both Blocks and Barrels. The CME Barrel market is used to price Barrels only. (Tr. 1736:14-1736:23 [Testimony of Darin Hanson]; Tr. 1812:11-1812:28 [Testimony of Paul Bauer].) Whereas, the CME Block market is used to price nearly all other natural cheese. (Ex. 114 at 5; Tr. 1488:18-24 [Testimony of Dr. Peter Vitaliano]; Ex. 117 at 8-9; Tr. 1620:14-19 [Testimony of Darin Hanson]; Ex. 126 at 1; Tr. 1934:20-24 [Testimony of Christian Edmiston] ("[O]nly a very small fraction of cheese [is] priced off of [Barrel].").) For example, mozzarella cheese is approximately one-third of the natural cheese produced in the

United States; it is priced off the CME Block market. (Tr. 1736:14-1736:23 [Testimony of Darin Hanson].) A conservative estimate is Blocks serve as a pricing index for at least 75 percent of natural cheese; but that figure is likely higher and may be as high as 90 percent. (Ex. 114 at 5; Tr. 1488:25-27 [Testimony of Dr. Peter Vitaliano].) Since Barrels are only 9 percent of the natural cheese produced, and therefore only serve as a price index for 9 percent of cheese, they are not representative of the cheese market. Allowing Barrels to continue determining nearly half of the protein price means allowing a product that is not representative of the market to disproportionately determine the price for Class III milk. (*See* Tr. 1636:5-1636:12 [Testimony of Darin Hanson] ("But I think an order of magnitude it impacted dairy producers. I mean, because barrel cheese is only 9 percent of total commodity cheese, but it represents 52 percent of the price calculation of Class III milk. So that's a 5X of magnitude that dairy producers are getting impacted by the block-barrel spread.").)

Perhaps most telling, there are only nine companies that make Barrels either some of the time or all of the time. (Tr. 1831:20-1831:25 [Testimony of Paul Bauer].) Yet, the price these nine companies utilize for Barrels receives equal treatment to the price used by all other cheese manufacturers that either make or rely on Blocks for market pricing. Simply put, the NDPSR price no longer reflects how producer milk is actually used in the cheese market. (Tr. 1742:6-9 [Testimony of Darin Hanson].) The consequence of this is: "[O]ver the past five years dairy producers have not realized the benefits of the higher block price to the extent that they should have in the Class III milk price." (Tr. 1742:16-1742:27 [Testimony of Darin Hanson].)

While the Secretary set a $0.03 spread between the Block Price and Barrel Price to try to synthetically equate the dissimilar products, since 2017, the spread between the Block Price and Barrel Price has averaged $0.11 annually. (Ex. 117 at 7; Tr. 1619:20-1620:2 [Testimony of Darin

Hanson].) Every penny in that spread translates to $0.048 per hundredweight in the milk price. (Tr. 1744:6-1744:11 [Testimony of Darin Hanson].) As a result, *regulated* dairy farmers have lost over $2,000,000,000, from 2017 to 2023, directly caused by the Barrel Price being included in the protein price formula. (Ex. 117 at 3; Tr. 1744:12-21 [Testimony of Darin Hanson]; Tr. 1793:3-10 [Testimony of Paul Bauer].) In addition to this figure not capturing unregulated areas, this impact is understated because of the significant depooling of Class III in 2020 and 2021. (Ex. 117 at 2-3; Tr. 1616:23-1617:1 [Testimony of Darin Hanson].) And because Class III is used to calculate Class I, Class I value has been underreported or undersold in the marketplace. (Tr. 1793:14-1793:27 [Testimony of Paul Bauer].) That revenue, taken from the dairy farmers, has gone into the pockets of manufacturers using the CME Block market as a pricing index because they have been underpaying for the value of the protein in their cheese. (Tr. 1793:14-1793:27 [Testimony of Paul Bauer].) Eliminating the Barrel Price from the protein price, and thus the Class III price, formula will financially benefit dairy farmers. (Ex. 114 at 6; Tr. 1621:27-1622:5 [Testimony of Dr. Peter Vitaliano].)

With the current structure of the protein price formula, producers either absorb the financial impact through direct ownership of the plant via a cooperative, or through lower milk prices paid to producers by a plant in areas outside FMMOs. (Ex. 126 at 1; Tr. 1935:3-12 [Testimony of Christian Edmiston].) Producers will continue to absorb that lost revenue absent a change. While eliminating the Barrel Price from the protein price formula may increase total cost of operations for cheese plants, including those owned by dairy farmers, this amendment will increase prices for dairy farmers, which is the mandate of the AMAA. (Tr. 1729:27-1730:13 [Testimony of Darin Hanson].) Further, "it takes the disruption out of the marketplace, because it causes a lot of uncertainty about what earnings are going to be month to month, quarter to quarter." (Tr. 1729:27-

1730:13 [Testimony of Darin Hanson].) Eliminating the Barrel Price from the Class III price calculation will reduce financial uncertainty for processors, including cooperatives, where cheese prices are not reflective of actual market conditions. (Ex. 117 at 9-10; Tr. 1621:27-1622:5 [Testimony of Darin Hanson].)

3. A Decrease in Volume Is Justified to Ameliorate Volatility: the Protein Price Should Be Based on One Source.

The use of Blocks and Barrels in the protein price is a synthetic arrangement that sacrificed simplicity and uniformity for the sake of volume—a deal not struck in any of the other component price formulas. At Order Reform, the Secretary synthetically adjusted the Barrel Price by $0.03 to make up a cost of processing difference between Blocks and Barrels. 64 Fed. Reg. 16026, 16098. That is, to force two commodity products into a single component price formula, Barrels were adjusted to look more like Blocks. While perhaps well intentioned, that synthesis has aged poorly and no longer tracks with the justifications for changing to MCP—(a) stability and predictability; (b) simplicity, uniformity, and transparency; (c) "sound economics—e.g., consistency with market conditions"; and (d) reduced regulation. 64 Fed. Reg. 16026, 16091. Change is needed, even if it means less cheese volume will be surveyed for the protein price.

From Order Reform until 2017, the problem with including both Blocks and Barrels, which are not interchangeable, was not evident because their price variations coincidentally tracked with each other. Without volatility in this price spread, the flaws in the Class III pricing formula structure were not evident. (Ex. 126 at 2; Tr. 1935:25-28 [Testimony of Christian Edmiston].) Beginning in 2017, the historically stable relationship between the Block Price and Barrel Price ended. (Ex. 126 at 2; Tr. 1935:28-1936:4 [Testimony of Christian Edmiston].) The stable relationship has not reestablished itself. Rather, volatility has ensued to the present day and has created significant financial impacts on producers. (Ex. 126 at 2; Tr. 1935:14-24 [Testimony of

Christian Edmiston].) The protein price formula needs to be modernized.

> [T]he structure of the dairy industry has changed. What may have been very appropriate at the time of Federal Order Reform, and for years after that, in many cases has become inappropriate because the industry has changed and the formulas have not. And the inclusion of [Barrels], which [NMPF] would concede would have been appropriate, because it was not disruptive up until through 2016, is now inappropriate because the industry has changed and Barrels and Blocks have become two different markets.

(Tr. 1605:7-1605:16 [Testimony of Dr. Peter Vitaliano].)

The only justification proffered by the Secretary for inclusion of Barrels in the protein price formula has been volume. *See* 64 Fed. Reg. 16026, 16098; 73 Fed. Reg. 35306, 35328. The additional volume comes with a cost that contradicts the motives behind moving to component pricing: a less stable protein (and Class III) price, a more complex component price formula, and increased regulation. *See* 64 Fed. Reg. 16026, 16091. While these may have been tolerable for a period of time, they no longer are because the protein price formula no longer reflects current marketing conditions. *See id.* (noting "sound economics—e.g., consistency with market conditions" as a consideration for moving to component pricing). The volatility of the protein formula—which comes at great cost to dairy farmers—outweighs any benefit gained from increased volume. "[T]here is a trade-off…if you seek to achieve more volume in the survey by including inappropriate products, that trade-off is a negative one." (Tr. 1604:24-1605:1 [Testimony of Dr. Peter Vitaliano].)

Without Barrels, there will still be adequate survey volume for accurate price discovery. Approximately 69 percent of cheddar cheese is in the form of Block or 640-pound blocks. Reported volumes of Block on the NDPSR represent 16 percent of total cheddar cheese production.[8]

[8] The gulf between Blocks produced and reported to the NDPSR is explained by the myriad exceptions to reporting. *See* 7 C.F.R. § 1170.8(a)(8); (*see also* Tr. 1972:14-1972:26 [Testimony of Christian Edmiston] (testifying blocks do not reach the NDPSR because of aging)). Congress

(Ex. 114 at 6; Tr. 1492:3-5 [Testimony of Dr. Peter Vitaliano]; Ex. 126 at 2; Tr. 1936:7 [Testimony of Christian Edmiston] ("Price discovery will not be impacted"); Ex. 117 at 4; Tr. 1618:10-16 [Testimony of Darin Hanson].) The volume of Block production has grown substantially since Order Reform, with the volume of Blocks reported on the NDPSR growing by more than 334,400,000 pounds since 2000, or an annual growth rate of 4.19 percent. (Ex. 132 at 3; Tr. 2137:19-24 [Testimony of Emma Downing Reynolds]; Tr. 2003:1-2003:4 [Testimony of Mike Brown].) And there is at least twice as much capacity for production of Blocks versus Barrels. (Tr. 2020:13-2021:3 [Testimony of Mike Brown].) Thus, even using 16 percent of production, the protein price would be "more representative of what the commodity cheese production is in the country by removing a price series that does not represent what's actually being produced in the marketplace." (Tr. 1727:4-1727:11 [Testimony of Darin Hanson].)

As for Barrels, the CME Barrel market is the primary mode of price discovery for Barrels. (Tr. 1978:24-1979:5 [Testimony of Christian Edmiston].) There is no reason to believe that market will evaporate if the Barrel Price is removed from the protein price formula.

> Q. If the barrels are taken out of the price formulas here, that doesn't – that doesn't make the CME market vanish, does it?
>
> A. It does not. There's no control over the CME market to add standards, change transportation, or to modernize their process. There's no mechanism for the dairy industry to do that. Dairy farmers to do that, I should say.

(Tr. 1812:11-1812:28 [Testimony of Paul Bauer]; Tr. 1990:9-1991:2 [Testimony of Mike Brown] ("Barrels are generally priced off the CME barrel market. That market would not go away with the adoption of this proposal.").) The protein price formula has relied on Blocks and Barrels for

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expressly granted the Secretary authority to dictate what products must be reported for the purpose of establishing minimum prices. 7 U.S.C. § 1637b. If the Secretary believes more volume is necessary to achieve an appropriate Class III minimum price, then the Secretary is empowered to change the mandatory reporting of dairy product information. *Id*.

the sake of volume alone, with the assumption that it will lead to accurate price discovery. The evidence has been to the contrary. There has been no evidence that Barrels are necessary for accurate discovery of the protein price. The testimony from witnesses intimately familiar with the cheese industry has been the inclusion of Barrels is a detriment to accurate price discovery because it disproportionately skews the protein and Class III price. Maintaining the status quo is to "legitimize a slight flaw in the Federal Milk Marketing Order system…

> at the end of the day, the industry needs to price cheese protein off of one source, just like all the other commodities. And when that is achieved, then we can have – every other cheese product – or every other dairy product has one market that they price off of, and then we can establish whether that's a good price or a bad price. With this volatility, it almost makes it impossible to continue the way it is.

(Tr. 1791:23-1792:10 [Testimony of Paul Bauer].)

Indeed, basing the protein price off one commodity source will reduce volatility because it will assist with risk management. There are no Barrel market futures or options available today, and existing risk management tools (Class III, Cheese, Block futures/options) will be more efficient to price customers and manage input cost risk with the elimination of Barrels from the protein price formula. (Ex. 117 at 9-10; Tr. 1621:27-1622:11 [Testimony of Darin Hanson].) "[M]any financial products have been developed since the component pricing has been installed. Every single component value, with the exception of barrel, has a counter-ability to lay off risk[;]…[B]arrels…do not have a futures market. That adds extra basis risk to producers and, by extension, processors, because [processing cooperatives] are an extension of the producer." (Tr. 1836:4-1836:13 [Testimony of Paul Bauer].) Simply eliminating Barrels from the protein price formula makes risk management more efficient. (Tr. 1742:10-13 [Testimony of Darin Hanson].)

Finally, maintaining Barrels in the protein price formula ***solely*** for the sake of volume is incongruous with the butterfat price formula. (Tr. 1595:15-1596:1 [Testimony of Dr. Peter

Vitaliano] ("eliminating barrel cheese would eliminate some volume, [but] it would not create a thin market situation when you look particularly compared to butter").) The NDPSR weekly butter survey represents 9 percent of butter production. (Ex. 117 at 4-5; Tr. 1595:22-1596:1 [Testimony of Darin Hanson]). That price is the only commodity product price used in the butterfat price formula, 7 C.F.R. § 1000.50(l), which affects all Class prices. If 9 percent of production is sufficient to discover a price for a component that affects all Class prices, then the 16 percent that represents the pricing index for the vast majority of the cheese market is ample for the protein price. There is no need to rely on two products given the trade-off is volatility and suppressed producer prices. "Adding anything else will add confusion. How well intended it will be, it will add confusion further, 10, 15, 25 years later like we are today." (Tr. 1833:27-1834:12 [Testimony of Paul Bauer].)[9]

4. The Opposition Suggests Fear of the Unknown Is Reason Enough to Keep a Broken Protein Price Formula; Barrels Are Not Market Clearing.

Opposition to Proposal 3 focused on two themes: (1) there is uncertainty as to what will happen with elimination of Barrels from the protein price formula and (2) Barrels are market-clearing products that represent the minimum price for Class III. Both arguments fall flat.

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[9] Likewise, NMPF opposes the modification submitted by Edge Cooperative to weigh the Block Price and Barrel Price in the protein price formula by price index usage in the marketplace. It is unclear how this would be accomplished on a rolling basis, but the proposed modification is a dead letter. Any inclusion of Barrels in the protein price formula is inappropriate.

> It's basically using a method or some way to limit the impact of barrel cheese into the formula. However, the problem becomes is that barrels are not a substitute for block cheese, which is…what the system has been based on. And plus or minus a few percentage points, 90% of the cheese is priced on the block market. … So no matter how you look at it, barrel manufacturers in Federal Milk Marketing Orders are subsidizing other producers of cheese, the other 90%.

(Tr. 3176:2-3176:6 [Testimony of Paul Bauer].)

First, uncertainty as to what will occur with cheese pricing is not a reason to keep a flawed formula. The goals of component pricing are (a) stability and predictability; (b) simplicity, uniformity, and transparency; (c) "sound economics—e.g., consistency with market conditions"; and (d) reduced regulation. 64 Fed. Reg. 16026, 16091. While uncertainty as to what will occur in the future tenuously falls within the category of "predictability," the other aims will unequivocally be achieved with the elimination of Barrels. The instability caused by using multiple commodities to determine one component will be erased. The protein price formula will necessarily become simpler, *compare* 7 U.S.C. § 1000.50(n) *with* (Ex. 114 at 11; Tr. 1493:5-27 [Testimony of Dr. Peter Vitaliano]); the formula will be uniform with the other component formulas (in that the protein price will only rely on one commodity); the formula will be consistent with market conditions, *see supra* at 62-67; and regulation will necessarily be reduced because the protein pricing provision will eliminate subsections. None of the opposition's arguments overcome these justifications for changing the protein price formula. (*See* Tr. 1992:25-1993:11 [Testimony of Mike Brown] ("Q. [S]o whether my revenue goes up or not will be driven by market supply and demand shocks, not by regulatory changes? A. That's always the case with dairy from my experience.").)

Rather, the opposition's "never do anything" position is a confused mixture of concerns about volume, price discovery, and competition with unregulated areas. These concerns can be dispatched in short order. Volume is not a concern because the current and growing production of Blocks is adequate for price discovery of protein. Keeping Barrels in the formula depresses the price of protein and takes value out of the protein price, to the detriment of producers. Moreover, the volume argument makes little sense given the butterfat formula, which impacts the other three Classes, is based on a survey that only captures 9 percent of production. The volume of Blocks in the NDPSR is adequate for an accurate protein price.

Opponents to Proposal 3 suggested that removal of Barrels from the protein price formula would put regulated Barrel manufacturers at a competitive disadvantage with unregulated Barrel manufacturers. (*See* Tr. 2040:26-2041:25 [Testimony of Mike Brown].) This objection is of no moment. It is a federal order truism that barrel manufacturers, or any other dairy product manufacturer, are not required to be pooled if it is not in their financial interest. Barrel manufacturers can pool, or depool, in accordance with the pooling regulations of the applicable order and avoid the minimum FMMO prices. In any event, the CME Barrel market will continue, even with adoption of Proposal 3, and that is the basis for Barrel price discovery, as the IDFA witness testified. (Tr. 1990:9-1991:2 [Testimony of Mike Brown] ("Barrels are generally priced off the CME barrel market. That market would not go away with the adoption of this proposal.").)

Next, opponents of Proposal 3 suggested Barrels are a market-clearing product and therefore accurately represent the minimum price. *See* 7 U.S.C. § 608c(5). This position is untenable. First, the Secretary did not hold this view at the inception of the protein price formula (i.e., Federal Order Reform). *See* 64 Fed. Reg. 16026, 16094 ("More milk is used in cheese production nationally than is used in Class I. The nonfat dry milk industry is now one which balances surplus milk storage and removals."). Second, at least three witnesses with extensive knowledge of the cheese industry rebuked this notion.

Two of the witnesses supporting Proposal 3—Paul Bauer (CEO of Ellsworth) and Christian Edmiston (Vice President of Procurement for LOL)—work for two of the nine companies that produce Barrels. (Tr. 1786:7-1787:24 [Testimony of Paul Bauer]; Tr. 1971:23-1971:25 [Testimony of Christian Edmiston].) Ellsworth and LOL both support elimination of the Barrel Price in the protein price despite not knowing for certain ***all*** of the potential effects on price.

Knowing potential side effects is beside the point. The elimination of Barrels from the protein price will help producers, which is the mandate of the AMAA, because it will put the protein price at its true value. Additionally, FF, which produces 500,000,000 pounds of cheese annually (though not Barrels), supports the change because the "vast majority" of the 13,800,000,000 pounds of cheese produced annually is priced off the Block market. (Tr. 1746:11-1747:13 [Testimony of Darin Hanson].)

All three witnesses—Paul Bauer, Christian Edmiston, and Darin Hanson (Senior Vice President of Supply Chain and Risk Management at FF)—testified that Barrels are not market clearing products. Specifically, the witnesses testified that almost any manufactured product can be market-clearing; it depends on the particular circumstances of a given business. For example, Ellsworth considered any cheese that could be used in process cheese could potentially be market-clearing, but Barrels are decisively not a product of last resort.

> Q. What – what products do you – do you use to make processed cheese?
>
> A. We use barrel cheese, predominantly, and then, it's approximately 60 [percent] depending on the recipe and the type of cheese that we use. And then we use other market-clearing cheeses in the industry in order to make the rest of that process.
>
> So at 2.3 billion pounds of processed cheese we estimate only 1.2 billion pounds of barrel cheese of maximum capacity. That difference of 1.1 billion pounds is other cheese in the industry that has not found a home or needs a market-clearing price.
>
> So in reality, processed cheese is really the market-clearing aspect to the market when it comes to cheese.
>
> Q. Do you consider barrels to be a market-clearing product?
>
> A. Absolutely not. Our plant has its production sold out through 2024. That would not indicate that we are a market-clearing price.
>
> In the making of processed cheese, you have your base cheese that you – you make, and then as you find opportunities to add to that

> processed cheese that still will conform to the standard of identity and label, that will be added to that processed cheese batch in order to make that particular style of cheese.

(Tr. 1786:7-1787:24 [Testimony of Paul Bauer].)

> Q. And is it your intention that – or it's your opinion, though, that barrels are no longer a market-clearing product? That's not where the milk necessarily goes as a last resort?
>
> A. I actually take offense at that a little bit, I'm sorry, because there was earlier testimony that blocks are nothing more than a market-clearing product, and I disagree with that. We sell out our production ahead of time, which would therefore indicate that it's not market-clearing.
>
> My contention is, is that trying to find a Class III protein price using the block as – and then – price, and then adding a calculated value to add more barrels to get to the block price is no longer appropriate. The industry standard, in my opinion, should be block cheddar cheese, and that should be used to price protein levels.

(Tr. 1840:21-1841:9 [Testimony of Paul Bauer].) Whereas, similar to the Secretary's comments in Order Reform, LOL considers Class IV products to serve more of a market clearing function.

> [M]y view of the market is that Class IV plays a bigger role in the clearing of milk that doesn't otherwise have a home than Class III. We certainly see that with our two milk receiving plants, as I mentioned in California and Pennsylvania.
>
> Q. [D]o you define barrels as a market-clearing product?
>
> A. I think they shoulder part of the responsibility, but certainly not all, even within Class III. But the then as you add Class IV, obviously, even a smaller portion of the total responsibility for balancing milk.

(Tr. 1979:12-1979:25 [Testimony of Christian Edmiston]); *see also* 64 Fed. Reg. 16026, 16094 ("More milk is used in cheese production nationally than is used in Class I. The nonfat dry milk industry is now one which balances surplus milk storage and removals."). Likewise, IDFA's primary opposition witness—Mike Brown—agreed that other products clear the market. (Tr. 2004:12-2004:24 [Testimony of Mike Brown] ("nonfat dry milk is still, and butter are probably the preferred products for balancing the market, but cheese does, to some extent”).)

Finally, FF, similar to Ellsworth, testified that nearly any Class III product can be market clearing. However, Barrels are less likely than ever to be a market-clearing product because they are a demand product now and it is difficult to balance using Barrels.

> Q. And I think we heard a little bit when we were talking with Dr. Vitaliano about the market-clearing nature of the barrel – of barrels. Can you talk about that?
>
> A. Yeah. I think every – every manufacturer has its own plant network where they have to balance and have balancing levers to make sure that they are making product out of milk. I mean, for Foremost, for example, we make 40-pound blocks, we make 640-pound blocks, and we make mozzarella.
>
> If we have too much milk because milk production is up, or if we have lower demand, we may have to balance 40-pound blocks in the spot market. Or if we have – don’t have orders for 640s, we may have to balance 640-pound blocks. Or we – it might be the same with mozzarella too where we have to make mozzarella cheese and put that on the spot market.
>
> So it’s not just like barrels are the balancing lever in the industry and – and the place of last resort. I think, every – every manufacturing company has to balance within their own network.

(Tr. 1623:13-1624:5 [Testimony of Darin Hanson].)

> Q. So would you consider barrels today to be a market demand product than a residual or market-clearing product?
>
> A. I’d consider them a demand product. I mean, there’s a demand for barrel cheese going into processed cheese.
>
> Q. And then I think you might have said this, but just to make sure that the record is clear on this. Is it a product of last resort?
>
> A. I mean, it’s – it’s going to really depend on where the market prices are and where those specific manufacturers have open capacity. I mean, for us it’s – for Foremost Farms, it is not a market of last resort. We don’t make barrels. If companies are making both blocks and barrels, it may be their product of last resort. But if barrel prices are higher than blocks, then they are going to make – they are going to make barrels versus – versus blocks.

> Q. Just to respond to the natural demand of the marketplace?
>
> A. Right.

(Tr. 1624:6-25 [Testimony of Darin Hanson].) "And so there's not a lot of balancing that you can just make barrels with excess milk." (Tr. 1725:5-1725:6 [Testimony of Darin Hanson].)

> Q. So you balance with whatever production capacity you have, not necessarily barrels or blocks?
>
> A. Yeah. We may have times where we don't have the demand for mozzarella, but we have the demand for cheddar. So the cheddar lines are running and it is getting sold, but then we have to – we may not have 100 [percent] sales for the mozzarella, and so we still have to make the product, and then sell that on the spot market. But that can change. That can – we can be full on mozzarella, which is a lot of times the case, and we have to balance on the – with 40-pound blocks, and then 40-pound blocks become the balancing outlet.

(Tr. 1746:11-1747:13 [Testimony of Darin Hanson].)

In sum, three credible witnesses who are actively involved with the Class III market testified that Barrels are not market clearing, meaning surplus milk is not cleared by manufacturing Barrels. Companies, and cooperatives in particular, balance milk by relying on internal plant networks and external partners. What products are made as part of balancing and clearing surplus milk is determined by the nature of a company's product portfolio. The notion of Barrels as a market clearing product appears to be a vestige of the Commodity Credit Corporation that used to clear the market by purchasing surplus products. Regardless, the nature of Barrels and the cheese market have changed. Modernization of the protein price and Class III formula is due. Barrels should be eliminated from the protein price. Proposal 3 should be adopted without modification.

V. PROPOSAL 7 SHOULD BE ADOPTED: A MODEST UPDATE TO MAKE ALLOWANCES IS THE ONLY OPTION THAT PROTECTS PAY PRICES FOR PRODUCERS AND ACCOUNTS FOR THE INCREASED COST OF MANUFACTURING.

PROPOSED FINDINGS OF FACT

A. Make Allowances Should Not Be Raised Beyond the Values in Proposal 7 Pending a Mandatory Audited Cost Survey.

1. Minimum milk prices are set by determining the value of the components through PPFs. PPFs determine implied component value by taking the selling prices for wholesale commodity style dairy products, subtracting the non-milk costs of manufacturing (i.e., "make allowance"), and applying appropriate yield factors. (Ex. 142 at 5; Tr. 2433:11-14 [Testimony of Dr. Peter Vitaliano]; Ex. 144 at 3-4; Tr. 2531:13-22 [Testimony of Christian Edmiston].)

2. The current make allowances in the uniform pricing provisions are: $0.1715 per pound for butter, 7 C.F.R. § 1000.50(l), $0.1678 per pound for nonfat dry milk, *id.* § 1000.50(m), $0.2003 per pound for cheddar cheese, *id.* § 1000.50(n), and $0.1991 per pound for dry whey, *id.* § 1000.50(o).

3. Make allowances are fixed numbers in the uniform pricing provisions and were last adjusted in 2008. (Ex. 142 at 5; Tr. 2433:22-27 [Testimony of Dr. Peter Vitaliano]); 73 Fed. Reg. 35306.

4. The make allowances that are part of the PPFs are intended to generally represent the costs of converting raw milk into those end products. The cost structure associated with converting raw milk into those four end products is higher today than it was in the mid-2000s when the make allowances were last evaluated. (Ex. 155 at 2; Tr. 2764:2-8 [Testimony of Rob Vandenheuvel].)

5. While it is virtually certain that the current costs of manufacturing are above the current make allowance values (Ex. 142 at 5; Tr. 2434; 4-6 [Testimony of Dr. Peter Vitaliano]),

making a one-time change to the make allowance that reflect possible—but not known—current costs would be disruptive to dairy producers and impose undue financial hardships on them, with potentially negative impacts on providing adequate supplies of milk to manufacturing operations. (Ex. 142 at 6; Tr. 2437:9-15 [Testimony of Dr. Peter Vitaliano].)

6. Indeed, no make allowance adjustment has impacted the farm level milk prices by more than $0.35 per hundredweight. (Ex. 175 at 19; Tr. 3397:1-10 [Testimony of Edward Gallagher].)

7. NMPF proposes modest increases to make allowances:

Butterfat: from $0.1715 to $0.2100 per pound of butter,

Nonfat Solids: from $0.1678 to $0.2100 per pound of nonfat dry milk,

Protein: from $0.2003 to $0.2400 per pound of cheddar cheese,

Other Solids: from $0.1991 to $0.2300 per pound of dry whey.

(Ex. 142 at 4; Tr. 2431:10-20 [Testimony of Dr. Peter Vitaliano].)

8. These proposed changes would decrease farmer milk prices by approximately $0.50 per hundredweight—i.e., the largest change ever. (Ex. 175 at 21; Tr. 3319:8-12 [Testimony of Edward Gallagher].) Whereas, Proposals 8 and 9—submitted by WCMA and IDFA, respectively—would raise make allowances over four years culminating in lowering farmer milk prices by approximately $1.45 per hundredweight. (Ex. 175 at 13; Tr. 3305:23-3306:2 [Testimony of Edward Gallagher].)

9. Raising make allowances to levels above those in Proposal 7 will reduce producer prices to levels that would narrow margins and negatively impact the availability of adequate supplies of milk, and thereby create disorderly marketing. (Ex. 142 at 4 Tr. 2432:10-14 [Testimony of Dr. Peter Vitaliano].) A greater change would destroy dairy farmer profitability. Dairy farmers cannot absorb a change that will reduce their pay prices by more than $0.56 per hundredweight,

let alone the $1.45 per hundredweight that would result from competing Proposals 8 and 9 (Tr. 3389:8-3392:16 [Testimony of Edward Gallagher].)

1. **The Industry Provided Evidence That Manufacturing Costs Have Increased Since 2008.**

10. Multiple NMPF member cooperatives that also operate manufacturing plants provided evidence that their costs have increased. LOL operates several cheese, butter-powder, and value-added plants in the Upper Midwest, East, and California. (Ex. 144 at 1; Tr. 1934:2-5 [Testimony of Christian Edmiston].)

11. LOL operates two manufacturing plants that produce branded butter and commodity-style nonfat dry milk located in Tulare, California and Carlisle, Pennsylvania. Combined, these plants process approximately 13 million pounds of producer milk per day. The manufacturing costs per pound of commodity products at both plants have increased since 2006. (Ex. 144 at 2; Tr. 2529:16-25 [Testimony of Christian Edmiston].)

12. LOL also operates a cheese plant in Kiel, Wisconsin. LOL made significant investments in this plant to update the cheese and whey processing facilities, which led to increased manufacturing costs per pound of cheese and per pound of dry whey since 2006. (Ex. 144 at 3; Tr. 2530:9-13 [Testimony of Christian Edmiston].)

13. LOL acknowledges NMPF's proposed make allowance increases will not fully offset the increases in manufacturing costs for commodity-style butter, nonfat dry milk, cheddar cheese, and dry whey since 2008. Instead, LOL acknowledges these increases offer a balance between the impact on producers versus processors. (Ex. 144 at 1; Tr. 2527:14-22 [Testimony of Christian Edmiston].)

14. FF has eight plants in its dairy manufacturing network, including three Italian cheese manufacturing plants, two cheddar type manufacturing plants, and one butter

manufacturing plant. All of these plants are located in Wisconsin. FF utilizes two-thirds of its members' milk in its products and markets the remaining one-third of its milk to raw milk processors. (Ex. 154 at 1-2; Tr. 1614:28-8 [Testimony of Darin Hanson].)

15. FF plants have experienced higher operating costs due to inflation since 2008 but especially over the past two years. (Ex. 154 at 2; Tr. 2742:9-13 [Testimony of Darin Hanson].)

16. California Dairies Inc. ("CDI") is co-owned by 258 member-owners, operating 297 member farms, all within the state of California. Among the products produced by CDI-owned manufacturing facilities, butter and milk powder are the vast majority. Four of CDI's six facilities produce butter, and all six facilities produce milk powders. CDI also produces a range of processed fluids that are marketed in bulk to customers primarily in the Western United States. (Ex. 155 at 1; Tr. 2376:7-8; 21-27 [Testimony of Rob Vandenheuvel].)

17. CDI, like many cooperatives, experiences significant swings in milk processing volumes as it balances the seasonal ebbs and flows of member-owners' milk production, as well as the ebbs and flows of seasonal demand for raw milk. In 2022, the six CDI-owned manufacturing facilities processed as much a 31.8 million pounds per day in April and as little as 24.6 million pounds per day in October. Managing balancing with outdated make allowances increases the costs borne by CDI's member owners. (Ex. 155 at 2-3; Tr. 2765:6-21 [Testimony of Rob Vandenheuvel].)

18. Northwest Dairy Association ("NDA") is a cooperative marketing the milk of approximately 295 dairy farmers in Washington, Oregon, Idaho, and Montana. NDA conducts all processing and marketing operations through a wholly owned subsidiary, known as Darigold, that operates five distributing plants and six manufacturing plants. (Ex. 159 at 1; Tr. 2810:9-11; 2810:17-2811:6 [Testimony of Monty Schilter].) Additionally, NDA is building a plant in Pasco,

Washington, which will take in eight million pounds of milk per day and is located closer to NDA's milk source in Eastern Washington. (Ex. 159 at 2; Tr. 2813:18-21 [Testimony of Monty Schilter].)

19. Under the current make allowances, NDA does not expect the Pasco plant to be profitable. NDA expects a lower cost of production due to the efficiency of the new operation and its size and scale, but combined with NDA's other manufacturing plants, NDA does not expect to be manufacturing products at costs less than the current make allowances. As a result, NDA intends to innovate by producing more value-added milk powders. (Ex. 159 at 2; Tr. 2813:18-21 [Testimony of Monty Schilter].)

20. NDA has seen noticeable increases in energy, fuel, labor, and packaging. From 2008 to 2022, manufacturing costs increased by over 80 percent. NDA's Fiscal Year 2023, which ended in March 2023, was one of the worst years in recent history attributable in large part to these increased costs that are not captured in the current make allowances. NDA has needed to implement a producer paycheck deduction to help balance the books for these continued cost challenges. (Ex. 159 at 2; Tr. 2812:1-13 [Testimony of Monty Schilter].)

21. Maryland and Virginia Milk Producers Cooperative, Inc. ("MDVA") is a cooperative located and operating in the Mid-Atlantic and Southeast geographies of the United States. MDVA is a cooperative made up of around 920 dairy farmer members who produce around 2.3 billion pounds of milk each year. MDVA owns and operates three distributing plants and two supply plants. (Ex. 160 at 1-2; Tr. 2858:4-14 [Testimony of Mike John].)

22. MDVA manufactures butter and nonfat dry milk. This manufacturing provides a balancing function in MDVA's marketplace. (Ex. 160 at 2; Tr. 2859:9-10 [Testimony of Mike John].)

23. MDVA has seen increases in the costs to produce butter and nonfat dry milk since

the last update to make allowances. For example, MDVA has seen a 64 percent increase in the standard cost to convert raw milk into nonfat dry milk compared to approximately 12 years ago. (Ex. 160 at 4; Tr. 2860:24-28 [Testimony of Mike John].)

24. Because this increased cost cannot be captured in the sale of a commodity product to the marketplace, MDVA implemented a cost recapture as a "market adjustment" on members' monthly milk statements. This means cooperative members absorb the impact of manufacturing cost increases rather than allowing it to be passed through to consumers on a much smaller pro-rata scale. (Ex. 160 at 4; Tr. 2861:1-7 [Testimony of Mike John].)

25. Agri-Mark, Inc. ("Agri-Mark") is a dairy cooperative owned by approximately 550 dairy farm families in New England and New York, which supply more than 3.2 billion pounds of milk annually that Agri-Mark uses to make award-winning Cabot branded cheeses, dairy products, and ingredients. Agri-Mark operates four supply plants—three cheese plants in Cabot, Vermont, Middlebury, Vermont, and Chateauguay, New York and one butter/powder plant in West Springfield, Massachusetts. (Ex. 170 at 1; Tr. 3111:4-21 [Testimony of Catherine de Ronde].)

26. Manufacturing costs of butter, nonfat dry milk, cheddar cheese, and dry whey have increased since 2008. (Ex. 170 at 3; Tr. 3115:20-21 [Testimony of Catherine de Ronde].)

27. Costs of processing across Agri-Mark's four plants have increased on average 20 percent since 2008, which is approximately the increases in Proposal 7. Agri-Mark has made investments in it plants to improve efficiencies and reduce costs of processing, but many costs are market-driven and outside of Agri-Mark's control. Most recent and notable are increases in the cost of insurance, manufacturing labor and benefits, and repair and maintenance. (Ex. 170 at 3; Tr. 3115:26-3116:7 [Testimony of Catherine de Ronde].)

28. On a weighted average Class III basis, Agri-Mark's three cheese plants have seen

costs of processing increase 23 percent since 2008. (Ex. 170 at 3; Tr. 3116:26-28 [Testimony of Catherine de Ronde].)

29. On a Class IV basis, Agri-Mark's butter/powder plant has seen a cost of processing increase of 17 percent since 2008. (Ex. 170 at 3; Tr. 3117:1-5 [Testimony of Catherine de Ronde].)

30. Agri-Mark's butter/powder facility in West Springfield has long served a balancing function in Federal Order 1. When it serves a balancing function, that comes at a higher cost of processing to Agri-Mark and its member-owners. (Ex. 170 at 3; Tr. 3117:6-18 [Testimony of Catherine de Ronde].)

31. Ellsworth has a barrel cheese plant and a sweet whey drying plant. In 2022, Ellsworth produced 70.9 million pounds of cheese through its barrel plant and processed 33.7 million pounds of sweet whey solids, which resulted from 777 million patron pounds. Also in 2022, Ellsworth opened a new cheese plant in Menomonie, Wisconsin for specialty and block cheese. In addition, Ellsworth runs a process cheese plant in New London, Wisconsin. Ellsworth has the unique position of supplying information to NDPSR on two products, barrel cheese and sweet whey powder. (Ex. 171 at 1; Tr. 3164:9-19 [Testimony of Paul Bauer].)

32. Since 2006, Ellsworth's cost of supplies for cheese increased $0.022 per pound, and wages increased $0.059 per pound. (Ex. 171 at 2; Tr. 3166:6-12 [Testimony of Paul Bauer].) Ellsworth's cost for utilities has increased by 37 percent since 2006, but Ellsworth innovated and ran efficiently to keep costs low. (Ex. 171 at 3; Tr. 3166:24-3167:12 [Testimony of Paul Bauer].) In total, Ellsworth's costs in its barrel cheese plant have gone up $0.064 per pound in 16 years. (Ex. 171 at 3; Tr. 3167:20-22 [Testimony of Paul Bauer].)

33. For whey processing, since 2006, the cost of packaging material increased by $0.0011 per pound, wages increased $0.043 per pound, depreciation increased $0.003 per pound,

and utilities increased $0.003 per pound. (Ex. 171 at 4-5; Tr. 3168:22-3169:17 [Testimony of Paul Bauer].) In total, the cost to produce dried whey has gone up $0.054 per pound in 16 years. (Ex. 171 at 5; Tr. 3169:23-24 [Testimony of Paul Bauer].)

34. Lone Star Milk Producers, Inc. ("Lone Star") operates a butter and nonfat dry milk supply plant in Canyon, Texas that opened in 2017. (Ex. 172 at 2; Tr. 3218:22-26 [Testimony of Travis Campsey].) Since opening, Lone Star's labor costs to operate the plant have risen 35 percent on average across operations departments, and insurance costs have risen 378 percent. (Ex. 172 at 2; Ex. 173; Tr. 3220:2-7; 3221:6-8 [Testimony of Travis Campsey].) Lone Star has managed to keep utility costs constant by investing "millions of dollars [since 2017] to upgrade" the operations of the plant. (Ex. 172 at 2; Tr. 3220:12-16 [Testimony of Travis Campsey].)

2. A Mandatory, Audited Cost Survey Is Necessary Before Raising Make Allowances Further Than Proposal 7.

35. A regular and systematic method of ensuring PPFs—and specifically the make allowances within them—remain accurate and current has not been established. (Ex. 142 at 5; Tr. 2433:20-22 [Testimony of Dr. Peter Vitaliano].)

36. Having accurate and updated plant processing costs to establish appropriate make allowances and appropriate product yield factors is critical for this indirect method of determining milk prices. (Ex. 142 at 5 [Testimony of Dr. Peter Vitaliano]; Ex. 144 at 4; Tr. 2531:23-2532:1 [Testimony of Christian Edmiston].)

37. Actual, audited manufacturing cost data from plants making the four commodity products represents the ideal data for USDA to use in establishing make allowances. (Ex. 144 at 2; Tr. 2529:7-10 [Testimony of Christian Edmiston].)

38. Although the current Federal Order make allowances are overdue for updates, the data available is not sufficiently comprehensive to establish revised make allowances confidently.

(Ex. 144 at 8 [Testimony of Christian Edmiston]; Ex. 142 at 7; Tr. 2439:2-6 [Testimony of Dr. Peter Vitaliano] ("Although the current Federal Order make allowances are overdue for updates, the data available to do so are not sufficiently comprehensive, verifiable and unambiguous to establish revised make allowances confidently.")

39. Larger, more representative sample sizes than those achievable by previous, voluntary, and unaudited studies are needed to establish proper values for the critically important make allowances and yield factors. (Ex. 142 at 6; Tr. 2435:24-28 [Testimony of Dr. Peter Vitaliano].)

40. There are certain unknowns due to limitations in the available manufacturing cost data sources, such as: range of costs that may be seen if all plants making eligible products were required to report plant costs to USDA; product yields using current technology; benefits of automation; and energy efficiencies or other improvements to plant efficiencies. (Ex. 155 at 3; Tr. 2766:20-2767:1 [Testimony of Rob Vandenheuvel].)

41. The industry supports (Congress) providing USDA with authority to collect, mandatorily, cost data. (Ex. 142 at 5-6; Tr. 2435:6-21 [Testimony of Dr. Peter Vitaliano]; Ex. 144 at 9; Tr. 2529:7-14 [Testimony of Christian Edmiston]; Ex. 154 at 4; Tr. 2745:2-4 [Testimony of Darin Hanson]; Ex. 155 at 3; Tr. 2766:18-25 [Testimony of Rob Vandenheuvel]; Ex. 175 [Testimony of Edward Gallagher].) In lieu of accurate, audited manufacturing costs, Proposal 7 provides the balanced approach that should be adopted. (Ex. 155 at 6; Tr. 2771:27-2772:5 [Testimony of Rob Vandenheuvel].)

B. In the Absence of Complete, Actual Manufacturing Cost Data, Make Allowance Increases Must Be Balanced to Protect Producer Profitability and Their Ability to Supply the Industry.

42. All market participants benefit from the orderly marketing system enabled by cooperatives operating milk balancing plants within the market. (Ex. 144 at 6-7; Tr. 2535:18-25

[Testimony of Christian Edmiston].)

43. Cooperatives operate dairy manufacturing plants in nearly all Federal Order marketing areas. These manufacturing plants balance milk supplies in the market when Class I, II, and III customers need more or less milk to service their accounts. At the same time, cooperative manufacturing plants represent financial investments by their members. Cooperative members—dairy farmers—have paid to build and maintain their cooperatives' manufacturing plants and are responsible for the costs to operate them. (Ex. 144 at 6; Tr. 2535:8-17 [Testimony of Christian Edmiston].)

44. When Federal Order make allowances are established at too low of levels, farmers whose cooperatives own and operate balancing plants end up absorbing those costs that other market participants do not experience. (Ex. 144 at 6-7 Tr. 2535:18-25 [Testimony of Christian Edmiston].)

45. As cooperatives pass the market-wide service-related balancing losses to their members via reduced pay prices, producers shipping to cooperatives and other handlers that do not operate balancing plants do not experience these lower pay prices. This unfairly penalizes dairy cooperative members who invest in plant and marketing systems to support orderly marketing. (Ex. 142 at 7 Tr. 2438:10-16 [Testimony of Dr. Peter Vitaliano].

46. Failure to maintain a make allowance that fairly represents current manufacturing costs creates a disincentive to invest in processing infrastructure for use in balancing milk supply and demand, which will ultimately create significant disorderly conditions if or when producers are unwilling or unable to take on that cost. (Ex. 155 at 3; Tr. 2766:11-16 [Testimony of Rob Vandenheuvel].)

47. Cooperatives making commodity-style products reportable to the NDPSR and

operating under FMMOs may not be able to recover a larger margin on their survey reported commodity products. If they raise their commodity product prices to capture a larger margin to cover higher costs, those higher prices go directly into the survey and would have an upward bias in the determination of class prices. This would reduce the larger margin, if the sales were more than the average price of the week, and entirely eliminate the larger margin if it were equal to the average reported price. In effect, the Federal Order make allowances are the fixed margins to commodity production at cooperative plants. (Ex. 144 at 5; Tr. 2533:15-23 [Testimony of Christian Edmiston].)

48. Yet, given the length of time since the last make allowance update, making the sudden change to make allowances to fully reflect current manufacturing costs—whatever those are—would be very disruptive to dairy producers and impose undue financial hardships on them. (Ex. 144 at 7; Tr. 2536:10-14 [Testimony of Christian Edmiston].)

49. Any increase in make allowances will negatively impact producer milk prices, and their margins will be compressed. (Ex. 144 at 7; Tr. 2536:21-23 [Testimony of Christian Edmiston].)

50. If make allowance changes are implemented, the full impact to the milk price will be felt by dairy producers immediately, but milk premiums to dairy producers and basis to customers could be much slower to adjust. (Ex. 154 at 4; Tr. 2744:22-26 [Testimony of Darin Hanson].)

51. Large increases to make allowances would be an abrupt change to producer pay prices, and such a change would likely force changes to farm operations. Due to financial pressures of lower milk prices, resulting from a large make allowance increase, dairy producers may decide to exit the dairy industry, at a time when processors are incentivized to ramp up production.

(Ex. 154 at 3; Tr. 2744:10-17 [Testimony of Darin Hanson].)

52. Raising make allowances beyond the levels in Proposal 7 could negatively impact the availability of adequate supplies of milk, and thereby create disorderly marketing. (Ex. 144 at 2; Tr. 2528:2-6 [Testimony of Christian Edmiston].)

53. The increases in Proposal 7 will likely not ensure that all manufacturing plants will operate profitably since plants vary by location, size, age, depreciation, yield, operating costs, and other factors. (Ex. 142 at 4; Tr. 2432:14-18 [Testimony of Dr. Peter Vitaliano].) However, make allowances should not be raised to an extent that ensures all manufacturing plants will operate profitably. (Ex. 144 at 2; Tr. 2536:5-14 [Testimony of Christian Edmiston].)

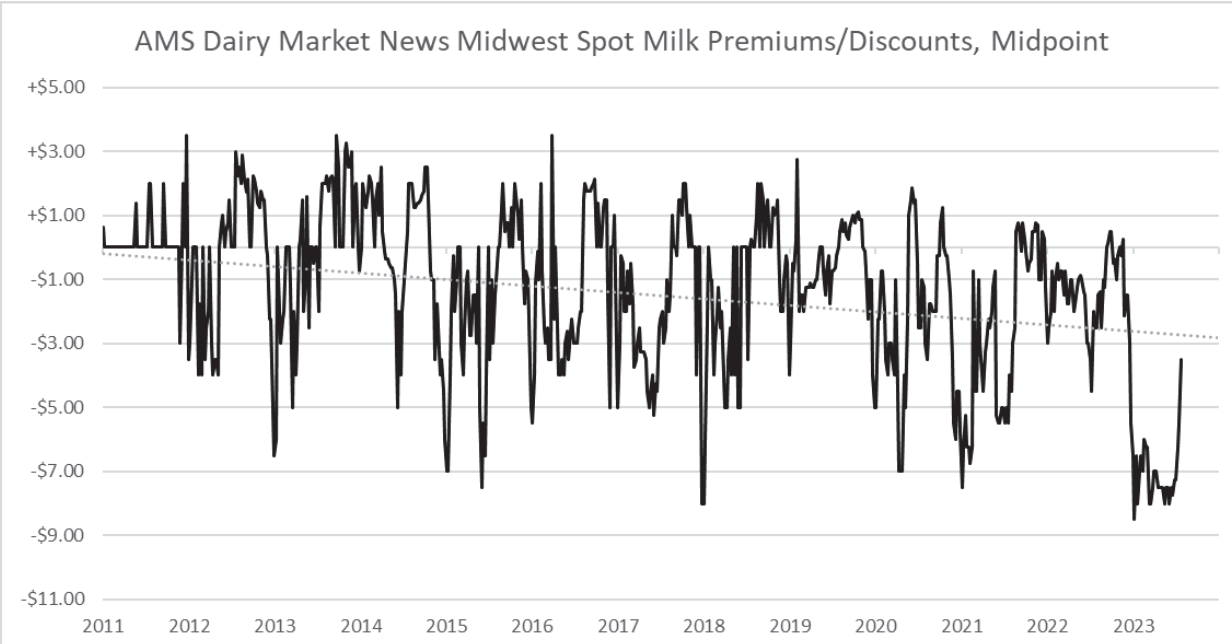
54. Further, make allowances should not be considered on a plant-by-plant basis. Make allowances must be considered on a market-wide level to avoid discrepancies in producer pay prices within the same market. (Ex. 170 at 2; Tr. 3113:3-6 [Testimony of Catherine de Ronde].)

55. Proposal 7 strikes a fair balance between the reduction in producer pay price and the reduction in processor milk cost resulting from increasing make allowances. (Ex. 154 at 2; Tr. 2742:5-8 [Testimony of Darin Hanson].)

1. Processors Have Means Other Than Make Allowances to Remain Profitable.

56. FMMO manufacturing class prices are not mandatory prices that are required to be paid by milk buyers to dairy producers. Payments to dairy producers can also include other pluses and minuses, such as volume premiums, quality incentives, hauling cost allocations, and market adjustments. Since 2015, in the Midwest and in the Mideast, customer basis has been declining, which has pressured member premiums for milk procurement to also go lower. This is partially in response to higher processor operating costs. (Ex. 154 at 2-3; Tr. 2742:21-27; 2743:16-24 [Testimony of Darin Hanson].)

57. As make allowances have aged, spot milk premiums have trended lower.



(Ex. 144 at 6; Tr. 2535:4-12 [Testimony of Christian Edmiston].)

2. Dairy Farmers Cannot Remain Profitable if Make Allowances Are Increased as Suggested by Proposals 8 and 9.

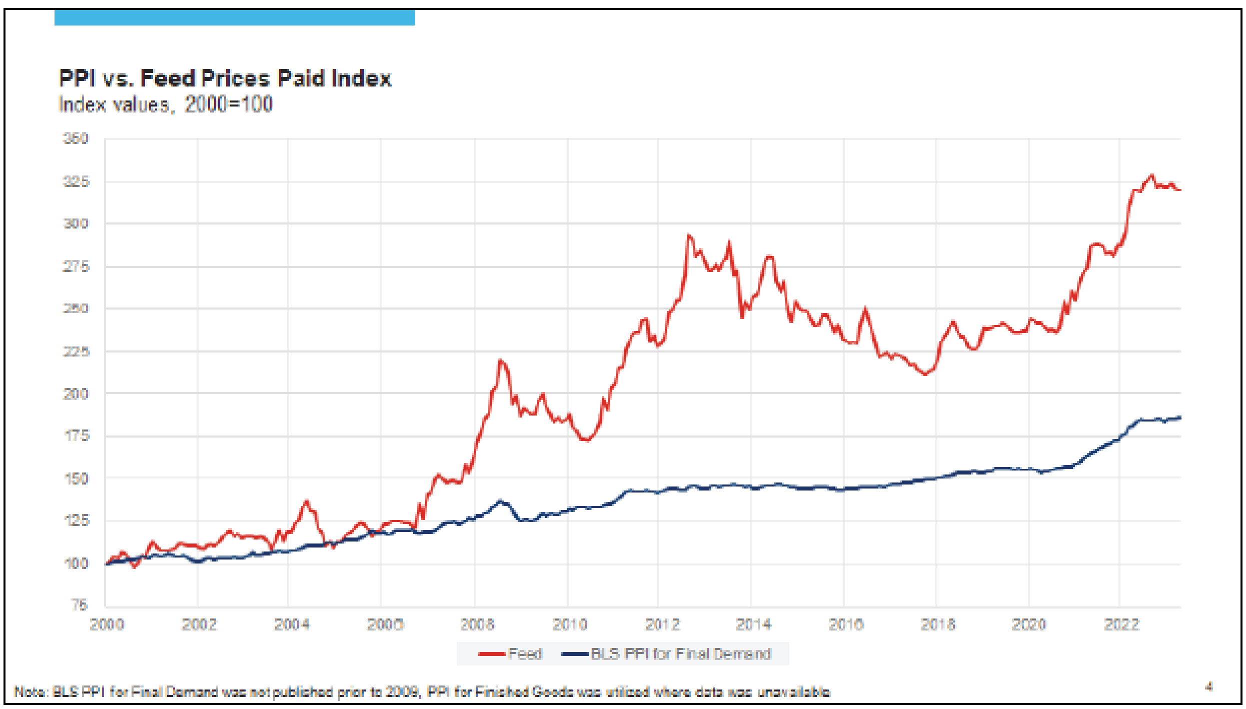
58. Dairy farmers are concerned about a wealth transfer from their families' businesses to manufacturing plant operators through their milk checks by federal fiat. (Ex. 175 at 3; Tr. 3293:8-11 [Testimony of Edward Gallagher].)

59. The cost of on-farm inputs has increased dramatically since the last time make allowances were adjusted. Livestock feed often represents 50 percent or more of the cost of production on a dairy farm so inflationary or deflationary pricing aspects of feed are an important factor in the cost of producing milk. (Ex. 175 at 4; Tr. 3296:16-20 [Testimony of Edward Gallagher]; Ex. 279 at 2 [Testimony of Perry Tjaarda] ("Feed costs are historically 50 percent to 60 percent of our milk check. However, this year [2023] they have been as high as 90 percent.").)

60. To demonstrate the ongoing cost pressures dairy farmers face, general inflationary measures should be considered. The United States Federal Bureau of Labor Statistics' Producer

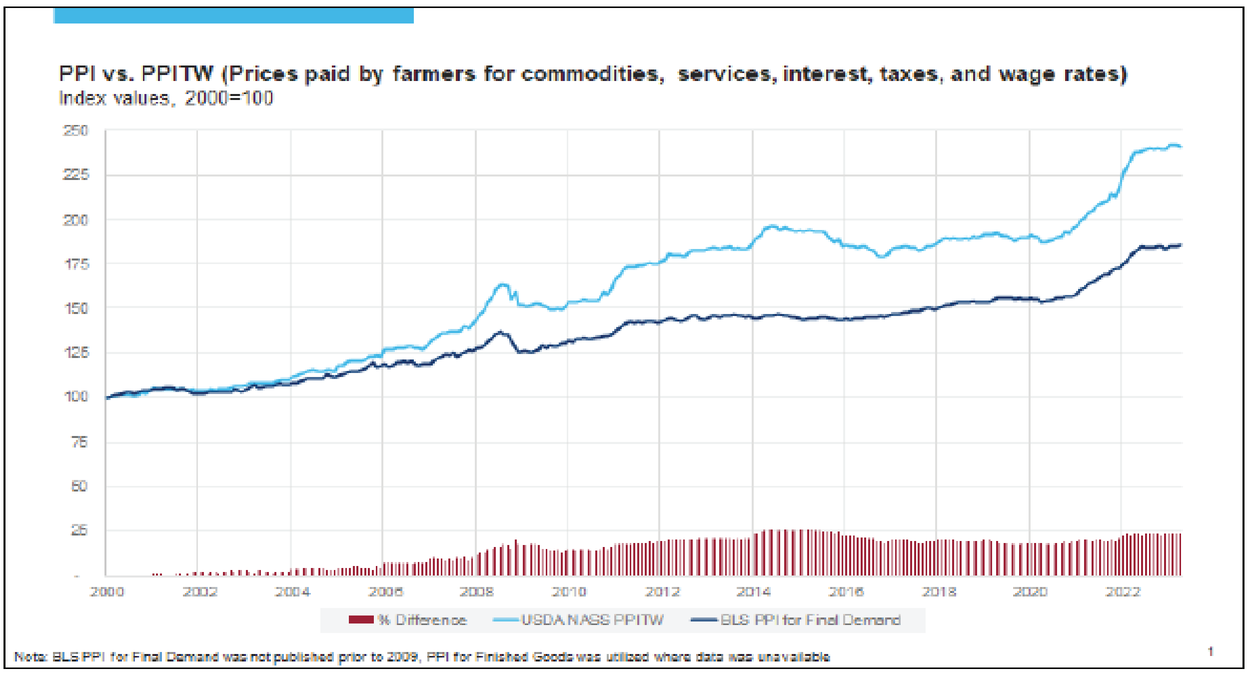
Price Index for final demand ("PPI") is a common measurement of inflation impacting producers of goods and services across the US; it surveys the price that was received for selling the input produced by the manufacturers or service providers. (Ex. 175 at 4; Tr. 3296:24-3297:3 [Testimony of Edward Gallagher].) Changes over time can provide indications of general inflation or deflation facing businesses as they would raise or lower their selling prices to either pass along higher input prices or pass along deflating input prices. (Ex. 175 at 4; Tr. 3297:4-8 [Testimony of Edward Gallagher].)

61. The Feed Index PPI, which specifically measures the increased cost of feed, is 3.25 times higher than it was in 2000, but the PPI is only about 1.8 times higher:



(Ex. 175 at 5; Tr. 3297:23-24 [Testimony of Edward Gallagher].)

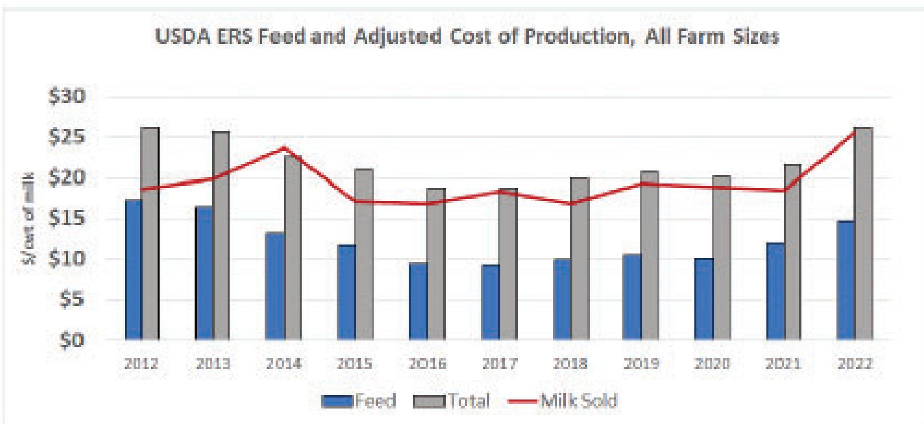
62. Farm-level inflation is also captured in the Prices Paid by Farmers for Commodities, Services, Interest, Taxes, and Wage Rates Index ("PPITW"). (Ex. 175 at 9; Tr. 3301:25-3302:1 [Testimony of Edward Gallagher].) The PPITW combines on farm input prices for feed, seed, fertilizer, chemicals, fuel, wages, and interest. (Ex. 175 at 8; Tr. 3301:19-24 [Testimony of Edward Gallagher].) This agricultural inflation index can be compared to the PPI to further see the divergence between inflation affecting the average consumer and inflation affecting the farmer:



(Ex. 175 at 9; Tr. 3302:2-4 [Testimony of Edward Gallagher].)

63. Beginning in 2004, the indexes began to diverge and there has been significant divergence since 2006. (Ex. 175 at 9; Tr. 3302:2-4 [Testimony of Edward Gallagher].) From January 2006 to April 2023, the PPITW increased 90.0 percent versus a 56.5 percent increase in the PPI. (Ex. 175 at 9; Tr. 3302:2-4 [Testimony of Edward Gallagher].)

64. Unlike processors, production costs for dairy farmers, of which feed costs are the largest, are not covered by the milk price, in whole or in part, and farmers have operated with an average deficiency of $2.06 per hundredweight since 2015 as shown in the chart below, which uses USDA data on milk production costs, revenue, and profitability:



(Ex. 175 at 11; Tr. 3395:8-15 [Testimony of Edward Gallagher].)

65. While every business has faced inflation since make allowances were last raised, producers are not able to recoup inflationary pressures through the Federal Order system in the same manner as processors, who can seek raises in make allowances. (Ex. 175 at 9; Tr. 3302:5-15 [Testimony of Edward Gallagher].)

66. Indeed, adopting Proposal 8 or 9, which are identical, will be catastrophic for dairy farmers. In year one, the make allowances proposed in Proposals 8 and 9 will reduce the all-milk price for dairy farms of 1,000 cows or larger by more than their average profitability since 2015:

DFA's Adjusted Profitability Data based on USDA's Milk Production Estimates, by Selected Dairy Farm Size

	Number of Milking Cows on Farms		
	1,000-1,999*	2,000 or more*	All Sizes
2012	($2.05)	($2.05)	($4.98)
2013	($0.03)	($0.03)	($3.33)
2014	$7.44	$7.44	$4.17
2015	$1.92	$1.92	($1.24)
2016	$0.25	$0.58	$0.18
2017	$1.44	$1.77	$1.32
2018	($1.13)	($0.58)	($1.42)
2019	$0.40	$1.01	$0.21
2020	$0.46	$1.13	$0.36
2021	($0.50)	$0.20	($1.55)
2022	$2.80	$3.66	$1.42
Avg since 2012	$1.00	$1.37	($0.44)
Avg since 2015	$0.71	$1.21	($0.09)

*In 2016, USDA began reporting 2,000 or more milk cow statistics.

Data Source: USDA, ERS Milk Produciton Estimates, various years.

DFA's Estimated All-Milk Price Impact of Various Make Allowance Increases

Proposal	Class III	Class IV	All-Milk Price
	$/cwt of milk		
NMPF	($0.58)	($0.52)	($0.56)
	Cumulative by Year		
IDFA Yr 1	($0.76)	($0.66)	($0.73)
IDFA Yr 2	($1.01)	($0.89)	($0.97)
IDFA Yr 3	($1.27)	($1.11)	($1.21)
IDFA Yr 4	($1.52)	($1.33)	($1.45)

(Ex. 175 at 13; Tr. 3306:12-28 [Testimony of Edward Gallagher].)

67. Contrasted with NMPF providing detailed data about the profitability of dairy farmers currently and projected under Proposals 8 and 9, the record is devoid of any analysis of manufacturing input costs and profitability for proprietary processors, other than small, artisan style cheese makers. Further, no proprietary cheese manufacturer testified that it is unprofitable. (Ex. 175 at 18; Tr. 3312:3-7 [Testimony of Edward Gallagher].)

68. Additionally, evidence suggests manufacturing processors see financial opportunities under current make allowances. For example, the recent construction of multiple

large, efficient, and modern cheese manufacturing facilities—some of which cost nearly $1,000,000,000—suggests cheese processors have developed means to be profitable despite a fixed cheese make allowance set in 2008. (Ex. 175 at 18; Tr. 3312:13-25 [Testimony of Edward Gallagher].)

3. There Is No Evidence in the Record of "Actual Manufacturing Costs": the Studies on Which Proposals 8 and 9 Rely Are Insufficient to Justify Nationwide Make Allowances at Those Levels.

69. There is no industry consensus on the current average costs of manufacturing. Likewise, there is no industry consensus that a simple average of the 2023 survey by Dr. Mark Stephenson and econometric analysis of Dr. Bill Schiek equates to an appropriate make allowance. (*See* Ex. 155 at 5 [Testimony of Rob Vandenheuvel]); Ex. 175 at 20 [Testimony of Edward Gallagher].)

70. At the request of IDFA—proponent of Proposal 9—retired University of Wisconsin professor Mark Stephenson conducted a 2023 survey, "Cost of Processing in Cheese, Whey, Butter and Nonfat Dry Milk Plants" ("2023 Survey"). (Ex. 178.) IDFA made this request after a similar survey conducted by Dr. Stephenson in 2021 ("2021 Survey" (*see* Ex. 158)) had been met with skepticism regarding allocation of costs by use of a novel transformation factor. The results between the 2021 and 2023 Surveys were noticeably different, though likely attributable to sample size rather than the transformation factor.

> Q. Okay. So just to recap a couple things. Your 2023 report had a smaller set of observations than the 2021 report, correct?
>
> A. Yes.
>
> Q. And as you noted often, the sample matters in terms of the usefulness of the data reported, correct? Or the conclusions reached perhaps is more accurate?
>
> A. Correct.

> Q. Of those plants that did report, fully two-thirds didn't participate in the 2021 report, correct?
>
> A. About that, yes.
>
> Q. Those new plants that did participate were identified by an e-mail from IDFA's CEO to its membership and maybe an e-mail from you, correct?
>
> A. Yes.
>
> Q. And the 2023 report does not include the degree of transformation factor which you believe is valid, correct?
>
> A. Correct.
>
> Q. And you abandoned using that at the request of IDFA who commissioned you to perform the research, right?
>
> A. It was the request, yes.

(Tr. 3568:10-3569:2 [Testimony of Mark Stephenson].)

71. IDFA also requested the Executive Director of the Dairy Institute of California, Bill Schiek, conduct a regression analysis speculating what costs of manufacturing are today in California (only) based on what they were in 2016 and the years preceding ("Regression Analysis"). (Ex. 179 [Testimony of Bill Schiek].) Dr. Schiek made clear his analysis, also known as an econometric model, should not be used in isolation.

> [E]conometric forecasts are projections based [on] estimated relationships using historic plant data and are not actual data on current plant costs. Rather than being relied upon as a sole source of information for updating manufacturing costs allowances, the estimates from this modeling exercise are best used in concert with other sources of cost data such as Dr. Stephenson's study.

(Ex. 179 at 13 [Testimony of Bill Schiek].)

72. More problematic, the Regression Analysis extrapolated costs for California only, even though the 2023 Survey already included California.

> Q. Okay. And California's about 18 percent of U.S. milk production, correct?

> A. That sounds about right.
>
> Q. And so Dr. Stephenson has already weighted California – or he's included California in his study, correct?
>
> A. Correct.
>
> Q. And IDFA wants to take those California numbers and have it account for a full half of it, correct?
>
> A. Correct.
>
> Q. On top of what's already in Dr. Stephenson's study, correct?
>
> A. Correct.

(Tr. 3687:15-3687:27 [Testimony of Bill Schiek].)

73. Despite these issues, which are not exhaustive, the proponents of Proposals 8 and 9 insisted the numbers in the 2023 Survey and Regression Analysis presented "real numbers" and that a ***simple average*** of the 2023 Survey and Regression Analysis, even though they are duplicative, should be the make allowances. IDFA and WCMA recognize these make allowances will be a "material increase" and as a result suggested a four-year implementation. Petition of Int'l Dairy Foods Ass'n for a Hearing to Amend Fed. Milk Marketing Order Make Allowances at 3-4 (May 30, 2023) https://www.ams.usda.gov/rules-regulations/moa/dairy/petitions. The make allowances in Year 1 of Proposals 8 and 9 exceed the make allowances in Proposal 7, which means dairy farmers would be materially financially harmed immediately by the make allowances in Proposals 8 and 9.

C. Producers Support Proposal 7: NMPF Offers a Modest Increase to Make Allowances Until Accurate Cost Information Can Be Ascertained.

74. DFA is a global dairy industry leader, the largest United States dairy cooperative and the largest United States milk business. (Ex. 175 at 1 [Testimony of Edward Gallagher].) DFA does not believe there is "data that leads to industry-wide confidence" of the actual costs of making dairy products. (Ex. 175 at 3; Tr. 3293:20-28 [Testimony of Edward Gallagher].)

75. DFA supports Proposal 7 to maintain dairy farmer confidence in the credibility of the administrative process of changing the make allowance, and in the absence of robust, credible, and audited manufacturing cost information from a federal government source. (Ex. 175 at 1, 21; Tr. 3319:1-8 [Testimony of Edward Gallagher].)

76. LOL believes the make allowances in Proposal 7 are adequate, acceptable, and reasonable. (Ex. 144 at 9; Tr. 2538:9-12 [Testimony of Christian Edmiston].)

77. CDI supports Proposal 7. (Ex. 155 at 6; Tr. 2771:27-2772:5 [Testimony of Rob Vandenheuvel].)

78. FF supports Proposal 7. (Ex. 154 at 4; Tr. 2745:11-16 [Testimony of Darin Hanson].)

79. Lone Star supports Proposal 7 because the modest increases proposed "recognize[ ] both the need to make an adjustment in make allowances but is reserved enough in its magnitude so as to not jeopardize the confidence the industry has in Federal Order pricing." (Ex. 172 at 5; Tr. 3223:8-19 [Testimony of Travis Campsey].) Further, NMPF Proposal 7 recognizes "the needs of dairy farmers to not see excessively large downward changes in the Orders' Class prices, since such large changes can themselves create market disorder." (Ex. 172 at 5; Tr. 3223:20-24 [Testimony of Travis Campsey].)

80. Agri-Mark supports Proposal 7. (Ex. 170 at 2; Tr. 3114:22-27 [Testimony of Catherine de Ronde].)

81. MDVA supports Proposal 7 because any greater increase in make allowances "would be very disruptive to dairy farmers' monthly milk pay prices." (Ex. 160 at 3-4; Tr. 2861:8-13 [Testimony of Mike John].)

82. NDA/Darigold supports Proposal 7. (Ex. 159 at 1, 3; Tr. 2811:22-27; 2815:8-10

[Testimony of Monty Schilter].)

83. FarmFirst Dairy Cooperative ("FarmFirst") has nearly 2,600 dairy farmer members in seven Upper Midwestern states, which include Illinois, Indiana, Iowa, Michigan, Minnesota, South Dakota, and Wisconsin. Their milk is pooled under FMMOs 30, 32, and 33. (Ex. 174 at 3; Tr. 3248:26-3249:2 [Testimony of Jeff Lyon].)

84. FarmFirst supports NMPF Proposal 7 because increasing make allowances beyond those proposed by NMPF will negatively impact the profitability of producers. (Ex. 174 at 5-6; Tr. 3253:22-3254:4 [Testimony of Jeff Lyon].)

85. Missouri producer Sean Cornelius supports NMPF Proposal 7. Even though he "struggle[s] with any increase in make allowance[s] [because he] know[s] it's a direct cost to [his] pay price," Mr. Cornelius "understand[s] that all facets of the dairy industry must work together to bring [dairy] products to consumers." (Ex. 162 at 4; Tr. 2895:10-19 [Testimony of Sean Cornelius].)

86. Maryland producer Matt Hoff supports NMPF Proposal 7. As a board member of MDVA, he knows the costs to operate MDVA's plants have increased since 2008. (Ex. 166 at 1, 3; Tr. 2942:22-2944:4 [Testimony of Matt Hoff].)

87. Connecticut producer and Chair of the Agri-Mark board James "Cricket" Jacquier supports NMPF Proposal 7. Cost of processing has increased for Agri-Mark by 20 percent since the last make allowance update in 2008. (Ex. 168 at 1; Tr. 2976:27-2977:3; 2977:9-11 [Testimony of James Jacquier].) Inadequate make allowances have created a reality in which some farmers are already receiving reduced pay prices compared to their neighbors because the increased costs of production are transferred to cooperative members. (Ex. 168 at 2; Tr. 2977:22-2978:5 [Testimony of James Jacquier].)

88. California producer Perry Tjaarda supports Proposal 7. Over the last 10 years, the profitability of his 3,200-cow dairy farm has been less than $1.45 per hundredweight, which is the final financial impact of increasing make allowances as found in Proposals 8 and 9. Proposals 8 and 9 would be devasting to his family dairy and many dairies throughout California. (Ex. 279 at 3 [Testimony of Perry Tjaarda].)

ARGUMENT

D. Proposal 7 Updates Make Allowances with the Necessary Consideration of Producer Supply.

1. The Producer Costs in Sections 608c(17) and (18) Must Be Considered When Considering a Change to Make Allowances.

With the AMAA, Congress delegated the Secretary authority to change the make allowances in the uniform pricing provisions.

> 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.

7 U.S.C. § 608c(18) (emphasis added).[10] The legislative history of Section 608c(18) makes clear

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[10] The last sentence of Section 608c(18), which is omitted from the quoted language, reads: "Thereafter, as the Secretary finds necessary on account of changed circumstances, he shall, after due notice and opportunity for hearing, make adjustments in such prices." IDFA incorrectly argues this sentence means the Secretary need not consider the specific factors in subsection 18 (e.g., price of feeds) when *amending* make allowances. The legislative history of Section 608c(18) is clear to the contrary.

[T]he House report on the AMAA contains the following commentary:

> The proposed amendment ... provides that if the Secretary finds that the national parity price for milk does not adequately reflect the price of feeds, the available supplies of feeds, and other economic conditions which affect

that when amending prices pursuant to the authority granted in Section 608c(18), "[*t*]*he Secretary is to use the same standard in adjusting prices as is to be used in the fixing of prices initially in the regulation of any marketing area.*" *Lansing Dairy, Inc. v. Espy*, 39 F.3d 1339, 1352 (6th Cir. 1994) (emphasis in original) (quoting S. Rep. No. 565, 75th Cong., 1st Sess. (1937)). This means the Secretary must consider "price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand for milk" when "fixing" prices. Because make allowances are part of the PPFs in the uniform pricing provisions, any change to make allowances will "fix" new prices. Thus, these considerations must be part of the Secretary's decision on any amendment to make allowances.

In spite of this direct language evincing Congress' intent for the Secretary, some courts, and IDFA, have suggested Section 608c(18) does not require direct consideration of producer costs enumerated in Section 608c(18) because the PPFs account for those considerations. *See*

> market supply and demand for milk in the marketing area to which the marketing agreement or order relates, he shall fix such prices as will reflect such factors, insure a sufficient quantity of pure wholesome milk, and be in the public interest. **The proposed amendment further provides that as the Secretary finds necessary on account of changed circumstances, he shall make adjustments in such prices. Such adjustments are to made in accordance with the same standards as are provided for the initial fixing of prices under this subsection.**

H.R.Rep. No. 75–468, at 3 (1937) . . . . The Senate Report reflects a similar sentiment:

> The intricate problems of the milk industry as described in the above cited opinion, explain the use of the several pooling and price plans authorized for inclusion in milk orders. Their effectiveness depends upon their adaptability to conditions affecting each marketing area and upon their adjustment from time to time to meet changing conditions. **The Secretary is to use the same standard in adjusting prices as is to be used in the fixing of prices initially in the regulation of any marketing area.**

S.Rep. No. 75–565, at 3 (1937) . . . .

Bridgewater Dairy, LLC v. U.S. Dep't of Agric., No. 3:07 CV 104, 2007 WL 634059, at *6 (N.D. Ohio Feb. 22, 2007) (emphasis in original) (citations omitted).

Bridgewater Dairy, 2007 WL 634059, at *7. If an amendment only considered make allowances, the same courts have reasoned, then the portions of the formulas that require consideration of producer costs are untouched and the Section 608c(18) factors are not implicated.[11] *Id*. In 2008, Congress rebutted this notion.

> As part of any hearing to adjust make allowances under marketing orders ***commencing prior to September 30, 2012***, the Secretary shall—
>
> (i) determine the average monthly prices of feed and fuel incurred by dairy producers in the relevant marketing area;
>
> (ii) consider the most recent monthly feed and fuel price data available; and
>
> (iii) consider those prices in determining whether or not to adjust make allowances.

7 U.S.C. § 608c(17)(G) (emphasis added). Congress amended the AMAA to crystallize the Secretary's obligation to consider price of feeds and fuel incurred by ***producers*** when adjusting make allowances. Congress made specific the Secretary's obligation by dictating the Secretary ***shall*** consider "average monthly prices of feed and fuel" and consider the "most recent monthly data." 7 U.S.C. § 608c(17)(G)(i), (ii). This mandate is, of course, consistent with Section 608c(18), which generally requires consideration of the price and availability of feeds but also requires consideration of other factors that implicate producers. Section 608c(17)(G) is an overlay on the Secretary's already general obligation to consider the Section 608c(18) factors.

The plain language of Section 608c(18) and Congressional history demonstrate the Secretary must take into account the "price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand." 7 U.S.C. § 608c(18). Further, the

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[11] This reasoning makes little sense given make allowances are part of the PPFs and are part of "fixing" prices—the hallmark for Section 608c(18) applicability. *See* 7 C.F.R. §§ 1000.50(l), (m), (n), (o); *see also, e.g.*, 73 Fed. Reg. 35306, 35325 (referencing make allowances as part of the Class III and Class IV PPFs).

Secretary must specifically consider the factors articulated in Section 608c(17)(G) for every marketing order that commenced prior to September 30, 2012—in this hearing, every order but FMMO 51. However, since this is a national hearing to amend the uniform pricing provisions, it is unclear if this delineation is possible. Regardless, the Secretary must consider the Section 608c(18) factors and must consider the Section 608c(17)(G) factors for, at least, 10 of the 11 FMMOs when setting make allowances.

2. Manufacturing Costs Have Increased Since 2008, But the Extent of the Increases Are Unknown and Warrant Cautionary Increases.

There is industry consensus that the costs of manufacturing have increased since make allowances were last changed in 2008. *See* 73 Fed. Reg. 35306-35331. There is, however, no industry consensus on the extent of those changes because there is no reliable data with a sufficient sample size. The best solution for future amendments is reliance on a periodic, mandatory, audited cost survey. There is industry consensus that USDA should have authority to conduct such surveys, but implementation requires an act of Congress. While NMPF is confident Congress will grant USDA this authority, it does not resolve the proposals in this matter. For now, the key objective must be to avoid raising make allowances impetuously. Modestly raising make allowances recognizes a rise in the costs of manufacturing but also recognizes there is imperfect data, which should caution against aggressive amendment. Raising make allowances beyond the amounts in Proposal 7 will be disastrous for America's dairy farmers.

The established policy is to err on the side of lower make allowances, or, at most, "average" make allowances—if those can be ascertained. The reasoning is multi-faceted. Foremost, make allowances are not meant to guarantee processors a profit.

> [M]anufacturing allowances incorporated in the formulas will not provide enough of an allowance to assure that every processor, no matter how inefficient or high-cost, will earn a profit. Allowances set at such a level certainly could result in the situation warned of

> by producer groups in which processors manufacture greater volumes of product than the market demands because they are guaranteed a profit on all their production. As a result, the only way to market all of the product would be to reduce prices, with a profit still locked in through the make allowance, which would result in decreasing prices paid to producers. In addition, manufacturers who are assured a profit on all of their output would have no incentive to make a sufficient quantity of milk available for fluid use—a basic goal of the Federal milk order program.

65 Fed. Reg. 76832, 76840-76841 (Dec. 7, 2000).

Nor are make allowances intended to cover the entire cost of manufacturing.

> [M]ake allowances included in the component price formulas do not cover all of the costs of all processors, and probably allow for greater costs than are experienced by some processors. In this sense, the margins experienced by processors under product price formulas are variable between plants. Also, it is likely that processors share some of their margin with producers in the form of over order prices. The degree to which this sharing occurs certainly may vary with producers' cost/price situations, as perceived by processors.

67 Fed. Reg. 67906, 67914-67915 (Nov. 7, 2002).

Make allowances in the uniform pricing provisions must be reliable national estimations of costs.

> [E]stimation of manufacturing costs for national application requires that national production volumes of these commodities be considered in determining the level of make allowances to be relied upon….

73 Fed. Reg. 35306, 35325. This is because the "purpose of the Class III and IV price formulas and make allowances is to set individual minimum class prices for the Federal milk order program on a national basis." *Id.* at 35326; *see also* 78 Fed. Reg. 9248, 9269 (Feb. 7, 2013) ("Accordingly, the accuracy of deriving the minimum value of raw milk is dependent on the accuracy of the commodity sale prices reported and, in large part, the accuracy of the manufacturing cost factors, or make allowance factors, that are used in the pricing formulas."). But "minimum prices" are not and cannot be identical to "prices as close to zero as possible," which would suggest raising make

allowances as high as possible.[12] *See, e.g.*, 7 U.S.C. § 608c(5)(A) (permitting the Secretary to adjust minimum prices based on market factors). The purpose of "minimum prices" is to set prices at such a level that still guarantees dairy farmers a sustainable amount of income above what dairy farmers would otherwise receive in the absence of regulation. *See* 7 U.S.C. § 602(4) ("maintain such orderly marketing conditions…***in the interests of producers***" (emphasis added)). Put another way, minimum prices must be set to reflect supply and demand. 64 Fed. Reg. 16026, 16094. Minimum prices that are set too low will negatively impact producers' viability and therefore supply. Thus, minimum prices must be set so as to comport with the purpose of the AMAA: raise producer prices.

Only NMPF's Proposal 7 meets the historical characteristics for setting make allowances. Proposal 7 strikes a balance among multiple objectives. First, Proposal 7 is directionally correct, increasing make allowances from their current levels, which were set in 2008. Multiple NMPF witnesses testified how costs to run manufacturing plants within their cooperatives have increased since 2008. (Ex. 160 at 5; Tr. 2862:7-14 [Testimony of Mike John] ("[W]e have seen a dramatic increase in conversion costs to make both nonfat dry milk and butter…. This lack of needed reinvestment in itself causes a higher cost of conversion which in turn causes a higher burden on our members' monthly milk checks while we provide a necessary service to our marketplace."); Ex. 144 at 2-3; 2529:23-25 [Testimony of Christian Edmiston] (testifying that manufacturing costs per pound at LOL's plants have increased since 2006); Ex. 154 at 2; Tr. 2742:9-11 [Testimony of Darin Hanson] (testifying that FF has experienced higher operating costs since 2008); Ex. 155 at

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[12] Indeed, the policy statements of the AMAA suggest minimum prices were originally envisioned as being related to *parity* prices, which implicates USDA's obligation under "permanent law" to purchase milk at 75-90% of parity pricing. *See* 7 U.S.C. § 602(1). The parity price for milk as of January 2024 was $65.50 per hundredweight. USDA NASS, *Agricultural Prices* at 21 (Feb. 29, 2024), https://usda.library.cornell.edu/concern/publications/c821gj76b?locale=en.

2-3; Tr. 2765:17-21 [Testimony of Rob Vandenheuvel] (testifying that costs borne by CDI member owners have increased as a result of outdated make allowances); Ex. 159 at 2; Tr. 2811:28-2812:1; 2812:10-13 [Testimony of Monty Schilter] (testifying NDA's manufacturing costs have increased since 2008 and NDA has had to implement producer paycheck deductions); Ex. 170 at 3; Tr. 3115:25-28 [Testimony of Catherine de Ronde] (testifying that Agri-Mark's manufacturing costs have increased on average 20 percent since 2008); Ex. 171 at 2-5; Tr. 3165:1-17; 3166:3-4; 3167:28-3168:1 [Testimony of Paul Bauer] (testifying Ellsworth's costs to manufacture cheese and whey have increased since 2006); Ex. 172 at 2; Tr. 3219:11-14 [Testimony of Travis Campsey] (testifying Lone Star's manufacturing costs for butter and nonfat dry milk have increased since Lone Star opened plant in 2017).)

While manufacturing costs have risen for seemingly every plant, make allowances should not be raised hastily. It is producers that are most negatively affected by raises in make allowances (processors are also affected but positively). Producers support a modest raise, but the Secretary should not ignore the precarious and unique position that producers are in by advocating for a proposal that will immediately lower their milk checks. Proposal 7 recognizes the increased cost of manufacturing but does so without bankrupting America's dairy farmers. (*See, e.g.,* Ex. 155 at 3; Tr. 2767:8-16 [Testimony of Rob Vandenheuvel] ("The impact on dairy farmers and on the regulated monthly milk price must be considered when evaluating these adjustments. It is simple arithmetic that an increase in the make allowance will generate a lower resulting classified milk price. While a regulated milk price reduction due to higher manufacturing costs can be justified, the impact on dairy farms from a sudden and large milk check adjustment is a consideration that supports a more tempered approach.").)

Second, while not technically a part of Proposal 7, the Secretary should be aware that

NMPF continues to support (Congress) granting authority for USDA to conduct mandatory, auditable plant processing cost studies and present the resulting data to the industry. This will enable the industry to make requests for further make allowance adjustments on the basis of complete data. Pending complete data it is important to avoid raising make allowances too high and creating a situation that requires overcorrection. (*See, e.g.*, Ex. 155 at 3; Tr. 2766:19-2767:1 [Testimony of Rob Vandenheuvel] ("CDI recognizes that there is also a risk of overcorrection. There are certain unknowns due to limitations in the available manufacturing cost data sources, such as: Range of costs that may be seen if all plants making eligible products were required to report plant costs to USDA; Product yields using current technology; Benefits of automation; and Energy efficiencies or other improvements to plant efficiencies.").)

Finally, in the absence of definitive data, Proposal 7 does not increase make allowances so high as to be dependent on projections or on plant processing cost surveys that have been disputed. (Ex. 144 at 9; Tr. 2440:3-8 [Testimony of Christian Edmiston]; *see also* Ex. 155 at 3; Tr. 2467:5-7 [Testimony of Rob Vandenheuvel] ("[T]he absence of available, reliable data provides a justification for a more tempered adjustment in the very near term, which is what Proposal Number 7 represents.").) The limited data that proponents of Proposals 8 and 9 presented is a small sample size. The Secretary should not consider "limited data" to be the same as "all the data" and should discount the limited data presented accordingly. *See infra* at 103-121 (discussing the limitations of the 2023 Survey and Regression Analysis). Proponents of Proposals 8 and 9 have put forth their proposals based on past conduct of the Secretary where manufacturing cost data from the California Department of Food and Agriculture was averaged with previous surveys conducted by Dr. Stephenson and colleagues. That approach may have made sense in 2008. However, critical to the Secretary's decision in this proceeding is a recognition that the dairy industry has changed since Order Reform and since make allowances were last updated in 2008. It is entirely appropriate to depart from historical norms when those norms no longer reflect the current landscape of the dairy industry The way make allowances were previously set is no longer an appropriate solution.

Certain assumptions for setting make allowances need to be re-evaluated because "[i]t is important that the product-price formulas reflect current market conditions, not market conditions that may be possible but not widely achieved or not reflective of general industry wide conditions." 73 Fed. Reg. 35306, 35327. For example, it is no longer true that "[t]he ability of a manufacturer to offset cost increases are limited by the level of make allowances in the Class III and Class IV price formulas." *Id.* at 35323. Proprietary manufacturers—***none of which provided <u>any</u> manufacturing cost data or supplied information about their profitability***—have multiple options (that they are taking) to lower costs. *See infra* at 129-140 (discussing the deafening silence from proprietary processors on the nature of their costs despite building plants costing up to $1,000,000,000). Proprietary manufacturers increase the efficiency of their plants, build plants in unregulated areas, reduce premiums to producers, and choose to depool. While proprietary handlers have these outlets, dairy farmers do not.

> So first of all, if you make a Make Allowance increase that reduces milk prices by $1.45 per hundredweight, dairy farmers that are supplying the Class I marketplace will receive $1.45 less. And it doesn't matter whether they belong to a dairy cooperative that has manufacturing facilities or not, because any one of those dairy cooperatives with manufacturing facilities, if they are a Federal Order handler, probably has some Class I sales, and so their producers, their farmer-owners will see a net decrease. So that's pretty significant.
>
> For dairy cooperative members where their milk goes to their own plants and they're Class III or IV plants, it's a – it is probably a net sum zero game because there's these two ledgers. Right?
>
> We have already seen – and again, I come back to the cheese side. You have got a block-barrel spread that a lot of the cheddar

> cheese manufacturers benefit from, that is like a back door Make Allowance increase, that's probably worth [$0.0]3 to $0.04 a pound to them. I don't think I'm understating that over-order premiums have gone down at least $0.50 a hundredweight, so that's about another $0.05. For some, there's depooling income. For some, they passed higher costs along during the inflationary period because everybody else did. And most of the – most of the cheese produced in the United States isn't included in a survey, so there is no circularity.
>
> And so when you square all that up, some of these cheese plants have over the course of time since 2006 received anywhere from [$0.0]5 to $0.10 a pound or so in reduced cost or increased revenue. And so when you hear of double-dipping, dairy farmers want to make sure that you're not allowing them that and then also taking the value of the milk price away from them.
>
> So there's a lot to weigh here, and unfortunately we don't have good data, so you're in a – you're on a slippery slope about how you look at all these things. And I would say, I think, of the – of the handlers that are participating in this hearing, I think most of the handlers accept the fact that a Make Allowance increase of the equivalent of the National Milk proposal is okay.

(Tr. 3398:2-3399:28 [Testimony of Edward Gallagher].) Proprietary manufacturers have taken advantage of market conditions such as out-of-date pricing methods—using the Block/Barrel spread as a backdoor make allowance—and have made business decisions to producers' detriment—reducing over-order premiums and depooling more frequently—to maintain profitability in response to claimed rising manufacturing costs. It would be inequitable to raise make allowances to the levels in Proposals 8 and 9 when proprietary manufacturers are already evolving their operations to meet or beat current make allowances. NMPF—the voice of America's dairy farmers—has accepted a modest change to make allowances, but the incomplete cost data available does not justify raising make allowances that affect milk prices by four-fold greater than ever before. Raising make allowance and causing such a reduction in producer pay prices is an extreme change. And "extreme changes will have extreme impacts on milk production." (Ex. 159 at 3; Tr. 2814:27-2815:7 [Testimony of Monty Schilter].)

a. The Manufacturing Costs Proposed by IDFA and WCMA Rely on Incomplete Data.

To be sure, proponents of Proposals 8 and 9 submitted generalized cost data, but the forcefulness and usefulness of that data is weak. Proposals 8 and 9 are *simple averages* of Dr. Stephenson's 2023 Survey *commissioned by IDFA* and Dr. Schiek's *California only* survey, which is a projection of data that was actually included in the 2023 Survey. This approach—a simple average of two studies that do not independently each represent 50 percent of the manufacturing—is too problematic to be considered reliable data on which to set national make allowances. The data and methods in both analyses is biased since they were paid for by the proprietary manufacturers and Class I processors that will realize financial windfalls from any make allowance change—especially a significantly large change.

Dr. Stephenson's 2023 Study, while perhaps an attempt at industry-wide inclusivity, is notable for its deficiencies. Foremost, Dr. Stephenson conducted a 2021 Survey, autonomously, that has noticeably different results from the 2023 Survey commissioned by IDFA. It is not a random survey. The 2023 Survey is a *targeted* survey paid for by an industry interest group that wants make allowances raised as high as the Secretary will permit.

In addition to the bias of the 2023 Survey, there were noticeable differences between the 2021 Survey and 2023 Survey. For certain products, there were dissimilar costs even though volume was similar between the 2021 Survey and 2023 Survey.

> Q. … But for the butter, you had generally the same number of plants reporting, and it averages out to a similar volume, but you think the difference is just a – it was just basically a different set of plants that reported, a significantly different set of plants?
>
> A. Yes, they were – I mean, not a perfectly different set, there were some same plants. But they were – in that – in the two samples, really very different plants that were reporting this time around. So the volume was similar, the number of plants was similar, the results not similar.

(Tr. 3594:28-3595:10 [Testimony of Mark Stephenson].)

The number and type of participants in the 2023 survey should raise alarm about the statistical significance of the results. For example, that the butter make allowance could substantially change by virtue of the *participants* when the *volume was the same* is cause for concern. It is not possible to delineate which cost survey is more accurate because of the variable participants.

> Q. Did you hear [Dr. Stephenson] testify, though, that he looked into that to see if that was the cause of what was driving the differences in the numbers?
>
> A. I heard that, yes.
>
> Q. And did you hear him also say that he concluded that it wasn't that, but it was the sample size?
>
> A. I heard him say that, yes.
>
> Q. Do you trust that what he said is accurate?
>
> A. I would say he knows the work he did better than I do. So, yeah.
>
> Q. Okay. And – and then you understand that he redid that study on behalf of IDFA for 2023?
>
> A. Yes.
>
> Q. And the numbers that he got in 2023, did that seem to fit better with what you would have expected?
>
> A. Yeah. I mean, in terms of the relationship between butter and powder particularly, yeah.
>
> Q. Because the delta between dry whey and nonfat dry milk is now three times difference; is that right?
>
> A. Well, yeah. But it's – the dry whey costs are higher, which is what I – more what I would expect.
>
> Higher than nonfat dry milk.
>
> Q. And so almost a $0.09 difference from 2021 to 2023; is that right?

> A. I don't have the numbers in front of me, so I'll take your word for it.

(Tr. 3667:14-3668:11 [Testimony of Bill Schiek].) For the 2023 Survey, Dr. Stephenson believed he had good representation for two categories where he obtained responses from 50 percent of the available volume. While a *random* sample of 50 percent may qualify as "good representation," a targeted survey, such as the 2023 Survey, does not. For example, given the butter make allowances drastically changed between the 2021 Survey and 2023 Survey by virtue of the identity of the participants, rather than volume, the Secretary should not assume 50 percent is a "good representation." In addition to a concern about the identity of the participants, there should also be concern about the sample size because two of the categories received responses for somewhere between 10 percent to 50 percent of the total volume.

> Q. Okay. And did you hear Dr. Stephenson say that in his cost study, for the one that – the two categories that he believed he had a good representation on, he believed it was probably around 50 percent?
>
> A. Yeah.
>
> Q. And then there were two categories that fell somewhere between 10 and 50 percent?
>
> A. Yes, I – I had heard the testimony.
>
> Q. Yeah. And – and then did you also hear him say that sample size matters?
>
> A. Yes. I heard him say that.
>
> Q. Do you agree with that, that the sample size matters in the accuracy of the information that's reported?
>
> A. Yes***. The more representative your sample is, the more representative it is of actual cost***. So I would agree with that.

(Tr. 3654:1-3654:20 [Testimony of Bill Schiek] (emphasis added).)

The problem with relying on a sample size between 10 percent and 50 percent should be mathematically obvious. Consider, for example, if the dry whey category only received a 30 percent (halfway between 10 percent and 50 percent) response rate. Proposals 8 and 9 suggest a new make allowance of $0.3172 for dry whey. Continuing the hypothetical, consider if the remaining 70 percent were highly efficient processors that actually had a cost slightly above the current make allowance of $0.1991 and were around $0.2000. The resulting weighted average of the responses received and the unreported costs would be $0.23516—just slightly above the $0.2300 offered by Proposal 7.[13] Sample size matters. Since ***no*** large, efficient processor provided actual cost data, these types of hypotheticals must be considered and hedged against when setting make allowances.

NMPF astutely noted the problem of sample size during the hearing.

> So – and I focus on the data collected for cheese manufacturing plants. You know, Mr. Stephenson can only – can only analyze what the businesses send them, and the cheese businesses didn't send them enough. And so in the first survey in 2019 – I can't remember if it was eight or ten milk plants that were cheese plants that were included – and when you looked at the more – he – he – he divides his sample size – I believe this, and I apologize if I'm misrepresenting it. Mr. Stephenson can correct me when he gets up here – or he can cross-examine me and fix it right now.
>
> I think he takes his data sample and divides by two. And he takes – he sorts from most – you know, by lowest costs, so if you had ten, he has an array of ten plants, and he goes in the – divides – takes the first five least cost plants, and that's one group, and then – and he did.
>
> So – so when you look at that in his first study, his first survey, and you looked at then what was the total amount of cheese, it was obvious there was not a lot of large cheese plant contribution. Study two, sort of doing the same thing he had better, better information from the cheese plants, because I believe he had 18 cheese plants.

[13] This hypothetical is generally consistent with the cost increases seen by Ellsworth, which ***did*** provide cost data. Ellsworth has seen an increase in costs for dried sweet weight of $0.054 per pound in 16 years. (Ex. 171 at 5 [Testimony of Paul Bauer].) Adding $0.054 to the current dry whey make allowance results in a figure ($0.2531) much closer to Proposal 7 than Proposals 8 and 9.

> When you take his average for all 18 and multiply it out by the 18 plants, you get about roughly 2.2 to 3.9 billion pounds of cheddar cheese made in 2022. And when you look at the nine plants that are most efficient, and you look at – you convert that back to the average milk intake per month, it's about 130 million pounds of milk a month, on average, for the most efficient.
>
> And so there – there are a lot of very large cheese plants that still did not contribute their data. And I don't know this, but I would be concerned that those large – those – the rest of the data is from large – most of the rest of the data is from really large cheese plants, seven or eight of the largest cheese plants in the United States and that their costs of manufacturing cheese are at the low end.
>
> And when you look at his – his low end, which I believe is $0.22 a pound, if you just took the low end by the delta of the cheese that's missing from the survey, determine the total cost from all that, add it into the total cost that's already in the survey, and then divide it by all the cheddar cheese, you come out with $0.245 a pound. And this is a rough estimate, a back-of-the-envelope calculation that I have done.
>
> So that would suggest that the average price that he's – because he doesn't have the full data – is suspect in its accuracy.
>
> I'd take one more step, though. That in the average of the nine plants that is $0.22 a pound, and we all recognize an average means probably four or five are higher than the average and four or five were lower. We don't know what the lower – it could be a tenth of a cent, it could be a couple cents. I don't know. I would be concerned that of those seven or eight large cheese plants that I believe aren't included in the survey because they didn't provide Mr. Stephenson with the data, I believe they could be averaging below the average.
>
> So there's serious questions about whether we have enough data in the survey that accurately represents a meaningful cost of production to lower dairy farmers' milk prices. I think with what we have done across National Milk Producers Federation have come to a pretty reasonable point that I think, in my back-of-the-envelope calculation, I hope we're not too high.

(Tr. 3389:8-3392:16 [Testimony of Edward Gallagher].)

In addition to the 2023 Survey containing an insufficient sample size that could dramatically change the results, the 2023 Survey does not capture how manufacturing costs may be skewed by balancing, which is a critically important consideration for cooperative-manufacturers.

> Q. That's an interesting point, which makes me wonder, if a plant didn't operate consistently throughout the year because it was a balancing facility, would that also skew the data?
>
> A. No, I try to capture – well, I mean, it may change that. I – it's – it's one of the conjectures that we might have as to why a plant operates at higher costs. They are carrying capacity that's not used all of the time, and, you know, that is certainly an additional cost.
>
> I do try to ask enough questions to be able to look at, at least, the monthly differences in product manufacturing out here, so that we can see whether the plant was providing a good deal of seasonal balancing***. I don't look at inter-week balancing or collect data at that level.***

(Tr. 3552:17-3553:4 [Testimony of Mark Stephenson] (emphasis added).)

Several cooperatives that operate manufacturing plants testified to the financial burden the balancing places on their operations. Those manufacturing plants must run at less than full capacity to provide the valuable balancing service to their markets. Raising make allowances too high will incentivize those plants to run full and manufacture products rather than incurring the extra cost of balancing. All of these deficiencies—bias, identity of participants, sample size, incomplete consideration of costs for cooperatives—undermine any persuasive value in the 2023 Survey.

Similarly, Dr. Schiek's Regression Analysis is of little, if any, utility because of its deficiencies. It cannot account for basic changes to California manufacturing since 2016 such as plants opening or closing or productivity improvements.

> Q. So have you – does your model account for any changes in the makeup of California plants since that time, new plants or closed plants?
>
> A. It does not.

(Tr. 3690:15-3690:18 [Testimony of Bill Schiek].) Nor can the Regression Analysis be extrapolated to any other state because of the regulatory differences that affect cost of labor and operational expenses.

> Q. Okay. Do you have a way to factor into your analysis that the minimum wage in Wisconsin is 50 percent of what it is in California?
>
> A. No. This is really a prediction of California costs.
>
> Q. Okay.
>
> A. Because we're using California data to do it. Yeah.
>
> Q. Okay. And extrapolate from that in a way that would be –
>
> A. Reflective of California conditions.
>
> Q. Okay. And so you're not suggesting that it would be reflective of the rest of the country's conditions?
>
> A. Not any more than the fact that they are operating in the same environment – you know, the same general business environment because they are making the same products. But, yeah, it's not – the costs can be different in other parts of the country for sure.
>
> Q. And you would agree with me that there are other parts of the country that have very different cost structures than what California has?
>
> A. I believe that's the case, yes.

(Tr. 3648:21-3649:14 [Testimony of Bill Schiek].) Likewise, the data on which the Regression Analysis relies did not include dry whey costs. Instead of excluding dry whey from the analysis, Dr. Shiek simply added $0.03 to the nonfat dry milk cost. Critically, Dr. Shiek has no way to verify whether this roughshod approach has any validity.

> Q. And so it's nonfat dry milk plus $0.03, and then that's how you calculated the dry whey number?
>
> A. Uh-huh.
>
> Q. Is that a "yes"?
>
> A. Yes. That is a yes.

> Q. But Dr. Stephenson, if you look at his spread in 2023 between dry whey and nonfat, it has $0.0611; is that right?
>
> A. I – let's see. I don't think I have that in front of me, but I'll take your word for it.
>
> Q. Did you review his numbers?
>
> A. I looked at his numbers. I just don't have them in front of me right now.
>
> Q. Did you consider using the spread that he came up with as the spread for your calculation?
>
> A. No. I – when I was doing my work, we didn't have his most recent numbers. And because the CDFA data used a different way of allocating unallocated costs than his 2021 numbers, so I didn't use those because that was a different methodology. So, you know, I just went with an estimate that – $0.03 is a number I have heard in the industry that is representative of Incremental drying costs, whey versus nonfat dry milk, so – and it – it was the approximate difference in the Make Allowance. So those–- that was the reason I used it.
>
> ***And I don't know if that number is accurate or not***. I – I have asked people who are knowledgeable about whey manufacturing, if that number still makes sense or has it gone up, has it gone down. And, you know, I kind of get, well, that might be – yeah, might be $0.03. You know, it's kind of – I don't – I don't – I can't put a lot of faith in whether $0.03 is the right number for incremental drying costs or not, but that's – that's kind of what's in the current Make Allowance, so that's what I used.

(Tr. 3663:10-3665:9 [Testimony of Bill Schiek] (emphasis added).) Dr. Schiek understood the compartmentalized and counterfactual nature of his Regression Analysis. He admitted the Regression Analysis is a "projection" based on historical information, not actual cost data. (Ex. 179 at 13 [Testimony of Bill Schiek] ("Rather than being relied upon as a sole source of information for updating manufacturing costs allowances, the estimates from this modeling exercise are best used in concert with other sources of cost data.").) Of course, using the simple average of the Regression Analysis and the 2023 Survey overweighs California's costs into the average for the entire country, but California costs may be higher than average because of regulatory, environmental, and other economic costs of production there, including strong demand and higher prices for land.

The Regression Analysis is completely disconnected from current manufacturing costs in the industry as it exists today. The Regression Analysis is, counterintuitively, a projection of events that have already occurred. The costs the Regression Analysis "projects" are for 2016 to 2023; costs that could be checked against the costs manufacturers actually incurred. Eviscerating any modicum of lingering utility, the Regression Analysis is only for California, does not consider any changes in the California dairy industry since 2016, cannot be used on its own, and is duplicative of the 2023 Survey, which also included California plants. The proponents of Proposals 8 and 9 offer no way to reconcile these two data sets other than falling back to a simple average. This cannot be sufficient when the livelihood of dairy farmers is at stake.

IDFA and WCMA use this fallback position by pointing to past rulemaking that relied on the average of multiple surveys. *See* 73 Fed. Reg. 35306, 35324-35325. But the "formula"—i.e., the simple average of two incompatible and unreliable surveys—for Proposals 8 and 9 is too simplistic and does not represent reality. The ad hoc nature of Proposals 8 and 9 cannot be ignored. Indeed, USDA previously dismissed make allowance information gathered for a particular proceeding "under the auspices of IDFA" as not "sufficiently reliable for us in establishing a make allowance." 65 Fed. Reg. 76832, 76838. Likewise, USDA has refused to consider other studies that it found insufficiently reliable. 73 Fed. Reg. 35306, 35326 (rejecting Cornell Program and Dairy Markets and Policy surveys for setting cheese make allowance because two surveys produced inconsistent results). The Secretary should not hesitate to again disregard unreliable data and should reject the 2023 Survey and Regression Analysis for purposes of setting make allowances.

IDFA and WCMA recognize the *simple average* of a modest national survey and a Regression Analysis for one state will have immediate harmful impacts on producers and suggest a four-year implementation to help offset those impacts. But in year one the increase exceeds Proposal 7 and the milk price decrease of Proposal 8 and 9 would wipe out the average profitability of 1,000-cow or less dairies from 2015 to 2022, as shown by USDA data. Additionally, the four-year implementation grants proprietary manufacturers a profit margin—via predictable make allowance increases—for the next four years without having to adduce proof that those figures are representative of average costs of manufacturing. IDFA and WCMA rely on the 2023 Survey and the Regression Analysis because they *seem* correct, even if the proponents do not actually know.

> Yeah. Where that gets difficult is the fact that we don't make dry whey at our California plants, so there's really no way to compare that. If we were to look at like Dr. Schiek's results relative to percentage changes that we might see on the cheese side, again, you know, it's kind of an apple and an orange with mozzarella versus cheddar, again**, it looks like** it's reasonable and valid data.

(Tr. 3982:6-3982:13 [Testimony of Alison Krebs] (emphasis added).) Of course, the figures reached by 2023 Survey and Regression Analysis *seem* correct to IDFA and WCMA because they raise make allowances more dramatically than Proposal 7; Proposals 8 and 9 build in future profit for proprietary manufacturers that are clearly already profitable, even where those companies refused to share ***any*** cost data. *See infra* at 138-140. If proprietary manufacturers are already at or beating current make allowances or if their costs are anywhere below the year four numbers in Proposals 8 and 9, their profits will rise. And because those same manufacturers refuse to share ***any*** cost data, producers have no greater leverage to bargain for over-order premiums or some other mechanism to share in the manufacturers' profits (assuming manufacturers are willing to share). IDFA and WCMA put their faith in the 2023 Survey and Regression Analysis because that grants them bigger profits, regardless of what their actual manufacturing costs are. Indeed, the authors of the 2023 Survey and Regression Analysis recognize their methods are not the preferred methods for setting make allowances.

> Q. Okay. And so then if we have the mandatory audited cost survey as the number one way that we could achieve accuracy, and then a cost survey below that –
>
> A. Uh-huh.
>
> –. – such as the one that Dr. Stephenson has conducted, either in 2021 or 2023, and then your modeling would be below that; is that right?
>
> A. In order of preference for – for policy purposes in setting Make Allowances, yes.
>
> Q. Okay. So would you agree with me that by adding your numbers in the modeling to Dr. Stephenson's 2023 numbers, and then taking an average of those two, that it is something less than or less valuable than just looking at his alone?
>
> A. I think it depends on how confident you are that his numbers are representative of the current conditions in the marketplace. And, you know, I think one of the things I said I think in the study that, you know, his – his estimate for the manufacturing costs for cheddar cheese is lower than the estimate for 2022 that we came up with in my modeling. I think all the other ones, dry whey, nonfat dry milk, butter, his estimates are all higher than what I came up with.
>
> And, you know, I don't know – I – I just – I kind of track these costs through 2016. I have a talk to people, I don't know that, you know – I can't say that definitively that his cost estimates in all of the commodities are – are a better representation of where a cost level is today than – than – than my estimates.
>
> Q. And that's because based on your experience in the industry, you see some anomalies in his number that don't match up with what you would expect to see in his actual numbers; is that fair?
>
> A. I would say some of those numbers seem a little on the high side to me, yeah.

(Tr. 3672:26-3674:4 [Testimony of Bill Schiek].)

Simply put, adopting Proposal 8 or 9 will put dairy farmers out of business because they propose increases that are too large.

> Q. You talk on the second page, and all throughout your testimony really, about not – not – the importance of not adopting a Make Allowance that is too large and its impact to producers. And I just want to ask kind of what would you consider too large?
>
> . . . .
>
> A. Too large would be something that reduced average dairy farm milk prices by more than $0.56 a hundredweight.

(Tr. 3389:8-3392:16 [Testimony of Edward Gallagher].) The problematic studies put forth by the proponents of Proposals 8 and 9 are riddled with deficiencies that propose make allowances be raised above a breaking point for dairy farmers. However, the 2023 Survey and Regression Analysis are not accurate representations of *national average* costs of manufacturing. Proposals 8 and 9 should not be adopted.

3. The Secretary Must Consider Producer Costs and Profitability When Setting Make Allowances.

When setting make allowances, which will in part fix prices, in the uniform pricing provisions, the Secretary must consider "price of feeds, the available supplies of feeds, and other economic conditions which affect market supply and demand." 7 U.S.C. § 608c(18). For every FMMO other than FMMO 51, the Secretary must consider the "average monthly prices of feed and fuel." 7 U.S.C. § 608c(17)(G)(i). It is undeniable that feed prices have increased substantially since 2008. Some of the reasons for that increase were nonexistent the last time make allowances were set. For example, significant feed price inflation is, in part, caused by federal government providing incentives to produce fuel from livestock feed sources. These government energy incentives, which directly impact the cost of feed, did not exist in prior make allowance hearings. Again, it is not sufficient to rely on old methods. The Secretary must adapt to the current state of the dairy industry when setting make allowances.

It is further undeniable that plant profitability is considered when setting make allowances. *See* 65 Fed. Reg. 76832, 76840 (considering return on investment when setting make allowances). Dr. Stephenson factored in return on investment in the 2023 Survey; though, plants were free to value their plants however they saw fit.

> Q. Okay. If I look at the return on investment column, the low cost plants show an ROI of $0.0269, the high cost plants show an ROI of $0.0618, and all plants $0.0392.
>
> Does it seem anomalous that the plants with the highest costs get the highest return on investment?
>
> A. Well, these are plants that would have reported a higher market value for assets. And, you know, this is one of the places – I have tried to explain that a number of times, that it is a bit of a decision on the part of the plant what they think they could sell this plant for. And I don't throw a plant out because they reported too low a value or too high a value. I have never bought or sold a butter plant in my life. I have some ideas about that the cost of a new plant might be or perhaps even the sale of existing plants. But if it's an outrageous number that's returned to me, then I would at least ask about that as to, is this justifiable? So this does reflect self-reported value of assets.

(Tr. 3561:27-3562:17 [Testimony of Mark Stephenson].) Because the overarching goal of fixing prices is to create orderly markets—that is, the orderly administration of supply and demand—it makes little sense to focus on one side of the equation—i.e., only looking at plant profitability. The AMAA demands aspects of producer profitability be considered. This makes sense. If producer profitability is not considered carefully when setting make allowances, make allowances may be set at a level that would destroy dairy farmers' livelihoods. This would in turn lead to a supply problem and cause disorder.

a. Producers Struggle to Maintain Profitability at Current Make Allowance Levels.

> –So – so let's go back to the purpose of Federal Orders. So the purpose of Federal Orders, the Agricultural Marketing Agreement Act and Federal Orders were established to fairly distribute – to prevent uneconomic competition for – for sales to Class I fluid

> plants and to fairly distribute that revenue to dairy farmers supplying that milk shed. That's what the purpose of Federal Orders are. And so everything else is sort of, how do you value the rest of the milk in the pool?
>
> And so the number one purpose of Federal Orders is all about the Class I market. And if we have a significant Make Allowance change that decreases milk prices by $1.45 a hundredweight, you are significantly decreasing the pay prices for dairy farmers doing what the policy of the federal government is, supplying milk to Class I milk plants. I think USDA needs to consider that impact.

(Tr. 3371:20-3372:8 [Testimony of Edward Gallagher].) The final make allowances in Proposals 8 and 9 will result in farm level milk price decreases of $1.45 per hundredweight. (*See, e.g.,* Tr. 3975:5-3975:9 [Testimony of Alison Krebs] ("Q. So – and I'm trying to summarize, not to put words in your mouth, but you are advocating for Make Allowance changes which will reduce producer prices in the short-term, correct? A. Yes.").) No make allowance adjustment has impacted the farm level milk prices by more than $0.35 per hundredweight. (Ex. 175 at 19; Tr. 3318:24-26 [Testimony of Edward Gallagher].) Within this context, Proposal 7 is historic in that it would result in an approximately $0.50 per hundredweight decrease in farm level milk prices. Proposals 8 and 9 suggest a raise three times the historic raise in Proposal 7. This is unworkable for the average dairy farmers' ledger.

The primary cost to dairy farmers is feed inputs. Since 2000, the cost of feed has inflated at nearly twice the rate of general inflation (3.25 versus 1.8). (Ex. 175 at 5; Tr. 3297:18-24 [Testimony of Edward Gallagher]; *see also* Tr. 3934:20-3935:10 [Testimony of Alison Krebs] ("Q. Would you agree that the pressures that your business as a processor are experiencing, such as labor, and some of the supplies, and the energy, and the fuel costs, are also costs that dairy farmers are also experiencing? A. Oh, I don't deny that at all. Everybody's seeing higher costs.").) There is no make allowance equivalent for dairy farmers' production costs. Producers are dependent on the milk price to recoup cost inputs. Since 2015, dairy farmers have on average operated at a deficit, with their production costs falling $2.06 per hundredweight less than the milk price. (Ex. 175 at 11; Tr. 3395:11-15 [Testimony of Edward Gallagher].)

b. Cooperative Producers Must Absorb Costs That Proprietary Processors Do Not Face.

Cooperatives operate dairy manufacturing plants in nearly all, if not all, FMMOs. Unlike proprietary manufacturers, cooperatives—meaning their member owners—have additional costs they must absorb when also operating as a manufacturer. A raise in make allowances results in no additional income for the cooperative.

> Q. And – but you would agree with me that when Make Allowances are increased, farmers with cooperative-owned plants would experience financial benefits from those increases through the plant side of their cooperative income, correct?
>
> A. No.
>
> Q. "No"? Why not?
>
> A. So if you could think about two ledgers at a cooperative for determining pay prices at their own plants. One ledger – I'm not going to be able to get this on the record, I'm sorry, if I use my hands. I like to use my hands to make – but one ledger is the ledger at the plant, and the other ledger is the ledger of what you pay dairy farmers.
>
> So if a dairy cooperative is losing money, they can only afford to pay what – what they have to pay out, and so dairy producers receive less money. If there was a Make Allowance change of $0.04 a pound that allowed a Class III manufacturer to make $0.50 a hundredweight more on the milk going into their plant, it would on the other ledger result in a milk price decrease to their farmer-owners of $0.50 a hundredweight. So there is no change in the valuation or the value of the farmer milk in that example.
>
> Q. And I'm talking about just the plant side of that ledger. So I understand the impact of both, but just on the plant side, farmers who are members of cooperatives with plants would benefit on that side of the ledger from an increase in Make Allowances, correct?
>
> A. You have to – at a dairy cooperative, you have to look at both sides, unlike a proprietary cheese plant that doesn't have its own

> producers and that $0.50 falls right to the bottom line and there's no additional income for the dairy cooperative whose dairy farmers are supplying the plant.

(Tr. 3368:8-3369:14 [Testimony of Edward Gallagher].)

Additionally, cooperative manufacturing plants often perform balancing functions within their market. (*See* Ex. 144 at 5; Tr. 2533:6-9 [Testimony of Christian Edmiston] ("[C]ooperative manufacturing plants balance the market by providing an outlet for milk not needed by their customers on a monthly, weekly, and even daily basis.").) This usually results in plants running at less than full capacity and an increased cost per unit. Yet, cooperatives making commodity-style products operating under FMMOs cannot recover a larger margin on their commodity products. If they raise their commodity product prices to capture a larger margin to cover higher costs, those higher prices go directly into the class prices and effectively eliminate the larger margin. The make allowances are the fixed margins to commodity production at cooperative plants. If cooperatives choose not to balance, producers will face lower prices at the farms and consumers will face higher prices in the market. (Ex. 159 at 2; Tr. 2814:10-12 [Testimony of Monty Schilter] ("There is a tipping point when running your balancing plants full makes more economic sense than selling milk into a Pool Distributing Plant.").) Proprietary manufacturers do not face these pressures. Proprietary plants have make allowances built into their margins and take the amount of milk they want, when they want it.

Finally, proprietary cheese manufacturers have diversified operations that include significant manufacturing of products not reportable to the NDPSR. *See* 7 C.F.R. § 1170.8(a) Consequently, the make allowance for blocks has limited impact on their overall profitability. This contrasts with producers where the Class III price directly prices much of Class III use *and* prices a meaningful portion of the Class I price. While cooperatives are cheesemakers too, the make allowance for Class III presents a bigger issue for producers than for proprietary processors.

The role cooperative manufacturers play in the market and additional costs they incur cannot be ignored when setting make allowances.

c. Raising Make Allowances Beyond Those in Proposal 7 Will Threaten Milk Supply and Cause Disorder.

The phased-in approach in Proposals 8 and 9 is an admission by the proponents—IDFA and WCMA—that setting make allowances above the levels in Proposal 7 will be disastrous for dairy farmers. The all-milk price will decrease $0.73 per hundredweight in the first year. This is nearly 30 percent greater than the total decrease that will result from Proposal 7 and is greater than double the largest make allowance adjustment ever. The make allowances proposed by IDFA and WCMA are unsustainable for the dairy industry.

DFA's Estimated All-Milk Price Impact of Various Make Allowance Increases

Proposal	Class III	Class IV	All-Milk Price
	$/cwt of milk		
NMPF	($0.58)	($0.52)	($0.56)
	Cumulative by Year		
IDFA Yr 1	($0.76)	($0.66)	($0.73)
IDFA Yr 2	($1.01)	($0.89)	($0.97)
IDFA Yr 3	($1.27)	($1.11)	($1.21)
IDFA Yr 4	($1.52)	($1.33)	($1.45)

> Q. If USDA adopts NMPF's Make Allowance levels as proposed, farmer milk prices will still go down, correct?
>
> A. Yes.
>
> Q. And when prices go down, as you said, farmer – farms will consolidate and milk supply could shrink; is that right?
>
> A. Mischaracterization a bit. So there are – and I – I mentioned it earlier – milk prices go up and down all the time because supply and demand is changing. So this change is a structural milk price change that reduces milk prices on top of all that other stuff. And it reduces milk prices to a point that is going to be very unprofitable – if you go all the way to the IDFA proposal, reduces milk prices to the point that it's going to be unprofitable, that over time, there's going to be a restructuring in the dairy industry of those who produce the milk, and there's going to be a long, painful process involving human beings that operate dairy farmers [sic] that aren't going to be able to cash flow, maybe not going to be able to make feed bill payments, aren't going to be able to pay back their loans. And those family

> farms are going to be forced out of business. And it will be a slow, painful process, that over time will decrease milk production, before something else changes and you reach a new equilibrium and something else changes. It's going to be an ugly situation. And we're trying to prevent that from happening.

(Tr. 3363:14-3364:12 [Testimony of Edward Gallagher].)

Indeed, proprietary manufacturers were unabashed in noting dairy farmer profitability will decrease.

> Q. Are you suggesting that the farmers in West Texas and New Mexico who supply Southwest Cheese are going to be more profitable if IDFA's Make Allowance proposals are adopted?
>
> A. I would not suggest they would be more profitable.

(Tr. 3759:20-3759:24 [Testimony of James DeJong].)

> Q. So – and I'm trying to summarize, not to put words in your mouth, but you are advocating for Make Allowance changes which will reduce producer prices in the short-term, correct?
>
> A. Yes.

(Tr. 3975:5-3975:9 [Testimony of Alison Krebs].)

In response to criticism, proprietary manufacturers suggested that there is too much supply currently. For example, a witness for Leprino claimed the Upper Midwest had experienced the phenomenon of milk dumping "extensively," but then testified that milk dumpings "are very isolated events" that have only happened "a couple times." (Tr. 3938:4-6 [Testimony of Alison Krebs].) Equally untenable, the Leprino witness also suggested that dairy farmers could rely on the Dairy Margin Coverage ("DMC") program to "cushion farms" if make allowances are increased, but then admitted that only a small percentage of milk produced is covered by DMC while Leprino builds a new facility costing nearly $1,000,000,000. (Tr. 3975:13-3976:13 [Testimony of Alison Krebs].) Make allowances are not intended to control milk supply (though too large of increases will negatively impact supply). Regardless, make allowances should not be increased based on unsubstantiated hearsay about supply problems or set at levels whereby the default assumption is government subsidies will keep dairy farmers afloat. Instead, proprietary manufacturers' true motivation—profit—and unwillingness to cooperate with dairy farmers should be at the forefront.

> Q. So Leprino is asking to lower prices, while a federal government program fills the hole, and $1 billion company expands their plants, right?
>
> A. I don't think that that's – I don't appreciate – or I don't think that's a real accurate characterization. But, you know, we're trying to create an expansion, we're trying to provide a – you know, be a secure, reliable supplier for our customers, as they want to grow. In that – in doing that, it provides a market for farmers who want to expand and grow as well.

(Tr. 3976:14-3976:23 [Testimony of Alison Krebs].)

With the make allowances increase in Proposals 8 and 9, consolidation of the producer sector of the United States dairy industry will occur more rapidly towards extremely large operations that can potentially weather the make allowances proposed by IDFA and WCMA.[14] In fact, only dairy farmers that have at least 2,000 cows would come ***close*** to breaking even with the make allowances in Proposals 8 and 9. (Ex. 175 at 13 [Testimony of Edward Gallagher] (noting the average profitability of farms with 2,000 or more cows has been $1.37 per hundredweight since 2012, which is $0.08 short of the financial impact of Proposals 8 and 9).) If the largest dairies making most of the milk are not going to be profitable from an excessive make allowance increase, then it would appear there is a significant risk to the milk supply. (Ex. 175 at 12 [Testimony of Edward Gallagher].)

The result of adopting the make allowances proposed by IDFA and WCMA is to endorse

[14] Left unsaid by IDFA or WCMA is how USDA is to reconcile this position with the mandate that USDA must consider the impact of proposed regulations on small businesses. 5 U.S.C. §§ 603, 604.

disorder in the dairy industry; it is to support a radical change where small dairy farmers are irrelevant and large proprietary manufacturers are more profitable, invest in more plants, and dominate the industry. Bluntly, it is to make federal policy supporting the rapid reduction in dairy farmers. Proposals 8 and 9 cannot be adopted.

4. The Proprietary Processor Opponents to Proposal 7 Seek to Raise Make Allowances Further Despite Not Providing Any of Their Costs and Already Being More Profitable Than Producers.

The loudest voices for change in make allowances are those that need it least. Large, proprietary manufacturers—Saputo, Glanbia, Hilmar, Leprino—testified that a raise in make allowances is needed because their costs have risen since 2008. While this may be true, it does not mean those manufacturers are operating at a loss.

> And I think that part of the danger is that we also assume that, well, then, many of these plants are not covering their costs, they must be losing money, just hemorrhaging money, you know. And I don't believe that's the case. Why would we stay in business if that were happening? There are probably also plants that are selling their product at the higher end of the NDPSR price observations.

(Tr. 3551:24-3552:3 [Testimony of Mark Stephenson].) Rather, proprietary manufacturers have changed strategy to ensure profitability in ways that dairy farmers cannot. Proprietary manufacturers always have the option to depool, which renders make allowances irrelevant. Indeed, proprietary manufacturers are building plants with little regard to whether they can recoup production costs through make allowances; rather, they are building plants with the intention to depool.

> And so it is a different environment, and many of those regions are not finding that there's enough money available to be a pool plant, and farms appear to be okay with that.
>
> Q. Can you give examples of states or regions where you see that occurring?

> A. Well, in what was my own backyard, anyway, in the Upper Midwest, the I-29 corridor, in places where we have seen some significant plant investments, and not all those plants are pooling all the milk. They are making investments that aren't based on expected equalization payments.

(Tr. 3553:17-3554:20 [Testimony of Mark Stephenson].) For example, Hilmar is building a $600 million dollar plant in Kansas with the intention of not pooling that plant. (Tr. 3851:16-24 [Testimony of Wes Eveland].) Manufacturers with their own producer supply are able to choose, in most FMMOs on a monthly basis, to take part in a regulatory scheme only if it will be in their financial interest.

Relatedly, proprietary manufacturers are building and operating in unregulated areas where they can ignore FMMOs and pay lower prices to farmers.

> Q. So do you pay an excess already? Is that what you are saying?
>
> A. Pay in excess of?
>
> Q. The Class III prices?
>
> A. We do not pay in excess of the Class III prices, typically. I would say that the competitive milk pricing for Idaho is typically – for cheese plants, is typically below Class III, sometimes well below Class III.

(Tr. 3781:1-3781:8 [Testimony of James DeJong].)

Large, proprietary manufacturers also have significant financial resources that allow them to constantly improve efficiency. Improving efficiencies through diversification, new equipment, or other tools is normal business operation. It is consistent with federal policy: make allowances should not guarantee a profit. 65 Fed. Reg. 76832, 76840-76841. But large manufacturers have financial flexibility that outpaces dairy farmers, who operate almost exclusively on debt.[15] The

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15 [D]airy farm[ing] is a business, and like any business, you have to continue investing in your business, recapitalizing your business. You have to buy new things to replace things that get worn out.

testimony of proprietary manufacturers was littered with their strategy of depooling, operating outside regulations (e.g., operating in states with no FMMOs or diversifying to produce products not reportable to the NDPSR), and constantly improving efficiency. Additionally, every large proprietary manufacturer that testified in support of raising make allowances had recently built, was currently building, or planning to build a new facility that cost between $240,000,000 and $1,000,000,000.

Saputo

Saputo has three "world class facilities" in the United States and recently opened a fourth in Wisconsin that cost $240,000,000; Saputo also completed a $75,000,000 expansion for string cheese on the West Coast. (Tr. 4049:26-4050:28 [Testimony of Terry Brockman].) Those projects are expected to be profitable by the end of 2024. (Tr. 4051:1-4 [Testimony of Terry Brockman].) Simultaneously, Saputo closed four plants and repurposed a fifth to improve overall companywide processing efficiencies by 47 percent. (Tr. 4051:21-4052:20 [Testimony of Terry Brockman].)

Glanbia

Glanbia has ***full control*** over milk prices for producers in Idaho (Tr. 3818:23-24

> And so what dairy farmers do, is from their profits, they use that to help buy things they need or make down payments on things they need and then borrow the rest. There are very, very few dairy farmers that – in fact, I don't know any – that can borrow 100% of the cost of anything.
>
> And for dairy farms to be able to remain viable, they need to continually recapitalize, and that includes recapitalizing their milking facilities, which can cost millions of dollars. They buy tractors. They have lots – a big farm, a large farm, 2,000-cow farm, they have lots of tractors. And so they need to continue to recapitalize. And a lot of what they earn in profit is used to support that recapitalization. So they are investing it back in their business to maintain the viability of their business.

(Tr. 3401:7-3402:7 [Testimony of Edward Gallagher].)

[Testimony of James DeJong]), and the milk price for cheese manufacturing in Idaho is usually below the Class III price, "sometimes well below Class III." (Tr. 3781:1-8 [Testimony of James DeJong].) As a result of its full control over an unregulated state that is one of the five largest milk producing states, Glanbia has a competitive advantage.

> Q. … Can you tell me what you mean by "disorderly marketing" there?
>
> A. Well, in this case, if the Class III price was too high and you were pooling all of your milk, you would be at a financial disadvantage to a plant that is either not pooling, partially pooling, or has some kind of milk supply agreement, for example, with a cooperative that is paying less than the Class III price in reblending. So there – if you were a dairy processor pooling all of your milk, you would be at a financial disadvantage to somebody who was finding their way outside of the system.
>
> Q. And so would that include a plant like the plants that you have in Idaho?
>
> A. Glanbia operates outside the Federal Order system in Idaho.
>
> Q. Okay. And does that give Glanbia a competitive advantage for the products that it manufactures out of those plants?
>
> A. It – it gives us more flexibility I would say.
>
> Q. Does that flexibility give you a competitive advantage over – over other plants that are making products that are within a Federal Order system?
>
> A. In some ways I think it is an advantage to operate in Idaho.
>
> Q. Does the size of Glanbia also give it a competitive advantage over its competitors?
>
> A. In general, that there are certain cost efficiencies that could be gained with having a very large plant.

(Tr. 3796:1-3797:10 [Testimony of James DeJong].)

When asked to comment on why Glanbia needed higher make allowances despite building a facility costing at least $470,000,000 and holding a competitive advantage by operating in an unregulated area. Glanbia responded that such information was proprietary.

> Q. Further down on that page you describe the investment in Midwest Cheese. And you – I think you're testifying that the cost to construct that facility was $470 million; is that right?
>
> A. That is what is published online and publicly available.
>
> Q. So it might not be the actual cost to install it or to construct it?
>
> A. It was my understanding that the final cost was close. That could – it could be a bit over or under that. I am not sure. But that was what the press release announced price was.
>
> Q. Okay. That plant is located in Federal Order 33, correct?
>
> A. Correct. Mideast.
>
> Q. And the milk that supplies that plant, do you know if it's producer milk on Order 33?
>
> A. The milk handlers in our case have pooling decision. So we would not be aware of how that milk is pooled.
>
> Q. Well, it seems like an awfully lot – an awful lot of money to invest in a plant regulated by a system with insufficient Make Allowances.
>
> A. Well, I cannot get into the proprietary milk supply agreements given that Select is also a partner. Your – I don't know if they have authorization to talk about that. But I have not been given authorization to talk about our milk supply agreement.

(Tr. 3762:6-3763:5 [Testimony of James DeJong].) Glanbia does not want to share any information related to costs or profitability because they would not support raising make allowances. Glanbia coined a term for its operations that is highly suggestive of its ability to beat make allowances: "deadly efficient." (Tr. 3783:15-3783:15 [Testimony of James DeJong].)

> Q. Okay. So as the largest American cheese manufacturer in the U.S., you say that you are deadly efficient, meaning you strive for the lowest possible cost of production possible; is that right?
>
> A. We absolutely do.

> Q. Does that mean that you implement and deploy the most innovative and modern techniques for processing and making American cheese as well as all of the other products that Glanbia makes?
>
> A. We try to do that. If there is an efficiency project that has a positive payback, we will generally try to look at that investment, because one of the ways you can become more profitable is becoming more efficient. Glanbia is a publicly-traded company. We are very sensitive to get a return for our owners. And if keeping our manufacturing costs as low as possible creates a more positive return for our shareholders, we will do that.
>
> Q. Okay. And, in fact, you have an obligation to do that for your shareholders; is that right?
>
> A. Yes.

Glanbia provides a profit to its shareholders by being "an extremely, extremely efficient operator." (Tr. 3769:17-3769:17 [Testimony of James DeJong].) Unlike cooperative plants that may have to balance, Glanbia "keep[s] [its] cost of production as absolutely low as possible [by] try[ing] to keep [its] plants as full as possible." (Tr. 3779:22-3779:24 [Testimony of James DeJong].) As a result, Glanbia has been and is profitable.

> Q. In the five years that you have been there, has Glanbia been able to report a profit every year?
>
> A. Glanbia PLC, as far as I am aware, yes.
>
> Q. And that is not withstanding the investment that Glanbia has made of those countless millions and the joint venture plant that it constructed that cost $470 million?
>
> A. Yes. I mean, if we're going to go into the road of Glanbia's publicly reported financials, I would asterisk – put an asterisk on some of this.
>
> I went to some length at the beginning of my testimony breaking down the different parts of Glanbia's business. I specifically broke down our branded products, Glanbia Performance Nutrition. Their profitability would be rolled up into Glanbia PLC. Also, our joint ventures, and also Glanbia Nutritionals, which is the main entity I'm representing now, and the joint ventures.

> But for Glanbia Nutritionals, specifically, we are extremely diversified.

(Tr. 3791:3-3791:20 [Testimony of James DeJong].)

> Q. Okay. Is Glanbia Nutritionals, as its own separate business unit, a profitable entity?
>
> A. Yes, it is. And, again, I would say that even within Glanbia Nutritionals, we have a very large piece of our business that is either, one, not directly related to dairy or, two, the piece that is related to dairy is extremely invested in value-add dairy products, like higher proteins, premixes, custom nutrition solutions for all sorts of uses.

(Tr. 3793:21-3794:1 [Testimony of James DeJong].) A profitable proprietary processor that operates in an unregulated area and is too efficient to share cost data should not be testimony on which the Secretary relies to set make allowances.

<u>*Hilmar*</u>

Hilmar—the second largest manufacturer of American-style cheese—claims to be both "ruthlessly efficient" and "deadly efficient." (Tr. 3874:23, 3850:15-26 [Testimony of Wes Eveland].)

> Q. Did you hear Mr. DeJong talk about the deadly efficiency of his plant?
>
> A. Yes. You two enjoyed that comment.
>
> Q. You know, I'm going to keep it going. Do you believe that your plant operates equally as efficiently?
>
> A. I – I think that we're very neck-in-neck. Both operations have to be efficient. That's key in the space.

(Tr. 3862:16-3862:23 [Testimony of Wes Eveland].)

Like its ability to be ruthlessly and deadly efficient, Hilmar also claims the accuracy of make allowances is "key." However, Hilmar admits its decision to pool is entirely based on its economic self-interest, not the accuracy of the make allowances. Even if the make allowances were

100 percent accurate, Hilmar "***might*** go back [to the pool]."[16] (Tr. 3855:26-3856:9 [Testimony of Wes Eveland] (emphasis added).) Put another way, if Hilmar can make more money not pooling, it will not pool.

Given its size and efficient operations, any cost data by Hilmar could potentially be helpful. But when Hilmar was given the chance to provide ***any*** information on its costs of production, it refused.

> Q. Okay. So in 2021 survey results, Stephenson concluded that the Make Allowance for cheese was $0.2476. Does that sound right?
>
> A. I am not sure.
>
> Q. Okay. Well, if that's right, is that a number that you believe correlates well to Hilmar's cost of making cheese?
>
> A. I – I would have to defer to our finance people. Again, it gets into the proprietary nature of costs and some of the customer conversations on the competitive side of things.
>
> Q. Yeah. And I don't want to know your number.
>
> A. Sure.
>
> Q. I just – when you said that you had a comfort level when you compared Hilmar's cost of production to what Dr. Stephenson had come out with, I just wanted to ask you if you felt that confidence with his 2021 survey results?
>
> A. Yeah. We feel that the survey was put together well, we participated in it, and we felt it was reflective of what our experience was. I'll leave it at that.
>
> Q. You do have some concerns with National Milk's proposed number; is that right?
>
> A. Correct.
>
> Q. And are you aware that National Milk's proposal is $0.24?

[16] Given Hilmar's efforts to operative outside of FMMOs, one must question why Hilmar cares about make allowances. Hilmar does not work with cooperatives. (Tr. 3870:23-24 [Testimony of Wes Eveland] (noting only 1-2% of the milk Hilmar purchases comes from cooperatives).)

> A. Our bigger concern is the lack of data. We – a significant amount of processors participated in the Stephenson survey. It's my understanding that the – there was other processors that were asked to participate who would be part of National Milk that chose not to provide their data.
>
> I think all the data is helpful to get to an accurate number, and that's really what we want is, data.
>
> Q. Okay. And accuracy, right?
>
> A. Correct.
>
> Q. Yeah. Thank you. I appreciate that.
>
> I'm just curious, if Stephenson's cheese cost is $0.2476, and you felt comfortable just by comparing that with whatever it is that Hilmar has for cost of producing its cheese, how come you couldn't do the same by comparing the proposal from National Milk's $0.24 with the cost of production to see if it – if it felt like it was in the right range?
>
> A. Yeah. I think we would like to go back and look at the data a little closer. I won't be able to speak to it specifically. It gets back to our financial team.

(Tr. 3879:17-3881:7 [Testimony of Wes Eveland].) Hilmar is willing to question Proposal 7 but unwilling to provide any data to rebut the proposal. As a result of its unwillingness to share cost data and devotion to depooling, Hilmar's testimony is due no weight.

Leprino

Leprino too is an efficient proprietary manufacturer.

> Q. And then you go on in the next paragraph and talk about Leprino Foods there, and you say that "Leprino Foods is perceived to be an efficient dairy processor." Is Leprino an efficient dairy processor?
>
> A. We hope we are.
>
> Q. Is that the goal?
>
> A. Sure.
>
> Q. And in your opinion, is Leprino Foods an efficient dairy processor?

> A. To my knowledge, I think we work very hard to be an efficient dairy processors. I'm not close to a lot of our cost data. But, you know we look at performance information that's available across the industry, which obviously is limited. But, you know we want to be competitive and efficient.

(Tr. 3942:7-3942:21 [Testimony of Alison Krebs].)

Leprino has been profitable enough and has sufficient financial flexibility that it is building a new plant in Lubbock, Texas that will cost an estimated $1,000,000,000. (Tr. 3947:18-21 [Testimony of Alison Krebs].) While there was some insinuation during the hearing that higher make allowances will stop large proprietary manufacturers from building new plants, Leprino admitted it does not plan to build another plant for a while regardless. (Tr. 3960:16-25 [Testimony of Alison Krebs].) A billion-dollar plant should be satisfactory for the time being.

Saputo, Glanbia, Hilmar, and Leprino All Refuse to Share Cost Data

Proprietary handlers categorically refused to share ***any*** information related to cost or profitability. Leaning heavily on the crutch of "proprietary information," handlers would not provide even basic information about their operations. (*See, e.g.*, Tr. 3748:16-21 [Testimony of James DeJong] (refusing to provide nature of Block production at Glanbia plants despite being the largest cheddar cheese processor in the country); Tr. 3750:8-14 [Testimony of James DeJong] (refusing to provide ***any*** cost information for Glanbia plants subject to FMMO despite being asked to provide broad ranges or percentages); Tr. 3765:16-24 [Testimony of James DeJong] (refusing to provide ***any*** information as to whether Glanbia pays producers based on the FMMO other solids price and again refusing to provide broad product mix information); Tr. at 3783:5-11 [Testimony of James DeJong] (refusing to discuss whether Glanbia even uses the current make allowances in its milk procurement formulas for unregulated areas); Tr. 3810:8-9 [Testimony of James DeJong] (refusing to speak about "Glanbia's specific cost of production."); Tr. 3811:28-3812:14 [Testimony of James DeJong] (refusing to discuss whether Glanbia would provide producers with higher over order premiums if make allowances are raised, despite claiming that is how producers should respond); Tr. 3854:28-3855:13 [Testimony of Wes Eveland] (refusing to provide broad answers to nature of product mix at Hilmar plants); Tr. 3858:26-3859:3 [Testimony of Wes Eveland] (refusing to provide ***any*** information as to how producers are paid by Hilmar for milk that goes into cheese and whey products); Tr. 3865:11-16 [Testimony of Wes Eveland] (refusing to provide ***any*** information about cost of production for Hilmar, including simply whether current costs are above or below current make allowances); Tr. 3872:25-3873:7 [Testimony of Wes Eveland] (refusing to provide any information about over order premiums Hilmar pays or how Hilmar deals with what it perceives to be inadequate make allowances); Tr. 3943:9-15 [Testimony of Alison Krebs] (refusing to provide whether Leprino's cost of manufacture is more or less than make allowances); Tr. 3947:5-8 [Testimony of Alison Krebs] (noting the percentage increases provided do not permit calculation of whether Leprino is beating current make allowances); Tr. 4038:25-4038:2 [Testimony of Terry Brockman] (unwilling to share dry whey costs for Saputo, a top three cheese manufacturer); Tr. 4042:2-15 [Testimony of Terry Brockman] (refusing to provide overhead, raw materials, and labor costs for Saputo and instead providing only general inflationary data).)

The record is devoid of useful information as to proprietary handlers' costs—costs that could help affirm or deny the 2023 Survey or give the Secretary guidance on updating make allowances. Indeed, the only handlers that were willing to put in specific costs were small, artisan style processors who recognize their costs are not representative of the processor community. (*See* Ex. 203; Ex. 204 at 1 ("we are not advocating for our costs").) This selective cost data is incongruously complimented by the 2023 Survey that suffers from multiple deficiencies. The inference is clear. The large, "deadly efficient" manufacturers, who are building expensive new plants and routinely operate outside FMMOs do not want to provide any specifics about costs of production because it will be less than the make allowances in Proposals 8 and 9. Put another way, the largest proprietary processors want a financial windfall without showing a need for increased make allowances.

VI. PROPOSAL 13 SHOULD BE ADOPTED: THE CLASS I MOVER SHOULD BE RESTORED TO THE EFFECTIVE AND PREDICTABLE HIGHER-OF FORMULA.

PROPOSED FINDINGS OF FACT

A. The "Average-Of" Class III and IV Was a Legislative Change to the Uniform Pricing Formulas That Did Not Meet the Standards Set Forth in Order Reform.

1. The Class I skim milk price is the applicable Class I differential "plus the simple average of the advanced [Class III and IV skim milk price], plus $0.74 per hundredweight." 7 C.F.R. § 1000.50(b). The "average of" the advanced Class III and IV skim milk price plus $0.74 is commonly referred to as the "Class I Mover," the "Average-Of," or the "Base Skim Milk Price for Class I," or the "Class I Skim Milk Price."

2. The current language in 7 C.F.R. § 1000.50(b) is the product of one formal rulemaking and a Congressionally dictated final rule: (1) Federal Order Reform, and (2) the Final Rule implementing Section 1403 of the Agriculture Improvement Act of 2018 ("2018 Farm Bill"). (Ex. 229 at 4; Tr. 4670:22-26 [Testimony of Dr. Peter Vitaliano].)

3. In Order Reform, USDA moved away from reliance on Grade B milk to set prices and transitioned to classified pricing derived from PPFs. When a new Class I Mover needed to be identified, the Secretary determined the Mover should be the "Higher-Of" the most currently calculated advanced Class III or Class IV skim milk pricing factors. (Ex. 229 at 4; Tr. 4671:11-15, 4671:21-26 [Testimony of Dr. Peter Vitaliano].)

4. Order Reform identified at least four reasons for using the Higher-Of as the Class I Mover: (1) the Higher-Of more accurately reflects the value of milk in the four different classes; (2) using the Higher-Of to move Class I prices helps reduce volatility in milk prices; (3) the Higher-Of reduces class price inversions and depooling; and (4) the Higher-Of assists Class I handlers in competing for milk supply. (Ex. 229 at 4-5; Tr. 4671:26-4673:13 [Testimony of Dr. Peter Vitaliano]; Ex. 245 at 3-4; Tr. 5004:26-5005:13 [Testimony of Craig Alexander].)

5. The 2018 Farm Bill changed the Class I Mover to the current language, which uses the Average-Of. (Ex. 229 at 5; Tr. 4673:23-27 [Testimony of Dr. Peter Vitaliano].)

6. Due to the Congressional mandate, USDA could not apply the four criteria analyzed when choosing the Higher-Of in Order Reform. (Ex. 245 at 4; Tr. 5006:20-24 [Testimony of Craig Alexander]); *see also* 84 Fed. Reg. 8590, 8590 ("In accordance with the 2018 Farm Bill, the amendment is effective indefinitely, until further modified, and may not be modified earlier than two years after the effective date of this rule.").

7. This legislated change of the Mover resulted from a request by Class I handler representatives to change the Mover to one that would better allow them to hedge the cost of Class I milk in the dairy product futures markets. NMPF acquiesced to this request, subject to the incorporation of the $0.74 per hundredweight fixed differential, which was perceived to be the historical difference in performance of the Higher-Of versus Average-Of. (Ex. 229 at 5; Tr. 4674:4-6 [Testimony of Dr. Peter Vitaliano].)

8. The intention of both Class I milk buyers and dairy farmer sellers was that the change would be *revenue neutral* and would accommodate processors' desires to better manage their price risk ***without harming the sellers***. (Ex. 229 at 5; Tr. 4674:10-14 [Testimony of Dr. Peter Vitaliano].)

9. While the objective of facilitating price risk management strategies for fluid milk processors may have merit, it is not an objective of FMMOs, and not one that should come at the expense of the objectives of the Class I Mover articulated in Order Reform. (Ex. 229 at 5, n.9 [Testimony of Dr. Peter Vitaliano].)

10. Moreover, the demand for hedging Class I sales is less than clear. Upstate-Niagara Cooperative ("UNC") maintains four Class I plants. UNC's customers have been less interested in

pursuing a fixed price if there was any chance that they would be uncompetitive in the marketplace in any given month. Customers have also been reluctant to pursue risk management/fixed pricing unless it comes at no additional cost to them. (Ex. 245 at 8; Tr. 5016:11-27 [Testimony of Craig Alexander].)

11. While some Class I customers may use hedging, there is no evidence to suggest it is anything other than a small minority of the overall fluid milk market. (Ex. 245 at 8-9; Tr. 5017:3-6 [Testimony of Craig Alexander].)

12. Prairie Farms, the second-largest fluid bottler in the United States, has not seen an increase in Class I fixed price sales agreements and has seen a decrease in producers using forward contracts. (Ex. 247 at 3; Tr. 5089:16-24 [Testimony of Chris Hoeger].)

13. At most, Class I hedging is confined to a small minority of Class I sales associated with extended shelf life ("ESL"), aseptic, organic, and other value-added products. (Tr. 5486:26-5487:9 [Testimony of Chris Herlache]); Tr. 5523:16-5523:20 [Testimony of Kimberly Greenbaum].)

14. HTST,[17] or "conventional milk," is the largest Class I product——estimated to be 90 percent of packaged fluid milk sales—and is not being hedged. (Ex. 296 at 2 [Testimony of Calvin Covington].) It is doubtful it will be hedged with maintenance of the Average-Of. HTST operates on pass-through pricing whereby when milk prices change for processors, they pass that price to their customers. (Tr. 5918:17-5919:5 [Testimony of Michael Newell] ("[W]e find out what our milk cost is going up, and we – we increase by that amount to our customers.").) As a result, large retailers, such as Kroger, do not hedge HTST.

[17] HTST is an acronym for "high temperature, short time" pasteurization. *See* 7 C.F.R. § 58.101(n). HTST is the most common form of pasteurization for fluid milk. *See* IDFA, "Pasteurization," https://www.idfa.org/pasteurization (last accessed Mar. 24, 2024).

(Tr. 6180:13-6182:1 [Testimony of Mike Brown].)

B. The "Average-Of" Has Cost Dairy Farmers Nearly $1,000,000,000 (And Counting) in Lost Income.

15. The Average-Of has not operated as intended or anticipated by NMPF or its producers. The Average-Of has exacerbated disorderly marketing conditions, and negatively impacted producer revenue. These serious and negative outcomes will continue so long as the Average-Of remains in place. (Ex. 245 at 4; Tr. 5006:25-5007:3 [Testimony of Craig Alexander].)

16. At least four problems arose and persist for producers as a result of the adoption of the Average-Of:

- Pricing of Class I milk was significantly reduced without recovery for producers in other class prices;
- Price inversions and depooling increased;
- Class I prices were less effective at incenting milk to fluid processors relative to manufacturing; and
- Volatility.

(Ex. 245 at 5; Tr. 5007:10-27 [Testimony of Craig Alexander].)

17. Any regulatory change—such as the Average-Of—that contributes to lower Class I prices, and therefore lower blend prices, relative to manufacturing prices will reduce incentives to pool. (Ex. 245 at 7; Tr. 5010:13-21 [Testimony of Craig Alexander].)

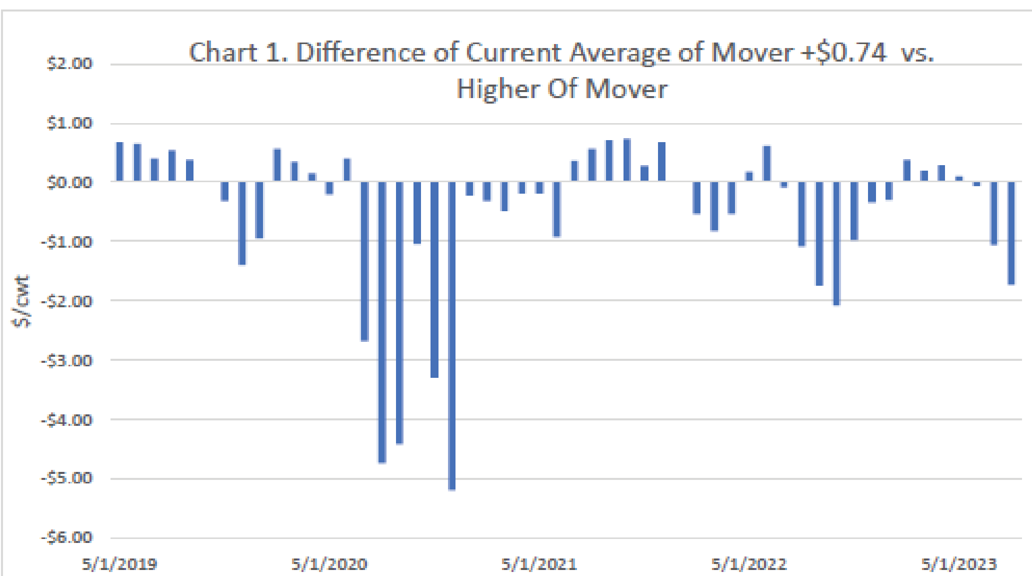
18. The higher prices for Class I function as a real time signal from Class I processors to producers to draw more milk when needed to Class I use versus manufacturing uses and encourages farmers to produce more milk when needed. The Average-Of exacerbates delays in price transmission because it disconnects the Class I price from competing with manufacturing prices and thus fails to disincentivize depooling. (Ex. 245 at 7-8; Tr. 5013:21-5014:7 [Testimony

of Craig Alexander].)

19. Comparing the Higher-Of, in operation from January 2000 to April 2019, to the Average-Of, in operation since May 2019, reveals a clear asymmetrical impact on producers. The Higher-Of will exceed the Average-Of whenever the Class III and IV advanced skim milk pricing factors differ by more than $1.48 per hundredweight. (Ex. 229 at 6; Tr. 4675:21-28 [Testimony of Dr. Peter Vitaliano].)

20. Thus, the maximum amount by which the Average-Of can exceed the Higher-Of is $0.74 per hundredweight, which occurs when the two advanced skim milk pricing factors are equal. However, there is no practical limit to the Average-Of falling below the Higher-Of. (Ex. 229 at 6; Tr. 4676:4-9 [Testimony of Dr. Peter Vitaliano].)

21. The asymmetric price risk inherent in the Average-Of became evident during the second half of 2020 and then again during much of 2022. During these periods, the Average-Of routinely, and significantly, fell below the Higher-Of. (Ex. 229 at 6; Tr. 4676:10-14 [Testimony of Dr. Peter Vitaliano].)



(Ex. 245 at 5 [Testimony of Craig Alexander].)

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22. More specifically, since the Average-Of has been in place there have been three episodes when the Higher-Of exceeded the Average-Of by close to $1.00 per hundredweight or more. (Ex. 229 at 6; Tr. 4676:25-4677:1 [Testimony of Dr. Peter Vitaliano].)

23. The first episode occurred during the six months from July through December, 2020. The difference averaged -$3.56 per hundredweight, generating total losses of pooled Class I skim milk value of $753.2 million, or an average of $125.5 million per month. (Ex. 229 at 6; Ex. 230; Tr. 4677:4-8 [Testimony of Dr. Peter Vitaliano].)

Difference In Class I Skim milk Movers $/cwt	Federal Order: Order #:	Northeast 1	Appalachian 5	Florida 6	Southeast 7	Upper Midwest 30	Central 32	Mideast 33	California 51	Pacific Northwest 124	Southwest 126	Arizona 131	All Markets
							Million dollsrs						
-$2.67	Jul-20	-$17.2	-$8.3	-$4.2	-$7.0	-$5.6	-$9.8	-$13.9	-$10.6	-$4.1	-$8.8	-$2.7	-$92.1
-$4.74	Aug-20	-$29.9	-$14.8	-$7.5	-$11.6	-$9.5	-$17.2	-$25.5	-$18.5	-$6.0	-$15.4	-$4.5	-$160.4
-$4.41	Sep-20	-$28.2	-$14.0	-$6.9	-$11.4	-$9.2	-$16.5	-$23.9	-$17.6	-$5.9	-$14.4	-$4.3	-$152.5
-$1.04	Oct-20	-$7.3	-$3.4	-$1.8	-$2.8	-$2.3	-$4.2	-$6.0	-$4.5	-$1.5	-$3.7	-$1.1	-$38.6
-$3.29	Nov-20	-$21.9	-$10.7	-$5.7	-$8.3	-$6.9	-$12.5	-$18.5	-$13.7	-$4.5	-$10.9	-$3.5	-$117.1
-$5.19	Dec-20	-$36.9	-$17.6	-$8.9	-$14.2	-$11.6	-$20.9	-$29.8	-$22.2	-$7.4	-$18.0	-$5.6	-$193.1

24. The second episode occurred during the four months from August through November 2022. The difference averaged -$1.47 per hundredweight, generating total losses of pooled Class I skim milk value of $197.8 million, or an average of $49.4 million per month. (Ex. 229 at 6-7; Ex. 230; Tr. 4677:9-13 [Testimony of Dr. Peter Vitaliano].)

Difference In Class I Skim milk Movers $/cwt	Federal Order: Order #:	Northeast 1	Appalachian 5	Florida 6	Southeast 7	Upper Midwest 30	Central 32	Mideast 33	California 51	Pacific Northwest 124	Southwest 126	Arizona 131	All Markets
							Million dollsrs						
-$1.08	Aug-22	-$6.9	-$3.4	-$1.8	-$2.6	-$1.8	-$3.9	-$5.3	-$4.2	-$1.4	-$3.6	-$1.1	-$36.0
-$1.75	Sep-22	-$11.5	-$5.4	-$2.7	-$4.1	-$2.9	-$6.3	-$8.7	-$6.8	-$2.4	-$5.6	-$1.9	-$58.4
-$2.08	Oct-22	-$13.7	-$6.7	-$3.8	-$4.6	-$3.4	-$7.5	-$10.6	-$8.1	-$2.8	-$6.6	-$2.3	-$70.1
-$0.98	Nov-22	-$6.5	-$3.2	-$1.7	-$2.2	-$1.6	-$3.6	-$5.0	-$3.9	-$1.3	-$3.1	-$1.1	-$33.3

25. The third episode occurred during the two months of July and August, 2023. The difference averaged -$1.40 per hundredweight and generated an estimated $88 million of total pooled Class I skim milk values, or an average of $44 million per month. (Ex. 229 at 7; Ex. 230;

Tr. 4677:14-20 [Testimony of Dr. Peter Vitaliano].)

Difference In Class I Skim milk Movers $/cwt	Federal Order: Order #:	Northeast 1	Appalachian 5	Florida 6	Southeast 7	Upper Midwest 30	Central 32	Mideast 33	California 51	Pacific Northwest 124	Southwest 126	Arizona 131	All Markets
		Million dollsrs											
-$1.06	Jul-23	-$6.4	-$3.0	-$1.6	-$2.0	-$1.5	-$3.3	-$5.1	-$3.6	-$1.3	-$2.9	-$1.2	-$31.8

26. By contrast, the maximum positive difference of $0.74 per hundredweight would generate a gain in total pooled Class I skim milk values of $25.4 million per month, based on average monthly producer milk volumes during May 2019 through July 2023. (Ex. 229 at 7; Tr. 4677:21-4678:1 [Testimony of Dr. Peter Vitaliano].)

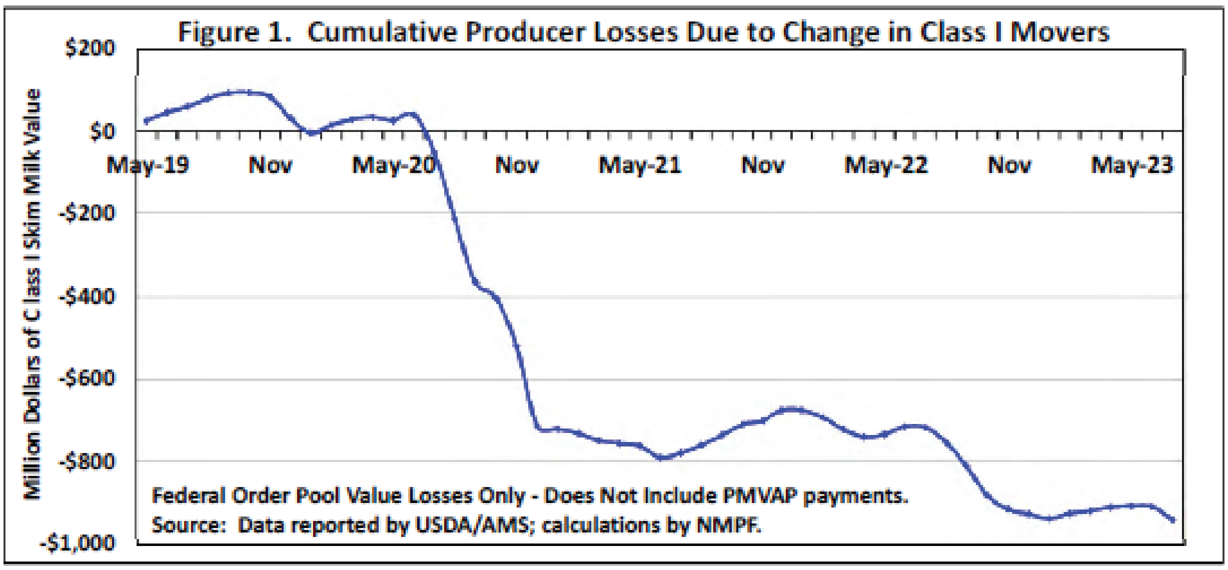
27. The difference between Class III and IV prices have exceeded $1.48 per hundredweight (the level where current Class I prices are capped by the Mover), 106 months out of a total 282 months between 2000 and June 2023 or 39.6 percent of the time. The volatility has been more pronounced recently since the adoption of the Average-Of: in 2022, in 9 of 12 months, Class IV exceeded Class III by more than $1.48 per hundredweight. (Ex. 245 at 8; Tr. 5015:9-23 [Testimony of Craig Alexander].)

28. 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 been utilized. The Average-Of was lower than the Higher-Of for two months in 2019, eight months in 2020, six months in 2021, nine months in 2022, and two months in 2023 as of June. (Ex. 248 at 2; Tr. 5145:18-26 [Testimony of Calvin Covington].)

29. Of those 27 months, the Class III skim milk price exceeded the Class IV price by more than $1.48 per hundredweight in 16 months. In 11 of the 27 months, the Class IV skim milk price exceed the Class III price by more than $1.48 per hundredweight. (Ex. 248 at 3; Tr. 5146:10-14 [Testimony of Calvin Covington].)

30. Since the Average-Of became effective in May 2019, the cumulative market losses in pooled Class I skim milk values in all FMMOS reached $941.1 million through July 2023. (Ex. 229 at 6; Tr. 4676:15-18 [Testimony of Dr. Peter Vitaliano].)

31. While there have been periods of relative stability and modest gains since enactment of the Average-Of, the volatile episodes have had a disproportionate impact resulting in significant cumulative losses to dairy farmers:



(Ex. 229 at 7; Tr. 4678:2-5 [Testimony of Dr. Peter Vitaliano].)

32. The Average-Of has promoted disorderly marketing by reducing Class I prices relative to the manufacturing classes—creating class-price inversions—and has created greater incentives to depool. (Ex. 229 at 7; Tr. 4678:26-4679:1 [Testimony of Dr. Peter Vitaliano].)

33. For example, during the first episode of volatility, the enhanced demand for cheese in 2020 relative to the demand for butter and nonfat dry milk widened the spread between Class III and Class IV prices well in excess of the $1.48 per hundredweight break point.[18] As a result,

[18] This increased demand was likely from federal government programs in response to the COVID pandemic. It is true producers also received pandemic assistance, but that is not a solution to the problems caused by the Mover.

Class I prices were lower than where the Higher-Of would have set them; the Average-Of caused class price inversions and extensive depooling of Class III milk during the second half of 2020. (Ex. 229 at 7-8; Tr. 4679:6-14 [Testimony of Dr. Peter Vitaliano].)

34. During the second episode of volatility, a long period of tight milk supplies led to high Class IV skim milk prices because butter and nonfat dry milk plants play balancing roles. The tight milk supplies caused inversions and substantial depooling of Class IV milk. (Ex. 229 at 8; Tr. 4679:18-27 [Testimony of Dr. Peter Vitaliano].)

35. The third incident of volatility occurred when cheese and whey prices fell due to excessive milk supplies relative to domestic and reduced export demand. This pressured Class III prices relative to Class IV. (Ex. 229 at 8; Tr. 4679:28-4680:5 [Testimony of Dr. Peter Vitaliano].)

> Q. Okay. We've heard lots of questions about, but there was government assistance and – either through the Pandemic Relief or otherwise, that might have offset some of the losses that – that the producers felt by moving to the average-of.
>
> Do you know whether the producers have been made whole for the differences that they have experienced in the prices they have received?
>
> A. They have not.
>
> Q. And is it National Milk's position that producers should rely on government subsidies in order to make themselves whole?
>
> A. We don't think it is appropriate. We appreciate the assistance when – when it was needed, but we don't think it's appropriate for the Federal Order program to rely on appropriated funds spent by the Secretary to make – make whole problems with the class price formulas, when changes to those formulas can be made regulatorily to fix those problems. And that's what we're proposing now.

(Tr. 4816:21-4817:11 [Testimony of Dr. Peter Vitaliano].) Further, this assistance would not have been necessary if the Class I Mover had performed as expected. (Ex. 229 at 6 [Testimony of Dr. Peter Vitaliano].)

36. Thus, a wide variety of market conditions cause market volatility on a regular basis that drive Class III and Class IV skim milk prices sufficiently far apart to drop the Average-Of below where the Higher-Of would set Class I skim prices. Asymmetrically, periods of relative market stability, with the difference between Class III and Class IV prices in the limited range of $0.01 to $0.74, are needed for the Average-Of to be financially beneficial to producers compared to the Higher-Of. (Ex. 229 at 8; Tr. 4680:6-15 [Testimony of Dr. Peter Vitaliano].)

37. Since enactment of the Average-Of, Prairie Farms has had difficulty securing milk for Class I use from proximally close suppliers. Such suppliers would rather sell their milk further away at a premium price and avoid the consequences of their milk being pooled. (Ex. 247 at 2-3; Tr. 5087:22-5088:8 [Testimony of Chris Hoeger].)

38. The increased frequency and size of negative PPDs suggests this is common. In FMMO 32, during the six-year period prior to May 2019, 27.36 percent of the months had negative PPDs, which averaged ($0.34) per hundredweight. In the four-year period since May 2019 (i.e., forced adoption of the Average-Of), 37.36 percent of the months had negative PPDs, which averaged ($2.85) per hundredweight. (Ex. 247 at 3; Tr. 5088:27-5089:5 [Testimony of Chris Hoeger].)

39. The Average-Of unnecessarily places more risk on dairy farmers, and the downside risk is greater than the upside risk. In areas where Class I utilization is high—i.e., FMMOs 5, 6, 7—the Average-Of results in a lower blend price and narrows the gap between blend prices in lower Class I utilization FMMOs. As a result, milk deficit areas have a hard time attracting supplemental milk to meet Class I demand. (Ex. 248 at 4; Tr. 5149:6-16 [Testimony of Calvin Covington].)

40. To date, the largest reduction in FMMO revenue, resulting from the Average-Of

was in 2020, when FMMO 5 blend price was reduced by $1.28, FMMO 6 blend price was reduced by $1.37, and the FMMO 7 blend price was reduced by $1.16. Such large reductions in blend prices was the tipping point for some dairy farmers to exit the dairy farming business and further reduce supply in already deficit areas. (Ex. 248 at 3; Tr. 5147:24-5148:9 [Testimony of Calvin Covington].)

C. Alternatives to the Higher-Of Lack Efficacy and Fail to Send Appropriate Market Signals.

41. NMPF proposes to amend the Class I skim milk price Mover to return it to its original form, as initially adopted in Order Reform. (Ex. 229 at 8; Tr. 4681:8-10 [Testimony of Dr. Peter Vitaliano].)

42. Returning to the Higher-Of will restore more orderly marketing and raise producer confidence in FMMOs by:

- Eliminating the asymmetric price risk to producers;
- Enhancing correct market signals to producers;
- Reducing incentives to depool;
- Restoring traditional price relationships between Class I and other classes.

(Ex. 245 at 9-10; Tr. 5019:15-5020:9 [Testimony of Craig Alexander].)

43. While NMPF considered alternatives similar to Proposal 14 submitted by IDFA and Proposal 15 submitted by MIG, those proposals effectively adopt the Higher-Of as the standard for generating Class I skim milk price revenue, but those proposals do so in an after-the-fact manner that fails to maintain the maximum monthly separation between the advanced Class I and the manufacturing class prices. Thus, those proposals fail to generate the best performance for a Class I Mover identified by the criteria in Order Reform. (Ex. 229 at 9; Tr. 4681:27-4682:9 [Testimony of Dr. Peter Vitaliano].)

44. These alternative proposals provide the wrong economic signals paying back dairy farmers after-the-fact, which 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. (Ex. 248 at 5; Tr. 5151:12-20 [Testimony of Calvin Covington].)

45. "Adjusting" the Class I Mover in later months to compensate for losses resulting from using an Average-Of unnecessarily complicates compensation for dairy farmers. For example, dairy farmers may not be compensated equitably or at all because 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 a dairy farmer's decision of whether to stay in business. 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. (Ex. 248 at 5; Tr. 5151:21-5152:3 [Testimony of Calvin Covington].)

46. "The FMMO system is incapable of restitution to the affected parties for market inefficiencies, suggesting that for Proposals 14, 15, and 16 there is a must-be present-to-win methodology." (Ex. 238 at 18; Tr. 4908:16-19 [Testimony of Sara Dorland].)

47. [B]etween 2020 and 2022, there were 3,720 fewer dairies, meaning some of those dairy producers may have been impacted by these price proposals to the point of closing their dairies. Under the Higher-of formula, these dairy producers would have received timely Class I milk payments in 2020 and 2022 – for some, it may have made a difference. Under Proposals 14, 15, and 16, different dairies would benefit from restitution payments for the 3,720 dairies that closed, undermining the "made whole" assertion expressly stated in all of the proposals.

(Ex. 238 at 18; Tr. 4908:23-4909:3 [Testimony of Sara Dorland].)

48. While Proposals 14, 15, and 16 attempt to tackle the Class I skim price with slightly different approaches, at their core they are

> iterations of the current Average-of price formula. Although Proposal 16 purports to be a Class III Plus – the Plus is determined by comparing the Announced Class III skim milk price to the Higher-of over a 36-month period. In each instance, these proposals tether the Class III Plus/Average-of skim price determination to the Higher-of price. At its most basic, every proposal concedes that the Class III Plus or Average-of 1) cannot adequately replicate the Higher-of price in future periods and 2) is not shared equally among dairy producers and others, necessitating a periodic recalibration. Rather than recognizing the limitation of the Average-of formula and what prevents the price from imitating the Higher-of performance - these proposals suggest additional steps to align the Average-of and Higher-of formulas and distribute costs between processors and producers.
>
> . . . .
>
> The proposals' steps to recalibrate prices disrupt the timely communication of market signals to participants, as the information would be years in arrears. The new methodologies offer 24-month to 36-month lookbacks to determine the adjustment that should be incorporated into the Class I skim calculation. At its core, these lookback approaches are inherently flawed as they attempt to apply past performance to future periods, which may or may not accurately reflect current market conditions.

(Ex. 238 at 14 [Testimony of Sara Dorland].)

49. Likewise, eliminating advanced pricing—under Proposals 16, 17, or 18—will be unnecessarily disruptive. Advanced pricing allows Class I processors to know the cost of raw milk and price it accordingly with their customers. "Waiting until most of the product is already distributed, and much of it consumed before knowing the price, is not a prudent business practice." (Ex. 296 at 2 [Testimony of Calvin Covington].)

50. There is no market—such as the CME—to which Class I processors and customers can look for milk pricing. Without advanced pricing, customers will be forced to purchase milk and find out the price at a later date after most of the milk has been sold. If there is a significant monthly increase in the Class I price, retailers may ask their fluid milk processor, who in turn will ask their dairy farmer cooperative suppliers, for relief from the price increase. This opens the

potential of fluid milk processors in the same marketing area not having equitable raw milk costs, and the potential of producers in the same marketing area not having uniform pricing. (Ex. 296 at 2-3 [Testimony of Calvin Covington].)

51. Alternatively, Class I customers will ask processors or cooperatives to provide estimated Class I prices in advance and then the possibility for "true-ups" at a later date once the Class I price is announced. This creates an added financial burden on processors or, more likely, cooperatives to go without full payment until months after their milk has been sold. (Ex. 296 at 4 [Testimony of Calvin Covington].)

D. Producers Overwhelmingly Support a Return to the Higher-Of.

52. Dairy Farmers want an immediate return to the Higher-Of. (Ex. 108 [Testimony of Ken Nobis]; Ex. 122 [Testimony of Gerben Leyendekker]; Ex. 123 [Testimony of Jared Fernandes]; Ex. 125 [Testimony of Kristopher Scheider]; Ex. 135 [Testimony of Doug Chapin]; Ex. 136 [Testimony of Karl Wedemeyer]; Ex. 137 [Testimony of Kristine Spadgenske]; Ex. 138 [Testimony of Brian Rexing]; Ex. 148 [Testimony of Eric Palla]; Ex. 149 [Testimony of Paul Windemuller]; Ex. 150 [Testimony of Matt Johnson]; Ex. 162 [Testimony of Sean Cornelius]; Ex. 200 [Testimony of Frank Doll]; Ex. 201 [Testimony of Bryan Henrichs]; Ex. 207 [Testimony of Neil Hoff]; Ex. 208 [Testimony of Sietse Tollenaar]; Ex. 212 [Testimony of Brian Hemann]; Ex. 252 [Testimony of Richard Kraft]; Ex. 253 [Testimony of Thomas Bellavance]; Ex. 266 [Testimony of Brittany Nickerson- Thurlow]; Ex. 269 [Testimony of H. H. Barlow]; Ex. 279 [Testimony of Perry Tjaarda]; Ex. 281 [Testimony of Jennifer Lawrence]; Ex. 284 [Testimony of Simon Vander Woude]; Ex. 320 [Testimony of Rick Podtburg]; Ex. 326 [Testimony of Marty Hallock]; Ex. 385 [Testimony of Geoff Vanden Heuvel].)

53. AFBF has thousands of cooperative and independent dairy farmer members. Prior to notice of this hearing, AFBF held a national conference where there was consensus among

members to return to the Higher-Of as a policy objective. (*See, e.g.,* Tr. 5748:16-18 [Testimony of Brittany Nickerson- Thurlow].)

54. Dairy farmers are losing money each day the Higher-Of is not reinstituted. (Ex. 266 at 1, 3 [Testimony of Brittany Nickerson- Thurlow] ("As a producer in the highest Class I utilization market in the country, I have watched as more than half of the 110 Florida dairy farms that were in business when I came back in 2017 shut down their farms…my family's farm has lost almost $600,000 dollars over a 4-year period.").)

55. The Average-Of has not operated as intended; the change has not been revenue neutral. (Ex. 280 at 2-3 [Testimony of Clara Ayer] ("Class I skim milk prices average[ed] $3.56/cwt lower during the second half of 2020 than they would have under the 'higher of' mover…. In 2022, Class I skim milk prices averaged $0.62 lower than they would have under the 'higher of' mover…. [F]armer revenue neutrality has been grossly under met. Given the price volatility that persists in today's dairy markets, the current 'average of' formula is expected to continue to negatively and meaningfully cost dairy farmers compared to the previous 'higher of' mover."); Ex. 281 at 3 [Testimony of Jennifer Lawrence] ("Farmers, whose job it is to fed the world, especially in times of need, have been effectively punished by the unintended consequences of a miscalculated policy decision.").)

56. The Higher-Of better supports producer risk management. (Tr. 623:12-623:15 [Testimony of Somula Schwoeppe] ("My personal opinion would be that I would love us to go back to the higher-of milk pricing immediately because that is what our risk management tools were designed to support."); Ex. 212 at 2 [Testimony of Brian Hemann] ("The current formula disrupts blend price forecasting due to significant increase in the incidence of depooling and hinders my effective hedging against the blend price…the existing formula, with its inherent flaws

and unintended consequences, have had a profound and detrimental impact on dairy farmers and the stability of the industry as a whole.").)

57. The Higher-Of will raise blend prices. (Ex. 253 at 4 [Testimony of Tom Bellavance] ("This experiment has not been revenue neutral…this lowered my blend price by $0.17 per cwt."); Ex. 208 at 3 [Testimony of Sietse Tollenaar] ("We were told this change was important to the Class I processing industry to allow them to hedge their Class I milk. I'm not sure how that 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 the revenue to my blend price on a monthly basis.").)

58. The Higher-Of compensates producers contemporaneously. (Ex. 201 at 2 [Testimony of Bryan Henrichs] ("The negative PPD's have taken money from the producers checks…the 'Higher of' will ensure that the dairy producer is compensated at the time of the sale instead of later by some other form of support.").)

ARGUMENT

E. The "Average-Of" Is a Failed, Congressionally Mandated Experiment That Has Been Ruinous for Dairy Farmers.

1. Order Reform Set Out Criteria for a Class I Mover That the Average-Of Does Not Satisfy.

In Order Reform, the Secretary utilized four distinct criteria to evaluate and establish the Class I Mover.[19] Those criteria, and the inherit policy objective within each criterion, still carry

[19] Adoption of the Class I Mover was part of the broader project of instilling a replacement to the BFP and M-W price series. In deciding to implement uniform pricing provisions and PPFs, the Secretary articulated broad policy objectives that should be considered with any regulatory change affecting those provisions or formulas.

> The goals and criteria to be met by a replacement for the basic formula price were discussed in detail in the proposed rule. Briefly, the goals are: (a) Meet the supply and demand criteria set forth in

validity. The Secretary chose the Higher-Of because it best fit the well-reasoned bases for what a Class I Mover is intended to do. A reexamination of those four criteria and objectives demonstrates the Higher-Of is still the best Class I Mover and should be restored.

First, "the decision to use the higher of the Class III or Class IV price for determining the Class I price…should more accurately reflect the value of these different categories of use." 64 Fed. Reg. 16026, 16094. Axiomatic to the FMMO uniform pricing provisions is the supremacy of Class I and the integrity of classified pricing.

> A. [T]he Class I primacy is vital to the FMMO system function. A higher Class I milk price relative to other milk – other class prices sends signals throughout the market to move milk to and from surplus and deficit regions to ensure adequate fluid milk supplies for the market. It acts as a governor or control.
>
> Class I primacy is necessary to support the current FMMO system design and reduce instances of disorderly marketing. When depooling is allowed to persist, more than one price exists in the pool, creating an incentive for supply plants to disassociate from the order affecting Class I handlers and dairy producers.
>
> Although Class I use has declined due to rising milk production and lower per capita consumption of bottled milk, Class I's ability to attract milk to the pool, one of its primary purposes, remains intact.
>
> . . . .
>
> Q. So one of the questions – we might talk about this in further detail, but one of the questions that's come up is, what does it mean to you to have a disorderly market condition?

> the Agricultural Marketing Agreement Act of 1937 (the Act), (b) not deviate greatly from the general level of the current BFP, and (c) demonstrate the ability to change in reaction to changes in supply and demand. [¶] The criteria established to evaluate the various alternatives were: (a) Stability and predictability; (b) simplicity, uniformity, and transparency; (c) sound economics—e.g., consistency with market conditions; and (d) reduced regulation.

64 Fed. Reg. 16026, 16091.

> A. Disorderly markets, if we look at it from a trading perspective, that means that we have sudden bursts of unexplained volatility. Markets change, things happen, but there's not necessarily some event that we can tie it to. There's no – no – nothing happening.
>
> That has some translation into the FMMO system, specifically when we look at things like depooling. While that is a part of our system and can be codified differently by the various FMMOs, it's something that historically has been contained until the market can self-calibrate and the Class I can resume its top spot. Depooling can exist.
>
> What we've found since 2019 is it can persist in perpetuity because there's no guarantee that the average of the two manufacturing classes will actually exceed any one of those prices over time, and that can create a little bit of chaos and disorder, which has implications for all classes of milk, not just Class I.

(Tr. 4884:26-4886:12 [Testimony of Sara Dorland].) By its nature, the Higher-Of practically guarantees Class I prices will remain higher than manufacturing class prices because the highest manufacturing price plays a large role in driving the Class I base price. The Average-Of, as has been observed, cannot guarantee this outcome because it cannot always move Class I enough to outpace a heavily demanded manufacturing class, as shown in three separate periods since 2020. Even though the manufacturing class should be considered a lower value, high demand will push prices upward and cause producers to value selling to a manufacturing class over the needs of Class I. If, as a result, the manufacturing class price exceeds the blend price, depooling will result and those farmers supporting Class I would see their milk lose some of its value. The Average-Of increases the likelihood that manufacturing classes will be valued higher than Class I. Whereas, under the Higher-Of, when a manufacturing class is in demand, Class I is pushed higher and will tend to maintain its supremacy. This in turn maintains the incentive to deliver milk to Class I plants and pushes the blend price above the in-demand manufacturing price, which disincentivizes depooling.

When Class I loses its supremacy and classified pricing loses its structure, market signals become muted, and milk fails to move as needed because manufacturing class prices exceed Class I prices.

> The Class I milk price is the power source of the current FMMO system, the mechanism that keeps the system functioning, implying changes to the Class I milk price should be done infrequent and done with the utmost care.
>
> If the Class I milk price does not establish the price correctly, the system begins to malfunction. Hindsight being 20/20, the industry found the average-of Advanced Class III and IV skim milk prices plus $0.74 per hundredweight and the higher-of the Advanced Class III or IV skim milk prices are not the same.
>
> They do not function the same, and the changing – and changing the mechanism has caused the system to stop working properly and efficiently since May 2019 – since the May 2019 implementation, which has affected all aspects of dairy producer risk management, without achieving the three goals justifying the change.
>
> And on the right side I just restated the objectives again.
>
> Q. Okay. And, again, just to reiterate, a move back to the higher-of mover, do you believe that it would defeat these goals that are outlined here?
>
> A. No, I don't. I – I – I actually think it would be better. The system would function more efficiently. Depooling would be more managed. The producer sell-side liquidity that the system needs would be present because they would have confidence in the risk management tools that they use, that they wouldn't be penalized for doing the right thing.
>
> Q. Do you believe that a move back to the higher-of system would make the mover more accurately reflect the current market conditions?
>
> A. I do.

(Tr. 4910:15-4911:18 [Testimony of Sara Dorland].)

Second, "[t]he adopted pricing system will allow other manufactured products (i.e. Class IV) to move Class I prices, helping to reduce the volatility in milk prices." 64 Fed. Reg. 16026, 16094. At Order Reform, the Secretary recognized that manufacturing prices are volatile, and that supply and demand swings are caused by factors outside of regulatory control.

> Cheese consumption patterns are based on many factors outside the dairy industry's control…'anything that results in demand weakness for cheese will likely result in a markedly different outlook for the entire dairy sector.'
>
> . . . .
>
> [Since 1993], cheese prices, and to a lesser extent butter prices, have shown considerable fluctuation while the nonfat dry milk price remained relatively stable. Price changes for these finished products are indicative of varying supply/demand situations over time. The stable nonfat dry milk prices and the butter prices prior to the fall of 1995 were a reflection of large stocks being carried in storage and flat demand. Prices for nonfat dry milk and butter became more volatile once government inventories were depleted and were no longer a factor in stabilizing prices. Butter prices increased during May and June of 1997 in response to demand for cream, while both cheese and nonfat dry milk prices remained relatively flat. These differences in price movements indicate separate supply and demand balances for different manufactured dairy products.

64 Fed. Reg. 16026, 16094.

A noticeable by-product of market volatility is depooling. Market-wide pooling is intended to create uniform prices among producers. *See* 7 U.S.C. § 608c(5)(B)(ii). When manufacturing classes are volatile—e.g., when there is a significant spread between Class III and Class IV—depooling is elected by Class III and/or Class IV handlers in order to remain competitive or achieve a higher price for producer-owners or shareholders. While some depooling may be inevitable, depooling has been more frequent and has resulted in more severe milk price consequences under the Average-Of Mover. Depooling becomes destabilizing to the dairy industry when dairy farmers in close proximity receive different prices because one delivered to a processor that pooled and the other delivered to a processor that depooled. (*See* Tr. 4793:13-4794:8 [Testimony of Dr. Peter Vitaliano]) ("But when milk is routinely depooled and causes disparities, particularly between producers – we represent dairy farmers and so we're particularly sensitive to those – that then becomes disorderly.").) The tendency of the Average-Of to foster an environment that favors more frequent incidences of depooling and disparities in producer prices undermines uniform pricing.

The reason the Average-Of contributes to depooling is because "[t]he interplay between the Class III and IV skim values is [ ] complicated. No formula or stipulation relates or binds the Class III and IV skim milk price relationship. Rather, a series of market drivers, like global supply and demand, stocks, policy, trade, etc., change the underlying commodity value." (Ex. 238 at 7; Tr. 4893:17-22 [Testimony of Sara Dorland].) To dampen the effect of volatility in the manufacturing classes on Class I, the highest priced manufacturing class should provide the foundation for determining the Class I price. Creating an artificial relationship between Class III and Class IV—as the Average-Of does—leads to adverse consequences—i.e., loss of producer income—that is far less likely with the Higher-Of, which will nearly always push Class I above the highest priced manufacturing class. With more Class I contribution, the uniform price rises, and the incentive to depool lessens.

Third, "[s]ince volatility in the manufactured product markets is expected to continue, the Class I price mover developed as part of this Federal milk order reform process should address this disorderly marketing situation." 64 Fed. Reg. 16026, 16102-103. When using the phrase "disorderly marketing situation" the Secretary meant class price inversions. *See id.* at 16102.

> Class price inversion occurs when a markets's [sic] regulated price for milk used in manufacturing exceeds the Class I (fluid) milk price in a given month, and causes serious competitive inequities among dairy farmers and regulated handlers. … Milk used in Class I in Federal order markets must be pooled, but milk for manufacturing is pooled voluntarily and will not be pooled if the returns from manufacturing exceed the blend price of the marketwide pool. Thus, an inequitable situation has developed where milk for manufacturing is pooled only when associating it with a marketwide pool increases returns.

See id. at 16102.

Since implementation of the Average-Of, there have been significant fluctuations in the demand for Class III (during the COVID pandemic) and Class IV (during tight milk supplies in 2022 and continuing today). Regardless of which manufacturing class was in demand, the result was the same: the manufacturing class price exceeded the blend price (inversion) and reduced producer revenue as a result (depooling). The Higher-Of would have tempered that volatility by ensuring Class I remained above the manufacturing classes almost every month. With the Average-Of allowing manufacturing prices to routinely exceed the Class I price, producers can lose significant revenue compared to a modest upside.

The Average-Of exposed producers to an asymmetric risk caused by the nature of its formulaic construction. When comparing the performance of the two Movers, the Higher-Of will be greater than the Average-Of whenever the Class III and IV advanced skim milk pricing factors differ by more than $1.48 per hundredweight. (Ex. 229 at 6; Tr. 4675:21-28 [Testimony of Dr. Peter Vitaliano].) The maximum amount by which the Average-Of can exceed the Higher-Of is $0.74 per hundredweight, which occurs when the two advanced skim milk pricing factors are equal. However, there is no practical limit to the amount by which the Average-Of falling below the Higher-Of. (Ex. 229 at 6; Tr. 4676:4-9 [Testimony of Dr. Peter Vitaliano].) Thus, dairy farmers lose out on significant revenue when the Class III and Class IV prices differ by $1.49 per hundredweight or more, which has occurred over 50 percent of the time since implementation of the Average-Of. A greater than $1.48 per hundredweight spread between the manufacturing classes continues to occur today. Dairy farmers are left exposed by this volatility. Dairy farmers only benefit from the Average-Of during times of relative price stability which, as the Secretary observed during Order Reform, cannot be assumed or predicted. As a result, in just over four years with the Average-Of, the cumulative market losses in pooled Class I skim milk values in all

FMMOS reached $941.1 million.[20] (Ex. 229 at 6; Tr. 4676:15-19 [Testimony of Dr. Peter Vitaliano].)

The volatility and disparity between Class III and Class IV prices is not just an anomaly of the COVID pandemic. The Class III skim price is prone to particular volatility as three factors—butter, whey, and cheese—drive price volatility as compared to one factor—nonfat dry milk—with the Class IV skim price.

> The other thing I want to mention here, and something I didn't put in my testimony, but it's kind of a particular aspect of the Class III skim formula. And interestingly, while one product, nonfat dry milk prices, impact the Class IV skim price, multiple ingredients impact the Class III skim price. So prices changing for cheese, prices changing for whey, and prices changing for butter. … So holding cheese prices and whey prices constant, if you increase the butter price, you reduce the skim value. So it's kind of an unstable price just because of how it moves. And so having the higher-of and having that other aspect of Class IV kind of providing a little bit of a balance to that, we think is another aspect that makes higher-of a better idea.

(Tr. 5067:24-5068:10 [Testimony of Craig Alexander].) As recent prices have shown, Class IV has the propensity to be the higher of Class III and Class IV prices. This is likely because the federal government milk price support program no longer exists, and the lack of purchases of surplus nonfat dry milk tends to depress the market price for nonfat dry milk. Instead of the price support program, nonfat dry milk (and skim milk powder) tends to be exported in greater quantities and is subject to prevailing international market prices., As result, the negative aspect of the asymmetric risk to producers is likely to continue.

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[20] Proposal 13 opponent MIG questioned where this money went or from where it would have come had it been paid to producers. Given the industry had been operating under the Higher-Of for nearly 20 years and no processor put forth evidence that it lowered its prices to its customers or paid premiums to producers as a result of the Average-Of, it is safe to assume this money that should have been in the pool and subsequently paid to producers prior to May 2019, remained in the pockets of Class I processors.

Fourth, "[u]se of the higher of the Class III or Class IV price will make it more difficult to draw milk away from Class I uses for manufacturing." 64 Fed. Reg. 16026, 16103. All processors compete for the same ingredient: raw milk. In order to maintain the stability and structure of classified pricing and the supremacy of Class I, there must be an incentive to draw milk to Class I plants. Order Reform recognized the incentive role the Mover must play.

> Because handlers compete for the same milk for different uses, Class I prices should exceed Class III and Class IV prices to assure an adequate supply of milk for fluid use. Federal milk orders traditionally have viewed fluid use as having a higher value than manufacturing use. The replacement Class I price mover reflects this philosophy by using the higher of the Class III or Class IV price for computing the Class I price.

Id. at 16103. If the Mover does not meet this criterion, then producers receive the wrong price signals when the Class III or Class IV price is above the Class I price (i.e., inversion). If the Mover is based on the higher of the Class III or Class IV prices, then producers providing to Class I are assured the pool will grow, and the uniform price will be elevated. Simultaneously, there will be less incentive to depool because the higher Class I contribution is more likely to result in manufacturing prices below the uniform price. (*See* Ex. 229 at 4; Tr. 4679:16-18 [Testimony of Dr. Peter Vitaliano] (noting given the separation of manufacturing milk into two classes, using the higher of Class III and IV would "assure that shifts in demand for any one manufactured product will not lower . . . Class I prices.").)

The problem of attracting milk away from manufacturing is worse in FMMOs where Class I utilization is high because the uniform price is generated proportional to utilization. In those FMMOs (i.e., 5, 6, and 7), which generally are deficit areas, it becomes more difficult to attract supplemental milk because there is no incentive to supply Class I over a manufacturing class when the prices are comparable or there is an inversion. "[T]he Average-of formula is incapable of conveying current information about the market to facilitate the movement of milk from surplus regions to deficit regions as intended because it is grounded in historical rather than contemporaneous price relationships." (Ex. 238 at 6; Tr. 4907:3-8 [Testimony of Sara Dorland].) The Higher-Of avoids price signal confusion by virtually guaranteeing Class I will win the competition with manufacturing classes. Simply, the Higher-Of helps the uniform pricing provisions of the FMMOs operate as intended.

2. With the Higher-Of Functioning As Intended, Class I Processors Nonetheless Demanded a Change.

Despite no evidence that the Higher-Of negatively impacted producers or failed to meet the criteria of Order Reform, Class I processors pushed for a change in 2017 for their own, unrelated reason.

> Q. [I]n 2017, IDFA approached National Milk and said that they were having some risk management challenges and asked if National Milk would support a move of the mover to the average-of?
>
> A. The original request did not specify an average-of, but move to something from the higher – move from the higher-of to something that the two sides could agree would have been more hedgeable.
>
> Q. Okay. And ultimately that discussion became the higher-of – or I'm sorry – ultimately that discussion became the average-of?
>
> A. Fairly quickly that discussion settled on the average-of as the alternative mechanism.
>
> Q. And just for my chronology, I just want to clarify, it was around 2017 and at the initiation of IDFA?
>
> A. That's correct.
>
> Q. And the goal at that time was to solve for risk management challenges that they were having?
>
> A. Yes. To make Class I prices more hedgeable.
>
> Q. And a key consideration from National Milk's perspective was the fact that it would be revenue neutral?
>
> A. Yes. We –

> Q. Meaning revenue neutral with respect to the impact on the dairy producers?
>
> A. Yes. The producers would not lose any net – any revenue from Class I skim milk pool values.
>
> Q. And so National Milk agreed, on behalf of its members, to support what was initiated by IDFA in order to assist them with their risk management and hedging tools, on the condition that it was understood to be risk neutral?
>
> A. Revenue neutral, yes.
>
> Q. Revenue neutral I should have said.
>
> A. That's correct.
>
> Q. And ultimately that was accomplished through some legislative changes?
>
> A. Yes.

(Tr. 4807:28-4809:24 [Testimony of Dr. Peter Vitaliano].) Producers agreed to work with Class I processors to accomplish the Class I processors' goal as long as economic harm did not befall producers as a result. With the industry in alignment, Congress directed the Secretary to amend the Mover in the Class I skim price.

> 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. Thus, 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.

84 Fed. Reg. 8590, 8591; *id.* at 8590 ("In accordance with the 2018 Farm Bill, the amendment is effective indefinitely, until further modified, and may not be modified earlier than two years after

the effective date of this rule.”). Any pretense of the Average-Of being revenue neutral quickly dissipated.[21]

> Q. And there was a two-year trial period that was put in place to make sure that everybody had a window of time within which they could see how it played out.
>
> A. Yes. There were precedents for that.
>
> Q. Okay. And then – and at the end of that trial period, and in particular when the pandemic hit in 2020, it allowed you to see in realtime that there were some unintended consequences to having the average-of be the mover?
>
> A. That’s correct. Shortly – not much longer than a year after the change, the market taught the industry a very severe lesson on its unpredictability.

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[21] As producers found out, the history of the Class III and Class IV relationship is a poor indicator of future performance because of the idiosyncrasies of supply and demand for dissimilar products.

> While no formula can be expected to be highly predictive under all circumstances, the deficiencies of the Average-of formula are extensive as any one historical period is unlikely to be predictive or reflective of future market conditions as there are too many variables that can alter the relationship between Class III and IV skim milk. There is no structure to establish or maintain a relationship between the Class III and IV milk prices. Absent a formula that creates a stable relationship between the Class III and IV skim milk prices, the Average-of may lead to delayed, muted, or overstated market signals that create volatility by transmitting inaccurate information to participants about the current market supply and demand balance, leading to inferior FMMO function – that has implications for risk management. Furthermore, the positive skew indicates that dairy producers, more than processors, are likely to feel the brunt of any inequity.

(Ex. 238 at 8 [Testimony of Sara Dorland].)

> Q. And is it fair to say that your producers were – were very unhappy with how the real world had taught them that lesson?
>
> A. That is an understatement.

(Tr. 4807:28-4809:24 [Testimony of Dr. Peter Vitaliano].)

Changing the Mover proved improvident. While the industry—prompted by Class I processors—admittedly pushed Congress to act, Congressional action is not a substitute for formal rulemaking. Directing an amendment to implement a new version of the Mover could never be as careful or thoughtful as developing an evidentiary record and that considers possible (negative) consequences. For example, in Order Reform, USDA presciently noted the negative consequences of using an average-of style Mover:

> In some markets ***the use of a simple or even weighted average of the various manufacturing values may inhibit the ability of Class I handlers to procure milk supplies in competition with those plants that make the higher-valued of the manufactured products***. … For example, if the Class IV price were used as the Class I price mover there would be months in which the Class III price would be more than two dollars above the Class IV price. As a result, the Class I differential would have to be well over two dollars for the Class I price to remain above the Class III price. If the Class III price is used as the Class I price mover, the reverse situation of having the Class IV price well above the Class III price would result in the same problem.

64 Fed. Reg. 16026, 16103 (emphasis added). A formal rulemaking hearing would have likely illuminated such potential problems when evaluating the Average-Of against the Mover criteria from Order Reform.

As Congress trusted the industry, producers trusted the industry would act cooperatively should the Average-Of not meet its two industry-agreed upon objectives: (1) permit easier risk management for processors and (2) be revenue neutral for producers. Whether the first objective has been met is unclear, and, regardless, only a small minority of processors are using risk management for Class I. *See infra* at 175-180. However, the second objective has emphatically not been met. Nearly $1,000,000,000 in revenue has gone unrealized by dairy farmers because the Average-Of did not avoid the pitfalls Order Reform cautioned against when choosing a Mover. However, unlike the implementation of the Average-Of, processors would not permit a modification back by industry consensus and lobbying. It cannot be overlooked what happened when the Average-Of inflated processors' profits at the expense of producers.

> Q. Okay. So then in response to National Milk's attempt to get IDFA to work together to get back to what was intended, which was revenue neutrality in the mover, what IDFA responded, and I think when you were talking with Mr. Rosenbaum, you said IDFA rebuffed National Milk?
>
> A. That is correct.
>
> Q. What did IDFA do?
>
> A. They said they were going to study the issue, but they did not – unlike the way National Milk reacted to the original request from IDFA to accommodate their interest in getting a mover that was more hedgeable, they gave absolutely no indication that they would support this.
>
> And they must have communicated to the Secretary of Agriculture that they, you know, would – would not support that, to the extent that when we developed a request for an emergency hearing on the issue in the spring of 2021, we were given feedback that the Secretary, quite understandably, did not want to hold a hearing on something that was as divisive as apparently that issue would have been.
>
> Q. Okay. So it was your understanding that IDFA thwarted National Milk's attempts to work with the USDA to have an emergency hearing?
>
> A. Yes. To institute an early version of IDFA Proposal 14.

(Tr. 4812:11-4813:8 [Testimony of Dr. Peter Vitaliano].)

> Q. And if IDFA said that they were going to do some further economic analysis and then maybe thwarted your efforts to try and get the emergency hearing, did they then come back to you and say, we're willing to consider this at this time because it seems to be continuing?

> A. I did not see any IDFA – I do not recall that IDFA came back to us with any conclusion or data or evidence on their examination of alternative movers.
>
> Q. And now that we have National Milk's proposal at this hearing, which reverts to the higher-of, it's your understanding that IDFA would like to now go back and reconsider the offer that National Milk had made to – to have a compromise position in February of 2021; is that right?
>
> A. That's how I would interpret IDFA Proposal 14 and MIG Proposal 15.

(Tr. 4816:5-4816:20 [Testimony of Dr. Peter Vitaliano].)

When it became clear the Average-Of was disastrous for dairy farmers, they sought agreement from processors to address the problem—similar to how processers had originally asked producers for help. Processors ignored the pleas of dairy farmers. Only once this hearing became imminent did processors respond by putting forth Proposal 14, which is a transparent attempt to save the profits from the Average-Of and pay lip service to the significant financial harm caused to dairy farmers.

> In sum, the "average of" Class I mover is inconsistent with the Federal Order Reform justifications for the "higher of" and does not operate as intended because it builds in an unintended asymmetric risk to producer income, which has resulted in nearly one billion dollars in losses of producer income in little more than four years of operation. The current Class I mover dramatically increases the marketing disorder represented by volatile volumes of depooled milk. Market and price volatility continue to be a basic feature of dairy markets and can be anticipated to occur in the future. Little to no data has yet been provided to suggest that the "average of" Class I mover has facilitated actual risk management activity with a total value to fluid milk processors anywhere near in magnitude to the quantifiable losses it has dealt to the nation's dairy farmers. The experiment with the Average-Of Class I mover must therefore be deemed a failure, and the Federal Orders should be amended to return to the "higher of" formula.

(Ex. 229 at 8 [Testimony of Dr. Peter Vitaliano].)

F. Processor Risk Management Opportunities Should Not Be Preserved at the Expense of Dairy Farmers: A Return to the Higher-Of Is Necessary to Comport with the Mandate of the AMAA.

The Average-Of has not been revenue neutral. Yet, processors refuse to revert to the Higher-Of because of nebulous claims that the Average-Of permits risk management opportunities the Higher-Of does not. Regardless, without equivocation, processors are abandoning their agreement with producers that permitted the Average-Of to be implemented—i.e., the Average-Of must be revenue neutral when compared to the Higher-Of. As for the processors' justification—increased opportunities to engage in risk management—there is a paucity of evidence that the value of any risk management opportunities has exceeded the value lost to producers. The conspicuous inference is processors' real motivation for wanting to keep a version of the Average-Of is it keeps the economics of the dairy industry in their favor.

1. The AMAA Is Intended to Benefit Producers, Not Accommodate Risk Management.

Before considering what evidence opponents to Proposal 13 have given, it is important to consider what the FMMOs are intended to do and who the AMAA is intended to help. The AMAA contains no provision aimed at protecting handlers or making accommodations for risk management.[22] Too often during this hearing proprietary processors' testimony devolved into

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[22] It is undeniable that risk management is becoming a larger aspect of the dairy industry. However, the prudent approach may be to allow risk management to develop organically without specifically tailoring policy and regulations.

> So how do you think Federal Orders should prioritize that versus the other provisions in the Act that is explicit that they should provide for?
>
> A. It's obvious that just in my – think about the last ten years, the use of risk management, hedging, futures market by dairy farmers has grown quite a bit. In fact, if you look at USDA programs, Dairy Revenue Program, Livestock Gross Margin, you know, even USDA's involved in it.

whether they are being treated equally to producers. That is irrelevant. The AMAA regulates processors; it does not afford special consideration to their financial well-being other than price uniformity. Congress has dictated that dairy farmers are to receive preferred status under the law; a legitimate aim caused by the historical power imbalance between dairy farmers and processors. *See* 7 U.S.C. § 602(4) ("It is declared to be the policy of Congress [t]hrough the exercise of the powers conferred upon the Secretary…to establish and maintain such orderly marketing conditions…as will provide, in the interests of producers and consumers, an orderly flow of the supply thereof to market…to avoid unreasonable fluctuations in supplies and prices."). With Class I, this imbalance is more pronounced.

> An imbalance of market position between farmers with a perishable product and fluid milk processors with variable demand, saw the developing need to price milk differently for fluid needs versus milk used for manufacturing cheese, nonfat dry milk, butter, and other more storable products.

(Ex. 245 at 2; Tr. 5001:15-20 [Testimony of Craig Alexander].) The AMAA is to benefit producers by raising prices, not cater to proprietary processors' hedging needs. If the criteria for establishing the Mover in Order Reform is no longer being met, then the Mover needs to be changed. More bluntly, if a regulation championed by proprietary processors causes lower prices for producers, that requires correction.

The opponents to Proposal 13 suggest the increased opportunities for risk management

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> But in my – this is just giving my opinion, so far all these programs have been voluntary. A dairy farmer can choose if he wants to be involved in it. If a plant wants to use it, they can be involved in it. And I would prefer to see it remain on a voluntary basis, that the Federal Milk Marketing Orders continue to do what they have done, in my opinion, so well for a number of years, set minimum prices, enforce payment, pool, and so forth.

(Tr. 6803:5-6804:1 [Testimony of Calvin Covington].)

warrant maintaining some form of the current Mover.[23] To be clear, the risk management opportunity created for Class I processors is one-sided. Class I producers are not likely to better manage risk with the Average-Of because "[f]ew dairy producers should consider hedging Class I"

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[23] The use of risk management by the opponents of Proposal 13 is meaningfully different from NMPF's use of risk management as a justification in Proposal 1.

> I would say that achieving multiple objectives through the Federal Order program, such as – and please note that National Milk first introduced at this hearing the notion of the importance of hedging and risk management in terms of how that can be accommodated in the Federal Order pricing formulas by our suggestion of a 12-month implementation delay for our Proposal Number 1. And likewise, when we talked with the – with the processors in the summer of 2017, we took totally seriously the processors' express desire to be able to better hedge Class I. There was no bad faith in that at all.
>
> But it has turned out that in the case of Proposal 1, we found that there were – that taking risk management factors into account is worth, let's call it some – some level of deviation from strict Federal Order, you know, pricing regulations. The way it was explained to me is that if USDA makes a decision that a current feature of Federal Orders needs to be changed, they are under almost an obligation to change it as quickly as possible.
>
> We're trying to introduce some nuances that if it is not too great an imposition on the normal order of business in Federal Orders to accommodate the growing importance of risk management, then it would be appropriate to do so.
>
> In the case of the – the importance of hedging some Class I milk by processors, the costs – we were more than willing to countenance the original change and to keep alive a modification of the average-of base movers to preserve that hedging as long as we possibly could have.
>
> But in the end, our decision-making body determined that it was – that the importance – the downside cost of continuing an average-of base mover of whatever form was – did not outweigh the – you know, the problems that it caused and would likely continue to cause in the future.

(Tr. 4729:24-4731:9 [Testimony of Dr. Peter Vitaliano].)

in the first instance. (Ex. 238 at 12 [Testimony of Sara Dorland].)

> Dairy producers are less likely to hedge Class I. While the proposal suggests that dairies have equal opportunities to manage Class I risk, the data does not bear out that assertion. Dairies should undertake Class I hedging to the degree it impacts their milk price.
>
> Meaning, if Class I utilization is 30 percent of the uniform price, as that is the basis of payment for the dairy, it should avoid hedging more than 30 percent of its milk price as Class I, otherwise risk may be created.
>
> Based on the number of cows needed to hedge Class I milk and USDA-ERS, "Consolidation in United States Dairy Farming," in 2017, that would have eliminated 87 [percent] of the nation's dairies from accessing hedge one – excuse me – Class I hedging, contrary to several Class I formula proposals.
>
> The change to the average-of price methodology was done to further risk management efforts. Unfortunately, it created a systematic risk that caused dairy producers to step back from all risk management or employ less effective tools in response to the losses that resulted from depooling. Most of the market's sell-side liquidity still comes from producers, suggesting changes that would cause dairy producers to reduce hedging activity across all classes of milk could be detrimental to markets.
>
> . . . .
>
> So what that would say is dairy producers, cooperatives, and others are still very instrumental in – in that sell-side liquidity that our markets crave in order to function properly.
>
> The issue is, is when we have depooling that can last in perpetuity, it hurt dairy producers. Their hedging was far less effective, and they stepped away from it.
>
> So I think what folks have to understand is, we're not talking about just providing folks access to potentially Class I hedging. It's if we disrupt that Class I price, the mechanism that keeps our entire system functioning, we run the risk that we could lose that sell-side liquidity in our markets for cheese, nonfat, butter, Class III, and Class IV milk.

(Tr. 4901:16-4903:5 [Testimony of Sara Dorland].) "With most dairy producers unable to access Class I risk management, it weakens the basic tenets of the Average-Of proposal." (Ex. 238 at 13

[Testimony of Sara Dorland].)

2. The Evidence Against Returning to the Higher-Of Is Unavailing.

With the understanding that hedging or expanding risk management opportunities for Class I are ***only*** for processors, the evidence Class I proprietary processors have put forth to support their cause is less than convincing. Some of the witnesses did not work in risk management (Tr. 5521:5-9 [Testimony of Kimberly Greenbaum] (noting she is not involved with the risk management team)), and at least one Class I proprietary processor is still in the contemplative phase of Class I risk management. (Ex. 271 at 4 [Testimony of Chuck Turner] (noting an undisclosed ***plan*** to hedge Class I).) Proprietary processors shared no detailed evidence of their specific hedging programs, but they generally made broad claims about their use of risk management.

The modest information put into the record about Class I processor risk management made clear that ***all*** hedging or risk management is associated with ESL, aseptic, or other specialty products that make up a minority of the Class I market. No Class I processor gave evidence of hedging HTST, which is 90 percent of the Class I market. (*See* Ex. 296 at 2; Tr. 6760:22-25 [Testimony of Calvin Covington].) For example, Schreiber Foods does not sell *any* HTST products and only 5 percent of its product portfolio is made up of Class I products.

> Q. So you are not talking about the variables that happen between the dairy farm and your customer outlet, you are talking about your customer locking in the risk and then you, Schreiber Foods, being able to lay off your risk?
>
> A. Correct. That's – that's our – that's what we consider risk management, and that's the hedge that we put on to lay off our risk, correct.
>
> Q. And then so does Schreiber Foods have any ESL products?
>
> A. Yes.
>
> Q. What about non-ESL Class I products, do you have any of those?

> A. I don't believe we do.
>
> Q. Okay. So of all the Class I products that you have which makes up less than 5 [percent] of your products, that would all fall in that ESL category?
>
> A. I believe so, yes.
>
> . . . .
>
> Q. Okay. And are those contracts for ESL products or HTST products?
>
> A. They are all going to be for ESL. I failed to mention, they would be ESL or aseptic.
>
> . . . .
>
> Q. So your customers for HTST products don't typically look to lock in a price?
>
> A. We don't have any – we don't sell any volume that's HTST.

(Tr. 5439:26-5440:15, 5486:26-5487:9 [Testimony of Chris Herlache].) Likewise, Nestle's only Class I use of raw milk is for Nesquik—a shelf-stable product that is not HTST.

> Q. And do you know which of those products are – are Class I – or that Class I milk is used to make?
>
> A. Just the Nesquik.
>
> Q. Okay. So only the ready-to-drink milk?
>
> A. Yes, ma'am.

(Tr. 5523:16-5523:20 [Testimony of Kimberly Greenbaum].) Affirming NMPF's point that Class I hedging is a niche concern, an IDFA witness suggested proprietary processors are deciding not to hedge HTST products.

> Q. Now, some members of MIG or other bottlers have testified that although they are intrigued by hedging their HTST products, it has not been largely adopted in the 40 years that it's been available.
>
> Did you hear any of that testimony?

> A. Oh, yes. I did.
>
> Q. Okay. And you stated that at least in Kroger's experience, they have made a decision not to hedge their HTST milk?
>
> A. Yeah. I don't think that's changed, but from my experience, yes, that's correct.
>
> . . . .
>
> Q. One of the main reasons that processors have requested that the average-of be maintained is for these very risk management issues. But it seems to me that the vast majority of the milk in Class I, which is HTST, either can't, isn't, or won't participate in hedging.
>
> Do you agree with that?
>
> A. No. Because I don't know. I can say from my experience at Kroger, it's not likely. I can't speak for even other grocery store chains what their thoughts are on that. I just honestly don't know.

(Tr. 6180:13-6182:1 [Testimony of Mike Brown].) Consistently, HP Hood testified that HTST is passthrough pricing, which means the announced Class I price can be passed from the proprietary processor to its customer (e.g., retailers).

> [Y]our HTST business is mostly passthrough on pricing?
>
> A. Yes.
>
> Q. Can you just elaborate on that a little more on what you mean by "passthrough"?
>
> A. Passthrough?
>
> Q. Yes.
>
> A. So I mean, we – we find out what our milk cost is going up, and we – we increase by that amount to our customers.
>
> Q. And then the ESL business is not priced the same way?
>
> A. The ESL business we have, we offer more of a fixed price over an extended period of time. So we – we absorb a lot of changes. If we – with hedging, we – there's, you know, less upside risk, so that we even have more surety being able to kind of maintain our price.

. . . .

> A. Because the advanced pricing is very well accepted on the HTST side of the business, which makes that market function very orderly, because you and all your competitors are kind of moving in conjunction.
>
> Q. In effect, the industry is used to it?
>
> A. Yes.

(Tr. 5916:13-5916:18, 5918:17-5919:5 [Testimony of Michael Newell].) A witness for MIG confirmed that HTST and specialty products, such as ESL, are different markets, and the HTST market does not hedge because it can rely on advanced pricing.

> Q. If for all markets, the Class I raw milk price in 2018 had a variance from high to low of 18 [percent], but the retail whole milk price reported by USDA had a volatility of 3.2 [percent], and in 2022 the volatility of the raw milk price was 27.4 [percent], and the volatility of the retail price was 15.6 [percent], does that suggest that Class I handlers are effectively hedging their costs?
>
> A. To the best of my knowledge today, the number of participants, there are folks within Class I who are using these tools, but it – as we have heard from other witnesses, this – this is – this sort of risk management and using – constructing hedges to be able to collar your price for retail is not – has not been widely adopted within the HTST market. And most of that price survey that you are looking at is going to be the HTST market. I mean, that's the bulk of what's out there for sale today.
>
> Q. Is that difference in the ESL market, in your experience?
>
> A. In my experience, the ESL market is much more likely to be hedging and trying to set a more stable price.
>
> Q. And so the HTST market in 2020, the average 2 [percent] gallon was $1.48, which is – for a gallon, which is the same price that Nestle's charging for 14 ounces of their ESL product.
>
> So they are very, very different markets, correct?
>
> A. They are – they are very different markets. And a gallon jug is really different than a small bottle of Nesquik. They are – they are very different products.

> Q. Right.
>
> And the hedging that is done is very, very different in your experience?
>
> A. So in my experience with the HTST market, it's much more like – it's – the HTST market, the terms of trade, people very much rely on the advanced pricing. And advanced pricing – and there are routinized monthly price changes that are going from the processors of all types, so cooperative processors, fluid processors, retailer-captive processor – sorry – cooperative fluid processors, proprietary fluid processors, and the retailer captives. And that monthly price change dynamic related to advanced pricing is a very routinized part of the HTST terms of trade today.

(Tr. 5761:12-5762:26 [Testimony of Sally Keefe].)

No processor brought forth evidence that the combination of hedging and the shift to a pricing formula using the Average-Of had increased sales. To the contrary, HP Hood testified that sales have been steadily successful for the last 20 years. (Tr. 5926:13-22 [Testimony of Michael Newell].) Moreover, any price stability brought about by the Average-Of only benefits proprietary processors because they have not changed their pricing strategy with their buyers as a result of their reduced risk. (Tr. 5943:17-:5944:2 [Testimony of Michael Newell].) If proprietary processors were successful prior to the Average-Of and those same processors are not passing along the financial benefit of their reduced risk to consumers, then their reason for maintaining the Mover is a façade.

Further emphasizing the niche interest in keeping the Mover, no small Class I processor testified to engaging in hedging because the volume necessary to hedge under the Average-Of is likely too significant for any company but the biggest processors—$1,000,000,000 brands such as fairlife—to consider. The "discussion fail[ed] to address all categories of Class I risk management that may lend themselves to over-the-counter or custom solutions. Additionally, the data suggests that the higher-of or average-of risk management performance is relatively similar, meaning either can be used to mitigate risk." (Tr. 4905:1-4905:6 [Testimony of Sara Dorland].) No processor presented evidence that the (sizable) margins on specialty products were insufficient to pay for hedging under the Higher-Of. Most important, no Class I processor legally justified maintaining a regulation that is empirically economically detrimental to dairy farmers for the sake of a few large processors' ability to hedge specialty Class I products, which comprise a mere fraction of the Class I market.

> Regardless of the amount hedging occurring in the Class I market, we would question the disruption of market signals and cost to producers by use of the Average of Mover. We recognize that there may be some processors or end users in specialized Class I product channels that may utilize hedging, however, we would contend that it is a relatively small slice of total Class I sales. By way of illustration, if we assume that this segment represents 15 [percent] of total Class I sales, and Class I sales on a national basis are about 30 [percent], the percentage of milk that may be interested in hedging would at most calculate out to be about 4.5 [percent] of all pooled milk.

(Ex. 245 at 8-9; Tr. 5016:28-5017:15 [Testimony of Craig Alexander].) Dairy farmers should not be financially ruined by allowing large profitable, proprietary processors to become larger and more profitable. In order to appropriately establish minimum Class I prices, a return to the Higher-Of is necessary.

G. Alternatives to Proposal 13 Are Neither More Orderly Nor More Beneficial to Producers than the Higher-Of.

1. Proposals 14, 15, and 16 Should be Rejected.

Based on the number of proposed alternatives to the Average-Of, there is industry consensus that the current Average-Of is not an appropriate Mover. Any attempt to save the Average-Of through further revision and modification is doomed because the Average-Of relies on faulty premises. For the Average-Of method to be valid, the assumptions driving the relationship between Class III and IV skim milk must 1) be similar in scope and scale to the study period and 2) exist in future periods. (Ex. 238 at 5 [Testimony of Sara Dorland].) However, utilizing past performance for current market conditions is a fool's errand because there is no predictable, reliable, and established relationship between Class III and Class IV. (Tr. 4890:21-4890:22 [Testimony of Sara Dorland].) "[A]bsent a defined relationship between the advanced Class III and IV skim milk prices, any variant of the Average-of formula will struggle to replicate the Higher-of performance, resulting in disproportionate risks for dairy producers and distorted market signals that undermine efficient FMMO function." (Ex. 238 at 14 [Testimony of Sara Dorland].) For example, the termination of the federal government's milk price support program and the increase in dairy product exports show why the historical relationship between Class III and Class IV prices, which is a necessary premise to the Average-Of, is not projectable into the future. (Ex. 238 at 7 [Testimony of Sara Dorland].) Thus, any permutations of the Average-Of is similarly doomed to failure and to contribute to volatility and market disorder.

Avoiding volatility and disorder are Mover specific considerations already discussed, *see supra* at 156-165, and they apply with equal force to the makeshift solutions described in by Proposals 14, 15, and 16. Reifying the need to return to the Higher-Of, the Secretary should also revisit the policy considerations used at the genesis of modern FMMO pricing when examining which Proposal—13, 14, 15, 16, 17, or 18—provides the best path forward. When considering replacements to the BFP, the Secretary established criteria "to evaluate the various alternatives [ ]: (a) Stability and predictability; (b) simplicity, uniformity, and transparency; (c) sound economics—e.g., consistency with market conditions; and (d) reduced regulation." 64 Fed. Reg. 16026, 16091. When measured against these principles, an obvious winner emerges: Proposal 13.

Proposal 14 (by IDFA) and Proposal 15 (by MIG) maintain a form of the Average-Of and add a retrospective adjuster to compensate dairy farmers retroactively for a shortfall between what the Class I price under the Higher-Of would have been compared to their nouveau Average-Of proposals. Proposal 16 (by Edge) seeks to change the Class I skim price to the announced Class III skim price plus an adjuster, as well as eliminate advanced pricing. The adjusters in Proposals 14, 15, and 16 require a look back period ranging from 24 to 36 months. This means all three proposals are attempting to "true up" dairy farmers after the fact for revenue they should have received when their milk was sold. The Higher-Of does this nearly contemporaneously. These complicated—and in the case of Proposal 15 *overly* complicated[24]—proposals are inefficacious

[24] As Judge Clifton astutely pointed out:

> ***There's just got to be a simpler way***.
>
> Do you have any response to my dilemma here?
>
> THE WITNESS: I understand your dilemma. Regrettably – regrettably the simple $0.74 adjuster didn't do a good job, because even though this is a pretty small percent of the price, it's enough of a difference that people care.
>
> And so the adjuster – the adjuster – we need – the adjuster is needed in order to have the average work in the same way that the higher-of works.
>
> You have to have an adjuster to keep them roughly equivalent.
>
> THE COURT: ***So what if it was just contemporaneous***, and it's – so it's volatile, it's tiny, it could be volatile. Did you – did you consider that?
>
> THE WITNESS: The – so by contemporaneous, do you mean without a lag?
>
> THE COURT: ***Without a two-year lookback and without a lag***. Is there any way to just have it be known?

(Tr. 5783:12-5784:25 [Testimony of Sally Keefe] (emphasis added).) That "simpler way" is the Higher-Of.

bandages on a wound that could be prevented by the Higher-Of. Taking the Order Reform policy considerations in turn: (a) none of these proposals are predictable because they are new and have never been implemented; whereas the Higher-Of is predictable because of its 20-year track record; (b) none of the proposals are as simple or as timely as the Higher-Of because they all involve look back periods and adjusters; (c) none of the proposals are more consistent with market conditions than the Higher-Of, which acts nearly contemporaneously with market conditions as opposed to a lengthy look back period; and (d) none of the proposals reduce regulation, as demonstrated by the proposed regulatory language for each proposal.

While the Higher-Of is known to meet the criteria and policy objectives for a Class I Mover, as stated in Order Reform, Proposals 14, 15, and 16 are untested formulas that could have unintended consequences—as the current Average-Of did. IDFA, MIG, and Edge cannot guarantee or accurately predict their proposals will maintain Class I supremacy, support classified pricing, reduce depooling, reduce disorderly marketing, or otherwise reduce the negative consequences caused by the current Mover. Proposal 16 additionally fails to account for the months when Class IV is significantly higher than Class III (as has been realized regularly over the past 18 months). *See* 64 Fed. Reg. 16026, 16103 (discussing the problems with an Average-Of Mover when the manufacturing class prices diverge by a couple of dollars or more). Finally, none of these proponents can credibly claim that the majority of producers—in a sufficient amount needed to pass a referendum on the Secretary's final rule—prefer any of these proposals over Proposal 13. The number of dairy farmers is shrinking; dairy farmers are making critical choices about their livelihood. A pricing formula that effectively provides restitution years after a dairy farmer should have been paid is promoting dairy farmers to exit the industry, even if the ultimate economic impact is predicted to be roughly revenue neutral over some period of time. Producers overwhelmingly prefer Proposal 13.[25] Any proposal advocating for any Mover other than the Higher-Of should be rejected.

2. Proposals 16, 17, and 18 Should Be Rejected.

Likewise, eliminating advanced pricing—under Proposal 16, 17, or 18—would be unnecessarily disruptive. Advanced pricing provides a Class I price based on more recent manufacturing use price and reduced the lag that contributes to class price inversions. 64 Fed. Reg. 16026, 16103. Advanced pricing allows Class I and Class II processors to know the cost of raw milk and price it accordingly with their customers. "Waiting until most of the product is already distributed, and much of it consumed before knowing the price, is not a prudent business practice." (Ex. 296 at 2; Tr. 6761:20-22 [Testimony of Calvin Covington].) There is no market—such as the CME—to which Class I and Class II processors and customers can look for milk pricing.

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[25] Processors likewise would not prefer a pricing methodology where they received money after the fact.

> Q. And, for example, Ms. Dorland gave an example of if you were to be paid the average-of $500,000, you didn't get any money – or I'm sorry – I guess it was an average of $250,000, you didn't get any money this year, you got $500,000 next year, that can present some cash flow issues in the first year; is that fair?
>
> A. I mean, that's speaking to – to a side of the business that I'm not directly, you know, involved in with my work at Schreiber Foods, so I don't want to – obviously, the cash flow yes. I can agree that that creates challenges. But, again, from the – from our position, I want to make sure that I'm not making assumptions or judgments or things like that that are affecting outside of our area of business.
>
> Q. Okay. And you don't have any arrangements like that with your customers where you would be willing to get payment next year and skip getting payment this year, do you?
>
> A. I certainly cannot talk to anything like that. That would be proprietary if we ever did. I have no idea if we do.

(Tr. 5448:12-5449:4 [Testimony of Chris Herlache].)

Without advanced pricing, one of two situations is likely to arise. Customers will be forced to purchase milk and find out the price at a later date after most of the milk has been sold. If there is a significant monthly increase in the Class I price, retailers may ask their fluid milk provider, who in turn may ask their dairy farmer cooperative suppliers, for relief from the price increase. This opens the potential of fluid milk processors in the same marketing area not having equitable raw milk costs, and the potential of producers in the same marketing area not having uniform pricing: a violation of the AMAA.

Alternatively, Class I customers are likely to ask processors or dairy farmer cooperatives to provide estimated Class I prices in advance and then use "true-ups" at a later date once the Class I price is announced. This creates an added financial burden on processors or, more likely, dairy farmer cooperatives to go without full payment until months after their milk has been sold. Either situation is less orderly than maintaining advanced pricing. Any proposal seeking to eliminate advanced pricing should be rejected.

VII. PROPOSAL 19 SHOULD BE ADOPTED: CLASS I DIFFERENTIALS NEED TO BE UPDATED TO REFLECT CURRENT COSTS AND ENSURE MILK MOVES TO MEET DEMAND.

PROPOSED FINDINGS OF FACT

A. Class I Differentials Are Out-Of-Date and Not Commensurate With Current Costs of Supplying the Class I Market.

1. The Class I skim milk price per hundredweight equals a location adjusted differential plus the Mover. 7 C.F.R. § 1000.50(b). Every county in the continental United States is assigned a location adjusted differential ("Class I differential") that adds a fixed amount to the Class I skim price based on the location of a given Class I plant. 7 C.F.R. § 1000.52. Similarly, the Class I butterfat price per pound equals a location adjusted differential divided by 100, plus the advanced butterfat price. 7 C.F.R. § 1000.50(c). Additionally, the Class I differential is used to adjust the value of the blend prices or PPDs when distributing the value of the pool to producers delivering to a Class I plant or any other plant receiving pool milk. *See* 7 C.F.R. §§ ____.75 (referencing 7 C.F.R. §§ ____.51 which incorporates 7 C.F.R. § 1000.52).

2. The majority[26] of Class I differentials have remained unchanged since Order Reform, and thus the underlying cost assumptions embedded in the Class I differentials are out of date. (Ex. 299 at 4; Tr. 6825:4-7 [Testimony of Dr. Peter Vitaliano].)

3. For example, fuel costs and the basic per-mile costs of hauling milk have increased significantly. The cost per hundredweight per 100 miles has almost tripled since the current Class I differentials were established a quarter century ago. (Ex. 299 at 4; Tr. 6826:11-14 [Testimony of Dr. Peter Vitaliano].)

4. Additionally, the miles that bulk, raw milk must travel to get from dairy farms to

[26] The Class I differentials in FMMOs 5, 6, and 7 were modestly updated in 2008. 73 Fed. Reg. 11194 (Feb. 29, 2008).

processing plants have increased. Development in exurban fringes has displaced dairy farms. The location of milk production is increasingly distant from human population centers, while Class I processing plants remain in cities, due to the higher per unit costs of transporting packaged fluid milk relative to bulk, unprocessed milk. (Ex. 299 at 4; Tr. 6827:1-8 [Testimony of Dr. Peter Vitaliano].)

5. The combination of increased miles milk must move to serve Class I markets and the significant increases in the per-mile cost of moving milk is threatening the reliability of milk supplies for Class I use in many FMMOs. (Ex. 299 at 4; Tr. 6827:9-13 [Testimony of Dr. Peter Vitaliano].)

6. In addition to increases in milk hauling costs since 2000, other costs have increased. All contributors to the cost of producing Grade A milk at the farm have also increased. (Ex. 299 at 5; Tr. 6827:18-20 [Testimony of Dr. Peter Vitaliano].)

7. Yet, larger fluid milk plants, higher costs of hauling, increased distances raw unprocessed milk must travel to supply Class I processing needs, and growing resistance by handlers to accept over-order prices are leaving many costs of serving Class I processors increasingly uncovered. (Ex. 299 at 5; Tr. 6828:21-26 [Testimony of Dr. Peter Vitaliano].)

8. The Class I differential base price now represents a modest nod to production costs at the producer level. NMPF proposes to update all Class I differentials to reflect modern production costs, with the minimum differential rising from $1.60 per hundredweight to $2.20 per hundredweight. Since 2000, producer costs have risen far more than the limited increases in Proposal 19. (Ex. 299 at 5, 12-82; Tr. 6827:28-9 [Testimony of Dr. Peter Vitaliano].)

1. NMPF—and Only NMPF—Engaged in a Robust Evaluation to Update Class I Differentials for Every County, Parish, and City.

9. NMPF commissioned an update to the University of Wisconsin (previously Cornell

University) national price surface model using 2021 input data including milk supplies, dairy product demand, cost of processing milk, and the cost of transporting milk and dairy products. (Ex. 299 at 6; Tr. 6830:3-8 [Testimony of Dr. Peter Vitaliano].)

10. NMPF used the outputs from the University of Wisconsin United States Dairy Sector Simulator ("USDSS") as a starting point for Proposal 19 and a new Class I differential price surface. NMPF then applied local knowledge of milk movements, plant locations, and historic price relationships to refine the USDSS results and prepare a rational regulated Class I value surface, using time-honored Class I price alignment techniques and processes, similar to the process used in Order Reform. NMPF's final Class I differential recommendations adjusted the USDSS results by relatively small increments due to a variety of real-world milk movement considerations. (Ex. 299 at 6; Tr. 6830:11-20 [Testimony of Dr. Peter Vitaliano]; *see also* Tr. 9459:8-9460:18; 9500:3-20 [Testimony of Edward Gallagher].)

11. Given the substantial increases in the costs of milk hauling, the recommended regulated Class I differential surface increased versus the current regulated Class I differentials. The tilt, or slope, of the price surface from reserve supply points to Class I demand points has become steeper, and the geographic locations representing the reserve supply of milk have generally shifted toward western states. Similar to the general nature of the existing Class I differential price surface, the updated price surface slopes from lower values in the Northwest and West regions, areas of reserve supply, with increasing values when moving toward the milk-deficit areas in the Southeast region. (Ex. 299 at 6; Tr. 6830:21-6831:6 [Testimony of Dr. Peter Vitaliano].)

12. The adjustments we made to overlay real world milk marketing factors continue to recognize this east to west slope and valuation. Since these values also determine the distribution

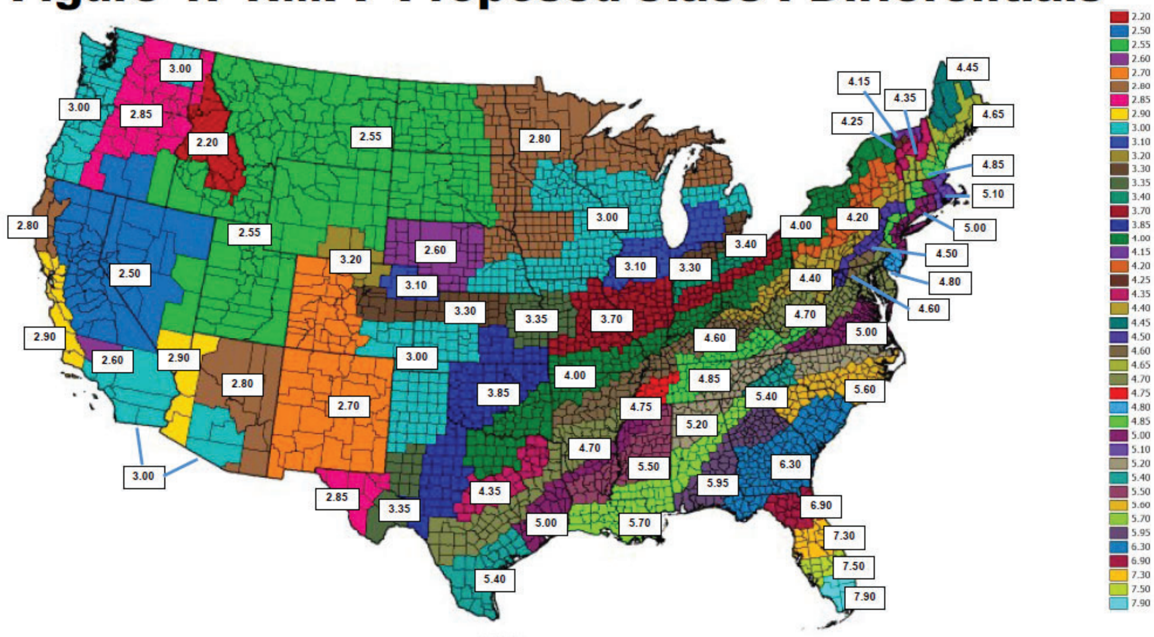
of the blend price or PPDs, NMPF also looked at the interplay between these values as they impacted these prices. A goal was to prevent a decrease in producer prices at any delivery location, solely as a result of the implementation of the proposed pricing surface (*See* Tr. 9496:18-9497:23; 9519:25-9520:17; 9537.17-21 [Testimony of Edward Gallagher].)

13. In developing Proposal 19, NMPF used the expertise of numerous individuals responsible for marketing milk in NMPF member cooperatives as well as others that have long-standing expertise in the national Class I price surface. Their expertise was used to further refine the model results to develop the proposed pricing surface that best fits the realities of today's marketplace. As such, the proposal does not follow the USDSS results in every instance as there are both positive and negative deviations from the USDSS results to better support a more orderly marketing system. (Ex. 299 at 6; Tr. 6831:10-21 [Testimony of Dr. Peter Vitaliano].)

14. The updated Class I differentials, as proposed, which resulted from this NMPF analysis, reflect less than the full cost of moving milk and thereby maintain USDA's long-standing principle of minimum prices. (Ex. 299 at 6; Tr. 6831:7-10 [Testimony of Dr. Peter Vitaliano].)

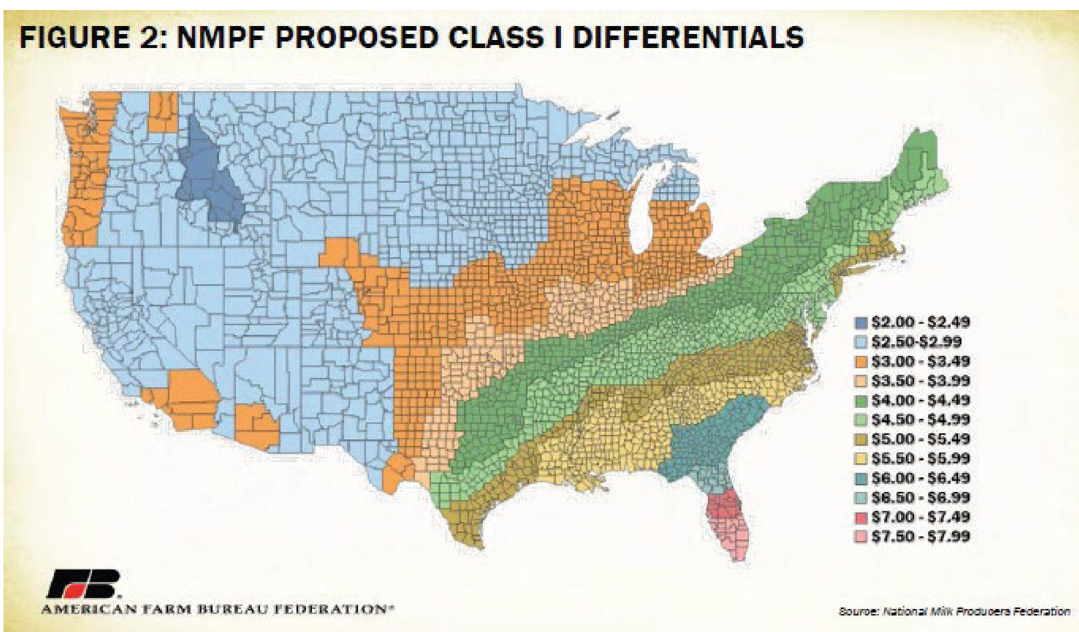
15. A depiction of the modern Class I differentials in Proposal 19 shows the increased values resulting in an appropriate slope towards the Southeast.

Figure 1. NMPF Proposed Class I Differentials



(Ex. 299 at 7 [Testimony of Dr. Peter Vitaliano].)

16. A slightly different depiction of Proposal 19 shows the orderly nature and correct slope.



(Ex. 384 at 2 [Testimony of Dr. Roger Cryan].)

2. The USDSS Is A Helpful Tool to Begin the Process of Setting Class I Differentials.

17. The USDSS is a highly detailed mathematical spatial optimization model, but at its core solves a practical problem: how to get milk from dairy farms to plants to be processed into various dairy products and distribute those products to consumers with the lowest cost possible. It indicates how to move that farm milk to plants via the existing road network and distributes the finished products to consumers also according to the road network. The objective of the USDSS is to find the least-transportation-cost combination of assembling milk from farms to plants, processing all different dairy products, and distributing them to meet domestic consumer and export demand while respecting a large number of constraints imposed. (Ex. 302 at 3, 12; Tr. 6922:5-15; 6922:16-24 [Testimony of Dr. Charles Nicholson].)

18. There are two types of results provided by the USDSS: a "primal solution" and a "dual solution." The primal solution describes the physical flows of product through the dairy supply chain network. The dual solution represents the relative monetary values of milk and dairy products at each model location. (Ex. 302 at 12; Tr. 6923:5-11 [Testimony of Dr. Charles Nicholson].)

19. The dual solution shows the spatial value of milk, or more specifically, the "marginal value" of milk at a processing location or at a supply location as for raw milk. Conceptually, this can be thought of as follows. If you would ask fluid plant owners how much more they would be willing to pay for another hundredweight of milk, they would have to consider all of their options for other milk supplies and the cost of transporting that milk to their plant. And, they would have to consider the additional sales opportunities for the finished product and the cost of distribution to those locations. (Ex. 302 at 15; Tr. 6924:1-17 [Testimony of Dr. Charles Nicholson].)

20. Three factors constitute the important causes of change in the spatial milk values—the price relatives. These factors are 1) changes in the milk supply, 2) changes in the composition and locations of demand for dairy products, and 3) changes in transportation costs. (Ex. 302 at 16; Tr. 6925:1-5 [Testimony of Dr. Charles Nicholson].)

21. Thus, the "dual values" provide estimates of the spatial value of milk and are reported for the purpose of considering Class I differentials. Individual values at fluid milk processing locations are used as inputs into spatial mapping software to develop a continuous "price surface" and then projecting values for each United States county. This price surface indicates estimated spatial values of milk for each county location in the contiguous United States, consistent with the spatial aggregation used for Class I differentials. (Ex. 302 at 15; Tr. 6924:1-13 [Testimony of Dr. Charles Nicholson].)

22. However, the indicated spatial milk values should not be interpreted directly as Class I differentials. The values should be thought of as "price relatives"; that is, the difference in values across locations. (Ex. 302 at 15; Tr. 6924:13-17 [Testimony of Dr. Charles Nicholson].)

23. For the United States dairy industry as a whole, the USDSS minimizes the systemwide cost of assembling milk at plants, making final and intermediate dairy products and transporting them to other plants and locations of final demand. Because the USDSS assumes milk supplies are fixed in a given month, the USDSS does not include the cost of milk production. However, it does include all of the principal costs between the farm gate and the retail locations for the consumer. (Ex. 302 at 3; Tr. 6922:16-21 [Testimony of Dr. Charles Nicholson].)

24. The plants are modeled within the county they are located in the large version of the model, a total of 663 locations. Although there are more plants than this in the United States, the USDSS uses a single location to represent multiple processing entities within a given county.

Plants are constrained to process only the products that are produced at any location (e.g., a fluid milk plant location cannot process cheese) and up to capacities expressed in terms of milk volumes per month. USDSS uses three locations for imports: the port cities in New York, Los Angeles/Long Beach, and Houston. (Ex. 302 at 6-7 [Testimony of Dr. Charles Nicholson].)

25. Transportation costs are key drivers of differences in spatial milk and product values. A road network using the shortest actual road mileage connects all of the supply, demand, plant, and export locations in the model. There are about 6.5 million road routes connecting all 3,108 county seats. States also have differing Gross Vehicle Weight ("GVW") limits, which restrict the size of loads shipping raw milk or finished products that can be transferred between some states. The most limiting state GVW along a route determines the cost of the route in the USDSS. Being able to haul greater GVWs reduces the cost of transporting raw milk and products. (Ex. 302 at 11 [Testimony of Dr. Charles Nicholson].)

26. All of the possible road routes have transportation costs calculated for raw milk assembly, interplant movements of bulk products (cream, skim milk, condensed skim milk, etc.), and final products, both refrigerated and non-refrigerated distribution. These transportation costs are based on simulated costs of product movements for farm milk, refrigerated and nonrefrigerated dairy products generated by a stand-alone transportation cost simulation program, updated to reflect changes in equipment, fuel, and labor costs for 2021. Regional variations in fuel and labor costs are reflected in the USDSS based on the point of origin for a transportation movement, i.e., transportation from states like California have significantly higher transportation costs than states like Texas. (Ex. 302 at 11 [Testimony of Dr. Charles Nicholson].)

27. The USDSS is designed to analyze the least-cost spatial organization of the entire United States dairy industry. That is, USDSS results serve as competitive benchmarks for the

lowest possible systemwide transportation costs, which also indicates the economic pressures for processing particular products at particular locations. The USDSS is not designed to replicate exactly existing patterns of milk processing and distribution. The USDSS does not directly represent existing commercial relationships that can be important determinants of the locations and volumes processed in existing operations. Finally, the USDSS does not consider the impact on processing locations and milk movements that derive from the incentives under Federal Milk Marketing Orders. (Ex. 302 at 14 [Testimony of Dr. Charles Nicholson].)

28. Current Class I differentials have a minimum of $1.60 in parts of California, Idaho, Minnesota, Montana, Nevada, North Dakota, Oregon, Utah, and Wyoming—all states with substantial surplus milk production. The USDSS assumes that dollar amount is needed to service fluid plants in surplus regions. Then, the USDSS adds an increment to the dual values such that the lowest Class I differential is equal to $1.60 per hundredweight and allows the price relatives to express a Class I differential from that minimum value. (Ex. 302 at 23 [Testimony of Dr. Charles Nicholson].)

> Q. Okay. And one of – one of the elements that we have heard about, and maybe you will hear more about as your cross-examination continues, is what the base was that was included in your model.
>
> Can you talk about that?
>
> A. Yeah. Sure. So another thing that's important for me to maybe clarify is when we run this model, we get a series of price relatives, as I've said. And it's basically about how steep is the price difference, so the marginal value difference between two locations.
>
> So typically what we need to do to actually convert that to something that is equivalent to what we might think of as the current Class I differential surface is we need to establish $1.60 as the minimum. So it would be fairly typical in a model simulation run to have one location that says the marginal value of milk is zero. We don't need any more milk here. There is no additional value from having another hundredweight of milk at this location.

> ***Well, we don't fully believe that the value of milk at any location is zero***. And so what we do to come up with the results that have been shared in the written testimony, and parts of here in the oral testimony this morning, is if we have a value of zero, we say, to align that with the current Class I differential surface, we're going to add a value of $1.60 per hundredweight to that and every other location. So it maintains the price relatives the same, but it takes the level, the minimum level, up to the current minimum level of Class I differentials of $1.60.
>
> And that's important, in part, to be able to compare the apples to apples that you have. Our model simulation results start with $1.60 per hundredweight, so do the Class I differential current surface, and then it makes it a lot more consistent to evaluate the differences between the spatial values of milk in our model and the current Class I differentials.
>
> Q. Okay. And that's what you did here in this case?
>
> A. Yes. That's what we did.

(Tr. 6943:17-6950:13 [Testimony of Dr. Charles Nicholson] (emphasis added).)

29. The USDSS is run for the months of May 2021 and October 2021 to represent both the flush and short months of the year. Milk supplies and components produced are estimated at the county level in the large model and aggregated to multi-county regions in the small model. Milk components are fully accounted for at the state and national levels. The same is true for dairy product consumption, imports, exports, and changes in stocks of dairy products. A mass balance on components is then run to ensure data integrity. Because there were excess components, especially in the October data, small adjustments were made to reduce the excess to levels to be more nearly equivalent to industry shrink. Transportation costs are equal to those of the 2021 USDSS year. These analyses accounted for known recent or near-term expected plant closures, openings, or expansions to represent current processing capacity by county. (Ex. 302 at 23 [Testimony of Dr. Charles Nicholson].)

30. The USDSS provides evidence of the need for change in Class I differentials

because it represents a spatial economic benchmark, but other factors such as existing commercial relationships can be important determinants of optimal spatial organization. The USDSS results provide relevant input for differences in county values but may need to be adjusted based on additional information about the special characteristics of particular locations. In fact, a review of model results for key locations and adjustment process was employed by AMS to specify differentials in 1998. This approach to adjustment is similar to the process used by NMPF to develop its proposed Class I differential values. For the USDSS, an analogy can be drawn to weather forecasts. The outputs of weather models are used as key inputs, but forecasters often adjust the "model guidance" with professional judgment to arrive at a more accurate forecast for a particular locality. (Ex. 302 at 29; Tr. 6928:14-6929:10 [Testimony of Dr. Charles Nicholson].)

31. The USDSS cannot be used to determine the inherent values of classes of milk.

> Q. Okay. And in this very tight-knit world in which we live in the dairy industry, you're familiar with Dr. Stephenson using the modeling in support of MIG's proposals for their differentials; is that right?
>
> A. I recently became aware of the fact that Dr. Stephenson had used model results to provide input to the MIG proposal.
>
> Q. And I think you said earlier that you're kind of the keeper of the model.
>
> Did he have to come to you and ask you for some information?
>
> A. So we have shared a lot of the information, both the inputs and the outputs, throughout the modeling process that was undertaken for National Milk.
>
> In regard to this particular question, I shared information with Dr. Stephenson to allow him to confirm that he had the correct values of spatial milk values from the model. I did not realize the purpose to which that information would be put.
>
> Q. Okay. And what do you understand is the difference in the methodology that he's deploying as compared to what you are doing?

A. Well, the same model is generating the information. And what's happening, somewhat like I described, we make a calculation that makes sure we have a $1.60 minimum Class I differential.

Dr. Stephenson is taking the information from the same model and using it to do some alternative calculations and for a different purpose.

Q. Okay. And what do you understand is the differences in how he's doing his calculation?

A. Okay. So what I understand is a core part of the analysis that's been submitted is to consider the model-generated differences in spatial milk values at Class III and Class I plants, without incorporating the $1.60 differential that is included in our analyses.

Q. Okay. And in your opinion, is it appropriate to use a Class I and Class III comparison in order to evaluate these numbers?

A. So it's a perfectly fine calculation to do to look at the difference between a Class III price and a Class I price, not including what the $1.60 differential would be.

Where I think I have a bit of a difference of opinion is that we have never used this model to try and determine what that minimum Class I differential should be. That is, we have never used this model to try and determine whether $1.60 is an appropriate number. And part of the reason that we have not done that is the model does not really represent the factors that underlie the justification for that $1.60 minimum Class I differential.

So my assessment is, given that the model was not really designed to evaluate what the minimum differential should be because it doesn't incorporate those factors, it is probably not appropriate to use the difference between a Class III model-generated value and a Class I model-generated value to suggest what the minimum Class I differential should be.

Q. Okay. And then I want to take us full circle, which was all the way back to my very first question that I asked when we started, which is, now we're back to we have two plants across the street from one another. And I posed you the question early on, if you have a Class I plant and a Class III plant across the street from each other, how the model impacts the decision to go one way or the other.

Do you remember that?

A. Yes.

Q. And I asked you, well, if you just took those plants and you replaced them with a cheese plant and butter nonfat dry milk plant, would the results change?

And what was your answer?

A. ***My answer was that regardless of the plant types, because of the factors that are included in the model, we would expect to see very similar differences regardless of what class plant or what product plant type that would be. So we would not expect to see large differences based on the factors that are accounted for in the model for the hypothetical situation where a cheese plant and a fluid milk plant are right across the road from each other***.

Q. So is the point there that this model doesn't tell you one way or another which one is the bigger driver between the – between the classes of milk?

A. So I guess I would say that the model is not going to accurately represent what a fluid milk plant should pay to get milk into the plant relative to what a cheese plant should pay. It's really good at describing how the differences across space exist for different fluid milk plants, but it's not designed to account for the fact – or the factors that affect what that minimum Class I differential should be.

Q. And your role here today, Dr. Nicholson, are you here as an advocate for National Milk's proposal or to object or oppose any other proposal?

A. No.

(Tr. 6955:13-6958:22 [Testimony of Dr. Charles Nicholson] (emphasis added).)

32. The USDSS must be supplemented with considerations that are beyond its scope. (Ex. 345 at 2; Tr. 8088:1-13 [Testimony of Rob Vandenheuvel].)

3. Costs to Produce and Move Milk Have Increased Nationally Since Order Reform; Over-Order Premiums Are Declining.

33. The current "base" Class I differential is $1.60 per hundredweight. At Order Reform, USDA identified three constituent parts to this "base" differential: maintenance cost associated with Grade A license for dairy farm ($0.40 per hundredweight); cost of balancing for Class I plants ($0.60 per hundredweight); and incentives to encourage deliveries to Class I plants

($0.60 per hundredweight).[27] (Ex. 336 at 18; Tr. 7832:18-7833:1 [Testimony of Dr. Eric Erba] (citing 63 Fed. Reg. 4802, 4907-09).)

34. While USDA recognized there is a cost associated with the conversion from a Grade B dairy to a Grade A dairy, those conversion costs were not considered; only the cost to the dairy of maintaining its Grade A license was considered. (Ex. 336 at 18; Tr. 7833:2-6 [Testimony of Dr. Eric Erba].)

35. There are costs to establishing a Grade A dairy farm in the first instance, as set forth in the Food and Drug Administration's Grade A Pasteurized Milk Ordinance ("PMO"). Generally speaking, the infrastructure for a Grade A facility, especially the milk room, milking parlor, vestibules, storage rooms, and other facilities must be maintained at a higher sanitary standard. The Grade A facility should provide a clean, well-lit, well-ventilated environment in good repair. A conservative estimate of establishing a Grade A farm is $2.83 per hundredweight. (Ex. 336 at 18-22; Tr. 7833:2-6, 7834:2-15 [Testimony of Dr. Eric Erba].)

36. Likewise, maintaining a Grade A farm has real costs. All the variable costs cited in the analysis establishing Grade A would continue to apply. These would include paying for inspections ($0.05 per hundredweight), increased electricity usage ($0.15 per hundredweight), increased frequency of hauling ($0.06 per hundredweight), and increased chemical usage for sanitation ($0.25 per hundredweight). In addition, the maintenance cost of the physical assets necessary for the dairy farm to meet the Grade A standards should also be included. Estimated

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[27] Proposal 19 did not create a "base" differential in the same manner as Order Reform. However, the elements of the base differential still have validity and should be considered if the Secretary chooses to adopt any or all of Proposal 19 and raise Class I differentials. There is no dispute that costs of maintaining a dairy farm, balancing costs, and the cost to incentivize Class I milk have all increased since Order Reform. Some of these costs are discussed in this section; some of these costs are discussed with the regional specific testimony. *See infra* at 204-277.

maintenance costs for physical assets such as barns and other farm structures range between 2 percent and 5 percent of replacement cost. Using construction costs as a proxy for replacement costs and using 3 percent as the maintenance cost, the cost to maintain the physical structures amounts to $0.85 per hundredweight. As such, the estimated ongoing cost of maintaining a Grade A license is $1.36 per hundredweight. This does not include the non-cash expense of depreciation, which represents about $1.30 per hundredweight. (Ex. 336 at 22-23; Tr. 7836:27-7839:5 [Testimony of Dr. Eric Erba].)

37. A trend in Class I markets is a tendency towards "Grade A+" whereby Class I processors demand higher standards than just Grade A and the standards set in the PMO. For instance, among the quality measures, the most rigorous requirement for Somatic Cell Counts ("SCC") was not greater than 180,000 SCC per milliliter. Some plants required not greater than 300,000, not greater than 350,000, and not greater than 400,000 SCC. No plant allowed milk with SCC above 400,000, which aligns with the export requirement to the European Union. Although the PMO sets the SCC limit at not greater than 750,000, which is the legal maximum for Grade A milk, the practical limit is 400,000, and most Class I plants require substantially lower SCC thresholds. Farms must maintain SCC levels significantly below the technically allowed limit to maintain Grade A status to service the Class I market. (Ex. 310 at 7 [Testimony of Jeffrey Sims].)

38. To achieve lower SCC milk, cooperatives such as Michigan Milk Producers Association ("MMPA") have quality premium programs where SCC premiums and deductions (in addition to Federal Order SCC adjustments computed in the producer pay price) are paid to producers. MMPA also pays modest volume premiums to large farms to recognize the marketing efficiencies associated with single farm loads. This adds costs to supplying the Class I market that are not paid for by Class I handlers. The additional milk quality and volume premiums paid to

producers exceed $0.50 per hundredweight. (Ex. 406 at 11; Tr. 9355:27-9356:9 [Testimony of Brad Parks].)

39. Customers that buy Class I bulk milk have increased their quality standards for milk and have increased their requirements for maintaining sustainability, environmental, and animal welfare programs, such as Farmers Assuring Responsible Management (F.A.R.M.). While dairy farmers support these efforts, they come with additional costs. Customers increasingly discourage cooperatives from supplying them with route milk or comingled loads of milk. Customers prefer to receive a single load of milk from a single farm. (Ex. 406 at 11-12; Tr. 9355:14-23; 9356:23-9357:1 [Testimony of Brad Parks]; *see also* Ex. 376 at 5; Tr. 8700:23-8707:4 [Testimony of Brent Butcher] (noting Arizona dairy farmers participate in F.A.R.M., which creates additional costs to produce Grade A milk).)

40. National retailers, with greater negotiation leverage, have put downward pressure on Class I margins, which in turn puts downward pressure on dairy farmers from Class I plants. Sometimes the retailer and Class I plant are the same. In the Mideast market (FMMO 33), three retailers operate six processing plants. The large retailers can offer cooperatives large milk volumes because of their expanded geographic footprint, but that offer of large milk puts downward pressure on over-order milk premiums in the market. Increasing over-order milk premiums today is more difficult than it was 20 years ago. As a result, over-order premiums have eroded since at least January 2012. (Ex. 406 at 13-14; Tr. 9358:19-28 [Testimony of Brad Parks].)

41. When evaluating milk movement costs, two basic considerations are miles traveled and the demographics of producer farm milk routes. Milksheds with low milk volumes that are "thin" (i.e., that require more stops and miles traveled to assemble a full load) would have a higher miles-hundredweight ratio. Milk haulers operating these routes will typically charge a "per load"

flat rate instead of a "per hundredweight" rate to cover added costs of milk assembly. Milk haulers operating these routes, at least within the Mideast region, will also typically charge a sizeable "stop charge" per producer (i.e., a charge levied upon the farm for each time the truck stops to pick up milk). The stop charge has ranged anywhere from $50 to $200. In contrast, milksheds that are high volume or that are "flush," requiring fewer stops to assemble a full load, will have a lower miles-hundredweight ratio. (Ex. 309 at 1-3; Tr. 7214:21-7215:22 [Testimony of Stephen Zalar].)

42. Input costs, such as labor and fuel, are variable by region of the country. Regardless of the location, the cost of labor for milk hauling has one of the largest percentage increases in comparison to any other cost inputs a milk hauler has faced. The standard hours of service rules require a maximum of 11-hours of work for a commercial truck driver which includes milk haulers. In "thin" milkshed regions where haulers have high miles-hundredweight ratios, the hours-of-service maximum creates a challenge. Hence, a relief driver may be required to complete the milk run. The use of an extra driver during milk assembly and milk delivery adds to a hauler's labor costs. Because of adoption of electronic driver logs, milk hauling operational costs have increased as hauler companies have had to recruit, train, and retain drivers willing to understand and to accept use of these types of technologies. (Ex. 309 at 4-6; Tr. 7217:22-26; 7219:18-7220:2 [Testimony of Stephen Zalar].)

43. Diesel fuel, like labor, will vary based on region and state taxes. Regardless of location, the cost of fuel is more today than in 2000. (Ex. 309 at 6-8; Tr. 7221:4-7 [Testimony of Stephen Zalar].)

44. When the current Class I differential surface was developed using data from around 1998, diesel fuel cost approximately $1.00 per gallon. At an average fuel economy of 5.2 to 5.3 miles per gallon for a typical truck and milk tanker trailer carrying 47,500 pounds of milk, the fuel

cost was about $0.19 or $0.0004 per hundredweight per loaded mile. In contrast, the national average cost of diesel fuel today is closer to $4.50 per gallon, and truck fuel economy has improved to around 6.2 miles per gallon. Consequently, the fuel cost today amounts to approximately $0.71 per loaded mile. With the increased load weights of around 49,500 pounds, the fuel cost reaches about $0.00143 per hundredweight per mile, marking an increase of 3.58 times or 358 percent. (Ex. 310 at 11 [Testimony of Jeffrey Sims].)

45. Other costs have risen as well: tires, equipment (trucks and tankers), license fees and taxes, interest rates on loans, insurance premiums, and costs associated with management and overhead. (Ex. 309 at 7-10; Tr. 7221:18-19, 7223:13-16; 7224:7-9 [Testimony of Stephen Zalar].)

46. The American Transportation Research Instituted ("ATRI") determined that the costs of operating a truck and trailer were $1.676 per mile in 2013, and $2.251 per mile in 2022. The 2022 operations costs are 135 percent of the 2013 rate, over just the last 10 years, not the 25 years since Order differential rates were last evaluated. The ATRI data are quoted per running mile, so the per loaded mile equivalent would be $3.352 for 2013, and $4.502 for 2022. (Ex. 310 at 10 [Testimony of Jeffrey Sims].)

47. Given these costs, the likelihood of start-up milk hauling businesses is low; it is a capital-intensive business with multiple challenges to manage. For the most part, cooperatives have entered the milk hauling business to assure that the cooperative owner-members' milk will be hauled and marketed. In several instances, the cooperative entering the hauling business was initiated due to an urgent need with little advanced warning of a disruption to the milk hauling logistics in a territory. Higher hauling rates contribute to uncertain farm profit margins on farms, which may accelerate farm exits from the dairy industry. (Ex. 309 at 10-11; Tr. 7226:16-18, 7227:5-11 [Testimony of Stephen Zalar].)

48. The Class I differentials in Proposal 19 would increase differential revenues of the 11 FMMOs by approximately 56 percent, based on the two representative months from 2022. When compared to a hauling cost increase of 100 to 150 percent, the requested regulated differential price only mitigates a small portion of the hauling cost increase. (Ex. 310 at 16 [Testimony of Jeffrey Sims].)

49. It is important to understand that a 56 percent increase in Class I differential revenues does not equate to a 56 percent increase in the regulated cost of Class I milk. At an average of $4.09 nationally, the new differential levels in Proposal 19 would represent just under 21 percent of the total regulated Class I costs. Thus, the proposed increase in Class I differentials would raise the regulated cost of Class I milk under the FMMOs by slightly less than 8 percent. (Ex. 310 at 17 [Testimony of Jeffrey Sims]; *see also* Ex. 315.)

4. The USDSS Cannot Account for All Factors Affecting Milk Movement: Regional Variations Are Justified.

The NMPF Process for Developing 3108 Updated Class I Differentials.

50. The process employed in developing the proposed updates to the Class I differential surface was collaborative and relied heavily on the expertise and local market knowledge of multiple staff members of numerous NMPF member cooperatives. (Ex. 310 at 21 [Testimony of Jeffrey Sims].)

51. NMPF established four regional working groups: the Northeast-Mideast region (FMMO 1 and FMMO 33 Marketing Areas, plus some unregulated territory); the Midwest region (FMMO 30 and the eastern portion of FMMO 32, plus some unregulated territory); the Southeast-Southwest region (FMMO 5, FMMO 6, FMMO 7, and FMMO 126, plus some unregulated territory); and the Western regional Working Group (FMMO 51, FMMO 124, and FMMO 131, the western portion of FMMO 32, plus the large unregulated territories of the western states).

(Ex. 310 at 21 [Testimony of Jeffrey Sims].)

52. The entire Class I working group employed a straightforward process similar to USDA's process from Order Reform in using the USDSS. To begin, three runs of the USDSS were completed, with improvements to the quality of the data each time. The entire Class I working group then analyzed the USDSS output, and collaboratively, in a face-to-face meeting, developed a set of initial Class I differentials for 19 cities, all of which were located near the border of two regions. These were labeled "anchor cities." The anchor city Class I differentials aided the regional working groups with a starting point for development of regional recommendations. (Ex. 310 at 22 [Testimony of Jeffrey Sims].)

53. Then, each regional working group developed the recommended Class I differential surface for the geographic area assigned to them. These regional working groups became colloquially referred to as the "colored pencil crews," in recognition of the need for deep dive, "hands-on" attention to the USDSS output and with a nod to an earlier method of doing this work with paper maps before computer-assisted methods became more widespread. Members of the regional working groups extended to cooperative staff members, beyond the members of the Class I working group, with day-to-day responsibilities in routing milk, balancing milk supplies, and selecting optimal farm to market supplies and deliveries of milk to real-life buyers and users of Class I milk. In other words, these are people who know their markets, where milk comes from, where it goes to, and why. (Ex. 310 at 22-23 [Testimony of Jeffrey Sims].)

54. As each regional working group completed the initial Class I differential recommendations, the recommendations were provided to the entire Class I working group. Neighboring regions then collaborated to align Class I prices across FMMOs or regional lines. There were a few minor adjustments on border areas. This process progressed until all four regions

completed their recommendations and their recommendations aligned with their neighboring regions. (Ex. 310 at 23 [Testimony of Jeffrey Sims].)

55. The number of adjustments made to satisfy price alignment criteria inter-regionally was small, and the magnitude of the few changes was small, often only $0.05 or $0.10. (Ex. 310 at 23 [Testimony of Jeffrey Sims].)

Northeast (FMMO 1 and Adjacent Unregulated Areas).

56. To update Class I differentials, the Northeast working group used the closest in proximity anchor city, Winchester, Virginia, at the USDSS average value of $4.50 per hundredweight for the county in which it is located (Frederick County), which is $1.70 higher than the current differential of $2.80 per hundredweight, to determine the proposed differentials for the remainder of the region. For context surrounding why Winchester was important to use as an anchor city and how its values are then used as a basis for the remainder of the Northeast region, it is important to understand this city's relationship with the Southeast milk markets and then with the Northeast milk markets. Winchester represents the southern edge of the Northeast milk marketing area and abuts to the Southern milk marketing areas. Because of its proximity to both areas, it is important for the milk that is being delivered to Winchester to be priced appropriately as to not give an advantage, or disadvantage, to one Order or another. If values had not been competitive for deliveries into Winchester compared to delivery points further south, milk could be delivered directly to FMMO 5 plants from FMMO 1 to gain higher differentials and potentially leave FMMO 1 plants unfilled, resulting in disorderly milk marketing. This practical application of making Winchester relatively comparable to the Southeast region is then extrapolated to the remainder of the Northeast to ensure that FMMO 1 milk maintains deliveries into FMMO 1 plants to support the infrastructure investments within the region, without providing a disproportionate

advantage to move milk to other FMMOs. (Ex. 360 at 11; Tr. 8487:14-21, 8488:12-8489:10 [Testimony of Skylar Ryll].)

57. By utilizing Winchester as the anchor city, the Northeast working group moved through the remainder of the region by looking at historical differential relationships from the anchor city, along with how the USDSS results related the surrounding counties to the anchor city. Ultimately, the regional working group proposed differentials for all counties within our region that were very much in line with the May and October 2021 USDSS average, resulting in an average differential higher than the USDSS suggested by $0.01 per hundredweight. Only 24 out of 274 counties within Proposal 19 for the Northeast represented values higher than the October 2021 USDSS, which included higher costs than May 2021. This variance is primarily due to historical milk movements in these counties. (Ex. 360 at 11; Tr. 8487:22-8488:8 [Testimony of Skylar Ryll].)

58. The Northeast working group attempted, where possible, to maintain historical price alignment so as to avoid creating competitive advantages. For example, the current Class I differential relationship between Landover, Maryland and Frederick, Maryland is $3.00 per hundredweight at Landover versus $2.90 per hundredweight at Frederick for a difference of $0.10 per hundredweight. Continuing with this two-city example, the USDSS suggests the Class I differentials should be increased to $4.90 per hundredweight for Landover, Maryland and to $4.55 per hundredweight for Frederick, Maryland. The resulting price relationship then becomes $0.35 per hundredweight, which is significantly higher than the current price relationship. Recognizing that these two locations are only about 55 miles apart and recognizing both are in the same competitive market, a $0.35 per hundredweight difference would create an artificial competitive advantage of one processor over another relative to the regulated cost of raw milk. NMPF took

this into consideration when proposing revisions to the USDSS' results for NMPF's Class I differential proposal by trying to preserve historical price relationships for which the USDSS cannot account. In another example, when comparing Philadelphia, Pennsylvania to York, Pennsylvania the current difference is $0.15 per hundredweight. The USDSS increased Class I differentials for both locations by $1.65 per hundredweight, thus preserving the historic price relationship. (Ex. 359 at 5-6; Tr. 8393:24-8395:7 [Testimony of Mike John].)

59. There were some instances where the regional working group utilized its collective expertise on milk movements and historical relationships with milk sheds to smooth out county differentials to reduce negative impacts to dairy farmers and Class I processing facilities. This helps prevent disorderly milk marketing and supports meeting Class I demand on a routine basis. (Ex. 360 at 14; Tr. 8490:10-16 [Testimony of Skylar Ryll].)

60. For example, there has been significant change in the production in Western and central New York and New Jersey since 2000. As a result, there are specific regions within New York that move away from the current differential pattern, including in Western and central New York. In general, Proposal 19 suggests flatter differentials in Western New York and more alignment with Western Pennsylvania differentials. Proposal 19 adjusts the differentials for changes in manufacturing assets, Class I utilization, and milk movement dynamics in the region that have occurred since 2000. At the time of Order Reform, the New York counties of Erie and Genesee had significant manufacturing plant capacity, with some Class I facilities that serviced the Buffalo and Rochester markets. Since then, there has been significant expansion in Class I processing in both counties, with more expansion that has been recently announced by Empire State Development in Genesee County. (Ex. 360 at 15; Tr. 8490:25-8491:20 [Testimony of Skylar Ryll].)

61. The Western New York marketplace has attracted other manufacturing investments, with more to be completed soon. Since 2000, there has been Class II investment in Genesee County. There is also a significant expansion in Class III manufacturing underway just south of there in Cattaraugus County in the coming year. The Cattaraugus County manufacturing facility will replace assets that are currently operating within Allegany County, and, according to the press release, the new facility will double the milk consumption of the existing plant. Although these counties are next to each other, and the facilities will be less than 20 miles apart, in the current differential structure, the counties would fall in different zones. Within Proposal 19, Allegany and Cattaraugus counties have been proposed to be at the same zone differential due to this transition and ultimately to be at the same level as the remainder of Western New York and Western Pennsylvania under the proposed flatter Class I differential structure. Regardless of the Secretary's decision on Class I differentials nationally, a modification should be made to align the differentials between Alleghany and Cattaraugus counties to reduce any disorderly marketing of milk within Western New York that would negatively impact farms. (Ex. 360 at 15-16; Tr. 8492:2-23 [Testimony of Skylar Ryll].)

62. The way that the milk supply moves to facilitate the demand within Western New York has changed as the demand has changed. Today, due to the investments and milk supply/demand dynamics, milk is moving in different directions in Western New York to fill demand, while some is staying local or moving to fill demand in central New York. Additionally, milk moves routinely North to South from the Western New York counties of Cattaraugus, Chautauqua, Allegany, Steuben, and Wyoming, to fill demand in Western Pennsylvania. These milk movements indicate that milksheds are overlapping for multiple different demand points for Western New York produced milk. Thus, a flattened zone differential structure would create fewer

challenges when moving milk to meet demand. (Ex. 360 at 16; Tr. 8493:16-8494:7 [Testimony of Skylar Ryll].)

63. In addition to the Class I investment that has already occurred in Western New York, a recent announcement by New York State Governor Hochul announced plans for a new five-million-pounds-per-day dairy beverage facility with some assumed Class I production in Monroe County, New York, to be completed in the coming years. (Tr. 8491:21-8492:1 [Testimony of Skylar Ryll].)

64. At the time of Order Reform, it was necessary to have a lower price in the Buffalo region (Erie County) to remain competitive with Class I plants in Western Pennsylvania that had a lower price. As Western Pennsylvania's differentials increase with the current proposal, it makes sense to create a flatter, common $4.00 zone in all Western New York and Western Pennsylvania. This also eliminates the difference between the Buffalo region (Erie County) and Rochester (Monroe County) markets. This creates a level playing field for milk costs from a common supply area moving in different directions. (Ex. 360 at 16; Tr. 8494:8-21 [Testimony of Skylar Ryll].)

65. The Western New York differentials should flatten compared to Western Pennsylvania in order to align blend prices. Due to the overlapping milksheds competing for farm milk between these two regions, alignment is necessary to not cause uneconomic milk movement and unequal raw product costs for processors. This is a difficult job to do when taking into consideration the different FMMOs (1 and 33) and the differing utilizations and pricing. Today, plants in Western Pennsylvania are in the $2.10 zone, but further east in Western New York the current differential reaches as high as $2.30. There is potential for misalignment between the FMMOs if the differentials in Western New York relative to Western Pennsylvania are lower than Proposal 19. The working group carefully considered blend price alignment between Western New

York and Western Pennsylvania in an effort to not impact current market dynamics between handlers and producers who face different pooling access and producer prices between FMMOs. The milk marketed in the unregulated area between FMMO 1 and FMMO 33 has functioned as a buffer, but state regulation, whether by New York or Pennsylvania, is limited in the ability to solve potential misalignment. (Ex. 360 at 16-17; Tr. 8494:22-8495:5, 8495:21-8496:4 [Testimony of Skylar Ryll].)

66. Moving east from Western New York to central New York, Onondaga and Madison counties are proposed at $0.20 higher than the average USDSS results and $0.20 higher than the flattened zone in Western New York. This is to enhance the current relationship that these counties have with Suffolk County, Massachusetts as well as other regions of New York. Currently, there is a $0.75 spread between the counties while in the proposal there would be a $0.90 spread. The cost to transport from central New York to other regions including New England and New Jersey continues to escalate and the proposal reflects this increased cost. This is important to ensure these milk movements going forward will fulfill demand with adequate supply. (Ex. 360 at 17; Tr. 8496:7-26 [Testimony of Skylar Ryll].)

67. Another item relative to central New York is the relationship between Oneida and Madison counties. The USDSS average results suggested two different differentials for these two counties, while Proposal 19 uses the same Class I differential for both Madison and Oneida counties. Within these counties, there are three primary manufacturing facilities – one a pool distributing plant, one a pool supply unit plant, and one a pool supply plant. Two of the three facilities are operated by the same organization and are often looked at as a unit for milk marketing purposes. As such, it would create disorderly marketing if these plants were separated by zones as they are utilizing milk from the same supply areas and milk is often swapped between the two to

maintain an adequate operating supply. (Ex. 360 at 18; Tr. 8496:27-8497:13 [Testimony of Skylar Ryll].)

68. Moving south from New York, the proposed differentials for the state of New Jersey address some transportation related challenges associated with servicing the New Jersey market. New Jersey largely relies on out-of-state milk production to fulfill consumer demand and typically brings in milk supplies from surrounding regions like New York and Pennsylvania. To transport milk into New Jersey, there are additional costs, including additional bridge tolls when exiting the state and returning to New York or Pennsylvania and decreased payload of trailers. The reduction in payload reduces overall efficiencies for hauling companies and therefore increases costs while delivering into New Jersey. Today, milk movements from Lancaster County, Pennsylvania to Philadelphia County, Pennsylvania maintain the same zone differential as milk movements from Lancaster County to Burlington County, New Jersey. However, to acknowledge the cost factors at play to service new Jersey from southeast Pennsylvania, the working group built in a $0.10 per hundredweight difference between southeastern Pennsylvania counties compared to Southern New Jersey instead of maintaining the same spread as the current differentials. (Ex. 360 at 18; Tr. 8497:14-8498:20 [Testimony of Skylar Ryll].)

69. Turning to the northern states in the region, the differentials generated by the USDSS were lower for Maine and Southeastern New Hampshire. However, there are two Class I plants in Cumberland County, Maine that rely on local milk. If the USDSS results were adopted unchanged, the respective differentials would have incentivized Maine milk to leave the state for plants in Eastern Massachusetts. Additionally, the Southern New Hampshire milk would have been incentivized to flow into Western Massachusetts. To prevent incentivizing counterintuitive milk movements, the working group flattened the proposed Class I differentials for the Maine zones to

keep the relationships consistent with the current Class I differentials. The average increase for Class I differentials in Maine was $0.39 per hundredweight above the USDSS. (Ex. 370 at 2; Tr. 8586:9-24 [Testimony of Scott Werme].)

70. In Vermont's northernmost counties, the working group reduced the differentials by $0.20 per hundredweight from the USDSS. In this region, there are no significant delivery points, and none are expected in the near future. Milk generally flows to Eastern Massachusetts, Western Massachusetts, and Vermont points further south. The lower differentials in Northern Vermont provide more of a slope to incentivize milk movements and better offset the cost of moving milk to these locations. (Ex. 370 at 2; Tr. 8586:27-8587:19 [Testimony of Scott Werme].)

71. In Northern New York, the working group reduced differentials $0.15 per hundredweight below the USDSS. This was especially necessary for the significant supply in St. Lawrence and Jefferson counties. Milk from these counties needs to move east. The lower differentials at the source counties increase the slope needed to incentivize appropriate milk movements to Northeastern New York and Northern and central Vermont. (Ex. 370 at 2-3; Tr. 8587:20-8588:18 [Testimony of Scott Werme].)

72. The reason for these detailed changes in this region is the change in costs since Order Reform. Constant ebbs and flows of milk orders placed by customers and their subsequent effects on the movement of milk are a fact of supplying the Class I market. This balancing adds additional costs and requires a steady and reliable source of revenue to serve the market. For example, MDVA's members own and operate one pool distributing plant and one pool supply plant in FMMO 1. The majority of MDVA's member milk is received and processed by Class I plants, including the plants owned by MDVA's members, serving FMMOs 1 and 5. MDVA is constantly moving milk from supply points located in FMMO 1 to demand points located in

FMMO 1 or FMMO 5. (Ex. 359 at 1-2; Tr. 8387:20-8388:2, 8388:19-28 [Testimony of Mike John].)

73. The cost of moving milk in FMMO 1 has greatly increased since the early 2000s. To continue to meet customer demands for milk, MDVA's dairy farmer members must make up the difference in that cost, which comes directly out of their monthly milk checks. (Ex. 359 at 3; Tr. 8389:11-16, 8389:28-8390:3 [Testimony of Mike John].)

74. The chart below shows how costs have risen for MDVA. The figures below are "running mile rates"; loaded mile rates would be double the rates below. (Ex. 359 at 3; Tr. 8390:9-13 [Testimony of Mike John].)

Round Trip Miles = 171						
Year	**Origin**	**Destination**	**Ave Load LBS**	**Total $**	**Rate Per Mile (RPM)**	**RPM % Change**
2008	Federal Order 1	Federal Order 1	47,500	$450.02	$2.63	
2023	Federal Order 1	Federal Order 1	55,000	$701.47	$4.10	
Difference			**7,500**	**$251.45**	**$1.47**	**56%**
Round Trip Miles = 732						
Year	**Origin**	**Destination**	**Ave Load LBS**	**Total $**	**Rate Per Mile (RPM)**	**RPM % Change**
2008	Federal Order 1	Federal Order 5	48,500	$1,118.07	$1.53	
2023	Federal Order 1	Federal Order 5	51,000	$1,883.53	$2.57	
Difference			**2,500**	**$765.46**	**$1.04**	**68%**
Round Trip Miles = 303						
Year	**Origin**	**Destination**	**Ave Load LBS**	**Total $**	**Rate Per Mile (RPM)**	**RPM % Change**
2008	Federal Order 5	Federal Order 5	47,500	$599.55	$1.98	
2023	Federal Order 5	Federal Order 5	49,000	$982.79	$3.24	
Difference			**1,500**	**$383.24**	**$1.26**	**64%**

(Ex. 359 at 4 [Testimony of Mike John].)

75. The changes within the northeastern states provide some clear examples of these systemic shifts within the industry since 2000. (Ex. 360 at 2; Tr. 8476:3-7 [Testimony of Skylar Ryll].)

76. According to the USDA, all but one of the states within the Northeast region decreased milk production from 2000 to 2022. The decreases seen across the 11 states of Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, Pennsylvania, Rhode Island, Vermont, and Virginia amounted to 3.043 billion pounds per year of milk from 2000 to 2022. However, growth in milk production in New York more than compensated for the combined loss with growth of 3.739 billion pounds per year from 2000 to 2022. Overall, total milk production grew by 696 million pounds, or 2.2 percent, from 2000 to 2022. (Ex. 360 at 3; Tr. 8476:13-25 [Testimony of Skylar Ryll].)

77. Milk production is decreasing where the resident population is increasing in the Northeast region. Total resident population across the area grew by almost 6.1 million people, or 9.1 percent from 2000 to 2022. The states with the most population growth from 2000 to 2022 were Maryland, New Jersey, Pennsylvania, and Virginia. These four states correlate with some of the highest milk production declines seen within the Northeast region with declines of 509 million pounds, 157 million pounds, 1,207 million pounds, and 476 million pounds, respectively. . (Ex. 360 at 4; Tr. 8477:5-16 [Testimony of Skylar Ryll].)

78. Although there has been an overall decline in consumption per person, some states have seen a rapid increase in the percentage of milk that needs to be brought in from out of state to meet consumer demand for fluid milk due to increases in resident population and decreases in milk production. This has resulted in increased transportation cost to bring milk supplies to these milk deficit regions for processing and, ultimately, for consumer consumption. (Ex. 360 at 5; Tr. 8478:14-22 [Testimony of Skylar Ryll].)

79. Along with population shifts and shifts in the location of milk production, from December 2001 to December 2022, the number of pool distributing plants operating within FMMO

1 decreased from a total of 63 to 49, due to industry consolidation and plant closures. The lost Class I production capacity has most heavily affected differentials at or above $3.00 per hundredweight. Examples of lost Class I production capacity within the $3.00 per hundredweight and above zones include the closures of Sunnydale Farms in Brooklyn, New York during 2005, Tuscan Dairy in Union, New Jersey during 2005, Farmland Dairies in Wallington, New Jersey during 2013, Elmhurst Dairy in Jamaica, New York during 2016, and Readington Farms in Whitehouse Station, New Jersey during 2022. These areas are more urban, being located along the eastern side of the Northeast region. (Ex. 360 at 7-8; Tr. 8479:28-8481:8 [Testimony of Skylar Ryll].)

80. As the relative volume of Class I processing has decreased in the $3.00 and above zones but with some demand still existing within those zones, and as growth in Class II and III has primarily been in $2.70 and below zones, local milk supplies are being utilized to fulfill Class II and III demand while Class I milk supplies must travel further today at a higher cost per mile than before. Though it is likely that there is less mileage associated with servicing plants where the primary growth has occurred for Classes II and III due to proximity to milk supply, there has been higher costs associated with transportation than there were in 2000. (Ex. 360 at 8; Tr. 8482:2-19 [Testimony of Skylar Ryll].)

81. DFA, as a cooperative with investment in hauling assets since 2002, has tracked costs associated with maintaining a fleet for the purpose of transporting raw milk from the farm to the processing location. These costs include the purchase of physical assets including trucks, trailers, and tires, as well as the cost associated with labor, insurance, and fuel. (Ex. 360 at 9; Tr. 8483:10-16 [Testimony of Skylar Ryll].)

Hauling cost factors, Dairy Farmers of America, Northeast Area				
	Year			
Hauling equipment costs	**2003**	**2022**	**Difference**	**% change**
Tractor, day cab	$ 81,300	$ 165,587	$ 84,287	104%
7,500 gallon, 2 compartment trailer	$ 50,210	$ 162,796	$ 112,586	224%
	Month / Year			
Other hauling costs	**Mar 2005**	**Jan 2023**	**Difference**	**% change**
Average labor rate, per hour	$ 12.50	$ 30.00	$ 17.50	140%
Average vehicle insurance, per vehicle, per year	$ 8,000	$ 11,100	$ 3,100	39%
	Year			
Diesel fuel costs	**2002**	**2022**	**Difference**	**% change**
Average price per gallon of No 2 diesel fuel, New England (PADD1A)[1]	$ 1.4048	$ 5.2720	$ 3.8672	275%
Average price per gallon of No 2 diesel fuel, Central Atlantic (PADD1B)[1]	$ 1.4032	$ 5.3538	$ 3.9506	282%

(Ex. 360 at 9 [Testimony of Skylar Ryll].)

82. Other factors contribute to increased costs as well. Today, there are not consistent laws within the northeastern states that allow for the same weights to be carried on trucks and trailers. As many loads travel across state lines, not being able to take advantage of increased weight capacities decreases efficiencies in the supply chain and increases cost. (Ex. 360 at 10; Tr. 8484:26-8485:11 [Testimony of Skylar Ryll].)

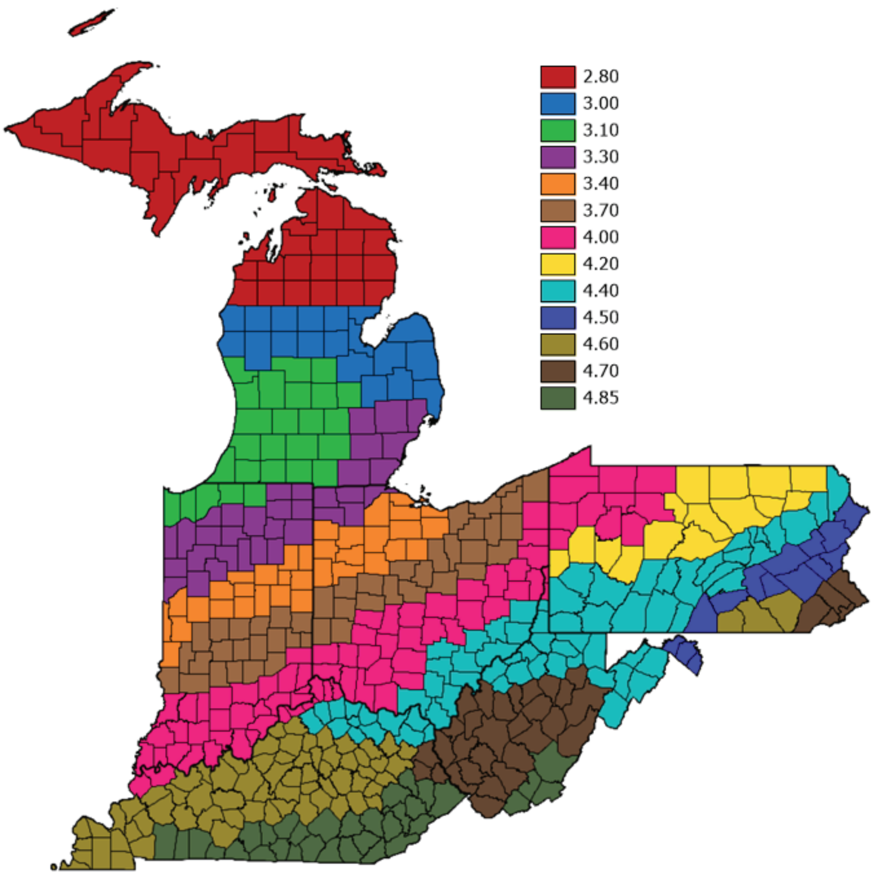
83. From 2000 to 2021, it is estimated that transportation costs paid by dairy farmers increased an average of $0.70 per hundredweight in the Northeast region. (Ex. 360 at 10; Tr. 8486:3-7 [Testimony of Skylar Ryll].)

Mideast (FMMO 33)

84. The geographic boundaries of the Mideast area roughly match those of FMMO 33 and a small portion of FMMO 5. It is comprised of six states, in whole or in part – Michigan, Ohio, Indiana, Kentucky, Pennsylvania, and West Virginia. The principal milk supplies of the Mideast area are found in central and Northeast Michigan, Northern Indiana, and Northwestern Ohio. Class I plants are scattered throughout the Mideast area but are typically close to large cities (e.g., Detroit, Grand Rapids, Indianapolis, Columbus, and Pittsburgh). The Mideast area also has many

small to medium-sized cheese plants in Northeast Ohio, two large cheese plants in central and western Michigan, and one large cheese plant in Eastern Pennsylvania. Milk powder plants and milk condensing plants are more numerous north and west of the Mideast Area. Over the last 25 years, the market has become increasingly milk deficit to the south (toward Kentucky) and to the east (toward Pennsylvania). (Ex. 336 at 2; Tr. 7810:16-7811:23 [Testimony of Dr. Eric Erba].)

Figure 1. NMPF proposed Class I differentials for six states in the Mideast Area



(Ex. 336 at 15; Tr. 7829:27-7830:7 [Testimony of Dr. Eric Erba].)

85. To develop the differentials in Proposal 19, the Mideast area working group developed anchor points, focusing on the larger cities initially. The working group used Charleston, West Virginia at $4.70 per hundredweight as the reference standard to preserve relative pricing relationships with the Northeast and Southeast working groups. From Charleston, the working group established values at other significant milk processing cities by moving north to

Sharpsville, Pennsylvania; moving west to Winchester, Kentucky; moving southwest to Nashville, Tennessee; moving west to Indianapolis, Indiana; and moving far north to Grand Rapids, Michigan. (Ex. 336 at 7; Tr. 7816:18-7817:1 [Testimony of Dr. Eric Erba].)

86. To begin the process of assigning values to the interior anchor points, the working group developed 10 two-city pairings. The process allowed the working group to discuss and to debate the relative value differences and the rationale for the differences. The objective was consistent in each of the pairings—i.e., to determine what value difference was needed to encourage milk to move from milk supply areas located in the north and in the west of the Mideast area to the areas of demand. Relative Class I value differences were decided by an independent assessment of staff representing four NMPF member cooperatives marketing milk in the Mideast area—DFA, MMPA, FF, and Prairie Farms. (Ex. 336 at 7; Tr. 7817:2-16 [Testimony of Dr. Eric Erba].)

87. First pairing: Chicago, Illinois – Grand Rapids, Michigan (distance of 180 miles). There is ample milk production around Chicago and around Grand Rapids, and there are no longer any fluid milk processing plants operating in the Chicago metropolitan area. All of the packaged product in the Chicago area is brought in from Grand Rapids, Michigan; Cedarburg, Wisconsin; Rockford, Illinois; or Dubuque, Iowa. To maintain Class I value continuity, the Class I differential in Chicago should be aligned with the prices at these other locations supplying packaged milk to Chicago. The Chicago Class I differential (Cook County) should be set at $3.20 per hundredweight and the Grand Rapids Class I differential (Kent County) at $3.10 per hundredweight. (Ex. 336 at 8; Tr. 7817:25-7818:11 [Testimony of Dr. Eric Erba].)

88. Second pairing: Grand Rapids, Michigan – Marquette, Michigan (distance of 400 miles). Marquette has a small population and an adequate milk supply to cover the needs of

Michigan's Upper Peninsula. Milk does not need to move far in the Upper Peninsula to get to the local Class I plant, and Upper Peninsula milk tends to stay local; it would not typically move south to other processing locations in Michigan. The Grand Rapids Class I differential (Kent County) should be set at $3.10 per hundredweight and the Marquette Class I differential (Marquette County) at $2.80 per hundredweight. The relative difference of $0.30 per hundredweight places more value on locations further south, which are closer to larger population centers and closer to more processing plants. (Ex. 336 at 8; Tr. 7818:12-27 [Testimony of Dr. Eric Erba].)

89. Third pairing: Grand Rapids, Michigan – Elkhart, Indiana (distance of 100 miles). Only a short distance separates the two locations, and milk production is ample around both cities. There is no need to encourage milk to move between the two locations; milk should have the same relative value at Grand Rapids and at Elkhart. The Grand Rapids Class I differential (Kent County) should be set at $3.10 per hundredweight and Elkhart Class I differential (Elkhart County) at $3.10 per hundredweight. (Ex. 336 at 8-9; Tr. 7818:28-7819:10 [Testimony of Dr. Eric Erba].)

90. Fourth pairing: Elkhart, Indiana – Indianapolis, Indiana (distance of 160 miles). Indianapolis is a large metropolitan area with a large population. There are several Class I plants in and around the Indianapolis metropolitan area. However, there is not much local milk near Indianapolis so milk from supply locations to the north needs to be encouraged to move south toward Indianapolis. The Elkhart Class I differential (Elkhart County) should be set at $3.10 per hundredweight and the Indianapolis Class I differential (Marion County) at $3.70 per hundredweight. The difference of $0.60 per hundredweight places more value on the location further south and east and located more distant from the milk supply. (Ex. 336 at 9; Tr. 7819:11-25 [Testimony of Dr. Eric Erba].)

91. Fifth pairing: Indianapolis, Indiana – Columbus, Ohio (distance of 175 miles). Both

cities have significant populations, but neither city is close to a milk supply. Logistically, it is easier to move milk to Indianapolis from Northern Indiana than to get milk into Columbus. The natural flow of milk is from north to south and from west to east. However, milk still needs financial encouragement to move, especially west to east. The Indianapolis Class I differential (Marion County) should be set at $3.70 per hundredweight and the Columbus Class I differential (Franklin County) at $4.00 per hundredweight. The difference of $0.30 per hundredweight places more value on locations further east. (Ex. 336 at 9; Tr. 7819:26-7820:11 [Testimony of Dr. Eric Erba].)

92. Sixth pairing: Columbus, Ohio – Cleveland, Ohio (distance of 150 miles). Logistically, it is relatively easy to get milk from Michigan into Cleveland via I-90. The mileage is significant, but they are relatively easy miles on interstate highways. The Cleveland Class I differential should be lower than Columbus and about the same as Indianapolis. The Columbus Class I differential (Franklin County) should be set at $4.00 per hundredweight and the Cleveland Class I differential (Cuyahoga County) at $3.70 per hundredweight. The difference of $0.30 per hundredweight places more value on the location further south. (Ex. 336 at 10; Tr. 7820:12-24 [Testimony of Dr. Eric Erba].)

93. Seventh pairing: Columbus, Ohio – Sharpsville, Pennsylvania (distance of 195 miles). Western Pennsylvania has a large cheese plant and a large Class I plant within 50 miles of each other with little local supply. Being a milk deficit area already and becoming more milk deficit each year, milk needs to move into the area from supply points located to the west. Milk needs financial encouragement to move to the Class I plant instead of moving to the local cheese plant. Milk haulers are challenged by long distance hauls from Mideast area supply locations and are reluctant to move milk from Michigan or Northern Indiana that far to the east because of the

strain on drivers, who are increasingly difficult to hire and to retain. There are also concerns about violating Department of Transportation driver hours of operation regulations. The best opportunity to get milk to the east is to stairstep milk by pulling milk from Eastern Ohio and backfilling with milk from Western Ohio, Northern Indiana, or Michigan. Eastern Ohio is already milk deficit because of the abundance of milk processing plants in the region; both Columbus and Sharpsville have similar challenges for milk movements. As such, their Class I differentials should be aligned. The Columbus Class I differential (Franklin County) should be set at $4.00 per hundredweight and the Sharpsville Class I differential (Mercer County) at $4.00 per hundredweight. (Ex. 336 at 10; Tr. 7821:6-7822:5 [Testimony of Dr. Eric Erba].)

94. Eighth pairing: Columbus, Ohio – Cincinnati, Ohio (distance of 110 miles). There is not much milk in Southern Ohio or Southern Indiana. Milk does not move north out of Kentucky to Cincinnati because Kentucky is already milk deficit. To service customers consistently, milk must move from the northern part of the Mideast Area to the south. Both locations have similar challenges for milk movements. Once milk gets to Columbus, it is relatively easy to get the milk to Cincinnati on I-71. The Columbus Class I differential (Franklin County) should be set at $4.00 per hundredweight and the Cincinnati Class I differential (Hamilton County) at $4.00 per hundredweight. (Ex. 336 at 10-11; Tr. 7822:6-19 [Testimony of Dr. Eric Erba].)

95. Ninth pairing: Cincinnati, Ohio – Winchester, Kentucky (distance of 100 miles). There is not much local supply in central Kentucky; it is a milk deficit state. Most of the local Kentucky milk is shipped to a large Class I plant in Winchester, Kentucky. However, there is not enough nearby milk to supply that plant's milk needs. Logistically, the distance and driver time are limiting factors to get milk to move that far south in the Mideast Area. Also, terrain and road quality are not as conducive to hauling milk in Kentucky. There must be incentives in place to

encourage milk to move out of Northern Indiana, Northwestern Ohio, or Michigan and into Kentucky. The Cincinnati Class I differential (Hamilton County) should be set at $4.00 per hundredweight and the Winchester Class I differential (Clark County) at $4.60 per hundredweight. The difference of $0.60 per hundredweight places more value on the location further south. (Ex. 336 at 11; Tr. 7822:20-7823:9 [Testimony of Dr. Eric Erba].)

96. Tenth pairing: Cincinnati, Ohio – Charleston, West Virginia (distance of 210 miles). West Virginia is a milk deficit area that is becoming more deficit as dairy farms exit the dairy business. To supply customers, milk must move from northern and western supply locations. Terrain and road quality are not as conducive to hauling milk in West Virginia. The best opportunity to move milk to the east is to stairstep milk by pulling milk from Eastern Ohio and backfilling with milk from Northwestern Ohio, Northern Indiana, or Michigan. The Cincinnati Class I differential (Hamilton County) should be set at $4.00 per hundredweight and the Charleston Class I differential (Kanawha County) at $4.70 per hundredweight. The difference of $0.70 per hundredweight places more value on the location further east. (Ex. 336 at 11; Tr. 7823:10-7824:13 [Testimony of Dr. Eric Erba].)

97. After the relative value differences among the 10 two-city pairings were established, the regional working group expanded the analysis to include additional cities. The 29 cities selected represent locations of pool distributing plants and major milk processing plants

categorized as Class I, Class II, Class III, or Class IV. (Ex. 336 at 11; Tr. 7824:14-19 [Testimony of Dr. Eric Erba].)

Table 5. Comparison of current and proposed Class I differentials in 29 cities relevant to the Mideast Area

City	County	State	Current Differential	Proposed Differential	Difference
Chicago	Cook	Illinois	$1.80	$3.20	$1.40
Marquette	Marquette	Michigan	$1.80	$2.80	$1.00
Grand Rapids	Kent	Michigan	$1.80	$3.10	$1.30
Remus	Mecosta	Michigan	$1.80	$3.00	$1.20
Allendale	Ottawa	Michigan	$1.80	$3.10	$1.30
St. John	Clinton	Michigan	$1.80	$3.10	$1.30
Cass City	Tuscola	Michigan	$1.80	$3.00	$1.20
Detroit	Wayne	Michigan	$1.80	$3.30	$1.50
Livonia	Wayne	Michigan	$1.80	$3.30	$1.50
Elkhart	Elkhart	Indiana	$1.80	$3.10	$1.30
Goshen	Elkhart	Indiana	$1.80	$3.10	$1.30
Huntington	Huntington	Indiana	$1.80	$3.30	$1.50
Indianapolis	Marion	Indiana	$2.00	$3.70	$1.70
Richmond	Wayne	Indiana	$2.00	$3.70	$1.70
Canton	Stark	Ohio	$2.00	$3.70	$1.70
Dayton	Montgomery	Ohio	$2.00	$3.70	$1.70
Columbus	Franklin	Ohio	$2.00	$4.00	$2.00
Cleveland	Cuyahoga	Ohio	$2.00	$3.70	$1.70
Cincinnati	Hamilton	Ohio	$2.20	$4.00	$1.80
Springfield	Clark	Ohio	$2.00	$4.00	$2.00
Tipp City	Miami	Ohio	$2.00	$3.70	$1.70
Orrville	Wayne	Ohio	$2.00	$3.70	$1.70
Newark	Licking	Ohio	$2.00	$4.00	$2.00
Sharpsville	Mercer	Pennsylvania	$2.10	$4.00	$1.90
Uniontown	Fayette	Pennsylvania	$2.30	$4.40	$2.10
Winchester	Clark	Kentucky	$2.60	$4.60	$2.00
Somerset	Pulaski	Kentucky	$2.90	$4.85	$1.95
London	Laurel	Kentucky	$2.90	$4.85	$1.95
Charleston	Kanawha	West Virginia	$2.20	$4.70	$2.50
Averages:			***$2.04***	***$3.69***	***$1.65***

(Ex. 336 at 12 [Testimony of Eric Erba].)

98. On average, the Class I differentials proposed for the 29 cities are $1.65 per hundredweight higher than the current values. Qualitatively, Proposal 19 recommends lower Class I differentials in Michigan than obtained from the USDSS. Class I differentials grow increasingly larger when moving to the south and to the east—i.e., higher Class I differentials are found in Ohio, Indiana, central Kentucky, and western Pennsylvania. In other words, Proposal 19 provides

a greater slope or additional financial incentives to encourage milk to move south and east out of the milk surplus regions located in Northern Indiana and Michigan. (Ex. 336 at 13; Tr. 7825:1-7826:14 [Testimony of Dr. Eric Erba].)

99. The Mideast Area shares touchpoints with the Midwest, Southeast, and Northeast regions. Some additional discussions with representatives from those regions were necessary to ensure the seams where the regions join were consistent. Comparing notes with other cooperative representatives, the regional working group identified areas within the Mideast where consolidating two or more pricing zones made sense. For example, the original exercise left a small pocket of higher Class I differentials around Columbus, Ohio which was later consolidated with an adjacent geographically larger zone that dovetailed well with the zones proposed for the Northeast region. Similarly, differences for counties along the seams were resolved through discussions with staff representing the Northeast, Southeast, and Midwest Areas. (Ex. 336 at 13; Tr. 7826:15-7827:2 [Testimony of Dr. Eric Erba].)

100. To finalize the Class I differentials proposed for the Mideast area, some fine tuning was necessary after adjustments were made after consulting with cooperative staff representing surrounding regions. Because input and suggestions were taken from many sources and resulting compromises were made to develop an explainable and contiguous Class I differential surface, a final check was a logical next step before concluding the process. Pool plants reported for FMMOs 33 and 5 in 2022 were plotted on a map of the proposed Class I differentials to determine if any inconsistencies persisted. A few such inconsistencies were identified. However, the process involved to resolve the pricing inconsistencies was the same for each instance encountered. (Ex. 336 at 13; Tr. 7827:3-19 [Testimony of Dr. Eric Erba].)

101. First, in western Pennsylvania, there are several Class I plants around the Pittsburgh

area. Some of them compete for business in that market, but not all were in the same pricing zone. A Class I plant located in Mercer County was in the $4.00 per hundredweight zone. A Class I plant located in Butler County was in the $4.20 per hundredweight zone. A Class I plant located in Fayette County, and two Class I plants located in Allegheny County were in the $4.40 per hundredweight zone. The solution was to move Allegheny County (where Pittsburgh is located) to the $4.20 per hundredweight zone because plants located in Allegheny County compete for Pittsburgh area business. This also applies to the plant located in Fayette County, as it is located further south of the Pittsburgh market. (Ex. 336 at 14; Tr. 7827:20-7829:4 [Testimony of Dr. Eric Erba].)

102. The second case involves Class I plants in southwest Ohio and in Eastern Indiana. A Class I plant located in Clark County, Ohio was in the $4.00 per hundredweight zone. A multi-use plant located in Wayne County, Indiana was in the $3.70 per hundredweight zone. A Class I plant located in Miami County, Ohio was in the $3.70 per hundredweight zone. A Class I plant located in Marion County, Indiana was in the $3.70 per hundredweight zone. Again, there are several plants within a relatively small geographical area that are likely competing for the same business around Columbus, Dayton and Cincinnati. The solution to equalize raw product costs was to move Clark County, Ohio to the $3.70 per hundredweight zone. (Ex. 336 at 14; Tr. 7829:5-13 [Testimony of Dr. Eric Erba].)

103. Proposal 19 in the Mideast area is mostly in line with the results obtained from the USDSS. Proposal 19 adds more of a pricing slope by placing a higher value on the locations to the south and to the east than the current Class I differentials. The increased slope addresses the difficulties of moving milk from areas of surplus milk supplies—i.e., Michigan, Northern Indiana, and Northwestern Ohio—to the milk deficit areas located to the south and to the east. (Ex. 336 at

15; Tr. 7830:14-21 [Testimony of Dr. Eric Erba].)

104. Over the past 23 years, the Mideast Area has realized a 20 percent increase in milk produced but shipped from 66 percent fewer dairy farms. There are fewer supply and distributing plants operating in the Mideast Area. The average Class I utilization has decreased, as has the average PPD. The average uniform price has nearly doubled since 2000. (Ex. 336 at 2; Tr. 7812:5-11 [Testimony of Dr. Eric Erba].)

105. In FMMO 33, the number of dairy farms has declined 66 percent from 10,030 in 2000 to 3,420 in 2022; the number of Class I plants has declined by 42 percent, from 57 plants in 2000 to 33 in 2022; and Class I utilization has declined from 47 percent in 2000 to 37 percent in 2022. (Ex. 406 at 2; Tr. 9345:22-27 [Testimony of Brad Parks].)

106. At the same time, milk production has increased by 6,000,000,000 pounds annually in Michigan, 2,000,000,000 pounds annually in Indiana, and 1,000,000,000 pounds annually in Ohio. Milk production has decreased by 380,000,000 pounds annually in Illinois. (Ex. 406 at 3; Tr. 9346:7-14 [Testimony of Brad Parks].)

107. Even a casual observer can confirm that the milk sheds and milk processing locations are growing more distant from each other. Processing plants that were at one time located in the middle of significant milk sheds have found themselves with diminishing abilities to attract enough local milk to satisfy their daily, weekly, monthly and seasonal needs. Within the last 10 years, two grocery store chains have built Class I plants in Tipp City, Ohio (west central Ohio) and Ft. Wayne, Indiana (Northeast Indiana). The addition of these plants may have contributed to the closure of two Michigan Class I plants in Evart and Livonia. The Michigan plants were located closer to milk supplies, but the Tipp City, Ohio and Ft. Wayne, Indiana Class I plants are located more strategically, being closer to population centers. The implication with the more strategic

positioning of the plants is that bulk raw milk must travel further from supply points to reach these plants. The mileage difference is significant – Tipp City is 350 miles south of Evart and 200 miles southwest of Livonia, and Ft. Wayne is 250 miles south of Evart and 165 miles southwest of Livonia. (Ex. 336 at 2; Tr. 7812:16-7813:14 [Testimony of Dr. Eric Erba].)

108. A further structural change is receipts by Class I plants. Receipts at Michigan bottling plants decreased by 478,000,000 pounds since 2015; receipts at Ohio bottling plants decreased by 196,000,000 pounds since 2015; whereas, receipts at Indiana bottling plants increased by 678,000,000 since 2015. Approximately 25 percent of the milk production in Indiana is shipped to other markets and pooled in FMMOs 5 and 7. (Ex. 406 at 5; Tr. 9347:21-9348:3 [Testimony of Brad Parks].)

109. While Michigan was a leading producer of milk in the region at Order Reform, its production growth has outpaced other states in FMMO 33.

Milk Production By State (Bil Lbs) (source USDA NASS May 4, 2023)					
Year	Illinois Milk (Bil Lbs)	Indiana Milk (Bil Lbs)	Michigan Milk (Bil Lbs)	Ohio Milk (Bil Lbs)	**Total (Bil Lbs)**
2000	**2.09**	**2.42**	**5.71**	**4.46**	**14.68**
2005	1.96	3.17	6.75	4.74	16.62
2011	1.90	3.55	8.48	5.14	19.07
2017	1.93	4.26	11.23	5.59	23.02
2022	**1.71**	**4.41**	**11.74**	**5.52**	**23.39**
% Change	-18%	82%	106%	24%	59%

(Ex. 406 at 4; Tr. 9346:3-14 [Testimony of Brad Parks].)

110. With Michigan's production exceeding all other states in the region by a wide margin, considering its Class I characteristics is important. Michigan currently has two Class I plants in the metropolitan Detroit area and four Class I plants on the west side of the state for a total of six. The reduction in Class I plants has caused milk to be transported greater distances to

reach Class I plants. Adjacent markets to Michigan have experienced similar Class I plant reductions. Two large fluid plants formerly located in Chemung and Huntley, Illinois that had primarily served the Class I fluid milk market in Chicago closed. Packaged Class I products are now supplied to Chicago retailers from Class I plants located in Western Michigan, Ohio, Wisconsin, and Iowa. (Ex. 406 at 5; Tr. 9349:11-25 [Testimony of Brad Parks].)

111. As Class 1 plants have closed in Michigan, additional plants have been built close to the milk supply competing for the same milk that is being supplied to more distant Class I plants. MMPA operates a balancing plant in Ovid, Michigan, which is the heart of the Michigan milk shed, and the Michigan milk market acts as a reserve source of milk for other states. Milk produced in Michigan travels south and east to reach Class I plants in Indiana, Ohio, Pennsylvania, and states even further south when needed. (Ex. 406 at 7; Tr. 9350:5-25 [Testimony of Brad Parks].)

112. It is further important to consider Michigan's relation to the rest of the Mideast market and beyond. In the past 10 years there have been four new Class I processing plants built in the Mideast market. These new plants are in Fort Wayne, Indiana; Tipp City, Ohio; Coopersville, Michigan; and just recently, a new ultra-high temperature processing plant opened in Morgantown, West Virginia. The new Indiana and Ohio plants are 200 to 350 miles farther south from where the milk supply is in Michigan. (Ex. 406 at 8; Tr. 9350:26-9351:5 [Testimony of Brad Parks].)

113. Michigan has become the reserve supply for growing markets in Ohio. Ohio has expanded its production capacity and a Class I plant in Canton, Ohio has more than doubled its milk volume in the past 10 years. Michigan also supplies milk as required seasonally to the deficit areas of the Southeast United States. (Ex. 406 at 8; Tr. 9351:8-21 [Testimony of Brad Parks].)

114. Current Class I pricing zones in the Mideast Area are too large geographically and

do not reflect the cost of moving bulk milk today, a cost which is borne by producers. When attempting to move milk to satisfy Class I customer ordering requirements, Class I differentials are the main regulatory tool available to incentivize milk movements. They must be set at levels high enough to encourage milk to move, at times, significant distances. The current Class I differentials fail this basic test. Simply, there is not enough of a "slope" or price difference to encourage or to facilitate movement of milk from supply sources to receiving points. A good example of the lack of slope is the $1.80 per hundredweight pricing zone that stretches an incredible 550 miles from Marquette, Michigan to Huntington, Indiana. The implication is that the milk in Marquette, Michigan has the same relative value as milk in Huntington, Indiana. (Ex. 336 at 6; Tr. 7814:7-24 [Testimony of Dr. Eric Erba].)

115. Proposal 19 addresses the inadequacies of one differential covering this large geographic area and adds rates across smaller zones to better reflect the cost to move milk. (Ex. 406 at 8 [Testimony of Brad Parks].)

116. In addition to the geographical considerations, there are more cheese plants competing for milk today compared to 2000. The Mideast market has three large cheese plants in Michigan, a large cheese plant in Western Pennsylvania, and multiple mid-size to smaller cheese plants in Ohio. In October 2020, a new cheese plant opened in central Michigan that absorbs eight million pounds of milk per day from the Michigan market. The current Class I differentials are too low and do not provide economic incentive to ensure that Class I plants get the milk they need and can successfully compete with manufacturing plants in the Mideast market. Cooperatives and their members end up subsidizing the costs to get milk to Class I plants due to marketing and hauling costs exceeding the current Class I differentials. However, the concern is that serving the Class I market is not economically sustainable long term because it is cheaper to deliver milk to local

manufacturing plants. (Ex. 406 at 9; Tr. 9352:11-9353:4 [Testimony of Brad Parks].)

117. Indeed, milk hauling costs have increased significantly since Order Reform. In the Mideast Area, from 2006 to 2023, overall costs for a 300-mile roundtrip load of milk on an Ohio based 6,200-gallon tractor trailer increased 70 percent. And with respect to large, 8-axle Michigan-based 12,000-gallon tractor trailers moving milk on a 300-mile roundtrip, run costs have risen 69 percent. (Ex. 309 at 1; Tr. 7213:28-7214:12 [Testimony of Stephen Zalar].)

Table 1. Milk hauling cost changes for Ohio milk assembly and delivery, 2006 to 2023[1]

50,000 lb. load, 300-mile round trip; cost per hundredweight

Variable Costs	2006	2023	Difference	% Increase
Fuel	$0.2137	$0.3484	$0.1337	62.6%
Labor	$0.4400	$0.7920	$0.3520	80.0%
Tires	$0.0445	$0.0703	$0.0258	58.0%
Maintenance	$0.0844	$0.1444	$0.0600	71.1%
Total Variable	*$0.7826*	*$1.3541*	*$0.5715*	73.0%
Fixed Costs				
Equipment	$0.1427	$0.2468	$0.1041	73.0%
License &Tax	$0.0199	$0.0359	$0.0160	78.6%
Insurance	$0.0370	$0.0548	$0.0178	48.2%
Mgt. & Overhead	$0.0493	$0.0658	$0.0165	33.3%
Total Fixed	*$0.2489*	*$0.4033*	*$0.1544*	*61.9%*
COST PER HUNDREDWEIGHT	*$1.0315*	*$1.7574*	*$0.7259*	*70.3%*

Table 2. Milk hauling cost changes for Michigan milk assembly and delivery, 2006 to 2023[1]

108,000 lb. load, 300-mile round trip; cost per hundredweight

Variable Costs	2006	2023	Difference	% Increase
Fuel	$0.1280	$0.2081	$0.0801	62.6%
Labor	$0.2241	$0.3972	$0.1731	77.2%
Tires	$0.0664	$0.0971	$0.0307	46.2%
Maintenance	$0.0576	$0.1048	$0.0472	81.9%
Total Variable	*$0.4761*	*$0.8072*	*$0.3311*	*69.5%*
Fixed Costs				
Equipment	$0.1170	$0.1902	$0.2633	62.5%
License & Tax	$0.0098	$0.0284	$0.0671	191.2%
Insurance	$0.0190	$0.0304	$0.0411	60.0%
Mgt. & Overhead	$0.0228	$0.0304	$0.0274	33.3%
Total Fixed	*$0.1686*	*$0.2794*	*$0.3989*	*65.7%*
COST PER HUNDREDWEIGHT	*$0.6447*	*$1.0866*	*$0.4419*	*68.5%*

(Ex. 309 at 2; Tr. 7213:26-7214:27 [Testimony of Stephen Zalar].)

118. Additionally, the number of haulers has decreased consistent with decreases in

dairy farm numbers. For example, in July 2006 in the Mideast area, DFA contracted with 194 milk haulers, but today, there are just 88 contract milk haulers being used. And during that same period, DFA's milk production in the Mideast area went from 565 million pounds per month to 601 million pounds per month, even as dairy farm numbers fell by over 70 percent. Fewer farms are producing more milk, and there are fewer milk haulers available to haul the milk to customers. With fewer haulers, dairy producers have fewer options for finding a milk hauler. (Ex. 309 at 5; Tr. 7217:8-21 [Testimony of Stephen Zalar].)

Appalachian (FMMO 5)[28]

119. The cost of moving milk in FMMO 5 has greatly increased since the early 2000s. To continue to meet customer demands for milk, dairy farmer cooperative members must make up the difference in that cost, which comes directly out of their monthly milk checks. (Ex. 359 at 3; Tr. 8389:25-8390:3 [Testimony of Mike John]); *see supra* at 214, ¶ 74 (providing a chart showing how hauling costs have increased for MDVA dairy farmers supplying FMMO 5).

120. For example, MDVA's members own and operate two pool distributing plants and one pool supply plant in FMMO 5. The majority of MDVA's member milk is received and processed by Class I plants, including the plants owned by MDVA's members, serving FMMOs 1 and 5. Constant ebbs and flows of milk orders placed by customers and their subsequent effects on the movement of milk are a fact of supplying the Class I market. This balancing adds additional costs and requires a steady and reliable source of revenue to serve the market. MDVA is constantly moving milk from supply points located in FMMO 1 to demand points located in FMMO 1 or FMMO 5. (Ex. 359 at 1-2; Tr. 8388:15-28 [Testimony of Mike John].)

[28] A general overview of how the regional working group established differentials in FMMO 5 is discussed in the regional section on FMMO 126. *See infra* at 258-260. For a detailed discussion, *see* Exhibit 310 at 24-50.

121. For FMMO 5, there were 17 city locations analyzed that included a pool distributing plant, or a partially regulated distributing plant of notable size. Overall, the proposed Class I differentials were not remarkably different from the USDSS. Over the entire 17 locations, the proposed Class I differentials averaged roughly $0.15 per hundredweight less than the USDSS results. The bulk of these differences were the result of the regional working group determining that milk can be supplied to plants located in the southern portion of Virginia and the Carolinas at costs somewhat less than suggested by the USDSS. (Ex. 310 at 38 [Testimony of Jeffrey Sims].)

122. The Southeast working group attempted to maintain historical price alignment in FMMO 5 so as to avoid creating competitive advantages. For example, the current Class I differentials for Mt. Crawford, Virginia and Verona, Virginia are the same at $2.90 per hundredweight. The USDSS determined a $0.10 per hundredweight higher differential for Verona. These two locations are approximately 15 miles apart and compete in the same markets. The working group kept the price relationship the same as current by increasing the differentials in both locations by $1.80 per hundredweight to a new proposed differential of $4.70 per hundredweight. (Ex. 359 at 6; Tr. 8395:8-19 [Testimony of Mike John].)

123. Another example is the relationship between Lynchburg, Virginia and Newport News, Virginia. Currently, both have the same Class I differential of $3.20 per hundredweight. The USDSS determined a $0.40 per hundredweight higher differential for Newport News. Because these two locations serve the same geographical market, and both locations draw farm milk from the same milk sheds, the working group kept the current price relationship and proposed a differential of $5.00 per hundredweight for both locations. (Ex. 359 at 6; Tr. 8395:20-8396:1 [Testimony of Mike John].)

124. The current Class I differentials are not adequate to cover the increased cost of

transporting milk to distant Class I plants. The key components of the milk hauling costs have all increased—diesel fuel, distribution equipment (trucks and tankers), driver wages and benefits, and liability insurance. (Ex. 406 at 9; Tr. 9353:5-12 [Testimony of Brad Parks].)

125. Additional rolling stock is needed today versus 2000 because of revisions in 2018 to driver hours of service allowed per day, and the increased distance milk must now travel to more distant Class I plant locations. New trucks also require more service to the emission systems and electronics. This results in more downtime compared to 2000. Diesel fuel costs have increased from $2.00 per gallon in 2006 to $4.40 per gallon today, an increase of 120 percent. As a result, cooperatives, such as MMPA, pay fuel surcharges to haulers that adds 38 percent to hauling costs just for fuel cost increases (August 2023). New Environmental Protection Agency regulations have increased the cost of a truck due to increased use of sensors and controls. The historical cost of a new truck in 2009 was $96,000; in 2019, $153,000; and in 2023, $183,000—a 90 percent increase in 14 years. The cost of a bulk milk tanker has increased. In 2020 a standard 48,000-pound bulk tanker cost $68,000, that same trailer today costs $96,000, an approximately 40 percent increase in just the past three years. (Ex. 406 at 9-10; Tr. 9353:16-9354:13 [Testimony of Brad Parks].)

126. To put a single number on current hauling costs, MMPA milk hauling costs for July 2023 to transport milk from mid-Michigan to Eastern Ohio was $1.06 per hundredweight, per 100 miles. (Ex. 406 at 11; Tr. 9355:9-13 [Testimony of Brad Parks].)

127. In many areas of the United States, milk hauling has become an increasingly fragile business enterprise with continued dynamics and uncertainty for the future. (Ex. 309 at 11; Tr. 7227:13-15 [Testimony of Stephen Zalar].)

Southeast (FMMOs 6, 7)[29]

128. For FMMO 6, there was little variation between the proposed differentials and the differentials suggested by the USDSS. Over the nine city locations in FMMO 6 that contain a pool distributing plant, the average difference between the USDSS and Proposal 19 is $0.03 per hundredweight, with Proposal 19 differentials being higher. (Ex. 310 at 39 [Testimony of Jeffrey Sims].)

129. For FMMO 7, there were some deviations in the proposed differentials and the USDSS, and like FMMO 6, those arose mostly from the desire to respect commonality in pricing for current like-zoned plants, or actually to expand the number of plants like-priced. There are 16 cities in FMMO 7 with a pool distributing plant or a notable partially regulated plant. Nine of the plant locations have proposed differentials that exceed the USDSS, one city where the proposed differential equals the USDSS, and six locations where proposed differentials are less than the USDSS. On average, for all of FMMO 7, the proposed differentials exceed the USDSS results by approximately $0.13 per hundredweight. (Ex. 310 at 39 [Testimony of Jeffrey Sims].)

130. Since 2021, Class I disposition in the Florida FMMO has increased. In 2021, Class I disposition was 1,996,086,644 pounds. In 2022, it was 2,042,133,745 pounds, a 2.3 percent increase. Through the first eight months of 2023, Class I disposition is 1.6 percent higher than the same period in 2022. The University of Florida projects the state to add another two (2) million residents by 2030. The number of potential milk consumers in FMMO 6 has grown and continues to grow. (Ex. 342 at 2; Tr. 7988:14-7989:3 [Testimony of Calvin Covington].)

131. In a fluid milk market, milk deliveries to pool distributing plants varies from month

[29] A general overview of how the regional working group established differentials in FMMOs 6 and 7 is discussed in the regional section on FMMO 126. *See infra* at 258-260. For a detailed discussion, *see* Exhibit 310 at 24-50.

to month and day to day. In Florida in 2022, during just a 90-day period from April to July, Class I demand dropped from averaging 5.830 million pounds per day to 4.939 million pounds per day. This is a decline of the equivalent of 18 loads of milk per day in just 90 days. And, just 90 days later, July to October, Class I disposition goes back up by 19 loads per day. (Ex. 342 at 2; Tr. 7989:11-18 [Testimony of Calvin Covington].)

132. There is a cost in managing these swings in milk demand. To adequately serve a fluid milk market, a cooperative must have access to a raw milk supply equal to the maximum milk volume needed by pool distributing plants on a given day. It costs money to adequately serve a fluid milk market and ensure there is fluid milk on the shelf for consumers and in school cafeterias. Class I differentials do more than encourage movement of raw milk to fluid markets, they also assist in covering the expenses needed to serve a fluid milk market. (Ex. 342 at 3; Tr. 7989:25-7990:8 [Testimony of Calvin Covington].)

133. Costs to transport raw milk from farm to milk plant have increased as well, which further supports the need to increase Class I differentials. In 2003, hauling charges to a producer for one load traveling 175 miles was \$0.82 per hundredweight or \$2.31 per loaded mile. In May 2023, the producer charge was \$2.11 per hundredweight or \$5.98 per loaded mile. Current producer milk hauling charges are almost double the charges in 2013 but the differentials are the same today as they were in 2013. (Ex. 342 at 3; Tr. 7991:7-20 [Testimony of Calvin Covington].)

134. Since 2020, average annual diesel fuel costs have increased by approximately \$1.72 per gallon. Since 2018, average annual milk hauler wages have increased by almost \$8.00 per hour. Since 2020, the cost for a Peterbilt day cab has increased approximately \$54,000, and since 2021 the cost for a 6,200-gallon tanker has increased a little more than \$20,000. Additionally, employee benefits, insurance premiums, tractor and tanker maintenance, tires, repairs, taxes, permits and

highway tolls have all increased in cost. (Ex. 342 at 4; Tr. 7992:18-7993:11 [Testimony of Calvin Covington].)

135. While costs have gone up, production in Florida continues to decrease. Of the 24 states in the NASS monthly milk production report, Florida had the largest year-over-year milk production decrease in 2022, down 10.9 percent. In 2022, Florida reported its lowest milk volume since 1984. More supplemental milk must be brought into Florida and predominately comes from south Georgia. However, the closest Florida FMMO pool distributing plant is 300 miles from the center of the south Georgia milk supply. Increasing hauling costs and the building of a new Walmart plant in south Georgia will affect Georgia famers' willingness to supply Florida with supplemental milk, which means that supplemental milk must be sourced from even more distant supply points. (Ex. 342 at 5-6; Tr. 7994:3-10, 7995:2-5, 7995:24-26 [Testimony of Calvin Covington]; Tr. 11463:12-11464:16 [Testimony of Jeffrey Sims].)

136. As of May 2023, a conservative cost estimate to transport a gallon of packaged milk from to Atlanta to the Interstate 4 Corridor[30] is about $0.22 per gallon. The $1.35 per hundredweight difference in the proposed Class 1 differentials (i.e., $7.30 - $5.95) equates to $0.12 per gallon, which is $0.10 per gallon less than the estimated transportation cost. Said another way, the cost to transport packaged fluid milk from the Atlanta area to the Interstate 4 corridor is greater than the Class I differential slope. (Ex. 342 at 8; Tr. 7999:11-21 [Testimony of Calvin Covington]; *see also* Tr. 8017:6-7 [Testimony of Calvin Covington] ("The [FMMOs] cannot guarantee a dairy farmer a profit.").)

137. The Interstate 4 Corridor and Miami areas include all but one of the FMMO 6 pool

[30] The Interstate 4 corridor runs from Tampa, Florida to Daytona Beach, Florida. (*See* Tr. 8031:27-8032:7 [Testimony of Calvin Covington].)

distributing plants. These two areas should increase by $1.90 per hundredweight. The differential for the Miami area, which includes the area from Palm Beach to Miami/Dade, should be $7.90 per hundredweight. The proposed Interstate 4 Corridor differential should be $7.30 per hundredweight, which includes the area from Daytona Beach to Tampa. (Ex. 342 at 7; Tr. 7997:17-24 [Testimony of Calvin Covington].)

> Q. So even given the challenges that we have heard quite a bit about and that you have testified to about, about attracting milk in Florida and keeping milk production in Florida, you feel that the USDSS model is sufficient to meet those needs?
>
> A. The term I would use, it's reasonable. And especially when I consider we had the increase, Miami had the largest increase back in 2008 as well, and putting all those factors together, and I knew there had to be price alignment, that USDA looks at price alignment, I felt that 7.90 was a reasonable number.

(Tr. 8029:20-8030:2 [Testimony of Calvin Covington].)

138. The results of the USDSS suggested more variation in Class I differentials in both the Interstate 4 Corridor and Miami areas. However, the historic pricing structure in each of these geographic areas should be preserved. Pool distributing plants, located within each respective area, compete for sales throughout the entire territory. Having more than one Class I differential in each respective area has the potential to create raw milk price inequities, disrupt flow of raw milk, and create disorderly marketing. To maintain orderly marketing and historical norms, the difference between the Class I differentials should be kept the same throughout each of the two respective areas—i.e., $7.90 per hundredweight in Miami and $7.30 per hundredweight in the Interstate 4 Corridor. (Ex. 342 at 8; Tr. 7997:25-7998:11 [Testimony of Calvin Covington].)

139. The location differential between the Miami and Interstate 4 Corridor Class I differentials should be preserved. Since May 2008, when the differentials in Florida were last updated, it has been $0.60 per hundredweight. Experience suggests this is an equitable and

workable price difference. There are less pool distributing plants in the Miami area today, compared to previous years. Florida's largest milk producing area is located between Miami and the Interstate 4 Corridor. Raw milk from this area moves to pool distributing plants in both geographic areas. The $0.60 per hundredweight differential facilitates a more orderly flow of milk. (Ex. 342 at 8; Tr. 7998:12-22 [Testimony of Calvin Covington].)

140. A common concern among plants is that their competitors have equal raw milk product costs. This is due to raw milk being a high percentage of the cost of packaged fluid milk at a plant's loading dock. There may be over-order premiums charged to most fluid buyers throughout the country including Florida, but in FMMO 6, over-order premiums do not adequately cover the expense of serving the market. Fluid milk buyers are concerned about the impact higher over-order premiums may have in creating unequal raw milk costs, possibly giving one processor an advantage over another processor. This creates a challenge in establishing over-order premiums at an adequate level to cover the expenses of serving the fluid milk market. Increasing the fluid milk price, by increasing the Class I differential, provides fluid milk processors greater assurance of equal raw milk costs. Milk buyers have confidence in the enforcement of minimum prices, which helps to maintain orderly milk marketing. (Ex. 342 at 8-9; Tr. 8000:26-8001:18 [Testimony of Calvin Covington].)

141. The Class I differentials in Proposal 19 will help improve the profitability of Florida dairy farms, thus slowing the exodus of dairy farmers within the marketing area. The proposed Class I differentials will help ease the transportation cost burden on farm milk coming into Florida from outside of the marketing area and encourage the continued availability of that milk for the Florida Class I market. (Ex. 342 at 9; Tr. 8001:28-8002:7 [Testimony of Calvin Covington].)

142. Turning to FMMO 7, in the last decade, milk volumes in Arkansas and Southern

Missouri have disappeared rapidly. Arkansas milk production dropped by 66 percent and Missouri overall dropped by 33 percent. In order to incentivize this distant outside milk to move to the plants in Southern Missouri and Arkansas, there is a need to pay large transportation costs to draw the milk into these plants. (Ex. 395 at 3; Tr. 9205:21-9206:5 [Testimony of Mike Herting].)

143. While there are transportation credits in FMMO 7, the credits only partially compensate for a small portion of the costs of hauling this out-of-area distant milk to local distributing plants. In fact, the FMMO 7 program fund usually does not have enough funding to fully pay requests for most of the year. (Ex. 395 at 3; Tr. 9205:10-20 [Testimony of Mike Herting].)

144. Moreover, the recently enacted Distributing Plant Delivery Credits in FMMOs 5, 6, and 7 work independently of Class I differentials in that they provide some compensation for milk moving south to north and east to west to meet Class I demand. Ordinarily, when milk moves, for instance south to north, it loses the benefit of the Class I differentials price surface. The credit provides some assistance, but that is effectively a counterbalance against the lost Class I differential. [31] (Tr. 8073:19-8075:5 [Testimony of Calvin Covington].)

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[31] The recent amendments to FMMOs 5, 6, and 7 (*see* 88 Fed. Reg 84038 (Dec. 1, 2023)) do not in any way reduce the need for updating of Class I differentials in the Southeast. This is true for several reasons and in several respects. First, the amendments to the Southeast Orders did not impact the market-wide pool; they were not adjustments to Class I pool charges and are not pooled among all producers. These market-wide service debits and credits – known as Transportation Credit Balancing Funds ("TCBF") and Distributing Plant Delivery Credits ("DPDC") are made by and to handlers of Class I milk deliveries for services of market-wide benefit. Furthermore, there is no duplication of the function served by the Class I differentials. Specifically, the TCBF credits, which operate seasonally and not year-round, provide reimbursement for a portion of the transportation cost of supplemental Class I milk supplies from out of the area and any difference in Class I differentials from shipping point to destination is netted against the supplemental compensation paid—i.e., no "double dipping." The newly instituted DPDC address the ever-worsening southeast regional production deficit which has led to milk movements from farm to plant being increasingly longer and "against the grain" of the differential price surface—i.e., moving from farms in price zones which are often higher than the plant zone, or distant but equal

145. The growing needs for milk to be brought into Arkansas and Southern Missouri is being met by purchasing milk supplies coming mostly from the west. This milk comes daily from Western Kansas and Western Texas dairy farms. Typically, loads of milk being delivered from these locations must travel over 500-650 miles. (Ex. 395 at 4; Tr. 9206:6-12 [Testimony of Mike Herting].)

146. In order to move raw milk to four southern and southeastern plants, Prairie Farms incurs a cost of approximately $5.25 per mile to $5.50 per loaded mile. With few opportunities for back hauls, this cost is incurred solely to support those plants due to declining milk production capacities in those areas. (Ex. 352 at 8 [Testimony of Chris Hoeger].)

147. Even when milk from the central Midwest is used to support plants located in the southeast on an everyday basis, the increase in "slope" in the range of $0.90 per hundredweight to $1.30 per hundredweight, as in Proposal 19, does not fully cover the cost of moving milk 300 miles or more. (Ex. 352 at 9; Tr. 8203:23-28 [Testimony of Chris Hoeger].)

Upper Midwest (FMMO 30)

148. The Upper Midwest price surface was reviewed by the NMPF Midwest regional working group. Discussions centered around finding the correct Class I price surface map to ensure a reliable milk supply as well as an equitable distribution of pool revenues. The working group concluded that too much of a "slope" between Minnesota, Wisconsin, and Chicago would create a tremendous incentive to move milk out of Minnesota (i.e., milk that would not be part of the local supply), thus making the plants in Minnesota uncompetitive for milk supply in a tight market. (Ex. 352 at 6; Tr. 8198:17-8199:16 [Testimony of Chris Hoeger]; *see also* Tr. 9476:10-21

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in zoning. These milk movements are either uncompensated or severely undercompensated by the slope of the present and proposed Class I price surface, but now will receive some compensation via the DPDC.

[Testimony of Edward Gallagher ("But we're going to see more milk demanded in the United States for Class II, Class III, for butter, for powder, for bakery opportunities. We're going to see the demand of milk grow here. And there's going to be more of our milk demanded by businesses and consumers in other countries. We do not have a measurable reserve supply of milk to fall back on. We're going to have to make sure we have a pricing system that supports the growth of milk in the United States to meet just the Class I demands we're going to have even if the market doesn't grow beyond what it is already. And so we've got this tight marketplace.").)

149. In order to maintain blend price alignment in the Upper Midwest, the working group maintained the current slope between Minneapolis and Chicago, which constituted a leveling of the slope from the output of the USDSS.

> But the one thing that [Dr. Nicholson] did tell us in the testimony – or not testimony, excuse me, in questioning was – and we had one thing that the [USDSS] doesn't take into consideration is kind of the current Federal Milk Market Order layout. So when it comes to zone back prices and so forth, and that led to some of our conversation analysis of doing a blend price analysis between Chicago and Minneapolis…hence, why Minneapolis is higher than the [USDSS], just because we came to an agreement on the Chicago number in reference to other inter – you know, other region issues within that alliance – or that – that part of the [USDSS]. So, hence, that's when that – there was a lot of discussion on that just because of the blend price analysis that we were doing.
>
> * * *
>
> Q…How much can you do for the blend price in a market that is 6 percent Class I?
>
> A. Well, you can't do a lot, but the – the issue is that if Chicago is going to be your baseline and that's where your Federal Order announcement price is, if you – if you follow the [USDSS] between Chicago and Minneapolis, there was $0.95 a hundredweight difference. So that zone back, why would a dairy producer even want to ship to Class I in the Minneapolis market if they were constantly going to get a negative return on – on the milk?

Q. Well, wouldn't the milk maybe for that location come from farther north where the price is even lower and so there was a benefit?

A. No. It was like I was just saying, you get to the point of equilibrium where the – it kind of flips. I mean, as an example, Goodhue County in Minnesota is south of Minneapolis, and that's a strong, strong milk county, and there are several large cheese plants near Goodhue County and also near the three bottling plants in Minneapolis. And so if you – it's actually shorter transportation to go from Goodhue County to like our Woodbury plant. It's 49 miles. If you had a $0.95 zone back, the dairy producer could make the decision to ship it to Le Sueur, Minnesota plant – do you need me to spell Le Sueur?

* * *

Q…[W]wouldn't you then want or need the slope north of Chicago to be greater in order to help move the milk south?

A. Yes. You – when you get to the point of what we'll call equilibrium, and then it comes down to – in our analysis, it comes down to blend price and that. And so that's really, once you get north of Chicago, our whole thought process was – was analyzing blend price.

* * *

[I]t was more about the correlation with the other plants in that region, which are also large cheese plants, and having a consistent level field for that – the – because like I mentioned on the Le Sueur plant, they would also compete in Goodhue County with the Minneapolis plants are competing for that milk supply.

If – if you had the zone back the way the [USDSS] suggested, there would be no incentive to ever supply any of Minneapolis.

* * *

A. Again, what we did is, when we did the analysis, we looked at the blend price, and then we also took in correlation to the current [USDSS]. So if there was a $0.10 drop in Chicago to Minneapolis currently, we tried to maintain that, so that – so that blend prices would not be dramatically impacted, good or bad.

(Tr. 8243:23-8244:10 Tr. 8251:25-8252:21; Tr. 8251:14-8251:21; Tr. 8261:4-8261:12; Tr. 8262:27-8263:4 [Testimony of Chris Hoeger].)

150. A secondary goal of addressing the Class I price surface was to minimize any negative impacts on producer blend prices. The Class I differentials proposed for the Upper Midwest would have a minimal impact on producer prices. Class I milk utilization in FMMO 30 is 10.67 percent on average. This means for an average increase in Class I differential of $1.21 per hundredweight, the average increase to FMMO 30 blend price would be about $0.13 per hundredweight. This is a minor price increase for dairy producers who still bear most of the cost of transporting milk to markets. (Ex. 352 at 6; Tr. 8198:17-8199:16 [Testimony of Chris Hoeger].)

151. Milk production has continued to move farther away from the population centers in the past 20 years. Growth in the West and Northwest area of the Upper Midwest has continued this trend. (Ex. 352 at 1; Tr. 8191:7-10 [Testimony of Chris Hoeger].)

152. The packaged fluid milk needs of the Chicago metropolitan area is served by several plants located in the Upper Midwest and Mideast regions. The members the Midwest working group wanted to ensure that there was price continuity for all plants that served the Chicago market. Also, the working group wanted to make sure no plant had a competitive advantage or competitive disadvantage when serving this large population center. In the last 18 months, this market lost a plant located in Chemung, Illinois that was a major supplier of fluid milk. The plant closure in the summer of 2022 forced increased reliance on other plants to supply the market. Proposal 19 assigned Class I differentials to those plants serving the Chicago market to make sure that no plant had a competitive advantage or disadvantage relative to other plants serving this large population center and to incentivize the movement of milk to the more deficiently supplied areas. (Ex. 352 at 6; Tr. 8197:20-8198:11 [Testimony of Chris Hoeger].)

Table 4: Chicago Market Analysis							
			Miles from		Current		Proposed
City	State		Chicago		Price Surface		Price Surface
Cedarburg	WI		111		$ 1.75		$ 3.00
Rockford	IL		86		$ 1.75		$ 3.00
Dubuque	IA		178		$ 1.75		$ 3.00
Battle Creek	MI		170		$ 1.80		$ 3.10
Grand Rapids	MI		179		$ 1.80		$ 3.10
Holland	MI		151		$ 1.80		$ 3.10
Fort Wayne	IN		162		$ 1.80		$ 3.30
Huntington	IN		157		$ 1.80		$ 3.30
Highland	IN		32		$ 1.80		$ 3.10

(Ex. 352 at 6; Tr. 8198:6-16 [Testimony of Chris Hoeger].)

Central (FMMO 32 and Adjacent Unregulated Areas)

153. Milk production has continued to move farther away from the population centers in the past 20 years. The creation of "dairy deserts" in Illinois and the eastern half of Iowa continues. "Dairy deserts" are areas that were once strong or had significant dairy farm numbers but now have minimal farm numbers (less than three farms per county) or no dairy production in the area. Plants are becoming more dependent on supplemental milk supplies to serve the St. Louis, Missouri market, as well as other large population centers in Southern Illinois and Missouri. (Ex. 352 at 1; Tr. 8191:7-19 [Testimony of Chris Hoeger].)

154. Milk production has decreased in Illinois from 1,173,396,523 pounds of milk in 2002 to 797,454,865 pounds of milk in 2022, a 32 percent decrease. Iowa shows a similar trend with milk production dropping from 3,170,628,596 pounds in 2002 to 2,938,460,431 pounds in 2022, a nearly 8 percent decrease. (Ex. 352 at 1-2; Tr. 8191:20-26 [Testimony of Chris Hoeger].)

155. Iowa has lost milk processing capacity in its eastern half due to several plant closures during the past 20 years. For example, Swiss Valley Farms closed a cultured plant in Cedar Rapids, Iowa in 2008. Also, the Kalona Cheese plant, which produced barrel cheddar cheese

in Kalona, Iowa closed in 2014. Closing these two facilities along with other plant closures resulted in loss of markets. The unfortunate result was that producers were required to ship their milk further to reach other markets, thereby incurring additional hauling costs. (Ex. 352 at 2; Tr. 8191:27-8192:9 [Testimony of Chris Hoeger].)

156. Furthermore, Prairie Farms closed its Peoria, Illinois fluid bottling plant in 2020. The milk processed by this plant was traditionally supplied from two main supply points – the Southern Illinois and Missouri milkshed and from the Northern Illinois and Eastern Iowa milkshed. Milk shipped from Northeast Iowa to the locations mentioned above would travel approximately 190 miles to the Peoria facility because we ship milk from central Illinois to fluid bottling facilities supplying the St. Louis metro market, as well as other southern population centers. The continued deterioration of the milk supply in central Illinois and Southeast Iowa over the past two decades and the continued closure of plants now prevents stair-stepping milk to the south. This is because with milk produced in south central Illinois and in Missouri being pulled to plants in FMMOs 5 and 7 year-round, it has become necessary for milk produced in Northern Illinois and Northeast Iowa to provide support not just occasionally but year-round. (Ex. 352 at 2; Tr. 8192:10-8193:18 [Testimony of Chris Hoeger].)

157. Costs for trucking power units and parts has increased, by one dealer's estimation, 31 to 33 percent in the Midwest since 2013. Additionally, tanker trailer costs have gone up dramatically in the last 20 years. For example, a 2023 Polar 6,500-gallon tanker trailer is almost double the cost of just a few years ago. Currently, a tanker trailer of that size would retail for about $91,250. These same tanker trailers were selling for $61,200 in 2020. (Ex. 352 at 8-9; Tr. 8202:5-11, 8202:23-28 [Testimony of Chris Hoeger].)

158. Turning to the southern part of FMMO 32, in the Nebraska, Kansas, and Missouri

region transportation costs saw noticeable increases since 2005. From 2005 to 2022, equipment costs were up 173 percent, license fees and taxes were up 71 percent, and labor expenses increased 176 percent. Overall, these increased hauler expenses resulted in a 151 percent rate increase in milk hauling costs. (Ex. 356 at 2; Tr. 8334:18-27 [Testimony of Joe Brinker].)

159. At the same time, since 2005, the number of farms located in the geography supplying the Kansas City (MO), Omaha (NE) and Wichita (KS) Class I markets, has decreased. The remaining farms are located farther from the Class I plant locations and in more rural areas, increasing the number of miles from farm to plant. (Ex. 356 at 2; Tr. 8334:11-17 [Testimony of Joe Brinker].)

160. While Class I demand in the Kansas City market has been relatively flat over the last 15 years, local milk production continues to decline, resulting in raw milk traveling farther to supply the Kansas City market. In the fall of 2015, 92 percent of Class I milk demand was supplied from farms that were located within 150 miles of Kansas City. By the fall of 2022, only 47 percent of the Kansas City Class I demand came from farms within 150 miles. (Ex. 356 at 3; Tr. 8335:20-28 [Testimony of Joe Brinker].)

161. The Omaha market has also seen a change in market dynamics. In the fall of 2015, 65 percent of Class I milk demand was supplied from farms that were located within 150 miles of Omaha. By the fall of 2022, only 55 percent of the Omaha Class I demand was supplied from farms within 150 miles. The change in the Omaha market demographics is less severe compared to Kansas City, resulting in the proposed Omaha differential increasing $1.15 per hundredweight versus $1.35 per hundredweight in Kansas City. (Ex. 356 at 3; Tr. 8336:1-9 [Testimony of Joe Brinker].)

162. The Wichita market has experienced a similar change in market conditions. In the

fall of 2015, 42 percent of Class I milk demand was supplied from farms that were located within 150 miles of Wichita. By the fall of 2022, only 27 percent of the Wichita Class I demand was supplied from farms within 150 miles. (Ex. 356 at 3; Tr. 8336:10-15 [Testimony of Joe Brinker].)

163. While maintaining current spreads in differentials for these three markets was considered, the differing changes in milk proximity to markets shows a need for differential recommendations that are not uniform. Market conditions justify a differential increase of $1.35 per hundredweight in Kansas City, $1.15 per hundredweight in Omaha and $1.65 per hundredweight in Wichita. Considerations were also made in regard to the recommended differentials in surrounding marketplaces. (Ex. 356 at 4; Tr. 8336:16-24 [Testimony of Joe Brinker].)

164. In Southwest Kansas a $3.00 differential, which is an $0.80 increase from the current differential is justified because of market conditions, as well as the recognition of the Southwest Kansas market's relationships with the Texas panhandle and Southeast Colorado and its supply relationship with Arkansas and Southern Missouri. (Ex. 310 at 40-41 [Testimony of Jeff Sims]).

165. The proposed $3.00 differential in Southwest Kansas is also necessary to maintain an appropriate alignment with manufacturing plants located in Western Kansas and Colorado and to ensure blend price equity and equity between dairy manufacturing regions in nearby states. (Ex. 407 at 6 [Testimony of Edward Gallagher]).

166. In Colorado, despite the growth in milk production, milk available to Class I markets continues to be constrained as it was in the year 2000. (Ex. 407 at 4 [Testimony of Edward Gallagher].)

167. Colorado milk production, and its usage, is mostly a market unto itself. Colorado

milk production stays within the state for processing. In rare circumstances, Colorado milk has moved to Utah but only to fill Utah's deficit market and at great transportation costs. Over the last 22 years relatively little raw milk has entered Colorado for processing and what has come into the state has been for serving the surplus needs for those states where the milk was sourced. Milk that is surplus in Idaho has at times traveled to Colorado for processing and/or that surplus has stair-stepped down into the Utah market. Then, at times, Utah production has been shipped to Colorado. At times, milk from Kansas has been shipped to Colorado for balancing needs. However, the overall volume of inbound milk to Colorado since 2000 has been relatively small. (Ex. 403 at 8 [Testimony of Steve Stout].)

168. While Colorado's milk production has increased by 3.2 billion pounds since 2000, all of that production growth has been to satisfy the needs of the Colorado's milk manufacturing, not the Class I market. For example, DFA has contractual commitments to supply Leprino's milk needs in Colorado. The DFA and Leprino business relationship is a significant component of the Colorado milk market that is not accounted for by the USDSS (Ex. 403 at 9-10 [Testimony of Steve Stout].)

169. The Leprino plant and its milk supply account for a large proportion of the milk supply in Colorado—much more than half of the raw milk produced in Colorado goes to the Leprino plant. (Tr. 9443:1-8 [Testimony of Ed Gallagher].)

170. The contractual relationship between DFA and Leprino in Colorado is unique because the raw milk supply in Colorado was specifically built up to service the Leprino plant. In other words, the supply of raw milk contracted to that plant, which the USDSS model construes as being available for Class I uses, would not exist in the absence of that plant. (Ex. 403 at 10 [Testimony of Steve Stout].)

171. With the decline in the beverage demand across Colorado, as has occurred across the United States, the needs of the Class I market have been met by Colorado production. The growth of the milk supply in Colorado has not changed due to the change in beverage demand, but due to the change in demands of milk needs for manufacturing. (Ex. 403 at 10 [Testimony of Steve Stout].)

172. The USDSS calculation for the zone values in Colorado is impacted by the large growth in Colorado's supply of milk relative to the Class I market demand in Colorado. The artificial intelligence of the USDSS suggests that with this significant growth in supply, that the Class I location and producer price location values at manufacturing plants decline slightly or are flat relative to their current levels when the opposite is true. All the growth in the supply of milk in Colorado is to satisfy the needs of the increased manufacturing milk demand. The Colorado values calculated by the USDSS are outliers relative to the results from all other areas across the United States where there were substantial ***increases*** in the values. The discriminatory valuations of the USDSS in Colorado is a red flag that the USDSS is not able to appropriately use its artificial intelligence to determine the appropriate economic values of the Colorado price surface. Due to this, NMPF has deviated from the USDSS results for Colorado. (Ex. 403 at 10-11 [Testimony of Steve Stout].) The USDSS fails to account for the unique nature of Colorado.

> [M]ore than half the milk that's produced in Colorado goes to [DFA's] valued customer, Leprino Foods in Greeley, CO. I don't think there is another major milk producing state in the United States that has a singular demand point of that significance for their state's milk production. So it is different."

(Tr. 9528:27-9529:6 [Testimony of Edward Gallagher].) The USDSS does not include this type of a constraint, but it should because including such a constraint would increase the USDSS values in Colorado.

173. The USDSS values for Colorado are—perhaps—mathematically correct based on

the data used by the USDSS, but not realistic relative to the Colorado marketplace and the increases in production seen there caused by demand from cheese, yogurt, and other manufacturers. Using the USDSS average of May and October values as the differentials, the blend prices at the Colorado locations were estimated to be about $0.40 per hundredweight lower than currently being received. The USDSS model results would result in significant economic harm to dairy farmers in Colorado, and significantly lower blend/PPD prices than any other state or area in the United States, solely as a result of the price surface changes. Additionally, it would be wholly inappropriate and unfair to burden Colorado dairy farmers with such a steep decline in blend prices on top of the declines they will face from the implementation of a make allowance increase. With the combination of the two changes, if using the USDSS results unadjusted, and the NMPF modest make allowance increase, Colorado milk prices would have a structural milk price decrease of about $1.00 per hundredweight. (Ex. 407 at 3 [Testimony of Edward Gallagher].)

174. Additionally, Colorado dairy farmers face unique financial pressures. Colorado is a relatively high-cost feed environment. (Ex. 304 at 2; Tr. 7072:21-27 [Testimony of Stephen Koontz].) Colorado is a destination market for feed. A destination market is where local demand for products is much larger than the local supply for that product. One large component affecting destination market feed prices and local basis prices is transportation costs. Transportation costs over the last 15-20 years have routinely increased. (Ex. 334 at 2; Tr. 7782:14-20 [Testimony of Hunter Jensen].)

175. Prior to 2006, the demand for corn was primarily livestock feed demand. The demand for corn to be used to produce ethanol for gasoline blending emerged in 2007 and has continued to escalate. The growth rate of this biofuel demand slowed in 2010 and has since grown modestly. Biofuel demand changed the corn market from a long-run average national price of

$3.00-3.50 per bushel to $4.50-5.50 per bushel. (Ex. 304 at 4; Tr. 7079:27-7080:7 [Testimony of Stephen Koontz].)

176. The average variable costs of production for Colorado are $10.29 per hundredweight for the 2007-2022 period. A similar calculation for the entire U.S. is $9.83 per hundredweight. Dairy fixed costs are 40-60 percent of variable costs. Inflation will elevate fixed costs, but variable costs are measured by feed prices. (Ex. 304 at 4; Tr. 7081:1-10 [Testimony of Stephen Koontz].)

177. For Colorado, the divergence from the USDSS in Proposal 19 is modest and is needed to maintain blend price equity relative to current Colorado PPD and blend price levels. Consider the effects of Proposal 19 on PPDs in select Colorado counties compared to Kansas City, which is the focal point for setting differentials in FMMO 32:

Estimated Changes in Producer Price Differential Prices at Selected Colorado and Kansas Locations using the NMPF Class I Differential and Price Surface Proposal

	May 2022			October 2022		
	Current	NMPF Proposal	Change	Current	NMPF Proposal	Change
Kansas City PPD	$0.01	$0.74	$0.73	$0.98	$1.68	$0.70
Denver Zone Adjustment	$0.55	($0.05)	($0.60)	$0.55	($0.05)	($0.60)
Denver Zone PPD	$0.56	$0.69	$0.13	$1.53	$1.63	$0.10
Kansas City PPD	$0.01	$0.74	$0.73	$0.98	$1.68	$0.70
Weld County Zone Adjustment	$0.45	($0.15)	($0.60)	$0.45	($0.15)	($0.60)
Weld County PPD	$0.46	$0.59	$0.13	$1.43	$1.53	$0.10
Kansas City PPD	$0.01	$0.74	$0.73	$0.98	$1.68	$0.70
Morgan County Zone Adjustment	$0.35	($0.25)	($0.60)	$0.35	($0.25)	($0.60)
Morgan County PPD	$0.36	$0.49	$0.13	$1.33	$1.43	$0.10
Kansas City PPD	$0.01	$0.74	$0.73	$0.98	$1.68	$0.70
Finney County, KS Zone Adjustment	$0.20	($0.35)	($0.55)	$0.20	($0.35)	($0.55)
Finney County PPD	$0.21	$0.39	$0.18	$1.18	$1.33	$0.15

(Ex. 407 at 4 [Testimony of Edward Gallagher].)

178. Changes to the Class I differentials in Colorado counties with manufacturing plants is consistent with the increases of other counties in FMMO 32 with manufacturing plants:

Comparison of Differentials in Selected Dairy Manufacturing Counties

County/State	Current Differential	NMPF Proposed Differential	Change	Estimate State Level Class I Percent 2000	Estimate State Level Class I Percent 2022
Morgan, CO	$2.35	$3.10	$0.75	44%	14%
Weld, CO	$2.45	$3.20	$0.75	44%	14%
Grant, SD	$1.80	$2.80	$1.00	10%	3%
Hamlin, SD	$1.70	$2.80	$1.10	10%	3%
Melrose, MN	$1.70	$3.00	$1.30	10%	7%
Perham, MN	$1.65	$2.80	$1.15	10%	7%
Waupaca, WI	$1.75	$3.00	$1.25	5%	2%
Columbia, CO	$1.75	$3.00	$1.25	5%	2%
Finney, KS	$2.20	$3.00	$0.80	34%	9%

(Ex. 407 at 5 [Testimony of Edward Gallagher].)

179. DFA, a primary producer of milk in Colorado, will continue to meet the needs of the Class I market; with adequate supply of milk within Colorado, DFA can continue to meet the needs of manufacturing milk. However, if the USDSS results hold and there is a decrease in milk prices for the Class I location differential, coupled with the decrease in milk prices from an increase in the make allowance, Colorado milk prices would go down by more than $1.00 per hundredweight. This would result in a reduction in the Colorado milk supply that would create inabilities for DFA to adequately supply Colorado Class I markets and the demand driven manufacturing marketplace. (Ex. 403 at 11 [Testimony of Steve Stout].)

180. In addition to wiping out the average net incomes of current dairy farmers, the decrease in milk prices would make it almost impossible for new dairy farmers to take the place of retiring farmers. Mr. Podtburg entered information from the accounting firm Ghenske-Mulder to show longer term profitability in Colorado for the surveyed farms was about $1.00 per hundredweight from 2018 to 2022. (*See generally* Ex. 321 [Testimony of Rick Podtburg].)

Additionally, dairy farmer Chris Kraft testified to profitability challenges in Colorado. (Ex. 252 at 3 [Testimony of Chris Kraft]).

181. If Proposal 7 is adopted and the USDSS is followed with no adjustments, dairy production in Colorado would most likely decline and the industry will have to transition to a composition of a few, very large and extremely efficient operations. Dairy production in total would decrease and the remaining businesses would have the absolute lowest fixed costs and the absolute highest productivity. These requirements can only typically be met by the few largest businesses. (Ex. 304 at 5-6; Tr. 7086:26-7087:6 [Testimony of Stephen Koontz].)

182. In the longer run, the pressures on water demand, the pressures on demand for land which is also productive farmland, and the relative opportunities for labor and employment are not in favor of agriculture. Improvements in productivity are needed in all animal agriculture in Colorado to simply maintain important contributions to the economy and specifically the rural economy. It is difficult to see how the Colorado dairy and milk production industry could adapt or make other adjustments to absorb the proposed policy change. (Ex. 304 at 7; Tr. 7091:13-23 [Testimony of Stephen Koontz].)

Mountains and Western Areas (FMMO 32 and Unregulated)

183. Since 2000, Colorado has seen a population growth of 35 percent, South Dakota a 20 percent growth, and both Wisconsin and Missouri a 10 percent growth. (Ex. 403 at 3 [Testimony of Steve Stout].)

184. Since before 2000, Denver has always had a Class 1 differential that was $0.55 per hundredweight higher than Kansas City within FMMO 32. Now, based on the same USDSS but with refreshed data, the USDSS is recommending the Class 1 differential for Denver to be $1.00 per hundredweight lower than Kansas City. This results in a net change from 2000 to 2022 for the

USDSS of a decrease for Denver of $1.55 per hundredweight. This significant of a decline for Denver is not equitable for regional Class I competition and will lead to a significant decline in blend prices for the Colorado producers. Instead, and directionally in line with the USDSS, the difference between Denver and Kansas City should be lowered from the current difference of a positive $0.55 per hundredweight over the Kansas City zone to a negative $0.05 per hundredweight for a total of $0.60 per hundredweight reduction between the two markets. (Ex. 403 at 7 [Testimony of Steve Stout].) And these zone values are important in protecting producer prices in Colorado (Ex 407 at 3 (Testimony of Edward Gallagher)).

185. The USDSS does not necessarily cover all the parameters that affect a milk market. Class I cannot be observed in a vacuum without looking at the manufacturing side of a given milk market. This coupled with local producer costs to produce milk for that market and hauling costs to bring milk into the market all affect how a supply of milk can meet the needs of the market including the subset of the Class I plants. (Ex. 403 at 8 [Testimony of Steve Stout].)

186. ATRI data shows hauling costs per loaded mile have increased from $1.676 in 2012 to $2.251 in 2022. DFA Mountain Area hauls approximately 70 percent of all DFA Mountain members' milk and its fleet consists of 185 tractors and 327 trailers with over 230 drivers to haul milk for its region. DFA Mountain Area's internal hauling costs has shown similar percentage increases as ATRI's data, though DFA has experienced higher costs than these national averages for the following reasons: (1) trailer costs are significantly higher for movement of raw milk with stainless steel food grade vessels compared against ATRI's average fleet of which nearly 50 percent of trailers are 28–53-foot dry van trailers, 5 percent are refrigerated trailers, 6 percent are flatbed trailers and 16 percent are tank trailers; (2) trailer load-bearing size has increased with capacities to haul up to 90,000 pounds of milk with quad-axle trailers; (3) tractor costs are higher

than ATRI's average tractor cost as DFA hauls load sizes from 50,000 pounds to over 90,000 pounds of milk which requires increased horsepower, transmissions, and tri-axle power trains; (4) driver shortages for the region have driven the driver labor costs higher over the last couple of years; and (5) per ATRI's study, fuel costs for the western portion of the United States for 2022 averaged from $0.064 to $0.105 per mile higher than the other four regions of the country. (Ex. 403 at 12-13 [Testimony of Steve Stout].)

187. NMPF is proposing a flat $2.55 per hundredweight location differential from western South and North Dakota, throughout Montana and Wyoming, and most of Idaho and Utah. (Ex. 403 at 15 [Testimony of Steve Stout].)

	Class 1 Location Differentials				
	Current	UoW Model Version		NMPF	NMPF
Region	USDA	May-21	Oct-21	Proposal	Vs. Current
Denver, CO	$2.55	$2.50	$2.50	$3.30	$0.75
Cheyenne, WY	$2.45	$2.30	$2.40	$3.20	$0.75
Billings, MT	$1.60	$2.50	$2.60	$2.55	$0.95
Twin Falls, ID	$1.60	$1.80	$1.90	$2.55	$0.95
Salt Lake City, UT	$1.90	$2.10	$2.20	$2.55	$0.65
Beaver, UT	$1.60	$2.40	$2.60	$2.55	$0.95
Cedar City, UT	$1.60	$2.40	$2.70	$2.55	$0.95
Las Vegas, NV	$2.00	$2.60	$3.00	$2.90	$0.90

(Ex. 403 at 15 [Testimony of Steve Stout].)

188. The $2.55 per hundredweight location differential throughout most of Wyoming is more of cosmetic than economic significance as there are no milk plants in the Wyoming counties proposed to be in the $2.55 per hundredweight area. Additionally, the milk plants in Idaho and Utah are not regulated under a Federal Order. The two pockets of milk production in Wyoming are in the north-central part of the state, and that milk feeds into the Southern Montana Class I plants and the southeastern part of the state that feeds into Ft. Morgan and Greeley manufacturing plants; Proposal 19 follows where this milk is marketed. (Ex. 403 at 18 [Testimony of Steve

Stout].)

189. Las Vegas is in Clark County, Nevada and is proposed to be $2.90 per hundredweight, which is up from its current level of $2.00 per hundredweight. The USDSS determined a value of $2.60 per hundredweight for the May analysis and $3.00 per hundredweight for the October analysis. A $2.90 per hundredweight value is more in line with the costs of serving the Las Vegas market as its population has exploded from 484,000 in 2000 to almost 2.9 million people, today – a 600 percent increase. Milk production in Utah (1.7 billion pounds) and Nevada (0.5 billion pounds) was 2.2 billion pounds in 2000 has modestly grown to 3.0 billion pounds in 2022 (Utah 2.2 billion pounds and Nevada 0.8 billion pounds). (Ex. 403 at 18 [Testimony of Steve Stout].)

190. The current differential in Iron County (Cedar City), Utah, where there is a Class I plant, is $0.40 per hundredweight less than Las Vegas at $1.60 per hundredweight. Proposal 19 raises the differential to $2.55 per hundredweight for Iron County, which is in line with the current price difference between Cedar City and Las Vegas and is in line with the USDSS. Similarly, Beaver County, Utah, where there is a manufacturing plant, is in line with the $2.55 per hundredweight value and maintains the same price as Iron County and a similar difference as exists relative to Clark County, Nevada. These two Utah counties anchor the western edge of the Proposal 19 $2.55 per hundredweight zone. Keeping a similar relationship in zone differentials for this geography helps to not disrupt this region's market conditions. (Ex. 403 at 18-19 [Testimony of Steve Stout].)

191. The remaining counties of significance in Utah with milk processing activity are those counties in and around Salt Lake City. The USDSS results for Salt Lake County ($2.10 per hundredweight in May and $2.20 per hundredweight in October), are inappropriate because they

are lower than the results for Iron and Beaver counties. Currently, the differential at Salt Lake is at $1.90 per hundredweight which is $0.30 per hundredweight higher than the Southwestern Utah counties. The population of the Salt Lake City metropolitan area grew from just under one million people in 2000 (968,858) to over 1.2 million today (1,203,000) – an increase of 24 percent. This represents about 36 percent of Utah's 3,380,803 population. Milk production in Utah north of Salt Lake continues to decline with urban encroachment and south of Salt Lake, milk continues to move further south into central and Southern Utah. The more modest growth in Utah's population and the need to have a flat pricing surface within the state of Utah are reasons for having a $2.55 per hundredweight price differential for the greater Salt Lake region. (Ex. 403 at 19 [Testimony of Steve Stout].)

Southeast and Southwest (FMMOs 5, 6, 7, 126)

192. Due to the milk deficit nature of the three southeast FMMOs and the eastern portion of FMMO 126, and the need to provide proper financial incentives to move milk into and within the Orders, the slope of the Class I differential surface in FMMOs 5, 6, 7, and 126 needed to steepen. (Ex. 310 at 25 [Testimony of Jeffrey Sims].)

193. To establish the differentials for the Southeast and Southwest, there were four anchor cities included in the Southeast-Southwest region: Winchester, Kentucky; Nashville, Tennessee; Asheville, North Carolina; and Amarillo, Texas. The Southeast-Southwest working group's critical review of the anchor recommendations was that they were appropriate recommendations for Winchester, Kentucky; and Nashville, Tennessee; these anchor prices were used to key off of when working through the FMMO 5, 6, and 7 differentials. (Ex. 310 at 25 [Testimony of Jeffrey Sims].)

194. The working group generated the differentials for FMMOs 5, 6, and 7 together. The

working group first established a proposed differential in Miami, Florida (Dade County). The working group agreed that the differential result from the USDSS for Miami, Florida was reasonable in light of the distance to south Florida from reserve supplies and adopted $7.90 per hundredweight as the recommended differential. At this point the working group had differential prices established at a city at the northern end of FMMO 5, Winchester, Kentucky at $4.60 per hundredweight; at a city roughly in the center of FMMOs 5 and 7, Nashville, Tennessee at $4.85; and at a city at the far south end of the region, Miami, Florida at $7.90 per hundredweight. (Ex. 310 at 26 [Testimony of Jeffrey Sims].)

195. Next, the working group established the southwest corner of FMMO 7, which focuses on three cities on the Louisiana Gulf Coast. These three cities currently have the same differential, and the working group determined that retaining that relationship was appropriate. The USDSS provided a range of prices for these three cities, ascending from west to east, Lafayette to Baton Rouge to Hammond. The working group agreed that the logical differential would be near the average of three outputs from the USDSS and set the differential for all three of these cities at $5.70 per hundredweight. (Ex. 310 at 26 [Testimony of Jeffrey Sims].)

196. Next differentials in Southern Missouri and Arkansas were evaluated. The working group determined that while the Missouri cities of Springfield and Fordland and the Arkansas cities of Fayetteville and Fort Smith currently exist across three FMMO 7 pricing zones, the common local milk procurement area and the common supplemental milk procurement area shared by these plants created a need for a common Class I differential across this four-city area. The working group determined that based on the proposed anchor city differential at Norman, Oklahoma of $3.85 per hundredweight, a price difference for Norman to Southwest Missouri and Northwest Arkansas was appropriate. A differential of $4.00 per hundredweight was recommended for the

two Southwest Missouri and two Northwest Arkansas cities. Having built something like the corners of a puzzle, the working group progressively worked toward the middle to develop differentials for FMMOs 5, 6, and 7.

197. FMMO 126 presented a unique challenge. There should be sufficient milk supplies to meet the Class I needs of the area. However, there is a major disconnect between the location of the milk supplies and the location of the majority of the population. The shear distances milk must move within FMMO 126 rival some of the distances supplemental milk moves into the southeastern FMMOs. The vast majority of FMMO 126 milk supplies are produced in the Texas panhandle and Eastern New Mexico areas, and along with those supplies of milk, exists the majority of FMMO 126 hard product manufacturing. (Ex. 310 at 30 [Testimony of Jeffrey Sims].)

198. The major population centers within FMMO 126 are largely located on the eastern side of Texas, and include the Dallas-Fort Worth metroplex, the Houston metro area, the San Antonio metro area, and the Austin metro area. On the western side of Texas is the Amarillo-Lubbock city cluster, and El Paso. There are two major metropolitan areas in New Mexico, Albuquerque in the north, and Las Cruces in the south. Not surprisingly, with the exception of Las Cruces, FMMO 126 pool distributing plants can mostly be found in these listed major cities. The Dallas-Fort Worth-Arlington metropolitan area is the fourth most populous in the United States, and the Houston-The Woodlands-Sugarland metropolitan area is the fifth most populous. From Hereford, Texas it is approximately 385 miles to the center of the Dallas-Fort Worth metroplex and approximately 635 miles to Houston. (Ex. 310 at 30-31 [Testimony of Jeffrey Sims].)

199. Currently, there are 19 pool distributing plants regulated by FMMO 126. Only two are located outside the major metropolitan areas. (Ex. 310 at 31 [Testimony of Jeffrey Sims].)

200. There was one anchor city located in FMMO 126, Amarillo, which sits at the

junction of FMMO 126 and the southern portion of FMMO 32. The anchor city differential was initially set by the full Class I working group at $2.65 per hundredweight. Nearby was the anchor city of Norman, Oklahoma, with an initial anchor city differential of $3.85 per hundredweight. (Ex. 310 at 31 [Testimony of Jeffrey Sims].)

201. Currently, there are equal stair steps in the Class I differential between the Texas panhandle, where Amarillo is located, and the Dallas-Fort Worth metroplex, and then between the Dallas-Fort metroplex and Houston. Currently, the panhandle differential is $2.40 per hundredweight, Dallas-Fort Worth is $3.00 per hundredweight, and Houston is $3.60 per hundredweight, which equates to two successive $0.60 per hundredweight steps coming out of the panhandle. The Southeast-Southwest working group determined that the magnitude of these steps is inadequate to attract milk south and east from the panhandle, but that equal steps between the locales is still appropriate. (Ex. 310 at 31 [Testimony of Jeffrey Sims].)

202. In reviewing the USDSS, the suggested differential for Houston was $4.70 per hundredweight. Comparing this differential to the Southeast-Southwest working group's recommended differential for plants along the Louisiana Gulf coast of $5.70 per hundredweight, the working group determined that a modestly higher differential than the USDSS suggestion for Houston was reasonable and established the Houston-Conroe differential at $5.00 per hundredweight. (Ex. 310 at 31 [Testimony of Jeffrey Sims].)

203. In reviewing the differentials established for the southeast Orders, and for the Midwest and Northeast regions, there emerged an obvious northeast to southwest differential zone of $4.00 per hundredweight, which, when extended, would reach the Dallas-Fort Worth area. Establishing a differential of $4.00 per hundredweight for the Dallas-Fort Worth area was determined to be reasonable, though it represented a small deviation from the USDSS. (Ex. 310 at

31 [Testimony of Jeffrey Sims].)

204. There is only one FMMO 126 pool distributing plant located in New Mexico, and that one plant is in Albuquerque, in the northern half of the state. The current Class I differential for Albuquerque is $2.35 per hundredweight. The supply for Albuquerque comes from counties near the middle of the state, occasionally supplemented by milk supplies produced in the heavy production region of southeast New Mexico. The distance milk would move from the middle of the state to Albuquerque is mostly less than an average of 60 miles, and thus this is a local and relatively low-cost haul. (Ex. 310 at 33 [Testimony of Jeffrey Sims].)

205. In reviewing the milk production data, and the general disincentives to move milk long distances within New Mexico due to the over-abundance of mountain ranges, and the dearth of suitable roadways, it became apparent that New Mexico has three pockets of milk production, each of which has what is effectively its own primary local in-state market for milk. Considering the nature of milk supplies across the state of New Mexico and how they are utilized, in particular the configuration of local plants within or nearby local milk sheds, it was determined that the same differential should be applicable across all of New Mexico, $2.70 per hundredweight. This recommended differential across New Mexico aligns well with the recommended differentials in the neighboring states of Colorado, the panhandle of Texas, Arizona, and the city of El Paso. (Ex. 310 at 33-34 [Testimony of Jeffrey Sims].)

206. The Southeast-Southwest working group then considered the Class I differentials at Austin and San Antonio, Texas. The current differential at Austin is $3.30 per hundredweight, $0.30 higher than Dallas-Fort Worth. The working group determined that a slight increase in the spread between Austin and Dallas-Fort Worth was needed, increasing the slope of the differential surface to attract milk supplies to the large metro areas south of Dallas-Fort Worth. The difference

in the differential between Austin and Dallas-Fort Worth should be increased from $0.30 to $0.35, thus the differential is proposed at $4.35 per hundredweight for Austin. (Ex. 310 at 35 [Testimony of Jeffrey Sims].)

207. The current differential at San Antonio is $3.45 per hundredweight, $0.15 higher than Austin, $0.45 higher than Dallas-Fort Worth, and $0.15 less than Houston. Based on the proposed differentials of $4.00 per hundredweight at Dallas-Fort Worth, $5.00 per hundredweight at Houston and $4.35 per hundredweight at Austin, a greater difference at San Antonio versus Austin and versus Dallas-Fort Worth is justified. The Southeast-Southwest working group determined that a $0.35 spread between Austin and San Antonio was appropriate, which also spread the difference between San Antonio and Houston to $0.30. The Class I differential proposed for San Antonio, Texas is $4.70 per hundredweight. (Ex. 310 at 35 [Testimony of Jeffrey Sims].)

208. Moving to the far western end of Texas, the Southeast-Southwest working group reviewed the recommended differential at El Paso. The current differential at El Paso is $2.25 per hundredweight, $0.75 less than Dallas-Fort Worth, and $1.05 less than Austin. The differential at Dallas should increase by $1.00 per hundredweight and increase by $1.05 at Austin. Thus, some increase at El Paso is warranted. El Paso's Class I differential should increase by $0.60 per hundredweight, less than Dallas-Fort Worth and Austin increases, but equal to the increase in the Texas panhandle. The El Paso differential should change from $2.25 to $2.85 per hundredweight. (Ex. 310 at 35 [Testimony of Jeffrey Sims].)

209. Lastly, the Southeast-Southwest working group reviewed Class I differentials for the pool distributing plants located in East Texas. There are currently two pool distributing plants located generally east of the Dallas-Fort Worth metroplex; these being in Sulphur Springs, Texas – Hopkins, County; and Tyler, Texas – Smith County. These plant locations all currently carry a

differential which is identical to the Dallas-Fort Worth metroplex. (Ex. 310 at 35 [Testimony of Jeffrey Sims].)

210. The Southeast-Southwest working group determined that, akin to prices established for many areas, both of these east Texas plant locations should carry a like Class I differential. The Southeast-Southwest working group concluded that a $0.35 greater Class I differential for plants in East Texas versus Dallas-Fort Worth was appropriate. Thus, the Class I differential for Sulphur Springs and Tyler, Texas should be $4.35 per hundredweight. (Ex. 310 at 36 [Testimony of Jeffrey Sims].)

211. There are 14 cities that include a pool distributing plant. All pool distributing plant locations in FMMO 126 are proposed to have Class I differentials that exceed the USDSS. The simple average of the proposed differentials across FMMO 126 exceed the USDSS by approximately $0.34 per hundredweight. While milk production in Texas has increased over the last several years, Texas still does not produce enough milk to satisfy all of the many milk demands that occur. (Ex. 310 at 43 [Testimony of Jeffrey Sims].)

212. Further compounding the problem, approximately 77 precent of production in Texas is in the panhandle where just 2 percent of the population resides. The distances across the state are massive. Hereford, Texas, located in Deaf Smith County, is often considered the center point of the panhandle's milk production. From Hereford to Houston, the location of two pool distributing plants, it is approximately 635 miles. From Hereford to Dallas, it is 400 miles. (Ex. 310 at 44 [Testimony of Jeffrey Sims].)

213. At the time of Order Reform only 4 percent of production in Texas occurred in the panhandle. The milkshed of Sulphur Springs, close to Dallas-Fort Worth, produced approximately 25 percent of the milk, and most milk was produced to the west of Dallas-Fort Worth in the

Windthorst-Stephenville milk sheds. (Ex. 310 at 47 [Testimony of Jeffrey Sims].)

214. National truck driving regulations require that a driver limit their actual behind-the-wheel time to 11 hours before a mandatory seven-hour break. A fresh driver, starting their 11-hour clock by getting into the cab of a loaded truck at Hereford, must average almost 58 miles per hour to get to Houston within the 11-hour window. The preferred route from Hereford to Houston takes a truck through the Dallas-Fort Worth metroplex, where traffic and delays are common. Failure to make it to a Houston plant, or to a drop yard near a Houston plant, means a night on the road, in transit. If that happens, after the seven-hour rest break, the driver completes the loaded trip, hooks to an empty trailer, and starts back toward Hereford. If the driver could not get to Houston in 11 hours on the loaded side of the trip without a mandatory break, it is unlikely he or she will be able to get back to Hereford on the second day. Practically, this is a three-day trip to deliver one load of milk. Thus, to deliver one load of milk per day to Houston requires three trucks on the road at all times. (Ex. 310 at 44 [Testimony of Jeffrey Sims].)

<u>*Arizona (FMMO 131)*</u>

215. When setting new Class I differentials in Arizona, the objectives were: 1) follow the guidance provided by the USDSS and make adjustments where local conditions warrant a change; 2) maintain the current pricing relations among competing handlers both within the market and with the surrounding states; 3) establish a smooth transition of Class 1 pricing from surrounding areas to maintain a consistent "slope" of price changes. (Ex. 376 at 2; Tr. 8694:16-8695:3 [Testimony of Brent Butcher].)

216. Dairy farming in Arizona presents a unique set of challenges that make it a formidable and costly endeavor. The most glaring obstacle is the arid desert climate that dominates the region, resulting in scorching temperatures and water scarcity. These conditions pose a

significant challenge to dairy farmers who require abundant water resources to sustain operations. Arizona is facing a severe and prolonged drought that poses serious concerns about water scarcity and long-term water management strategies to address the crisis. These inhospitable elements test the resilience of the animals, farmers, and the critical staff required to operate each dairy. (Ex. 376 at 1; Tr. 8692:21-8693:6 [Testimony of Brent Butcher].)

217. There are only two counties in FMMO 131 that have pool plants. The majority of the pool plants are in Maricopa County (Phoenix); Yuma County has two distributing plants. The proposed increase in the Class I differential in Maricopa County is 27.6 percent. The proposed increase in the Class I differential in Yuma County is 38 percent. The current cost to service the Class I market has increased more than these percentages. (Ex. 376 at 3; Tr. 8695:19-8696:1 [Testimony of Brent Butcher].)

218. United Dairymen of Arizona ("UDA") operates a manufacturing plant in Tempe that balances milk for Class I bottlers. UDA produces 12 million pounds of milk daily. (Ex. 376 at 1; Tr. 8693:13-25 [Testimony of Brent Butcher].)

219. Since 2000, Arizona's population has skyrocketed from 5.16 million people to over 7.35 million—a 42 percent increase. Land in Arizona is becoming more expensive, with the cost of farmland now ranging from $30,000 to $40,000 per acre, roads more congested, and competition for resources like water, energy, and labor has become tangible, every-day obstacles. All of the structural changes and competition for resources has had a clear impact: above average increased costs. (Ex. 376 at 1, 5; Tr. 8693:28-8694:15, 8702:8-12 [Testimony of Brent Butcher].)

220. The distance milk needs to move from UDA farms to customer to service the market is relatively low with most farm transportation distances within 150 miles of its manufacturing destination. But, with urban sprawl and population growth, the amount of time it

takes to deliver the milk has been steadily increasing. Due to population growth around the Phoenix metro area, drive times routinely exceed 30 minutes more than drive times in 2017. During rush hour traffic, drive times have increased by one hour or more depending on road conditions. Further, it normally takes drivers about 2.25-3.25 hours to unload and wash their trucks at the receiving plant. If there are delays because of plant construction projects or labor issues, the time it take to unload can increase. On top of the additional time, demurrage charges have increased by 60 percent. (Ex. 376 at 4; Tr. 8697:20-25, 8698:17-8699:25 [Testimony of Brent Butcher].)

221. Since 2018, the cost of a tanker has increased 35 percent. (Ex. 376 at 4; Tr. 8698:10-11 [Testimony of Brent Butcher].) Since 2017, fuel costs in Arizona have increased by 80 percent. Since 2017, other costs like insurance, repairs and maintenance, special permitting, and wages have cumulatively increased 38 percent. Likewise, the costs to maintain Grade A status—such as on-farm milk storage at lower temperatures, cleaning and upkeep of equipment, and cow comfort—have increased. (Ex. 376 at 5-6; Tr. 8700:10-22, 8700:28-8701:13 [Testimony of Brent Butcher].)

222. In recent years, Arizona has had record heat amid decade-long drought conditions. With these hot, dry conditions come more challenges and different priorities than other parts of the country, including how water is utilized. A shortage on the Colorado River means a reduction in the supply available to Lower Colorado River water users. This also means dairy farmers pay more for water than they did in the year 2000 and more than almost any other state. (Ex. 376 at 3; Tr. 8696:7-8697:3 [Testimony of Brent Butcher].)

223. The availability of water has a profound impact on Arizona dairy operations. Surface water for agricultural use has been restricted or, in some instances, cut off entirely. Wells are in use, but the cost of rehabbing them for an adequate supply of water (deeper or relocating

wells) has increased. Due to water availability issues, farms can no longer depend on growing their own feed to supplement their needs. Arizona dairy farmers are increasingly dependent on purchasing feed, and Arizona farmers are facing stiff competition and increased prices to locate feedstuffs. Arizona feed mainly comes from the Midwest. All aspects of transportation costs to deliver feed (rail and truck) have increased. (Ex. 376 at 5; Tr. 8701:18-8702:4 [Testimony of Brent Butcher].)

224. The need to affect higher prices on behalf of Arizona dairy farmers is essential to combat the increased production costs in one of the fastest growing population states in America. (Ex. 376 at 92; Tr. 8704:10-13 [Testimony of Brent Butcher].)

California (FMMO 51)

225. Proposal 19 maintains a relatively consistent relationship between California's Class I differentials and those of surrounding states. (Ex. 345 at 2; Tr. 8086:28-8087:3 [Testimony of Rob Vandenheuvel].)

226. California's primary milk supply region of the Central Valley and the major Upper Midwest milksheds of Wisconsin, Minnesota and South Dakota have substantial functional similarities. First, both regions share a profile as large milk producing regions with a vast majority of milk marketed to local non-Class I manufacturers and serving as a reserve supply for the relatively small portion of Class I bottlers in the region. In total, about 10 to 12 percent of California's milk production ends up in a Class I facility, but a majority of that Class I demand is from bottlers outside the Central Valley. While the Central Valley is home to approximately 90 percent of the total milk production in the State, only five of California's 20 current pool distributing plants are located in the area. The on-farm competitiveness of similar regions across the United States is not something the USDSS model is designed to solve for, but it is an important

factor to consider. Those same dairies compete for animal feed and other supplies sourced throughout the United States. (Ex. 345 at 3; Tr. 8088:14-8089:12 [Testimony of Rob Vandenheuvel].)

227. In light of these facts, Proposal 19 establishes updated Class I differentials in California's Central Valley ranging from $2.50 to $2.60 per hundredweight. Proposed Class I differentials in Wisconsin, Minnesota and South Dakota range from $2.55 to $3.00 per hundredweight. (Ex. 345 at 3; Tr. 8089:20-25 [Testimony of Rob Vandenheuvel].)

228. Proposal 19 includes necessary adjustments to some of the county-by-county relationships. There are generally three distinct regions of California, each with unique supply/demand dynamics. The Central Valley makes up approximately 90 percent of the state's milk supply. Southern California, made up of counties south of the Tehachapi Mountain Range, has a limited and shrinking milk supply, representing less than 5 percent of the state's total supply, but is home to 10 of the 20 total pool distributing plants in the state. As such, bulk raw milk from the Central Valley is regularly exported to Southern California. Finally, the Bay Area is a region of extremely limited and shrinking milk supply, representing less than 3 percent of the state's total supply, and is home to five of the 20 total pool distributing plants in the state. As such, bulk raw milk from the Central Valley is also regularly exported to the Bay Area. Proposal 19 incorporates a "slope" in the Class I differentials between the Central Valley and Southern California and between the Central Valley and the Bay Area at levels intended to incentivize dairies and milk handlers to serve the Class I needs in those urban regions. (Ex. 345 at 6; Tr. 8094:22-8095:18 [Testimony of Rob Vandenheuvel].)

229. Specific to Southern California, the current Class I differential map incorporates a $0.30 per hundredweight slope between Kern and Los Angeles Counties, with a significant volume

of Kern County milk regularly supplying Los Angeles County Class I needs, as it is the nearest available milk other than local farms located in Southern California. Proposal 19 includes a $0.40 per hundredweight slope between Kern and Los Angeles counties as a more appropriate slope. The average cost incurred by CDI in 2022 for delivering bulk milk from Kern County to Los Angeles County ranged from $1.39 to $1.50 per hundredweight. Meanwhile, the average cost incurred by CDI in 2022 for delivering bulk milk from those same farms in Kern County to the nearest local manufacturing plant in Tulare County was $0.68 - $0.81 per hundredweight. Simply put, the $0.40 per hundredweight slope in Proposal 19 provides an additional pool draw for those farms and milk handlers that is needed to at least partially offset the incentive that otherwise exists to simply deliver all milk to the local manufacturing plant in the Central Valley. (Ex. 345 at 7; Tr. 8095:19-8096:12 [Testimony of Rob Vandenheuvel].)

230. Proposal 19 includes a $0.50 per hundredweight slope between the remaining counties in the Central Valley and Los Angeles County. While that slope exists throughout the Central Valley north of Kern County, the slope is most important for Tulare and Kings Counties, as farms in those counties represent the next logical reserve milk supplies in the event Kern County milk is not sufficient to supply Class I needs in Southern California. This $0.50 per hundredweight slope is consistent with the current spread between the differential levels in Tulare and Kings Counties and Los Angeles County. (Ex. 345 at 7; Tr. 8096:13-23 [Testimony of Rob Vandenheuvel].)

231. The cost incurred by CDI in 2022 for delivering bulk milk from Tulare County to Los Angeles County ranged from $1.68 to $1.88 per hundredweight. Meanwhile, the average cost incurred by CDI in 2022 for delivering bulk milk from those same farms in Tulare County to the nearest local manufacturing plant in Tulare County was $0.44 - $0.54 per hundredweight. While

that gap is more than the $0.50 per hundredweight provided by the slope in the proposed differential map, it is consistent with the current slope for this reserve supply of milk available for Southern California Class I usage. (Ex. 345 at 7; Tr. 8096:24-8097:6 [Testimony of Rob Vandenheuvel].)

232. Specific to the Bay Area, the current Class I differential map incorporates a $0.10 per cwt slope between the coastal regions of San Francisco and the nearby milksheds of Sacramento, Stanislaus, and San Joaquin Counties, an insufficient differential when looking at the cost of servicing that market and attracting a long-term milk supply. Proposal 19 includes a more appropriate $0.40 per cwt slope between these same counties. The cost incurred by CDI in 2022 for delivering bulk milk from San Joaquin County to Alameda County, which includes Class I utilization and borders the San Francisco Bay, ranged from $1.08 to $1.29 per hundredweight. Meanwhile, the average cost incurred by CDI in 2022 for delivering bulk milk from those same farms in San Joaquin County to the nearest local manufacturing plant in Stanislaus County was $0.45 - $0.65 per hundredweight. The $0.40 per hundredweight slope proposed for the Bay Area would provide an additional pool draw to partially offset the incentive that otherwise exists to simply deliver all milk to the local manufacturing plant in the Central Valley. (Ex. 345 at 7-8; Tr. 8097:25-8098:19 [Testimony of Rob Vandenheuvel].)

233. Increased Class I differentials in California are justified by the increase costs to dairy farmers. California is a destination market for feed. A destination market is where local demand for products is much larger than the local supply for that product. One large component affecting destination market feed prices and local basis prices is transportation costs. Transportation costs over the last 15-20 years have routinely increased. (Ex. 334 at 2; Tr. 7782:14-7782:20 [Testimony of Hunter Jensen].)

234. A lack of updates to the Class I differential levels to recognize incremental increases in the cost of supplying Class I markets over the past two decades has also suppressed the pool revenues that could otherwise have been available as a further incentive for more farms and milk handlers to associate regularly with the FMMO pool. While there is no silver bullet that will incentivize more milk to associate with a Federal Order pool, other than a mandatory requirement to pool all Grade A milk handled, updating the Class I differentials will help to increase the incentive by growing overall pool revenues. Not only does an increased incentive to pool milk help ensure that more farms and milk handlers are willing to supply Class I needs, but it also creates more stability at the producer level, as blended prices paid for milk produced across an FMMO are more consistent from farm to farm. (Ex. 345 at 4; Tr. 8091:12-8092:3 [Testimony of Rob Vandenheuvel].)

235. In 2001, the California Department of Food and Agriculture, or CDFA, reported that there were 295 dairy farms in Southern California, housing an estimated 266,672 cows. That same report indicated that between the five milk producing counties surrounding the Bay Area – Sonoma, Marin, Solano, Contra Costa, and Santa Clara Counties – there were 125 dairy farms in 2001, housing an estimated 42,031 cows. In 2017, the last such report published by CDFA, those numbers had fallen to 92 dairy farms in Southern California, housing an estimated 90,675 cows, and fallen to 87 dairy farms in the five counties surrounding the Bay Area, housing an estimated 37,928 cows. Meanwhile, those respective regions also experienced population increases. The Southern California population centers of Los Angeles, Orange, San Bernardino, Riverside and San Diego Counties grew from 18.43 million residents in the 2000 Census to 21.10 million residents in the 2020 Census, a 14.5 percent increase; and the Bay Area population centers of San Francisco, Contra Costa, Alameda, and Santa Clara Counties grew from 4.85 million residents in

the 2000 Census to 5.66 million residents in the 2020 Census, a 16.7 percent increase. (Ex. 345 at 4; Tr. 8092:11-8093:8 [Testimony of Rob Vandenheuvel].)

236. Shrinking local milk supply and a shifting and growing population has resulted in the need for bulk raw milk to be sourced from further distances to meet the needs of milk bottlers located near the population centers. Extreme traffic congestion that is generally the rule, rather than the exception, in these metropolitan regions adds further complexity and cost that cannot be captured by current economic modeling. (Ex. 345 at 4; Tr. 8093:10-17 [Testimony of Rob Vandenheuvel].)

237. In addition, while cooperatives, including CDI, previously operated manufacturing plants available for balancing purposes in Southern California, those plants have since been closed. The nearest cooperative-owned balancing plant to the urban population center of Los Angeles County is CDI's butter and milk powder manufacturing facility in Tipton, California, roughly 150 miles—and over the Tehachapi Mountain Range—from the Southern California bottlers that need milk on a specific schedule in specific and varying quantities throughout the week. (Ex. 345 at 4-5; Tr. 8093:18-28 [Testimony of Rob Vandenheuvel].)

238. California geographically is a large, elongated state containing significant mountain ranges. Traffic at times is horrendous, particularly in the large urban areas but increasingly in the growing urban areas of the Central Valley as well. This adds significant travel time, wear and tear on equipment, and places additional strain on the driver pool. There are few milk producers in close proximity to the large Southern and Northern California urban areas which necessitates increasingly longer hauls. (Ex. 373 at 7; Tr. 8638:19-28 [Testimony of Johnny Hiramoto].)

239. Nevada has Class I operations in and around Las Vegas (Clark County) and Reno (Washoe County). DFA operates a medium-sized manufacturing plant in Fallon (Churchill

County). Washoe County and Churchill County are in Northern Nevada. Historically, Washoe and Churchill Counties and other counties in Northern Nevada, have followed the pricing structure of Northern California. For example, prior to November 2018, while California still operated under a state order, Nevada had adopted the same basic pricing structure in place in northern California for use in Northern Nevada. Currently, Washoe and Churchill Counties have the same differential as milk-producing counties directly to the west in California. Additionally, a plant in northern Nevada has consistent route distribution in Northern California. The counties in Northern California have a mix of Class I plants and manufacturing plants. It is necessary to continue a similar price surface between these plants in this bi-state region to maintain competitive equity for them relative to blend prices under FMMO 51. (Ex. 373 at 5-6; Tr. 8634:22-8635:20 [Testimony of Johnny Hiramoto].)

Pacific Northwest (FMMO 124)

240. In order to continue incentivizing service of Class I markets in the Pacific Northwest, it is important to consider regional competitiveness at the farm level, the rapidly changing landscape of the dairy industry in the Pacific Northwest, and geographic and population influenced cost drivers in the Pacific Northwest. (Ex. 397 at 2; Tr. 9234:8-9234:14 [Testimony of Monty Schilter].)

241. Regional competitiveness at the farm level needs to be maintained in areas and regions similar to each other across the United States. The Pacific Northwest, specifically around King County (Seattle), Washington, operates similarly to the urban parts of FMMO 32. The USDSS suggests increasing the Class I differentials associated with FMMO 32 from the current level of $1.85 per hundredweight to $3.00–$3.30 per hundredweight ranges in those counties near population centers. A similar increase in the Class I differential for King County is equitable. The

differential in King County should be at least the minimum of the range, $3.00 per hundredweight. Regional competitiveness also needs to occur within the Pacific Northwest and the simplicity of the USDSS in 2000 established three differential values that decreased by $0.15 per hundredweight as it moved away from the population centers. (Ex. 397 at 2; Tr. 9234:15-9235:10 [Testimony of Monty Schilter].)

242. Regional competitiveness needs to remain on the Interstate-5 ("I-5") corridor (west of the Cascade Mountain Range between the Canadian and California borders). Within the Pacific Northwest, there are geographical features and significant distances that separate the I-5 corridor from the rest of the order. The area represents the vast majority of the pool distributing plants. Eight of the 12 pool distributing plants are within the Seattle and Portland metro areas. All pool distributing plants in this region should compete on a level playing field thus a similar differential should be maintained across these pool distributing plants. (Ex. 397 at 2; Tr. 9235:14-26 [Testimony of Monty Schilter].)

243. The Pacific Northwest is an area of population growth and declining milk production. From 2000 to 2020, the population in Seatle increased from 3.04 million people to 4.02 million people. For the same period in Portland, Oregon, population increased from 1.93 million people to 2.51 million people. Combined, the regions grew by more than 30 percent in 20 years. This does not include the surrounding areas where growth was also occurring at similar or higher rates. At the same time, milk production in this region has been declining. (Ex. 397 at 3; Tr. 9235:27-9236:11 [Testimony of Monty Schilter].)

244. In December 2001 in the counties along the I-5 corridor, there were 794 farms producing 400 million pounds of milk. In those same counties in March of 2023, there were 261 farms producing 242 million pounds of milk. It represents a 67 percent drop in farms and a 39

percent drop in milk production in just over 20 years. A disproportionate amount of this activity occurred in the last five years. Five years ago, there were 398 farms producing 294 million pounds of milk; in 2023, there were 261 farms producing 242 million pounds of milk, representing a 34 percent drop in farms and a 17 percent drop in milk production over just the last five years. Servicing the pool distributing plants along the I-5 corridor will increasingly need to be satisfied by manufacturing plants located 200 miles or more away and/or milk producing areas that are much longer distances than before. (Ex. 397 at 3; Tr. 9236:11-9237:2 [Testimony of Monty Schilter].)

245. The majority of the milk that does and will continue to service the pool distributing plants comes from Eastern Washington, specifically, Moses Lake and Sunnyside, Washington. Internal freight data paid to haulers to assemble a load of milk and deliver it to either Seattle or Portland has gone from $1.00 per hundredweight in 2008 up to $2.10 per hundredweight in 2023. That is an increase of $1.10 per hundredweight in 15 years. Servicing the two markets of Portland and Seattle involves mountain passes that can be severely impacted by winter weather. There are usually at least two days per year when the mountain passes are closed and impassable and result in farms having to dump milk since it physically cannot get to market. As the population continues to grow in the Northwest region, it causes an increase in transportation congestion. Driving in and out of Seattle and Portland adds time and costs to servicing the pool distributing plants. (Ex. 397 at 3-4; Tr. 9237:11-9238:2 [Testimony of Monty Schilter].)

246. Looking at differentials for the region as a whole—Washington, Oregon, Idaho, and Montana—the differences between zone values stay the same as the 2000 version of the USDSS. Using King County as the base at a recommendation of $3.00 per hundredweight, the same spread of $0.15 per hundredweight for the counties east of the Cascade Mountains is

maintained. The counties in and around Spokane are at the same $3.00 per hundredweight differential as King County since that preserves the original relationship. In likely insignificant counties where there is no milk production, the Class I differential is recommended to go down to $2.50 per hundredweight. Moving into unregulated Idaho, in likely insignificant counties where there is no milk production, the proposed differential is $2.20 per hundredweight. This is the lowest Class I differential in Proposal 19. For areas with milk production, South Dakota served as a benchmark at $2.55 per hundredweight. In Montana, which has state regulated milk prices, all counties were treated similar to South Dakota at $2.55 per hundredweight. South Dakota was used as the benchmark in Idaho and Montana due to the fact that these are all areas with significantly higher milk production versus population and fluid milk bottling facilities. (Ex. 397 at 4; Tr. 9238:3-9239:7 [Testimony of Monty Schilter].)

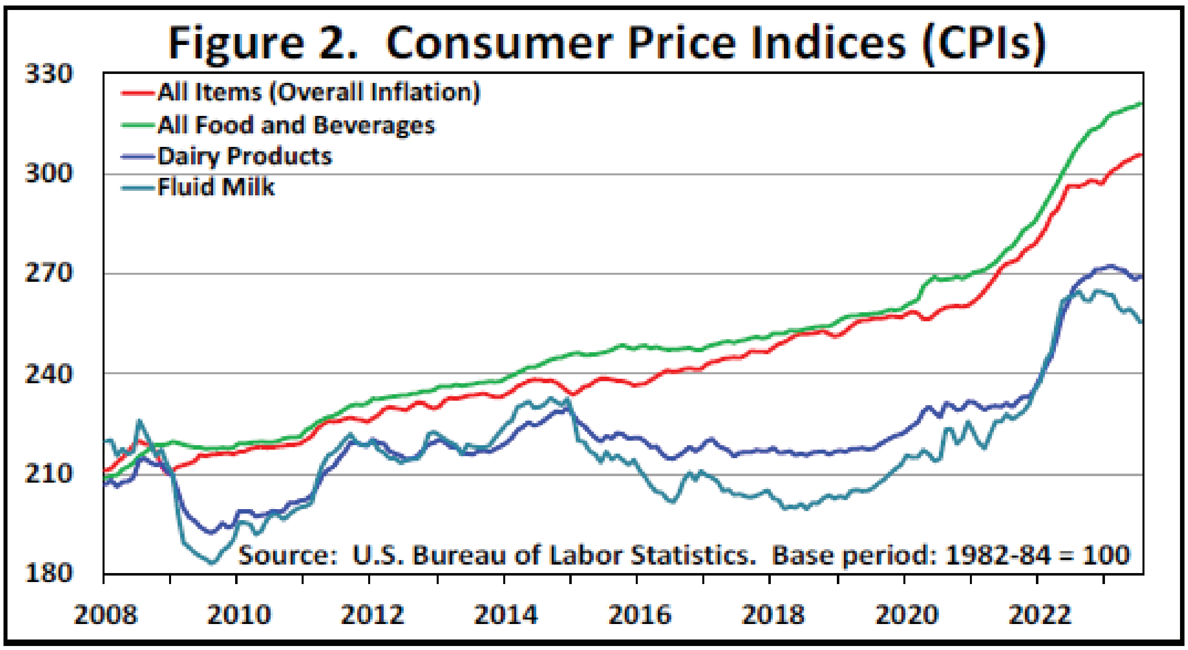
B. Raising Class I Differentials Is Further Justified Because Class I Sales Are Inelastic.

247. A price elasticity measures the percentage change in demand, given a 1 percent change in price. When firms have control over price setting, they will strive to raise the price when the current price is in the inelastic range of demand since doing so will result in a higher percentage increase in price than the corresponding percentage decrease in quantity, and therefore revenue will increase. (Ex. 115 at 1; Tr. 1555:24-1556:7 [Testimony of Dr. Harry Kaiser].)

248. The overwhelming majority of empirical studies that have measured the price elasticity of demand for milk have found it to be inelastic. This means that consumers are not overly sensitive to adjusting their fluid milk purchases in response to price changes. (Ex. 115 at 1; Tr. 1556:8-10, 1557:24-1558:1 [Testimony of Dr. Harry Kaiser].)

249. Milk is inelastic because it is considered a "staple good" in that milk buyers regularly consume it usually in the same amount regardless of price level. For regular milk

consumers, milk is considered more of a necessity than a luxury, which explains why consumers are not sensitive to price changes. They regularly buy milk and do not significantly alter their purchases in response to price changes. For non-milk consumers, such as vegans, people who are lactose intolerant, or people who simply do not like to drink milk, the price of milk has no impact at all on their decision whether or not to consume it. (Ex. 115 at 2; Tr. 1557:23-1558:10 [Testimony of Dr. Harry Kaiser].)



(Ex. 299 at 8; Tr. 6832:17-6833:3 [Testimony of Dr. Peter Vitaliano].)

250. The above figure shows a perspective on the impact on consumers of the Federal Order program, and potential changes to the regulatory provisions of that program. It charts the monthly Consumer Price Indices ("CPIs") reported by the U.S. Bureau of Labor Statistics ("BLS") over the past decade and a half for all items, which is the general measure of overall consumer price inflation, also referred to as the overall cost of living, together with the aggregate CPIs for all food and beverages, for all dairy products, and for all fluid milk products. (Ex. 299 at 8; Tr. 6832:17-6833:[Testimony of Dr. Peter Vitaliano].)

251. The overall cost to consumers of dairy products, and fluid milk products in particular, has declined since 2008 relative to both overall inflation as well as general food and beverage price inflation. (Ex. 299 at 9; Tr. 6838:21-25 [Testimony of Dr. Peter Vitaliano].)

252. Another way to demonstrate how unimportant price changes are in terms of driving milk demand, consider the fact that the *real* price of milk relative to all goods and services in the U.S. economy has fallen by 7 percent since 2013. (The *real* price is adjusted for inflation to remove any bias in the milk price over time). That means that milk has become less expensive to purchase relative to all other goods and services in the U.S. economy since 2013. Yet, during the same time period, per capita milk consumption actually decreased by 18.3 percent. That is, even though the price of milk has decreased relative to other products, per capita demand has decreased since 2013. Of course, there are other demand drivers that have helped cause this decline, but if the price of milk were actually elastic, one would expect the 7 percent decrease in the real milk price would have resulted in an increase rather than an 18.3 percent decrease in per capita demand. (Ex. 115 at 2; Tr. 1559:6-26 [Testimony of Dr. Harry Kaiser].)

253. There are at least three reasons for the decline in milk consumption, and they do not include the retail price of milk. First, the beverage market has become increasingly competitive with many new products introduced over time. In the distant past, milk lost significant market share to soda. Second, another cause has been the increasing trend in food consumed away from home. Finally, an important demographic change causing a decrease in milk demand is the proportion of young children in the population, which is lower than it was in 2013. Since young children are one of the largest fluid milk-consuming cohorts, any decline in that cohort negatively impacts per capita fluid milk consumption. Between 2010 and 2021, the proportion of the population under 19 years of age in the U.S. fell from 26.9 percent to 24.8 percent, which

represents almost an 8 percent decline in the youngest (and largest fluid milk-consuming) cohort of the population. (Ex. 115 at 2-3; Tr. 1560:1-1561:23 [Testimony of Dr. Harry Kaiser].)

254. Proposal 19 recommends a nationwide increase of the Class I price differential by an average of $1.49 per hundredweight. At current Class I prices, this is an 8.6 percent increase. An 8.6 percent increase in the Class I price would result in a 4.7 percent increase in the retail price for milk products. Based on the average retail price elasticity of demand, a 4.7 percent increase in the retail milk price would cause per capita fluid milk demand to decrease by 1.6 percent. Alternatively, using the median retail price elasticity of demand at 0.2 percent, a 4.7 percent increase in the retail milk price would cause per capita fluid milk demand to decrease by 0.9 percent. Using either estimate, the decrease in demand would be substantially lower than the increase in the Class I price and would therefore increase gross revenues to dairy farmers. (Ex. 115 at 3; Tr. 1562:23-1563:11 [Testimony of Dr. Harry Kaiser].)

255. If retail prices follow Federal Order Class I price, NMPF estimates an increase of approximately $0.149 per gallon for a consumer in the St. Louis, Missouri market. It will be less in the Chicago, Illinois; Des Moines, Iowa; and Minneapolis, Minnesota markets at approximately $0.112 per gallon**.** This will be about a 4.25 percent increase to the consumer, assuming an average retail price of $3.50 per gallon, which is close to the average retail price for milk over the last 20 years. If comparing the cost increase to the average retail price from the last two years, the impact would be 3.63 percent. The average milk price from 2000 to 2010 was $3.116 per gallon and the average price from 2011 to 2022 was $3.412 per gallon. Using data from the analysis above suggests the price increase proposed by NMPF would be less than 0.25 percent annually for a 20-year period. (Ex. 352 at 9; Tr. 8204:20-8205:6 [Testimony of Chris Hoeger].)

256. If there is any consumer demand response to milk price changes, it is a response to

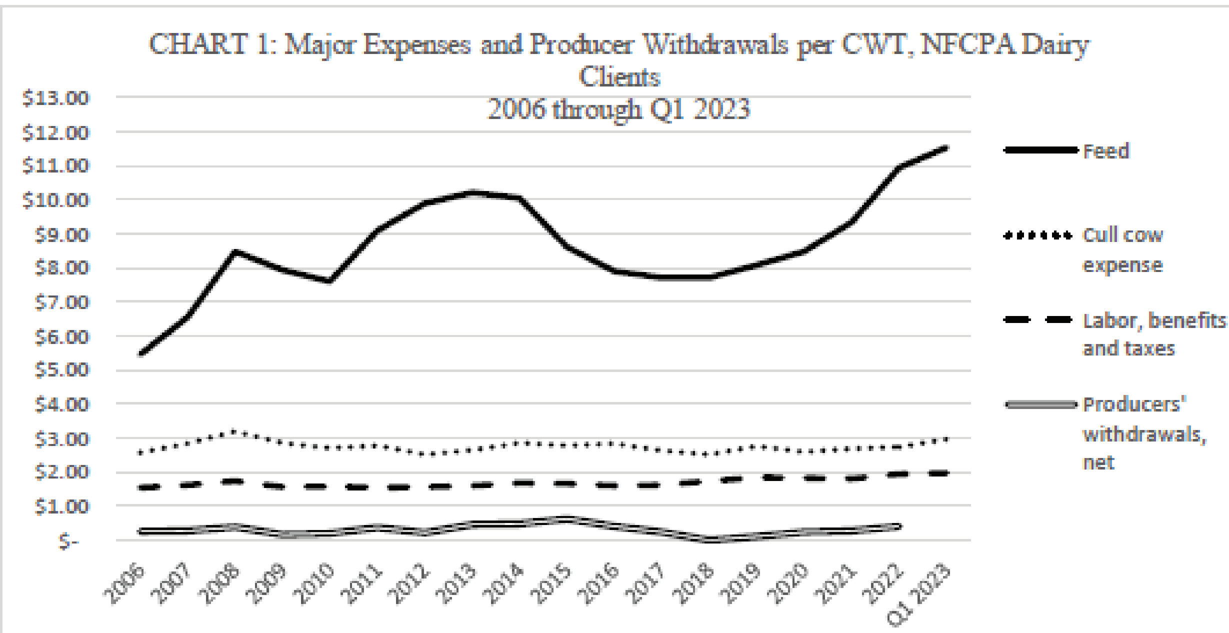
fluid milk ***retail*** price changes, not FMMO prices. There is no proven correlation between changes in FMMO Class I prices and retail fluid milk prices. For example, in 2023, retail milk prices reached their highest price ever, at a national average of $4.34 per gallon, which constituted an increase of about 1.9 percent from 2022. Over the same time, the national average annual Class I price decreased approximately 20.5 percent from $26.26 per hundredweight to $21.80 per hundredweight. (Ex. 494 at 13-14 [Testimony of Jeffrey Sims].)

C. Producers Support Raising Class I Differentials.

257. At least 24 current or former dairy farmers testified in support of raising Class I differentials due to increased costs of production on their dairies – including increased hauling costs, and their recognition of the importance of a higher difference between Class I and manufacturing prices to reduce depooling and support better producer revenue, some of which we included in the brief, but all of which is tremendously important. (Ex. 108 [Testimony of Ken Nobis]; Ex. 122 [Testimony of Gerben Leyendekker]; Ex. 123 [Testimony of Jared Fernandes]; Ex. 125 [Testimony of Kristopher Scheider]; Ex. 136 [Testimony of Karl Wedemeyer]; Ex. 137 [Testimony of Kristine Spadgenske]; Ex. 138 [Testimony of Brian Rexing]; Ex. 148 [Testimony of Eric Palla]; Ex. 149 [Testimony of Paul Windemuller]; Ex. 150 [Testimony of Matt Johnson]; Ex. 162 [Testimony of Sean Cornelius]; Ex. 200 [Testimony of Frank Doll]; Ex. 207 [Testimony of Neil Hoff]; Ex. 208 [Testimony of Sietse Tollenaar]; Ex. 252 [Testimony of Richard Kraft]; Ex. 253 [Testimony of Thomas Bellavance]; Ex. 266 [Testimony of Brittany Nickerson-Thurlow]; Ex. 269 [Testimony of H.H. Barlow]; Ex. 279 [Testimony of Perry Tjaarda]; Ex. 284 [Testimony of Simon Vander Woude]; Ex. 288 [Testimony of David Pool]; Ex. 325 [Testimony of John Painter]; Ex. 326 [Testimony of Marty Hallock]; Ex. 385 [Testimony of Geoff Vanden Heuvel].)

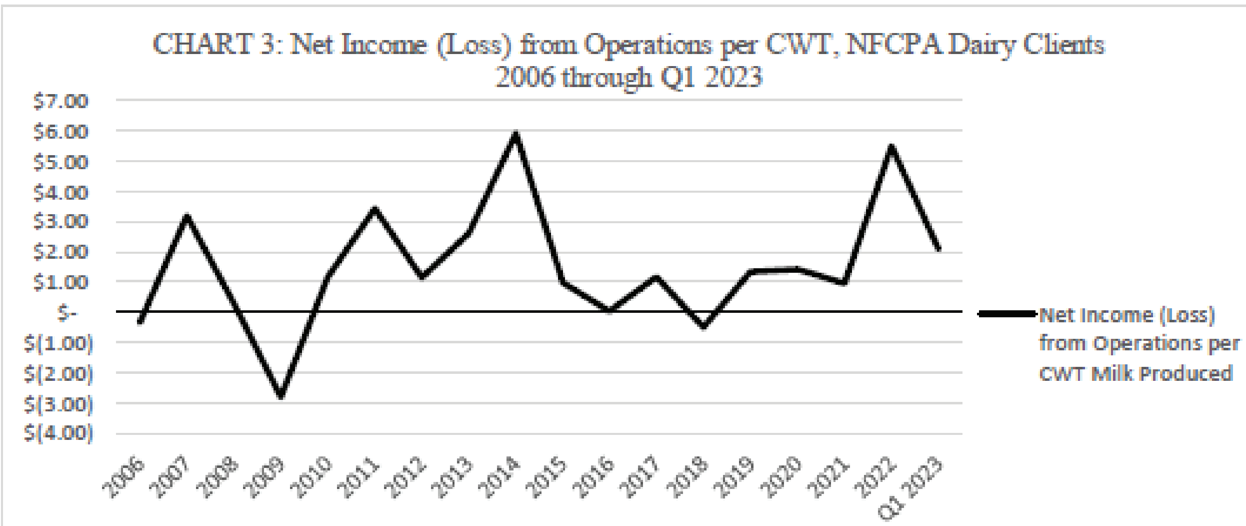
D. Dairy Farm Profitability Is Declining and Feed Costs Are Rising.

258. As discussed with Proposal 7 (make allowances), dairy farmers three largest expenses contributing to the cost of producing milk are purchased feed, labor, and cull cow expense (herd replacement cost). (Ex. 151 at 4 [Testimony of Jeff Bushey]; *see also* Ex. 153.) Feed expense per hundredweight has increased every year since 2018, jumping dramatically from 2021 to 2022. As the largest and most volatile expense account, feed expense greatly impacts the profitability of the producer. Labor has also seen an upward trend per hundredweight.



(Ex. 151 at 4 [Testimony of Jeff Bushey].)

259. The average net operating income for a cross-section of dairy farmers from 2006 to 2022 was $1.54 per hundredweight of milk produced. Consider also that this number is before any withdrawals by the producers to compensate their labor and provide for family living expenses. The average net withdrawals from 2006 through 2022 was $0.31 per hundredweight of milk produced. This leaves $1.23 per hundredweight of milk produced remaining after family living.



(Ex. 151 at 5 [Testimony of Jeff Bushey].) In general, dairy farmers nationally face low and negative margins. (*See generally*, Ex. 79-84 [Testimony of Leland Koostra].)

260. The farm milk price received is a primary determinant of farm profitability and farm financial resilience. Even the "best" managed dairy farms struggle financially in years of low milk prices. Financial stress from low milk prices can cause dairy farm managers to exit the dairy industry whether to undertake other agricultural enterprises or leaving farming entirely. Large amounts of farm exits would have impacts on those families as well as their local communities. USDA should be cognizant of these aspects when considering FMMO changes that will significantly impact farm milk price. (Ex. 169 at 12 [Testimony of Dr. Chris Wolf].)

261. Milk production profitability is highly variable and modest. The profitability of this

industry is not substantial. The month-to-month variability in profitability is both large and centers only modestly above zero. (Ex. 304 at 4-5 [Testimony of Stephen Koontz].)

ARGUMENT

E. Class I Differentials Must Be Raised to Reflect the Increased Cost to Service Class I and Achieve the Objectives of the FMMO System.

1. Class I Primacy Is Vital to the Functioning of the FMMO System.

FMMO policy is premised on dairy farmers offering an agricultural commodity that has unique market conditions: milk is highly perishable; there is no distinct harvest or season compared to field crops; production and demand have noticeable seasonal patterns; fluid milk demand is more inelastic relative to other dairy products; excess milk must move to longer-shelf-life products like nonfat dry milk powder, cheese, butter, yogurt; and the dairy industry has high fixed costs. (Ex. 103 at 1 [Testimony of Sara Dorland]); *see also* Joel L. Greene, Cong. Rsch. Serv., R45044, *Federal Milk Marketing Orders: An Overview*, at 1 (2022), https://crsreports.congress.gov/product/pdf/R/R45044.[32] Prior to FMMOs, a product with these characteristics left dairy farmers in a position of inferior market power because they needed a market for their product with unique characteristics, but buyers could choose not to buy unless their price was met. Congress granted the Secretary authority for the FMMO system to aid farmers facing low prices as a result of the power imbalance with processors and to stabilize the supply and price of milk.

The FMMO system is premised on Class I having the highest value. A higher Class I milk price, relative to the other class prices, sends signals throughout the market to move milk from surplus to deficit regions to ensure adequate fluid milk supplies for the market. As a result, Class I primacy is necessary to support the current FMMO system design and reduce instances of

[32] MIG requested official notice be taken of this document. (*See* Ex. 508.)

disorderly marketing. When Class I loses its primacy and de-pooling is allowed to persist more than one price exists in the producer marketplace. This creates an incentive for supply plants to disassociate from FMMOs, which financially affects Class I handlers and dairy producers and creates the possibility of different prices. *See* 7 U.S.C. § 608c(5)(A) (requiring handler price uniformity); *id*. § 608c(5)(B)(ii) (requiring producer price uniformity). Although Class I utilization has declined due to rising milk production and lower per capita consumption of bottled milk, the ability of Class I to attract milk to the pool, one of its primary purposes, remains intact. (Ex. 103 at 2 [Testimony of Sara Dorland].) Indeed, two of the objectives of FMMOs are to "promote orderly marketing conditions in fluid milk markets" and "improve the income situation of dairy farmers." *Federal Milk Marketing Orders: An Overview*, at 3. Phrased differently, producers are the intended beneficiaries of the AMAA and maintaining the integrity of classified pricing ensures the Class I price has the highest value, which is necessary to benefit producers.

Since Class I should have the highest value, classified pricing is set from the top down. During Order Reform, the Secretary laid out numerous criteria for establishing a Class I pricing structure that meets the overall objectives of the AMAA and FMMOs. The Class I price structure must meet four regulatory criteria. First, the Class I price structure must be considered from a national ***and local perspective***. 64 Fed. Reg. 16026, 16109. Although USDA must be mindful of local and regional concerns, the USDA must also account for national concerns regarding milk pricing. Second, the Class I price structure must recognize the location value of milk. As stated in Order Reform, the USDSS confirms that milk has value based on location, but "[w]hile the [USDSS] shadow prices d[o] not suggest Class I differentials for specific locations, they do provide a means to evaluate price relationships among locations." *Id*. Third, the Class I price structure must recognize all uses of milk. Class I milk has a higher value than manufactured products and the higher price encourages all milk to be used to satisfy Class I needs first. "At the point where the cost of moving milk from an alternate location for Class I use is equal to the cost to supply milk for manufactured products, demand for manufactured products influences a market's ability to procure milk for Class I needs." *Id*. Fourth, the Class I price structure must satisfy the broad tenant of the AMAA to establish and maintain orderly market conditions. *Id*.; *see also* 7 U.S.C. § 602(4). Prices must reflect economic conditions affecting supply and demand. ***Consideration should be given to whether the proposed prices would generate sufficient revenue for producers necessary to maintain an adequate supply of milk and provide equity to handlers with regard to raw product costs***. 64 Fed. Reg. 16026, 16109.

A critical aspect of the Class I pricing structure—and the substance of Proposal 19—is the location differential (i.e., the Class I differential). The location differential, with the Mover, forms the Class I skim price, *see* 7 C.F.R. §§ 1000.50(b), 1000.52, and, with the advanced butterfat price, forms the Class I butterfat price. *See* 7 C.F.R. § 1000.50(c). In addition, the Class I pricing surface is also used to determine the value of the producer price and the distribution of pool values at each milk plant receiving pool milk. It is this difference in plant pay prices that results in the intended policy goal of supporting milk to move to Class I plants. Though the Class I differential only affects locations where plants exists,[33] every county in the United States is assigned a differential (since a plant could theoretically be located in any county). *See* 7 C.F.R. §§ 1000.52, 1005.51(b), 1006.51(b), 1007.51(b). The Class I differential is intended to partially compensate producers for the costs of production and ensure milk is attracted to Class I. However, the differentials for most

[33] This includes Class II, III, and IV plants. An effect of altering Class I differentials is an adjustment to the plant location adjustments, which incorporate Class I differentials to make those adjustments. *See* 7 C.F.R. §§ ____.75 (referencing 7 C.F.R. §§ ___.51, which incorporates 7 C.F.R. § 1000.52).

of the country have not been meaningfully adjusted since they were set in Order Reform. Yet, it is undeniable that the costs that are the constituent parts of the Class I differential have increased since 2000. *See supra* at 198-204.

In addition to meeting the regulatory criteria, the Class I pricing structure must be assessed against six evaluative criteria and three administrative criteria originally used when transitioning to the current Class I pricing structure during Order Reform.

<u>Evaluative</u>

(1) Ensure an adequate supply of milk for fluid use.

> Class I price levels need to provide a sufficient price signal to maintain an adequate supply of milk for fluid use. ***This supply level can be achieved through either the movement of milk to where it is needed, increased production, or some combination of both***.

(2) Recognize quality (Grade A) value of milk.

> Grade A milk is required for fluid use. ***Additional costs of*** obtaining and ***maintaining Grade A*** status need to be reflected in Class I prices.

(3) Provide appropriate market signals.

> A Class I price should send timely signals to the market regarding supply/demand conditions.

(4) Recognize value of milk at location.

> [M]ilk for Class I use has a ***different value at different locations***. This value ***needs to be reflected in the Class I price*** in order for the system to recognize and resemble the market rather than interfere with the market.

(5) Facilitate orderly marketing with coordinated system of prices.

> A system of Class I prices needs to be ***coordinated*** on a national level. Appropriate levels of prices will ***provide alignment both within and among marketing areas***. This ***coordination is necessary*** for the efficient and orderly marketing of milk.

(6) Recognize handler equity with regard to raw product costs.

> Appropriate levels of Class I prices provide known and visible prices at all locations thereby ensuring that handlers are able to compete for available milk supplies on an equitable basis.

Administrative

(1) Minimize regulatory burden.

> This would include increased reporting requirements and record keeping, as well as possible increases in administrative assessments should Market Administrators be required to manage a more complex regulatory system.

(2) Minimize impact on small businesses.

> The Class I price should be set at a level that does not disadvantage small businesses in competition with large businesses.

(3) Provide long-term viability.

> The Class I price structure should be expected to operate for an extended time period without major modifications.

64 Fed. Reg. 16026, 16109-10 (emphasis added).

Finally, there are prudential concerns. The Secretary should evaluate Proposal 19 using the established regulatory, evaluative, and administrative framework, but the Secretary should also not lose sight of what is on offer. The Secretary has three options for the Class I differentials: (1) adopt Proposal 19 or some derivation thereof; (2) maintain Class I differentials as they currently exist; or (3) subtract $1.60 from the *current* Class I differentials and establish new differentials at the reduced levels (i.e., MIG's Proposal 20). NMPF—***and only NMPF***—took the time, committed the effort, and offered the Secretary thoughtful updates to the Class I differential price surface for all 3108 counties, parishes, and cities assigned Class I differentials. No other industry stakeholder thoughtfully attempted to provide the Secretary with new, realistic Class I differentials despite universal agreement that the costs of production and the costs to move milk have increased, and the movement of milk has changed since differentials were set. Without equivocation, options two and three are not realistic outcomes for dairy farmers, who are struggling to maintain profitability with the current Class I price structure, and for a dairy industry that has changed considerably since 2000. An increase and update to the Class I differentials are necessary.

2. The Historical Justifications for the Class I Differentials Are Still Relevant: Costs to Service Class I Have Increased Since 2000.

When setting location specific Class I differentials during Order Reform, the Secretary set a minimum differential of a $1.60 per hundredweight "because it would ensure a sufficient supply of milk for fluid uses in the ***most surplus regions***." 64 Fed. Reg. 16026, 16112 (emphasis added). The $1.60 should not necessarily be thought of as a "base" from which every other differential emanated; rather, the $1.60 was the minimum amount to attract milk to Class I in the most surplus regions—i.e., "base zones." In this sense, the "base" differential merely represented the lowest differential, or, put differently, the place where milk moved from the manufacturing uses to Class I at the lowest cost. *See* 63 Fed. Reg. 4802, 4907-4908 ("Since the USDSS model only determines the spatial value differences for fluid milk between location and not the price level, Option 1A utilizes $1.60 as the minimum price in the three base zones. Currently, the lowest differential in Federal Orders is $1.04 ($1.20 in Minneapolis) in the Upper Midwest order. A review of current marketing practices has revealed that the $1.04 per hundredweight base zone differential may not be established at a level high enough to ensure adequate milk supplies for fluid use.").

USDA went on to provide three constituent parts to the Class I differential. The minimum differential—$1.60—was broken down to: (1) $0.40 for Grade A maintenance; (2) $0.60 for marketing and balancing costs; and (3) $0.60 to compete with manufacturing plants. These were considered the minimum levels for the most surplus regions. Where Class I differentials were established in higher amounts, it was because these constituent parts were more expensive in those regions. The formula for Class I differentials was not—as suggested by opponents of Proposal

19—setting $1.60 for the entire country and then adding to it based on needing to move milk. The entire project of the Class I differential is to move milk by partially accounting for on-farm production costs to supply Class I. Those costs are higher in areas that are not the most surplus regions of the country.

The historical constituent parts of the Class I differential still have relevance and validity in the dairy industry today. First, the Grade B to Grade A conversion and maintenance factor. Even at the time of Order Reform the conversion aspect of this factor was almost irrelevant. *See* 63 Fed. Reg. 4802, 4908 (noting that because most milk had already converted to Grade A status, the focus needs to shift to maintaining Grade A status). In shifting the focus of this cost factor to maintenance of Grade A status for dairy farms, USDA created a durable consideration that is still applicable today. Despite the fact that even more milk is Grade A today (likely approximately 99 percent), there are real costs to maintaining Grade A status. Farms that choose to sacrifice sanitation standards or refuse to buy and maintain certain equipment will not remain Grade A. (*See*, e.g., Ex. 336 at 17-23; Tr. 7831:27-7839:5 [Testimony of Dr. Eric Erba] (detailing the costs of Grade A status).) The dollars that are used to maintain Grade A status represent an opportunity cost for dairy farmers, who could put the money to other uses to enhance the profitability of their farms. While Grade A status may be the "cost of entry," it is a production cost (and not one Class I handlers incur). The Class I differential is a regulatory means for producers to recoup some of this cost.

Further, the dairy industry has shifted its quality standards since Order Reform. Grade A is no longer enough; dairy farmers must now produce milk that is, effectively, "Grade A+" because *Class I handlers demand it*. If the historical focus was on conversion costs from Grade B to Grade A and then, with Order Reform, maintenance of Grade A, then the focus in the current environment should be on the maintenance of Grade A+. For example, the SCC that qualifies milk for Grade A is 750,000 per milliliter. (*See* Ex. 340 at 34 [Pasteurized Milk Ordinance].) However, that regulatory standard is no longer acceptable in the industry. In order to market their milk, dairy farmers must produce milk with an SCC of 400,000 or lower to meet Class I handler demands and regulations in export markets. (Ex. 310 at 7 [Testimony of Jeffrey Sims].) Likewise, while Grade A status can be achieved by cooling milk to 45 degrees Fahrenheit within two hours of completion of milking (*see* Ex. 340 at 34 [Pasteurized Milk Ordinance]), Class I handlers uniformly require lower temperatures. (*See* Ex. 312 [Testimony of Jeffrey Sims].) Class I handlers are also demanding milk quality metrics that are not required for Grade A status, as detailed in the PMO, such as preliminary incubation count, laboratory pasteurized count, and acidity. (*See* Ex. 312 [Testimony of Jeffrey Sims].) All of these heightened milk quality standards increase costs to dairy farmers, who must abide by the heightened standards in order to market their milk. If market pressures require dairy farmers to behave a certain way, then those requirements become de facto regulations. Supplying milk for the Class I marketplace today requires maintenance of Grade A+ standards. These costs are embedded in the marketplace and should be reflected in the updated Class I differentials.

Second, the marketing and balancing cost factor, valued at $0.60, "[t]raditionally" reflects marketing costs for supplying the Class I market. 63 Fed. Reg. 4802, 4908. This factor includes such costs 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." *Id*. NMPF presented multiple witnesses that testified about the valuable, but expensive, balancing service cooperatives provide for the Class I market. (*See, e.g.,* Ex. 359 at 2; Tr. 8388:21-23 [Testimony of Mike John] (noting balancing adds additional costs for MDVA and requires a steady and reliable source of revenue); Ex. 406 at 7; Tr. 9350:5-25 [Testimony of Brad Parks] (noting MMPA operates a balancing plant in the heart of the Michigan milk shed that acts as a reserve source for states to the south), and at 9 (noting serving the Class I market at the current differentials is not economically sustainable long term because it is less expensive to deliver milk to local manufacturing plants); Ex. 345 at 4-5; Tr. 8093:18-28 [Testimony of Rob Vandenheuvel] (noting balancing plants have closed in Southern California and only CDI maintains a cooperative-owned balancing plant within 150 miles of Los Angeles); Tr. 8003:3-15 [Testimony of Calvin Covington] (noting SMI's balancing costs for 2023 were $1.33 per hundredweight).) However, the Class I differential no longer provides dairy farmers with enough incentive to continue balancing into perpetuity. Many balancing plants have closed since Order Reform. Simply, "[t]here is a tipping point when running your balancing plants full makes more economic sense than selling milk into a Pool Distributing Plant." (Ex. 159 at 2; Tr. 2814:10-12 [Testimony of Monty Schilter].) When the costs of servicing Class I become prohibitively expensive, cooperatives must make decisions in the economic interest of their farmers, will act rationally, and move away from operating their manufacturing plants as balancing plants or cease serving Class I plants altogether—which will make it difficult for Class I plants to acquire an adequate supply.

Related to balancing costs increasing, the distance milk must travel and hauling costs have increased. The number of balancing plants and Class I plants is less today than in 2000. New Class I plants are being built near population centers; whereas, with urban sprawl, dairy farmers are increasingly further away from population centers. The net result of these changes to the industry is Class I milk must travel increased distances. Increasing the distance milk must travel alone would increase hauling costs. However, since 2000, the per-mile costs to haul milk have also increased throughout the country. (*See* Ex. 310 at 16; Tr. 7248:2-13 [Testimony of Jeffrey Sims]; Ex. 406 at 9-10; Tr. 9353:16-20 [Testimony of Brad Parks]; Ex. 309 at 2; Tr. 7214:7-27 [Testimony of Stephen Zalar]; Ex. 359 at 3; Tr. 8389:11-16 [Testimony of Mike John]; Ex. 342 at 4; Tr. 7991:7-27 [Testimony of Calvin Covington]; Ex. 356 at 2; Tr. 8334:11-20 [Testimony of Joe Brinker]; Ex. 403 at 12-13; Tr. 9297:13-28 [Testimony of Steve Stout].) Trucks, fuel, labor, insurance, maintenance, and all of the costs associated with moving a commodity product like milk have increased since 2000. The distances milk must move and hauling costs for producers delivering to Class I plants will increase. The incentive to service Class I will continue to decrease and the integrity of classified pricing will be in danger. Class I differentials need to be raised to reflect the increased cost of balancing and marketing milk.

Historically, the second factor (marketing and balancing) combined with the Grade A factor to form the Class I differential in the most surplus zones. However, USDA recognized at Order Reform that manufacturing plants in the Upper Midwest—i.e., the most surplus zone—were outcompeting Class I plants for raw milk supplies. 63 Fed. Reg. 4802, 4908-4909. The presumption became that the two factors comprising the Class I differential were inadequate to ensure a sufficient supply of milk to Class I.

To improve milk market efficiency, USDA raised the Class I differential further and observed an additional "competitive factor" valued at $0.60 in the most surplus zones. "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*. It is fair to assume, by observation of inflationary pressures alone, that $0.60 no longer reflects two-thirds of the *actual* competitive costs incurred by Class I plants to compete with manufacturing. As further evidence of this, the utilization in the most surplus zones has decreased. During Order Reform, Class I utilization in the

Upper Midwest was approximately 20 percent. *Id*. at 4908. Today, Class I utilization in the Upper Midwest is approximately 10.67 percent. (Ex. 352 at 6; Tr. 8199:9-10 [Testimony of Chris Hoeger].) This suggests there is not enough of a pricing incentive to encourage milk to move to Class I plant versus manufacturing plants.

> An additional benefit of establishing the minimum Class I differential at a level that more accurately reflects the actual value of milk for fluid purposes is the added monies generated in the Federal order pool. Class I milk provides the vast majority of pool value in Federal orders. If an order has a low Class I differential and a low Class I utilization, it frequently does not have enough pool value to provide proper price signals to pool participants. In these orders, the Class I price is established by the suppliers of milk at levels above the Federal order minimums. When these over-order markets dictate substantially higher prices than the order minimums there is a risk that handlers may not face equal raw product costs for various reasons. Thus, having a larger proportion of the actual value of Class I milk in the market order pool in these areas, than is now the case, should promote pricing equity among market participants.

63 Fed. Reg. 4802, 4909. The minimum Class I differential needs to be raised so that Class I can effectively compete by attracting milk from manufacturing in the most surplus zones. Without an increase, areas such as the Upper Midwest will see their pool dollars from Class I and the incentive to service Class I dwindle to zero.

The three cost factors from Order Reform are not—despite suggestions by opponents of Proposal 19—immutable. In Order Reform, USDA recognized these factors may change to meet the nature of the dairy industry, and, in fact, USDA changed how it looked at the constituent parts of the Class I differential. When it discussed Grade B to Grade A conversion, USDA noted:

> ***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.

Id. at 4908 (internal footnote omitted) (emphasis added). Then after discussing the marketing and balancing costs, USDA remarked:

> ***Originally recognizing these*** [Grade A conversion and marketing] ***factors in the base zone was sufficient*** to bring forth enough milk to meet Class I demands given the abundant volumes of milk and the abundance of manufacturing plants. ***However, recognizing just these two factors at the value specified may no longer be adequate*** to ensure sufficient supplies of Class I milk in the [most surplus region].

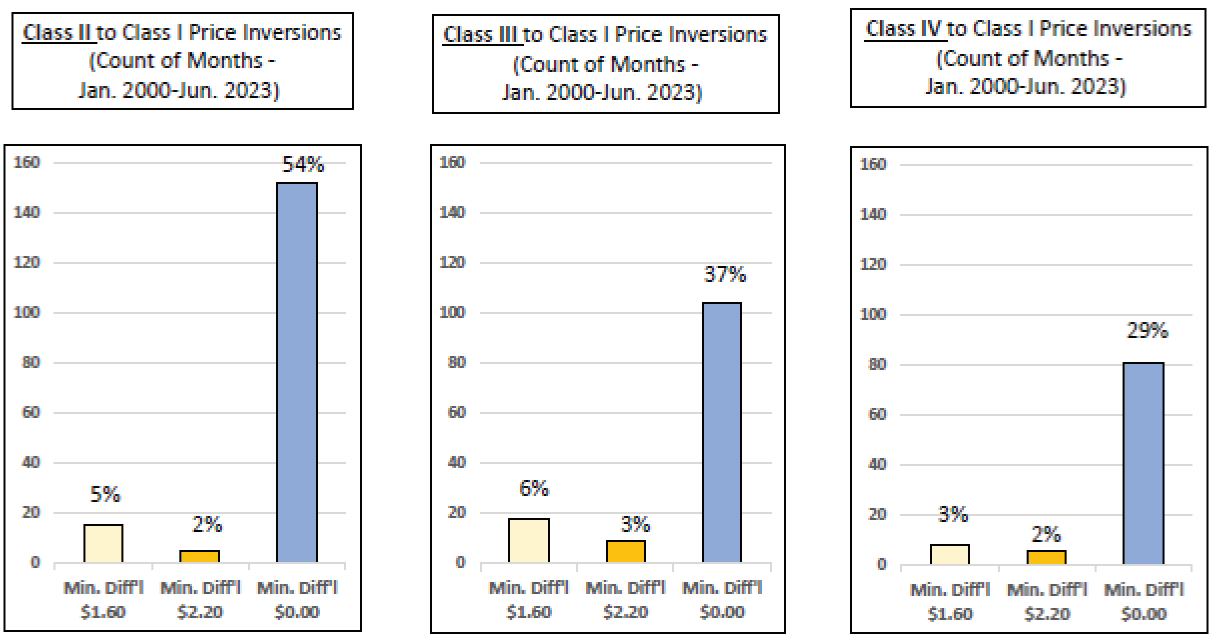
Id. (emphasis added). Thus, USDA broadened its consideration to the competitive factor of the Class I differential. Even then, USDA did so with a caveat:

> 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.

Id. (emphasis added).

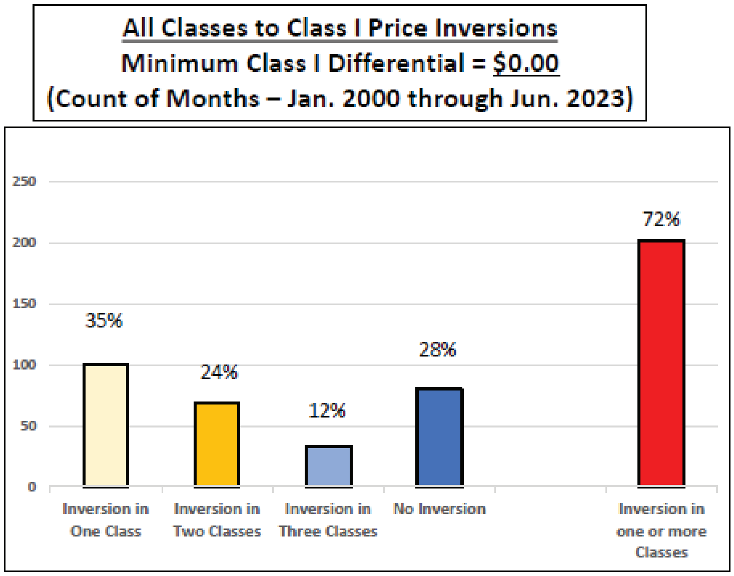
It would be consistent if the Secretary chose to add another factor or increase the current factors when addressing how to meet present supply and demand conditions. When evaluating present supply and demand conditions, a focus should be on limiting price inversions. Price inversions are tantamount to disorderly marketing. 64 Fed. Reg. 16026, 16112 ("[F]or markets with lower differential levels, there is a greater potential for class-price inversions that would increase the likelihood of disorderly marketing conditions."). The incidence of class price inversions provides evidence of the efficacy of Proposal 19 and the disfunction of Proposal 20.

Since Order Reform, Proposal 19 would have decreased class price inversions between 33 and 60 percent of the time, depending on the class. Whereas, Proposal 20 would have caused inversions, in some instances, at ***10 times higher rates*** than dairy farmers experienced with the current Class I differentials. Indeed, with Proposal 20, class price inversions would have occurred in 72 percent of the months since January 2000. Dairy farmers struggled with the modest occurrence of inversions since 2000. It is fair to question how many dairy farmers would have survived—or will survive—if Proposal 20 is adopted instead of Proposal 19.



Source: Exhibit NMPF – 37A, & Monthly Federal Order Class Price Announcements Page 26 of 64

(Ex. 318 at 26 [Testimony of Jeffrey Sims].)



Source: Exhibit NMPF – 37A, & Monthly Federal Order Class Price Announcements

(Ex. 318 at 27 [Testimony of Jeffrey Sims].)

With two and a half decades passing since Order Reform, the Secretary should consider the historical factors for the Class I differential within the context of the modern dairy industry. Present supply and demand conditions are different than at the time of Order Reform. Class I utilization has declined in the most surplus zones, the most milk deficit regions have become more deficit, balancing plants have closed, and the distance milk must travel to service Class I has increased, as has the underlying cost per mile. As a result, dairy farmers are increasingly incentivized to service local manufacturing plants over more distant Class I plants because the cost of servicing the Class I market has increased and continues to increase. The Class I differential is intended to counteract, in part, these changes to assure an orderly flow of milk to Class I and maintain the supremacy of Class I in the FMMO classified pricing structure. Regardless of how the minimum Class I differential is constructed, the underlying regulatory justifications for the

Class I differential—ensuring Class I can attract milk from manufacturing and maintaining orderly marketing conditions—can only be satisfied by raising the differentials.

3. Class I Plants Are Expensive to Serve: Regional Differences Matter and Are Not Captured by the USDSS.

a. The USDSS Has Inherent Limitations That Make It Unsuited to Precisely Set Differentials.

The primary opponent of Proposal 19—MIG—repeatedly attacked NMPF witnesses involved with developing Proposal 19. MIG suggested NMPF either fabricated the Class I differentials in Proposal 19 or modified the USDSS to give cooperatives competitive advantages. All NMPF witnesses consistently testified that the process of developing Proposal 19 did not involve consideration of ownership of plants or how to achieve a competitive advantage for cooperatives. NMPF witnesses did testify—and MIG ignored—that the USDSS has inherent limitations that necessitated a review by industry experts and professionals to develop a Class I differential price surface that better reflected reality. This is because the USDSS cannot account for all factors that make up the Class I differential. Dr. Nicholson, who is the keeper of the USDSS, candidly admitted as much.

> Q. And what are the major drivers of the model's dual price results?
>
> A. So the model, again, has both the dual results, which have no values, and then also the primal results, which are the physical flows through the supply chain.
>
> And as I noted in the statement this morning, there are some key things that are part of those millions of pieces of information that drive that. So the key things really are, where do we have milk, and what is its composition spatially throughout the United States? Where is the milk located? What's its composition? What's the composition and location of dairy product demand? What is the location and processing capacities of different dairy processing facilities?
>
> And what are the transportation costs that link a farm to a processing plant in terms of milk assembly, the movement – excuse me – of

intermediate products from one dairy processing facility to another, and the transportation costs associated with distribution.

So all of those are part of the core database that make up the USDSS analysis, and all of those things are a part of why we get the spatial price surface that we get.

Q. And I think in your testimony throughout, you refer to the model results as a benchmark.

Why do you consider them to be a benchmark?

A. So the terminology that I have used is a competitive benchmark. And in this case I'm kind of drawing upon the economic idea of perfect competition where we don't – we say, everybody is sort of equal, they are all small, they all take the same price or receive the same price from people, and that means that ***we're not really fully accounting for a number of institutional factors that could be relevant to refining the model results to come up with what might be a more appropriate industrywide Class I price surface***.

So what I'm saying competitive benchmark, what I mean is, this is sort of like the lowest possible systemwide cost that we can imagine in a perfect world. Right? And so we recognize, though, that that perfect world isn't the world in which the dairy industry lives. There are lots of other factors that might be important, even if this provides a basic scaffolding for thinking about what those price relatives should be.

Q. Okay. And we heard Dr. Vitaliano talk about some – some – what I would – that he called art, or what is an overlay over the numbers that – that come out of the benchmark.

Do you recall him talking about that?

A. Yes, I do.

Q. And is that the additional information that you believe would – is – is used or applied to the model results that come out of this model?

A. I guess I – I don't know exactly what information was used in the process, not having been a part of any of the discussions of what has been called the colored-pencils sort of adjustments. All I can do is comment on the things that I think the model does not fully incorporate that might be relevant.

Q. Okay. And what would those be?

A. I think they come into maybe three categories – well, four.

So one is really ***we use average transportation costs on the basis of difference in distance between a start and an endpoint for moving milk.*** We do actually adjust those for local conditions in the sense of having a different fuel cost and a different wage cost***. But what we don't account for, for example, is like the density of the milk supply in a particular county.***

So I used to work at Penn State University in the top-ranked supply chain management department, and from that I know that there are counties in Pennsylvania where there are a lot of plain sect folks, Amish, who have small farms. And our model would say, all that milk is at one location in the county, and to move that county down to the next county would all be the same costs. And the reality is that if you're trying to serve that particular set of farms, the cost would probably deviate a bit from what the model would say would be the cost to move it from one county to another.

Another example from when I worked in California is I'm quite familiar with how traffic can be in the Los Angeles area. So our model assumes all the costs are on the basis of a distance movement, which would say there's such and such a distance going from Bakersfield to Los Angeles, and the cost would be this, but we don't account for the fact that that time cost and the driver cost associated with it could be much different. Right?

So those are transportation cost examples that are probably more widely relevant for places that I haven't lived and worked that the others from the National Milk team may want to speak to.

Second thing is that the model has no compassion about keeping plants open because there's always been a plant there. In presentations that I have given about this model previously, I like to use the example of a model being a dairy dictator, like the Vladimir Putin of dairy supply chain allocations. And it would say, if you have a plant that's not in a good location, the model is not going to keep that plant operating. ***But for an individual company, that would probably not be an easy decision for them to make, especially in the short-term. So the model doesn't account for that existing capacity that an organization would want to keep usin***g.

Another example is commercial relationships. Again, we're hardhearted, we just want to get the milk and the dairy products from the farm to the plant, and to the consumer as a low cost as possible, with the analytical approach we're using here. We don't know anything about the commercial relationships that might link a

> particular farm milk supply to a farm, to a plant that actually has a contractual obligation on that milk. All right? ***So the model is going to show more flexibility than the real world in terms of not respecting that contractual obligation.***
>
> And the one last thing that's kind of important that often people have maybe been a little bit confused about is ***we use the model to generate these price relatives to provide a base of information for Class I differentials, but the model itself is a competitive benchmark from a supply chain perspective, it does not know anything at all about Federal Orders***. It does not know anything about pooling provisions, it does not know anything about current order boundaries.
>
> And so one of the things that can arise – and although I was not a part of the team at Cornell that did the modeling work in 1998, my understanding was that when the folks at Dairy Programs AMS were doing their version of the adjustment process to the model results, one of the things that they were interested in understanding and making sure was okay was sort of price alignment at Order boundaries. So we don't have any Order boundaries in the model, and therefore, ***we could come up with price relationships in nearby space that would be perfectly fine from a model perspective, but may not be acceptable from an Order boundary or price alignment perspective***.
>
> So we have sort of those ***four things*** that I think are relevant for why adjustments might be necessary to the raw results from the USDSS model that include some ***more detailed knowledge of local transportation conditions, the existing contractual arrangements, the existing capacity in wanting to maintain open a plant that you have invested in, and the issue of price alignment across orders in particular***.
>
> Q. Okay. And these four areas, these are the areas that you believe would be taken into account on top of the model results which are the benchmark that you have described?
>
> A. Now, again, I can't say what was taken into account in coming up with any differences between the model results and the proposal that's being put forward by National Milk. What I'm trying to do is point out that there are factors that I would consider relevant factors that would mean adjustments to the model would be appropriate.

(Tr. 6943:17-6950:13 [Testimony of Dr. Charles Nicholson] (emphasis added).)

The USDSS broadly does not adequately account for: (1) regional differences that affect transportation cost (e.g., geography, traffic); (2) business decisions (e.g., keeping a plant open that is not an efficient solution within the USDSS); (3) commercial relationships (e.g., milk may travel past the closest plant to a more distant plant because of a contractual obligation); and (4) FMMOs (e.g., how pool proceeds are distributed to producers). Within these spacious categories are a multitude of particulars that dairy professionals for NMPF did consider, and which the Secretary should also consider. For example, NMPF witnesses testified that at least the following were considerations when developing Proposal 19; these considerations all fall outside the parameters of the USDSS.

Regional Differences	**Business Decisions**	**Commercial Relationships**	**FMMOs**
Regional economic considerations	Existing commercial and business relationships	Existing commercial and business relationships	Meet the requirements of the AMAA (orderly markets; supply and demand)
Regional transportation costs	Practical limitations on movement of milk	Practical limitations on movement of milk	Equity: producer price uniformity
Transportation costs affected by geography and traffic	Consumer demand for manufactured products	Avoid competitive advantages/disadvantages	Equity: handler price uniformity
Feed costs	Lack of a reserve supply	Relationships based on differences in FMMOs	Feed costs and available supplies
Incenting milk to deficit areas	Incenting milk to deficit areas	Incenting milk to deficit areas	Incenting milk to deficit areas
Market intelligence (“boots on the ground”)	Market intelligence (“boots on the ground”)	Market intelligence (“boots on the ground”)	Account for differences across FMMOs
Consumer demand for manufactured products	Ensure adequate supply of fluid milk	Consumer demand for manufactured products	Ensure adequate supply of fluid milk

Price alignment and creating an appropriate slope: regionally and along FMMO boarders	Balancing costs	Balancing costs	Price alignment: regionally, along FMMO boarders, and nationally
Costs of production—Grade A+	Marketing costs	Marketing costs	Pay price equity across FMMOs
Producer blend price alignment	Producer blend price alignment		Producer blend price alignment

A final blind spot of the USDSS that requires consideration is the producer price surface and the need for blend price alignment. This is a factor because both the handler minimum Class I price and the producer blend price or PPD are determined in the FMMOs on the same location specific pricing grid. While most of the evidence supporting Proposal 19 is focused on plant prices, it is, nonetheless, important to understand and account for the effect of setting the location specific Class I differentials on producer prices. The adopted Class I differential price surface will determine the minimum Class I price which a Class I plant must pay for milk used in Class I, but it will also determine the location-adjusted blend price or PPD, which is payable on deliveries of producer milk to that Class I plant location. Importantly, producer location adjusted prices apply to producer deliveries to all plants, irrespective of the class of usage.[34]

Thus, the location differentials determine both the gross proceeds of an FMMO market-wide pool (higher Class I differentials generate a higher dollar average pool value) and also how those proceeds are divided among the producers supplying the market. For example, in a milkshed (the geographic area of the farm and plant locations making up a particular FMMO pool) in which the slope of the location differentials is steep—e.g. a difference of $1.00 per hundredweight from

[34] This occurs through the incorporation by reference of the Class I differential, 7 C.F.R. § 1000.52 into the minimum producer location adjusted prices. 7 C.F.R. §§____.75. In other words, the producer price at a Class III cheese plant is determined by the Class I differential value at that location, even though there is no Class I utilization at that plant.

high point to low point—producers delivering to the highest location points will receive a minimum blend price or PPD that is $1.00 more per hundredweight than the producers delivering to plants with the lowest location differential. On the other hand, a milkshed with less slope from low to high—e.g., $0.20 per hundredweight—will only see a difference of $0.20 per hundredweight in producer minimum prices. The competitive dynamics among producers supplying those two markets will be significantly different.

This is apparent in the Upper Midwest region (FMMO 30) where the NMPF working group had to reduce the slope suggested by the USDSS between Minneapolis and Chicago in order to maintain blend price alignment and assure milk would service Class I plants in the Minneapolis area. The USDSS suggested a $0.95 difference between Minneapolis and Chicago. Adopting these values would eviscerate the PPD for any dairy farmer delivering to a Minneapolis plant. *See* Ex. 46 (noting the market average PPD in FMMO 30 is $0.06). This would disincentivize dairy farmers from delivering any milk to Minneapolis compared to other, closer plants in FMMO 30. Proposal 19 seeks to maintain the current pricing relationship between Chicago and Minneapolis to avoid the already minimal PPDs from become nonexistent or negative. This factor—blend price alignment—must be contemplated in determining updated Class I differentials—and it is a factor which is not part of the USDSS.

Thus, NMPF correctly used the USDSS as a ***starting point***. With so many factors not considered by the USDSS, it would be malpractice to accept the USDSS as the last word on Class I differentials (it would also contradict the testimony of Dr. Nicholson, who expressly testified the USDSS does not set Class I differentials, and policy of USDA, which said the same. *See* 64 Fed. Reg. 16026, 16109). Indeed, it may be impossible for an algorithm or model to account for all of these factors: that is the point of the NMPF regional working groups. Regional working groups were able to meld the national considerations with regional differences and considerations.

b. NMPF Provided Credible Evidence of Regional Differences That Should Be Considered When Setting Differentials.

Nationally, the Class I differential must recognize that Class I has become more expensive to serve; hauling costs have increased, and Class I plants have decreased, and milk production has moved further away from plants. Against these costs, the unique characteristics of milk as an agricultural commodity have not changed. Milk is still highly perishable, produced every day, and must be moved from farm to plant promptly after being produced. The differential is a necessary tool for ensuring Class I is served in the current supply and demand conditions. While some milk moves between regions, most milk is produced and processed on a regional basis (with the notable exception of milk moving to the deficit regions of the Southeast). It is critical for the Secretary to consider the regional economic considerations when setting a new Class I differential price surface. *See* 7 U.S.C. § 608c(18); *see also* 64 Fed. Reg. 16026, 16109; *see also St. Albans Co-op. Creamery, Inc. v. Glickman,* 68 F. Supp. 2d 380, 390 (D. Vt. 1999) (requiring consideration of "region specific economic factors"). Only NMPF attempted to provide the Secretary with comprehensive guidance for such a large task.

NMPF formed four working groups that divided the United States into four regions. The regional working groups were comprised of individuals with in-depth knowledge of milk marketing in the regions of the United States to which they contributed. The NMPF cooperatives market more than 70 percent of the milk production in the United States and operate about half of the Class I processing capacity. This included individuals with day-to-day responsibilities in routing milk, balancing milk supplies, and selecting optimal farm to market supplies and deliveries of milk to real-life buyers and users of Class I milk. The regional working groups endeavored to create a differential slope that reflected the directions milk needs to move. To do this, the regional working groups used the USDSS as a starting point, worked from "anchor cities,"[35] and developed new Class I differentials for their region based on their insight and experience with regional economic conditions. After each regional working group had developed differentials, all regional groups worked together to form alignment across regions and FMMOs. The result: Proposal 19.

No other industry stakeholder attempted such a project. (*See* Tr. 10477:19-10477:25 [Testimony of Sally Keefe] (noting it was not "feasible" for MIG to develop an update to Class I differentials on a county-by-county basis).) Since no other stakeholder proposed a county-by-county update to Class I differentials, any criticism of NMPF's regional working groups must be viewed in that light and given less weight. MIG—the primary opponent of Proposal 19—repeatedly criticized NMPF's witnesses but did not present any ***evidence*** that the regional economic differences presented by NMPF are inaccurate. Stated differently, MIG does not know how to update Class I differentials (beyond the Proposal 20 broadside swipe at producer prices) but somehow knows that NMPF did it wrong. This is untenable.

No NMPF witness stated the Class I differentials in Proposal 19 were developed arbitrarily. All witnesses had reasons why certain regions need modification from the USDSS. Generally, regional differences that resulted in changes to the USDSS benchmarks included, among other reasons: the need to reflect current plant to plant price relationships; traffic environments and geographic factors that increase hauling costs; class and blend price alignment; practical milk movement limitations; and orderly marketing issues where orders or regions adjoin. These changes are consistent with avoiding the hallmarks of disorderly marketing. *See* 63 Fed.

[35] NMPF appropriately intended the "anchor cities" to foster price alignment. *See* 64 Fed. Reg. 16026, 16111 ("An important feature of [location-specific differentials] is the location adjustments that geographically align minimum Class I milk prices paid by fluid milk processors nationwide regardless of the defined milk marketing area boundaries or order pooling provisions.").

Reg. 4802, 4894 (noting price misalignment is a disorderly market condition); *see also* 64 Fed. Reg. 16026, 16046 ("Having the plant pooled under a succession of different orders with widely varying blend prices creates a disorderly condition for the producers involved.").

The testimony of NMPF's witnesses laid out the detailed regional economic reasons for deviations from the USDSS. The chart below details the base zone in each FMMO, the current Class I differential in each base zone, the USDSS output for each base zone, the Class I differential in Proposal 19 for each base zone, and the regional justifications for Proposal 19.

FMMO (Base) [County, State]	**Base Zone Differential**	**USDSS Base Zone**	**Proposal 19 Base Zone**	**Proposal 19 Justifications**[36]
1 (Boston) [Suffolk, MA]	$3.25	$5.15	$5.10	*See supra* at ¶¶ 56-83
5 (Charlotte) [Mecklenburg, NC]	$3.40	$5.90	$5.60	*See supra* at ¶¶ 119-127; 192-196
6 (Tampa) [Hillsborough, FL]	$5.40	$7.30	$7.30	*See supra* at ¶¶ 128-147; 192-196
7 (Atlanta) [Fulton, GA]	$3.80	$6.00	$5.95	*See supra* at ¶¶ 128-147; 192-196
30 (Chicago) [Cook, IL]	$1.80	$3.70	$3.10	*See supra* at ¶¶ 148-152
32 (Kansas City) [Jackson, MO]	$2.00	$3.35	$3.35	*See supra* at ¶¶ 153-191
33 (Cleveland) [Cuyahoga, OH]	$2.00	$4.10	$3.70	*See supra* at ¶¶ 84-118
51 (Los Angeles) [Los Angeles, CA]	$2.10	$2.25	$3.00	*See supra* at ¶¶ 2225-239
124 (Seattle) [King, WA]	$1.90	$2.40	$3.00	*See supra* at ¶¶ 240-246
126 (Dallas) [Dallas, TX]	$3.00	$3.75	$4.00	*See supra* at ¶¶ 192-214
131 (Phoenix) [Maricopa, AZ]	$2.35	$2.40	$3.00	*See supra* at ¶¶ 215-224

The detailed reasoning provided by NMPF in the evidentiary record and summarized in the Findings of Fact, *see supra* at 186-284, support adoption of Proposal 19. Moreover, scrutiny

[36] Referring to paragraphs in the Proposed Findings of Fact for Proposal 19, Section VII A-D.

of a few examples will make clear the opposition to Proposal 19 is baseless. To start, the Secretary should consider what evidence is in the record. NMPF presented 18 witnesses with significant experience in marketing milk. They provided detail about their regional considerations and why deviations in certain counties was necessary. While opponents of Proposal 19 cross-examined these witnesses about some finer points, no opponent of Proposal 19 presented evidence to refute the regional economic factors to which NMPF's witnesses testified. The validity of changes to the USDSS based on traffic and geographic factors cannot be questioned absent countervailing evidence. NMPF did not create the need to alter Class I differentials based on traffic and geography; it is a function of the USDSS.

> Q. Okay. Okay. Another question for you, and you talked a little bit about this with somebody, about kind of the art that goes into kind of taking the model results and then trying to bring them into the real world, not just what the model spits out.
>
> And you talked about what kind of things might people look at, factors go into different changes. And one, you talked about competitive relationships that currently exist, which the model does not account for.
>
> You also talk about places where geography gets in the way, so maybe that's mountain ranges or a lake.
>
> A. So let me expand on that just a little bit, if I may.
>
> So the geography that we have here is the road network. So if the road is going over a mountain and the milk and products are moving over a mountain, they are going over the mountain or they are not. It's not whether or not there is a mountain range. We don't account for any differential costs on a movement that would be going over a mountain range versus traveling flat across the plains once you got east of there. But we can have geography if it's based on the existing road network.
>
> So when I was thinking about things that were more related to the transportation network, I was kind of thinking about we don't account for traffic congestion in metropolitan areas, for example.

> Q. And maybe, back to my mountain example, maybe you don't count for it might cost more to go over that mountain, even though –
>
> A. That's correct.
>
> Q. Uh-huh. And that's something that – that's kind of the art of people with knowledge of that marketing area might be able to attest to?
>
> A. Yeah. And I should also say there's – and I grew up in San Diego, so I'm a little bit familiar with the California geography, but we can also think about how many arteries there really are to move product from a location like the west, and there aren't that many. So that actually might account for greater congestion on those routes, and we didn't account for that in the system that we use, which is sort of like this average costing of routing plus an adjustment for fuel and wages.

(Tr. 7043:23-7045:8 [Testimony of Dr. Charles Nicholson].)

NMPF expanded on the USDSS by modifying Class I differentials accordingly. For example, in the Pacific Northwest, most milk is produced on the eastern side of the Cascade Mountains, but most of the population lives along the Interstate-5 corridor (e.g., Seattle, Portland). The Class I plants are located near the population centers on the west side of the mountains. Thus, milk must travel from farms, through, over, or around the mountains, which have few roads, and to Class I plants in order to serve consumers. In addition to the significant costs of travel, if a mountain pass is closed because of snow, it may prevent ***any*** milk from moving for multiple days, which will result in dumping and millions of dollars being lost. Compounding this problem, the population along the I-5 corridor is continuously increasing and the number of dairy farmers is decreasing. Yet, Class I differentials have not been updated since 2000. Without an increase to the differentials in this region, the strain to serve pool distributing plants on the west side of the Cascade mountains will increase. (*See generally*, Ex. 397 [Testimony of Monty Schilter].) This is a new reality of the dairy industry for which opponents of Proposal 19 cannot account.

Likewise, NMPF's witnesses provide details about markets that opponents of Proposal 19 were satisfied to gloss over. For example, in FMMO 126, the USDSS had to be modified because it "presents a significant math problem." (Ex. 310 at 45 [Testimony of Jeffrey Sims].) Over the entire marketing area there are inter-Order price alignment considerations, there are plant to plant intra-Order price relationships to consider, there is the relationship the southwest has with the southeast as a major supplemental milk supplier to the western side of FMMO 7, and there is the overarching need to provide necessary incentives to move milk to supply Class I plants within Order 126. (Ex. 310 at 45 [Testimony of Jeffrey Sims].) NMPF noted that 70 percent of the milk in Texas is produced where 2 percent of the population lives—i.e., the panhandle. To deliver milk to Class I plants in Texas requires, at a minimum, a two-day drive and for some plants a three-day drive. Meanwhile, there are manufacturing plants near the panhandle where milk can be delivered without the expense of a three-day drive. The Class I differential is necessary to attract milk to the Class I plants. No one presented evidence to contradict these costs or provide an alternative solution that would permit Class I to compete with the more convenient manufacturing plants.

A final example of the diligence and effort by NMPF's regional working group can be seen in the Mideast Order (FMMO 33). NMPF witnesses provided detailed testimony about how this regional working group established 10 two-city pairings based on the anchor cities and then meticulously considered the relationships among these city pairings to develop proper price alignment. *See* 64 Fed. Reg. 16026, 16110 (noting price alignment is an appropriate reason to vary differentials); *see also id.* at 16111 ("An important feature of [location-specific differentials] is the location adjustments that geographically align minimum Class I milk prices paid by fluid milk processors nationwide regardless of the defined milk marketing area boundaries or order pooling provisions.").

On average, the USDSS would raise Class I differentials in the Mideast region by $1.65 per hundredweight. However, Proposal 19 suggests a steeper slope from Michigan to the south because of the sizeable growth in milk production in Michigan and its need to serve as a reserve supply for Class I plants to the south where milk production has decreased in some areas. The Mideast regional working group then considered how the proposed differentials would affect the 29 plants in that area and considered whether there were any alignment issues. The working group did some "fine tuning" in two locations where there seemed to be misalignment among competing counties. In the end, Proposal 19 in the Mideast area is mostly in line with the results obtained from the USDSS. Proposal 19 adds more of a pricing slope by placing a higher value on the locations to the south and to the east than the current Class I differentials. The increased slope addresses the difficulties of moving milk from areas of surplus milk supplies, i.e., Michigan, Northern Indiana, and Northwestern Ohio, to the milk deficit areas located to the south and to the east. (Ex. 336 at 6-15; Tr. 7811:19-23, 7824:7824:14-19, 7826:10-14, 7827:3-11 [Testimony of Dr. Eric Erba].) These are exigencies the USDSS did not "consider." No opponent of Proposal 19 presented ***evidence*** to suggest the Mideast regional working group acted inappropriately. Rather, opponents of Proposal 19 baldly criticized NMPF, and made unsubstantiated imputations that it was trying to create a competitive advantage. Opponents cherry-picked examples from each region, such as the Mideast, where Proposal 19 did not line up with the USDSS, regardless of whether the changes were an increase or decrease. Against these superficial criticisms, the Secretary should not forget that no opponent of Proposal 19 attempted to develop a Class I differential price surface that assesses regional economic considerations—for which the Secretary must account.

Since NMPF's regional economic considerations are almost entirely unrefuted by

evidence, the Secretary should adopt them. NMPF's evidence shows Proposal 19 meets the regulatory, evaluative, and administrative criteria that led to implementation of the current Class I differentials. Proposal 19 will help ensure an adequate supply of milk for Class I because it is a reasonable reflection of ***some*** of the cost to move Class I milk from farm to plant. The proposed differentials are not complete compensation for dairy farmers' cost of servicing Class I markets and maintaining the productive capacity to serve them in the future—i.e., respecting the policy for minimum pricing. Proposal 19 strengthens the integrity of classified pricing by raising Class I prices to ensure it remains supreme (i.e., recognize quality value, provide appropriate market signals, and recognize value of milk at location). Proposal 19 strengthens the pool as a measure for fairly compensating dairy farmers (i.e., facilitating orderly marketing and recognizing handler equity). Proposal 19 does not add any additional regulatory burden because the regulatory infrastructure is in place; only values need to be changed to satisfy regional economic considerations and price alignment.[37] Finally, Proposal 19 protects small businesses, which are the majority of dairy farmers, by raising their prices and strengthening the FMMO system. Proposal 19 should be adopted because NMPF has put forth sufficient evidence to support the Proposal and because it accomplishes the aim of the AMAA.

4. Proposal 20 Fails to Propose Differentials That Meet the Objectives of the FMMO System.

MIG's Proposal 20 is a transparent attempt to undermine the FMMO system by reducing Class I prices to be equal to, or less than, manufacturing prices. Proposal 20 does not claim to fall within current policy; it seeks to make new policy. The result, which is intended by MIG, is a return to the disorderly market that necessitated the need for the AMAA in the first instance.

[37] MIG seemingly agrees that price alignment is a reasonable concern since Proposal 20 maintains *all* current pricing relationships by simply removing $1.60 from every differential.

Proposal 20 will significantly reduce milk prices and lead to small and large dairy farmers going out of business. The obvious beneficiary of Proposal 20 are those proposing it: primarily large Class I processors and specialty dairy processors (e.g., organic, ESL) that are a minority of the market, but who, because of their market position, believe they can and should compete without classified or minimum prices.[38] Though it is questionable if Class I processors will be able to withstand a reduction of prices to dairy farmers when it affects their supply of milk. Regardless, the Secretary should summarily reject Proposal 20 but should take it seriously as an ominous sign. Proposal 20 is an existential threat to FMMOs. Proposal 20 essentially returns dairy farmers to their pre-AMAA, defenseless status.

Proposal 20 should be dismissed because it is based on multiple false premises. Proposal 20 incredulously suggests Class I differentials should not be increased but should be uniformly decreased. An implicit premise of Proposal 20 is that spatial relationships and milk movements are the ***same*** as at Order Reform, given that MIG did not propose a county-by-county update—only a uniform reduction nationally. Yet, no witness testified to that demonstrably false premise. Next and similarly, Proposal 20 assumes that the factors making up the Class I differentials are immutable; the thrust of the testimony supporting Proposal 20 is these factors no longer apply. However, as discussed, these factors are malleable within the regulatory framework and were so at Order Reform. *See supra* at 289-298. Reducing all Class I differentials by $1.60 does not accomplish the regulatory goals of the AMAA and FMMOs. It usurps them. Finally, Proposal 20 assumes that costs for dairy farmers serving Class I markets (production, hauling, marketing, competing with manufacturing) have not increased since Order Reform and, to the extent there has

[38] For example, bulk organic milk sells for approximately $35 per hundredweight. The January 2024 uniform price ranged from $15.59 (FMMO 30) to $23.05 (FMMO 6).

been an increase, over-order premiums from Class I processors can save all. Put another way, MIG wants a less regulated and more disorderly market, or at least individual handler pools, to set prices to dairy farmers. This would supersede the market-wide pools that the AMAA authorizes and USDA has found establishes orderly marketing. With these false premises exposed, Proposal 20 can be summarily rejected.

To the extent the Secretary considers the evidence marshalled in favor of Proposal 20, it is more important to consider what Proposal 20 did not show. Unlike NMPF, MIG failed to put forth evidence of what Class I differentials should be. MIG, as a group of Class I processors, wants certain Class I products (i.e., organic) treated differently in the FMMO system. The Secretary rejected inclusion of that proposal in this hearing. Thus, all evidence to that effect should be ignored. However, even were such evidence considered for some other reason, MIG failed to provide a coherent formula for treating different Class I products differently when setting new Class I differentials.

Proposal 20 seeks to slash $1.60 from the current differentials and set the subtracted solution as the new Class I differentials. This does not meet any of the regulatory, evaluative, or administrative criteria against which a Class I price structure is judged. Proposal 20 does not attempt to meet the evaluative and administrative criteria because it rejects the premises of a Class I differential: ensuring adequate supply for Class I, recognizing quality value of milk, providing appropriate market signals, recognizing value of milk at location, and facilitating orderly marketing Rather, Proposal 20 seeks to inject market inequities, removing the countervailing power and reasonable prices provided to dairy producers by the AMAA and replacing them with prices dictated by buyers of milk, who benefit from lower costs.

A review of the regulatory criteria exposes the sedition of Proposal 20. First, Proposal 20 offers little by way of local perspective. *See* 64 Fed. Reg. 16026, 16109. To be sure, Class I processors offered their experiences, which were presumably somewhat informed by wherever they are located, but they did not offer any evidence that producers costs of serving Class I markets and maintaining farm level productive capacity, which are the primary consideration for Class I differentials, have decreased. Second, Proposal 20 does not recognize the significant changes in the location value of milk; it assumes the location value from 2000 remains the same today. *See* 64 Fed. Reg. 16026, 16109. MIG does not believe Class I has the highest value of milk because its utilization is decreasing. MIG offered some evidence of the spatial relationships, but that testimony was to support the notion that Class III is now the most valuable and thus the current regulations should be overthrown. Third, Proposal 20 does not attempt to ensure Class I needs can be satisfied first. *See* 64 Fed. Reg. 16026, 16109. The goal of Proposal 20 is to usurp classified pricing and tie pricing to "value" based on utilization. Proposal 20 suggests Class I and Class III should be equal in FMMO pricing. Fourth, Proposal 20 does not satisfy the AMAA by maintaining orderly market conditions. 64 Fed. Reg. 16026, 16109; *see also* 7 U.S.C. § 602(4). With Proposal 20 more of the total price paid for milk is determined by the individual handler, without enforced uniform minimum prices being paid by all handlers to all producers. (*See* Ex. 494 at 2 [Testimony of Jeffrey Sims] ("Proposal Number 20 would effectively return much of the country to individual handler pools which can cause market disorder, rather than market-wide pools which have been determined by the Secretary to enhance orderly marketing and effectuate the declared policies of the AMAA.").) This replicates, or results in, the disorderly marketing inherent in individual handler pools which USDA has rejected.[39] Adopting Proposal 20 means undermining 87 years of

[39] An "individual handler pool" is where each plant/handler has its own "pool." That plant must pay the same price to each farmer delivering to the plant based on the "blended" value of its utilization for Class I, II, III, and IV. Individual handler pools cause disorder because they destroy

FMMO precedent and overthrowing the current regulations to benefit to processors when setting prices.

a. Demand for Class I Milk Exists and It Is Inelastic.

The intrinsic nature of milk used for Class I singles it out for different treatment. Class I use is marked by the perishability of fluid milk, variability of demand, and inelasticity. Class I milk processed as HTST has, at most, a three-week shelf life from cow to consumer. Within that perishability paradigm, there is a variability of demand that necessitates the need for balancing by Class I. For example, the demand by schools can greatly impact a Class I market. However, regardless of the fluctuations in demand, the average consumer of HTST milk is unlikely to stop buying it if the price goes up by a modest amount—i.e., Class I milk is inelastic. The FMMO system places Class I milk as paramount because of these special attributes.

To combat decades of FMMO policy, MIG's argument in favor of Proposal 20 involved two recurring themes: there is adequate milk for Class I and Class I no longer represents the highest value. The former is an appeal to ignorance, and the latter is a circular argument. Both are fallacies.

MIG argued there is adequate milk for Class I by suggesting a lack of shortages or dumping and by noting the decline in consumer consumption of Class I. Neither of these arguments prove there has been adequate milk for Class I or that there will be adequate milk for Class I tomorrow. Nor do these arguments suggest a decline in Class I *prices* is warranted. MIG's argument that there has been adequate milk for Class I was no more sophisticated than asking its Class I handler

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market-wide price uniformity. For example, a plant with 50% Class I and 50% Class IV pays its farmers' that average price. A plant next door, whose farmer suppliers are neighbors of the farms supplying the plant next door, has 90% Class I and 10% Class IV. Its "blended" price is much higher than the neighboring plant, and the neighboring farmers get much different FMMO minimum prices. If the plant is 100% Class III, it may be unregulated and have no FMMO price or, if regulated, it may have a very low "blended" price compared to the Class I plants. The neighbor farms will again have different prices. With market-wide pools, there is one minimum FMMO price which blends all the plants' utilizations.

members if they have ever had trouble obtaining milk. Of course, MIG's members have not: they take the amount of milk they want, when they want it. With the exception of CROPP, they have no obligation to take producers' milk. MIG's members also represent a minority interest of specialty processors; with the exception of some smaller Class I processors, they are not HTST processors. Quickly undermining MIG's echo chamber polling, at least one NMPF witness testified to difficultly obtaining milk during the hearing. (Tr. 715:8-18 [Testimony of Chris Hoeger].)

Proposal 20 ignores that there is a demand for Class I, even if consumption is declining. Approximately 20 percent of milk still needs to go to Class I, but producers are being compensated at values established in Order Reform. Moreover, the total volume of milk demanded by Class I plants is more than 40 billion pounds—a significant and important volume. Overall utilization of Class I has seen a noticeable decline because production has increased by 35 percent to meet the growing manufacturing demand while total pounds demand to Class I have remained about the same as in 2019 when FMMO 51 began.

Year	FMMO Number	Number of Pool Handlers	Number of Pooled Producers	Population of FMMO (in 1,000)	US Milk Production (in MM lbs)	Total Receipts of Producer Milk (in MM lbs)	Producer Milk Used as Class I (in MM lbs)	Percent of Producer Milk Used as Class I	Percent of US Milk in Pool
2000	11	346	69,585	228,899	167,393	116,923	45,989	39.3%	69.8%
2005	10	302	53,032	238,428	176,931	114,682	44,570	38.9%	64.8%
2010	10	251	45,918	284,480	192,877	126,909	44,970	35.4%	65.8%
2011	10	241	43,650	286,600	196,255	126,879	44,383	35.0%	64.7%
2012	10	237	40,745	288,732	200,642	122,388	43,492	35.5%	61.0%
2013	10	225	40,043	290,752	201,260	132,100	42,752	32.4%	65.6%
2014	10	223	39,146	292,825	206,048	129,420	41,420	32.0%	62.8%
2015	10	214	36,112	295,130	208,508	126,126	41,206	32.7%	60.5%
2016	10	216	34,689	297,291	212,451	133,846	41,140	30.7%	63.0%
2017	10	217	32,981	299,172	215,527	135,502	40,642	30.0%	62.9%
2018	11	233	32,061	300,171	217,568	141,684	40,945	28.9%	65.1%
2019	11	230	29,468	302,048	218,441	156,510	43,882	28.0%	71.6%
2020	11	228	24,906	303,063	223,309	137,818	43,766	31.8%	61.7%
2021	11		23,292		226,258	136,836	42,127	30.8%	60.5%
2022	11		23,108		226,620	151,614	40,986	27.0%	66.9%

(Ex. 103 at 2 [Testimony of Sara Dorland].)

Regardless of any decline in Class I consumption, fluid milk remains an inelastic product that permits FMMOs to administer a higher price be charged for Class I than for other classes. Raising Class I prices will generate more revenue than is lost through the potential of lower Class I demand.

> In summary, practically all past studies that have measured the price elasticity of demand for milk has found it to be inelastic. Likewise, many of these studies have found the cross-price elasticities of demand for milk substitutes to also be inelastic. These results suggest that increasing the Class I price by increasing Class I differentials will increase gross revenues to dairy farmers while not having a significant negative impact on milk sales volume.
>
> These insights are essential to validating the ongoing justification or rationale for establishing higher minimum prices for Class I milk. The underlying economic rationale hinges on two factors, one is the higher cost of serving Class I processors. The second relates to the economic argument that setting a higher price for the most inelastic use of milk will result in higher gross revenues to dairy farmers,

> even if there is a consequent lower price(s) for other uses of milk as markets find new supply and demand equilibria.
>
> It is important to understand clearly that the fact that the consumer demand for Class I products is price inelastic in no way conflicts with the obvious fact that per capita and total sales of those products have been trending down for over a decade. What the research indicates is that those sales trends are 1) caused by other factors than the price of milk and 2) would exist even if minimum Class I prices were lowered. This is not to say that changes in minimum Class I prices would have no impact on sales, but rather that those impacts would be minor in comparison to the other factors that are driving milk sales.

(Ex. 115 at 3-4; Tr. 1563:12-1564:16 [Testimony of Dr. Harry Kaiser].)[40]

Milk is inelastic because it is considered a "staple good" in that milk buyers regularly consume it, usually in the same amount, regardless of price level. For regular milk consumers, milk is considered more of a necessity than a luxury, which explains why consumers are not overly sensitive to price changes. They regularly buy milk and do not significantly alter their purchases in response to price changes. (Ex. 115 at 2; Tr. 1557:23-1558:3 [Testimony of Dr. Harry Kaiser].)

The demand for Class I exists and will continue to exist. Anecdotal testimony that Class I processors, who can choose to take milk when they want it, is not evidence that prices should be

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[40] In contrast to the unpaid, unbiased testimony of Dr. Harry Kaiser, Proposal 20 relies on the novel study produced by Dr. Oral Capps to suggest—***for the first time***—that retail demand for fluid milk is elastic. One study should not overcome the mass opinion meta-analysis conducted by Dr. Kaiser where that one study is based on an innovative methodology and/or data from a recent period. Dr. Capps' conclusion is reached because of how he conducted his study. Dr. Capps was hired and paid by IDFA. IDFA paid for data that is ordinarily not available to researchers. Dr. Capps' research did not include non-retail data and sample sizes were likely between 55 percent and 62 percent of Class I milk. (*Compare* (Ex. 386 at 6) *with Class I Utilization*, https://usda.library.cornell.edu/concern/publications/d791t6124?locale=en. Importantly, Dr. Capps' conclusion is premised on other products being interchangeable with milk. But non milk drinkers are irrelevant to an elasticity analysis. If someone does not drink milk, a change in price is not going to affect his or her buying behavior with respect to milk. Dr. Capps makes these consumers relevant by suggesting orange juice and soy milk, for example, are substitutes for milk. Someone who is a milk drinker is not going to consider orange juice or *more expensive* milk-like beverage to be substitutes if the price of fluid milk increases $0.10 per gallon.

reduced. MIG presented no evidence that production is in excess of demand. MIG ignored that dairy farmers that service Class I are becoming less incentivized to do so; adoption of Proposal 20 will in many cases put the Class I price in the base or lowest zones at the same price as that for manufacturing milk. This will assuredly turn dairy farmers away from Class I and cause supplies to run short.

b. Class I Must Be the Highest Valued Use of Milk: The USDSS Does Not Assign Value to Uses of Milk.

The other theme of Proposal 20 is Class I is no longer the highest value use for milk; Class III is. However MIG is defining "value," which seems tied to utilization, it is contrary to the premise of the FMMO system. The Class I price should have a higher base value than II, III, or IV because of the higher value inherent in Class I, which classified pricing and FMMOs are intended to capture for producers. The inherently higher value is based on at least two principles: (1) the inelastic demand for Class I which allows a higher price to be charged by the seller; and (2) the functional elements of the Class I usage (e.g., perishability, no distinct harvest or season compared to field crops, production and demand have noticeable seasonal patterns). Reducing Class I differentials by $1.60 would be a clear sign that Class I is no longer the highest valued class and would eliminate the incentive to supply Class I with milk.

Foremost, reducing Class I differentials by $1.60 will increase class price inversions even though Class I differentials should be "set at a level that minimizes the likelihood of class-price inversions." 64 Fed. Reg. 16026, 16113. Even presuming the Secretary returns the Class I Mover to the Higher-Of, Class I will be inverted with Class II any time the Higher-Of is the advanced Class IV skim milk price and the current differential for a county is $2.30 or less.[41] Because the

[41] If Proposal 20 were adopted, that inversion would happen in all counties with a remaining differential of $0.70 or less—i.e., the Class II differential.

weighted average Class I differential currently is approximately $2.60 per hundredweight, every time that the Class IV advanced skim milk price exceeds the Class III advanced skim milk price, nearly half of the country would experience a Class I to Class II skim milk price inversion. Were this the case, in many FMMOs, the Class II price would regularly be the highest of all the Class prices. (Ex. 494 at 3 [Testimony of Jeffrey Sims].) Proposal 20 reduces Class I prices such that the result will be, in many cases, that the Class I price will be equal to the manufacturing class prices. Proposal 20 will undermine the integrity of classified pricing because it will increase incidences of depooling and negative PPDs, which will reduce the income of dairy farmers and encourage disorder in milk markets.

To justify the departure from established FMMO precedent and the dictates of the AMAA, MIG hired Dr. Mark Stephenson to use 2016 USDSS data to suggest milk used in Class III is of more value than Class I. (*See generally* Ex. 451 [Testimony of Dr. Mark Stephenson].) To do this, Dr. Stephenson used the same model NMPF used as the starting point for Proposal 19: the USDSS. However, the conclusion Dr. Stephenson reached required permutating the USDSS to do something it was not intended to do. Dr. Stephenson suggests the output from the USDSS shows that a Class III plant across the road from a Class I plant in the Upper Midwest would value a hundredweight of milk higher than the Class I plant. But the model does account for the inherent value in different uses of milk that the FMMO system established.

> A. So the base marginal values generated in the model would be called by economists shadow prices or shadow values, and the only place where we depart from that is when we add the $1.60 to get to something that's comparable to the current Class I differential surface.
>
> Q. Are there occasions where that shadow price is, on Class I, a lot different than the other II, III, or IV shadow prices? And if they are, what's your view on what's causing that?

A. So I think you are — maybe you are talking about a broad set of differences between a Class III and a Class I value?

Q. Correct.

A. Yeah. So I mentioned numerous times that the way this model works is it's looking at all this information simultaneously. So as an example, we might expect that a Class III value would be different than a Class I value, except for that [$]1.60, in a location where there's a lot of cheese plants and a lot of milk going into cheese plants that are satisfying a demand. And it'd be particularly the case if there isn't a lot of demand for milk to go into a fluid plant. And I'm kind of thinking about in my mind an example of Idaho and Montana, right?

So there you could actually get differences between the need for milk to make cheese, which is big and strong, and saying, I need this right here based on the capacity, and not so much demand for fluid milk, and also a much sparser network of fluid plants in that region that mean you actually have to move that farm milk a lot longer distance to get it to a fluid plant.

Q. So if you had that county in Idaho that maybe had a fluid plant sitting next to a cheese plant, and one of them was a lot more — if Class — if the cheese value shadow price was significantly greater than the fluid value, what's that telling you? What's that — what's that telling us?

A. Okay. So I can imagine a situation in the real world where that might happen. In the model world, if you have a cheese plant right next to a fluid milk plant, the model only knows about the value differences due to what I mentioned before, like, there's a little bit of different component mix that's going into those different plants, and it only knows about what would the transportation costs be for me to go from one to the other.

So the model won't generate big differences in a Class III value and a Class I value, again, ignoring the [$]1.60 part, if they are right next to each other, because it's only accounting for those specific differences in the component use and in the transportation that would take you to go kind of this hypothetically across the road from one plant to another.

So the model won't generate something that looks like a big difference between those two values, other than that [$]1.60 that would come into play. And so the model can't really inform very much about what would happen if we saw that.

(Tr. 7048:19-7051:24 [Testimony of Dr. Charles Nicholson].)

In short, the USDSS does not account for the underlying factors that compose the Class I differential—value of quality of milk, balancing and marketing costs, and competitive costs. (*See* Ex. 302 at 3; Tr. 6922:4-24 [Testimony of Dr. Charles Nicholson] (noting because the USDSS assumes milk supplies are fixed in a given month, the USDSS does not include the cost of milk production).) Dr. Stephenson is improperly using a spatial relation model to show the intrinsic value of different uses of milk.

> Where I think I have a bit of a difference of opinion is that we have never used this model to try and determine what that minimum Class I differential should be. That is, we have never used this model to try and determine whether $1.60 is an appropriate number. And part of the reason that we have not done that is the model does not really represent the factors that underlie the justification for that $1.60 minimum Class I differential.
>
> So my assessment is, given that the model was not really designed to evaluate what the minimum differential should be because it doesn't incorporate those factors, it is probably not appropriate to use the difference between a Class III model-generated value and a Class I model-generated value to suggest what the minimum Class I differential should be.
>
> Q. Okay. And then I want to take us full circle, which was all the way back to my very first question that I asked when we started, which is, now we're back to we have two plants across the street from one another. And I posed you the question early on, if you have a Class I plant and a Class III plant across the street from each other, how the model impacts the decision to go one way or the other.
>
> Do you remember that?
>
> A. Yes.
>
> Q. And I asked you, well, if you just took those plants and you replaced them with a cheese plant and butter nonfat dry milk plant, would the results change?
>
> And what was your answer?

> A. My answer was that regardless of the plant types, because of the factors that are included in the model, we would expect to see very similar differences regardless of what class plant or what product plant type that would be. So we would not expect to see large differences based on the factors that are accounted for in the model for the hypothetical situation where a cheese plant and a fluid milk plant are right across the road from each other.
>
> Q. So is the point there that this model doesn't tell you one way or another which one is the bigger driver between the — between the classes of milk?
>
> A. So I guess I would say that the model is not going to accurately represent what a fluid milk plant should pay to get milk into the plant relative to what a cheese plant should pay. It's really good at describing how the differences across space exist for different fluid milk plants, but it's not designed to account for the fact — or the factors that affect what that minimum Class I differential should be.

(Tr. 6955:13-6958:22 [Testimony of Dr. Charles Nicholson].)

The USDSS does not assign value to products.[42] For Class I, it does not account for the additional challenges, and costs, of supplying a fluid plant. The USDSS builds an engineered solution around a fixed amount of milk production in fixed locations to be delivered through fixed processing locations to a fixed population. It does not, for example, address seasonal or weekly balancing challenges or the absolute need to meet fluid demands first. Any comparison between manufacturing plants and fluid plants by use of the USDSS is equivocation. Likewise, any attempt to assign value to Classes I and III and translate that into base class prices is beyond the epistemic scope of the USDSS. (Tr. 6997:8-6999:6 [Testimony of Dr. Charles Nicholson] ("The only place that it really recognizes a class distinction is really through the addition of the 1.60 minimum value

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[42] Dr. Stephenson proves this with his testimony. Figure 3 (page 19) of Exhibit 453 suggests the marginal value of milk is higher for Class III in most of the country, which apparently means the Class III price should be higher than Class I in most of the country. If such were the case, there would be no incentive to ship to Class I. This is absurd. In a classified price system, base class prices need to be determined on the basis of intrinsic values of milk for the particular use. The USDSS does evaluate the intrinsic nature of Class I use and therefore can provide no pertinent information on the base Class I price.

that's applied to Class I milk. Otherwise, it doesn't really know or doesn't really care where the milk is being used or what the current market structure is or whether some product was at a Class IV plant or Class III plant.").) The USDSS does not consider the marginal profit value of the additional hundredweight. That sort of value, and others, are reflected in the local competitive experiences testified to by witnesses supporting Proposal 19.

5. MIG's Proposal 20 Would Devastate Producer Returns: Over-Order Premiums Are Not a Substitute for Differentials.

The purpose of Class I differentials, and to a larger extent the FMMO system, is to compensate dairy farmers for their unique agricultural commodity without forcing dairy farmers to rely on the federally unregulated milk price market because they are at an inherent disadvantage. Proposal 20 seeks to upend that basic tenant. Proposal 20 would result in FMMO pool values being decreased by $660,000,000 annually. (Ex. 494 at 1 [Testimony of Jeffrey Sims].) Thus, it is questionable whether Proposal 20 can be adopted without violating the AMAA since Proposal 20 does not benefit, but rather actively harms, producers. *See* 7 U.S.C. § 602(4).[43]

Assuming Proposal 20 can be seriously considered as a plausible regulatory amendment—it is not—MIG offers two primary justifications. First, the factors that create the current $1.60 minimum differential are no longer applicable. But those factors maintain relevant today and are flexible standards the Secretary can use or abandon as necessary to set Class I differentials. *See supra* at 289-298. If a particular factor considered part of Class I differentials seems antiquated, then the Secretary should consider modern factors. The solution is not—as MIG suggests—elimination of $1.60 from all Class I differentials.

Second, MIG suggests any lost pool value can be recouped through over-order premiums.

[43] While the AMAA regulates processors, the intent of the AMAA is to benefit producers. There is no similar consideration for processors.

That is, MIG believes Class I differentials and producer prices should be reduced and any lost revenue can be recouped through producers negotiating with Class I processors in an open market. The only aspect of FMMOs that MIG seems intent on keeping is the data collection.

Over-order premiums are an inherent part of FMMOs, but they are not a substitute for an appropriate minimum Class I differential value. Over-order premiums are at the will of the Class I handler; they can evaporate as quickly as they come into existence—to the extent they come into existence at all. They are challenging to negotiate, and they are not guaranteed. Reliance on over-order premiums jeopardizes handler uniformity, a critical component of FMMOs because in the unregulated over-order premium marketplace Class I handlers have less visibility into their competitors' prices and no longer have assurance that their competitors are paying the same price. (*See* Ex. 342 at 8-9; Tr. 8001:7-18 [Testimony of Calvin Covington] ("Fluid milk buyers are concerned about the impact higher over-order premiums may have in creating unequal raw milk costs, possibly giving one processor an advantage over another processor…Increasing the fluid milk price, by increasing the Class I differential, provides fluid milk processors greater assurance of equal raw milk costs. Milk buyers have confidence in the enforcement of minimum prices, which helps to maintain orderly milk marketing.").) Further down the supply chain, retailers often rely on FMMO prices to set the price they will pay Class I handlers. (*See, e.g.*, Tr. 10922:9-26 [Testimony of Tim Kelly] (Q. And do you build in there a moveable variable price that's based on the announced Class I price? A. Yes, we do.").) Retailers, too, want to know there is price uniformity. If Class I differentials are reduced by $1.60, retailers will reduce their pay prices accordingly, and dairy farmers will suffer.

Over-order premiums are precarious. They are impermanent. They can be influenced by marketing conditions outside the market in which a dairy farmer operates.

> Q. That was kind of the long-term view. In the short-term, isn't it true that over-order premiums could adjust if there are tighter milk supplies or needs for milk that aren't being met through the minimum milk price?
>
> A. So over-order premiums exist now. There's manufacturing plants that are paying over-order premiums. I believe Mr. Lyons [sic] testified that those over-order premiums have declined. We have seen that in our own returns, although I don't have data to show you.
>
> And I think you have heard from some of the DFA farmer-owners who are worried about a double-dipping, that you are going to increase the Make Allowances even though some of those higher costs that are being complained about in this hearing have been covered by reducing the milk prices by reducing over-order premiums. That's the double-dipping that some dairy farmers reference.
>
> And so those over-order premiums some day may come back, but it is — I don't do this negotiation, but I hear about it — it is a battle to get a penny a hundredweight from somebody on over-order negotiation. It is — it is a battle. And so some day maybe some of that value might come back. But I don't know how much, and it's not going to automatically come back, in my mind.

(Tr. 3365:12-3366:7 [Testimony of Edward Gallagher].)

> Q. We have heard also repeatedly the MIG witnesses have testified that they want to eliminate the price differentials and for producers to just trust that they will put that into the over-order premium pool.
>
> Even if we assume that their intentions are as genuine and authentic as what they have testified to, I'm wondering if you can talk about what your experiences are in that continuing long-term.
>
> A. Over-order prices, in my career — and it's a fairly long one — I have seen the gamut in over-order prices. I have seen them pretty high, more than $3, approaching $4, and I have seen them at zero. And no matter how high they are or how — they always come down. If they get high, they come down. And the more you rely on over-order prices, and the more you rely on over-order prices to be high, the more likelihood they are to crumble. And they all crumble eventually. It's – it just kind of happens. And, in fact, the higher you make them, the more incentive there is for them to be caused to crumble.

> So we — my — my experience is that over-order prices are — you almost have to consider them here today, gone tomorrow. They do not generally last a long time, they go through cycles. And those cycles are difficult…The valleys are substantially longer in duration than the peaks. And over-order prices simply cannot be counted on to exist long-term.
>
> Q. And do you — in your experience, do you believe that producers have sufficient bargaining power in order to command the prices that they need to cover the elements that we have been talking about that are currently factored into Class I differentials?
>
> A. All I can say in response to that question is that it's the — it's a very unusual circumstance for over-order prices to cover all the costs of balancing plants. They generally are insufficient in their – in how much we are able to charge for — for those services.
>
> Q. And have you heard from plants how they use the Federal Order announced minimum price in order to pass that price along to their customers?
>
> A. Yes, that's a common theme. We hear plants, particularly traditional plants that have retail customers, say that their — the formulas that are used — that are used to set the wholesale price, the price that the plant gets from the — from the wholesaler, the retailer, are driven purely by month-to-month changes in the Federal Order prices. I think it's been described something like a tolling circumstance, where there's a fixed per gallon, per half gallon margin that in essence is — creates the transfer price, which is over and above the regulated Class I price.
>
> A very common statement when we talked with our customers about changes in pricing is that if it is on the Federal Order price announcement, we can pass it on; if it's in the form of a premium, not so much. In fact, it's very difficult for them to pass — if not impossible – to pass on to their wholesale and retail customers. If it's on the Federal Order price announcement, they can pass it on to their packaged milk customers. If it's in a premium, much, much, much more difficult for them to pass it on.

(Tr. 11464:17-11466:25 [Testimony of Jeffrey Sims].)

Many of MIG's members claimed a better approach to compensating dairy farmers is to pay them directly, rather than through the pool. However, no Class I processor that testified in favor of Proposal 20 ***pledged*** that all additional revenue it received from a reduction in Class I differentials would be paid to dairy farmers. (*See, e.g.*, Tr. 11228:12-11229:17 [Testimony of Jed Ellis] ("believing" Shehadey Farms would pay producers the differential through over-order premiums but not guaranteeing it).) Some of MIG's members—e.g., fairlife, Danone—are part of large companies that must answer to shareholders. Thus, no Class I processor could guarantee ***any*** additional money would be paid to dairy farmers for their balancing, hauling, and supply costs.

"[D]isorderly marketing conditions can arise from the actions of handlers that seek to pool milk on an order only when more favorable alternatives are not otherwise available." 63 Fed. Reg. 4802, 4934. Like make allowances, the proponents of Proposal 20 want a windfall for participating in the FMMO system. The members of MIG are predominately large multi-billion-dollar enterprises that are advocating to reduce prices to all dairy farmers.

They incredulously claim they will make farmers whole through over-order premiums, but the nature of Proposal 20 belies their position. That MIG is advocating for Proposal 20 in the first instance shows, like the members of IDFA with make allowances, that they want to shift the dairy industry economy decidedly in their favor. IDFA sought to accomplish that through extraordinarily high make allowances with little justification, and MIG seeks to continue that theme with an evisceration of FMMO policy and the Class I differential. Collectively, these changes will take billions of dollars out of dairy farmers' pockets to benefit large, multinational corporations.

Whereas, Proposal 19 is part of a package of proposals that will only have moderate effects on all milk prices and will level out relatively quickly as milk production harmonizes with the new baseline. (Ex. 421 at 10; Tr. 9807:19-24 [Testimony of Dr. Scott Brown].) Instead of presenting evidence to support its changes or taking the time to develop a Class I price surface, MIG nitpicked every conceivable aspect of Proposal 19, effectively venerating the USDSS, but then sought to undermine the USDSS by eliminating $1.60 from the *1998* USDSS results without the regional and location specific justifications offered by NMPF and Proposal 19. Much like its "promise" to provide over-order premiums to dairy farmers, MIG has presented no evidence to substantiate Proposal 20. Proposal 20 should be rejected.

VIII. NMPF OPPOSES PROPOSALS 4, 5, AND 6 AND THE PROPOSED MODIFICATION TO PROPOSALS 3 AND 4 BECAUSE THEY INTRODUCE MULTIPLE PRODUCTS FOR PRICING COMPONENTS WHEN ONE PRODUCT IS MORE ORDERLY.

AFBF submitted Proposals 4 and 5 requesting to add 640-pound cheddar cheese blocks to the protein price formula (Proposal 4) and unsalted butter to the butterfat and protein price formulas (Proposal 5). *See* 7 C.F.R. § 1000.50(l), (n). CDC, similarly, requested to add mozzarella to the protein price formula with Proposal 6. *See* 7 C.F.R. § 1000.50(n). Finally, during the hearing, Edge proposed a modification to Proposals 3 and 4 that sought to retain Barrels in the protein price formula by using a monthly weighted average. (*See* Ex. 134.)

NMPF opposes Proposals 4, 5, and 6 and the proposed modification because the proposals perpetuate the problem Proposal 3 seeks to fix: only one product should be used to set the protein price. As demonstrated by inclusion of Barrels in the protein price formula, when two products are used to set a price, it creates unintended consequences. Relying on two products means two different markets are setting the Class III skim milk price. When those two markets operate similarly, the inclusion of multiple products *can* operate without disorder. However, when the markets diverge, as the experience with Barrels and Blocks pricing protein has shown, it causes financial harm to producers and to processors of whichever product (Blocks or Barrels) is accounting to the FMMO pools at a protein price which is overstated to the value of that product in the marketplace. The modicum of evidence put forth in favor of these proposals did not overcome the weighty evidence provided by experts in the cheese industry, who supported Proposal 3. For those reasons and the reasons stated in support of Proposal 3, *see supra* at 48-77, Proposals 4, 5, and 6 and the proposed modification should be rejected.

IX. NMPF OPPOSES PROPOSALS 10, 11, AND 12 BECAUSE THERE IS INSUFFICIENT DATA TO JUSTIFY THE AMENDMENTS.

Select submitted three proposals accepted by the Secretary. Proposal 10 seeks to increase the butterfat recovery factor in the protein price formula, which would necessitate a corresponding increase in the butterfat yield in cheese. *See* 7 C.F.R. § 1000.50(n). Proposal 11 seeks to update the butterfat and protein yield factors in the component formulas to reflect "actual farm-to-plant shrink." *See* 7 C.F.R. § 1000.50(l), (n). Proposal 12 seek to update the nonfat solids factor. *See* 7 C.F.R. § 1000.50(m).

NMPF agrees with the spirit of Select's proposals to update the product price formulas, but NMPF does not support Select's proposals at this time. NMPF recognizes the need to consider updating the price formula yield factors, but there is a lack of any comprehensive data to justify setting the figures in Select's proposals. Similar to make allowances, the only way to establish the "correct" values for these critical component formula coefficients is through conducting a mandatory, auditable survey of plants that manufacture the products used in these formulas. NMPF, together with other industry stakeholders, is lobbying to secure the authority and funding for USDA to conduct just such studies in the Farm Bill. (Ex. 142 at 8; Tr. 2441:7-2442:2 [Testimony of Dr. Peter Vitaliano].) Proposals 10, 11, and 12 should be rejected.

X. NMPF OPPOSES PROPOSAL 21 BECAUSE IT WILL INCENTIVIZE DISORDERLY MARKETING.

Proposal 21, submitted by AFBF, seeks to increase the Class II differential from $0.70 to $1.56 (in tandem with eliminating advanced pricing (*see* Proposal 18)). *See* 7 C.F.R. § 1000.50(e). NMPF opposes Proposal 21 for two primary reasons that constitute disorderly marketing. First, it may incentivize the practice of substituting less expensive milk powder for fresh milk to make Class II products in order to offset the cost of the increased differential. (Ex. 499 at 2; Tr. 11517:28-11518:14 [Testimony of Carl Rasch].)

Second, Proposal 21 will encourage further depooling by partially regulated or unregulated Class II processors. Nonfat dry milk and butter prices have been strong for the last two years, which has resulted in Class IV prices significantly higher than Class III. This, in turn, increases the Class II price. *See* 7 C.F.R. § 1000.50(e). Effectively, whenever the Class II price (i.e., advanced Class IV plus the $0.70 differential) is greater than the Class III price plus the PPD, it will incentivize depooling because the Class II processor would be obligated to contribute to the pool. In FMMO 33, pooled Class II milk in 2022 was approximately 2,500,000,000 pounds less than in 2020. (Ex. 499 at 3; Tr. 11520:25-11521:28 [Testimony of Carl Rasch].) Raising the Class II differential will exacerbate depooling.

When depooling is prevalent, it results in different pay prices within the same FMMO. A producer that provides milk to a Class II plant that pools is paid the uniform price, but a producer that provides milk to a Class II plant that chooses not pool is usually paid the Class II price, which has recently been higher than the uniform price. (Ex. 499 at 3; Tr. 11521:28-11522:7 [Testimony of Carl Rasch].) This disorder undermines producer price uniformity. Proposal 21 also undermines handler price uniformity. If a Class I pool distributing plant uses its excess cream to generate Class II products, those products are included in the plant's obligation to the producer settlement fund because it is a fully regulated plant. However, if the same products are produced by a partially regulated or unregulated plant, then there is no obligation to the pool. Again, raising the Class II differential is likely to exacerbate this problem and cause Class I plants making Class II products to reevaluate whether to continue to generate revenue in that fashion. This is disorderly. Proposal 21 should be rejected.

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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 NATIONAL MILK PRODUCERS FEDERATION'S POST-HEARING BRIEF has been furnished and was served by electronic mail upon the following parties on April 1, 2024 by the following:

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