

BEFORE THE SECRETARY OF AGRICULTURE  
AGRICULTURAL MARKETING SERVICE

In the matter of:	)	
	)	
Proposed Amendments to	)	Docket No.
Marketing Agreements and Orders	)	23-J-0067
	)	
(Pricing Formulas)	)	AMS-DA-23-0031-0002
	)	

**Comments of the American Farm Bureau Federation**

The American Farm Bureau Federation (AFBF) hereby submits its comments in the above-captioned proceeding in response to the recommended decision. (89 FR 57580, et al.)

The proceeding was initiated to consider proposals to amend the four class price formulas applicable to all federal milk marketing orders. AFBF initiated four of the 21 proposals heard by USDA and has positions on several others. The post-hearing brief submitted by AFBF addressed the general problem of price misalignment and de-pooling, which underlies AFBF's positions on many of these proposals; AFBF encourages a review of that brief alongside this comment in response to this recommended decision. (See [https://www.ams.usda.gov/sites/default/files/media/FMMO\\_AmericanFarmBureauFederation\\_Brief.pdf](https://www.ams.usda.gov/sites/default/files/media/FMMO_AmericanFarmBureauFederation_Brief.pdf))

A letter to the Secretary is also being submitted with this comment, as well as a recent AFBF Market Intel report that illustrates some of the issues discussed below.

**AFBF Represents America's Dairy Farmers**

As the nation's largest general farm organization, AFBF represents nearly 6 million member families in all 50 states and Puerto Rico. AFBF policies are developed and approved by farmers. In recent years, AFBF's members have taken a leading role in federal milk marketing order (FMMO) policy to ensure that farmers are represented directly, in addition to the important representation that many – but not all – receive through the activity of their cooperative associations.

To that end, AFBF organized a Dairy Working Group, which spent more than three years diving into the details of FMMOs and developing a series of recommendations. In addition, AFBF hosted a Federal Milk Marketing Order Forum in Kansas City in October 2022, attended by 300 dairy industry leaders, the majority of whom were farmers, to develop a set of FMMO policy priorities. These recommendations and priorities were then carried home to county Farm Bureaus, where the formal policy development process led to votes by state and national farmer delegate bodies, and the refined set of policies on which AFBF's proposals for this hearing, as well as our response to this recommended decision, are based.

This regulatory proceeding seeks to consider proposals for amending the four class price formulas applicable to all federal milk marketing orders. AFBF initiated four of the 21 proposals reviewed by USDA and holds positions on most of the others. Our comments will address aspects of the recommended decision that align with, and those that diverge from, orderly marketing and the interests of AFBF and the dairy farmers we represent.

### **Recommended Decision Undermines Prices for Many Farmers**

The proposed amendments by USDA offer potential benefits for some dairy farmers, while raising significant concerns for many others. The proposed return to the “higher-of” Class I base price, the elimination of the barrel cheese price, and increases in composition factors and Class I differentials will all better reflect current market conditions and improve overall pricing for farmers. However, the unnecessary and excessive recommended increases in make allowances would undermine these gains, particularly in regions with high non-Class I utilization. The resulting lower manufacturing milk price would have damaging and regionally disparate impacts on farmers, despite the lack of data that would demonstrate a need for these changes. Furthermore, the recommended delay in implementing updates to composition factors and the added complexity of the extended shelf like milk adjuster ensure that these changes will harm dairy farmers overall in the first year of operation.

By AFBF’s calculations, at least 38% of farmers will lose money, based on a static analysis of the impacts of these changes over the last five years, including the separate USDA analysis of the delayed application of the changes in composition factors. (We have been unable to duplicate USDA’s results but find our analysis consistent with others.) We believe that that number will be higher in the future, because there was an unusually large divergence between the Class III and Class IV prices in the past five years, so the return to the higher-of will have a smaller positive impact on the Class I price and, so, the producer pool value. By our static analysis, the projected impact in the first year is negative for farmers overall.

AFBF also expresses disappointment that all four of AFBF’s specific proposals were rejected, including those to lift the Class II differential and to add 640-pound cheese blocks to the National Dairy Products Sales Report. The proposal to update the Class II differential to \$1.56 was based on the need to more accurately reflect the cost of drying milk, a crucial factor in maintaining the intended balance between Class II and Class IV milk prices, and simply an update of the calculation that USDA made to establish the Class II differential at the time of order reform. Increasing the minimum order value of Class II milk would enhance the average pool value across all markets and reduce the likelihood of negative producer price differentials (PPDs) and attendant de-pooling. Similarly, the proposal to include 640-pound cheese blocks in the National Dairy Products Sales Report aimed to better align price discovery with current market practices, ensuring more accurate and representative pricing. USDA’s decision to forgo these critical updates is a missed opportunity to improve price accuracy and fairness within the FMMO system.

AFBF remains committed to advocating for policies that equitably represent the interests of all dairy farmers and ensure the continued fairness and viability of the federal milk marketing system, and we don’t believe that this decision achieves those objectives.

The following addresses the individual issues in more detail.

## **Milk Composition Factors**

Raising the milk composition factors in the product price formulas is both necessary and overdue, as it will better align FMMOs with the current realities of milk production. Since the composition standards were established in 2000, the dairy industry has experienced significant advancements in genetics, nutrition, and farm management practices, and has responded to the incentive of component pricing under the FMMO system. These have all led to substantial increases in the average levels of protein and other solids in milk. Consequently, the current component factors in the skim milk price calculations no longer accurately reflect the value of the milk being produced and delivered to processors, and their application to Class I skim milk pricing and skim milk pricing in the four skim/butterfat markets created misalignment among classes and among markets, as demonstrated in the hearing. AFBF supports the proposed increase in the protein composition factor to 3.3%, the other solids composition factor to 6%, and the total nonfat solids composition factor to 9.3%.

Proponents, including the National Milk Producers Federation (NMPF) and National All-Jersey, have provided compelling evidence that the outdated standards contribute to a narrowing of the price differential between Class I fluid milk and manufacturing milk (Class III and IV), leading to more frequent class price misalignments. This narrowing not only complicates marketing efforts but also heightens the risk of price inversions and depooling, which can disrupt orderly market conditions. The proposed updates would correct this by ensuring that minimum prices paid to producers more accurately reflect the true value of the milk components being delivered.

Opponents argue that raising composition factors would increase costs for Class I fluid milk processors, who might struggle to recover these costs in the marketplace due to consumer preferences for fat content, freshness, and price, rather than higher nonfat solids levels. Notably, several fluid milk handlers declined to reveal component levels for the department to consider. This argument overlooks the broader benefits to the dairy industry from aligning component standards with current production realities. Additionally, opponents such as the International Dairy Foods Association and the Milk Innovation Group assert that fluid milk processors, required to participate in FMMOs, would be unfairly burdened by paying for components they do not actually receive. This argument assumes that all processors will consistently receive milk with lower-than-proposed component levels, which is not the case.

While the need for updating these standards is clear, AFBF opposes the recommended 12-month delay in their implementation. Such a delay would mean that while other adjustments take effect when the new order language is implemented, the increases in composition values would be postponed for a year. Such a delay would unnecessarily prolong the period during which producers are undercompensated for the higher-value milk they are already delivering. In a static analysis that replaces current composition factors with the proposed ones in class price formulas between 2020 and 2023, the average annual benefit to producers across the pool would be approximately \$220 million. The impact of this delay was not included in USDA's economic impact analysis. By AFBF's calculations, if this change is delayed for a year, dairy farmers will miss out on more than \$200 million in overall pool value, while they will feel the full negative impact of the large make allowance increases, so that the impact on farmers of the overall decision would be strongly

negative in the first year. (See <https://www.fb.org/market-intel/decoding-usdas-fmmo-recommendations-2>, also attached.)

The argument that this delay is necessary to account for risk management practices does not sufficiently justify postponing this much-needed adjustment to the composition factors, particularly since composition factors are the only proposed factor change for which USDA has recommended a delayed implementation—an arbitrary recommendation when all proposed amendments impact the underlying calculation of class prices. Many processors, cooperatives and producers, for example, use combinations of Class milk and butter futures and options contracts to hedge milk at test. This hedge is similarly undercut by a quick change in the make allowances and yield factors. (This is because the calculated value of milk at test – and particularly skim milk – using the butter price depends on the make allowance and yield factors used to convert the butter price to a butterfat price.)

The record clearly shows that milk component levels have been steadily increasing, particularly since the mid-2010s. Given this trend, the timely implementation of updated standards is crucial to ensure that producers receive fair compensation for the milk they produce. Any further delay in updating these standards would perpetuate the misalignment between actual milk composition and the assumptions used in price calculations, continuing to disadvantage producers in a program whose purpose is to even the terms of trade between producers and processors.

The proposed 12-month delay in implementation is unwarranted and unconscionable, unless there is also a 12-month delay in the make allowances.

The evidence clearly supports an immediate adjustment to these standards to better reflect the current state of milk production and ensure fairer pricing for all stakeholders involved. It is essential that the updated composition factors be implemented without unnecessary delay to restore equity and stability in the dairy market.

### **Surveyed Commodity Products**

AFBF appreciates USDA's efforts to reassess the Dairy Product Mandatory Reporting Program (DPMRP) survey in light of evolving market conditions. We strongly support USDA's proposed decision to remove 500-pound barrels from the survey. This decision is both timely and necessary to ensure that the prices used in FMMO pricing formulas accurately reflect the current dynamics of the cheddar cheese market. However, we are concerned over USDA's rejection of AFBF's proposal to add 640-pound blocks to the survey, a move that would have further strengthened the accuracy and representativeness of the DPMRP.

The inclusion of both 40-pound blocks and 500-pound barrels in the DPMRP survey was initially justified by the need to increase the survey's sample size and to provide a broad representation of the cheddar cheese market at a time when there was a relatively steady relationship between block and barrel prices, the same relationship that led to the 3-cent adjustment to barrel prices in the survey. However, market conditions have changed significantly since the early 2000s, particularly since 2017, when the price spread between blocks and barrels began to diverge dramatically. This divergence has led to increased volatility and has caused the average cheddar price derived from the survey to become less reflective of either product's true market value.

By overrepresenting 500-pound barrels—used primarily for processed cheese and constituting a relatively small portion of the natural cheese market—the survey has skewed the Class III milk price downward, reducing revenue for dairy producers. USDA’s decision to remove barrels from the survey aligns with the principle of ensuring that FMMO pricing formulas are based on consistent market-clearing, commodity-type products that accurately reflect supply and demand dynamics. This move will bring greater stability and fairness to the dairy pricing system, benefiting both producers and the broader market.

While AFBF supports the removal of 500-pound barrels, we believe USDA’s decision to reject the inclusion of 640-pound blocks was a missed opportunity that will ultimately undermine the integrity of the DPMRP survey. The addition of 640-pound blocks is a natural corollary to removing the 500-pound barrels because it would expand the survey volume, providing a more comprehensive and accurate representation of the cheddar cheese market, but using a product that is a much closer supply and demand substitute for 40-pound blocks. This is particularly important given the pronounced shift in the market toward production of the larger blocks, as many new cheese processing facilities have moved toward producing (and many users have moved toward handling) 640-pound blocks due to their efficiency and growing demand.

The argument that 640-pound blocks are typically priced off 40-pound blocks and thus do not contribute new price information is overly simplistic and overlooks the broader market trends, as well as the potential for mischief, which always must be considered in a regulatory system.

It is true that 640-pound blocks and 40-pound blocks often share nearly identical market pricing; however, the exclusion of 640-pound blocks now is likely to force a reconsideration in the not-too-distant future, as the volume of 40-pound blocks continues to dwindle. (See Exhibit 129, pp. 2-3.)

Moreover, the inclusion of 640-pound blocks would provide a deeper survey volume, helping to prevent potential disruptions in the market. For instance, it would discourage block manufacturers from switching between sizes to avoid and re-enter the price survey, thereby promoting more orderly marketing conditions. Large blocks can be cut into small blocks, and small blocks can be assembled into large blocks, as indicated in hearing testimony, so excluding either creates a risk of biased reporting by processors, in either direction, depending on their interest.

AFBF strongly supports USDA’s decision to remove 500-pound barrels from the DPMRP survey, as this will correct existing market distortions and align the cheese pricing formulas with the realities of the current market. However, we also urge USDA to reconsider the inclusion of 640-pound blocks. Adding these larger blocks to the survey would make the DPMRP more accurate and more robust, ensuring that FMMO pricing formulas remain fair, transparent, and more reflective of the cheddar cheese market. The combination of removing barrels and adding 640-pound blocks would provide a more stable and equitable foundation for dairy pricing, ultimately benefiting producers, manufacturers, and the broader dairy industry. By adopting both of these changes, USDA would not only correct existing imbalances in the survey but also future-proof the DPMRP against further shifts in market dynamics, ultimately benefitting producers, manufacturers, and the entire dairy industry.

### **Class III and IV Formula Factors**

AFBF opposes the proposed increases in make allowances by USDA. While we understand the need for make allowances to reflect current manufacturing costs, we believe that any such adjustments must be grounded in robust, accurate, and unbiased data, and respond to a clear market need. Unfortunately, the voluntary surveys upon which USDA is basing these make allowances fall short of these standards. We oppose the proposed values of \$0.2504 per pound for cheese, \$0.2653 per pound for dry whey, \$0.2268 per pound for nonfat dry milk (NDM), and \$0.2257 per pound for butter and urge USDA to defer any increases in make allowances until access to comprehensive and audited processor cost and yield data is available. We believe that the evidence of considerable growth in new cheddar cheese production capacity (mostly of 640-pound blocks), in particular, demonstrates that increases in the make allowances are unnecessary and inappropriate.

The proposed increases in make allowances, if implemented based on the current data, will have severe financial repercussions for dairy farmers. When these allowances are set too high, they reduce the price paid to dairy farmers, squeezing already thin margins and threatening the livelihood of family farms across the country. The potential reduction in milk prices could force many farmers out of business, exacerbating the ongoing decline in the number of U.S. dairy farms and undermining the stability of the milk supply. If the recommended increases in make allowances, (including butterfat recovery factor and butterfat yield factor in cheese change) had all been implemented between 2020 and 2023 they would have reduced Class I prices by an average of 81 cents/cwt; Class II prices by 74 cents/cwt; Class III prices by an average of 89 cents/cwt; and Class IV prices by 74 cents/cwt. This corresponds to a 3-6% decline in class prices that are already too low for many dairy farmers. (Again, see <https://www.fb.org/market-intel/decoding-usdas-fmmo-recommendations-2>, also attached.)

### **Survey Problems**

The proposed increases in make allowances are based on voluntary surveys conducted in 2021 and 2023. These surveys, which were well understood by participants as the likely basis for regulatory change, suffer from significant participation bias and do not provide a reliable basis for adjusting make allowances. The 2021 survey included only a fraction of plants: 60% of nonfat dry milk plants, 29% of dry whey plants, 24% of cheddar cheese plants, and 20% of butter plants. Such limited participation inevitably skewed these results, particularly when large, efficient processors opt out of the survey, potentially inflating the reported costs.

The 2023 survey, though it captured a higher percentage of plants, still left substantial gaps in the data, with nearly 45% of cheese and 50% of whey volume not accounted for. This incomplete dataset is inadequate for justifying the significant increases in make allowances proposed by USDA. Moreover, as it became increasingly clear to what end these surveys would be used, their voluntary nature created an incentive for manufacturers to selectively participate or report costs in a manner that could bias the results in their favor.

Most concerning about this data, and the clearest evidence on the record that it is biased, is the difference in average plant volumes between the DPMRP price survey and both of the Wisconsin cost of processing surveys. The average DPMRP NDM plant is between five and 24 times as large as the average NDM plant in the Wisconsin surveys; the average DPMRP whey plant is four to five times the size of the average Wisconsin survey plant; and the average DPMRP cheese plant is at

least six times as large as the average Wisconsin survey plant. (See table below, sourced from the record.)

### Average Plant Size, DPMRP Survey and University of Wisconsin Processing Cost Surveys

	<b>Cheese</b>	<b>Butter</b>	<b>Whey</b>	<b>NDM</b>
<b>DPMRP Volume, 2020</b>	1,252,993,047	202,695,713	288,651,793	1,058,680,318
<b>DPMRP Plants, Week of 7/8/2020</b>	29	19	15	27
<b>UWisc 2021 Study, Volume, Annual</b>	61,050,768	136,365,557	35,666,405	44,425,802
<b>UWisc 2021 Study, Plants</b>	10	12	8	27
<b>UWisc 2023 Study, Volume, Annual</b>	122,404,426	126,906,009	48,986,287	119,615,524
<b>UWisc 2023 Study, Plants</b>	18	13	9	15
<b>Avg size, DPMRP</b>	<b>43,206,657</b>	<b>10,668,195</b>	<b>19,243,453</b>	<b>39,210,382</b>
<b>Avg size, Wisconsin Study, 2021</b>	<b>6,105,077</b>	<b>11,363,796</b>	<b>4,458,301</b>	<b>1,645,400</b>
<b>Avg size, Wisconsin Study, 2023</b>	<b>6,800,246</b>	<b>9,762,001</b>	<b>5,442,921</b>	<b>7,974,368</b>

**Sources:** USDA (Exhibits 19-23); Mark Stephenson (Exhibits 158, 178); AFBF calculations

**Note:** 29 is the largest possible number of cheese plants in the DPMRP survey, adding the 17 block plants and the 12 barrel plants, ignoring possible overlap; a smaller number of plants would increase the average plant volume. It also excludes volumes of 640-pound blocks made in the same plants, which would increase the average plant volume, while the Wisconsin studies included 640-pound blocks.

It is well-established that larger plants tend to have lower costs. (This is demonstrated on the record by the CDFA cost survey results shown in Exhibits 183-195.) The extreme bias of the Wisconsin studies toward smaller plants makes the results effectively useless. It is also clear from the number of nonfat dry milk plants in the 2021 study, as well as Dr. Stephenson's discussion of his plant sample in Exhibits 158 and 178, that he drew from a number of plants that didn't qualify for the survey; whether that is because they were too small or didn't produce the DPMRP-specified product, these observations are irrelevant.

It is also important to note that Dr. Stephenson himself raised concerns about his own study's use for setting regulation, identifying self-selection bias as a significant risk in a voluntary survey. (See Exhibit 176, p. 3.)

The conclusion must be that the data provided by the University of Wisconsin is heavily biased toward smaller, less-efficient, higher-cost plants; and that the resulting cost estimates have led USDA to excessive make allowance increases.

### ***Current Cheese and Whey Make Allowances are Clearly Adequate***

Under the current make allowances, the U.S. has seen continued investment in commodity cheddar cheese production capacity, indicating clearly that the existing allowances for cheese and whey have not hindered industry growth. The cheese manufacturing sector has expanded, suggesting that efficient processors have found ways to remain profitable under the current framework, and that the cheese and whey make allowances, at least, are adequate. This ongoing growth in cheese production undermines the argument for the recommended immediate large

increases in make allowances, as it demonstrates that the current levels have not stifled industry innovation or capacity expansion. (See, again, Exhibit 129, pp. 2-3.)

The last comprehensive, mandatory, and audited survey conducted in California in 2016 provided a more accurate picture of processing costs and should serve as a model for any future adjustments to make allowances. Any adjustments based on higher prices of manufacturing inputs would ignore the steady growth in processing productivity, associated with the use of concentrated milk, improved processes for the use of powder, improved butterfat recovery, etc. Until a similar survey is conducted nationwide, any increases to make allowances would be premature and unjustified.

AFBF, along with the National Farmers Union and numerous other organizations directly representing dairy farmers, believe that any changes to make allowances must be based on data from a mandatory, audited USDA survey. Such a survey would provide the transparency and reliability needed to ensure that make allowances reflect the true costs of processing without unfairly penalizing dairy farmers. USDA is applying a flawed premise in attempting to set new make allowances on the basis of available data, because that data is unreliable. A better economic and statistical indication of the sufficiency of the current make allowances is the continued growth in cheese production capacity.

### ***Butterfat Recovery***

While AFBF opposes the proposed increases in make allowances, we do support the proposed adjustments to the butterfat recovery factor and yield factor. Increasing the butterfat recovery factor from 90% to 91% more accurately reflects modern cheesemaking technology and the efficiencies that many plants have achieved. This adjustment is a reasonable update that aligns with the realities of the industry and ensures that the FMMO pricing formulas reflect the true value of raw milk components.

### **Base Class I Skim Milk Price**

AFBF strongly supports USDA's intention to reinstate the higher-of Class I mover formula. This formula is critical for ensuring dairy farmers receive fair and adequate compensation for their milk, particularly in the face of volatile market conditions that have characterized the industry in recent years. The switch to the average-of formula in 2019, although well-intentioned to provide revenue neutrality and risk management opportunities, has proven to be detrimental to dairy farmers in recent years. The significant divergence between Class III and Class IV prices has led to substantial revenue losses, with producers losing out on over \$1.24 billion in pooled class value since the formula's implementation. The higher-of formula, developed through extensive deliberation and strongly endorsed by dairy farmers at AFBF's Federal Milk Marketing Order Forum, should be reinstated to safeguard dairy producers from further financial harm.

Opponents of the higher-of mover argue that maintaining the average-of formula is necessary for hedging and risk management. However, it is crucial to acknowledge that the vast majority of fluid milk processors have not increased their use of hedging since the adoption of the average-of mover, and the losses experienced by dairy farmers far outweigh the benefits purported by its proponents. According to testimony presented, numerous witnesses, including representatives from dairy cooperatives and fluid milk processors, emphasized that despite the shift to the



average-of mover, there has not been a meaningful increase in the adoption of hedging practices by fluid milk processors. For example, an NMPF witness noted, “The intent behind the adoption of the average-of formula was to facilitate greater use of risk management tools among fluid milk processors. However, the anticipated uptake of hedging has not materialized to the extent expected, leaving dairy farmers to bear the brunt of market volatility with minimal corresponding benefit to processors.”

AFBF is disappointed with USDA’s rejection of our request to omit a recommended decision for this specific issue, which would have allowed for the immediate implementation of the higher-of. The evidence of reduced pool values and corresponding milk checks clearly demonstrates the urgent need for this change to protect dairy farmers from further financial distress.

### **The Recommended Class for Extended Shelf Life Milk is Outside the Scope of the Hearing**

AFBF opposes USDA's proposal to create a new class for extended shelf life (ESL) milk. This is outside the scope of the hearing and it introduces significant complications to an already complex pricing system.

#### ***Outside the Scope***

The introduction of the ESL adjustment effectively creates a new class for ESL milk which handlers will be able to enter and exit according to their distorted price incentive. This approach adds unnecessary complexity, essentially resulting in five distinct milk classes instead of the current four. The recommended 1000.44(e) is wholly inadequate to manage this new class, mostly because it is, in fact, a new class and would require a new section of 1000.40, as well as specific allocation language, to be implemented; providing adequate conforming language would make the nature of this change obvious. This is, as we argued at hearing, outside the scope of this proceeding. (See Exhibit 383, p. 10.)

There is overwhelming support among producers and cooperatives for a return to the higher-of Class I formula. This ESL exception undermines this, allows for potential gaming of the pricing system, and raises serious concerns that this formula exception, which essentially creates a new milk class, is outside the scope of the current proceeding. The hearing notice did not contemplate a separate class for ESL milk, and it should be dropped. (See 88 FR 47396, et seq.)

The adjuster in proposed ESL class price, calculated as a rolling average of the differences between the higher-of and the average-of the advanced Class III and Class IV skim milk pricing factors over the prior 13 to 36 months, adds another layer of complexity. The adjuster would be computed and announced well in advance, adding yet another moving part to an already intricate system. USDA estimates that ESL milk currently constitutes approximately 8% to 10% of the fluid milk market, and their analysis of the proposed adjuster, if it had been in place in 2023, shows that it could have ranged from a 95-cent reduction to a \$1.18 increase per hundredweight. Static analysis of the Class I price with and without the ESL adjuster shows statistically insignificant differences in overall value; however the large negative and positive differences with the proposed Class I price create incentives for mischief.

USDA's definition of what constitutes an ESL product is vague, with the current reference being to a shelf life of over 60 days. This ambiguity opens the door to potential abuse and manipulation of the system. For instance, a processor could label a product with a shelf life of 59 days to benefit from a lower conventional mover price if it is advantageous in a particular month. Such scenarios highlight the risk of inconsistent application and the potential for market distortions, further complicating the pricing landscape for dairy producers and processors alike. This potential for gaming the price exception may be the most dangerous threat of this scheme to fair pricing and pooling.

In addition to complicating the current pricing system, the introduction of an ESL-specific mover raises concerns about the precedent it sets. This could open the door to the creation of even more differentiated classes and sub-classes for various specialty products, such as organic, grass-fed, or A2 milk. Such a trend would further fragment the market, leading to increased complexity, potential inconsistencies, and challenges in ensuring fair competition among processors. This is the same further fragmentation of the four classes which USDA has consistently rejected since order reform.

### ***The Tail Wags the Dog***

USDA may feel compelled to address risk management concerns of ESL processors raised during the hearing process. However, the proposed ESL class is not the appropriate solution. It is a “tail-wags-dog” solution to risk management, like the “average-of” price formula.

The simpler, obvious solution to risk management challenges for Class I milk is the establishment of Class I milk futures and options contracts; the witness from the CMEGroup indicated their willingness to serve their customers with whatever products are needed. Adopting the ESL exception would be to again set policy based on the CMEGroup's parameters (the existence of Class III and Class IV futures contracts), rather than to encourage the CMEGroup to adapt to customers' needs under USDA-defined regulatory conditions, which they expressed a willingness to do. The FMMO class and component pricing system has provided the dairy industry and the CMEGroup with an outstanding foundation for dairy market risk management: the announced prices allow for many producers, cooperatives, and handlers to hedge risks – with simple cash settlement – with little or no basis risk. The only hole in the current CMEGroup FMMO pricing complex is the lack of a set of Class I contracts; and the CMEGroup should – and almost certainly would – respond to USDA policy, rather than USDA policy responding to the market offerings of the CMEGroup. (Transcript p. 803.)

AFBF urges USDA to reconsider this recommendation and prioritize solutions that enhance transparency, simplicity, and fairness in the Class I pricing structure, within the scope of the current hearing.

### **USDA's Rejection of AFBF's Proposal to Remove Advanced Pricing**

AFBF is also disappointed by USDA's decision to reject our proposal to eliminate advanced pricing. Advanced pricing, as currently structured, has contributed to significant discrepancies in milk prices, creating challenges for dairy farmers who are already struggling to cope with market volatility. The delays inherent in advanced pricing have caused price inversions and de-pooling, resulting in lower payments to pooled producers at a time when every cent counts. Eliminating

advanced pricing would mitigate these issues, ensuring that milk prices more accurately reflect current market conditions and keeping class prices in their intended alignment. We have demonstrated on the record the substantial improvement that eliminating advanced pricing would make to class price alignment and to stabilizing producer price differentials. The rejection of this proposal is a missed opportunity to address a key issue that has long plagued the dairy industry, and we urge USDA to reconsider this stance in light of the substantial challenges facing dairy farmers today. (See Exhibit 294.)

### **Class I Differentials**

AFBF generally supports the proposed increases in Class I differentials, which are based on updated analysis and testimony that accurately reflect the cost of servicing the Class I market. The current differentials, largely based on the pre-2000 differentials with modest adjustments based on data from the 1990s, no longer account for significant changes in dairy economics, including increased transportation costs and market consolidation. The proposed updates align the Class I differentials more closely with the actual costs incurred by producers and cooperatives to ensure an adequate supply of fluid milk to urban markets, which are increasingly distant from milk production areas. AFBF believes, however, that basing the new Class I differentials on the October model results, rather than the May results, would provide more robust support for the delivery of fluid milk when most needed.

Opponents of the proposed increase have raised several objections, primarily arguing that there is already an adequate supply of milk for Class I needs and that increasing the differentials could further decrease Class I consumption by raising prices. However, these arguments overlook several key factors. While there may be an adequate national supply of milk, the costs associated with ensuring that this milk reaches fluid milk markets, particularly in urban areas and milk-deficit regions, have increased significantly. The proposed increase in differentials is not just about overall supply but aligning prices around the country so that the FMMO system treats producers and cooperatives equitably, regardless of the market they are serving.

Some opponents have cited studies suggesting that demand for fluid milk is elastic and that higher prices could lead to reduced consumption. However, a comprehensive review of long-term studies shows that fluid milk demand is relatively inelastic, meaning that modest price increases, such as those resulting from updated differentials, are unlikely to significantly impact overall consumption.

The FMMO system is designed to ensure orderly marketing conditions and an adequate supply of milk for fluid use. Increased Class I differentials are necessary to maintain the economic viability of producers efficiently supplying Class I markets, a core objective of the FMMO system.

### **Class II Differential**

AFBF is disappointed by USDA's outright rejection of the proposal to increase the Class II differential. It is perplexing that USDA acknowledges the need to update other pricing factors to reflect current costs but fails to apply this logic to the Class II differential. The same market dynamics that justify an increase in Class I differentials or make allowances, such as rising costs and market consolidation, also apply to Class II products.

The Class II differential, which was designed by USDA to reflect the costs of drying and rewetting milk, requires updating to serve its intended purpose. AFBF's proposal to update the Class II differential to \$1.56 was explicitly based on logic provided by USDA during order reform. By rejecting this proposal, USDA missed an opportunity to ensure that the pricing structure for Class II products is as up-to-date and reflective of current market realities as the structure for Class I products. Worse, USDA effectively rejects its own logic in establishing the Class II differential in the first place, and leaves it without a logical structure.

There is sufficient data and economic argumentation in the record for USDA to establish a higher Class II differential based on its own long-established logic, even if not as high as AFBF proposed, and AFBF urges USDA to make such a reconsideration.

## **Conclusion**

AFBF appreciates the complexities that USDA must navigate in amending the Federal Milk Marketing Orders to address the evolving needs of the dairy industry. However, the proposed amendments present a mixed bag of potential benefits and serious concerns for dairy farmers across the country. While certain proposals, such as reinstatement of the “higher-of” Class I base price, increase of composition factors, removal of 500-pound barrel cheese, and increases in Class I differentials, are steps in the right direction to better align FMMOs with current market realities, other elements, particularly the extreme proposed increases in make allowances, pose risks that could undermine the very objectives of the FMMO system.

The recommended increases in make allowances would lead to substantial reductions in pool values, particularly in the Upper Midwest, Southwest, and California orders, where farmers could see significant declines in their milk prices.

Moreover, the delay in implementing the necessary updates to milk composition factors further exacerbates these concerns. By postponing these updates, dairy farmers are left undercompensated for the higher-value milk they are already producing, missing out on potential revenue that could have been realized had these factors been adjusted in a timely manner. This delay, coupled with the added complexity introduced by the ESL milk adjuster, creates uncertainty and further complicates the already complicated FMMO pricing system. The ESL adjustment, in particular, risks introducing inconsistencies and potential market distortions, which could undermine the uniformity and fairness that the FMMO system is designed to promote.

In light of these challenges, AFBF strongly urges USDA to review once again the merits of AFBF's proposals to increase the Class II differential, to add 640-pound blocks to the Dairy Product Mandatory Reporting Program (DPMRP) and to eliminate advanced pricing of Class II skim milk and Class I milk. These proposals were carefully crafted to reflect the current realities of the dairy market and would contribute significantly to more accurate and equitable pricing within the FMMO system. Increasing the Class II differential would better align the pricing structure with the current costs associated with drying and rewetting milk, allowing dairy producers to receive fair compensation for their contributions to the manufacturing sector. The inclusion of 640-pound blocks would provide a more comprehensive and accurate representation of the cheddar cheese market, ensuring that pricing reflects the value of cheddar cheese production in the U.S. The

elimination of advanced pricing would very substantially reduce the Class price misalignment that even modest month-to-month changes in Class III and IV milk prices create in pool pricing.

As the rulemaking process progresses, it is crucial that USDA carefully considers the feedback from dairy farmer stakeholders to ensure that the final rule reflects a balanced approach that supports the long-term viability of producers across all regions. AFBF strongly urges USDA to reconsider the proposed make allowance increases and to prioritize the timely implementation of composition factor updates. Additionally, we advocate for the removal of the ESL adjuster to maintain simplicity and transparency within the Class I pricing structure.

One farmer after another testified at the hearing that the negative PPD's and depooling and the current pricing structure caused them economic stress; this decision does not go far enough to properly align the class prices to avoid that stress.

Ultimately, the goal of any amendments to the FMMO system should be to enhance the stability, fairness, and equity of milk pricing, ensuring that all dairy farmers, regardless of their location or market conditions, receive a fair and consistent price for their milk. AFBF remains committed to advocating for policies that uphold these principles and protect the livelihoods of dairy farmers nationwide. We look forward to continuing our collaboration with USDA and other industry stakeholders to achieve these objectives and to ensure that the FMMO system continues to serve the best interests of all dairy producers.

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