



Federal Order Modernization Summary

After months of in-depth analysis and examination of numerous Federal Milk Marketing Order (FMMO) issues by a dedicated team of technical experts from NMPF's member cooperatives, a set of policy recommendations has been unanimously approved by both the National Milk Producers Federation (NMPF) Economic Policy Committee and the Board of Directors.

Background

The FMMO program is an incredibly valuable system for dairy farmers designed to provide, among other things, stable milk marketing and transparent prices. FMMO pricing formulas have not been significantly updated since they were first implemented in 2000. Notwithstanding the challenges wrought by the recent coronavirus pandemic, the FMMO system has worked well for many years. But with significant industry changes occurring since 2000 – including in milk composition, product manufacturing costs, costs of transporting milk, consolidation, plant closures, and shifts in milk production areas, the time has come to modernize the program for today's industry.

Initially, NMPF last year surveyed its members on FMMO issues. The results showed that member co-ops overwhelmingly supported the federal order system while agreeing that its provisions need to be modernized to reflect industry changes. NMPF's Economic Policy Committee, chaired by Land O Lakes' Pete Kappelman, was tasked with implementing a process to determine potential FMMO provisions in need of updating. After initial committee consultations, a task force of technical experts from NMPF member cooperatives was established to conduct an in-depth review of key FMMO issues, evaluate possible approaches and distinguish national from regional issues.

These experts have been meeting since last December with four Working Groups established and charged with developing focused recommendations in specific topic areas. After nearly 100 meetings and based on an extensive examination of the key FMMO price formula issues, the task force submitted its comprehensive recommendations to the EPC. That committee deliberated on the task force

recommendations and approved the following proposals that were adopted unanimously by the Board of Directors at NMPF's Annual Meeting on Oct. 24:

1. Revert back to the "higher-of" in the Class I mover

The current Class I mover carries an asymmetric risk versus the previous "higher of" calculation. This means dairy farmers are exposed to unlimited risk on the downside, while benefits to dairy farmers are limited on the upside. This asymmetric risk was exposed during the pandemic-induced market volatility that occurred during 2020. But even after the pandemic, the current mover has significantly underperformed the previous mover for five consecutive months in 2022, demonstrating that serious negative impacts to producers from this asymmetric risk are not unique to the pandemic-induced market disruptions that occurred two years ago.

2. Discontinue use of barrel cheese in the protein component price formula

Presently, the FMMO formulas weight cheese blocks and barrels about 50/50 in the reports to USDA's weekly mandatory price survey. But that does not reflect the relative volumes of cheese actually produced and priced by these two forms of natural cheddar cheese. Eliminating barrel cheese from the pricing formula will better reflect the value of producer milk for manufacturing cheese.

3. Extend the current 30-day reporting limit to 45 days on forward priced sales of NFDM and dry whey

Increasing the number of reporting days on these two products will increase the representation of exported volumes of both NFDM and dry whey while still keeping the reporting limit narrow enough to ensure the reports represent current prices.

4. Update the milk component factors for protein, nonfat solids, and other solids in the Class III and Class IV skim price formulas.

The component composition factors in the FMMO skim milk formulas have not changed since 2000. Since that time, the composition of these milk components has increased, causing a steadily growing understatement of the value of producer milk in all four classes in the four fat-skim pricing orders and Class I milk in all orders.

5. Develop a process to ensure manufacturing allowances are reviewed more frequently

This includes enacting legislation to require USDA to conduct regular, mandatory and auditable processing plant cost studies every two years and to report the results. This would provide information necessary for the industry to consider requesting a hearing to update make allowances based on more accurate and up-to-date data. Current FMMO make allowances have not changed since 2008, while costs of manufacturing dairy products used in the FMMO component price formulas have increased. The problem of maintaining proper make allowances in the FMMO pricing formulas is exacerbated by the persistent lack of accurate information relative to costs of manufacturing dairy products.

6. Update current FMMO Make Allowances to the following:

- Cheese \$.2400
- Dry Whey \$.2300
- Butter \$.2100
- NFDM \$.2100

This recommendation was unanimously approved to provide an interim update to the inadequate make allowance values currently in the pricing formulas, pending implementation of the procedure in recommendation #5, above.

A final Task Force recommendation to review and make potential changes to the current nationwide Class I differential price surface is not yet complete. The current FMMO Class I differentials have for the most part not changed since they were first implemented in 2000, while the cost of delivering bulk milk to fluid processing plants has increased. As a result, the current Class I differentials have become increasingly inadequate to effectively supply milk for fluid use and are thereby creating disorderly marketing conditions.

The task force is continuing its work on the Class I differential price surface analysis, but the complexity of this issue requires additional time to complete the work and bring forth recommendations. Once completed, a detailed Class I price surface proposal is anticipated to be added to the package described above.

When the final plan has been approved by the Economic Policy Committee and Board of Directors, NMPF intends to petition USDA for a national FMMO hearing with this package as its proposal. It is expected this formal national hearing request will occur during the first quarter of 2023. Until filing its proposal, NMPF will continue to consult with USDA, as it has been doing throughout the entire process of examining issues and developing these recommendations.