



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 comprehensive set of policy recommendations has been approved by the National Milk Producers Federation (NMPF) Board of Directors. NMPF will now prepare its petition to USDA for a national Federal Order hearing. The petition will include all of the approved modernization recommendations. Once submitted, we are hopeful USDA will grant the hearing which, if granted, would likely occur sometime late summer/early fall of this year.

Background

The FMMO program is an incredibly valuable program for dairy farmers designed to provide, among other things, orderly milk marketing and price transparency. 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 began meeting in December, 2021 with four Working Groups established and charged with developing focused recommendations in specific topic areas. After fifteen months and nearly 140 meetings that included 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 meeting on March 7, 2023:

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 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.

7. Update current nationwide FMMO Class I price surface

The final Task Force recommendation was to review and update the current nationwide Class I differential price. To complete this final recommendation, the Task Force spent nearly a full year, because of its complexity, reviewing and analyzing the Class I price surface across the U.S.

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 initial basis for the newly developed Class I price surface was to conduct a detailed computer model simulating the supply and demand factors in the movement of milk to dairy processing plants and then the movement of dairy products to consumers. The Task Force secured the services of UW-

Madison ag economists to conduct the Class I price surface study. To form the basis for the newly recommended Class I differentials this study used a substantially-expanded version of the same computer model originally used to establish the current Class I differentials. After reviewing the model's results, several Regional Working Groups were formed to compare and evaluate the model results to "real world" milk movements. In essence, the Regional Working Groups and Task Force collectively used science-based and market reality-based analysis in developing its Class I price recommendation.

The table below summarizes the Class I price surface recommendation:

Current & Recommended Class I Differentials by Federal Order

Marketing Area	FO #	Current Class I Differential	Recommended Class I Differential	Difference
Northeast	1	\$2.88	\$4.64	\$1.76
Appalachian	5	\$3.17	\$5.10	\$1.93
Florida	6	\$5.23	\$7.07	\$1.84
Southeast	7	\$3.42	\$5.32	\$1.90
Upper Midwest	30	\$1.70	\$2.92	\$1.22
Central	32	\$2.03	\$3.49	\$1.46
Mideast	33	\$2.05	\$3.68	\$1.63
California	51	\$1.76	\$2.86	\$1.10
Pacific Northwest	124	\$1.85	\$3.10	\$1.25
Southwest	126	\$2.86	\$3.98	\$1.12
Arizona	131	\$2.08	\$3.08	\$1.00
Not Fed. Regulated	NR	\$2.03	\$3.54	\$1.51
	Total	\$2.59	\$4.07	\$1.48

As one would expect, increasing Class I differentials impacts various regions of the country differently. Servicing Class I markets continues to be a challenge especially in certain regions of the country. Despite all of the complexities in developing the Class I price surface recommendations, the Regional Working Groups along with the Task Force considered and evaluated many factors throughout this extensive analysis in order to achieve the right balance between the various orders.

Conclusion:

This spring, NMPF intends to petition USDA for a national FMMO hearing based on this package of modernization recommendations. While finalizing the proposed regulatory language of the proposal, NMPF will continue to consult with USDA and collaborate with other dairy stakeholders, as it has been doing throughout the entire process of examining issues and developing this package of recommendations.