NAJ Equity Newsletter December 2015
Vol. XLI, No. 5

# NAJ Testifies at California Federal Order Hearing

*Pricing protein and other solids separately superior to current state system*

On September 22, USDA's Agricultural Marketing Service convened a public hearing to consider promulgating a Federal Milk Marketing Order (FMMO) for California. Wrapping up on November 18, the testimony covered 40 days, included nearly 100 witnesses, and the official transcript is expected to approach 10,000 pages.

National All-Jersey Inc. (NAJ) entered testimony and supporting data analysis into the hearing record on October 20. This edition of the *Equity Newsletter* provides a synopsis of NAJ's testimony. NAJ's full statement and data are posted on NAJ's web site at https://goo.gl/1KRwPD.

NAJ emphasized that FMMO-style pricing would be superior to current California Department of Food and Agriculture (CDFA) pricing because FMMOs value protein and other solids separately. The current CDFA system combines the value of these two components into a single value for solids nonfat (SNF). The combined value signals producers that protein and other solids have the same value, which they do not. From 2009 through 2014 the average FMMO price for protein was $2.94/lb. while the average price for other solids was $0.31/lb. During the same time period the SNF price averaged $1.22/lb. Clearly the protein price of $2.94/lb. provides a stronger incentive for producers to increase protein production than the SNF price of $1.22/lb. Protein production currently and in the future plays a vital role in California's dairy industry, and the state's regulated pricing system should incentivize protein production.

### Whey Products

Over 40% of California's milk solids are used in cheese production. The importance of protein in cheese production has been well-established for many years. However, a fact that is sometimes overlooked is that higher protein milk results in higher protein whey. While the protein content in whey has minimal impact on the yield of dry whey, which is not protein standardized, yields of whey protein concentrates (WPC) and whey protein isolates (WPI) are directly impacted by whey's protein content because these products are protein standardized. Nationally, the amount of whey protein used in WPCs and WPIs is 2.5 times greater than the amount of whey protein used in dry whey.

### Milk Powders

The production of skim milk powder (SMP) and whole milk powder (WMP) is increasing and becoming a larger share of the milk powder market compared to nonfat dry milk (NDM). In 2009 SMP and WMP accounted for just 13% of California's milk powder production. By 2013 their market share increased to 46% before tapering off to 35% in 2014. Both SMP and WMP are protein standardized, and therefore, their yields are directly impacted by the level of protein in producer milk. NDM is not protein standardized. NAJ presented analysis showing that higher protein producer milk can increase SMP yields by over 8%.

### California's Minimum Standards for Fluid Milk

California's minimum SNF standards for beverage milk are higher than national standards. Ordinarily whole milk and skim milk do not need SNF fortification to meet the California standards. However, reduced fat (2%) and lowfat (1%) milk require fortification, which is primarily done with condensed skim and, to a lesser extent, with NDM. While fluid processors buy the additional SNF required for fortification, they are allowed a handling allowance to cover the costs of fortification processing. Producers, in effect, pay for the fortification allowance. NAJ's testimony showed that higher protein producer milk reduces the amount of SNF fortification required, and would have reduced the fortification allowance paid by producers by an average of $1.7 million per year from 2009 through 2014.

### Producer Price Differential

NAJ opposed the cooperatives' provision to modify the Producer Price Differential (PPD) from how it is handled in other multiple component pricing orders. Instead of paying producers a PPD based on total hundredweights of milk marketed, the cooperatives called for component values paid to producers to be adjusted by a pro-rated amount of the PPD value. In other words, months with positive PPDs would have producer protein, butterfat and other solids values increased, and months with negative PPDs would have producer component values decreased. NAJ's analysis of the PPD proposal found that PPDs would have been negative two-thirds of the months during the 2009 to 2014 time period.

As NAJ outlined in its preceding testimony, protein production needs to be incentivized in California. The cooperatives' PPD proposal would serve to dis-incentivize protein production by lessening protein's value to producers by an average of -$0.05 per pound every month. In addition, butterfat's value would have been reduced by an average of -$0.03 per pound. Given the higher component levels in Jersey herds, the PPDs paid to Jersey herds would have averaged -$0.34/cwt. compared to -$0.27/cwt. for herds with average component milk.

**Pool Plant Provisions**

The cooperatives' proposal required all manufacturing plants to be pool plants and, therefore, subject to regulated minimum pricing. The other FMMOs only require Class I (beverage milk) plants to be pool plants. Manufacturing milk has the option whether or not to be pooled. Any manufacturing milk that is pooled is subject to regulated minimum pricing, but the milk's handler also gets to share in the pool's Class I revenue, which is typically higher than revenue for manufacturing milk.

NAJ opposed mandatory pooling of manufacturing milk for two reasons. First, all FMMOs provide pooling exemptions for low-volume Class I processors and these same exemptions are proposed for a California FMMO. However, the cooperatives offered no exemptions for small-scale manufacturing plants such as artisan cheese makers. Exemptions for manufacturing plants are not needed in the other FMMOs because they have the option of pooling their milk. NAJ advocated for pooling exemptions similar to those allowed small-scale Class I plants. Subsequently, prior to the conclusion of the hearing, the cooperatives modified their proposal to provide exemptions for manufacturing plants processing less than 300,000 pounds of milk per month.

Second, NAJ objected to mandatory pooling of manufacturing milk because in times of surplus milk, being able to sell milk for less than the regulated price is critical to balancing the market. Some manufacturing plants exist primarily to balance markets' surplus. Because these plants do not operate at full capacity all of the time, their manufacturing costs per unit of product run higher than plants that constantly run at maximum capacity. Balancing plants offset their higher costs by purchasing surplus milk for less than regulated minimum prices. Requiring all manufacturing plants to pay regulated minimum prices would greatly hinder, if not eliminate, balancing plants from serving their role in the market. This would cause surplus milk to be hauled greater distances to be processed or even increase the amount of milk that gets dumped.

**California Specific Pricing**

NAJ opposed the processors' initiative to establish price formulas for a California FMMO specific to that Order. The processors requested that only commodity prices from western processing plants be used to establish component values for the California FMMO instead of national average prices. NAJ expressed belief that establishing separate pricing for an individual Order would result in requests from other Orders for unique price formulas. Non-uniform pricing will likely increase milk movement between markets based on regulated prices instead of market needs or marketing efficiency. NAJ stated its position that updating price discovery and commodity values is best addressed through a national hearing involving all Orders instead of on an Order-by-Order basis.

**Next Steps**

Now that the hearing is closed, the transcript must be reviewed for necessary corrections. Post-hearing briefs are due by the end of March, and reply briefs are due by mid-May. Next, Dairy Programs will publish a Recommended Decision, probably by late fall. Interested parties will have the opportunity to submit comments addressing the Recommended Decision. After reviewing the industry's comments, Dairy Programs will publish a Final Decision. A referendum among California producers on the Final Decision will be held, and a 60% affirmative vote is required for adoption. If the referendum is approved, the California FMMO will come into being. If the referendum fails, the existing CDFA regulated pricing system will continue.



**National All-Jersey Inc.** 6486 East Main Street, Reynoldsburg, OH 43068 www.usjersey.com
614-861-3636 VOICE naj@usjersey.com 614-861-8040 FAX