NATIONAL MILK PRODUCERS FEDERATION

James Mulhern, *President & Chief Executive Officer* | **Randy Mooney**, *Chairman*

October 22, 2015

The Honorable Tom Vilsack
Secretary
U.S. Department of Agriculture
1400 Independence Avenue, SW
Washington, DC 20250

Re: Opposition to Modified Wichita Option for Organic Milk

Dear Mr. Secretary:

The National Milk Producers Federation (NMPF) strongly opposes the Organic Trade Association's (OTA) petition for a hearing to amend all Federal Milk Marketing Orders (FMMO) to include alternative producer-settlement fund payments for USDA certified organic milk, and we request that you deny the hearing request.

OTA's proposal, if adopted, would certainly eliminate producer settlement fund payment obligations paid by organic handlers into the FMMO revenue sharing pools. But since there are no provisions in the proposal to ensure that organic dairy farmers are the recipients of the funds that would be withheld from the FMMO, the proposal would represent a windfall revenue enhancement opportunity for organic processors valued in the tens of millions of dollars each year. NMPF views this proposal as an ill-advised attempt to increase organic processors' revenues at the expense of both conventional and organic dairy farm families.

NMPF develops and carries out policies that advance the well-being of dairy producers and the cooperatives they own. The members of NMPF's cooperatives produce the majority of the U.S. milk supply, making NMPF the voice of more than 30,000 dairy producers on national issues. Any proposal to amend the FMMO system, such as OTA's, directly impacts all of our members and the majority of dairy farmers in the U.S.

OTA has petitioned to amend all FMMOs to provide for alternative producer-settlement fund payments for USDA certified organic milk. The proposal claims that FMMOs "do not bring forth an adequate supply of USDA certified organic milk" and as such disorderly marketing conditions exist in organic dairy markets. To address the issue the proposal seeks to eliminate producer settlement fund obligations through a modified "Wichita Option". The Wichita option, a provision in very limited use in FMMOs nationwide, allows partially regulated handlers to be exempt from pool obligations if the gross value of milk paid to producers, including premiums, exceeds a certain financial threshold, and is equivalent to individual handler pooling. Given the very large premiums above FMMO prices for organic milk, the OTA proposal will result in a de facto exemption of all organic milk from FMMO revenue sharing provisions. Balancing costs of serving the conventional and organic dairy markets, however, would remain in the FMMO pool and would be borne only by the non-organic farmers and handlers remaining in the FMMO.

The proposal asserts that monies not paid into the pool can instead be used to "bring forth an adequate supply of USDA certified organic milk." However, nothing in the proposal ensures that organic dairy farmers will share in the producer settlement dollars not paid into the FMMO revenue sharing pool. Instead, if the proposal were adopted, the monies withheld from the pool would likely accrue to organic processors and not to dairy farm families.

For a number of reasons the Department long ago determined individual handler pooling to be inferior to marketwide pooling in ensuring orderly marketing conditions. During the recent Producer-Handler hearing, the Department provided the following evidence why individual handler pools do not solve disorderly marketing conditions (Fed. Reg. Vol. 74 No. 202 (2009)).

> *Individual handler pooling does not directly address when and under what circumstances handlers can be exempted from pooling and pricing without undermining orderly marketing.*
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> *Abandonment of the marketwide pooling system in favor of an individual handler pool system would reverse the stability achieved by its adoption in all Federal milk marketing orders.*
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> *Marketwide pooling promotes orderly marketing conditions more completely and is one of the most important marketing order tools used to ensure uniformity in prices to producers.*
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> *The marketwide sharing of the classified use-values of milk among all producers supplying a marketing area is an essential feature of the Federal milk marketing order system. It ensures that producers supplying a given marketing area receive the same uniform price for their milk, regardless of its end use. In combination with classified pricing, marketwide pooling has, among other things, successfully mitigated price competition between producers seeking the higher-valued fluid outlets for their milk.*
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> *Under an individual handler pooling plan, producers supplying handlers with differing utilizations would receive different prices. These differences would be particularly notable between producers delivering to handlers with high manufactured class utilization and those with a majority of Class I uses. Producers supplying a handler with high Class I utilization would receive higher prices than producers whose milk was delivered to manufacturing handlers. Returns distributed to producers in this manner are not uniform nor can they be when a market consists of multiple handlers.*

Individual handler pools for organic milk would provide little to no incentive for expansion of reserve milk supplies and are not compatible with the 1937 Act's establishment of minimum order prices for both producers and handlers. First, under an individual handler pooling plan, organic producers supplying handlers with differing utilizations would have different regulated minimum organic milk prices. These differences could be particularly notable between organic dairy farmers delivering to handlers with processing, milk transfers, and diversions into manufacturing classes (e.g. organic yogurt or cheeses) and those with a majority of Class I uses. Organic dairy farmers supplying a handler with high Class I utilization could have a higher minimum price threshold than organic dairy farmers whose milk was delivered to manufacturing handlers. The returns distributed to organic dairy farmers in this manner would not be uniform.

Second, with respect to building the reserve supplies of organic milk, an organic dairy farmer would lack certainty in the ability to share in the higher returns from the organic market without access to one of the organic individual handler pools. While a majority of organic milk is priced in advance under terms of a forward contract, and generally at prices above prices of conventional milk, the prices and contracts are not guaranteed into perpetuity. Organic handlers may terminate, or modify, the contract for an organic dairy farmer, leaving the dairy farmer to search for a new organic processor or sell into the conventional market at lower milk prices. Such was the case in 2009 when Organic Valley imposed a 7% supply reduction on their dairy farmer suppliers. Farmers who were unable to quickly reduce production sold surplus organic milk into the conventional market (CROPP Cooperative 2009 Annual Report: http://www.organicvalley.coop/fileadmin/pdf/CROPP_Annual_Report_09.pdf).

As demand for organic milk products matures, similar supply situations as those experienced in 2009 could materialize. Organic handlers could move their surplus product into conventional markets at distressed prices, potentially undermining FMMOs and resulting in the conventional market disproportionately balancing the reserve supplies of organic milk. As an example, if an organic handler is committed to buying a block of organic farm milk, and consumer demand is less than the purchased volume, the organic surplus is bottled as conventional milk and displaces non-organic milk in the supply chain. As a result of this milk displacement conventional milk is redirected into lower priced manufacturing classes such as dry milk powders. Such a scenario would increase the supply of non-organic dairy products and would depress regulated milk prices paid to farmers across the United States. As a result, organic processors definitely benefit from the balancing functions performed in the conventional markets and settlement fund payments from organic milk should remain in FMMO pools to compensate the performance of these services. An organic exemption to the producer settlement fund obligation fails to recognize this market reality and does not provide orderly marketing conditions for individual producers.

Third, all organic handlers electing the modified Wichita option would have different regulated minimum prices. Handlers with large Class I market access would have higher regulated prices than handlers with a majority of organic milk used to produce manufactured products such as organic yogurts, cheeses, or butter. The lack of uniform regulated minimum milk prices through individual handler pools would give some handlers a competitive advantage. Handlers in close competition for retail sales could alter their utilization of organic milk, thereby altering their regulated milk price, in an effort to seek a pricing advantage in the retail channel. In both scenarios, the lack of uniformity in pricing leads to disorderly marketing conditions of organic milk and its products.

Fourth, marketwide pooling does not require the entire value of organic milk to be shared with all producers. Only the minimum regulated prices are used to determine handler pool obligations. Under the existing FMMO framework, the higher value associated with organic milk above FMMO minimum prices is paid directly to organic dairy farmers and is not part of the FMMO pool. In this manner all handlers, conventional and organic, share and benefit from orderly marketing and more stable markets provided by regulated minimum prices and marketwide pooling.

Finally, OTA's claim that FMMOs "do not bring forth an adequate supply of USDA certified organic milk" and as such disorderly marketing conditions exist in organic dairy markets, is neither substantiated nor quantified. Nor does OTA demonstrate how the proposed elimination of producer settlement fund obligations through a modified "Wichita Option" would remedy the problem identified as the basis for the proposal. Rather, the long and impressive growth rate in the organic dairy category, cited at "356% since 2003" by OTA, suggests that the organic milk supply continues to respond to price signals from the marketplace. The OTA proposal fails to consider other, more effective, ways to bring forth an adequate supply of organic milk. If current pricing arrangements are indeed failing to bring forth an adequate supply of organic milk to meet consumer demand, then elementary economic theory would suggest that adjustments to the pricing structure for organic milk at retail are called for. OTA's proposed solution to eliminate producer settlement fund obligations effectively proposes that dairy farmers should subsidize the production of organic milk in lieu of rectifying the mispricing of it.

If the Department were to advance OTA's proposal and hold a national FMMO hearing, any resulting referendum would force dairy farmers to choose between two negative outcomes. A majority of dairy farmers, most of whom produce non-organic milk, would have to vote in favor of modified FMMO provisions or risk voting out the order as amended. In short, dairy farmers would have to vote in favor of FMMO amendments guaranteed to have a negative impact on the financial health of their dairy operation, or lose the entire FMMO program. If the Department were to advance OTA's request, the nation's dairy farmers will certainly face a lose-lose proposition.

The Department is on record that individual handler pooling is inferior to marketwide pooling. Per OTA's proposal, individual handler pools for organic milk would reduce the farm income of conventional dairy farmers by "tens of millions of dollars per year" with no guarantee of any additional financial benefits flowing to organic dairy farmers. Furthermore, OTA's proposal would be a bad precedent as it would erode participation and undermine the stability of the FMMO system. Given the aforementioned market failures of individual handler pooling, and the policy implications of a "No" vote during a potential referendum process, NMPF strongly opposes OTA's proposal for a modified Wichita option for organic milk.

Thank you for your commitment to a strong and robust U.S. dairy industry. We encourage you to protect the integrity and effective functioning of the farmer-trusted Federal Milk Marketing Order Program by denying the hearing request from the Organic Trade Association.

Sincerely,

Jim Mulhern
President and CEO

10/22...

To: **Vilsack, Tom**

Agency: OSEC
Stop Code: 3301
Location: Whitten Bldg.
Room: rm116-a

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nmpf

National Milk Producers Federation

2101 Wilson Blvd.
Suite 400
Arlington, VA 22201

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The Honorable Tom Vilsack
Secretary
U.S. Department of Agriculture
1400 Independence Avenue, SW
Washington, DC 20250

Phone number
202-720-2791