SURREBUTTAL TESTIMONY OF SARA DORLAND ON BEHALF OF THE PA ASSOC OF MILK DEALERS

OVER-ORDER PREMIUM HEARING – DECEMBER 7, 2022

While I have concluded maintaining $1.00 makes sense, the data that we can see right now does not support a doubling of the premium. From a cost perspective, there may have been a time in the recent months to temporarily make a short-term increase, but the time has passed. We are now seeing an easing of some costs like fuel and fertilizer. Although other costs like feed and labor remain less than this year's peak, they are still higher than the last few years. At the same time, 2023 milk prices are expected to soften, we are still looking at Class III and IV 2023 milk price forecasts near or above $20/cwt. **Dorland Surrebuttal Exhibit 1**. That would make next year's Class III and IV milk prices the third highest behind 2014 and 2022, which are levels capable of offsetting higher input costs. Additionally, Pennsylvania milk is surplus, and I am not aware of any reasons why voluntary premiums would be expected to rise, so I would be concerned that such an increase could be significant enough to create some competitive concerns.

I also wanted to offer some comments on the Mailbox price. The Mailbox Price is not the best tool for evaluating the need to adjust the Over Order Premium. The Mailbox Price reflects milk check deductions but not cooperative profit, earnings and equity repayments. That means cooperative and individual dairy producer business decisions, whether it is for investment or transportation or otherwise, are reflected in the mailbox price. Further, the Mailbox Price is not adjusted for butterfat so variations in butterfat among regions would make comparisons unhelpful without more information. Given the significance of the butterfat value this year, small butterfat quantity differences could easily account for disparity from one region to the next. USDA discloses these considerations in its description of the methodology used for the Mailbox Price. ***See*** **https://www.ams.usda.gov/sites/default/files/media/CurrentandYeartoDateMailboxPrices.pdf**

The issues before this Board are not as black and white as Secretary Redding suggests. To me that means a three-month extension of the Over Order Premium is too short a review period for the Board, the Legislature and industry to sort through the issues and design, vet and implement something without interruption.

For example, the Secretary said the so-called inequity of the Over Order Premium is "further amplified by the testimony of Mr. Espenshade and Mr. Sattazahn and cannot continue indefinitely." I take it he is referring to the differences in their milk checks, but when I see different milk checks, and I've seen many over the years, I do not see inequity. I see trade-offs and individual business decisions and circumstances. For instance, producers that ship directly to a fluid milk plant face different tradeoffs than producers that are members of cooperatives with diversified investments. A direct ship producer's only source of milk revenue for their dairy is the milk check – they do not get to build equity with the success of the plant they serve, if they get cut off, they do not have a contractual assurance of a milk market - whereas a cooperative producer may see milk check deductions but later may receive earnings and profit distributions, build equity, and have market assurances among other things. Cooperative members may also experience greater services than the direct ship producers. There are several differences and tradeoffs that need to be identified and analyzed before the Board, the Legislature or the industry could substantiate the Secretary's belief that milk check differences makes the OOP inequitable.

Submitted: December 1, 2022

It is easy to say, I make Grade A high quality milk just like that other guy, but he gets the premium and I don't, so the premium should be terminated or pooled or otherwise changed. But that really can't be the end of the analysis because these differences exist cooperative to cooperative, county to county, and region to region. Regardless of changes to the OOP, milk check premium and deductions differences from farm to farm will not go away. Beyond the question of individual milk checks, the Board, the Legislature and industry should consider whether the OOP, as it has existed for decades, can continue to keep Pennsylvania's Class I industry from the fate that has befallen Class I sectors elsewhere in the US.

Given the depth and diversity of Class I processing relative to Pennsylvania's population and disproportionate level of small farms compared to the U.S. average, the OOP is succeeding. That brings up the adage – "if it ain't broke, don't fix it," attributed to a letter written by Bert Lance, the Director of the Office of Management and Budget that went on to write in Nation's Business (May 1977), "That's the trouble with government: Fixing things that aren't broken and not fixing things that are broken."

I make this point to inform the Board that there is a lot to unpack before the Board, the Legislature and industry can reasonably conclude that the Over Order Premium is not justified in its current state. I will be happy to participate in these future discussions. A 6-month extension provides status quo to Class I processors, cooperatives and producers while affording the Board, Legislature and industry additional time to analyze the complexities of the Pennsylvania milk market.

I am optimistic that the industry can identify ways to alleviate the concerns of non-Class I producers, but those plans need to be very carefully designed and done in a way that they do not harm the Class I industry and in a way that does not invite litigation that could leave the industry with nothing pending a legal challenge.

I'll end with a cautionary tale from the Federal milk marketing system – during the 2018 Farm Bill, industry, sidestepped the hearing process for a quick fix to the Class I milk price formula – dispensing with the higher of methodology and moving to the average of plus 74 cents/cwt. It was heralded as the solution that would stabilize milk prices and to allow for risk management. It sounded good, and a cursory review of the data said proceed. And since implementation, the new formula has met its objectives – by reducing the monthly variation in the Class I milk price and allowing for risk management. Unfortunately, a year after implementation, a pandemic spread throughout the country and challenged every inch of the dairy supply chain. The decades old Class I price formula would have been challenged, but not to the level of the new formula. The same groups that pushed for change, a year later were regretting that decision as the review as high-level and did not consider the complexity of the industry and interconnectedness of milk price formulas that ended up having significant consequences to dairy producer milk checks – costing upwards of $725 million dollars according to National Milk Producers Federation. **Dorland Surrebuttal Exhibit 2** also available at **https://www.nmpf.org/issues/milk-pricing-economics/class-i-mover/**. Additional time and scrutiny would have likely uncovered some of the issues with the newly proposed Class I milk price formula. Today, some in the industry agree with going back to the former Class I milk price formula. While it is far from perfect solution, it seems to be an acknowledgement the speed to implement change may not have worked and that the former formula with all of its blemishes worked better and more predictably over time.

Thank you for the opportunity to share my analysis and opinions.

CLASS IV MILK FUTURES - SETTLEMENTS

TRADE DATE WEDNESDAY 30 NOV 2022

FINAL DATA

Last Updated 30 Nov 2022 06:00:00 PM CT

ESTIMATED VOLUME TOTALS 158 PRIOR DAY OPEN INTEREST TOTALS 9,512

MONTH	OPEN	HIGH	LOW	LAST	CHANGE	SETTLE	EST. VOLUME	PRIOR DAY OI
DEC 22	21.55	21.55	21.55	21.55	UNCH	21.55	1	2,264
JAN 23	-	-	20.47A	20.47A	-.09	20.51	0	1,380
FEB 23	-	-	20.10A	20.10A	-.04	20.10	0	1,217
MAR 23	-	-	20.02A	20.02A	-.01	20.13	0	1,152
APR 23	-	-	20.16A	20.29B	-.04	20.22	0	817
MAY 23	20.31	20.31	20.15	20.15	-.02	20.21	10	762
JUN 23	20.33	20.33	20.29	20.29	+.04	20.29	6	712
JLY 23	20.54	20.54	20.42A	20.41A	-.05	20.46	13	299
AUG 23	20.56	20.59	20.53A	20.54	-.05	20.54	29	298
SEP 23	20.44	20.60B	20.44	20.60B	+.06	20.50	35	272
OCT 23	20.60	20.67B	20.60	20.67B	-.10	20.60	24	110
NOV 23	20.59	20.59	20.55	20.55	-.04	20.55	36	110
DEC 23	-	20.30B	-	20.30B	UNCH	20.28	4	119

Submitted: December 1, 2022

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QUOTES SETTLEMENTS VOLUME & OI TIME & SALES SPECS MARGINS CALENDAR FUTURES OPTIONS

CLASS III MILK FUTURES - SETTLEMENTS

TRADE DATE WEDNESDAY 30 NOV 2022

FINAL DATA

Last Updated 30 Nov 2022 06:00:00 PM CT

ESTIMATED VOLUME TOTALS 1,245 PRIOR DAY OPEN INTEREST TOTALS 20,416

MONTH	OPEN	HIGH	LOW	LAST	CHANGE	SETTLE	EST. VOLUME	PRIOR DAY OI
DEC 22	19.90	19.98	19.76	19.90A	-.02	19.83	712	4,885
JAN 23	19.53	19.63	19.40	19.45	-.19	19.42	302	3,716
FEB 23	19.51	19.59	19.43	19.47	-.21	19.43	44	2,438
MAR 23	19.73	19.78	19.65	19.66B	-.16	19.65	79	2,071
APR 23	19.84	19.87	19.74	19.80	-.07	19.80	20	1,418
MAY 23	19.93	19.97B	19.89	19.97B	-.01	19.95	27	1,388
JUN 23	-	-	20.05A	20.05A	UNCH	20.10	5	1,289
JLY 23	20.11	20.15	20.11	20.12	UNCH	20.11	9	773
AUG 23	20.20	20.20	20.20	20.20	UNCH	20.20	4	651
SEP 23	20.19	20.24	20.19	20.24	UNCH	20.19	7	657
OCT 23	20.19	20.21	20.19	20.21	+.02	20.21	11	353
NOV 23	20.06	20.10	20.06	20.10	+.04	20.10	18	319
DEC 23	19.70	19.82B	19.70	19.83B	+.10	19.80	7	308

(/)

KEY ISSUES

CLASS I MOVER

The Federal Milk Marketing Order (https://www.nmpf.org/issues/milk-pricing-economics/federal-milk-marketing-order/) system uses classified pricing based on milk use and creates a revenue pool to determine the minimum price of milk that participating handlers pay to dairy farmers. USDA classifies milk into four classes — Class I is used for fluid milk. To compute the base Class I price, USDA uses the Class I mover formula.

The 2018 Farm Bill changed the Class I mover at the urging of dairy processors, who sought greater predictability in managing risk on sales of fluid milk products. The formula was changed from a system that set the mover each month at either the Class III or Class IV price, whichever was higher (the "higher of" formula), to a set $0.74 /cwt added to the average of Class III and Class IV prices. This update reflected historical trends and was designed to be revenue-neutral between processors and dairy farmers.

But the COVID-19 crisis dramatically changed price relationships from historic trends, spotlighting a glaring flaw in the mover that must be rectified to ensure orderly markets and a healthy dairy sector. As USDA purchased large amounts of cheese for the Farmers to Families Food Box program, Class III and Class IV prices sharply diverged. As a result, the new Class I mover led to an estimated $725 million in losses for farmers compared to the "higher of" formula. Even after the pandemic, the current mover has at times significantly underperformed the previous mover for, demonstrating that serious negative impacts to producers from this asymmetric risk are not unique to the pandemic-induced market disruptions. The unequal risk dairy farmers bear compared to processors during unusual market volatility means the mover must change.

OUR POSITION

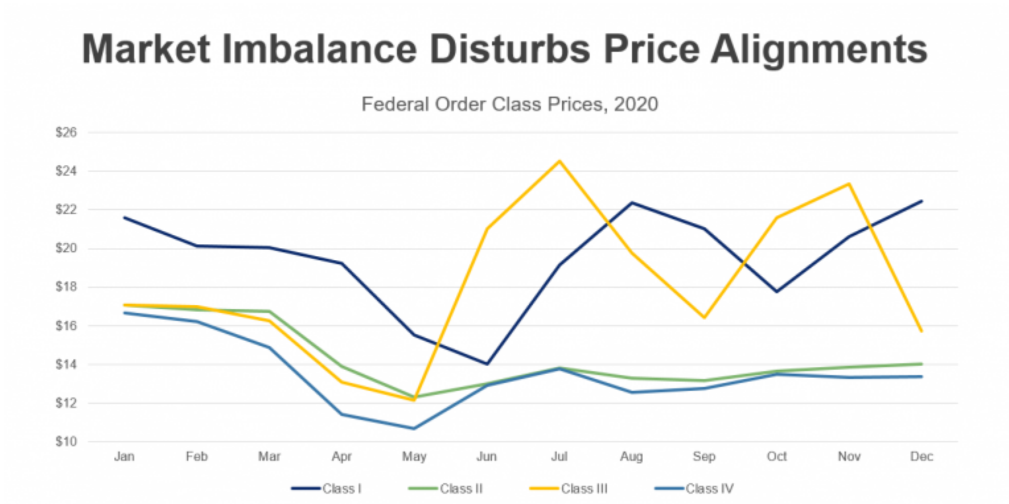
The current Class I mover carries an asymmetric risk versus the previous "higher of" calculation. This means dairy farmers are exposed to unlimited risk on the downside, while benefits to dairy farmers are limited on the upside. Among the policy recommendations unanimously approved (https://www.nmpf.org/nmpf-unanimously-endorses-marketing-order-modernization-plan-in-annual-meeting/) by both the NMPF Economic Policy Committee and Board of Directors on Oct. 25, 2022 is a return to the "higher-of" Class I mover.

KEY POINTS

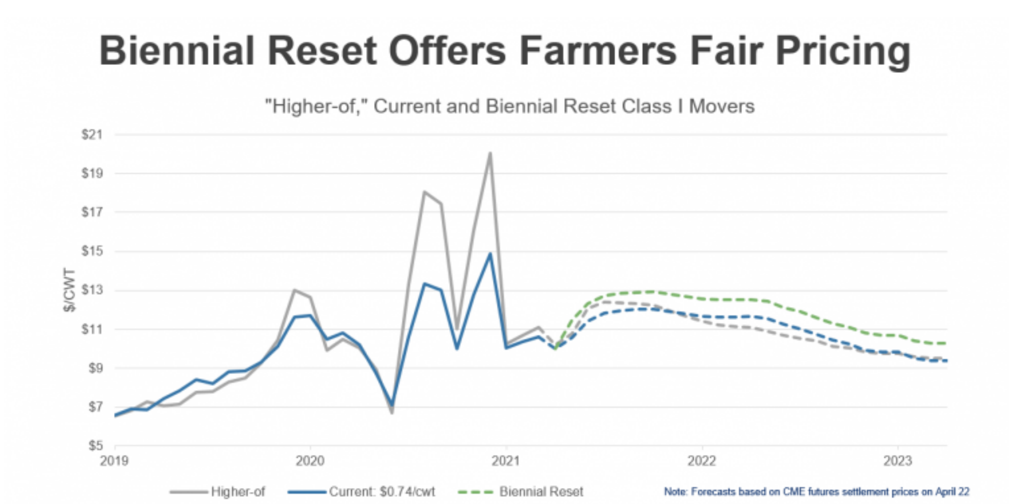
- The wild divergence of Class III and Class IV prices during the COVID-19 pandemic highlighted a flaw in Class I milk pricing that needs to be addressed, both for past effects and to ensure orderly markets in the future.
- Dairy farmers treated as legitimate the original concerns expressed by processors that led to the farm bill change in the mover. Farmer concerns regarding the real-world effects of that change are legitimate and must be addressed to reduce disorderly marketing conditions.
- 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.

MORE INFORMATION

- Federal Order Modernization Summary (https://www.nmpf.org/wp-content/uploads/2022/11/FMMO-Modernization-backgrounder-final-110122.pdf), *NMPF*
- An Overview of the Federal Milk Marketing Order Program (https://www.ams.usda.gov/sites/default/files/media/DairyFMMOBooklet.pdf), *USDA*



(https://www.nmpf.org/wp-content/uploads/2021/04/Class-I-Mover_Graphic-1.png)



Submitted: December 1, 2022