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Milk Marketing Board
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Official General
Order No. A-997

Posted:
Effective

March 21, 2017
April 1, 2017

**CLASSIFICATION AND MARKETING OF MILK
PURCHASED FROM PRODUCERS**

NOW, this 21st day of March 2017, the Commonwealth of Pennsylvania, Milk Marketing Board (Board) adopts and issues this official general order pursuant to the authority conferred by the Milk Marketing Law, 31 P.S. §§ 700j-101 – 700j-1204. This order will become effective at 12:01 a.m. on April 1, 2017.

SECTION I

The attached findings of fact and conclusions of law are incorporated herein by this reference as though fully set forth in this order.

SECTION II

For producer milk purchased during the period April 1, 2017, through September 30, 2017, due to severe market conditions, a cooperative marketing association which is also engaged in marketing the milk of independent producers may deduct from the Board's minimum price otherwise payable to such independent producers a market adjustment charge. The charge shall not be greater than the lowest such charge which is applied to the cooperative marketing association's member dairy producers.

SECTION III

(a) All parts of Official General Order A-903A not inconsistent with this order shall continue in effect.

(b) All parts of Official General Order A-893 not inconsistent with this order shall continue in effect.

PENNSYLVANIA MILK MARKETING BOARD

Luke F. Brubaker, Chairman

Lynda J. Bowman, Consumer Member

James A. Van Blarcom, Member

Date: March 21, 2017

**FINDINGS OF FACT AND CONCLUSIONS OF LAW
CLASSIFICATION AND MARKETING OF MILK PURCHASED
FROM PRODUCERS HEARING
February 28, 2017**

FINDINGS OF FACT

1. On February 28, 2017, the Pennsylvania Milk Marketing Board (“Board”) held a hearing for all milk marketing areas to receive testimony and evidence regarding changes to the requirements of Official General Order A-903A concerning the classification and marketing of milk purchased from producers.
2. Notice of the hearing was published at 47 Pennsylvania Bulletin 804 on February 4, 2017, and was mailed to those who have requested mailed notice of Board hearings by means of Bulletin No. 1526, dated February 3, 2017.
3. Elvin Hollon testified on behalf of Dairy Farmers of America, Inc. (“DFA”), and Dairy Marketing Services, LLC (“DMS”), as an expert in agricultural economics, milk marketing, and milk marketing regulation. Mr. Hollon is DFA’s Vice President for Fluid Marketing/Economic Analysis and has been employed by DFA or its predecessors for 37 years. Mr. Hollon requested changes to Pennsylvania minimum producer pricing in response to what he characterized as a severe imbalance between milk supplies and processing capacity in the Northeast and Mid-Atlantic region.
4. DMS is a cooperative marketing association whose members are DFA and St. Albans Cooperative Creamery, Inc. Mr. Hollon testified that DMS markets well over 700 loads of milk daily from more than 4,700 member-owners and other producers, including farmer-owned cooperatives and independent family farms, in the Northeast and Mid-Atlantic area. Included in that total are more than 80 million pounds per month from more than 900 independent producers; 287 of the independent producers are located in Pennsylvania. Mr. Hollon testified that DMS has been marketing milk for independent farms since its formation in 1999. There is no written contractual relationship with the independent farms and they may find another market at any time after providing 28 days’ notice, as required by Board regulations. The independent producers have always had the option to become a DFA member, a member of another cooperative, or to market through any other affiliation of their choosing.

Mr. Hollon testified that, in Pennsylvania, many of the independent farms became part of the DMS marketing system after the fluid milk plant they had been supplying closed or the plant owner contracted with DMS for the marketing and management of its independent supply. Mr. Hollon testified that the plants which DMS Pennsylvania independent producers previously supplied, but are no longer in business, include Kemps in York and Lancaster, Rosenberger’s in Hatfield, Crowley Foods in Binghamton, NY, Farmland in Wallington, NJ, and Dean Foods Tuscan in Union, NJ.

5. Mr. Hollon testified that milk marketers are presently dealing with a severe imbalance between milk supplies and processing capacity in the Northeast and Mid-Atlantic region. There has been a rapid and sizable increase in milk production in the area, while at the same time total processing plant capacity in the region has suffered a sizable net loss. Mr. Hollon testified that his survey of Federal Milk Marketing Order 1 found that since 2013 at least 10 plants have either closed or reduced throughput, resulting in an estimated loss of 325 million pounds of processing capacity each month. Mr. Hollon also testified that approximately 161 million pounds per month of additional capacity from four plants that were either new or had increased capacity had become available, but there had been much more capacity lost than gained.
6. Mr. Hollon believed that demand and available processing capacity would eventually come into balance in the region, but not soon. He explained that plants and processing capacity require large amounts of capital and long term planning for both the plant and marketing plans for the products that will be produced. He also testified that DFA has made, and is continuing to make, investments in capacity in the region in its facilities in Reading, PA, Middlebury, PA, New Wilmington, PA, Frederick, MD, Linwood, NY, Batavia, NY, New Britain, CT, and Portland, ME.
7. Mr. Hollon testified that DFA and DMS have also made new marketing arrangements to handle some of the increased milk volumes. In addition to sales into some of the new or expanded capacity, these arrangements include requesting that existing plants receive more milk, tolling agreements where DFA takes back ownership of the finished product, milk processing where the cream is separated and sold and then the skim is dumped due to no available sale, and as a last resort dumping milk at the farm. Mr. Hollon testified that all of these arrangements come at a very substantial cost, which has been borne by cooperative members and not substantially shared by the independent producers in the DMS system. Mr. Hollon testified that since July 2014 DFA members have been assessed a market adjustment charge ranging from \$0.15 per hundredweight to \$0.50 per hundredweight, reflecting the balancing costs which DFA/DMS have experienced.
8. Mr. Hollon testified that, to be more equitable with the costs associated with the imbalance between supply and demand, DFA/DMS had requested that the Federal Milk Marketing Order 1 Administrator apply the “Dairy Farmer for Other Markets” provision of Order 1 for the period April 1 to September 30 so as to allow partial depooling of individual producers’ milk. Mr. Hollon testified that this would have allowed the marketer of independent milk the flexibility to pay the market value for non-pool milk while retaining for the producer the full minimum blend value for all pool milk. Mr. Hollon explained that this is already what occurs with cooperative member milk, but cannot occur with independent milk without “regulatory relief.” Mr. Hollon testified that the request had been fashioned with great care to allow depooling only portions of an independent producer’s milk, so on that portion DMS would be able to assess a share of the market and balancing cost while retaining the ability to pay the market return on the balance of the month’s production which would remain in the pool. DFA/DMS withdrew the request due to lack of support from segments of the industry.

9. Mr. Hollon testified that the Federal Order request would have provided the most surgically-crafted relief possible throughout Order 1 and that limited depooling would have allowed DMS to continue to market independent producers' milk to the greatest advantage for the independent producers, as well as DMS cooperative members. He further testified, however, that since limited depooling would not be allowed, greater depooling would be necessary given the marketing conditions.
10. Mr. Hollon requested that the Board modify the provisions of Official General Order A-903A to allow DMS to recover from the independent producers it markets the balancing costs necessary to deal with the current supply/demand imbalance, and which are now being solely borne by DMS cooperative members. Official General Order A-903A provides that minimum class prices for Class II, III, and IV milk, equal to the federal order minimum class prices, be paid on all milk regardless of the federal pool status of the milk. Therefore, if a Pennsylvania independent producer's milk is not pooled on the federal order, the minimum price obligation remains the same, and DMS cannot recover the balancing costs from the independent producers that it recovers from its cooperative members.
11. Specifically, Mr. Hollon requested that, for April 1, 2017, through September 30, 2017, due to severe market conditions, a cooperative marketing association which is also engaged in marketing the milk of independent producers may deduct from the minimum price otherwise payable to those independent producers a market adjustment charge equal to, but not greater than, such charge which is applied to the cooperative's member dairy producers. Mr. Hollon requested that a similar allowance be made for proprietary dealers as well, allowing those dealers to deduct from payments otherwise due to independent producers on a current basis losses incurred, if any, on sales of distressed milk.
12. DMS markets independent producer milk in states outside Pennsylvania. Mr. Hollon testified that in Ohio and New York, for example, there is no state minimum producer pricing regulation, so DMS may pay any price to independent producers whose milk has been depooled. Mr. Hollon also testified that the independent producers marketed by DMS were made aware of several options they had for marketing their milk. Those options included maintaining their current relationship with DMS and accepting whatever marketing return was available, joining DFA, joining another cooperative, or attempting to find another independent market.
13. Arden Tewksbury testified on behalf of Progressive Agriculture Organization ("Pro-Ag") and the National Family Farm Coalition. Mr. Tewksbury opposed the DFA/DMS request. Mr. Tewksbury testified that Pro-Ag felt it had a moral obligation to its fellow dairy farmers to develop a plan in conjunction with the DFA/DMS request to Federal Order 1 that would allow the independent dairy farmers to not be depooled. Accordingly, Pro-Ag suggested to the Federal Order 1 Administrator that DMS be allowed to deduct from independent producers' payments an amount equal to the marketing deductions that cooperative members were being charged; Pro-Ag believed

that would be more reasonable to the 900 independent dairy farmers than the possible substantial loss those dairy farmers could or would experience by being depooled. The Market Administrator denied this request, ruling it could not be granted without holding a hearing.

14. Mr. Tewksbury testified that DMS could depool the independent producers at any time under the regular provisions of Federal Order 1. He testified that it was also possible that DMS could give any or all of the 900 independent dairy farmers regulatorily-required termination notices and no longer market their milk. However, and regardless of the suggestion made to the Federal Market Administrator in lieu of depooling, Mr. Tewksbury testified that the Board should deny the DFA/DMS request to modify the Board producer pricing order.
15. Mike Eby testified on behalf of the National Dairy Producer Organization (“NDPO”). Mr. Eby is a retired seventh-generation dairy farmer from Lancaster County and is the Chairman of NDPO. He testified that the goal of NDPO is dairy producer profitability for sustainability. Mr. Eby testified in opposition to the DFA/DMS request.
16. Mr. Eby testified that the biggest single threat to producer profitability is depressed milk prices due to production in excess of profitable demand and that NDPO had long advocated that cooperatives take control of the situation by instituting reductions in the amount of milk accepted from each producer. Mr. Eby testified that Land O’ Lakes, Inc., had recently instituted a base program which, according to Mr. Eby, allowed it to discourage excess milk production when an oversupply situation exists.
17. Mr. Eby testified that NDPO opposed the DFA/DMS request to the Federal Milk Marketing Order 1 Administrator regarding changes to the Order’s depooling provisions. In his view, DFA and DMS, rather than implementing the type of policies favored by NDPO, were reaching out to government agencies for special permissions and interpretations which would allow them to bypass programs that were intended to provide stability and fairness in milk pricing to dairy farmers. Mr. Eby testified that DFA/DMS had threatened that without the requested depooling changes, many smaller dairy producers will lose their markets.
18. Mr. Eby testified that depooling milk is destructive and destabilizing to producer pay price. Mr. Eby also provided evidence of two instances in which Mr. Hollon purportedly testified or provided a statement about depooling: a hearing in June 2012 before the California Department of Food and Agriculture Dairy Marketing Branch, and a hearing in September 2015 before the United States Department of Agriculture Agricultural Marketing Service.

NDPO’s Exhibit H, which purports to show Mr. Hollon’s testimony before the California Department of Food and Agriculture, consists of the cover page for a hearing held on June 1, 2012, and one page (page 325) of the transcript. The transcript page contains no indication that Mr. Hollon is the testifier. Nor does the transcript page alone provide the Board any context in which to evaluate the testimony.

NDPO's Exhibit I consists of a title page showing it to be the written testimony of Mr. Hollon and marked Cooperatives' Exhibit 5 and Exhibit 63, as well as what purports to be page 9 of the written testimony. Once again, the single page provides no context in which to evaluate what is purportedly Mr. Hollon's statement. Nor do we know if the statement or written testimony was ever subject to examination and cross examination and entered into the record of any hearing.

19. Gary Gojsovich testified on behalf of Board Staff as an expert in milk industry cost accounting and regulation of the milk industry, which includes determining producer, wholesale, and retail milk prices, and industry costs including producing, procuring, processing, packaging, delivering, and selling milk. Board Staff did not have a position for or against the DFA/DMS request. Mr. Gojsovich testified regarding how Board Staff would enforce the requested change to Official General Order A-903A if the Board approved the request.
20. Mr. Gojsovich testified that Board Staff currently conducts audits of DMS to ensure that independent producers marketed by DMS are paid at least the Board-mandated minimum price. Mr. Gojsovich testified that Board Staff would continue to perform those audits if the request were approved and would ensure that the DMS independent producers were paid at least the Board-mandated minimum price due after any revision to the order. Board Staff also provided modifications to the order language proposed by Mr. Hollon. Mr. Hollon testified that DFA/DMS had no objection to the modifications. Those modifications are incorporated into this order.
21. Mr. Hollon further testified that he did not agree with the primary points in Mr. Eby's testimony. Mr. Hollon testified that much of the marketing stress in the Northeast was caused not by production in excess of profitable demand, but rather the result of private firms closing plants and in some cases restructuring business operations to use less milk. Mr. Hollon noted that cooperatives have no ability to impact or control those decisions, but must live with the results. Mr. Hollon also testified that many of these changes had come in markets previously supplied by Pennsylvania DMS independent producers and that those markets now do not exist: Kemps, Rosenberger's, Farmland, and Kraft/Pollio-Campbell.
22. Mr. Hollon also testified that the DFA/DMS request was limited in time and effect specifically to avoid as much as possible taking action that would be destructive and destabilizing to producer pay price. Mr. Hollon testified that the alternative would be for DMS to be forced to take action with greater negative impact to its independent producers. He testified that DMS was pursuing the most positive outcome it believed possible to be fair and equitable to both independent producers and cooperative producers given current market conditions.
23. The Board finds that, due to the current severe imbalance between milk supplies and processing capacity in the Northeast and Mid-Atlantic region, the DFA/DMS request to

modify the minimum producer pricing provisions of Official General Order A-903A should be granted for the limited period of April 1, 2017, through September 30, 2017.

In so finding, the Board relies on the credible testimony of Mr. Hollon and finds Mr. Hollon's testimony more persuasive than the contrary testimony of Mr. Tewksbury and Mr. Eby. The Board also finds credible and persuasive Mr. Gojsovich's testimony that Board Staff will be able to audit DMS payments to independent producers to ensure compliance with minimum producer pricing requirements.

24. Official General Order A-893 provides a mechanism for milk dealers to recover losses on sales of surplus or distressed milk. While the DFA/DMS request included modification to that mechanism, we did not receive sufficient testimony or evidence to allow us to evaluate that part of the request. Therefore the Board finds that no change should be made to the current provisions of Official General Order A-893.
25. As more fully explained in the Discussion section below, given the choices before us, the Board finds that granting the limited in scope and time DFA/DMS request is the best response to the current somewhat extraordinary circumstances.

Pursuant to Official General Order A-903A, the price for Pennsylvania Class I milk in a Pennsylvania milk marketing area will continue to reflect the highest federal location differential for a county in the area where a Class I plant is located and the price for all Class I milk will be increased by the applicable over-order premium. Only Class II, III, and IV milk is affected by this order, and only for the limited period the order is in effect.

DISCUSSION

Currently there is a severe imbalance between milk supplies and processing capacity in the Northeast and Mid-Atlantic region. Over the past few years, milk production has increased while processing/manufacturing capacity has decreased. Milk production and processing/manufacturing capacity will eventually come into balance. However, it takes time and money to build new capacity and expand existing capacity. Nor is expanding processing capacity a simple matter of just building a new plant or expanding an existing one; a market for the finished product must exist and be identified, as it is no benefit to manufacture a product that no one will buy.

In the meantime, milk handlers, cooperatives in particular as they are the market balancers, must find a home for the milk being produced. Mr. Hollon described some of the measures that DFA and DMS are taking to handle the increased milk volumes. These measures come at a substantial cost, which is being borne by cooperative members. Since July 2014 DFA members have been assessed a market adjustment charge of \$0.15 per hundredweight to \$0.50 per hundredweight that reflects the costs which DFA/DMS incur balancing the excess milk supply. Once it leaves the farm, independent milk marketed by DMS is essentially indistinguishable from cooperative member milk – milk of members and independents can be

comingled on milk trucks and delivered to the same plants. Despite this, the independent producers who are marketed by DMS have not borne the same costs associated with handling the increased milk volumes in the region as cooperative members have, and are paid at least the federal order minimum blend price.

DFA and DMS have requested that the Board modify Official General Order A-903A to provide for, in the view of DFA and DMS, a more equitable way to share among cooperative members and independent producers the costs associated with handling the increased milk volumes. This would have a similar impact on independent producers marketed by DMS as Official General Order A-893 has allowed for proprietary handlers since 1996. Simply stated, OGO A-903A provides that when Pennsylvania producer milk is not priced by a federal order, the Board will establish a Pennsylvania-minimum price for that milk that is essentially the minimum price that would have been applicable had the milk been priced under the federal order system. DFA/DMS have requested that OGO A-903A be modified to allow DMS to, in essence, charge the Pennsylvania independent producers it markets the same market adjustment fee charged to cooperative members.

Given this background, how would this play out in practice? DMS has indicated that it may depool the 900 independent producers it markets in Federal Order 1. If those producers are depooled, DMS will no longer be required to pay them the federal order minimum blend price. At that point, DMS will be able to pay the non-Pennsylvania independents essentially any price. OGO A-903A, on the other hand, will require DMS to continue to pay the approximately 287 Pennsylvania independents it markets at least the federal order minimum class price plus the over-order premium.

To explain OGO A-903A in more detail, the order provides that, for milk not priced by a federal order (in this case, independent producer milk depooled from the federal order by DMS), the price for Pennsylvania Class I milk in a Pennsylvania milk marketing area will reflect the highest federal location differential for a county in the area where a Class I plant is located, with the price for all Class I milk increased by the applicable over-order premium, and that Class II, III, and IV milk is priced using the federally announced skim and butterfat prices.

Under ordinary circumstances, it is beneficial to the Pennsylvania dairy industry to require that Pennsylvania producer milk not priced by a federal order receive a Pennsylvania minimum price that is equal to the federal order class price. The current severe supply and processing capacity imbalance is not necessarily an ordinary circumstance, though. Keeping in mind that the modification to OGO A-903A is only necessary if DMS depools independent producers, the Board must carefully weigh all of the information we have and determine what is most beneficial to the Pennsylvania dairy industry given the current circumstances – grant the DFA/DMS request, deny the DFA/DMS request, or grant a modified version of the DFA/DMS request.

If the Board grants the DFA/DMS request, the price for depooled independent Class I milk would continue to reflect the highest federal location differential for a county in the area where a Class I plant is located, with the price for the Class I milk increased by the applicable over-order premium. Class II, III, and IV milk would continue to be priced using the federally

announced skim and butterfat prices, but DMS could then deduct a market adjustment charge that would be no greater than the lowest charge deducted from cooperative members. Non-Pennsylvania producers who were depooled would have no such minimum price protection.

If the Board does not grant the DFA/DMS request, and DMS depools its independent producers, the Pennsylvania independent milk would be priced using the federal order minimum class prices plus the over-order premium, while the non-Pennsylvania independent milk would have no minimum federal price. Therefore, DMS would have no minimum price obligation on non-Pennsylvania milk and a minimum price obligation equal to the federal order class prices plus over-order premium on Pennsylvania milk. The Board is concerned that in this situation, DMS would simply choose to terminate its relationship with the Pennsylvania independent producers, potentially leaving them with no market.

On the other hand, if the Board grants the DFA/DMS request, the DMS Pennsylvania independent producers would still receive a minimum price, albeit a slightly reduced one, and we believe it would be less likely that DMS would choose to terminate its relationships with those independents. So the Board must decide what is best for the Pennsylvania dairy industry – denying the request and risk having Pennsylvania independent producers terminated and left with no market, or granting the request and attempting to help maintain the independents’ market at a lower minimum price (and remembering that the lower price would be effective for only a limited period of time).

After carefully weighing the evidence and the potential consequences, the Board believes it is in the best interest of the Pennsylvania dairy industry to grant the DFA/DMS request. The change will be effective for a limited time, through the end of September 2017. We believe it is better to provide a limited environment of slightly lower prices than potentially expose 287 Pennsylvania producers to the risk of having their market terminated. The Board believes that DFA/DMS made the request because it wants to continue to handle the Pennsylvania independent producer milk; if DMS intended to simply terminate those producers, it would have no reason to request this modification to the producer price order.

CONCLUSIONS OF LAW

1. The February 28, 2017, hearing regarding changes to the requirements of Official General Order A-903A concerning the classification and marketing of milk purchased from producers was held pursuant to the authority granted to the Board in sections 801 and 803 of the Milk Marketing Law (Law), 31 P.S. §§ 700j-801 and 700j-803.
2. The hearing was held following adequate notice and all interested parties were given a reasonable opportunity to be heard.
3. All parts of Official General Order No. A-893 not inconsistent with the attached order will continue in effect.
4. All parts of Official General Order A-903A not inconsistent with the attached order will remain in effect.
5. In adopting this order, the Board considered the entire record and concludes that the order is supported by a preponderance of credible evidence and is reasonable and appropriate under sections 801 and 803 of the Law.
6. The attached order may be amended pursuant to the procedures set out in section 801 of the Law.

PENNSYLVANIA MILK MARKETING BOARD

Luke F. Brubaker, Chairman

Lynda J. Bowman, Consumer Member

James A. Van Blarcom, Member

Date: March 21, 2017

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