REDACTED TO PROTECT CONFIDENTIAL ATTORNEY-EYES-ONLY MATERIAL SUBJECT TO PROTECTIVE ORDER

Surrebuttal Testimony of Sara Dorland

On Behalf Of The Pennsylvania Association of Milk Dealers

Over Order Premium Hearing Before the Pennsylvania Milk Marketing Board

August 30 – September 1, 2022

A. Comparisons of Cooperative Members and Independents Producers Require More Than The Milk Check

It is easy to get lost in the forest of milk marketing especially because many producers do not have the experience of being both independent and cooperative. As a consultant, I have had an opportunity to see each side. In my career, I have worked with several cooperatives throughout the United States, both on the buy and sell side of a transaction, proprietary processors to assist with procuring milk, and soliciting independent producers in various states. The PADC comparison between the Mt. Joy and Clover producers is only a partial analysis that leads to the faulty conclusion that there is a disparity between cooperative and independent producer that is then exacerbated by the OOP. In fact, the milk check differences highlighted do not lead to the conclusion that independent farmers are far better off than cooperative members when one considers the different business models. Furthermore, the milk check deductions highlighted by PADC have nothing to do with the OOP and should not serve as a criticism of the OOP. Rather, these deductions are common and exist on milk checks from coast to coast.

As I have stated before, business decisions will result in different approaches, but not disparities. By disparity I mean the differences between the cooperative member and independent producer experiences do not necessarily mean one is better off than the other. While there can be more costs associated with a cooperative milk check, they cannot be considered without the corresponding benefits; and the lack of charges on independent producers' checks doesn't mean they don't incur different but similar costs in terms of risk and actual cost to their operation.

Service: Cooperatives can assess members service fees related to milk marketing, generally on a per cwt basis. Those fees support cooperative administration and working capital requirements. This would include the executive team, the sales general and administrative staffs, supply chain, and field services as examples. Coop staff ensures trucks show up, the lab tests are completed, there is an infrastructure for farm services and risk management and a host of other services that can range from loans to health insurance. Some of these services exist as part of the business model and are funded by all the members through dues and milk marketing activity, and other of the services are supported by user fees like risk management, insurance, loans, etc., but the existence of the cooperative infrastructure makes these user-based programs cost effective.

Independent dairy producers do not have service fees; however, they are responsible for day-to-day management of hauling, insurance, regulatory compliance, and similar items. There is no membership to set up a structure for user-based programs. If the independent producer's truck doesn't show up, they need to work to get a replacement taking time out of their day to resolve. Presently, there are discussions of Federal Milk Marketing Order or FMMO changes – independent producers need to seek out an organization or research the matter themselves to understand the potential implications to their business, whereas the coop infrastructure will handle such things on behalf of their members. Depending on the arrangement with their customer, if these farms have excess milk they are responsible for marketing it. This fee difference has nothing to do with the OOP – it is a choice about outsourcing to a cooperative for a fee or assuming the duties in exchange for fewer fees. Service fees exist nationwide.

Market Adjustments: When there is more milk in the milk shed than the cooperative has sales or capacity for, due to pandemic or seasonality, the coop has to move the milk to the next best outlet for that milk. The coop concept is that all the producers share in that incremental cost, and this gives rise to market adjustment fees. For surplus milk it means that the member whose milk is moved a longer distance receives cost sharing from his fellow members whose milk just as easily could have been the milk to go further. In contrast, proprietary Class I plants make no promises – the independent producer typically will incur the cost of incremental hauling without an ability to cost share with other producers - whether the milk goes to that processor's plant or a plant two states away. If a producer's load is inefficient, meaning less than full, it costs them directly and they need to arrange and manage it. This difference has nothing to do with the OOP. Market adjustments can and do exist outside of PA.

Base Excess Programs: Cooperatives work to manage the needs of a complex set of member priorities. Unmanaged growth can negatively impact members by increasing costs through the system and depressing milk and dairy product prices. As a result of the boom-bust cycles and the rising cost of capital investment most coops across the country began instituting base-excess plans a few years ago. Coops still provided secure home for milk; however, the base plans recognize that incremental milk may not have the same value.

Cooperatives adopted a methodology to pay the value that could be obtained in the market for incremental milk. Members have choices - continue production and receive what the market will bear or reduce milk production. If the income over feed calculation is positive, inclusive of the base-excess deduction – they will likely continue to produce the milk. In fact, the base-excess adjustments are not costs – they are the fair market value of milk at that time.

Independent farmers do not have access to such programs. Their plants can limit production as they are not milk marketers; rather, they are Class I processors. Proprietary Class I plants are fully regulated by the FMMO, meaning they have to pay the minimum price to independent producers – discounts for excesses are absorbed by the processor. For example, when a Class I plant can only sell surplus milk to a balancing plant for [**BEGIN CONFIDENTIAL ATTORNEY-EYES ONLY MATERIAL**] [redacted] [**END CONFIDENTIAL ATTORNEY-EYES ONLY MATERIAL**] below Class, the Class I plant cannot reduce the independent farm milk check by the same amount. While independent dairy producers may not incur base-excess deductions, the ability of the independent to expand operations, or contract if necessary, is more compulsory than voluntary as compared to cooperative farms who can choose. This difference has nothing to do with the OOP. Base excess programs exist nationally.

Retains: Cooperative can assess retains to fund various projects or investments that are intended to generate a return. Independent producers do not incur this potential fee, but they do not share in the value of their Class I processor's business venture. In terms of milk marketing, the independent producers only generate revenue based on the milk they sell. This difference has nothing to do with the OOP. The concept of retains exists nationally.

CWT: Some coops choose to participate in the Cooperatives Working Together or CWT program. If your cooperative participates, producers incur a 4-cent per cwt deduction. Funds contributed to CWT provide participating cooperatives the opportunity for export assistance for some dairy products into certain markets. This difference has nothing to do with the OOP. Participation in the CWT program exists nationally.

Patronage/Equity: This is the benefit of retains, deductions, and re-blending. In exchange for being a coop member, producers share in the value generated by the cooperative enterprise that goes beyond the Class I market in PA. As I mentioned, the independent producer shipping to Class I may not incur the same deductions as cooperative members, but they do not enjoy the security cooperative members have, and they do not have the opportunity to share in the value of the broader cooperative enterprise and its many other potential sources of income. This difference has nothing to do with the OOP. Patronage programs exist nationally.

Risk of Loss (Casualty): Coop members' risk ends when their milk is picked up. Independent producers carry the risk of loss while their milk is transported to the plant. In my career, I have seen tanker trucks get in accidents or crumple. The coops manage those events and compensate the members for their milk. The independent producer must carry insurance to defray this risk but would have to prove that the loss was covered, and the producer may have to reimburse the Class I plant for the cost to replace the lost milk. Additionally, the producer may have to wait months or years for a claim payment for the milk, whereas the coop will issue payment in real time. This difference has nothing to do with the OOP. This difference exists nationally.

As implemented and deployed today, the OOP appears to fairly drive additional revenue to producers. The OOP program makes dairy producers eligible for a payment if two conditions are met 1) PA milk is processed in a PA facility, and 2) PA milk is sold as Class I in PA. Based on my review of the information, this goal is being met. In many cases, the repayment is not always specifically titled "OOP premium" on a cooperative member's milk check, but the testimony of the Mt. Joy producer demonstrates that it is being used for the members.

Cooperatives pay several premiums or bonuses to members; however, few are paid on a flat per hundredweight basis. Cooperatives use an incentive program to encourage efficiency, reduce seasonality, and obtain higher quality milk so they can better serve the Class I market, among others. Paying flat premiums – like the OOP, would reward members without creating an incentive. When paying flat premiums – they are typically smaller. That allows all members to have a share of the supplemental income.

The Mt. Joy producer's cooperative pays some of the OOP collected as a flat per hundredweight "special premium." In addition, "an additional portion of the premium is used to subsidize quality bonuses," consistent with typical cooperative programs. When contemplating the volume, quality and OOP collectively, the Mt. Joy producer's premium is approximately 24.5 cents per hundredweight compared to the Clover producer's 35 cents – relatively comparable figures when you consider what appears to be similar PA Class I utilization.

In summary, the OOP is not the cause of the differences between coop and independent producer experiences. Business decisions and different business models drive the differences.

B. The Current OOP Method Is Justifiable

Most of my rebuttal testimony explains why PADC is inaccurate in saying the current OOP is unfair or unsustainable. As I have mentioned, the OOP method appears to help Pennsylvania's Class I processors by enabling them to pay the premiums they need to attract producers and cooperatives willing to supply the Class I market. All indications are this is a factor that has helped maintain more Class I processors in PA compared to other states and has resulted in slower farm declines in PA, especially in the smaller farm category, relative to the national average.

Doing away with the OPP, or modifying the OOP by taking it away from the producers supplying Class I plants and paying it to all Pennsylvania producers, will increase burdens on Class I plants and producers.

Reducing revenue available to Class I producers may result in cost cutting, like inferior feed, less maintenance, all things that happen when margins are squeezed. It may also adversely affect producers who rely on the availability of the current OOP for financing to keep up with the requirements of the Class I market. If cost cutting is not enough, it may drive producers out of business. Class I plants are not necessarily going to be able to stop producer margin erosion by replacing the lost OOP with additional premiums. With Class I sales declining, HTST margins are razor thin and there is a lot of competition meaning more often than not Class I sellers are price takers rather than price makers. If Class I plants are unable to afford milk they too may be faced with the exit decision.

USDA has indicated that the Class I differential was designed in part to send a price signal to encourage milk to service the Class I market. See, https://www.ams.usda.gov/sites/default/files/media/Class%20I%20pricing%20structure.pdf. I have studied FMMOs for a number of organizations and conclude that the Class I differentials established with FMMO reform based on 1997 data are outdated. In my opinion, the OOP is a way to supplement the FMMO system's outdated Class I differentials.

Doing away with or pooling the OOP opens the door for producer exits, Class I plant consolidation, closures and potentially milk from other areas serving the local market.

Modifying or eliminating the OOP does not stop at the OOP. Under the FMMO, the Class I milk price is often one of the highest prices meaning it contributes to a higher blend price. Class I plants typically pay a portion of the Class I minimum price to the FMMO producer settlement fund, which in turn distributes that pool of money to manufacturing plants so that all pool plants pay the blend price to pool producers. PA retaining a larger number of Class I processing plants benefits all PA producers in FMMOs 1 and 33 with higher blend prices.

If changing the OOP causes Pennsylvania to follow trend and lose Class I plants to consolidation or plant closings, that should worry Pennsylvania producers that are pooled under Orders 1 or 33 because with consolidation comes limited access to the pool which may necessitate lower pooling requirements and in turn dilute the blend price.

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Also, in addition to the supply chain issues I mentioned in my rebuttal testimony we have recently seen that there can be real consequences for schools when milk plants are shuttered. Right now, the popular press is reporting that schools in the South are scrambling to find milk with the recent closing of two Borden plants in Mississippi and Alabama. See for example, an article in dairyherd.com discussing the closing of one of the plants which can be found at https://www.dairyherd.com/news/business/bordens-impending-plant-closure-leaves-100-school-districts-scrambling-find-milk. School milk is not very profitable. Processors produce school milk for brand identity and a favorable association with future consumers. It does not make sense to put more pressure on these plants that are so essential for Pennsylvania's schools by changing or doing away with the OOP simply because there is a vocal group that does not like the idea that those serving the Class I market get the OOP and others do not.

Thank you for considering my testimony.