

Testimony of Sara Dorland on Behalf of the Pennsylvania Association of Milk Dealer
Before the Pennsylvania Milk Marketing Board
Over Order Premium Hearing – Aug 30 – Sep 1, 2022

Introduction

My name is Sara Dorland. My business address is 360 East Avenue #300, Ketchum, Idaho. I run Ceres Consulting which advises dairy industry clients across the United States on matters pertaining to Federal Milk Marketing Orders, state regulatory programs, and risk management. I have attached my CV here as **Dorland Rebuttal Exhibit 1**.

I am testifying on behalf of the Pennsylvania Association of Milk Dealers (“PAMD”) to offer a perspective on the Over Order Premium. I have reviewed and analyzed data pertaining to the OOP’s impact on Pennsylvania’s producers, dealers and retail sales. The data I have been able to review indicates that the OOP has had a positive impact on PA producers, plays a key role in helping maintain Class I plants to be able to pay premiums to attract high quality milk, and to recover that cost, and has not adversely impacted Class I sales. For that reason, I conclude that the Over Order Premium should be retained in its current form. If there are problems that persist in the industry, I believe the industry should look at the Federal Milk Marketing Order program for relief from factors such as the fact that the current program is based on outdated data. If that is not enough, perhaps supplementing rather than terminating or changing the OOP would make more sense.

Review of the OOP

I would like to address the primary issue of whether the PMMB should retain the Over Order Premium. The short answer after analyzing the data is yes. (A) The data I’ve reviewed suggests the OOP is a distinguishing factor in why Pennsylvania has been able to break trend by having a smaller reduction in farm numbers than the national average. (B) I see nothing about the OOP structure that suggests an unfairness or inequity among producers. (C) The structure of the OOP helps milk processors pay and recoup higher costs related to serving the fluid beverage market. (D) The data I’ve reviewed indicates that Pennsylvania has not seen retail sales decline at a higher rate than the national average.

A. The OOP is a distinguishing factor in why Pennsylvania has been able to break trend

Pennsylvania has lost fewer dairies than the national average, down 65% between 1990 and 2020, compared to 84% nationwide for the same period. **DORLAND REBUTTAL EXHIBIT 2** That is a significant number because Pennsylvania producers face significantly higher costs of production than the national average according to the 2016 Agricultural Resource Management Survey (ARMS) data (USDA Economic Research Service, 2022) Pennsylvania 2021 operating costs were \$18.33/cwt compared to the National average at \$17.27/cwt– a \$1.06/cwt difference. Despite higher costs, on average, Pennsylvania experienced fewer farm losses than other states with operating cost advantages. Interestingly, Pennsylvania producers’ gross value of production in 2021

was higher by about 12-cents than the national average with Pennsylvania at \$21.45 and the national average at \$21.33/cwt. **DORLAND REBUTTAL EXHIBIT 3** The gross value of production is a way of referring to revenue that includes milk value, cow sales and other income like premiums, which would include the OOP, cooperative premiums, patronage, etc.

Lancaster County, PA has the most cows per county east of the Mississippi, exceeding counties in New York, Michigan and Wisconsin; it rivals counties in Colorado, Texas, Idaho and California. What is different is that Lancaster County has a higher density of smaller herds than western counterparts. That is not to say that Pennsylvania lacks larger dairies – it does not. Rather, it is highly unusual in today’s dairy industry for small dairies to thrive in a commodity market. When reviewing what could support a unique dairy eco-system, the OOP stands out in Pennsylvania.

The OOP is a significant source of other revenue that according to Dr. Hardbarger’s article of December 13, 2021, in Lancaster Farming reaches 641 direct ship producers and has the prospect of reaching thousands of cooperative producers whether it is enumerated on the milk check. Whether direct-ship dairy or cooperative, anyone servicing the Pennsylvania Class I market and meeting the PMMB eligibility will receive a payment for the pounds of qualifying milk. The OOP is a mandated supplemental payment available to Pennsylvania dairy producers that is not present in surrounding markets. Anytime you can add money or slow deductions on milk checks, there is a benefit to the producer.

B. The ability to pay out the OOP and helps Class I plants attract quality milk

Proprietary processors in the FMMO are at considerable risk as they are the most regulated of all processors with no ability to mitigate costs relative to cooperatives and producer-handlers. Nationally, Borden and Dean Foods provide the best examples of primarily HTST milk processors that entered bankruptcy in 2020. While numerous factors led to the demise of these companies, a contributing factor was they paid the regulated milk price and had to compete with those that could pay less than the regulated price. Class I differentials have not been updated since FMMO reform which put pressure on Class I plants to find other ways to offset higher costs. In the FMMO system, proprietary processors cannot 1) reduce milk prices below the minimum or 2) deduct from the milk check beyond FMMO authorized reductions – they are not afforded the same mitigation steps.

Retaining Class I processors in a local market is important. The dairy system is like an ecosystem, it is interdependent with each group relying on the other for survival. The PMMB wholesale price provides Pennsylvania Class I processors with vital, contemporary cost reimbursements that maintain competitiveness. Removing the OPP tool to compensate farmers and recover the cost could destabilize the network. Eliminating a processing plant can result in fewer sales for dairies and cooperatives, including fewer opportunities to pool milk locally, and reduce milk prices and drive-up costs. That can cause dairies to exit the business. Once dairies start exiting, the entire region can suffer as things like efficient and cost-effective hauling is an interdependency.

C. The OOP is not inequitable

There doesn’t appear to be inequity in the PMMB OOP approach. How and how much OOP moves back to farms will vary depending on the relationship and structure of each entity. While the collection and distribution methodology may be sound, it may be perceived as inequitable, which is a mischaracterization of the OOP.

For example, if only one dairy producer shipped 100 pounds of milk in the state to a fluid milk processor who processes and sells all of the milk in Pennsylvania, \$1/cwt would be returned to the dairy producer by PMMB mandate. If the market grew to three plants, each taking 100 pounds of milk, including the same fluid milk plant, but now a cheese and a powder plant, the dairy producer could triple their production, but the OOP would decline to \$0.33/cwt. across all milk on that producer's milk check assuming a zero premium from the other two plants. It is called dilution. While the fluid beverage plant still pays \$1/cwt, introducing other dairy products dilutes the impact of the OOP on the farm's milk check. That is what is happening in Pennsylvania. Cooperatives get the full OOP on their deliveries of Class I milk but because they market a lot of milk in and out of state, to multiple class uses, and represent a lot of members, the OOP is diluted when applied across all their milk in a similar fashion to my three-plant example. I want to be clear that cooperatives are being responsible when they diversify and do not place all of their eggs in the Class I basket. Their members benefit from that in terms of risk mitigation and because of the value that manufactured products can generate.

When a cooperative diversifies or spreads that same amount of money across its many members, that is their prerogative, but the fact that members faced dilution should not serve as an indictment of a payment method that treated both deliverers of the similar amounts of milk to plants with similar characteristics the same.

Producers or cooperatives not supplying Class I milk may not receive the OOP and neither should that generate criticism that the OOP is unfair. They do not have to perform for the Class I market. This is in contrast to the FMMO system where in order to share in the proceeds of the Class I market, producers must demonstrate an ability and willingness to serve the Class I market. It is noteworthy that, cooperatives delivered more milk to PA's Class I plants according to Dr. Hardbarger's December 2021 article and generated revenue for their farmers.

There are two types of cooperatives – milk marketing and brick-and-mortar. Milk marketing cooperatives do as their name states – they market milk to handlers but do not own processing assets. Brick-and-mortar cooperatives may sell milk to third parties, but they own processing assets also - ranging from bottling to milk powder plants. In regions with more processing capacity than milk, milk marketing cooperatives can be lucrative for dairy producers as they tend to have fewer deductions and lower overheads than their brick-and-mortar counterparts. Note, however, deductions by the brick-and-mortar counterparts tend to support broader business objectives and investment that may provide members an opportunity to expand and may also provide future returns commonly referred to as the "13th check.". Further, brick-and-mortar cooperatives will ensure a secure home for their members' milk first, permitting outside milk secondarily and conditioned upon price and available capacity.

Today cooperatives own more fluid milk processing assets precipitated by the 2020 Dean Foods and Borden bankruptcies. That change profoundly impacted milk marketing to bottling plants nationwide. I believe this may explain some frustration at the last OOP hearing voiced by a witness. They noted their farm is located in Tioga County, but that the farm's milk ships past Pennsylvania bottling plants and is processed in Maryland. As I understood that producer's testimony, they made a business decision sell their base in a brick-and-mortar cooperative in exchange for payment and then joined a milk marketing cooperative to sell milk that appears to be a casualty of the changing ownership structures in PA.

Proximity to a plant should not be confused with a guaranteed market for milk. Long hauls are becoming endemic throughout the US dairy industry – milk travels miles and may be subject to discounts to access available capacity and avoid dumping. That can change quickly as it did in Michigan with the commissioning of the St. John's cheese plant in 2021 – milk moving interstate remained in the state for processing.

The collection and distribution of OOP appear fair and consistently applied and differences in its distribution make sense in light of business circumstances in PA.

D. OOP Impact on Consumers' Purchase Decisions

A major determinate of the appropriateness of an OOP is whether consumers push back or switch to less expensive beverage milk alternatives due to higher comparative retail prices versus lower-cost out-of-state alternatives. AMS collects retail milk prices for selected cities with an average of three outlets. This sample provides a glimpse of the retail milk price consumers will see in the local market. The survey includes two Pennsylvania cities – Philadelphia and Pittsburgh. In 2021, Philadelphia had the highest reported price; however, Kansas City, a region with a lower Class I differential and no state OOP, was within 10 cents of Philadelphia. Further, Milwaukee, WI, Chicago, IL, and Minneapolis, MN were within 20% of Philadelphia with an FMMO Class I differential over 25% less than those in Pennsylvania and no state OOP or minimum retail price. **DORLAND REBUTTAL EXHIBIT 4**

That said, higher prices may not be a deterrent for local milk. Study after study concluded that consumers are willing to pay more and seek local products. In 2020, Forager, an online platform designed to connect local farms with retailers, conducted a survey focused on produce. The conclusions drawn for produce can be applicable to fluid beverage milk. The survey found that 86% of respondents were seeking healthier eating, and almost one-third identified as “eating more sustainably and reducing my carbon footprint.” (Gustafson, 2020). A 2017 study (Roerink, 2017) concluded that 80% of consumers bought locally to keep “money in their local economy, creating prosperity for their friends, neighbors, and their own families.” **DORLAND REBUTTAL EXHIBIT 5** Further, with all of the product offerings, a University of Indiana study concluded that when consumers buy locally, they use price as a determinate of quality (Indiana University, 2019). The Journal of Marketing found consumers identify with “the region or town” where the products originated (Settembre, 2019). The issue, there is no federal definition of “local,” implying that some may take advantage of consumer perceptions and market products from remote locations as in the area. While states define local – the definition varies from state to state, and 36 states do not specify how much product must contain “local” product to meet the requirements.

A higher price may not result in switching, given current consumer trends and attitudes toward local products; at the very least, it may be one of several complex choices consumers make when selecting a product. Consumers willing to pay up to 20% more for local products suggest that the AMS reported retail prices for cities in Pennsylvania are within acceptable ranges. Additionally, the AMS data is not sufficiently granular to determine which retailers are charging premiums and whether that can be directly attributed to Pennsylvania fluid milk processors alone or if it results from added costs for milk transported longer distances to market.

It is not appropriate to judge the OOP just because PA milk sales are dropping. The more precise question is whether Pennsylvania milk dropping faster than the national average? Based on the PMMB Over-Order Premium Effect from 1988 to July 2019, monthly pounds assessed the OOP declined from 1.57 billion pounds in 2015 to 1.37 billion pounds in 2018 – a 4.4% decline. Over the same period, ERS reported nationwide fluid beverage milk sales dropped 4.9%, from 49.7 billion pounds in 2015 to 47.2 three years later. The data suggests that the OOP may have minimal impact on consumers' purchase decisions as the rate of decline was comparable to the national average, where most milk is sold within the FMMO system and without a state OOP or minimum retail price.

That is not to suggest that some retailers in Pennsylvania source packaged milk from outside the region to reduce costs – they certainly may. That is where the hearings become important so the Board can maintain a competitive

OOP. But, again, the same could be said for milk in all states. Retailers will evaluate the net landed cost at their store, and if it is possible to source milk for a reduced price, they may. With the cost of transportation and efforts to reduce carbon emissions significantly by 2030 and again in 2050, some may be reevaluating those decisions to factor in other criteria like distance to market, carbon emissions, on-farm practices, etc. moving forward. Fluid milk tends to weight-out (meaning the weight rather than the space available caps the load) on trucks implying it is an expensive product to transport in packaged form – especially HTST gallon and half gallons. Smaller packages in corrugated boxes and products with longer shelf-life tend to move further as each unit can absorb higher handling costs – the same is not true of gallon and half gallon packages implying there is a finite distance the produce can move before diminishing returns sets in. Additionally, the higher cost of labor, replacement parts and fuel are frustrating such efforts and may continue to do so until costs abate. Presently, the United States has a truck driver shortage forecast to last and worsen through the decade **DORLAND REBUTTAL EXHIBIT 6**. Fewer drivers are willing to make long hauls, and most prefer local routes. That is not to imply there will be no competition within Pennsylvania for fluid beverage milk sales; on the contrary, it could increase moving forward as processors compete for shrinking sales; however, transportation of out-of-state HTST milk long distances, absent additional product attributes, is expected to be more difficult in the future.

Finally, to the extent packaged milk is coming from out of state in the form of specialized products. While, the overall fluid beverage milk category is declining, some subcategories are experiencing growth. Lactose-free, flavored milk, organic, and high protein demand expanded over the last decade, suggesting that traditional high-temperature-short-time (“HTST”) gallons and half-gallons are declining at a faster rate. If PA does not have the capacity to process those categories, they will come into PA regardless of the OOP.

In summary, the data that I reviewed suggests that the OOP is not driving down fluid beverage milk sales within Pennsylvania and whether consumers are overwhelmingly selecting lower-cost alternatives from other states.

CONCLUSION

The data does not point to factors suggesting disproportionate milk consumption declines. Further, other factors like the pandemic-driven supply chain disruptions, driver shortages, cost of transportation, and the like are driving costs up and making local milk far more cost competitive. For decades, US consumers have taken the US food supply chain for granted, assuming that store shelves would be stocked with whatever products we desired and whenever we wanted. The 2020 pandemic proved more than the current supply chain could handle – add to that all too frequent hacking events that disrupt processing operations or so much consolidation that the US food supply is susceptible to quality events at a single processor. There is no better current example than the infant formula shortage. Due to exhaustive regulation, and for a good reason, US infant formula manufacturers consolidated into three groups providing most US products. Unfortunately, one manufacturer had production and quality issues at a single site resulting in stockouts of a product vital to infant nutrition. Those stockout figures skyrocketed to over 40% this spring, forcing the Biden Administration and FDA to source infant formula from overseas to avoid the situation from deteriorating further. Pennsylvania should take heed and should want to do everything it can to maintain a local Class I milk supply.

Today Pennsylvania exports approximately 60% of its annual milk production to other states for processing according to Dr. Hardbarger’s January 8, 2022 article in Lancaster Farming. However, if the OOP were eliminated and the rate of farm declines matched the US national average, it could be catastrophic for the state. In some cases, the \$1/cwt OOP is a small price for consumers to pay for the surety of supply – and marketing studies and

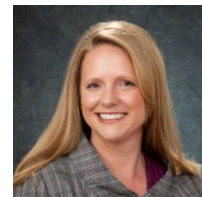
trends indicate consumers are willing to pay PA's prices to support local agriculture and processors. That said, consumer preferences and lifestyles continue to change, and drinking milk is declining. There is little data to suggest that Pennsylvania's fluid milk sales are dropping faster than the national average, meaning the OOP has little to no impact on that trend. Additionally, it is well-documented that milk moves from state to state regardless of state regulation. Eliminating the OOP will not stop that business phenomenon; eliminating minimum retail prices and OOP could speed it up as there are fewer inducements for proprietary processors to buy local milk.

Eliminating over-order premiums from the market does not undo past decisions; it does not make milk more marketable; it does not make consumers begin to buy milk; it doesn't drive efficiency; it does not stop competition. All of these are present in markets that operate without groups like PMMB and OOPs – suggesting termination will not eliminate these problems but could exacerbate or accelerate them. Terminating over-order premiums can hurt Pennsylvania dairy producers that use the money to defray higher on-farm costs to ensure a vibrant local milk market capable of servicing demand. Further, if the pandemic has proven anything, a vibrant and diversified local Class I market is vital to the local economy's health and the surety of supply.

Thank you for your consideration of my testimony.

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Education:

SEATTLE UNIVERSITY ALBERS SCHOOL OF BUSINESS / Graduate, MBA	2001
UNIVERSITY OF WASHINGTON FOSTERS SCHOOL OF BUSINESS / Bachelor of Arts	1995

Professional Experience:

MANAGING PARTNER / CERES DAIRY RISK MANAGEMENT LLC – Sun Valley, Idaho	2009 to Present
DIRECTOR OF RISK MANAGEMENT / DARIGOLD, INC. – Seattle, Washington	2005 to 2009
DIRECTOR OF FINANCE – INGREDIENTS DIVISION / DARIGOLD, INC. – Seattle, Washington	2001 to 2005
INTERNAL AUDIT MANAGER / DARIGOLD, INC. – Seattle, Washington	1999 to 2001

Professional Training:

HARVARD SCHOOL OF BUSINESS / Strategy & Competition Certificate ADVISOR: Michael Porter	Certificate
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Professional Specialties:

Providing risk management, market research and financial consulting services to agriculture and food-based businesses with a particular focus on the dairy industry to clients throughout the supply chain. Work includes collaborating with dairy producers, cooperatives, manufacturers and consumer products companies nationwide.

Risk management activities involve a broad array of hedging activities, ranging from swaps and futures trading to go to market techniques for both domestic and international sales as well as education and consulting on a wide variety of dairy industry topics – ranging from “Introduction to Dairy” to business case analysis for dairy plants and milk shed analysis.

Project work includes input cost management for dairy farmers and processors including hedging of natural gas, corn, alfalfa, soy oil and work with fuel and resin contracts. Additionally, projects, on behalf of clients, comprised sourcing a vast array of milk and dairy products that have reduced supply chain costs. In addition to financial review for new U.S. dairy manufacturing investments.

Memberships in Professional Organizations:

U.S. Dairy Export Council	National Milk Producers Federation
American Dairy Products Institute	National Women Business Owners Corporation
Wisconsin Dairy Business Association	Dairy Management Inc. – Advising Board Member
Idaho Milk Processors	

Published Articles:

DAILY DAIRY REPORT	2012 to 2020
CHEESE MARKET NEWS	
Rocketing Cheese Prices	Jan. 2014
Butter Markets Continue to Rocker Higher	Jun. 2014
Cheese Market Article	Oct. 2014
A Year in Review	Dec. 2014
What Gives with Butter	Sep. 2015
Second Half of Year Likely Won't Disappoint with Its Own Revelations	Jul. 2016
PROGRESSIVE DAIRYMEN	
Market Article (Quarterly)	2019 to present
US DAIRY EXPORT COUNCIL	
Co-authored paper: The Dodd-Frank Act Amendments to the Commodity Exchange Act and the Impact on the U.S. Dairy Industry (Sara Dorland and Katie Trkla, Partner Foley and Lardner LLP)	Mar. 2012

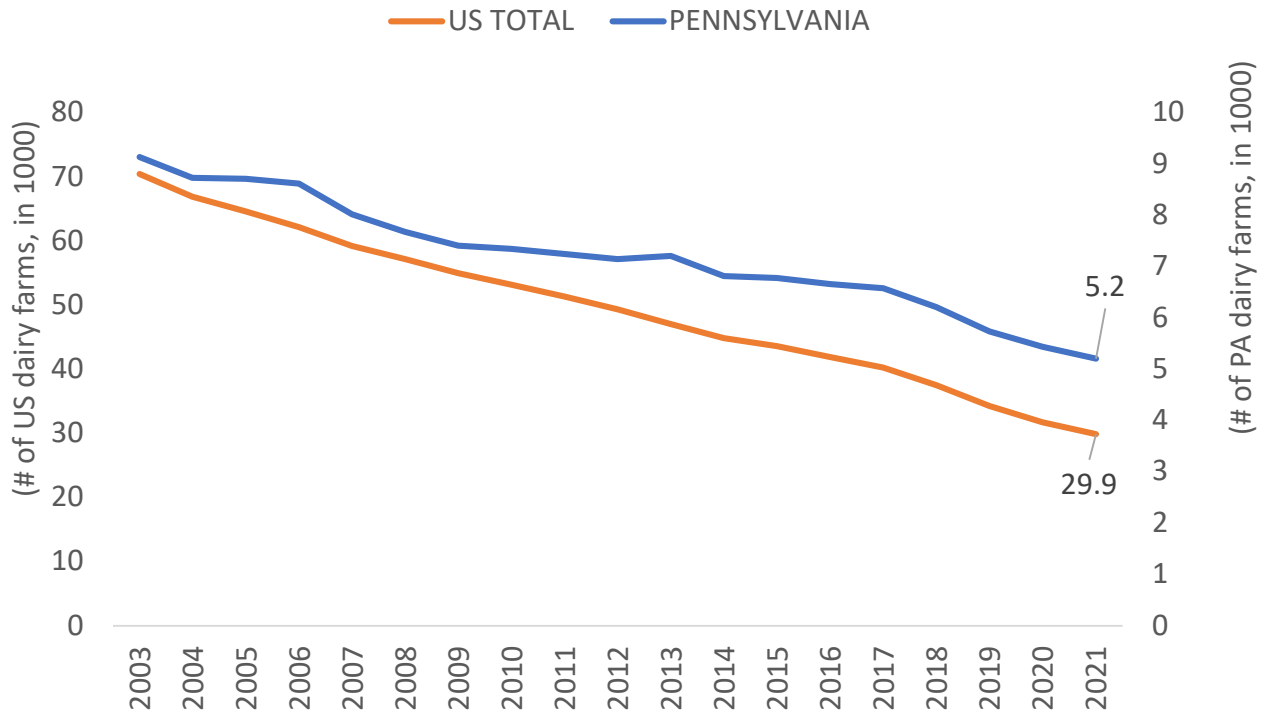
Speaking Engagements:

U.S. Dairy Export Council – South Korea Conference	Nov. 2017
Central Plains Dairy Expo Women's Conference	Nov. 2017
ADPI/CME Risk Management Seminar – Dairy Risk Management	Dec. 2017
International Sweetener Colloquium	Jan. 2018
Ag Choice – Farm Credit: Economic Update	Mar. 2018
U.S. Dairy Export Council – Reverse Trade Mission	May 2018
ADPI – Deep Dive on Price Discovery	Sep. 2018
ADPI – Risk Seminar	Nov. 2018
Idaho Dairymen's Annual Meeting	Nov. 2018
Compeer – DBA Webinar	Feb. 2019
Fusion Conference	Feb. 2019
US Dairy Export Council – Annual Meeting	Nov. 2019
ADPI Webinar	May 2019
Fusion Conference	Feb. 2020
StoneX Conference	Feb. 2020
ADPI Annual Meeting- Risk Management Panel	May 2020
ADPI Annual Meeting – Market Outlook Panel	Aug. 2021
ADPI 360 Degree – Risk Management and Logistics	Sep. 2021
ADPI Annual Meeting- Risk Management Panel	Sep. 2021

Recent Projects:

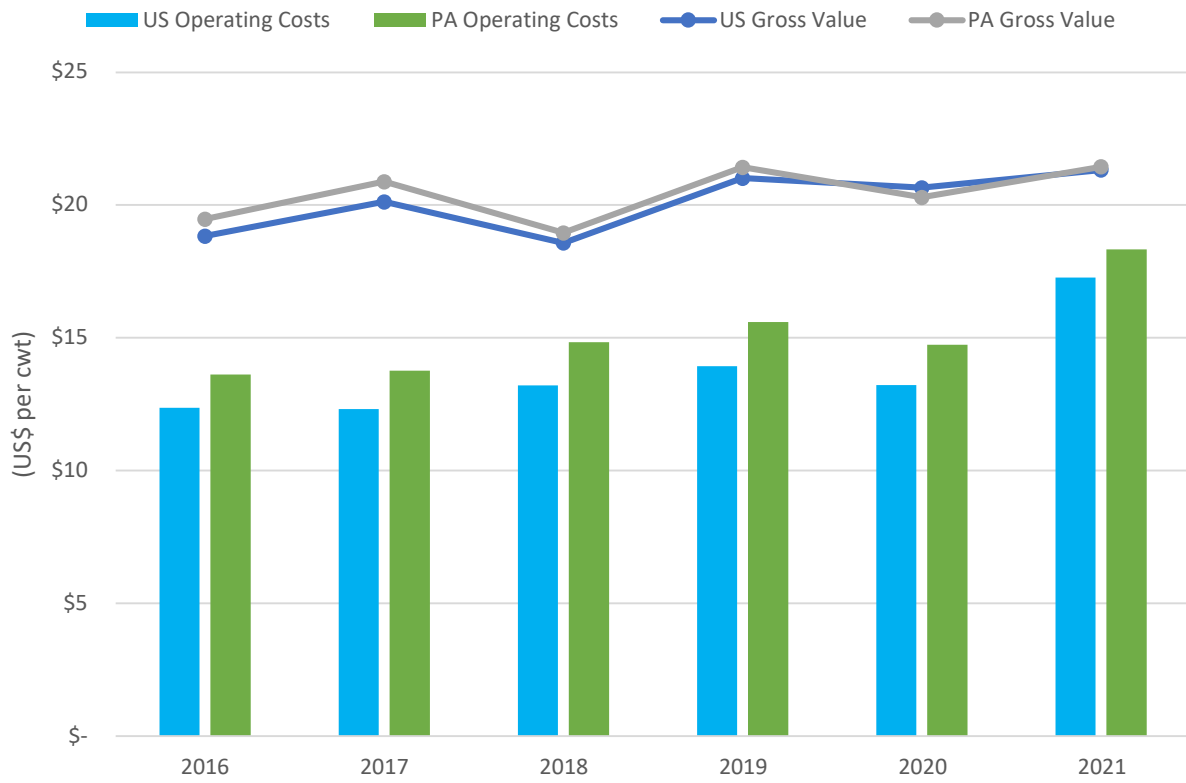
- Developed business case for milk plants in the United States
 - Includes review of location based on milk shed, environmental, competitive, and cost analysis
 - Location (2) the Central States, (1) Western States
 - Developed financial modeling for plant
 - Detailed business case and competitive analysis
 - Including a review of the cost of milk throughout the United States (regulated & unregulated markets) and impact on plant location
 - Environmental impact of dairy/processing expansion
 - Detailed review of competitors and customers
 - Market analysis
- Developed business cases for milk powder plants in the United States
 - Includes review of location based on milk shed, environmental, competitive and cost analysis
 - Developed financial modeling for the plant in (2) Western States and (3) Central States
 - Detailed business case and competitive analysis
 - Including a review of cost of milk throughout the United States (regulated & unregulated markets) and impact on plant location
 - Environmental impact of dairy/processing expansion
 - Detailed review of competitors and customers
 - Market analysis
- Developed business case for consumer products butter lines and other butterfat products
 - Locations (3) Western States and (1) Central States
 - Includes review of the location, sourcing, and costs analysis
 - Developed financial modeling for the facilities
 - Detailed business case and competitive analysis
- Developed business case for UHT production facility
 - Location (2) Western States
 - Includes review of the location, sourcing, and costs analysis
 - Developed financial modeling for plant
 - Detailed business case and competitive analysis for domestic and global market
- Conducted milk shed review to determine future growth potential
 - Location – (1) Idaho and (1) Indiana
 - Work included a detailed analysis of existing milk supply and factors that could promote or inhibit growth.
 - Provided the client with reported detailing environmental considerations, surrounding crops and financial health of dairy producers in the market.
 - Provided the client with a market assessment of potential products and markets.
- System implementation
 - Review of the current Enterprise Resource Planning (ERP) systems with recommendation for implementing standard costing system vs. actual costing for a dairy manufacturing company
- Dodd-Frank regulatory review and analysis for impact on dairy risk management activities
 - Includes review detailed review of law and impact to dairy risk management programs
- Review of Canadian supply management plan and potential impact of trade pacts on the system
- Review and analysis of federal and state milk marketing orders and implications for processors and how/where they market dairy products and their costs.
 - Included review and analysis of cost mitigation steps.
 - Review of order-order premium structure and impact on the project.
 - Verification of assumptions with respective federal milk marketing administrator.

DORLAND REBUTTAL EXHIBIT 2: US AND PENNSYLVANIA DAIRY FARMS (2003 TO 2021)



SOURCE: NASS INVENTORY AVG, OPERATIONS WITH INVENTORY, AVG

DORLAND REBUTTAL EXHIBIT 3: ERS RECENT MILK COST OF PRODUCTION ESTIMATES, GROSS VALUE OF PRODUCTION AND OPERATING COSTS – US AND PA (2016 TO 2021)

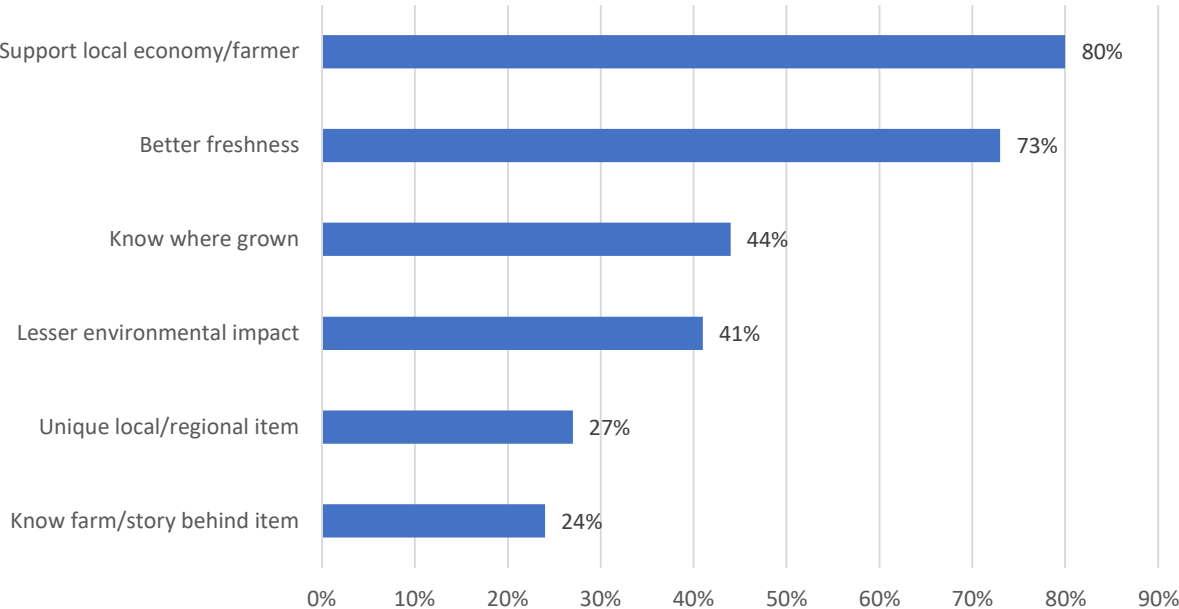


SOURCE: 2016 AGRICULTURAL RESOURCE MANAGEMENT SURVEY (ARMS) DATA

DORLAND REBUTTAL EXHIBIT 4 EXCERPTS AMS RETAIL MILK PRICE REPORT (2021)

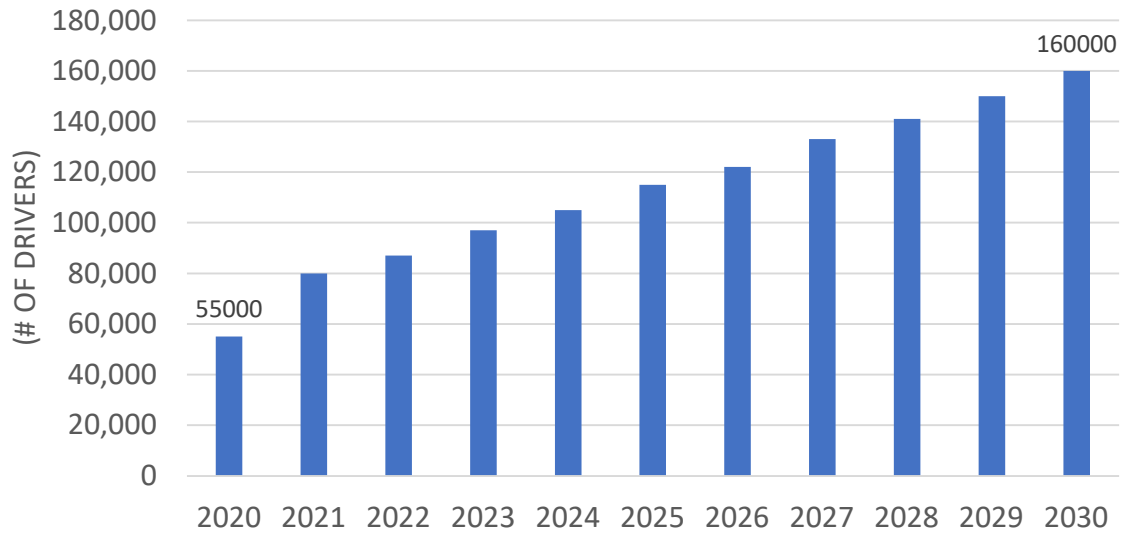
2021 Average	Philadelphia, PA	Pittsburgh, PA	Kansas City, MO	Wichita, KS	Max	Simple Avg
Whole Milk	\$ 4.91	\$ 4.36	\$ 4.85	\$ 2.65	\$ 4.91	\$ 3.66
2% Milk	\$ 4.77	\$ 4.22	\$ 4.67	\$ 2.65	\$ 4.77	\$ 3.62

DORLAND REBUTTAL EXHIBIT 5: CONSUMERS' REASONS FOR PURCHASING LOCALLY GROWN PRODUCE IN THE UNITED STATES IN 2017



SOURCE: FMI, 2017

DORLAND REBUTTAL EXHIBIT 6: US DRIVER SHORTAGE FORECAST



SOURCE: AMERICAN TRUCKING ASSOCIATION, DRIVER SHORTAGE UPDATE 2021