

**CONTAINS CONFIDENTIAL – ATTORNEY EYES ONLY MATERIAL  
REDACTED PURSUANT TO PROTECTIVE ORDER DATED AUGUST 10, 2018**

**Pennsylvania Milk Marketing Board**

**November 5, 2018**

**Testimony by Rob Blaufuss**

**On behalf of Dean Foods in Opposition to the Proposal on the  
Cooperative Procurement Cost**

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My name is Rob Blaufuss and I am currently employed by Dean Foods as the Director of Dairy Procurement and Risk Management. My business address is located at 2711 North Haskell Ave, Dallas, Texas, 75204. Dean Foods owns and operates four distributing plants located in the Commonwealth of Pennsylvania.

Given the changes to the Pennsylvania Milk Marketing Board, I'd like to provide a quick overview of my background. I was raised on a grain and hog farm in west central Minnesota that my family still operates. I received my Bachelor of Science in Agricultural Economics with a minor in Political Science from North Dakota State University. I then went on to receive my Master of Science degree at the University of Illinois. While at University of Illinois I was a research assistant for Dr. Robert Thompson and for three semesters helped teach a course which focused on domestic and international food production and consumption.

Prior to joining Dean Foods, I worked at the International Dairy Foods Association as an economic analyst. My primary duties at IDFA included performing economic research and analysis in order to assist strategy and policy decisions as well as monitoring trends in domestic and international dairy demand. Since my starting at Dean Foods in March 2011, I have held various roles. While at Dean my duties have included dairy commodity price forecasting, dairy risk management, dairy policy analysis, milk price regulations and other analytical projects. In my current role I am responsible for procuring milk and dry dairy ingredients for various Dean plants as well as dairy risk management and dairy economics.

I am here today in opposition to the Pennsylvania Association of Dairy Cooperatives (PADC) proposal to create a Cooperative-only procurement charge. Given the steps in recent years to increase the competitiveness for Class I raw milk in the Commonwealth of Pennsylvania, adding a Cooperative-only procurement charge above and beyond the current regulated minimum premium level would represent a step in the wrong direction. While I have sympathy for Cooperatives marketing milk in the Commonwealth of Pennsylvania today, and the Northeast as whole, attaching a nearly \$0.29/cwt increase to the PMMB Class I raw milk price would decrease the competitiveness of those bottlers that produce,

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process and sell PA milk. There is also the potential that handlers could decide to adjust their current milk procurement sourcing to maintain their competitiveness for packaged milk sales

**Reduced Competitiveness for Class I Handlers Who Produce, Process and Sell PA Milk**

In recent years the PMMB has taken the tough steps to bring the Pennsylvania Class I minimum over-order premium into better alignment with prevailing premiums surrounding PA. Testimony in the October 2017 Over-Order hearing from both my former colleague at Dean Foods, Evan Kinser, and PADC painted a poignant picture of the current competitive market for raw milk in and around the Commonwealth. (PAMD Ex. No. D9, *Testimony of Evan Kinser*); (*PADC Testimony, Over Order Premium Hearing, Dec. 6, 2017, <[https://www.mmb.pa.gov/Public Hearings/Dec2017/Documents/PADC\\_testimony.pdf](https://www.mmb.pa.gov/Public Hearings/Dec2017/Documents/PADC_testimony.pdf)>*). The milk marketing dynamics discussed at that PMMB over-order hearing have not significantly changed.

Though Mr. Cooper attempts to down-play the level of increase that PADC is asking the board to consider when he states, “while the cost to the Pennsylvania consumer to eliminate this discriminatory treatment among Pennsylvania farms would average less than \$0.02 per gallon,” it is not an insignificant ask. In fact, using their cost level of \$0.2894/cwt would equate to nearly \$0.0250 per gallon, not less than \$0.02 per gallon<sup>1</sup>. Given the hyper-competitive nature of the fluid milk industry today where sales are won and lost over fractions of a penny, this per-gallon increase in the PA Class I raw milk cost could lead to lost business to handlers who produce, process and sell Pennsylvania milk. Two of the PADC hearing proponents, Dairy Farmers of America and Maryland & Virginia Milk Producers, own and operate Class I plants in areas surrounding the Commonwealth and should be well aware of this fact. Additionally, they would not only benefit directly from the cooperative only premium on their sales of fluid milk to Pennsylvania fluid milk processors, but would also achieve a competitive advantage over handlers who produce, process and sell Pennsylvania milk.

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<sup>1</sup> A Gallon of 2% milk weighs 8.62 pounds.  $(100/8.62) = 11.6$  gallons per cwt  
 $(\$0.2894/11.6) = \$0.0249/\text{gallon}$

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The current competitive landscape for Class I sales simply will not allow for a \$0.2894/cwt Cooperative-only increase in the price of milk produced, processed and sold in Pennsylvania absent changes in the current regulated minimum over-order premium level. The PADC is again discussing additional regulated premium costs in piecemeal fashion without discussing the impact of the total cost buildup of the combined over-order premium, fuel adjuster and the cooperative-only procurement charge. These cost buckets however do not happen in a vacuum. Ultimately the end customer is merely concerned with the total cost they would be required to pay for finished fluid milk products that are produced, processed and sold and how that total cost build-up compares to buying product from a processor that does not carry the mandated PA costs. Premiums, including premiums for cooperative services, in areas surrounding Pennsylvania will continue be driven by competitive supply and demand conditions in the marketplace. As it is today, the over-order premium will be the primary mechanism used to ensure PMMB prices are in-line with prevailing prices in the areas surrounding the Commonwealth. Should the Board make the decision to add the Cooperative-only procurement charge to the cost-buildup there is the very real risk that should current market conditions hold, the total over-order premium level would need to be adjusted to keep PA processors competitive. Why should the PMMB choose to lock-in revenue for the Dairy Cooperatives over independent milk producers?

**Long-Standing Relationship between Fluid Processors and Independent Producers**

Unlike most areas of the country, there is a significant amount of independent milk in Pennsylvania today. These independent producers have held long-term relationships with their various milk buyers. A fluid handler that procures milk from independent producers faces a different set of requirements with regards to minimum producer payment obligations than does a dairy cooperative. Milk handlers who procure milk directly from milk producers in Pennsylvania (and around the U.S.) cannot pay below the regulated minimum price nor can they re-blend losses back onto their milk shippers. Cooperatives however are under no obligation to pay minimum prices to their members and can re-blend any losses experienced by the Coop back to their members. I mention this key difference as it helps explain why it is important for milk dealers to recover the cost of procuring their independent milk

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supply. If Class I bottlers in Pennsylvania were unable to include the costs of procuring milk from their long-standing independent milk supplies, the Board would potentially be asking the fluid processor to sell milk in the Commonwealth at an unsustainable loss given the regulated price structure. Cooperatives however do not face the same restriction and may reduce the amount paid to cooperative members if the market requires such action – in exchange, those members also share in the upside of being a cooperative member. Though cooperative members must fund the operation through dues and re-blending, they receive returns on this investment including the opportunity to share in the profits of the cooperative enterprise, which reaches beyond the raw milk marketing arm to manufacturing, supplies, insurance, and which includes benefits on the raw milk side including a guaranteed market for their milk and the increased likelihood that their milk will receive the FMMO blend price even if it is not shipped to a Class I plant. I therefore ask the Board to recognize that although the cooperative farmer may receive a smaller portion of Pennsylvania’s mandated over-order premium, that cannot be viewed in isolation. Viewing issues in isolation can lead to a patchwork of decisions that ultimately fail to reflect reality.

**[BEGIN ATTORNEY EYES ONLY MATERIAL SUBJECT TO PROTECTIVE ORDER]**

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[REDACTED] **[END ATTORNEY  
EYES ONLY MATERIAL SUBJECT TO PROTECTIVE ORDER]**

The Pennsylvania Dairy Cooperatives have ultimately made the decision to market milk in the Commonwealth of Pennsylvania. They chose to act as the intermediary between milk producers and milk processors in Pennsylvania. In return for this service, they gain access to the Class I market in the area and the mandated minimum over-order premium and fuel adjuster that are, for the most part, higher than prevailing over-order premiums being paid in areas surrounding the Commonwealth. Importantly, they also gain access to pooling under Federal Milk Marketing Orders, which provides substantial benefits in terms of higher prices on cooperative milk that is used in manufacturing. Contrary to the implication in Mr. Cooper’s testimony, the cooperatives are not helpless and have not been forced to supply the fluid market in Pennsylvania. They have fought hard to win the milk supply contracts they have in the Commonwealth and they have chosen to win the business. Currently the market is in a surplus situation with handlers primarily concerned with finding homes for milk. **[BEGIN ATTORNEY EYES ONLY MATERIAL SUBJECT TO PROTECTIVE ORDER]** [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED] **[END  
ATTORNEY EYES ONLY MATERIAL SUBJECT TO PROTECTIVE ORDER]**

Neither we, nor the cooperatives, are locked in competition to attract more farmers. If this cooperative-only premium is adopted, it will give the cooperatives more money to work with to use when, inevitably, the competition for milk producers returns.

**Cooperatives and Proprietary Handlers Have Different Cost Structures**

Proprietary processors and dairy cooperatives are, from a cost perspective, two different animals. The inherent structural differences between proprietary processors and dairy cooperatives can create

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noticeable differences in cost structures. While the main goal of both firms is to return a profit to their respective owners, Cooperatives are also faced with the goal of ensuring a home for all their members' milk. This difference in focus for proprietary processors and cooperatives can lead to disparate costs. One cannot simply assume that proprietary processors and dairy cooperatives cost structures are one-in-the-same. For example, dairy producers who are members of a Cooperative are ultimately responsible for funding the day-to-day operations of the Coop through their dues requirement and re-blending. A portion of the producer's total annual dues is eligible to be written down.

**Implementation**

Finally, I am concerned that PADC is asking the Board to impose a regulated premium on plants with cooperative milk without providing for full recovery of that mandate. **[BEGIN ATTORNEY EYES ONLY MATERIAL SUBJECT TO PROTECTIVE ORDER]** [REDACTED]

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**Summary**

I realize that PADC is asking for this Cooperative-only premium, but I am not entirely sure that they have taken the long view and I respectfully suggest the Board should do so. The request by PADC would represent a reversal of the hard-fought decisions undertaken in recent years to bring the PMMB mandated over-order premium levels into a more competitive alignment with areas surrounding the Commonwealth. There is a very real risk absent changes in the current milk supply and demand conditions in the Commonwealth that the Board will be asked to lower the Over-Order Premium as an offset, to the detriment of independent producers

Dean Foods asks the Pennsylvania Milk Market Board to reject the proposal before it today to include a Cooperative-only procurement charge to the Pennsylvania Class I cost of raw milk. The current

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competitive landscape simply does not allow for the PMMB to simply add \$0.2894/cwt to the Class I cost build-up absent an across the board change in the regulated minimum Class I over-order premium.

Thank you for allowing me to testify before the Board today.