BEFORE THE PENNSYLVANIA MILK MARKETING BOARD

Cooperative Procurement Costs Hearing

ALL MILK MARKETING AREAS

October 9, 2018

Testimony of Troye Cooper

Presented on behalf of the Pennsylvania Association of Dairy Cooperatives:

Dairy Farmers of America, Inc., Dairy Marketing Services, LLC,

Lanco Dairy Farms Co-op, Inc., Land O'Lakes, Inc., and

Maryland & Virginia Milk Producers' Cooperative Association, Inc.

Good morning, my name is Troye Cooper. My business address is 1985 Isaac Newton Square, West, Reston, VA 20190. I am currently the Director of Operations, Milk Marketing and Member Services for Maryland and Virginia Milk Producers Cooperative Association, Inc. My resume, PADC Exh.9, summarizes my professional education and experience.

In addition to my current employment with Maryland and Virginia, I also serve as the Vice-Chairman of the Pennsylvania Association of Dairy Cooperatives (PADC). Members of the PADC include Maryland & Virginia Milk Producers' Cooperative Association, Inc., Lanco Dairy Farms Co-op, Inc., Dairy Farmers of America, Inc., Dairy Marketing Services, LLC, and Land O'Lakes, Inc.

Thank you for the opportunity to testify today on behalf of the PADC and specifically, on behalf of approximately three thousand five hundred (3,500) producers in Pennsylvania who market their milk through PADC members.

Pennsylvania cooperative farms and independent farms in 2016 supplied an almost equal volume of milk – more than 1.5 billion pounds -- to Pennsylvania cross-section dealers. (PADC Exh. 8) Under PMMB regulations, the same over-order premium was applicable to all these producers and their production. However, the Board's current regulations treat the cooperative farms and the independent farms quite differently with respect to the costs of assembling and supplying their milk from the farm to the plant for Pennsylvania consumers' Class I use. For independent producers these costs are borne by the dealer which in turn passes them on to its customers (minimum wholesale prices) and ultimately to the Pennsylvania consumer (minimum retail prices). For cooperative producers, these costs are borne by the cooperative however, the member owners of the cooperative must absorb all of the same costs of assembling and supplying milk to Class I dealers without those costs being reimbursed and passed through to the ultimate consumer.

Timeline

I will provide a little background on why we are here today and how we got here. Going back as far as the Summer of 2013, the then, Greater Northeast Milk Marketing Agency (GNEMMA), which was the predecessor organization of today's PADC, filed a petition to the Pennsylvania Milk Marketing Board ("Board") to consider terminating the Over-Price Premium, and to also consider building the cost of procuring, assembling and supplying cooperative milk to Pennsylvania Class I dealers into the price of all Pennsylvania Class I sales. There were several components to that hearing and eventually on the 4^{th} of November 2015, the Board issued Official General Order No. A-992 (OGO A-992PADC Exh. 3) In addition, OGO-925 remained in effect allowing the Over-Price Premium to continue.

Importantly, the Findings of Fact contained within OGO A-992, addressed the concerns that were raised by the cooperatives during that hearing. Specifically, Finding of Fact #10 states (in part) that "… The Board finds, based on the totality of the evidence presented that cooperatives provide certain services to their member dairy farmers that are essentially the same as services provided by milk dealers to their independent producers. The Board also finds, based on the totality of the evidence presented that cooperatives incur costs when providing those services." In addition, Finding of Fact #13 states that "The Board finds it appropriate to develop a framework, set of regulations, and reporting mechanism for cooperatives similar to that in place for milk dealers that will allow us to accurately determine relevant cooperative costs. When we can begin to collect such accurate and uniformly generated data, the Board can decide if and how to recognize cooperative costs."

This prompted the promulgation of 7 Pa. Code § 149.46 "Cooperative Cost Centers" being added to the Board's regulations which carry out its responsibilities under the Pennsylvania Milk Marketing Law. After the appropriate regulatory review process, Section 149.46 was finally adopted on March 9, 2018 and became effective on March 10, 2018. The process has required significant investment of cooperatives' staff time and significant financial commitment from our member dairy farmers to get where we are today. We believe this has been a very worthwhile effort. While the efforts to remedy this gross inequity in the PMMB system have brought us a long way, we aren't quite to the finish line just yet. These efforts can conclude with a decision by this Board to not only recognize that these substantive, quantified, reported and audited costs exist but also allow for cooperative member dairy farmers to recover these costs which are necessary to adequately service the Class I milk dealers of Pennsylvania. This record will show that the unreimbursed costs to the Pennsylvania cooperative farms are $.2894 per cwt, while the cost to the Pennsylvania consumer to eliminate this discriminatory treatment among Pennsylvania farms would average less than $.02 per gallon.

During the course of nearly three years since the issuance of OGO A-992, PADC member cooperatives, along with RKL, LLP, CPAs, have worked closely with PMMB staff to appropriately collect, quantify and organize an accurate set of uniformly generated data that is consistent with § 149.46 Cooperative Cost Centers. Our work also included the annual filing of the PMMB 60c report for the years of 2015 and 2016 and the audit of those filings by the PMMB staff.

Cost Centers

I would like to now review the costs centers that have been established and please allow me to provide a little more detail of the essential functions that are included in each Cost Center.

(1) **Field Services** – Field Representatives for both independent dealers and cooperatives are a necessity to maintain an adequate, wholesome, high quality supply of milk to Pennsylvania dealers. First and foremost, in Pennsylvania, Field Reps are the licensed inspectors that are designated by the Pennsylvania Department of Agriculture to insure each farm meets the minimum Grade A standards of the Pasteurized Milk Ordinance (PMO). In addition, they help producers identify potential quality concerns and will troubleshoot farm production systems, equipment and practices when lab results are out of spec. They also are involved in helping producers understand the requirements of the marketplace which are most often above and beyond the minimum Grade A requirements. This includes things like verifying a farm to be certified as rBST free. Administration of standardized animal care programs like the National Milk Producers' Federation (NMPF) Farmers Assuring Responsible Management (FARM) program. Other marketplace requirements might include assurance of environmentally responsible and sustainable farming practices. Also, because of the general complexity of milk pricing, these Field Reps often need to spend time with producers to help them understand how their pay price is determined. These are the core functions of a Field Representative, but as you can imagine, the list of other things they do is fairly extensive.

(2) **Laboratory** – For every milk pick-up at every farm, whether from an independent patron or cooperative member, a sample must be taken by a State Certified Weigher/Sampler which then must often accompany the load of milk to the dealer where it delivers. The receiving plant will also take a representative sample of the trailer load for screening before receiving. If the results of the load sample meet the dealer's acceptance criteria the load will be unloaded. But the laboratory testing doesn't end there. The producer sample will then be taken to a laboratory for further testing. Those laboratory tests almost always include milk component testing, somatic cell count (SCC) testing, and often include bacteriological testing such as standard plate count (SPC), preliminary incubation Count (PIC), milk urea nitrogen (MUN) testing and cryoscopic (Freeze Point) testing. Some of these tests are required in order to simply meet regulatory Grade A requirements. Many of these tests are required to be performed at the request of our customers. While others are to help provide the producer and field rep information about the overall health of the animals and the effectiveness of the on-farm cleaning systems. Sometimes even further laboratory testing, such as culturing may be required to help isolate problems that are found by initial screening. The bottom line is that the marketplace demands high quality milk from healthy animals and producers need to have all the information they can get to ensure they meet or exceed the expectation of our dealer customers.

(3) **Producer Payroll** – All payments to producers, whether independent patrons or cooperative members start with the Federal Order price. Most Pennsylvania plants are

primarily located in and/or are regulated by either Federal Order 1 or Federal Order 33. Both of those Orders are priced based on components. Each transaction between the producer and the handler starts at the point of farm pick-up. In addition to pulling an official sample, the State Certified Weigher/Sampler must also fill out a manifest at each producer pick-up to record the amount of milk being picked up from that farm. That manifest must also include the name of the dealer where the milk is delivered so information between the producer and the dealer can be reconciled. Of course, both parties need to match the components shipped by each farm (see Laboratory above) with the components delivered to each dealer. That information then needs to get to Producer Payroll in order to know who the payment obligation is due from and who the payment obligation is due to. Once the value of the components and Producer Price Differential (PPD) is determined and announced by the Federal Orders, the producer payroll payment issuance process can begin. Because payment dates are determined and regulated by the Federal Orders, dealers must be prepared to turn those payments to producers around in a fairly short window of time. This is the core function of producer payroll, but again, the list can get fairly extensive when you begin to consider the additional accounting for location adjustment based on where the milk delivers, quality incentive programs, other programs and milk hauling payments/deductions to name a few.

(4) **<u>Sales Invoicing</u>** – As stated above, when milk is delivered to a dealer, a payment obligation is created. Whether an independent patron or cooperative member, the pounds and components from the producer and pounds and components delivered to the dealer still need to be reconciled to determine the amount of obligation to each party. And whether an invoice is created or just an obligation is created, a charge gets generated nonetheless. Also, certain required market administrator and some state reports need to be completed and filed each month as well. The cost replacement hearing records (PADC Exh. 4) for 2016 show that the cross-section dealers diverted and transferred, i.e. sold to other dealers, as much as 1 billion pounds of bulk milk all of which would be invoiced to the purchasing party, with the dealers' costs of documenting those transactions rolled into their overall costs. I would also suggest that when dealers purchase milk from independent producers the transaction requires them to in essence invoice themselves for the milk. While the independent producer doesn't submit an invoice per se to the dealer, the dealer must determine the price they are going to pay, determine the obligation to each producer and pay that 'invoice' to the producer. When the dealer buys from a cooperative, the cooperative does this work for them.

(5) **<u>Dispatch, logistics and hauling</u>** – This is another function of complexity when it comes to managing raw milk from farms to dealers. And again, a function that exists whether procuring milk from an independent patron or a cooperative member. It takes knowledge, time and skill for someone to figure out how to minimize costs of milk

transportation. This requires knowing where pick-up routes finish loading, what time they finish loading, and identifying the closest plant that needs a load at that time, all the while figuring out how to maximize legal payload capacity. And as we have testified in the past, dealers that have an independent farm supply also purchase milk from cooperatives to balance out the plant's daily milk requirements. While the independent patron's milk is typically delivered to the same plant every day, dealers call on the cooperatives to be the 'shock absorber'. Some days, these dealers don't require any milk from the cooperative while on other days they may require as many as five or ten loads. In order to appropriately and adequately service the needs of these dealers, a certain volume of cooperative milk supply must be maintained to meet their peak requirements. Orders, and consequently dispatch plans, are continuously changing nearly 24 hours a day / 7 days a week to properly service class I milk plants

(6) **Calibration Services** – New bulk tanks installed on farms are generally delivered with a calibration chart that is set at the factory assuming that the bulk tank will be installed level. Professional installers do the best they can to install bulk tanks to be level, but tank calibrations should still be verified after installation. Also, over time, the earth moves and milkhouse floors may settle or buckle so bulk tank calibrations need to be re-done after a certain period of time. Because many measuring sticks or tubes are calibrated to the nearest centimeter or 1/32nd of an inch, the slightest variation in slope of the tank can significantly affect the accuracy of the calibration chart. And on-farm bulk tanks are generally bigger than they were years ago, simply by the inherent nature of farm sizes increasing. And as you can imagine, in the center of the bulk tank where it is the widest, being one centimeter or 1/32nd of an inch off can mean a lot of milk volume over time being "gained or lost" by the producer. Keeping up with bulk tank calibrations is a must, even required by some contracts and so a cost that must be incurred.

(7) **Producer Relations** – Developing and maintaining positive relationships is another function that is essential to both independent dealer patrons and cooperative members. As a person who has been both a buyer and a supplier of raw milk from dairy farms, I know first-hand the value of keeping good relations with farmers that produce the milk. This might include something as much as inviting patron farms to a "family-day" at a local amusement park for the day, or handing out 'free' tickets to sporting events or as little as taking a thermos of coffee and a box of donuts to a member farm that recently experienced a hardship such as the loss of a family member. Today's marketplace demands that dairy farmers have a good understanding what customers and consumers are expecting today. And having a positive relationship with the producer goes a long way in getting farmers to understand and comply with the ever increasing expectations of the marketplace.

(8) **Customer Relations** – Again, whether an independent dealer or a cooperative, entities that source milk from dairy farmers always need to have good contacts within the industry. Those contacts may not be raw milk customers today, but they may be raw milk customers tomorrow. Yes, cooperatives sell bulk milk. After all, that is the core function of a cooperative. And dealers who source milk from independent patrons also sell bulk milk. A dealer never knows when they might need to call someone else to either help process and/or package milk on their behalf because of a plant breakdown or shutdown or purchase some un-needed milk that they have because their supply of raw milk is out of balance with their immediate needs. Let me reiterate to this Board that Pennsylvania cross-section dealers across the Commonwealth reported that they diverted or transferred as much as 1 billion pounds of milk in 2016. Additionally, marketplace and customer requirements continue to become increasingly more difficult. It is common for cooperatives to have to respond to requests from dealers about member farms that are supplying their plant. Things like: What is the average mileage of the farms supplying the plant? How many member farms are in each township or county surrounding the plant? Are there any non-electric or Amish farms supplying the plant? What is the average quality of member farms supplying the plant? How many dollars in quality premiums does the cooperative payout to farms supplying the plant? What are the working conditions like on the farms supplying the plant? In order to help facilitate a better understanding of these things, it is not uncommon for cooperatives to arrange tours of multiple farms that supply that plant. These tours might include employees of the plant, customers of the plant, and sometimes even film crews. It is becoming more important than ever for farmers to provide full transparency to customers and this next generation of consumers to maintain or gain their confidence to continue to purchase real milk.

(9) **General and Administrative** – All businesses, dairy or not, whether for profit or not, incur General and Administrative (G&A) overhead expenses. Even this Milk Marketing Board incurs G&A costs. These costs include costs associated with human resources functions (employee payroll, employee benefits, employee training, employee hiring and firing); information technology functions (systems and systems support); corporate functions (investor); and executive expenses (senior management); and professional expenses (legal, consulting).

You may hear the objection that dealers do not have costs for "producer relations" or "customer relations" or "sales invoicing" and therefore those costs, and maybe others, should not be included in a cooperative procurement charge. This objection is not well-founded. Let me explain.

If Pennsylvania Class I milk dealers took full responsibility for acquiring the milk they need for their operations directly from dairy farmers, we would not be here. Because they choose to only purchase about 50% of their needed supply directly from producers, the remainder of the milk supply needed for Pennsylvania consumers must come from Pennsylvania dairy producer cooperatives. Cooperative members must fill the gap and dealers count on them to provide the needed supplies. Consequently, **all** the necessary aspects of a cooperative supply are absolutely indispensable to the milk procurement enterprise: the milk will not be supplied without the cooperative's functions as enumerated in the cost centers described above. Specifically:

- Without a cooperative servicing its members – "producer relations" – there will be no cooperative and no milk supplied by a cooperative.
- Without the cooperative supplier servicing its customer's needs – "customer relations" – the customer will not be serviced and the required milk will not be supplied.
- Without the sales to the customer being reported and invoiced – "sales invoicing" – there will be no sales transaction and the required milk will not be supplied.

All of the cooperative cost centers are proper and absolutely essential to assembling, dispatching and delivering the needed milk to Class I dealers and are indisputable.

<u>Regulated vs. Voluntary</u>

The argument has been made that no regulated cooperative procurement charge should be adopted because cooperatives can and do charge and recover those costs to their dealer customers as over-order service charges. This argument must be rejected for two clear reasons: First, voluntary, negotiated charges -- which are subject to all the supply-demand and other influences of the competitive marketplace -- can never be a sufficient replacement for regulated, required payments which would be equivalent to dealer cost recovery. Secondly, the PMMB over-price premium data clearly show that cooperatives do **not** recover their procurement costs in over-order charges. As the PMMB August 2018 price sheet shows (PADC Exh.5) the over-price premium is $.11 or less in 3 of the 6 areas and, ironically, highest in Areas 5 and 6 where the cooperative supply is less than 10%. Clearly, cooperatives are not able to recover their costs of milk procurement from voluntary, negotiated over-order charges.

Incorporating Cooperative Costs Into Minimum Prices

Now that we have established that these are real costs that are incurred by dairy-farmer-owned cooperatives and are certainly similar to those costs that independent dealers incur when procuring milk directly from independent patron farms, we need to establish how these costs of procurement for cooperative milk could be reflected in the wholesale and retail prices of milk produced, processed, and sold in Pennsylvania.

On this point I want to say first that as cooperatives, we see the manner of the incorporation of the costs of procurement for cooperative milk to be a technical issue primarily within the province of the Board itself, with the advice of its staff, and subject to comment and input by the milk dealers. For the past five years, our position has been and remains that these costs for cooperative dairy farmers should be reflected in the PMMB system to the same extent and with the same annual updating as are the costs related to the dealers procurement of milk from Pennsylvania farms of non-cooperative members. So long as the system treats the costs the same, the precise methodology is relatively speaking a matter of indifference to us. That said, I will just offer a few thoughts for the Board's consideration:

(1) **Statewide v. Area-by-Area implementation**. As information provided by the Board staff show (PADC Exh. 8), there is a variation among PMMB areas in the relative percentages of purchases by dealers from cooperatives versus independents. Therefore, it would appear reasonable and equitable to pass-through the cost of milk procurement on an area by area basis.

(2) **Annual review and update**. To be consistent, the cost should be built into the minimum wholesale and retail price mark-ups on an annual basis and updated annually in the same manner as all other dealer costs, including dealer milk procurement costs.

(3) **Blending by area purchase percentage**. One way that the cost could be built into the cost build up sequences would be to calculate it for each Area on the basis of cross-section dealer purchase percentages from the prior year; and then add that amount to the milk cost before packaging total, just as the over-order premium is now added. See Exh. 4.1.A at Staff Exh.6 So, if an Area cross-section had 50% of its milk from cooperatives, that procurement cost would be blended into the cost-replacement, like all other dealer costs and added to the milk cost schedule. If the procurement cost on cooperative milk were $.29, 50% of $.29 per cwt would be $.145 per cwt for that Area. A 10% cooperative Area would then include $.029 per cwt and a 100% cooperative Area would include $.29 per cwt on its cost of milk before packaging.

(4) **Blending directly into Dealer costs**. Alternatively, each dealer buying cooperative milk might incorporate that cost into its 'receiving, lab, and fieldwork' cost categories, or some other logical cost category, and the cost would then be blended throughout the cross-section like any other costs. There could be dilution issues with this method; but, perhaps, they could be addressed in a satisfactory manner.

(5) **Consumer impact**. Fundamentally, the costs of procuring milk from cooperative farms should be reflected to the Pennsylvania consumer to the same extent as dealer costs now reflected. We fully believe that Pennsylvania consumers would and do want it that way. Undoubtedly, if asked, they would wonder why they would pay costs of milk from some farmers and not others. The precise means of building this uniformity and equality into the PMMB system we are confident can be ascertained by the Board and interested parties.

Summary

It is fundamentally unfair and inequitable for the milk procurement costs which cooperatives incur to be treated differently in the PMMB system than the milk procurement costs incurred by dealers with independent patron farms. The costs of maintaining a milk supply by dairy farmer cooperatives in order to meet the milk requirements of Pennsylvania fluid milk dealers should be recovered in a like manner as dealers with an independent patron milk supply recover their costs. And consumers should pay for milk from cooperative member farms on the same basis as they do for milk from independent patron farms. If this Board chooses not to treat these costs fairly and equitably, we hope that this Board would consider thoroughly re-evaluating what costs (in totality) are currently allowed to be recovered by all dealers.

On behalf of the approximately three thousand five hundred (3,500) Pennsylvania dairy farmers PADC represents, I want to thank the Board for the opportunity to present this important information to you today.