

Written Comments Submitted By:

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## **I. INTRODUCTION**

I am Marvin Beshore, a private attorney in Harrisburg and counsel to the Greater Northeast Milk Marketing Agency (GNEMMA), a common marketing agency of cooperatives which market milk of their dairy farmer members in Pennsylvania, as well as other northeastern states. I appreciate the opportunity to appear today to discuss the GNEMMA cooperatives' perspective on "stranded premiums" in the Pennsylvania Milk Marketing Board regulatory system. But first I'd like to provide just a bit of background on the GNEMMA cooperatives and their role in milk marketing in Pennsylvania.

## **II. DESCRIPTION OF GNEMMA**

The GNEMMA cooperatives with dairy farmer members in Pennsylvania are: Dairylea Cooperative Inc., Dairy Farmers of America, Inc. (DFA), Dairy Marketing Services, LLC (DMS), Land O'Lakes, Inc., Maryland and Virginia Milk Producers' Cooperative Association, Inc., and Upstate Niagara Cooperative, Inc.<sup>1</sup> Together these GNEMMA member cooperatives represent more than one-half of the Commonwealth's dairy farmers and are responsible for marketing about 70 percent of the State's milk production.

## **III. OVERVIEW OF THE ROLE OF DAIRY FARMER COOPERATIVES IN MILK MARKETING IN PENNSYLVANIA**

Cooperatives are the backbone of the milk marketing system in Pennsylvania. About two-thirds of Pennsylvania dairy farmers market their milk as cooperative members; and other

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<sup>1</sup> St. Albans Cooperative Creamery, Inc. and Agri-Mark, Inc. are also members of GNEMMA. Those cooperatives have operations and members in New York and the New England states.

farmers who are not cooperative members market jointly with cooperative members where dairy processors have retained DMS to provide milk procurement services for them. Cooperatives are owned by dairy farmers and managed and operated at the direction of the dairy farmer owners. Cooperative management is accountable to, hired by, and fired by the cooperative's board of directors who are exclusively dairy farmers and owners of the cooperative. Each cooperative's board of directors is elected by the cooperative's farmer member owners in one-producer, one-vote elections and the cooperative boards control the cooperatives' operations, setting policies which are then implemented by management.

The cooperatives' responsibility for marketing about 7 billion pounds of Pennsylvania-produced milk annually is a huge undertaking. While private dealers, as they have testified in PMMB hearings, will lay off dairy farmers or cut back on milk orders from cooperative suppliers when sales are down, cooperatives have the obligation to market all of their members' milk production, 7 days a week, 365 days a year. The Hershey Chocolate Company, or Dean Foods, or any private milk processor can and will routinely close their processing facilities, or drastically curtail operations, for holidays and vacation periods. But the cows do not take vacations and the cooperatives must market the milk of their dairy farmers every day. It is well known in the industry, but not necessarily among the general public, that the Thanksgiving and Christmas to New Year holiday periods are the busiest and most stressful times of year for cooperative personnel and facilities. When the rest of the industry is on holiday, the cooperatives are working overtime, literally around the clock, to market their dairy farmer members' milk production to the best possible financial advantage. This means processing the milk into storable dairy products such as butter and nonfat milk powder in cooperative-owned facilities in or near

Pennsylvania, and/or when those facilities are at capacity, transporting the milk sometimes very long distances to the nearest available processing facility.

This task of 'balancing' the market – making sure that every hundredweight of milk is marketed to the best possible use every day – is performed by the GNEMMA cooperatives. In order to balance the marketplace, GNEMMA cooperative member dairy farmers have invested tens of millions of dollars in balancing facilities in Pennsylvania, most notably the Land O'Lakes butter and milk powder plant in Mt. Holly Springs, the DFA- Deitrich's plants in Reading and Middlebury Center, and the Farmers' Cheese plant in New Wilmington.

In what is sometimes felt to add insult to injury, the balancing services of the cooperatives are largely uncompensated by the marketplace, although all market participants benefit. The economic realities are that "balancing" (surplus) milk supplies necessarily go to the lowest valued milk products, generally Class IV products (which are butter, nonfat dry milk powder, whole milk powder, and other dried milk products). As a function of supply and demand, the greatest volume of balancing is needed when supply greatly exceeds demand which is when the value of surplus products are lowest. On the other side of the market swings, when supply is short relative to demand, and the value of milk is higher, the cooperatives' balancing plant facilities sit idle or underused, at substantial cost to their farmer owners.

The cooperatives' market balancing services keep all milk prices higher than they would be otherwise. When surplus volumes of milk have a 'home', the marketer of that milk is not forced to offer it at lower and lower prices to find a market. Consequently, premium levels in the market generally can be higher and everyone in the market benefits. At the same time, balancing services earn no premium payments under the PMMB system.

The question is often asked: How are cooperative members paid? The revenues and expenses, profits and losses, of cooperative marketing activities are shared among the members as directed by the boards of directors of each cooperative. The right of cooperatives to determine how they divide or ‘blend’ sales revenues among members has been recognized in both federal and state law.<sup>2</sup> Policies and practices with respect to payment of premiums vary from cooperative to cooperative; but, generally, revenues and expenses are shared in the cooperative across the entire membership or over broad geographic areas, again at the direction of the elected cooperative boards. The GNEMMA cooperatives compete for producer members and set pay prices to farmers independently.

With that background and from the cooperatives’ perspective, I would like to make a few comments on the PMMB ‘stranded premium’ issue.

#### **IV. HOW THE PRESENT PMMB REGULATIONS “STRAND” PRODUCER PREMIUMS**

The Pennsylvania Milk Marketing Law (PAMML) in Section 805, 31 P.S. § 700j-805, requires that “the benefits of any increase of prices received by milk dealers, by virtue of the minimum price provisions of this article, shall be given to producers, except in any case where the board deems a deviation from this policy necessary in order lawfully to maintain proper milk markets and outlets for producers and consumers.” Thus, the General Assembly has clearly stated in Section 805 that the benefits of minimum wholesale and retail prices “shall be given to producers”, i.e. shall not be “stranded” at the wholesale or retail level unless the PMMB finds a deviation from that policy “necessary”. How is this policy implemented today?

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<sup>2</sup> See 7 U.S.C. 608c(5)(F) and 31 P.S. § 700j-809

“Stranded premium” does not have a legal definition in any regulatory or legal context. However, in current dairy industry discussion, “stranded premiums” are understood to be dollars which Pennsylvania consumers have paid for fluid milk at the retail level (which through Pennsylvania Milk Marketing Board regulations involve a discrete amount calculated on the basis of the Board’s established producer premium for Class 1 milk) which dollars are not required by PMMB regulations to be distributed to dairy farmers. To state it a bit more bluntly and directly: Stranded premiums are funds that Pennsylvania consumers are required to pay in the price of milk for the benefit of dairy farmers, which funds are not required to be passed on to the dairy farmers.

How does this “stranding” occur? PMMB regulations establish minimum prices for every unit of Class 1 (drinking) milk sold in stores, schools, nursing homes, restaurants or to consumers in Pennsylvania via any other channel. Those retail or wholesale prices, under current regulations, build in a “premium” – which for the current month of June 2010 is \$3.18 per hundredweight or 27.3¢/gallon. That 27.3¢ is included in every minimum priced transaction at wholesale or retail which occurs in the Commonwealth. A substantial portion of the milk in such transactions in the Commonwealth is milk “produced, processed, and sold” in Pennsylvania. For those milk volumes, the PMMB regulations require that the 27.3¢/gallon be paid back to the particular Pennsylvania dairy farms (or their cooperative) supplying the processing plant. However, a portion of Class I milk sales in Pennsylvania do not consist of milk “produced, processed, and sold” in Pennsylvania. These are the transactions with “stranded” premiums.

The “stranded” premium issue is largely a product of the PMMB’s individual handler pooling system as it interfaces with interstate transactions. The individual handler pooling

system administered by the PMMB is not designed to generate dollars for Pennsylvania dairy farmers. Rather, the system is intended to provide Pennsylvania fluid milk dealers with a competitive advantage in procuring their raw milk supply. A consequence of this individual handler pool system is stranded premiums.

**V. IN 2009 MORE THAN 30% OF PRODUCER PREMIUMS WERE  
'STRANDED' AT RETAIL OR WHOLESALE**

The "stranded premium" transactions can be identified to be of four types. Three of these transactions result in 100% stranding of premiums, i.e. no portion of the \$.273 premium embedded in the retail price is required to be paid to farmers. One category of transactions has resulted in partial stranding of the producer premiums. The category of transaction which has involved partial stranding of the retail premium dollar has occurred where milk has been processed in-state by a dealer purchasing from both in-state and out-of-state farms. In that transaction, the PMMB has required only partial payment of the wholesale (and retail) premium dollar to farmers. The Board's recent action, June 2, 2010, in OGO ("Official General Order")-A-968 would change that circumstance to require payment of closer to 100% of those premium dollars to producers. That PMMB action has drawn a federal constitutional lawsuit by the Pennsylvania Association of Milk Dealers.

The three sets of transactions in which there is 100% stranding of the premium are: (1) where the milk has been produced in Pennsylvania, but processed out-of-state and sold at retail in Pennsylvania; (2) where the milk has been produced in Pennsylvania, processed in Pennsylvania, but sold at wholesale out-of-Pennsylvania and then imported back into Pennsylvania for retail

sale; and (3) where the milk has been produced and processed out-of-state but sold at retail in Pennsylvania.

The total volume and precise value in aggregate of these stranded premium transactions is not known; but some data is available. For the category of transactions addressed in OGO-A-968, in January – March 2009, 78,365,037 lbs of Class I sales in Pennsylvania were affected. On those sales, 23.4% of the premium dollars were “stranded” under the PMMB’s previous order. Under the PMMB’s formula as adopted in OGO-A-968, the percentage of stranded dollars would be reduced to 3.4%. The annual value of the ‘stranded’ premiums in the OGO-A-968 transactions, using the current rate of \$3.18 per cwt is approximately \$ 6 million. Viewed in the context of all PMMB over-order premiums statewide, the value of these transactions is 10% to 12% of all over-order premiums.<sup>3</sup>

There is PMMB data (see Exhibit 1 attached) with respect to the category of transactions involving milk produced in Pennsylvania, processed out of state and brought back into Pennsylvania for sale at retail. Using data compiled by the PMMB staff for 2009, out-of-state dealers who purchased milk from Pennsylvania farms distributed 495,610,977 pounds of Class I products in Pennsylvania to which the PMMB over-order premium applied. This is equal to 21.5% of total Class I (fluid) milk sales by all dealers, in-state and out-of-state in 2009. In other words, in 2009, 21.5% of producer premium dollars paid by Pennsylvania consumers were paid to the retailer in these transactions without any obligation that they be distributed to dairy farmers. In June 2007 in OGO-A-943, after a seven day hearing, the PMMB declined to

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<sup>3</sup> “Over-order premiums” refers to values set by the PMMB above federally-established mandated minimum prices.

establish a producer premium on these transactions (among others), denying a request supported by the GNEMMA cooperatives, Farm Bureau, the Secretary of Agriculture and the Governor.

The volumes, and therefore the stranded premium value, of the final two categories of transactions are not available to the best of our knowledge. However, we do know that in some cases these transactions are not insubstantial. For instance, with respect to transactions where the milk is produced and processed in Pennsylvania, delivered wholesale out of state and then retailed in Pennsylvania, we know from PMMB hearing testimony that one major distributor with a warehouse in New Jersey purchases 14 trailer loads of Class I products from Pennsylvania dealers daily, f.o.b. its New Jersey facility, and redistributes a substantial portion of those volumes back into Pennsylvania. This dealer's costs of operation and market share are sufficiently significant that its financial data is used by the PMMB as part of the "dealer cross-section" of costs which are used to set minimum prices in PMMB Area 1 (Philadelphia area). In April 2009 in OGO-A-961, the PMMB, after a four-day hearing, denied the request of the GNEMMA cooperatives, the Pennsylvania Farm Bureau, the Secretary of Agriculture and the Governor, to require a premium be paid to farmers on certain of these transactions.

## **VI. CHALLENGES TO CAPTURING "STRANDED PREMIUMS" FOR DAIRY FARMERS**

There are a number of issues which must be addressed in connection with any attempts to capture these stranded premium dollars for the benefit of dairy producers. I would identify three (3) issues. First, the so-called "dormant" or negative commerce clause of the United States Constitution which limits the extent to which states can regulate interstate transactions. Secondly, there are administrative challenges for any state agency which seeks to regulate parties

with respect to transactions which partly occur outside of the boundaries of the state. Finally, there is the issue of the PMMB's authority under Pennsylvania's Milk Marketing Law as currently written. The extent to which these challenges limit the PMMB's ability to capture stranded premiums varies with the type of transaction involved. However, it is fair to say that, in our view, the issues with respect to Pennsylvania legislative authority are identifiable and solvable by the General Assembly, should it see fit; the administrative issues, likewise, are such that we believe them to be surmountable with precise administration.

## **VII. STRANDED PREMIUMS CAN EFFECTIVELY BE CAPTURED THROUGH A PRODUCER PREMIUM POOL**

To address this problem in the most constructive way, the individual handler pooling system needs to be addressed. The premiums embedded in wholesale and retail prices, representing the price of milk for dairy farmers, should be committed to a fund, a pool, the sole beneficiaries of which are dairy farmers. This would be a major paradigm change from the current PMMB system which, in essence, treats those funds as belonging to the seller of milk, be it the processor or the retailer. If those funds, whether collected at wholesale or retail, were treated as producer funds, payable to a "pool" for producers, there would be no 'stranded' premiums.

This pool should be a statewide pool, distributable to all dairy farmers in Pennsylvania, whether or not their milk was processed by a Class I dealer or was 'balancing' milk used for other purposes. This pool, consistent with the Commerce Clause, could not be limited exclusively to Pennsylvania producers where it is funded from fluid milk products supplied in whole or in part by out-of-state farms. That is the teaching of the United States Supreme Court's

decision in *West Lynn Creamery v. Healy*, 512 U.S. 186 (1994). In *West Lynn*, Massachusetts collected a fee on all fluid milk distributed in the Commonwealth, irrespective of the source of the raw milk. The fund collected was, however, distributed solely to Massachusetts farmers; out-of-state suppliers were ineligible. The Supreme Court struck down the program under the Commerce Clause because it unconstitutionally discriminated among and between the in-state and out-of-state milk supplies.

A statewide pool of over-order premiums could capture most or all of the currently stranded premiums<sup>4</sup>, share them in a constitutional, pro-rata manner with out-of-state suppliers and generate substantial net dollars to Pennsylvania dairy farms.

I would comment, just briefly, about the various categories of stranded premiums and the ability to capture these dollars for dairy farmers:

1. Pennsylvania distributed milk from processing plants which also purchase from out-of-state producers. This category of stranded premiums was addressed in PMMB's order dated June 7, 2010. We understand that order is being challenged on constitutional grounds by the Pennsylvania Association of Milk Dealers in federal court.
2. Pennsylvania produced milk, processed out-of-state, and distributed in Pennsylvania. These transactions are currently tracked by the PMMB (see Exh 1) through its licensing and reporting regulations. However, under present producer

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<sup>4</sup> Decisions would have to be made, legislatively or administratively, as to whether premiums in all categories would be included. The category of sales produced and processed out of state have the most attenuated relationship to the Commonwealth and are probably the most limited volume category.

payment regulations, no premiums are required to be returned to the Pennsylvania dairy farm suppliers. We believe that this could be done both administratively, and constitutionally. The authority of the PMMB could be legislatively enhanced to assist this effort.

3. Pennsylvania produced and processed milk. This, in our view, is the most readily reachable set of transactions. It would require action by the PMMB and perhaps the General Assembly to provide for additional accountability in tracking milk at retail establishments. However, the constitutional ability to capture the producer value on these transactions is clear, in our opinion.

4. Milk distributed in Pennsylvania, processed and produced out-of-state. This category of “stranded premiums” could only be captured if premium revenues were being collected at the in-to-store wholesale or out-of-store retail level.

GNEMMA recently suggested a system of this type for New Jersey. We believe that revenues could be constitutionally captured at this point in the distribution chain for the benefit of producers and distributed to producers, so long as they were equitably distributed among all suppliers of milk to the transaction both in-state and out-of-state or in non-discriminatory basis. This would require new authority in the Pennsylvania Milk Marketing Law.

## VIII. CONCLUSION

The General Assembly has been on record since the adoption of the Milk Marketing Law in 1937 stated in Section 805 of the Act its “legislative intent that the benefits of any increase of prices received by milk dealers, by virtue of the minimum price provisions [of the law] shall be

given to producers. . . .” In 2009, however, over 30% of premiums paid by Pennsylvania consumers were not required to be paid to dairy farmers and were ‘stranded’ on the retailers, wholesalers, or processors operating statements. These premiums can be, and should be, captured for dairy farmers. Doing so simply requires that the regulatory body, the PMMB, treat these funds as belonging to dairy farmers and that, if necessary, the General Assembly provide any additional authority which the PMMB may need to carry out that mission.

On behalf of the GNEMMA cooperatives, I want to thank the Committee again for this opportunity to present our views with respect to stranded dairy producer premiums under present PMMB regulations in Pennsylvania.

SOURCE: Provided by PMMB staff: Data for 12 months, 2009

Out-of-State Dealers

Area PA Rec	OS Rec	Tot Rec	In Area	Other PA CI	OS CI 1	Tot CI 1	CI 2	CI 3	CI 4	Tot Util
2,534,792,064	509,485,941	3,044,278,005	-	495,610,977	1,794,673,793	2,290,284,770	110,907,056	614,456,788	28,629,390	3,044,278,004
83.26%	16.74%	100.00%		16.28%	58.95%	75.23%	1.31%	7.25%	0.34%	35.91%
Pennsylvania Dealers										
Area PA Rec	OS Rec	Tot Rec	In Area	Other PA CI	OS CI 1	Tot CI 1	CI 2	CI 3	CI 4	Tot Util
1-0 1,191,203,156	78,792,235	1,269,995,391	328,448,563	58,013,410	549,067,456	935,529,429	316,837,940	6,090,335	13,244,403	1,271,702,107
2-0 966,221,060	22,683,564	988,904,624	44,110,442	36,287,317	308,234,688	388,632,447	258,397,666	50,948,682	290,925,826	988,904,621
3-0 797,223,106	696,270,922	1,493,494,028	207,338,977	164,174,274	72,717,273	444,230,524	26,015,207	786,065,476	237,183,668	1,493,494,875
4-0 2,416,794,332	106,003,861	2,522,798,193	220,723,071	110,291,064	140,462,906	471,477,041	592,597,974	194,979,402	1,263,717,803	2,522,772,220
5-0 1,151,358,267	803,567,322	1,954,925,589	452,171,672	61,650,536	472,832,509	986,654,717	88,701,565	831,875,084	47,694,253	1,954,925,619
6-0 240,062,403	7,590,967	247,653,370	98,575,257	23,940,376	13,885,500	136,401,133	47,759,540	42,064,411	21,428,284	247,653,368
6,762,862,324	1,714,908,871	8,477,771,195	1,351,367,982	454,356,977	1,557,200,332	3,362,925,291	1,330,309,892	1,912,023,390	1,874,194,237	8,479,452,810
79.77%	20.23%	100.00%		21.30%	18.37%	39.67%	15.69%	22.55%	22.11%	100.02%
9,297,654,388	2,224,394,812	11,522,049,200	1,351,367,982	949,967,954	3,351,874,125	5,653,210,061	1,441,216,948	2,526,480,178	1,902,823,627	11,523,730,814

Month	PA CI 1 Util over Total PA Prod	PA CI 2 Util over Total PA Prod	PA CI 3 Util over Total PA Prod	PA CI 4 Util over Total PA Prod	PA to Out-of-State
January	17.29%	12.74%	18.31%	17.94%	35.25%
February	17.29%	12.74%	18.31%	17.94%	35.25%
March	17.29%	12.74%	18.31%	17.94%	35.25%
April	17.29%	12.74%	18.31%	17.94%	35.25%
May	17.29%	12.74%	18.31%	17.94%	35.25%
June	17.29%	12.74%	18.31%	17.94%	35.25%
July	17.29%	12.74%	18.31%	17.94%	35.25%
August	17.29%	12.74%	18.31%	17.94%	35.25%
September	17.29%	12.74%	18.31%	17.94%	35.25%
October	17.29%	12.74%	18.31%	17.94%	35.25%
November	17.29%	12.74%	18.31%	17.94%	35.25%
December	17.29%	12.74%	18.31%	17.94%	35.25%

A (E+F) 1,805,724,959 Class 1 Sales into PA by PA Dealers  
 B (A+G) 2,301,335,936 Total Class 1 sales into PA All Dealers

% of milk used that is PA milk

93.8%
97.7%
53.4%
95.8%
58.9%
96.9%