

## SENATE TESTIMONY

### **Dave DeSantis**

Good morning Chairman Brubaker and members of the Committee. My name is Dave DeSantis and I work for the Pennsylvania Milk Marketing Board as the Chief of Enforcement and Accounting. The Milk Marketing Board and I would like to thank you and the Committee for this opportunity to discuss the Board's role in the economic health of Pennsylvania's dairy farmers. I would like to begin by emphasizing that although the Board's impact on Pennsylvania dairy farm income is significant, it is not without limits. Regardless of any action taken by the Board or even this legislature, we operate within a federal system that not only specifically regulates milk but all interstate commerce. Today we would like to discuss where we are with producer milk pricing in Pennsylvania, what we may do to maximize the effects of our present authority and finally where we feel the limits of our authority exist.

Briefly, before I begin, there have been requests for data from the Board. We are in the process of changing the primary programs that manage our data. It is for this reason that I am reluctant to rely on specific information until we have had a chance to verify completely the reliability of the reports we will now be relying on. In any event, we want to be of whatever assistance we can be to the Committee and will gladly provide additional information and analysis to support or clarify any conclusions reached using previously supplied Board-generated data.

**The Present** – To start at the beginning, farm pickup of milk is closely monitored by the Milk Marketing Examiners to ensure that the drivers picking up the milk employ

procedures that allow farmers to be paid for all the milk picked up with a representative sample of the milk used for accurate component payment for the milk.

After the milk is picked up we begin to see some very significant aspects to the economic regulation of producer milk. Nearly all milk purchased from Pennsylvania producers is now protected by a bond guaranteeing payment for that milk. Dealers located both in and outside Pennsylvania are posting bonds with the Board to ensure that our producers will be paid for the milk they produce.

The Board also conducts monthly audits of all dealers purchasing Pennsylvania producer milk to verify that they are paying for their milk on time and at least at minimum prices established by the Board. For year 2009, Board Auditors detected over \$80,000 in underpayments to Pennsylvania producers, which we required the dealers to pay so that the Pennsylvania producers received all of the money to which they were entitled. The Auditors also conducted several enforcement actions against dealers who were late in paying their Pennsylvania producers.

At present the Board sets the minimum price that must be paid to Pennsylvania dairy farmers under most circumstances. The Board enforces a minimum producer price which is comparable to the federal price for milk used for Class 2 (creams), 3 (cheeses) and 4 (butter and powdered milk.) The Board also enforces minimum producer prices for Class 1 (beverage type milk) purchased from Pennsylvania dairy farmers by Pennsylvania-located dealers. The Board enforces this Class 1 minimum price based on where the milk was sold in the state. This sales-point pricing provides a hidden premium that is seldom recognized. The sales-point price enforced by the Board for milk sold in Pennsylvania is usually significantly above the plant-point price

enforced by the Federal Market Administrators. I would term this sales-point price as our base price.

As I understand it, the focus of this hearing is on the Over-Order Premium. The Over-Order premium is a Board-mandated premium that must be paid by Pennsylvania Dealers to their Pennsylvania producers for Class 1 sales in the state. This Premium is above the base price. Since the Board instituted the Premium, nearly \$500 million dollars has been paid to our dairy farmers. As required by the Milk Marketing Law, the Board sets resale prices based on costs incurred by dealers and retailers to process, package, deliver and sell the milk. This regulated resale price structure has allowed all costs, including the Over-Order Premium, to flow through to the consumer.

The Board recently held a hearing to address how that Over-Order Premium obligation must be calculated. The Board has issued an order which will significantly increase the Over-Order Premium paid to Pennsylvania producers who are selling milk to Pennsylvania Class 1 dealers with in-state and out-of-state milk supplies. While the old formula used a ratio of in-state to total producer purchases, the formula adopted by the board uses the lower of a dealer's Pennsylvania producer purchases or Pennsylvania Class 1 utilization. Board Staff testimony at the hearing suggested that since the entire Premium was built into the resale price structure, the affected dealers will receive all of the Premium dollars paid to Pennsylvania producers back in the minimum resale price they receive from the Pennsylvania retailers. In the study presented at the hearing, the cross-section dealers that would be affected would have an additional \$392,000 Over-Order Premium that they would pay to Pennsylvania

producers for the month of March 2009. That order will take effect in October, but there is the possibility that it will be appealed or challenged in federal court.

The question remains, will all of the Over-Order Premium dollars paid by Pennsylvania consumers that we have built into the minimum out-of-store price, be returned to our Pennsylvania producers? Our studies indicate that, with the change in the formula, dealers located in Pennsylvania will be returning the vast majority of the Premium dollars they receive in the minimum wholesale price to their Pennsylvania producers.

There remain two areas where Over-Order Premiums may have been paid by Pennsylvania consumers and not returned to Pennsylvania producers: packaged milk brought into the state by out-of-state dealers and milk brought in by importing retailers.

Considering the milk brought in by out of state dealers, this milk may have originated at a Pennsylvania dairy farm. At present the point of sale for that producer milk is undefined and therefore the Board does not set a minimum price on that milk. If the legislature were to declare that, absent a contract to the contrary, possession of milk and title transfers at the farm in Pennsylvania, I believe that the Board would then have the ability to regulate that sale from the Pennsylvania producer to the out-of-state dealer. The Board could value that milk in the same way it is valued when purchased by a Pennsylvania-located dealer and an Over-Order Premium may apply. When the out-of-state dealer sells that milk at wholesale, the Over-Order Premium is part of that minimum wholesale price.

Using rough estimates, of average Class 1 consumption, we believe that over 35 million pounds of milk may be brought into the state by importing retailers each year.

While we have knowledge that a portion of that milk originates from out of state producers, we believe a significant portion comes from Pennsylvania dealers or out-of-state dealers that buy Pennsylvania-produced milk. Again remember that when the importing retailer sells that milk to Pennsylvania consumers, the Over-Order Premium is part of that out-of-store minimum price. At present we do not license importing retailers or require them to report their sources of milk. If it were clear that importing retailers must be licensed and report the sources of their milk, the Board might then be in a position to attach the Over-Order Premium to that milk that is produced in this state. Since we don't at present have any reports on these retailers, we cannot provide an estimate as to how much additional Premium dollars might be generated.

**The Future** – I believe the Board has done what it could do to maximize Pennsylvania dairy farm income with the latest change in the calculation of the Over-Order Premium. If the legislature acts to clarify where milk transfers possession and specifies that all persons bringing milk into the state must be licensed, pay license fees, and complete detailed reports regarding where their milk came from and where it was distributed within Pennsylvania, the gap between what the consumers pay in Over-Order Premium and what our producers receive will be significantly decreased. This will also level the playing field in Pennsylvania. Out-of-state dealers and retailers now selling milk in Pennsylvania will be paying more of the Over-Order Premium than our domestic dealers and retailers are currently paying.

There may be other suggestions such as taxing or leveling a fee on all milk sold in Pennsylvania and returning those dollars to our dairy farmers. I would caution that many of these tactics have been tried in other states and found to be unconstitutional.

There may be still other propositions that on their face have a great appeal. For example some legislatures have considered having the dealers rather than the producers pay for hauling. As I said, this may sound good and sensible, but if Pennsylvania is the only state with this type of imposition, we may find no market for Pennsylvania-produced milk.

I would like to thank the chairman and the committee for allowing us to testify today. We understand that no action taken by the legislature or by the Milk Marketing Board will be risk-free. The actions we have proposed here today, we believe have the greatest chance of withstanding challenge while delivering significant benefits to our dairy industry.