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PROPOSED RULEMAKING

MILK MARKETING BOARD

[7 PA. CODE CH. 143]

Transactions Between Dealers and Producers; Termination of Dealer-Producer Contract

[49 Pa.B. 3606]

[Saturday, July 13, 2019]

The Milk Marketing Board (Board) proposes to amend § 143.31 (relating to written notice required) and proposes to delete § 143.32 (relating to forfeit use of notice rights) to read as set forth in Annex A.

Effective Date

This proposed rulemaking will be effective upon publication of the final-form rulemaking in the *Pennsylvania Bulletin*.

Statutory Authority

Section 301 of the Milk Marketing Law (act) (31 P.S. § 700j-301) gives the Board the authority to "supervise, investigate and regulate the entire milk industry of the Commonwealth, . . . including the purchase and sale of milk. . . in this Commonwealth, and including the establishment of reasonable trade practices. . . ." Section 307 of the act (31 P.S. § 700j-307) gives the Board the authority to adopt and enforce regulations necessary or appropriate to carry out the provisions of the act.

Purpose and Explanation

This proposed rulemaking extends the current 28 day notice requirement to terminate a dealer-producer relationship to 90 days. It also provides for waivers to address situations where a 90 day notice would financially imperil a milk dealer.

At the beginning of March 2018 approximately 27 independent dairy farmers of this Commonwealth received termination notices from the milk dealer purchasing their milk. These producers received 90 days' notice that their agreements would be terminated, yet many had difficulty finding new markets. One purpose of this proposed rulemaking is to provide additional time for dairy farmers to find an alternative market when they lose their current market.

In the case of the 27 producers that received notices in March 2018, their dealer could not, from a financial and economic standpoint, continue to purchase their milk. The exceptions to the 90 day notice requirement in this proposed rulemaking are intended to provide a shorter notice period in the case of a dealer's financial hardship, business loss or catastrophic event. The exceptions also provide for a dealer to make a charitable donation of packaged milk and maintain its purchasing agreement with a producer.

This proposed rulemaking is intended to provide additional time to producers in a manner that minimizes adverse impact on milk dealers.

Description of Proposed Amendments

Section 143.31(a) is proposed to be amended to increase the required notice period to terminate a dealer-producer purchasing agreement from 28 days to 90 days.

Section 143.31(c) is proposed to be added to provide an exception to the 90 day notice requirement for dealers in "financial distress." Financial distress is determined objectively by calculating the dealer's Ohlson O-score. The O-Score was developed in the 1980s using financial information from over 2,000 companies. It is generally considered to be more accurate than its predecessor, the Altman Z-score, which was developed in the 1960s using information from just 66 companies. The O-Score was selected as the primary objective metric for determination of dealer financial distress because of its reliability (consistent results over time) and validity (accurate results over time) in financial accounting since 1980. It is a result of a 9-factor linear combination of business-related ratios readily obtained through milk dealer financial statements currently filed with the Board by milk dealers on an annual basis. The O-Score is significantly more reliable than its predecessors as it was derived from a study of over 2,000 companies; it has over 90% accuracy. The O-Score provides an accurate determination of dealer financial distress to be used in a review of dealer applications for waiver of the 90 day producer termination notice requirement.

Section 143.31(d) is proposed to be added as an objective backup to address cases of potential dealer financial distress that are not captured in the O-score.

Section 143.31(e) is proposed to be added to provide an exception to the 90 day notice requirement for dealers not in financial distress but which lose customers and/or sales resulting in potential financial distress if required to continue to make producer purchases for which there is no customer for the packaged milk.

Section 143.31(f) is proposed to be added to provide an opportunity for milk dealers with producer milk purchase obligations in excess of customer sales to make a charitable donation of the associated excess packaged milk rather than to terminate producers. This section is not intended to limit or affect other charitable contributions that milk dealers make.

Section 143.31(g) is proposed to be added to provide an exception to the 90 day notice requirement when a dealer suffers a sudden and large scale (catastrophic) event affecting its ability to handle, process or sell/deliver packaged milk products.

Section 143.31(h) is proposed to be added to clarify when the exceptional 28 day notice requirement begins.

Sections 143.31(i) and (k) are proposed to be added to clarify that the notice period does not apply when contracts between dairy farmers and their cooperatives, and producers and dealers, respectively provide for a different notice requirement.

Section 143.31(k) is proposed to be added because a common issue raised by producers who received termination notices in March 2018 was that they did not know who to contact for assistance.

Section 143.32 is proposed to be deleted. As milk marketing conditions have changed and evolved, and continue to change and evolve, there is a likelihood that a producer may be selling some of its milk to a dealer while also processing, packaging and selling its own milk at its farm. At one time, exempting those producers from receiving notice may have been appropriate, but the Board has determined that current conditions are such that these producers should receive the same notice as other producers.

Public Hearing

As the result of a petition from the Department of Agriculture to extend the termination notice period, the Board held a public hearing on July 2, 2018. Notice of the hearing was published in the *Pennsylvania Bulletin* on May 19, 2018. The Board also provided notice on May 7, 2018, by

means of the Board Bulletin to parties who have requested notice of Board hearings by means of e-mail or first class mail, or both.

The following parties testified at the hearing or provided written comments, or both, as part of the hearing: Department of Agriculture, Pennsylvania Center for Dairy Excellence, Milk Marketing Board Staff, Progressive Dairymen's Cooperative, United Ag Services, Rutter's Dairy, Harrisburg Dairies, Pennsylvania Association of Dairy Cooperatives, Progressive Agriculture Organization, National Family Farm Coalition, Dairy Farmer Nelson Troutman, Melissa Bravo, Pennsylvania Farm Bureau and Pennsylvania Association of Milk Dealers.

After the hearing the Board worked with the Pennsylvania Association of Milk Dealers to draft the sections providing exceptions to the 90 day notice requirement. The Pennsylvania Association of Milk Dealers also tested the Ohlson O-score and the Dun and Bradstreet Quick Ratios.

Fiscal Impact

This proposed rulemaking would have little fiscal impact on this Commonwealth, its political subdivisions or the public.

Exceptions to the amended 90 day notice requirement that would allow milk dealers to essentially provide the current 28 day notice requirement would not be effective for up to 10 business days after a dealer requests the exception. Therefore, there is the possibility that a dealer may be required to purchase producer milk for up to 10 business days longer under the proposed amendments than dealers are currently required. The cost associated with purchasing milk is different for each dealer and is based on many factors, including, but not limited to, utilization, location, monthly milk price and volume purchased. Given the uncertainties, a precise quantification of this impact is not possible, but at a minimum could be as much as \$14,000.

Paperwork Requirements

This proposed rulemaking was drafted in consultation with the Pennsylvania Association of Milk Dealers in a manner that would require no additional paperwork requirements.

Regulatory Review

Under section 5(a) of the Regulatory Review Act (71 P.S. § 745.5(a)), on July 1, 2019, the Board submitted a copy of this proposed rulemaking and a copy of a Regulatory Analysis Form to the Independent Regulatory Review Commission (IRRC) and to the Chairpersons of the House and Senate Committees on Agriculture and Rural Affairs. A copy of this material is available to the public upon request.

Under section 5(g) of the Regulatory Review Act, IRRC may convey comments, recommendations or objections to the proposed rulemaking within 30 days of the close of the public comment period. The comments, recommendations or objections must specify the regulatory review criteria in section 5.2 of the Regulatory Review Act (71 P.S. § 745.5b) which have not been met. The Regulatory Review Act specifies detailed procedures for review prior to final publication of the rulemaking by the Department, the General Assembly and the Governor.

Public Comment

Interested persons are invited to submit written comments, suggestions or objections about this proposed rulemaking to Doug Eberly, Chief Counsel, Pennsylvania Milk Marketing Board, 2301 North Cameron Street, Harrisburg PA 17110, or by e-mail to ra-pmmb@pa.gov within 30 days after publication in the *Pennsylvania Bulletin*. Individuals who require this information in a different format may call (717) 787-4194 or (800) 654-5984 which is the Pennsylvania AT&T Relay Service for TDD users.

Fiscal Note: 47-18. No fiscal impact; (8) recommends adoption.

Annex A

TITLE 7. AGRICULTURE

PART VI. MILK MARKETING BOARD

CHAPTER 143. TRANSACTIONS BETWEEN DEALERS AND PRODUCERS

TERMINATION OF DEALER—PRODUCER CONTRACT

§ 143.31. Written notice required.

(a) [No dealer shall terminate his contract or purchasing agreement with a producer and no producer shall terminate his contract or selling agreement with a dealer except by giving such producer or dealer at least a 28-day written notice before termination. The dealer shall specify in such notice the reasons for termination and shall pay in full the producer whose contract has been terminated by the 20th day of the following month.]

No dealer shall terminate its contract or purchasing agreement or ordinary continuance of a previous course of dealing with a producer except by giving such producer at least a 90-day written notice before termination. No producer shall terminate its contract or purchasing agreement or ordinary continuance of a previous course of dealing with a dealer except by giving such dealer at least a 90-day written notice before termination. The period of notice shall begin when the producer or dealer receives the notice. The dealer shall specify in such notice the reasons for termination and shall pay in full the producer whose contract has been terminated by the 20th day of the following month. If a dealer petitions for a shorter notice period, the notice to the producer must inform the producer that the dealer is petitioning for the shorter notice period.

(b) Repetitions of the causes set forth in § 143.44 (relating to rejection of producer's milk) may, however, cause termination of the contract without the requisite notice.

(c) A dealer may terminate a contract or purchasing agreement or ordinary continuance of a previous course of dealing with a producer by giving a 28-day written notice if the dealer is in financial distress. "Financial distress" means an Ohlson O-score of 0.5 and higher. The dealer's Ohlson O-score shall be calculated as follows:

$$O = -1.32 - 0.407\log(TA_t/GNP) + 6.03TL_t/TA_t - 1.43WC_t/TA_t + 0.0757 \\ CL_t/CA_t - \\ 1.72X - 2.37NI_t/TA_t - 1.83FFO_t/TL_t = 0.285Y - 0.521(NI_t - NI_{t-1})/(NI_t + NI_{t-1})$$

where TA = total assets

GNP = Gross National Product price index level found at
(<https://fred.stlouisfed.org/series/A001RG3A086NBEA>).

TL = total liabilities

WC = working capital = (current assets) – (current liabilities)

CL = current liabilities

CA = current assets

X = 1 if TL > TA, 0 otherwise

NI = net income after taxes

FFO = cash flow from operating activities

Y = 1 if a net loss for the last two years, 0 otherwise

t = most recent year data

t – 1 = prior year data

The Board shall complete its computation and review of the Ohlson O-score, and notify the dealer and affected producers, within 10 business days of receiving the necessary documentation from a dealer. "Necessary documentation" is the Balance Sheet and Statement of Operations found in the Milk Dealer's Financial Statement (PMMB-60), and the Statement of Cash Flows prepared annually with the dealer's financial statements.

(d) A dealer may terminate a contract or purchasing agreement or ordinary continuance of a previous course of dealing with a producer by giving a 28-day written notice if the dealer's Ohlson O-score is between -1.0 and 0.5 if any 3 of the following five solvency ratio conditions are met

i. Quick ratio less than or equal to 0.6, where quick ratio = (cash on hand + accounts receivable)/current liabilities;

ii. Current ratio less than 1.0, where current ratio = current assets/current liabilities;

iii. Current liabilities/total equity greater than 2/3;

iv. Total liabilities/total equity greater than 1.0;

v. Fixed assets/total equity greater than 3/4.

(e) A dealer may terminate a contract or purchasing agreement or ordinary continuance of a previous course of dealing with a producer by giving a 28-day written notice if the dealer has raw milk volumes for which there are insufficient customer sales. Raw milk volumes for which there are insufficient customer sales shall be determined as follows:

(1) Identify sales reductions or customer losses experienced within any 90-day rolling period;

(2) Document weekly average sales history in pounds for the customer(s) decreased volume or for the lost customer(s) based on a 26-week rolling average, or a lesser time period if such customer was a customer for less than 26 weeks or was a school(s) and the school contract was lost during the school year;

(3) Affirm that good faith efforts were made to replace the lost sales;

(4) If the lost sales calculated according to subsection (e)(2) above amount to at least 40,000 pounds or 3% of raw milk receipts, whichever is less, of raw milk per week and the dealer has made the affirmation required by subsection (e)(3) above, the Board shall

approve the 28 day written notice based on the dealer having raw milk volumes for which there are insufficient customer sales.

(5) The Board shall determine if a dealer has raw milk volumes for which there are insufficient customer sales, and notify the dealer and affected producers, within 10 business days of receiving the necessary documentation from a dealer.

(f) If a dealer has raw milk in excess of customer sales as calculated by subsections (e)(1) and (e)(2) above and has affirmed that it has made a good faith effort to dispose of the excess raw milk and has no other more economically sound disposal alternatives than dumping, skimming and dumping, or donating, and the dealer packages and donates the surplus milk to a Food Bank licensed by the Board, the producer milk packaged for such donation shall be exempt from any Pennsylvania-mandated premiums. The value of the donation may be reported to the Board as an authorized contribution. The value of the donation shall be equal to the minimum wholesale price applicable to the donation including discounts, less any Pennsylvania-mandated premiums incorporated into the minimum wholesale price. The donation shall not be considered a dealer inducement under 7 Pa. Code Chapter 146 (relating to transactions between dealers and customers). The Board shall determine if a dealer has raw milk in excess of customer sales for purposes of this subsection, and notify the dealer and affected producers, within 10 business days of receiving the request and supporting information from a dealer.

(g) A dealer may terminate a contract or purchasing agreement or ordinary continuance of a previous course of dealing with a producer by giving a 28-day notice if the dealer has raw milk volumes for which there is insufficient plant output due to a verifiable catastrophic event affecting a milk plant's ability to handle, process, or sell/deliver historical volumes of packaged milk products, which is reasonably expected to last beyond 28-days. Raw milk volumes for which there is insufficient plant output shall be determined as follows:

(1) Identify catastrophic event to include but not be limited to mechanical failure; weather-related damage; infrastructure-related damage; shut down or slow down of plant operations; government-imposed plant shutdown, partial or otherwise; or other similar catastrophic circumstance;

(2) Document weekly average plant output as measured by sales in pounds of packaged milk products prior to catastrophic event based on a 26-week rolling average;

(3) Document weekly average raw milk receipts in pounds prior to catastrophic event based on a 26-week rolling average;

(4) Document reasons, nature, and extent (estimated in pounds) of reduced ability to handle, process, or sell/deliver historical output of packaged milk products;

(5) Affirm that good faith efforts have been made to return to historical plant output documented under subsection (g)(2);

(6) Affirm that despite good faith efforts the reduction in output will last beyond 28-days;

(7) If the reduction in plant output documented in subsection (g)(4) amounts to at least 40,000 pounds or 3% of historical raw milk receipts in subsection (g)(3), whichever is less, of raw milk per week and the dealer has made the affirmations required in subsections (g)(5) and (g)(6), the Board shall approve the 28-day written notice based on the dealer having raw milk volumes for which there is insufficient plant capacity due to catastrophic event.

(8) The Board shall determine if a dealer has raw milk volumes for which there is insufficient output due to catastrophic event and notify the dealer and affected producers within 10 business days of receiving the information required by this subsection.

(h) Any 28-day notice period as provided by this section shall commence on the day the 28-day notice is approved by the Board.

(i) If a contract between a cooperative and a member of such cooperative provides for the amount of notice required to terminate the contract, this section shall not apply.

(j) Notwithstanding subsection (a), a producer and dealer may contract for either more or less than a 90 day notice period to terminate a contract or purchasing agreement. Subsection (a) shall apply when the contract, purchasing agreement, or ordinary continuance of a previous course of dealing between a producer and dealer does not contain a termination provision.

(k) The Board shall maintain a current list of government agencies and nonprofit organizations which are available to assist producers who receive a termination notice. The termination notice shall not be considered received by the producer unless it includes this list.

[§ 143.32. Forfeit use of notice rights.

A producer who offers milk for sale at his farm under the exemptive provisions of section 402 of the act of July 31, 1968, (31 P.S. § 700j-310) shall be considered to have elected the status of a milk dealer and to have forfeited his rights under § 143.31 (relating to written notice required).]

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