



Commonwealth of Pennsylvania
Milk Marketing Board
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Official General
Order No. A-929

Posted: June 16, 2004
Effective: July 1, 2004

OVER-ORDER PREMIUM

NOW, this 16th day of June 2004, the Commonwealth of Pennsylvania, Milk Marketing Board (Board) adopts and issues this official general order pursuant to the authority conferred by the Milk Marketing Law, 31 P.S. §§ 700j-101 – 700j-1204. This order will become effective at 12:01 a.m. on July 1, 2004, and will expire at 12:00 midnight on September 30, 2004.

SECTION I

The attached findings of fact and conclusions of law are incorporated herein by this reference as though fully set forth in this order.

SECTION II

(a) In all milk marketing areas the calculation of the Class I price for milk produced, processed, and sold in Pennsylvania shall include an over-order premium of \$1.30 per hundredweight effective 12:01 a.m. on July 1, 2004, through midnight on September 30, 2004.

(b) Milk dealers shall show by line item on their monthly statements to independent producers and cooperatives the specific amount of the Pennsylvania Milk Marketing Board's over-order premium being paid.

SECTION III

All parts of Official General Order A-893 not inconsistent with this order shall continue in effect.

PENNSYLVANIA MILK MARKETING BOARD

Boyd E. Wolff, Chairman

Luke F. Brubaker, Member

Barbara A. Grumbine, Consumer Member

Date: June 16, 2004

**FINDINGS OF FACT AND CONCLUSIONS OF LAW
OVER-ORDER PREMIUM HEARING
MAY 20, 2004**

FINDINGS OF FACT

1. On May 20, 2004, the Pennsylvania Milk Marketing Board (Board) convened a hearing for all milk marketing areas to receive testimony and evidence concerning the level and duration of the over-order premium.
2. Notice of the hearing was published at 34 Pennsylvania Bulletin 2143 on April 16, 2004, and was mailed to those who have requested notice of Board hearings by means of Bulletin No. 1358, dated April 7, 2004.
3. At the end of the hearing, a briefing schedule was set. Principal briefs were due on June 8, 2004, and reply briefs were due on June 11, 2004. Due to an unscheduled federal holiday, the due date for reply briefs was subsequently changed to June 14, 2004.
4. Charles Seidel, a dairy farmer from Berks County, testified on behalf of Pennsylvania State Grange. Mr. Seidel recommended that the Board set the over-order premium at \$1.95 per hundredweight. In recommending \$1.95 per hundredweight, Mr. Seidel testified that milk production costs have escalated. Mr. Seidel testified that his cost for soybean meal and corn had increased. Mr. Seidel also testified that the hay he had in storage (which he had to buy last winter) was of poor quality, but that he could not afford not to use it. Mr. Seidel further testified that his fixed costs continued to increase and that his negative producer price differential impacted negatively on his milk check. Mr. Seidel also noted that the Pennsylvania Agricultural Statistics Service (PASS) Special Dairy Report showed Pennsylvania milk production down 5.7% for the first quarter of 2004 compared to the first quarter of 2003, with the number of milk cows down 24,000 for the same period. Mr. Seidel theorized that milk production and cow numbers were declining because many farmers simply cannot afford to stay in business.
5. Edward Gallagher testified as an expert in agricultural economics and milk marketing on behalf of Dairylea Cooperative, Inc.; Dairy Farmers of America, Inc.; Land O' Lakes, Inc.; Dairy Marketing Services, LLC; the Northeast Milk Marketing Agency, and Maryland and Virginia Milk Producers' Cooperative Association, Inc. Mr. Gallagher recommended that the over-order premium be set at \$1.95 per hundredweight for July 2004 through December 2004. Mr. Gallagher testified that milk price levels have been the key contributor to the lack of dairy farmer profitability and that declining profitability since late 2001 has led to dairy farmers not staying in business, new dairy farmers not entering the business, and existing farms not purchasing the cows being sold by exiting Pennsylvania dairy farmers or purchasing cows from other states. Mr. Gallagher testified that these factors had led to declining milk production in Pennsylvania.
6. Mr. Gallagher provided specifics regarding the decline in Pennsylvania milk production. He noted that Pennsylvania milk production in April 2004 had declined 5.1% from April

2003, following declines of 7.0%, 7.7%, and 5.4% for January, February, and March 2004 (compared to year prior levels). Mr. Gallagher testified that these declines were due to lower cow numbers and lower output per cow from year-earlier levels. Mr. Gallagher opined that output per cow would continue to decline through September 2004 due to poor feed and the 50% allocation of Posilac. Mr. Gallagher did note, however, that there had been some month-to-month increase in cow numbers, but he felt that the growth in cow numbers would be limited through the remainder of the year due to limited numbers of replacement heifers and cows and the "voracious appetite" for cows from Western United States dairy farmers. Taking all these factors into account, it was Mr. Gallagher's opinion that milk production in Pennsylvania would continue to decline through the summer, but that there was a possibility (if cow numbers did continue to increase and this fall's forages were of higher quality) that Pennsylvania milk production could show modest year-over-year increases during the last quarter of the year.

7. Mr. Gallagher testified that milk supply and demand dynamics in Pennsylvania were currently "very tight," pushing the voluntary premium market higher. Mr. Gallagher noted that manufacturing plants in Pennsylvania were laying off employees and receiving declining volumes of milk; he found this particularly alarming because it was occurring during the spring flush. Mr. Gallagher forecast that less milk would be produced in the summer and through the second half of the year, compounding the issues at Pennsylvania's manufacturing plants, leading to even higher voluntary premiums in an attempt to attract needed milk supplies to the manufacturing plants. Mr. Gallagher also testified that with east coast and southeast milk production declines, additional pressure would be brought to shift milk from Pennsylvania to service markets in the south. Mr. Gallagher further testified that voluntary Class I premiums were poised to increase across the northeast, mid-Atlantic, and mid-east marketplaces, noting that as production declined due to feed and Posilac issues and normal seasonality, the premiums would rise. Mr. Gallagher opined that the \$0.30 increase he recommended would be in line with the market through the summer and fall.
8. Joel Rotz testified on behalf of Pennsylvania Farm Bureau as an expert in dairy economics with particular focus on dairy pricing and costs of production. Mr. Rotz recommended that the over-order premium be set at \$1.80 per hundredweight for the last six months of 2004. Mr. Rotz testified that Pennsylvania was experiencing a "dramatic" reduction in milk production as a result of low milk prices in recent years. Mr. Rotz noted that cow numbers in Pennsylvania had declined by 21,000 from March 2003 to March 2004 and that milk production had declined 5.4% during the same period. Mr. Rotz further testified that costs were increasing: the cost of replacement cows was "astronomical," the cost of soybeans had increased 42% from March 2003 to March 2004, and there had been a 4.8% increase in the cost of fertilizer since March 2003. Mr. Rotz testified that more significant increases could be expected in the near future due to the rise in oil prices driving urea used for nitrogen fertilizer even higher.
9. Mary Keough Ledman testified on behalf of Dean Foods as an expert in milk marketing. Ms. Ledman testified that milk prices will be strong through September 2004, with the Class I mover going down for June and July, but likely to bounce back for September

(and October). Ms. Ledman explained that she took factors other than just the futures markets into account when forecasting prices, so her forecast may be different from a forecast that relied solely on the futures markets.

10. Ms. Ledman also testified that she was involved in a meeting among out-of-state producers and an out-of-state processor regarding the possibility of servicing Pennsylvania accounts with out-of-state milk. Ms. Ledman testified that this type of situation showed that premium alignment was critical to prevent loss of market share by Pennsylvania producers. However, Ms. Ledman did not have an opinion regarding the level of the over-order premium, other than that the current \$1.65 per hundredweight was too high (Dean Foods recommended \$1.10 per hundredweight in its brief). Ms. Ledman did recommend, though, given the amount of volatility in the market this year, that the premium be re-examined in three months, rather than six.
11. Mike Ambruso testified on behalf of Dean Foods. Mr. Ambruso testified that one of his customers, a milk distributor, had moved to New Jersey. One result of this move was that this customer paid a premium of \$1.20 per hundredweight, rather than \$1.65 per hundredweight, on milk it received at its New Jersey location, despite the fact that this same packaged milk was eventually distributed back into Pennsylvania. Mr. Ambruso testified that there were "rumors going around" that other retailers would try to utilize the same type of strategy to take possession of milk outside Pennsylvania to save the difference between the Pennsylvania over-order premium and the out-of-state premium.
12. Mr. Ambruso also testified that his sales in April went down perhaps one to one and a half percent and that his sales for the first two weeks of May went down four to five percent, declines that he attributed to the increasing cost of milk in April and May. Mr. Ambruso noted that it was possible that supermarkets bought milk at the end of April to avoid the large increases in May. Mr. Ambruso testified that, in any event, when the selling price of milk went up 50 to 60 cents per gallon, sales were hurt.
13. Carl Herbein testified on behalf of the Pennsylvania Association of Milk Dealers (PAMD) as an expert in milk cost accounting. Mr. Herbein conducted a study of the premiums paid by milk dealers for sales inside and outside Pennsylvania. The cross section of milk dealers utilized by Mr. Herbein included both in-state and out-of-state milk dealers. The study revealed that the weighted average premium paid on Pennsylvania Class I sales for March 2004 was \$1.57 per hundredweight, while the weighted average premium paid on Class I sales outside of Pennsylvania was \$1.30 per hundredweight. Mr. Herbein's study also revealed that the overall plant blended premiums paid on all milk by dealers located in Pennsylvania for March 2004 was \$1.27 per hundredweight, while the overall plant blended premiums paid on all milk by dealers located outside Pennsylvania was \$1.26 per hundredweight. Mr. Herbein testified that none of the premiums paid outside Pennsylvania were higher than the premium paid inside Pennsylvania. Mr. Herbein offered no recommendation regarding the level or duration of the over-order premium. In its brief, PAMD recommended a premium of \$1.10 per hundredweight for three months.

14. The Board finds that an over-order premium of \$1.30 per hundredweight for a three-month term is the best response to conditions in Pennsylvania at this time.

While we found the testimony of all the witnesses to be credible, the Board does not believe it is advisable to raise the over-order premium at a time when we are seeing the highest milk prices we have seen in three years. On the other hand, we recognize the importance of providing an incentive for producers to increase production, so we do not believe it is advisable to decrease the premium to the level recommended by Dean Foods and PAMD (and we also note that two of the witnesses forecast at least the possibility of an increase in production by the last quarter of the year, without necessarily tying that forecast to any level of the over-order premium). We also believe that the increase in milk prices did have at least some adverse impact on demand, which is of some concern to us.

The Board believes that the disparate recommendations of the interested parties regarding the level of the over-order premium is indicative of some uncertainty about market conditions through the remainder of the year. Because of this apparent uncertainty, the Board finds that the best course to take now is to set a three-month term for the over-order premium so that we can revisit and re-evaluate these issues at a firm future date.

CONCLUSIONS OF LAW

1. The May 20, 2004, hearing on the over-order premium was held pursuant to the authority granted to the Board in sections 801 and 803 of the Milk Marketing Law (Law), 31 P.S. §§ 700j-801 and 700j-803.
2. The hearing was held following adequate notice and all interested parties were given a reasonable opportunity to be heard.
3. All parts of Official General Order No. A-893 not inconsistent with the attached order will continue in effect.
4. In accordance with Official General Order No. A-894, milk dealers shall continue to show by line item on their monthly statements to independent producers and cooperatives the specific amount of the Pennsylvania Milk Marketing Board's over-order premium being paid.
5. In accordance with Official General Order No. A-894 (Supplemental), the over-order premium will continue to apply only to Class I milk produced, processed, and sold in Pennsylvania.
6. In adopting this order, the Board considered the entire record and concludes that the order is supported by a preponderance of credible evidence and is reasonable and appropriate under sections 801 and 803 of the Law.
7. The attached order may be amended pursuant to the procedures set out in section 801 of the Law.

PENNSYLVANIA MILK MARKETING BOARD

Boyd E. Wolff, Chairman

Luke F. Brubaker, Member

Barbara A. Grumbine, Consumer Member

Date: June 16, 2004

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