



Commonwealth of Pennsylvania
Milk Marketing Board
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Official General
Order No. A-982

Posted:
Effective

June 19, 2013
July 1, 2013

OVER-ORDER PREMIUM

NOW, this 19th day of June 2013, 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, 2013, and will expire at 12:00 midnight on December 31, 2013.

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 \$1.60 per hundredweight effective 12:01 a.m. on July 1, 2013, through midnight on December 31, 2013.

(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

Luke F. Brubaker, Chairman

Richard Kriebel, Member

Lynda J. Bowman, Consumer Member

Date: June 19, 2013

**FINDINGS OF FACT AND CONCLUSIONS OF LAW
OVER-ORDER PREMIUM HEARING
MAY 22-23, 2013**

FINDINGS OF FACT

1. On May 22 and 23, 2013, the Pennsylvania Milk Marketing Board (“Board”) held 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 43 Pennsylvania Bulletin 1678 on March 23, 2013, and was mailed to those who have requested mailed notice of Board hearings by means of Bulletin No. 1493, dated March 13, 2013.
3. On May 7, 2013, the Board issued a protective order. The protective order was issued to provide parties an opportunity to provide confidential/proprietary evidence in a manner that would protect the information presented from disclosure.
4. Dennis Schad testified as an expert in agricultural economics and milk marketing on behalf of the Greater Northeast Milk Marketing Agency (“GNEMMA”). Members of GNEMMA with producers in Pennsylvania are Dairy Lea Cooperative Inc.; Dairy Farmers of America, Inc.; Dairy Marketing Services, LLC; Land O’Lakes, Inc.; Maryland and Virginia Milk Producers Cooperative Association, Inc.; and Upstate Niagara Cooperative, Inc. (“Cooperatives”). Mr. Schad recommended that the over-order premium be set at \$1.85 per hundredweight through December 31, 2013.
5. Mr. Schad testified that after two years of bad harvests, crop production conditions improved in 2012, but drought conditions in the Midwest had increased feed prices during 2012 and into 2013. He also testified that futures prices indicated an easing of feed prices during the second half of 2013, noting, though, that futures prices reflected anticipated harvests rather than actual available feed.
6. Mr. Schad testified that the current milk futures market indicated that the 2013 Pennsylvania all-milk price would have the second highest average over the past five years. He also testified that the income over feed costs for 2013 would average the second highest of the past five years, with a second half of 2013 average of \$8.09 per hundredweight. Mr. Schad further testified that the Pennsylvania margin per hundredweight would average the second highest of the past five years.
7. Mr. Schad testified that national milk production and the number of cows in the national dairy herd increased slightly during the first months of 2013. He also testified that Pennsylvania’s milk production and dairy herd had increased slightly in 2013.
8. Mr. Schad testified that the GNEMMA over-order price in New Jersey had remained consistent since the last hearing at \$1.37 per hundredweight, including a \$0.17 fuel adjustment and rBST-free affidavit milk. The GNEMMA price for distribution in

Maryland and Delaware is \$0.10 higher than the New Jersey price. Mr. Schad also testified that the marketing agency in common over-order price in the Mideast for April class I milk was \$2.67 per hundredweight including a fuel adjustment and affidavit premium.

9. Richard Ebert testified on behalf of the Pennsylvania Farm Bureau. Mr. Ebert operates a dairy farm in Westmoreland County with his brother. Mr. Ebert is also Vice President of Pennsylvania Farm Bureau and Chairman of the Pennsylvania Farm Bureau Dairy Committee. Mr. Ebert requested that the over-order premium be set at \$1.85 per hundredweight for at least six months. Mr. Ebert testified that dairy farmers continue to face serious challenges that have placed considerable stress on already tight margins. He testified that while milk prices have improved considerably and some key feed costs have dropped, the majority of his input costs have continued to rise and that despite efforts to efficiently manage the farm, his cost of production is significantly higher than it was a few years ago.
10. Mr. Ebert testified that his farm's income over feed costs for March 2013 was 26 percent lower than it was in March 2011. Mr. Ebert testified that he had been able to reduce this cost of production in 2012 compared to 2011, but at the cost of extending the period between routine maintenance of farm machinery and by delaying needed capital improvements. While manageable now, he testified that continuation of those efforts over the long run would increase the risk of mechanical failure and operational disruptions that would negatively impact profitability.
11. Mr. Ebert testified that his farm had experienced astronomical increases in crop expenses between 2009 and 2012, despite a decrease in acreage in 2012. Crop expenses had increased 97 percent between 2009 and 2012 and due to cost he had decided to not purchase crop insurance in 2013.
12. Mr. Ebert is in the process of bringing his son onto the farm as a partner. He testified that would involve adding cows to the operation and that they will have to work even harder to sustain cash flow, particularly if current conditions remain the same. Mr. Ebert testified that he is concerned that the farm is just one low price swing away from disaster.
13. Michael Evanish testified on behalf of Pennsylvania Farm Bureau as an expert in dairy farm accounting and dairy farm business analysis. Mr. Evanish is manager of MSC Business Services ("MSC"). MSC provides an array of business services to assist farmers economically manage their farm operations. MSC has contracts with over 1,000 dairy farms. Based on comparisons of cost and price averages for 2012 experienced by MSC-serviced farms included so far in preparation for the 2013 Dairy Herd Analysis with cost and price averages for 2011 experienced by these same farms and by all farms included in the 2012 Dairy Herd Analysis, Mr. Evanish recommended that the over-order premium for the remainder of 2013 be set at \$1.85 per hundredweight.

14. Mr. Evanish testified that MSC was in the process of gathering year 2012 information for the production and publication of the 2013 Dairy Herd Analysis. He testified that he was able to identify approximately 250 dairy farms for which MSC had the 2012 information and for which 2011 data were also available, providing a farm-to-farm comparison for 2011 and 2012. For those approximately 250 farms, the total cost of production per hundredweight between 2011 and 2012 was essentially unchanged while the average milk price per hundredweight decreased almost two dollars.
15. Mr. Evanish testified that the past several years have seen the profitability of Pennsylvania's dairy farms being seriously and increasingly challenged by increases in purchased feed costs, with the purchase of feed being the largest expense on dairy farms. Mr. Evanish testified that purchased feed costs represented approximately 23% of revenue for decades, but that beginning in 2008 purchased feed costs increased to represent 29% to 30% of milk revenue. The approximately 250 farm comparison showed a slight decrease in per hundredweight feed expenses between 2012 and 2011.
16. Matthew Espenshade testified on behalf of the Pennsylvania State Grange. Mr. Espenshade is a seventh generation dairy farmer in Lancaster County. His family has owned and operated the farm since 1867. Mr. Espenshade requested that the over-order premium be set at \$1.85 per hundredweight. Mr. Espenshade is a member of Mount Joy Farmers Cooperative. He testified that all of his cooperative's milk goes to plants within Pennsylvania, with the exception of one plant in New Jersey, and that approximately 52% of the milk produced by his cooperative goes to Class I facilities.
17. Mr. Espenshade testified that since January his milk price and margins have declined every month. Mr. Espenshade testified that he had changed feed companies and that feed was less expensive with the new company, but he also testified that the feed mix was different and that the corn in the mix was processed differently; Mr. Espenshade was monitoring his cows to determine the new feed's impacts, if any. Mr. Espenshade testified that fuel costs continue to be a challenge.
18. Carl Herbein testified on behalf of the Pennsylvania Association of Milk Dealers as an expert in cost accounting and milk cost accounting. Mr. Herbein testified that the Board should reduce the over-order premium and fuel adjuster premium by \$1.50 per hundredweight. He testified that the level of out-of-state premiums is considerably lower than the current Pennsylvania premiums facing Pennsylvania retailers. Mr. Herbein further testified that the continued success of the Pennsylvania-mandated premium program depended upon resetting the mandated premiums to a level that the economic inducement to avoid Pennsylvania transactions is eliminated.
19. Mr. Herbein testified that the difference between the Pennsylvania-mandated Class I over-order premium and fuel adjuster and out-of-state premiums in New Jersey, Maryland, and Ohio ranged from \$1.04 per hundredweight to \$1.38 per hundredweight. He testified that this disparity is faced by wholesale and retail customers in Pennsylvania as they evaluate whether to buy packaged milk from a Pennsylvania processor.

20. Mr. Herbein testified that Dean Foods had lost a large retail customer this spring. He testified that the lost business represented approximately 4.9 percent of Pennsylvania's Class I volume. Based on interviews with senior sales executives Mr. Herbein also estimated that existing importing retailer volume represented 9.21 percent of current Pennsylvania Class I sales. Mr. Herbein testified that these Pennsylvania stores have chosen to engage in out-of-state transactions that involve lower raw milk cost pass through and that to recapture this business would partially require addressing the misalignment between Pennsylvania's premium structure and out-of-state premiums.
21. Rob Blaufuss testified on behalf of Dean Foods as an expert in agriculture and dairy economics. Mr. Blaufuss recommended a \$1.50 reduction in the over-order premium and fuel adjuster. Mr. Blaufuss testified that Dean was losing a large volume of milk in Pennsylvania this spring to two out-of-state processors who were able to procure milk at premium levels substantially below the Pennsylvania-mandated premium.
22. Mr. Blaufuss testified that when a customer is comparing raw milk cost components from different suppliers the relevant considerations are the federal order regulated minimums or a state minimum price plus additional premiums. For Pennsylvania processors the additional mandated premiums are the Class I over-order premium and the fuel adjuster which are built into the minimum price. Mr. Blaufuss explained that out-of-state processors can pass through in their wholesale price to retailers the weighted average of premiums paid out. Mr. Blaufuss testified that the Pennsylvania-mandated premium exceeds the premium costs that out-of-state processors in the areas surrounding Pennsylvania have to pass through.
23. Mr. Blaufuss testified that national milk production exceeded year-ago levels in the first quarter of 2013. He also testified that Pennsylvania milk production had increased from year-ago levels for January, February, and March 2013. Mr. Blaufuss further testified that milk production in New Zealand and the European Union had been challenged and shown declines. Mr. Blaufuss testified that reduced world milk production and continued strong international dairy demand would support dairy prices moving forward. He testified that the Six Economists, of which he is a member, forecasted an average Class I mover price of \$18.83 per hundredweight for the second half of 2013, which would be the third highest second half of the year average Class I mover price since 2000.
24. Based on purchased feed costs, Mr. Blaufuss estimated Pennsylvania income over feed costs to average \$8.51 per hundredweight for the second half of 2013. Mr. Blaufuss also estimated the Pennsylvania income over feed costs for the second half of 2013 to average \$7.54 if the Board reduced the mandated over-order premium and fuel adjuster by \$1.50 per hundredweight. Mr. Blaufuss further testified that the majority of Pennsylvania dairy farms grow a substantial amount of their feed, so he expected that actual income over feed costs calculated for individual Pennsylvania dairy farms would be higher.

25. Lynne Bohan testified on behalf of the Pennsylvania Association of Milk Dealers' request to reduce the over-order premium and fuel adjuster premium by \$1.50 per hundredweight. Ms. Bohan is the Vice President of Public Relations and Government Affairs for HP Hood LLC ("Hood"). Hood owns and operates two plants in Pennsylvania.
26. Mr. Bohan testified that Hood's out-of-state competitors are able to offer lower pricing due to the current higher Pennsylvania-mandated premiums built into the wholesale price. She testified that major retailers have begun to recognize that if they purchase milk outside Pennsylvania they can reduce the raw milk portion of their wholesale price. Ms. Bohan testified that Hood's intelligence indicated that premiums in New England and portions of New York were in the neighborhood of \$1.62 per hundredweight.
27. John Pierce testified on behalf of Lehigh Dairies and Swiss Premium Dairy. He testified in support of lowering the over-order premium and fuel adjuster by \$1.50 per hundredweight.
28. Mr. Pierce testified that effective June 1 Lehigh and Swiss would no longer be serving 121 retail stores in Pennsylvania, Delaware, Maryland, and New Jersey that they had been serving for the past nine years. He testified that 78 of those stores were located in Pennsylvania. Mr. Pierce testified that he was involved with the bidding process for that account and believes that if Pennsylvania's mandated premiums were in alignment with premiums in New Jersey, he would have been able to achieve a competitive bid price to retain the business.
29. Mr. Pierce testified that the loss of business amounted to over 14 million gallons per year to an out-of-state processor and would result in 30 layoffs. Mr. Pierce also testified that without a significant adjustment to the mandated-premiums and additional measures such as tweaking dock discounts, the inability of Pennsylvania processors to compete against out-of-state processors would result in additional retailers sourcing milk out-of-state.
30. Mr. Pierce testified that with a realistic over-order premium structure, it would be possible to better determine additional steps, such as larger dock discounts, to address any remaining competitive issues.
31. Robert K. H. Mertz testified on behalf of Schneider-Valley Farms Dairy and Schneider's Dairy. Mr. Mertz is the General Manager of Schneider-Valley Farms Dairy and supported lowering the over-order premium and fuel adjuster premium by \$1.50 per hundredweight.
32. Mr. Mertz testified that both plants had experienced significant volume losses in recent years. He testified that the plants had lost customers to out-of-state competition and that volume the plants wanted to serve also moved out-of-state. Mr. Mertz also testified that he was worried that existing customers were asking the Schneider plants to set up

out-of-state transactions. Mr. Mertz testified that the Pennsylvania-mandated premium structure built into the wholesale minimum price, which had risen above premiums in surrounding states for an extended period of time, was at the root of those issues.

33. Mr. Mertz cited specific accounts that were lost to out-of-state transactions and other accounts that were not available for bid unless the transactions were set up to occur out-of-state. These out-of-state transactions would not include Pennsylvania-mandated premiums in the wholesale price, but would allow the customers to collect the Pennsylvania-mandated premium in the minimum retail price once products were sold in Pennsylvania stores. Mr. Mertz was concerned that the Schneider plants would continue to see their volumes decline since store margins can be improved by sourcing packaged milk outside Pennsylvania. Mr. Mertz further testified that the volume losses already experienced had resulted in farmer layoffs and the elimination of positions at the plants.
34. Dean Ellinwood testified on behalf of GNEMMA as an expert in raw milk procurement, milk marketing, and sales to handlers. Mr. Ellinwood is the Vice President of Sales and Marketing for Dairy Marketing Services (“DMS”). Mr. Ellinwood testified that the over-order premium should be \$1.85 per hundredweight.
35. Mr. Ellinwood testified that the GNEMMA over-order price in New Jersey is \$1.37 per hundredweight, comprised of a \$1.20 premium and a \$0.17 fuel adjuster. He also testified that an additional premium is paid for affidavit milk. Mr. Ellinwood further testified that class prices for milk cannot be directly compared to blend prices paid to producers. Mr. Ellinwood submitted, pursuant to the protective order issued for this hearing, information on total sales volumes and weighted average over-order pricing for DMS class I customers in New Jersey. Among the information provided was the weighted average price on all milk of all utilization, wherever distributed.
36. Mr. Ellinwood testified that the real premiums paid to farms in Ohio should account for hauling subsidies that are not written on milk checks. He testified that the hauling subsidies take the real premiums to between \$1.53 and \$1.63 per hundredweight and that Ohio milk is overall more expensive to the buyer than Pennsylvania milk.
37. Mr. Ellinwood testified that the GNEMMA cooperatives provide balancing plants for the marketplace. He testified that there are millions of dollars of costs providing the service to balance the Class I market and that the money to cover those costs comes from the over-order premium.
38. Mr. Ellinwood testified that building of new plants and the expansion of existing plants in New York are creating a need for additional milk and consequently higher premiums. He testified that the pull of milk within the region is out of Pennsylvania, not into Pennsylvania. Mr. Ellinwood further testified that a reduction in the over-order premium would have an adverse impact on Pennsylvania milk production and Pennsylvania’s competitiveness as a source of supply in the region.

39. Troye Cooper testified on behalf of GNEMMA as an expert in raw milk marketing, milk procurement from producers, and sales to handlers. Mr. Cooper is the Director of Milk Marketing for Maryland and Virginia Milk Producers' Cooperative Association, Inc. Mr. Cooper testified in opposition to any reduction in the over-order premium.
40. Mr. Cooper testified that out-of-state blended premiums should be compared with in-state blended premiums in order to draw any reasonable conclusions. Mr. Cooper testified that there are significant differences between the Pennsylvania-mandated premiums and the weighted average of premiums actually paid out. The Board understands the difference and we believe we understand Mr. Cooper's point. However, we believe the milk dealers' point in comparing the Pennsylvania-mandated Class I premiums to the weighted average blended premiums from surrounding areas is to demonstrate that a higher cost (i.e., the Pennsylvania mandated premium) must be passed through in wholesale transactions that occur in Pennsylvania than the cost that must be passed through (i.e., weighted average blended premiums) in wholesale transactions that occur outside Pennsylvania.
41. Mr. Cooper testified that, based on 2012 Pennsylvania Class I utilization, a \$1.50 per hundredweight reduction in the over-order premium and fuel adjuster would amount to a \$24.6 million reduction in over-order premium payments.
42. Mr. Schad testified that if Pennsylvania Class I sales had declined because of the level of the over-order premium, there should be evidence of changes in sales when the premium level changes. He testified that correlation is a statistical tool used to measure the relationship between two variables. Mr. Schad analyzed the correlation between the combined over-order premium and fuel adjuster and Pennsylvania Class I sales between January 2006 and February 2013 and found only a weak relationship.

Mr. Schad also analyzed the correlation between the over order premium and fuel adjuster level and in-state Class I sales by out-of-state dealers between January 2007 and February 2013. Mr. Schad testified that this correlation was -0.33, indicating that in-state Class I sales by out-of-state dealers declined when the over-order premium increased.

The data Mr. Schad refers to in GNEMMA Exhibit 22 as "Imported Volume" was provided by Board Staff. Mr. Schad described it as in-state Class I sales by out-of-state dealers. Essentially, those are wholesale in-state transactions, subject to Pennsylvania-mandated minimum wholesale prices. Those are the same wholesale in-state transactions, subject to Pennsylvania-mandated minimum wholesale prices, that Pennsylvania processors would make. Contrary to Mr. Schad, the Board would expect dealers subject to the same mandated minimum wholesale prices to appear similar in a correlation analysis using the over-order premium level as a variable, as the over-order premium level is a component of the mandated minimum wholesale price. Both in-state and out-of-state processors are subject to the same over-order premium level as a component of the mandated minimum price on transactions that occur in Pennsylvania, so the Board expects that the correlation would be similar. As Mr. Schad testified, it is

a weak correlation between the level of over-order premium and sales, but the fact it is similar is not surprising.

43. The Board finds that the over-order premium should be set at \$1.60 per hundredweight from July 1, 2013, through December 31, 2013.

Official General Order A-983 establishes a fuel adjuster to the over-order premium of at least \$0.25 per hundredweight, so the combined Pennsylvania mandated premium level will be at least \$1.85 per hundredweight.

44. In finding that the over-order premium should be set at \$1.60 per hundredweight, the Board is persuaded by the totality of the evidence that the level of the over-order premium built into the Board-mandated minimum wholesale price is having a negative impact on in-state sales by in-state processors. We believe that lessening that negative impact on in-state sales now will ultimately result in greater positive impacts on all segments of Pennsylvania's dairy industry. In addition, the testimony was generally in agreement that milk prices would be relatively strong through the second half of 2013, which we find gives the Board some room to reduce the over-order premium for the second half of the year.

45. The Board understands the distinction drawn by various witnesses between the Pennsylvania-mandated Class I premium and weighted average blended premiums. We took into consideration the levels of the weighted average blended premiums as we made our decision. However, as noted above, we are persuaded at this time that the level of the Pennsylvania-mandated Class I premium incorporated in Board-mandated minimum prices has caused a negative impact on in-state sales by in-state processors.

The Board also understands that the over-order premium is paid only on Class I milk produced, processed, and utilized in Pennsylvania and premiums in surrounding markets are generally paid on all classes of milk. However, we do not believe that the Pennsylvania premiums for milk other than Class I Pennsylvania produced, processed, and utilized can be accounted for through the mandated Class I over-order premium.

The Board is concerned that a combination of factors has conspired to begin to adversely impact in-state sales by in-state dealers. Reduced in-state sales by in-state dealers has a negative impact on all segments of Pennsylvania's dairy industry. We emphasize that we do not believe the mandated premiums are the only factor; in fact, we intend to examine all facets of Pennsylvania milk pricing. However, we believe it is appropriate at this time to adjust the mandated over-order premium so that it is more reflective of premiums in surrounding markets and in recognition that it should not be bearing the burden for other classes of milk.

46. The Board appreciates the willingness of witnesses to provide confidential evidence pursuant to the protective order. Much of the evidence provided pursuant to the protective order factored into our decision. Without going into detail regarding that evidence, based on it and the public evidence, we find that a total mandated premium of

\$1.85, consisting of a \$1.60 over-order premium and at least a \$0.25 fuel adjuster, is the lowest that the Board can set the premium. If issues remain with the Pennsylvania-mandated minimum wholesale price, the Board believes at this time that those issues must be addressed other than by reducing the mandated premium any further.

47. The Board is keenly aware of the importance of the over-order premium to Pennsylvania's dairy industry. Given the widely divergent recommendations presented to us and because of the vital importance of the over-order premium to the entire dairy industry, we carefully considered the entire record and find that the weight of the evidence supports this order. Once again, we were challenged with another decision making and believe it is the best decision at this time for Pennsylvania's dairy industry.

CONCLUSIONS OF LAW

1. The May 22 and 23, 2013, 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. The record of the May 5, 2004, hearing regarding diesel fuel add-ons to minimum wholesale prices and the over-order premium was incorporated by reference in this record.
7. Those portions of the record of the December 5-6, 2012, over-order premium hearing containing the examination and cross-examination of Michael Evanish were incorporated by reference in this record.
8. Those portions of the record of the December 5-6, 2012, over-order premium hearing containing the examination and cross-examination of John Turcinov concerning mailbox prices were incorporated by reference in this record.

9. 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.
10. The attached order may be amended pursuant to the procedures set out in section 801 of the Law.

PENNSYLVANIA MILK MARKETING BOARD

Luke F. Brubaker, Chairman

Richard Kriebel, Member

Lynda J. Bowman, Consumer Member

Date: June 19, 2013

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