



Commonwealth of Pennsylvania

Milk Marketing Board
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Official General
Order No. A-914

Posted: June 5, 2001
Effective: July 1, 2001

OVER-ORDER PREMIUM

NOW, this 5th day of June 2001, 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, 2001, and will expire at 12:00 midnight on December 31, 2001.

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 will include an over-order premium of \$1.10 per hundredweight.
- (b) Milk dealers shall show by line item on their monthly statements to independent producers and cooperatives the specific amount of the over-order premium being paid.

SECTION III

All parts of Official General Order No. A-893 not inconsistent with this order shall continue in effect. This official general order supersedes Official General Order No. A-912.

PENNSYLVANIA MILK MARKETING BOARD

Beverly R. Minor, Chairwoman

Luke F. Brubaker, Member

FINDINGS OF FACT AND CONCLUSIONS OF LAW
OVER-ORDER PREMIUM HEARING
MAY 16, 2001

FINDINGS OF FACT

1. On May 16, 2001, the Pennsylvania Milk Marketing Board (Board) convened a hearing for all milk marketing areas to receive testimony and evidence concerning whether an adjustment should be made to the level of the over-order premium of \$1.40 per hundredweight established by Official General Order (OGO) A-912.
2. Notice of the hearing was published at 31 *Pennsylvania Bulletin* 2242 dated April 21, 2001, and was mailed to those on the Board's interested persons list by means of Bulletin No. 1300 dated April 9, 2001. (PMMB Exhibits 1 and 2)
3. At the conclusion of the hearing, a schedule was established for the submission of briefs and reply briefs on May 25, 2001, and May 30, 2001, respectively.
4. C. Arthur Zug, a dairy farmer from Juniata County, testified on behalf of the Pennsylvania Grange. The Pennsylvania Grange supports the continuation of the over-order premium of \$1.40 per hundredweight plus the \$.25 fuel cost. (N.T. 17) Mr. Zug testified that this recommendation was based on a milk supply that is low and demand that is "slightly increasing," production costs that have not decreased in recent months, and fertilizer and seed costs that increased slightly in the last year. (N.T. 17-18) Mr. Zug testified that these additional costs have not been overly excessive, but they still add to the production costs. (N.T. 18) Mr. Zug further testified that milk production on the East Coast has declined which "further indicates that keeping the over-order premium at \$1.40 will not hinder the dairy industry." (Id.) Mr. Zug testified that compared to a year ago, the mailbox price for his milk rose between \$2 and \$3 per hundredweight to \$14.05 for March 2001, while the production costs were in the high "12s, low 13s." (N.T. 30) Mr. Zug recommended that the over-order premium established in this order be in effect for six months. (N.T. 34)
5. Joel Rotz, an expert in dairy economics, testified on behalf of the Pennsylvania Farm Bureau (PFB) that the over-order premium should be lowered to \$.80 per hundredweight for a six-month period, in addition to the \$.25 per hundredweight fuel adjustment cost. (N.T. 37, 46) Mr. Rotz testified that for the Board to make a reasonable determination on the level of over-order premium that will be needed in response to the increase in federal milk prices, "it is necessary for the Board to try and look into the future to assess what levels of prices for milk are expected, if all other conditions remain the same." (N.T. 38) Mr. Rotz developed projected prices for the last six months of 2001 by using Class III and IV futures from the Chicago Mercantile Exchange. (Id.) Based on Mr. Rotz's testimony, the average price to be paid to Pennsylvania producers during the last six months of 2001 would be approximately \$15.87 per hundredweight. (PFB Exhibit 1, N.T. 39)
6. Mr. Rotz presented information from the Pennsylvania Agricultural Statistics Services (PASS) report for the first quarter of 2001 estimating that the average cost of production

for Pennsylvania producers for the 12-month period ending March 2001 was \$14.36 per hundredweight of milk. (PFB Exhibit 2, N.T. 39) Mr. Rotz testified that PFB does not anticipate the cost of production being lowered in the near future. (N.T. 40) Based on this data, the projected margin between the production cost and price received by the producer would result in approximately \$.51 per hundredweight of milk. (N.T. 40) Mr. Rotz further testified; however, that there will actually be a shortfall to the producer when the cost for management (\$.79 per hundredweight), cost for interest on equity (\$1.75 per hundredweight), and a profit of \$.56 per hundredweight (3.5% of cash receipts of the average dairy farm at \$12.41 per hundredweight) is added to the \$14.36 production costs for a hundredweight of milk, resulting in a total of \$17.46. (PFB Exhibit 3, N.T. 41) Based on an average price received by the producer of \$15.87 per hundredweight of milk produced, there would be a shortfall of \$1.59. (Finding of Fact 5, N.T. 42)

7. Mr. Rotz presented evidence that listed the last 12-month averages of costs of production and the average hundredweight price received by the producers as recorded by PASS, along with the margins between the two figures. (PFB Rebuttal Exhibit 1, N.T. 49) Mr. Rotz testified that the margin resulting from the PFB recommended over-order premium of \$.80 per hundredweight is "in line with historically what the Board has provided in similar margins." (N.T. 49) Mr. Rotz also provided testimony that milk production was down 5.3 percent in March 2001 with about 18,000 fewer cows compared to March 2000, and down 4.3 percent over 2000's first quarter with about 14,000 fewer cows. (N.T. 42)
8. Mr. Rotz further testified that the declining cow numbers plus poor quality feed have resulted in lower milk production; however, he noted that recent and projected milk price increases along with higher quality forage may increase milk production but the milk supply will not be returning to last year's levels in the near future. (N.T. 42-43)
9. Edward Gallagher, testified as an expert in agricultural economics and dairy marketing, on behalf of Dairylea, Dairy Farmers of America's Northeast Council, and DMS, that the over-order premium should not be lower than \$1.40 per hundredweight "and that's without the fuel adjustment, \$1.65 with the fuel adjustment." (N.T. 98-99) Mr. Gallagher testified that even at \$1.40, Pennsylvania's Class I procurement ability may be in jeopardy because he is expecting severely tight milk markets in Pennsylvania and throughout the northeast this fall and the Pennsylvania processing plants will have to pay higher handling and voluntary premiums to maintain their milk supply. (N.T. 99-100) Mr. Gallagher expressed concern that the processing plants would be unable to get a quick cost recovery for these voluntary premiums through the Board's wholesale pricing regulations. (N.T. 100, 120, 136, 141, 148, 165, 180-181) According to Mr. Gallagher's testimony, the "significantly sharper decline in the northeast's milk production in the face of strong demand growth, has created the region's tightest supply demand situation in recent memory" and has "put handling and premium increases higher throughout the northeast as a means of rationing the milk supply to some extent." (N.T. 109) Mr. Gallagher also testified that Pennsylvania producers supplied almost 500 million pounds of milk to Federal Order No. 5 (Southeast) during 2000, making Pennsylvania the largest supplier not within the boundaries of that marketing area and predicted that increased procurement of Pennsylvania milk by southeastern handlers will occur this year in order to meet Class I milk sales requirements. (N.T. 114-116)

10. Mr. Gallagher testified that New York city area milk plants are paying premium levels close to the \$1.65 level; Crowley Foods has been paying premiums in excess of \$1.50; voluntary premiums in the compact area are increasing to \$1.50; and manufacturing handlers in Pennsylvania are offering premiums in excess of \$1.60. (N.T. 112) According to Mr. Gallagher's testimony, the current demand and supply imbalance has caused milk handlers to significantly increase premiums paid to producers and predicts that by autumn the premiums "could easily exceed \$2." (N.T. 119)
11. Mr. Gallagher testified that milk production is "significantly" lower in the Northeast by approximately 333 million pounds for January through March with Pennsylvania milk production declining 5.3 percent between March 2000 and March 2001. (DMS Exhibits 1 and 2, N.T. 102, 122) Mr. Gallagher further testified that this lowered milk production, along with increased demands for milk both in the Northeast and the Southeast, has resulted in a "significant bidding up of milk premiums" and that Pennsylvania is an important milk supply area for the south. (N.T. 103) Mr. Gallagher testified that the recommended over-order premium of \$1.40 per hundredweight of milk is based on declining cow herds, farms selling out, and poor feed quality; all factors relative to the decline in milk production in Pennsylvania. (DMS Exhibits 4 and 5, N.T. 104, 106) Mr. Gallagher further testified that the new forage being grown offers hope for improved feed quality with that effect being felt in the late summer. (N.T. 107)
12. Dennis Schad, testifying on behalf of Land O'Lakes and Maryland and Virginia Producers Association as an expert in dairy economics and dairy marketing, recommended an over-order premium of \$.55 per hundredweight plus the \$.25 fuel adjustment for a total premium of \$.80 per hundredweight for a six-month period beginning July 1 and ending December 31, 2001. (N.T. 193, 223) Mr. Schad based this recommendation on three factors: (1) the cost of production for Pennsylvania dairy farmers relative to the price received for milk; (2) supply situation inside the state; and (3) competitive premiums outside the state. (N.T. 192, 249, 251)
13. Mr. Schad testified that the annual cost of production for March 31, which covered the previous twelve months, was \$14.36 per hundredweight of milk, and the cost of production in Pennsylvania for the year ending December 31 was \$14.20. (LOL Exhibit 1 Tables 1 and 2, N.T. 194-195) Mr. Schad presented evidence from the Pennsylvania Agriculture Statistics Service (PASS) reflecting a decrease in feed costs, including corn (\$2.29 per bushel down from \$2.57 a year ago), hay, and soybeans, with the cost of purchase feed amounting to twenty percent of the cost of milk in Pennsylvania. (LOL Exhibit 2, N.T. 197, 199, 208) The PASS report also indicated that Pennsylvania farmers are expected to plant the same amount of corn, a five percent increase in soybeans, and more acres of hay being planted. (LOL Exhibit 2, N.T. 202) Mr. Schad further testified that the U.S. government gave a deficiency payment of \$.65 per hundredweight to approximately ninety percent of Pennsylvania dairy farmers. (N.T. 196, 263)
14. Mr. Schad testified that the annual price received by Pennsylvania dairy farmers in 2000 was \$13.76 per hundredweight reflecting an average price received higher than the average cost of production. (LOL Exhibit 1 Table 2, N.T. 195-196, 199) Mr. Schad estimated that the average blend price for the last half of 2001 will be \$16.09 in Lancaster, compared to the previous year's average blend price of \$13.49 (N.T. 207)

Mr. Schad determined this projected price through a method of forecasting using the future prices presented by the Chicago Mercantile Exchange. This is the same method used by Mr. Rotz in his estimation of Class I prices as well as the blend price. (N.T. 204) Mr. Schad's estimate was \$.19 per hundredweight on average higher than Mr. Rotz's estimate because Mr. Schad used more recent future prices. (N.T. 205, 265) Mr. Schad testified that using future prices is more than an economic estimation but rather the "market place for future time." (N.T. 206)

15. Mr. Schad testified that the current net premium in Maryland is \$1.50 per hundredweight of milk and in New Jersey the net premium is \$1.03 per hundredweight of milk. To arrive at the gross premium paid \$.22 to \$.25 per hundredweight is added to reflect service and handling costs, as well as a \$.20 payment for the cost of balancing. (N.T. 211-212) The southeast is controlled by a pricing agency, the Dairy Cooperative Marketing Agency, and the announced premium for May 2001 is \$.89 per hundredweight with an anticipated June premium of \$.63 per hundredweight of milk. (N.T. 213) Mr. Schad testified that this is a transition time when competitive premiums are going to drop because of the function of the milk price --- when prices go down, the premium goes up and the inverse happens as well. (N.T. 222)
16. Mr. Schad testified that the current National Agriculture Statistics Service (NASS) numbers indicate there is a lower supply of milk in Pennsylvania. Mr. Schad agreed that milk production was down and farm numbers are down but was not certain as to the exact extent. (N.T. 226) Mr. Schad testified that Pennsylvania production is down and Land O'Lakes' production is down but that, when doing a year-to-year comparison, they're "going to come more back into line." (N.T. 210)
17. Earl Fink, testifying on behalf of the Pennsylvania Association of Milk Dealers (PAMD), recommended that the \$1.40 over-order premium plus the \$.25 fuel adjustment be continued for four months beginning July 1, 2001 and that a hearing be held in September or October to consider further adjustments. (N.T. 302) Mr. Fink testified that the factor in PAMD's support of the higher premium was the fact that the milk dealers are unable to recover the over-price premium in the minimum wholesale price until the following year. (N.T. 302-303)
18. The Board finds that the testimony presented by the interested parties indicates that production costs are level or declining slightly and the estimated price of milk to the producer is increasing. Historically, the Board has decreased the over-order premium based on this current market condition. The Board also finds that there is a current market environment reflecting decreased milk supplies with higher demands for milk. The Board finds that the current over-order premium of \$1.40 per hundredweight is no longer at an appropriate level; however, the Board finds that a decrease in the over-order premium of \$.60 to \$.85 per hundredweight may result in Pennsylvania producers being unable to rebound from last year's low milk prices and high production costs. The Board, therefore, finds that an appropriate level of over-order premium is \$1.10 per hundredweight (excluding the \$.25 fuel add-on) and that this over-order premium shall be in effect for a six-month period beginning July 1, 2001.

19. The Board takes administrative notice of the announcement by the U.S. Department of Agriculture on May 31, 2001, that its Commodity Credit Corporation will increase the price it pays for butter by 19.99 cents to \$0.8548 per pound, and decrease the price of nonfat dry milk by 10.32 cents to \$0.9000 per pound. (U.S. Department of Agriculture, Office of Communications News Release) The Board recognizes that this may affect the price that Pennsylvania dairy farmers receive for their milk; however, the Board also recognizes that there has always been and will continue to be volatility in the dairy industry. The Board finds that the over-order premium of \$1.10 per hundredweight and the time period of six months set by this Order remains an appropriate decision of the Board.

CONCLUSIONS OF LAW

1. The May 16, 2001 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 A-893 not inconsistent with the attached order will continue in effect.
4. In accordance with Official General Order 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 over-order premium being paid.
5. In accordance with Official General Order 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 has 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

Beverly R. Minor, Chairwoman

Luke F. Brubaker, Member

Dated: June 5, 2001

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