



Commonwealth of Pennsylvania
Milk Marketing Board
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Official General
Order No. A-961

Posted: April 1, 2009
Effective: April 7, 2009

OVER-ORDER PRICING

NOW, this 1st day of April 2009, 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 April 7, 2009.

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

The Board will not establish a Class I over-order price or pricing formula for milk produced in Pennsylvania, processed in Pennsylvania, and utilized in a contiguous state with a state-mandated over-order price.

PENNSYLVANIA MILK MARKETING BOARD

Richard Kriebel, Chairman

Luke F. Brubaker, Member

Barbara A. Grumbine, Consumer Member

Date: April 1, 2009

FINDINGS OF FACT AND CONCLUSIONS OF LAW
OVER-ORDER PRICING HEARING
MARCH 14, 2008
MARCH 27, 2008
JUNE 24, 2008
JUNE 25, 2008

FINDINGS OF FACT

1. On March 14, 2008, the Pennsylvania Milk Marketing Board (“Board”) convened a hearing for all milk marketing areas to receive testimony and evidence concerning the establishment of a Class I over-order price or pricing formula for milk produced in Pennsylvania, processed in Pennsylvania, and utilized in a contiguous state with a state-mandated over-order price. The hearing continued on March 27, 2008, June 24, 2008, and June 25, 2008.
2. Notice of a hearing was published at 37 Pennsylvania Bulletin 4961 on September 8, 2007, and was mailed to those who have requested mailed notice of Board hearings by means of Bulletin No. 1417, dated August 28, 2007. These hearing notices did not specify a hearing date, time, or location.
3. Hearing notices establishing a hearing date of March 13, 2008, were published at 38 Pennsylvania Bulletin 138 on January 5, 2008, and mailed to those who have requested mailed notice of Board hearings by means of Bulletin No. 1423, dated December 21, 2007. At the request of the Pennsylvania Association of Milk Dealers (“Dealers”), the beginning of the hearing was continued to March 14, 2008.
4. On December 5, 2007, the Board issued a protective order.
5. New Jersey is the only contiguous state with a state-mandated over-order producer price.
6. Edward Gallagher testified as an expert in agricultural economics and milk marketing on behalf of Dairylea 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 Cooperatives, Inc. (“Cooperatives” or “Cooperative Petitioners”). Mr. Gallagher is the Vice President of Economics and Risk Management for Dairylea Cooperative and Dairy Marketing Services and acts in a consultant basis with Dairy Farmers of America.

Mr. Gallagher testified that the Cooperatives were requesting that the Board establish an over-order premium for milk produced in Pennsylvania, processed in Pennsylvania, and distributed into New Jersey. He testified that the premium should be equal to the Pennsylvania over-order premium fuel adjuster, noting that the fuel adjuster premium formula used by New Jersey was almost exactly the same as that used by the Board.

7. Mr. Gallagher testified that the United States and Pennsylvania dairy industries are now involved in a global dairy market. Worldwide demand for meat, oil, energy, and other commodities has increased, putting upward pressure on farm input costs in the United States. In addition, federal and state energy policies promoting the use of animal feed for ethanol have also increased input costs to dairy farmers. Mr. Gallagher testified that as long as worldwide economic growth and ethanol production continue, livestock feed prices will remain highly volatile and expensive.
8. Mr. Gallagher testified that historically and over the long term the price of milk has to cover the average cost of producing milk plus the appropriate return for a farm to continue its investment in the dairy industry. However, in the short term, the market place will determine a milk price that is based on the international supply of milk and the international demand for milk. Mr. Gallagher testified that this leads to “treacherous” milk price volatility impacting Pennsylvania’s dairy farms, with milk price cycles fluctuating between record highs and periods in which the average milk price does not cover most farms’ cost of production. Mr. Gallagher further testified that with the increased international influence and the growth in ethanol production, he expected the milk price variability to increase dramatically.

Mr. Gallagher testified that Pennsylvania dairy farmers cannot survive on the prospect that the long term milk price will cover their costs of production since they do not receive the average milk price month-in and month-out. He testified that Pennsylvania dairy farmers need to derive additional income to assist them in managing through low milk prices, high production costs, and the milk price uncertainty inherent in the global market place. Mr. Gallagher further testified that the additional income needs to be derived on a consistent basis to reduce the risk of operating and continuing to invest in the dairy business.

Mr. Gallagher testified that the Board could assist in improving dairy farmer income and reducing the financial risks inherent in dairy farming by extending the scope of the over-order premium. He testified that, in addition to directly increasing milk prices, extending the scope of the over-order premium would have an indirect effect allowing cooperatives to obtain additional premiums outside of Pennsylvania that would benefit Pennsylvania producers.

9. Mr. Gallagher noted that the Pennsylvania Milk Marketing Law requires that the Board’s prices not be “destructive” of the price structure of producers in other states. He testified that this means that Board prices should not “undermine” efforts by other states to set prices to support their dairy farming sector. Mr. Gallagher testified that presently the Board’s establishment of pricing for milk produced and processed in Pennsylvania and sold in New Jersey “threatens” the ability of New Jersey to operate its over-order pricing program.

Mr. Gallagher testified that the Cooperatives have established over-order Class I premiums for milk processed in Pennsylvania and distributed into New Jersey. Mr. Gallagher also testified that for Pennsylvania plants purchasing milk from independent

dairy farmers, there is no premium for milk distributed into New Jersey. He testified that for Pennsylvania plants with independent producers, the Class I over-order premium for milk produced, processed, and sold in Pennsylvania generated a producer premium to the independent producers of a sufficient level that they did not have to pay their farms additional premiums, meaning that the entire cost of their independent milk supply could be charged to Pennsylvania consumers, allowing these plants to sell into New Jersey at a zero premium. Mr. Gallagher testified that this undermined the ability of New Jersey and the Cooperatives to establish over-order premiums in New Jersey to protect its dairy farmers from the increased price variability emanating from the global dairy industry. He also testified that since significant volumes of Pennsylvania-produced milk are sold into New Jersey, the lack of a Board-mandated premium on sales into New Jersey undermines the ability of the Cooperatives to mitigate price volatility issues for Pennsylvania dairy farmers.

Mr. Gallagher acknowledged, however, that while the mandated premium for sales into New Jersey was zero, the market premium was not zero. Mr. Gallagher also testified that independent producers were being paid competitive prices.

10. Mr. Gallagher also testified that the Board-mandated premium on milk produced, processed, and sold in Pennsylvania could not continue at the levels it has been at if there were no premiums in surrounding states. He testified that the Cooperatives' efforts to add premiums in surrounding states reinforces the Board in its efforts to maintain premiums in Pennsylvania.
11. Dennis Schad testified as an expert in agricultural economics and milk marketing on behalf of the Cooperative Petitioners. Mr. Schad testified that the Board should establish an over-order price for milk produced in Pennsylvania, processed in Pennsylvania, and sold in New Jersey, equal to Pennsylvania's over-order premium fuel adjuster.
12. Mr. Schad testified that while Pennsylvania dairy farmers enjoy a higher milk price than the national average, they also incur higher costs than the national average. He testified that between January 1998 and December 2007, the Pennsylvania-specific milk-feed ratio exceeded the expansion threshold ratio of 3.0 18% of the time, while the national milk-feed ratio exceeded the expansion threshold 51% of the time, indicating that higher feed costs never allow Pennsylvania dairy farmers to share in the really good times of high milk prices.
13. Mr. Schad testified that Pennsylvania producers have been in a precarious position during the last ten years despite the efforts of the Board, with high costs and inadequate milk returns leading to a decrease in dairy farm numbers, cows, and milk production since 1998. Mr. Schad also testified that Pennsylvania's share of national milk production has decreased since 1998.
14. Mr. Schad predicted decreased Pennsylvania producer prices for 2008. He also predicted that the Pennsylvania-specific milk-feed ratio would decline to below 2.0

during 2008. He testified that milk-feed ratios below 2.0 can only portend disastrous consequences for Pennsylvania's dairy farms.

15. Mr. Schad testified that it was possible that dealers could incur an unrecoverable cost paying the over-order price proposed by the Cooperative Petitioners.
16. Michael Evanish testified on behalf of Pennsylvania Farm Bureau as an expert in dairy farm accounting and financial business analysis. Mr. Evanish has been the Manager of MSC Business Services ("MSC") since 1997 and has over 30 years experience with MSC providing business and financial consulting services to farm clients. As part of that service, MSC Business Services develops and presents proposals to financial institutions for securing credit for its clients. Mr. Evanish testified that additional income was needed to economically sustain average-sized dairy farms in Pennsylvania and grow the state's dairy industry and that the Board should expand the scope of the state-mandated over-order premium.
17. Mr. Evanish testified that the Board's mandated over-order premium has played a substantial role in keeping many individual Pennsylvania dairy farm operations in business, helping to sustain the industry as a whole in the state. He testified, however, that the price received by average-sized Pennsylvania dairy farms has not been sufficient to alleviate the consistent pattern of negative profit margins these farmers have experienced in recent years.
18. Mr. Evanish testified that an analysis of MSC's dairy farm clients showed, for farms with 100 cows or less, a five-year (2002-2006) average net loss of \$0.90 per hundredweight. The average number of cows reported in the "100 cows or less" category closely resembles the number of cows reported to be the average size for Pennsylvania dairy farms.
19. Mr. Evanish testified that during 2007 and 2008 the prices projected to be received by Pennsylvania dairy farms would be better than the prices they received during 2002 – 2006. However, Mr. Evanish also testified that the higher prices would not necessarily equate to profitability for average Pennsylvania dairy farms due to sharp increases in feed costs. Mr. Evanish further testified that despite the relatively improved price situation, average-sized Pennsylvania dairy farms had not recovered from the financial problems they encountered from 2002 – 2006.
20. Mr. Evanish testified that there were 800 fewer commercial dairy herds in 2006 than 2002 and that cow numbers had steadily declined from 2002 through 2007. Mr. Evanish testified that this continuing trend would discourage new farmers from entering into dairy production and that the future financial health of Pennsylvania's dairy industry would be adversely impacted if farmers lost through retirement and natural attrition were not replaced.
21. Mr. Evanish testified that Pennsylvania's dairy farmers are facing an uncertain future due to their continued levels of sustained losses. He testified that the continued

inability of these farmers to operate profitably made it difficult for them to maintain and make needed upgrades to their farm operations, infrastructure, and machinery, and weakened their ability to be viably operated.

22. David DeSantis testified on behalf of Governor Rendell and Secretary of Agriculture Wolff (“Commonwealth”) as an expert in the Pennsylvania Milk Marketing Law and its implementation and enforcement, and auditing and accounting procedures. Mr. DeSantis also testified as an expert in the movement of milk regulated by the Board and monitored by the Board. The Commonwealth requested that the Board establish an over-order premium for milk produced and processed in Pennsylvania for distribution into New Jersey, equal to the Pennsylvania over-order premium fuel adjuster.
23. Mr. Desantis performed an analysis of Pennsylvania dealers selling Class I packaged product into New Jersey. Mr. DeSantis excluded from the analysis an organic processor because organic producers receive a price greater than any price that could be mandated by the Board. Mr. DeSantis also excluded producer-dealers, who do not buy milk from other producers, selling into New Jersey.

Mr. DeSantis gathered information on Pennsylvania dealers’ Class I packaged sales into New Jersey, the amount of Pennsylvania producer milk bought by those dealers, and total Class I packaged sales by those dealers from reports filed with the Board by those dealers. Mr. DeSantis calculated that a hypothetical premium rate of \$0.15 per hundredweight would have generated \$773,212.00 in 2005, \$806,982.00 in 2006, and \$680,830.00 during the first ten months of 2007.
24. Mr. DeSantis testified that Pennsylvania dealers currently report all of the information needed for the Board to calculate minimum producer obligations if a premium were to be mandated on packaged sales into New Jersey.
25. Gary Truckenmiller testified in favor of expanding the scope of the over-order premium. Mr. Truckenmiller is an independent Pennsylvania dairy producer shipping to Readington Farms in New Jersey. Mr. Truckenmiller testified that he favored the proposal to expand the scope of the over-order premium even though it would not directly benefit him. He believed that he would receive an indirect benefit because it would raise the market price paid to other shippers.
26. Todd Rutter testified. Mr. Rutter is President of the Dairy Division of Rutter’s Dairy (“Rutter’s”) in York, Pennsylvania. Rutter’s has been processing milk since 1921 and has operated a farm since 1747. Rutter’s has about 150 employees and sells milk in Pennsylvania, New Jersey, Maryland, Delaware, and Virginia. Rutter’s also owns 50 stores, all located in Pennsylvania, to which the dairy sells milk at applicable Pennsylvania minimum wholesale prices. Mr. Rutter testified that for sales out-of-state, sales were competitive to the tenth and hundredth of a cent per unit.
27. Mr. Rutter testified that about 72% of Rutter’s business in New Jersey is sales of half-pint containers to a New Jersey distributor who resells to New Jersey state institutions

and New Jersey school districts. Mr. Rutter further testified that the distributor operated on yearly contracts with its customers and that it would have no ability to change its pricing formats in the middle of a contract term. Mr. Rutter explained that there was a Class I mover adjustment but no provision to acknowledge additional surcharges or premiums on the cost of milk. The remainder of Rutter's business in New Jersey is mixed sizes to another distributor.

28. Mr. Rutter testified that approximately 78% of the milk supply to the Rutter's processing plant is from independent producers. He testified that he pays a competitive price to the independent producers on "the high side," and noted that Rutter's had not lost a producer due to price since he had been in charge of the independent milk supply and that Rutter's had a waiting list of farmers wanting to supply Rutter's. Mr. Rutter also testified that there are multiple cooperatives that want to sell milk to Rutter's and that they compete against each other to sell milk to Rutter's. Mr. Rutter testified that Rutter's is billed by the cooperative supplying it milk for distribution in New Jersey in excess of \$0.65 per hundredweight. Mr. Rutter testified that 80% - 85% of the milk Rutter's receives is from Pennsylvania farms, with the remainder coming from Maryland farms. He testified that Rutter's receives both independent and cooperative milk from both Pennsylvania and Maryland.
29. Mr. Rutter testified that if Rutter's had to pay an additional premium on New Jersey distribution, causing Rutter's to become uncompetitive in New Jersey, then there was "little doubt" that Rutter's would lose most of its New Jersey business within 30 days. Mr. Rutter testified that Rutter's competes against plants in New Jersey, Maryland, and New York for New Jersey business. Mr. Rutter did testify that one way to "circumvent" an additional mandated premium would be to only accept Maryland milk from the cooperative supplying Rutter's, thus reducing Pennsylvania pounds. Mr. Rutter also testified that the competition in New Jersey is greater than in any other state where Rutter's sells.
30. Tom Mullery testified. Mr. Mullery has worked in the Pennsylvania dairy processing industry since 1963. He is currently a Vice President for Clover Farms Dairy ("Clover") in Reading, Pennsylvania. Mr. Mullery testified that Clover is an independent family-owned milk processor that has been in business since 1937.
31. In describing Clover's competitive situation, Mr. Mullery testified that Clover prices packaged products to five decimals. Mr. Mullery testified that approximately 60% of Clover's milk supply is from independent producers and that Clover's milk supply is 100% Pennsylvania-sourced. He further testified that independent producers are paid, in addition to Pennsylvania-mandated prices, quality premiums, volume premiums, and a Clover premium. Mr. Mullery testified that Clover's cooperative supply is paid "the mandated pricing."
32. Mr. Mullery testified that if a mandated premium on New Jersey distribution caused Clover to become uncompetitive, it would try to adjust its voluntary premiums. Mr. Mullery explained that the voluntary premiums may have to be adjusted because of the

competitive conditions in the market, where low cost handlers do better than high cost handlers. Mr. Mullery estimated that the New Jersey-mandated fuel adjuster premium amounted to \$0.005 per gallon for New Jersey processors and that a similar premium would amount to at least \$0.055 - \$0.06 per gallon for Clover. He also testified that he understood that the New Jersey-mandated premium was greater than just a fuel adjuster.

33. Mr. Mullery testified that Clover sells to distributors in New Jersey, which he characterized as the typical way business is done in New Jersey. Mr. Mullery testified that over 50% of Clover's volume of packaged milk sales goes to New Jersey and New York. Mr. Mullery also testified that Clover has competition for New Jersey sales from plants in New York, Maryland, New Jersey, and from Costco sales at retail of milk shipped from Ohio. Mr. Mullery also testified that if Clover's raw milk costs increase, Clover would have to charge its customers the amount of the increase and would risk losing those customers to plants that do not have to pay the increased cost. Mr. Mullery further testified that Clover had concluded that its customers "appear to be very willing" to take their business from Clover if the fuel adjuster premium is adopted. In that case, Mr. Mullery testified, Clover would have to lay off employees and farmers, which would damage the agricultural economy of Berks County.
34. Donald Duncan testified. Mr. Duncan is an independent Pennsylvania dairy producer shipping to Clover. Mr. Duncan testified that, as an independent shipper, it was his responsibility to monitor and control the price he receives for his milk and that if he felt his price was not competitive with other markets in his area, he had the opportunity to ship to other markets. He testified that he had not chosen to change markets because he would lose some advantages of shipping to Clover and also because it was important to him that Clover was a secure market. Mr. Duncan believed that Clover was paying a competitive price to retain producers. Mr. Duncan also believed that if Clover were required to pay a premium on New Jersey distribution Clover could lose business, causing Clover to lay-off shippers. Mr. Duncan also testified that if he lost his Clover market and had to ship to a cooperative that he would receive less money for his milk.
35. Christine Dewey testified. At the time of her testimony, Ms. Dewey was a financial analyst and in the process of moving to a marketing position for Harrisburg Dairies. Harrisburg Dairies was founded in 1931 by Ms. Dewey's great grandfather.
36. Ms. Dewey testified that Harrisburg Dairies has a 100% Pennsylvania independent supply of raw milk. She testified that Harrisburg Dairies attempts to pay the highest price in the market. She testified that Harrisburg Dairies pays, in addition to the Pennsylvania-mandated over-order premium, a quality premium, a volume premium, and an rBST-free premium. Ms. Dewey testified that in Harrisburg Dairies' experience, producers look to the bottom line on their paycheck and are not concerned about what individual line items are called. She further testified that if a mandated fuel adjuster premium is implemented, Harrisburg Dairies could re-evaluate its voluntary premiums in order to stay competitive.

37. Ms. Dewey testified that when bidding business, tenths of a penny on a gallon determined whether Harrisburg Dairies would be successful. She also testified that the previous two years had been the toughest Harrisburg Dairies had experienced in its history, leading to farmer and employee lay offs for the first time in the company's history. Ms. Dewey testified that sales to New Jersey were not a huge volume of Harrisburg Dairies' business, but that those sales were not insignificant and that losing those sales would be a significant loss. Ms. Dewey testified that Harrisburg Dairies ships to approximately 15 states, with the largest volume going to Pennsylvania, Maryland, and Virginia. She testified that sales to New Jersey were to distributors and some direct store sales through regional accounts. Ms. Dewey also testified that the distributor sales were actually a little higher than market price.
38. Ms. Dewey testified that an increased cost of \$0.65 per hundredweight on the New Jersey sales would cause Harrisburg Dairies to lose the distributor accounts, since they were already slightly above market price. She also testified that it would put the entire regional accounts at risk if Harrisburg Dairies could not be competitive in New Jersey. Ms. Dewey further testified that if Harrisburg Dairies lost its New Jersey business, it would have to lay off two or three additional farms.
39. Dan Rice testified. Mr. Rice ships to Harrisburg Dairies. His farm, at the time owned by his uncle, began shipping to Harrisburg Dairies in 1931. Mr. Rice testified that he considered Harrisburg Dairies to be the benchmark for competitive pricing for its producers and that he was concerned that if Harrisburg Dairies lost business that a producer like himself could be laid off.
40. Evan Kinser testified on behalf of Dean Foods Company, Inc. ("Dean"), as an expert in agricultural and dairy economics. Dean owns and operates five distributing plants located in Pennsylvania, each of which purchases milk from Pennsylvania producers and sells milk in Pennsylvania. Two of the Dean Pennsylvania plants also sell milk into New Jersey. Dean also owns and operates a plant located in New Jersey that sells milk into Pennsylvania and other states. Mr. Kinser opposed the expansion of the over-order premium to include a fuel adjuster on sales into New Jersey.
41. Mr. Kinser testified that Dean is concerned about the Board making the "significant" policy shift of expanding the scope of the over-order premium. Mr. Kinser testified that the Board should not expand the scope of the over-order premium beyond milk produced, processed, and sold in Pennsylvania for the purpose of benefiting other states' dairy farmers without fully understanding the implications for the Pennsylvania dairy industry as a whole. Mr. Kinser testified that implementing the fuel adjuster on New Jersey sales would have a minimal impact on Pennsylvania dairy farmers compared to the existing value that the Board provides Pennsylvania dairy farmers with a largely cooperative industry effort. He further testified that the "real winners" would be dairy farmers in other states and that the risk for Pennsylvania dairy farmers and processors alike would be a reconstructed competitive landscape that benefits out-of-state entities.

42. Mr. Kinser testified that if the fuel adjuster premium for sales into New Jersey was implemented, Pennsylvania milk plants would be “challenged” to keep their milk sales into New Jersey. He testified that the Pennsylvania plants would see their costs increase on sales into New Jersey and that there are already existing sales from competitors located in surrounding states without state-mandated premiums. Mr. Kinser testified that Pennsylvania dairy farmers would not be able to maintain their market share if their purchasing plant loses New Jersey customers.
43. Mr. Kinser testified that generally Dean faces existing broad competition from processors located in Ohio, New York, and other locations for sales in New Jersey. Mr. Kinser characterized the market in Pennsylvania and New Jersey as “very, very competitive.” Mr. Kinser testified that in February 2008 Dean lost its sales to the New Jersey Costco stores to Superior Dairy, which is located in Ohio. The Dean sales to Costco were from Dean’s New Jersey plant. Mr. Kinser testified that Superior Dairy offers a caseless jug to Costco and that Dean had a similar product that it had sold to Costco. Dean believes it lost the Costco business due to price. Mr. Kinser testified that there were impacts beyond just the loss of the Costco business: per unit costs increase in the plant so that it becomes more expensive to serve existing customers and when the lower cost appears at retail Dean faces pressure from existing customers to help them be competitive with the new retail price point.
44. Mr. Kinser testified that Dean had not observed Ohio-based processors being constrained by milk supply issues. He testified that they aggressively press Dean and that he had not heard of Dean picking up any Ohio business, so the Ohio plants are not essentially replacing one sale for another.
45. Mr. Kinser testified that payments above the Pennsylvania-mandated minimum are “absolutely” fungible. Mr. Kinser testified that in Pennsylvania Dean had lowered a quality premium while increasing the state-mandated premium to be in compliance with the law, but in such a way that it had zero impact on Dean’s cost of raw milk.
46. Carl Herbein testified on behalf of the Pennsylvania Association of Milk Dealers (“Dealers”) as an expert in cost accounting and milk cost accounting. Mr. Herbein testified that the proposal to mandate an over-order premium equal to the Pennsylvania fuel adjuster on milk produced in Pennsylvania, processed in Pennsylvania, and sold into New Jersey would not result in any additional premium payments to Pennsylvania dairy producers or to their cooperatives.
47. Mr. Herbein conducted a study of ten Pennsylvania dealers that sold milk into New Jersey from January 2005 through October 2007. Mr. Herbein analyzed product sales data and producer payment information for the ten dealers for the months of May 2005, October 2005, December 2005, May 2006, October 2006, December 2006, May 2007, and October 2007 (Mr. Herbein used July 2007 for two of the dealers because Board Staff had not completed October 2007 audit work at those two dealers by the time Mr. Herbein conducted his study). Mr. Herbein opined that the eight months he studied were representative of market conditions from January 2005 through October 2007.

Mr. Herbein calculated the amount of additional over-order premium cost that would be incurred by each dealer for each tested month based on their actual sales into New Jersey. Mr. Herbein testified that Pennsylvania dealers were paying premiums on raw milk above the amounts required by the Board-mandated over-order premium.

48. Mr. Herbein compared the amount of the overpayment to producers to the additional cost that would have been incurred if the premium on milk sold into New Jersey had been in effect. Mr. Herbein used the fuel adjuster premium of \$0.65 per hundredweight effective in New Jersey in February 2008 for his comparison. Mr. Herbein testified that for each dealer for each month analyzed there was an excess of overpayment. Mr. Herbein concluded that, if the fuel adjuster premium had been in effect for sales into New Jersey, Pennsylvania dealers would not have needed to make any additional premium payments – the voluntary premiums they paid were in excess of what would have been the mandated fuel-adjuster premium. After an opportunity to re-review Producer Obligation Worksheets and Board Bulletin 1376 (regarding calculation of minimum producer obligation when a line item on a check or remittance advice indicates voluntary premiums that are represented to the producer to be over and above the Board-enforced minimum producer price), Mr. Herbein testified that he continued to believe that little, if any, additional revenue would be generated if the fuel-adjuster premium were implemented. Mr. Herbein also testified that the trend was for the voluntary over-price premium to increase over time, making adoption of the fuel-adjuster premium even less likely to have real life effect.
49. Mr. Herbein also testified that there was a potential, if market conditions or subsequent proposals alter the out-of-state premium, for a non-competitive market condition if the over-order premium were expanded to include sales into New Jersey. Mr. Herbein testified that plants physically located in Pennsylvania could be placed at a competitive disadvantage to plants located in New Jersey. Mr. Herbein provided as an example two similar fluid processing plants, one located in Pennsylvania and one located in New Jersey, both using raw milk sourced in Pennsylvania. The Pennsylvania plant would have a mandated fuel-adjuster premium on its Pennsylvania-produced milk for sales into New Jersey and the competing New Jersey plant would have no mandated premium on its Pennsylvania-produced milk. The Pennsylvania plant would not be able to be competitive with the New Jersey plant because the fuel-adjuster premium would make the Pennsylvania plant's raw milk costs higher than its New Jersey competitor's. Mr. Herbein did note that as long as market conditions remained unchanged from the time of his study, there would be no practical impact and the raw milk competitive disadvantage he described remained theoretical. However, Mr. Herbein testified that the impacts could not really be known precisely because current marketing conditions provided a buffer to any present impacts.
50. Mr. Herbein testified that the dealers used in his study acquired milk from both independent producers and cooperatives, which required some additional analysis to determine if the mandated fuel-adjuster premium for sales into New Jersey would be less than or greater than voluntary over-price premiums. Mr. Herbein determined that one dealer would have had to increase its independent producer premium \$0.01 per

hundredweight in October 2005 and \$0.03 per hundredweight in December 2005. Mr. Herbein testified that the additional payment to that plant's independent producers for those two months would have totaled \$2,300.00.

51. Mr. Herbein testified that money is fungible. He testified that overpayments that could be impacted by Board Bulletin 1376 could be renegotiated or relabeled. Mr. Herbein testified that labels on milk checks can and do change as marketing conditions change and that producers are interested in receiving fair market price regardless of how the check is labeled.
52. Mr. Herbein was questioned on cross-examination regarding the application of Board Bulletin 1376 and its effect on his analysis. Mr. Herbein continued to testify that payments between processors and producers were fungible and that there were other ways that payments could be labeled and made.
53. Dave DeSantis testified regarding the fungible nature of processor payments to producers and the application of Board Bulletin 1376. Mr. DeSantis testified that if the Board implemented the fuel adjuster premium for sales into New Jersey, Pennsylvania dealers that were not already paying New Jersey-based premiums would increase their payments to their producers. He also testified that to the extent that the fuel adjuster premium was higher than the rate being paid by dealers paying a New Jersey-based premium, those dealers would pay more to their producers.

Mr. DeSantis analyzed May 2007 overpayments for the same group of dealers used by Mr. Herbein in his study. Mr. DeSantis concluded that the majority of the overpayment fell into categories that Board auditors would exclude from consideration when evaluating minimum payments to producers pursuant to Board Bulletin 1376.

54. Mr. DeSantis testified that implied in Mr. Herbein's argument was the idea that if the Board increased mandated premiums, the dealers would reduce voluntary premiums. Mr. DeSantis conducted an analysis of the mandated Pennsylvania over-order premium and the average voluntary over-price premium paid by dealers from 2004 through 2007. Mr. DeSantis testified that there was no correlation between the level of the mandated over-order premium and the level of the voluntary over-price premium. Mr. DeSantis concluded that if the fuel adjuster premium for sales into New Jersey were implemented, there would be an increase in Pennsylvania producer income, dependent on the rate set by the Board and the dealers' future milk procurement and sales behavior.
55. Mr. DeSantis testified that it would be "very proper" to allow milk dealers to recover through Pennsylvania minimum resale prices any additional costs incurred by paying a fuel adjuster premium for sales into New Jersey. He testified that the Pennsylvania system of minimum resale pricing encourages dealers to pay premiums because the dealers can recover the costs of those premiums in the minimum resale price. Mr. DeSantis also testified that he understood New Jersey to have a law providing that milk

dealers could not sell milk in New Jersey below their costs, including payments to producers.

56. Jeffrey Sims testified on behalf of the Cooperative Petitioners as an expert in agricultural economics, milk marketing, and over-order pricing. Since 1996 Mr. Sims has been an independent contractor providing consulting and business services to the dairy industry. Prior to that, he was an Assistant Federal Milk Market Administrator in Louisville, Kentucky, for five years; Assistant to the Federal Milk Market Administrator in Atlanta, Georgia, for four years; and an agricultural economist for the Federal Milk Market Administrator in Atlanta, Georgia, for four years.
57. Mr. Sims testified that if a fuel adjuster premium were implemented for sales into New Jersey, there were three possible scenarios regarding dealer to producer price response. First, that total producer prices would decrease, which Mr. Sims considered extremely unlikely. Second, that producers would see no net gain in their income – that currently unregulated payments would simply become regulated payments – which he considered not likely. The third scenario, which Mr. Sims considered much more likely, is that net producer income would increase. Mr. Sims testified that producer cooperatives would receive the mandated premium and attempt to preserve some portion of existing overpayments. He testified that, given the history of over-price premiums and their response to changes in the Pennsylvania-mandated over-order premium, it was a distinct possibility that virtually all of the existing over-price premiums would be preserved. Mr. Sims further testified that, in recent years Federal Order producer minimum prices had rarely been increased, but that when they had over order prices had remained at levels at or very near those levels existing prior to the Federal price change and that consequently producer income had increased.
58. Mr. Sims testified that payments by processors to producers above the regulated minimums represent payment for something of value or are competitively driven, or are a combination of the two. He testified, for instance, that high quality provides an economic benefit to processors by allowing them to extend the shelf life of their products. Mr. Sims also noted that cooperatives provide services to processors such as balancing of supplies, scheduling, payroll, milk accounting, and quality assurance, all of which have attendant costs which the processors would have to incur if they performed the functions themselves and which the processors pay to the cooperatives in the form of a service charge.
59. Noting the lack of correlation between Pennsylvania over-order premium levels and over-price premium levels, Mr. Sims testified that the over-price premiums are driven by competition. Mr. Sims testified that processors, although desirous of reducing the key raw milk input cost, seemed not to decrease the level of over-price premium being paid even when the mandated over-order premium increased. Mr. Sims testified that it was doubtful that imposition of the fuel adjuster premium for sales into New Jersey would change that dynamic. He concluded that any reductions to payments to producers in excess of regulated minimums would be less than the increase in mandated

payments and that total producer income would increase if the fuel adjuster premium were implemented.

60. Mr. Sims testified that even if current voluntary payments were simply relabeled as mandatory payments, leading to no net increase in producer income, there were still economic justifications for implementing the fuel adjuster premium. He testified that an additional important value of milk price regulation is stability; milk prices established by regulation have an assurance of existence, thereby providing producers something of value.
61. Mr. Gallagher testified regarding whether Pennsylvania dealers would be placed at a competitive disadvantage with respect to dealers located in other states if the Pennsylvania dealers were required to pay a mandated premium on sales into New Jersey. Based on the cost to move packaged milk, milk availability and cost, and the then-current fuel adjuster premium of \$0.98 per hundredweight, Mr. Gallagher testified that packaged milk could not be brought in more competitively from Ohio, Maryland, Delaware, New York, or New Jersey to displace Pennsylvania sales into New Jersey.
62. Mr. Gallagher also testified regarding the availability of non-Pennsylvania produced milk for Pennsylvania dealers. Mr. Gallagher testified that all producer milk had a home and that it was all competitively priced. He testified that what it would cost to haul the milk in and what it would cost to get the milk away from whoever was purchasing it would exceed \$0.98 per hundredweight.
63. The Board finds that a Class I over-order price or pricing formula for milk produced in Pennsylvania, processed in Pennsylvania, and utilized in a contiguous state with a state-mandated over-order price should not be adopted. The Board is not persuaded that mandating such an over-order price will result in any economic benefit for Pennsylvania producers.
64. The Board finds credible and persuasive the testimony of Mr. Rutter, Mr. Mullery, and Ms. Dewey that mandating the fuel adjuster premium could have serious adverse impacts on their businesses due to making them uncompetitive on sales into New Jersey. The Board also finds credible and persuasive Mr. Rutter's testimony that Rutter's could attempt to "circumvent" a new premium by only accepting Maryland milk from its cooperative supplier. The Board finds credible and persuasive Mr. Mullery's testimony that Clover could adjust its voluntary premiums in response to a new mandated premium and that loss of New Jersey sales could lead to Clover laying off farmers and employees. The Board finds credible and persuasive Ms. Dewey's testimony that if Harrisburg Dairies lost its New Jersey business it would have to lay off farmers.
65. The Board finds credible and persuasive Mr. Herbein's testimony that money is fungible and that dealers would react to a mandated New Jersey premium by simply recharacterizing or relabeling existing voluntary overpayments. We note that this testimony is supported by Mr. Mullery's credible and persuasive testimony. The Board

also finds credible and persuasive the supporting testimony of Mr. Kinser that Dean had lowered a quality premium while increasing the state-mandated premium in such a way that there was no impact on Dean's cost of raw milk.

We recognize that Mr. DeSantis and Mr. Sims testified that money is not fungible and that they expected net producer income to increase if the fuel adjuster premium for sales into New Jersey was implemented. However, we believe that their analysis of the response of the Pennsylvania over-price premium to changes in the mandated Pennsylvania over-order premium is less persuasive than the testimony of Mr. Herbein, Mr. Mullery, and Mr. Kinser. Dealers who pay the over-price premium to Pennsylvania producers have a mechanism to recover that cost in Pennsylvania-mandated minimum resale prices, which apply to any dealer selling milk in Pennsylvania. However, dealers who would pay the proposed fuel adjuster premium would have no mechanism to recover that increased cost through mandated minimum resale prices (the Board rejects Mr. DeSantis's suggestion that the increased cost be recovered through Pennsylvania minimum resale prices); the only mechanisms available to those dealers would be attempting to recover the increased cost from customers and potentially losing business, or adjusting existing premium payments to producers so that there would be no net increase in a dealer's costs. Based on the testimony of Mr. Herbein, Mr. Mullery, and Mr. Kinser, we believe that dealers will adjust existing premiums.

We also recognize Mr. DeSantis's analysis of May 2007 overpayments by the Dealers used in Mr. Herbein's study. We do not find that analysis persuasive for many of the reasons noted above regarding the fungible nature of money. Mr. DeSantis's analysis was historical and the producer payments were based on the then-existing over-order premium order, which did not include any mandated premium based on New Jersey sales. Based on the testimony of Mr. Herbein, Mr. Mullery, and Mr. Kinser, we believe that dealers will, in compliance with Bulletin 1376, adjust the existing premiums to comply with whatever over-order premium order is in effect, leading to no net increase in the dealers' costs and no net increase in producer payments.

66. The Board finds credible and persuasive the testimony of Mr. Gallagher, Mr. Schad, and Mr. Evanish that Pennsylvania producers face rising production costs and price volatility. However, we believe that implementing the proposed premium will not necessarily address those issues. We believe it is more likely that Pennsylvania dealers will either lose New Jersey business due to their increased costs, thus adversely affecting Pennsylvania producers, or adjust existing voluntary premiums so that they can keep their New Jersey business but at the expense of providing any net increase to producer income.
67. The Board finds that the prices prescribed by the Board for milk produced in Pennsylvania and sold in Pennsylvania for shipment and ultimate sale into New Jersey are not destructive of the price structure of New Jersey producers.

We are not persuaded that the evidence indicates that Board prices "undermine" efforts by other states to set prices to support their dairy farming sector, nor are we persuaded

that Board-established prices “threaten” the ability of New Jersey to operate its over-order pricing program. Since we are not persuaded that Board-established prices “undermine” or “threaten” in any way any other state’s ability to establish minimum producer prices, it is not necessary to decide whether and to what extent “undermining” and “threatening” equate to “destructive.” We will note here, however, that our use of the terms “undermine” and “threaten” does not necessarily mean that the Board considers them to be the standard to determine if Board-prescribed prices are “destructive” of the price structure of producers in other states.

We also find it significant that no official from New Jersey appeared at the hearing to testify that the prices prescribed by the Board in any way affect New Jersey’s ability to operate its over-order pricing program, let alone that Board-prescribed prices are “destructive” of the price structure of New Jersey producers.

68. In its brief, the Pennsylvania Association of Milk Dealers requested that the Board take official notice of facts contained in various United States Department of Agriculture publications. 1 Pa. Code § 35.173 provides that official notice of facts may be taken during the hearing. However, 1 Pa. Code § 35.173 also provides that a hearing participant requesting the taking of official notice after the conclusion of a hearing must set forth the reasons that the request was not made prior to the close of the hearing. Since no reason was offered, the Board declines to take official notice of the facts requested by the Pennsylvania Association of Milk Dealers in its brief.

CONCLUSIONS OF LAW

1. The hearing that commenced on March 14, 2008, 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. 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.
4. The attached order may be amended pursuant to the procedures set out in section 801 of the Law.

PENNSYLVANIA MILK MARKETING BOARD

Richard Kriebel, Chairman

Luke F. Brubaker, Member

Barbara A. Grumbine, Consumer Member

Date: April 1, 2009

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