



Commonwealth of Pennsylvania
Milk Marketing Board
2301 North Cameron Street
Harrisburg, PA 17110-9408

717/787-4194
717/783-6492

WEB SITE: <http://www.mmb.state.pa.us>

E-mail: RA-PMMB@pa.gov

Official General
Order No. A-979

Posted:
Effective

June 20, 2012
July 1, 2012

OVER-ORDER PREMIUM

NOW, this 20th day of June 2012, 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, 2012, and will expire at 12:00 midnight on December 31, 2012.

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 \$2.15 per hundredweight effective 12:01 a.m. on July 1, 2012, through midnight on August 31, 2012.

(b) 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 \$1.95 per hundredweight effective 12:01 a.m. on September 1, 2012, through midnight on December 31, 2012.

(c) 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 20, 2012

**FINDINGS OF FACT AND CONCLUSIONS OF LAW
OVER-ORDER PREMIUM HEARING
MAY 2, 2012**

FINDINGS OF FACT

1. On May 2, 2012, the Pennsylvania Milk Marketing Board (“Board”) convened a hearing for all milk marketing areas to receive testimony and evidence concerning the level and duration of the over-order premium.
2. Notice of the hearing was published at 42 Pennsylvania Bulletin 1589 on March 24, 2012, and was mailed to those who have requested mailed notice of Board hearings by means of Bulletin No. 1483, dated March 13, 2012.
3. Dennis Schad testified as an expert in milk marketing and agricultural economics on behalf of the Greater Northeast Milk Marketing Agency (“GNEMMA”). Members of GNEMMA with producers in Pennsylvania are 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 Cooperative, Inc. (“Cooperatives”). Mr. Schad recommended that the over-order premium be set at \$2.15 per hundredweight through December 31, 2012. Mr. Schad also recommended that the over-order premium fuel adjuster, Official General Order A-927, continue through the period.
4. Mr. Schad testified, based on Board Staff’s cost of production estimate, that Pennsylvania dairy farmers experienced a moderate return to profitability in 2010 following significant losses in 2009. However, Mr. Schad also testified that the index-updated Staff cost of production estimate for February 2012 indicated that increasing costs had resulted in below break-even returns for Pennsylvania dairy farmers. Mr. Schad testified that current commodity prices for dairy inputs are mixed and very volatile as a consequence of last year’s poor harvests and the expectation of increased plantings in 2012. Using futures markets to forecast feed costs and Pennsylvania milk prices, Mr. Schad expected the income over feed cost for a cow producing 65 pounds per day to be lower than all but one year of the past five years. Mr. Schad forecast the Pennsylvania all milk price to drop through May and then increase through the fall. Mr. Schad also testified that, between March 31 and April 23, futures markets had changed such that his Pennsylvania all milk price forecast had decreased and his feed cost estimate had increased for the second half of 2012, leading to a reduction in his income over feed costs estimates.
5. Mr. Schad testified that the national dairy herd had increased over the past two years, leading to increased national milk production. Mr. Schad also testified that milk production was increasing internationally. However, conditions in Pennsylvania were different, with cow numbers remaining constant and milk production marginally down in 2011.

6. Mr. Schad testified regarding premiums in nearby markets. The GNEMMA over-order price for Class I distribution in New Jersey remained at \$1.37 per hundredweight (including a \$0.17 fuel adjustment) plus an additional premium for customers requiring rBST-free affidavit milk. Mr. Schad testified that the GNEMMA price for distribution in Maryland and Delaware remained \$0.10 per hundredweight higher than the New Jersey price. The over-order Class I price for April 2012 set by the marketing agency in common in the southeast, including fuel adjustment and rBST-free affidavit premium, was \$3.96 per hundredweight, with credits of \$0.57 per hundredweight available. The marketing agency in common in the midwest had an over-order price for April 2012 of \$2.91 per hundredweight including fuel adjustment and rBST-free affidavit premium, with credits of \$0.80 per hundredweight available.

In October 2011, the southeast over-order Class I price \$3.82 with \$0.40 of credits available (potentially \$3.42, then, with credits) and the midwest over-order Class I price was \$3.33 with \$0.60 of credits available (potentially \$2.73, then, with credits). (Official General Order A-974 Finding of Fact 7) In April 2012 the potential Class I over-order price in the southeast has essentially remained the same, but the potential Class I over-order price in the midwest has decreased to \$2.11 per hundredweight.

Mr. Schad did not provide any testimony regarding any credits offered by GNEMMA for distribution in New Jersey, Maryland, or Delaware.

7. Mr. Schad testified that 2012 will be a year of uncertainty for Pennsylvania dairy farmers. Feed stocks are stressed due to two years of poor harvests. Milk prices are down and coupled with high feed prices will cause dairy farmers to face tightened margins. There is uncertainty over what will happen with the federal Farm Bill. While milk supplies have increased nationally, Pennsylvania's milk production decreased 1.2% in 2011 compared to 2010.
8. 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 \$2.15 per hundredweight and that the fuel adjuster premium continue.
9. Mr. Espenshade testified that between November 2011 and April 2012, his milk price had decreased \$4.27 per hundredweight while his feed cost decreased \$0.12 per hundredweight. He testified that his April 2012 income over feed cost was \$6.10. Mr. Espenshade noted that many farms across Pennsylvania have faced shortages of feed and poor quality feed, due in large part to fall 2011's unusual weather. Mr. Espenshade also testified that his farm saw 20 consecutive months of negative profitability beginning in October 2008, losing over \$200,000 in equity and incurring a debt load that continues to impede his operation.
10. 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 \$2.15 per hundredweight for at least six months. Mr. Ebert also recommended that the OGO A-927 fuel adjuster remain in effect.

11. Mr. Ebert testified that despite decent milk prices, dairy farmers still face a challenging environment in Pennsylvania. He testified that sharp increases in input costs undercut producers' opportunity to make significant profits from higher milk prices in 2007 and 2008 and that the high input costs continued during the historically low 2009 milk prices. In 2010 the milk price increased, but input costs remained high. Mr. Ebert testified that input costs and milk prices showed some stability in 2011.

12. However, Mr. Ebert concurred with Mr. Espenshade's testimony that 2011's weather conditions caused repercussions that are still being felt on Pennsylvania dairy farms. Mr. Ebert testified that dairy farmers, including himself, were running out of feed. He also testified that dairy farmers were also challenged by poor feed quality. These feed issues have led to increased feed costs, adverse effects on milk production, and problems in the breeding program.

Mr. Ebert testified that for most of 2011 his income over feed costs was fairly strong, but that he has seen a steady decline since January 2012 – his income over feed costs for March 2011 was \$9.75, but for March 2012 had decreased to \$6.86.

13. Earl Fink testified on behalf of the Pennsylvania Association of Milk Dealers as an expert in milk marketing as defined by the ability of fluid milk processors to procure milk competitively and the ability to sell packaged milk competitively and profitably, and Pennsylvania Milk Marketing Board regulation and enforcement. Mr. Fink recommended that the over-order premium be set at \$1.40 per hundredweight.

14. Mr. Fink testified regarding the challenges faced by Pennsylvania milk dealers. There has been rapid growth in importing retailers in Pennsylvania who source their milk from out-of-state; Mr. Fink testified that some of these importing retailers do not actively solicit price quotes from Pennsylvania processors. Mr. Fink testified that Pennsylvania processors' Pennsylvania market share is threatened not just by lost business, but by the fact that new opportunities are not being presented to Pennsylvania milk dealers that source milk from Pennsylvania.

Mr. Fink also testified that Pennsylvania processors are losing existing business based on price. He testified that Sysco took business from Marburger Dairy, which was delivering to a Pennsylvania warehouse, and gave the business to Superior Dairy, an Ohio processor that delivers to an Ohio warehouse. Mr. Fink testified that Schneider's Dairy has been asked to present options to a national company in Pennsylvania that would allow for an out-of-state transaction.

Since the over-order premium is payable on milk produced, processed, and sold in Pennsylvania, the milk that is sourced from out-of-state or that is delivered to out-of-state warehouses is not subject to over-order premium pricing.

15. Mr. Fink testified that there appeared to be a continuing disparity between out-of-state premiums and the mandated over-order premium. Mr. Fink testified that out-of-state processors with independent milk supplies can pay premiums in the range of \$0.65 to \$1.00 per hundredweight. Mr. Fink also testified that he believed that Pennsylvania milk was viewed as too expensive.
16. Rob Blaufuss testified on behalf of Dean Foods as an expert in agricultural and dairy economics. Mr. Blaufuss recommended that the over-order premium be set at \$1.40 per hundredweight through December 31, 2012.
17. Mr. Blaufuss testified that mild winter weather, increased herd sizes, and the effects of high milk prices had led to the current dairy market being oversupplied. He testified that the wave of surplus milk began in California in January and has progressed eastward. The United States Department of Agriculture World Agricultural Supply and Demand Estimates forecast released April 10, 2012, called for a 2.5% increase in U.S. milk production in 2012, which would be the largest year-over-year percentage increase since 2006. Mr. Blaufuss also testified that other major dairy-producing countries were also reporting very strong production increases.
18. Mr. Blaufuss testified that Class I milk prices will decline in 2012 as compared to 2011's record high prices. Mr. Blaufuss forecasted Class I prices to average higher in the second half of 2012 as compared to the first half.
19. Mr. Blaufuss testified that, in contrast to last year, the mild winter and warm spring had allowed crop producers to start the spring planting season earlier than usual this year. He testified that while commodity prices were expected to remain historically elevated, there was a potential for price declines in 2012. Among the potential reasons is the expectation that yields for corn, soybeans, and hay would improve due to better weather conditions than what was experienced in 2011. Another potential reason is expected increases in acres of corn planted.
20. Mr. Blaufuss testified that current market realities do not support setting the over-order premium at \$2.15 per hundredweight. While the over-order premium has remained constant, premiums in surrounding states have declined. There is a substantial amount of independent milk available to the west and north of Pennsylvania at premium levels ranging from \$0.80 per hundredweight to \$1.00 per hundredweight. The growing disparity between the over-order premium and out-of-state premiums creates greater incentive for Pennsylvania retailers to import lower cost milk into the state.
21. Carl Herbein testified on behalf of the Pennsylvania Association of Milk Dealers as an expert in cost accounting and milk cost accounting.
22. Mr. Herbein testified that the cross-section of processing dealers located in Pennsylvania used for cost replacement hearings paid a premium of \$1.85 per hundredweight for December 2011 on all milk purchased by those plants. That

premium payment includes the mandated over-order premium, fuel adjuster, and all other premiums paid to producers.

23. Mr. Herbein testified that the same dealer cross-section experienced a 4.0% reduction in Class I sales in 2011. He testified that for 2011, as reported by the United States Department of Agriculture, there was a national reduction in Class I sales of 1.8%. A comparison of 2011 Pennsylvania Class I utilization by the cross-section dealers to all processing dealers located in Pennsylvania reveals that the cross-section dealers accounted for almost 91% of Pennsylvania Class I utilization (GNEMMA Surrebuttal Exhibit 10).
24. The Board finds that the over-order premium should be set at \$2.15 per hundredweight for July 2012 and August 2012. In so finding the Board relies on the credible and persuasive testimony of Mr. Schad regarding projected lower milk prices for July and August 2012 and the tightened producer margins expected due to the lower milk prices and high feed prices. The Board also finds credible and persuasive the testimony of Mr. Espenshade and Mr. Ebert regarding their costs and the effects the costs and projected milk prices will have on the margins on their farms.
25. The Board finds that the over-order premium should be set at \$1.95 per hundredweight for September 2012 through December 2012. Mr. Blaufuss and Mr. Schad both forecasted that milk prices would begin to increase toward the end of the year. Based on Mr. Blaufuss's testimony, we also believe that there is potential for better quality feed at less high prices in 2012 as compared to 2011. The Board finds credible and persuasive the testimony of Mr. Blaufuss and Mr. Fink that there is a disparity between the over-order premium and out-of-state premiums that has an effect on the competitiveness of Pennsylvania processors in procuring wholesale sales to Pennsylvania retailer customers. We also note that the marketing agency in common Class I over-order price to the west of Pennsylvania has decreased recently.

The Board also finds credible and persuasive Mr. Herbein's testimony regarding the greater reduction in fluid milk sales experienced by Pennsylvania cross-section dealers as compared to the nationwide reduction in fluid milk sales. These dealers pay the over-order premium on milk produced, processed, and sold in Pennsylvania. The important transaction, then, is the wholesale transaction from a Pennsylvania dealer to a purchaser in Pennsylvania. When Pennsylvania retailers purchase packaged products out-of-state, that milk does not qualify for the over-order premium; Pennsylvania farmers are then receiving a reduced over-order premium payment because of the out-of-state transaction.

The Board finds that setting the premium at \$1.40 per hundredweight would be too drastic a decrease given the inherent uncertainty involved in dairy farmer price and cost forecasts and the adverse impact such a premium would have on Pennsylvania dairy farms. The Board finds that setting the premium at \$1.95 per hundredweight for September 2012 through December 2012 will strike the proper balance between addressing the competitive and loss of sales issues faced by Pennsylvania processors

and providing the best possible margins for Pennsylvania producers. Less milk is produced, processed, and sold in Pennsylvania as Pennsylvania processors lose Pennsylvania business, lessening the impact of the over-order premium on Pennsylvania producer prices. We find that an over-order premium rate of \$1.95 per hundredweight for September 2012 through December 2012 is the level that will be most beneficial to all segments of Pennsylvania's dairy industry.

CONCLUSIONS OF LAW

1. The May 2, 2012, hearing on the over-order premium was held pursuant to the authority granted to the Board in sections 801 and 803 of the Milk Marketing Law (Law), 31 P.S. §§ 700j-801 and 700j-803.
2. The hearing was held following adequate notice and all interested parties were given a reasonable opportunity to be heard.
3. All parts of Official General Order No. A-893 not inconsistent with the attached order will continue in effect.
4. In accordance with Official General Order No. A-894, milk dealers shall continue to show by line item on their monthly statements to independent producers and cooperatives the specific amount of the Pennsylvania Milk Marketing Board's over-order premium being paid.
5. In accordance with Official General Order No. A-894 (Supplemental), the over-order premium will continue to apply only to Class I milk produced, processed, and sold in Pennsylvania.
6. In adopting this order, the Board considered the entire record and concludes that the order is supported by a preponderance of credible evidence and is reasonable and appropriate under sections 801 and 803 of the Law.
7. The attached order may be amended pursuant to the procedures set out in section 801 of the Law.

PENNSYLVANIA MILK MARKETING BOARD

Luke F. Brubaker, Chairman

Richard Kriebel, Member

Lynda J. Bowman, Consumer Member

Date: June 20, 2012

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