



**Commonwealth of Pennsylvania**  
Milk Marketing Board  
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Official General  
Order No. A-918

Posted: December 4, 2002  
Effective: January 1, 2003

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### **OVER-ORDER PREMIUM**

NOW, this 4<sup>th</sup> day of December 2002, 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 January 1, 2003, and will expire at 12:00 midnight on June 30, 2003.

#### **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 \$1.50 per hundredweight effective 12:01 a.m. on January 1, 2003, through midnight on January 31, 2003.

(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 \$1.40 per hundredweight effective 12:01 a.m. on February 1, 2003, through midnight on February 28, 2003.

(c) In all milk marketing areas the calculation of the Class I price for milk produced, processed, and sold in Pennsylvania shall include an over-order premium of \$1.30 per hundredweight effective 12:01 a.m. on March 1, 2003, through midnight on March 31, 2003.

(d) 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 \$1.25 per hundredweight effective 12:01 a.m. on April 1, 2003, through midnight on June 30, 2003.

(e) 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 A-893 not inconsistent with this order shall continue in effect. This official general order supersedes Official General Order A-917.

#### PENNSYLVANIA MILK MARKETING BOARD

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Beverly R. Minor, Chairwoman

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Luke F. Brubaker, Member

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Barbara A. Grumbine, Consumer Member

Dated: December 4, 2002

**FINDINGS OF FACT AND CONCLUSIONS OF LAW  
OVER-ORDER PREMIUM HEARING  
NOVEMBER 6, 2002**

FINDINGS OF FACT

1. On November 6, 2002, the Pennsylvania Milk Marketing Board (Board) convened a hearing for all milk marketing areas to receive testimony and evidence concerning the continuation of the over-order premium that is scheduled to expire on December 31, 2002, and whether an adjustment should be made to the level of the over-order premium.
2. Notice of the hearing was published at 32 Pennsylvania Bulletin 5150 on October 12, 2002, and was mailed to those on the Board's interested parties list by means of Bulletin No. 1323, dated October 3, 2002. (PMMB Exhibits 1 and 2)
3. At the end of the hearing, a briefing schedule was set. Principal briefs were due on November 25, 2002, and reply briefs were due on November 27, 2002.
4. C. Arthur Zug, a dairy farmer from Juniata County, testified on behalf of Pennsylvania State Grange. Mr. Zug recommended that the \$1.65 over-order premium be extended for at least another six months. Mr. Zug based his recommendation on several factors. First, he noted that the \$1.65 over-order premium had not flooded the Pennsylvania market with milk, with milk production and cow numbers expected to continue to decline over the next six months. Mr. Zug also noted the dire financial situation of Pennsylvania dairy farmers, with three in his neighborhood recently selling out due to an inability to pay current expenses. Finally, Mr. Zug testified that the drought conditions had an adverse affect on profitability of dairy farms, with farmers paying to plant a crop that produces reduced yields, and then paying "retail" prices for feed to make up for the reduced crop yields.
5. Joel Rotz testified on behalf of the Pennsylvania Farm Bureau as an expert in dairy economics, with an special emphasis in factors that affect production costs and price. Mr. Rotz also advocated maintaining the over-order premium at \$1.65 per hundredweight. Mr. Rotz testified that for the Board to make a reasoned determination on the level of the premium that would be needed in response to current marketing conditions, it would be necessary for the Board to look into the future to assess anticipated milk price levels. Mr. Rotz testified that the most reliable source for projecting milk prices under the current milk pricing system for the first six months of 2003 is the current Class III and Class IV futures price levels established under the Chicago Mercantile Exchange. Using these data, Mr. Rotz projected that the average price paid at Lancaster to Pennsylvania producers for the first six months of 2003, adjusted for federal Milk Income Loss Contract payments but not accounting for any voluntary or mandated premiums, will be about \$13.61 per hundredweight.
6. Mr. Rotz observed that the Special Dairy Report published by the Pennsylvania Agricultural Statistics Service (PASS) for the third quarter of 2002 estimated

- Pennsylvania producers' average cost of production for the twelve month period ending September 2002 at \$13.29 per hundredweight of milk. Mr. Rotz saw no reason that the production cost will be lower in the near future and opined that the decline in PASS cost of production from the previous quarter was attributable to a dairy industry in decline, rather than dairy producers achieving better cost efficiencies. Mr. Rotz also noted that the most recent PASS report did not seem to reflect recent increased costs for purchased feed. So, assuming no increase in cash cost of production, the projected margin for the average Pennsylvania producer for January 2003 through July 2003, based on current cash costs of production alone, would be \$0.32 per hundredweight of milk. However, Mr. Rotz also testified that Farm Bureau believes a more complete cost of production estimate would include producers' price needs for management, interest on equity, and a reasonable profit of 3.5%, for a total price need of \$16.30 per hundredweight.
7. Mr. Rotz also testified that Pennsylvania producers have not been able to maintain last year's levels of milk production and that Pennsylvania's cow numbers also continue to decline from last year's levels. Mr. Rotz noted that drought conditions across the state and nation had also taken a toll on crop production, resulting in higher feed prices at a time when the drought had greatly diminished Pennsylvania producers' own crop production.
  8. Dennis Schad testified on behalf of Land O' Lakes, Maryland and Virginia Milk Producers Association, Northeast Milk Marketing Agency, Dairylea Cooperative, and Northeast Council of Dairy Farmers of America as an expert in dairy economics and dairy marketing. Mr. Schad recommended that the Board maintain the \$1.65 over-order premium through June 30, 2003. Mr. Schad testified that the average cost of producing milk in Pennsylvania for the 12 months ending September 2002 was \$13.29 per hundredweight. Mr. Schad noted that corn and hay prices were markedly higher in Pennsylvania this year as compared to last year. Mr. Schad testified that he calculated the average adjusted price received by Pennsylvania dairy farmers during the twelve month period ending September 2002 to be \$15.21 per hundredweight. Mr. Schad also testified that the estimated prices in PFB Exhibit 1 were "adequate" for purposes of this hearing. Mr. Schad expected dairy farmers to react to the lower milk prices and higher feed costs by decreasing production.
  9. Mr. Schad noted that milk production in Pennsylvania in 2001 fell by 2.7 percent compared to 2000 and had not rebounded in 2002, being in fact about a half percent lower still through June 2002 than it had been in 2001, with cow numbers continuing to trend downward. Mr. Schad testified that premiums in surrounding states remained unchanged, NEMMA maintaining premiums in Maryland and Delaware at \$1.50 per hundredweight and in New Jersey at \$1.10 per hundredweight; these premiums have been in effect since December 2001. He also testified that the over-order premium in the Southeast was counter-cyclical, increasing as the Class I mover decreases, and had been at a level of \$1.93 per hundredweight since May.
  10. Edward Gallagher testified on behalf of Dairylea Cooperative, Dairy Farmers of America's Northeast Council, and Dairy Marketing Services as an expert in agricultural

economics and milk marketing. Mr. Gallagher testified in favor of maintaining the over-order premium at \$1.65 per hundredweight. Mr. Gallagher testified that milk production in Pennsylvania continued to be "growth challenged," while milk production in other states in the region was growing. Mr. Gallagher further testified that Pennsylvania's milk production may show nominal growth for the first half of 2003, but that was, at best, an optimistic prediction. Mr. Gallagher noted three considerations in arriving at his conclusion: the financial and psychological stress on dairy farms due to low prices, the exasperation level of dairy farmers, and drought impacted feed supplies that would force farmers to buy more than the usual quantities of feed at higher prices than in recent years. Mr. Gallagher acknowledged that one or more customers had come to him within the previous four or five months pointing out that the Pennsylvania over-order premium of \$1.65 per hundredweight was causing competitive equity issues for them in the marketplace.

11. Carl Herbein testified for Dean Foods as an expert in cost accounting, especially as it relates to Pennsylvania milk marketing matters. Mr. Herbein conducted a study of in-state and out-of-state premium levels for the months of July, August, and September 2002. For the cross section of dealers that he used for the study, Mr. Herbein determined the volume of milk coming into the plants, who it was coming in from, and what the handler was paying for the milk. Mr. Herbein excluded cooperative handling charges and administrative charges relative to handling independent producers from the calculations, so that what was shown as a premium was, indeed, a premium. Mr. Herbein also noted that the study involved almost 60 percent of the Class I market, which he opined was significant coverage and a valid sample. The study showed that the weighted average blended premium paid in Pennsylvania for July, August, and September 2002 was \$1.10 per hundredweight, while the weighted average blended premium paid outside Pennsylvania for the same months was \$0.79 per hundredweight.
12. Mr. Herbein explained that premium was assigned to in-state or out-of-state milk based on where the milk was utilized. Mr. Herbein testified that the numerical effects of the premium disparity were more severe in metropolitan areas in the east and west of the state, and less of a problem in the central area; he did not study the practical effects of the disparity. Mr. Herbein opined that, to reduce the in-state premium level to the same level as the out-of-state premium, a reduction in the over-order premium of \$0.46 per hundredweight was necessary.
13. Frank Mariello testified regarding Lehigh Valley Dairies, where he has been employed for 12 years. Mr. Mariello testified that his employer has plants in multiple states and thus, he was familiar with the costs. He agreed with Mr. Herbein's assessment of the range of difference for in-state versus out-of-state premiums. Mr. Mariello testified that one of his customers, a distributor, had recently decided to move its operation from Pennsylvania to New Jersey. He testified that one of the factors was the difference in premiums between Pennsylvania and New Jersey. Mr. Mariello also acknowledged that other factors contributed to the decision to move the operation. Mr. Mariello knew of major retailers that were looking at similar arrangements.

14. Frank Chrastina testified about the situation at Dean Dairy's Sharpsville plant. Mr. Chrastina is the vice president and general manager of the Sharpsville plant and has been employed there in various capacities for 45 years. Mr. Chrastina also agreed with the range of premiums paid in-state versus out-of-state testified to by Mr. Herbein. Mr. Chrastina testified that the premium difference was having an impact on his business. He noted that his major retail customers were beginning to become more educated on milk procurement issues and that it was becoming a challenge to somehow bring Pennsylvania pricing more in line with Ohio pricing. Mr. Chrastina testified that if this challenge could not be resolved in short order, one of the retail customers would be making some changes, which might involve bringing Ohio milk into Pennsylvania or using Pennsylvania produced milk sold in Ohio. He was also aware of similar situations involving other retailers in his marketing area. Mr. Chrastina also testified that he had lost a major customer within the previous six months to an out-of-state plant.
15. Carl Conover testified on behalf of Dean Foods as an expert in premiums in the dairy industry, the impact on plant competitiveness of premiums and pricing, the impacts of milk regulation on private industry, milk procurement, the interplay between state and federal milk pricing regulations, and the impact of raw milk prices on plant competitiveness. Mr. Conover recommended that the over-order premium be set at \$1.20 per hundredweight. Mr. Conover testified that the country as a whole was in a normal milk production situation and that in contrast to Pennsylvania's lower production, milk production in both Ohio and New York had increased. Mr. Conover noted that a Pennsylvania plant facing competition from plants with lower premiums had the incentive to look for a supply of milk at a premium that would keep the plant competitive with respect to raw milk costs. Mr. Conover concluded that seeking an out-of-state supply of raw milk was a viable alternative for Pennsylvania plants caught in a noncompetitive situation because of the mandated over-order premium.
16. Mr. Conover opined that if the prevailing price signals from the Board remained unchanged, there is a strong likelihood that Pennsylvania processors would see a portion of their market share eroded by out-of-state processors packaging milk produced out-of-state. In this case, Mr. Conover expected that Pennsylvania processors would then increase their reliance on out-of-state raw milk. Mr. Conover also opined that if there are fluctuations in the premium there is no reason to restructure business practices, but that if a price difference became a fixture in the market, the incentive to take advantage of that situation is increased.
17. The Board finds that the market for Pennsylvania produced milk is threatened in that the difference between the Pennsylvania over-order premium and voluntary premiums paid out-of-state is causing Pennsylvania processors to seek arrangements that would allow them to avoid paying the over-order premium. The Board further finds that not only is this a theoretical possibility, but that, due to their customers' demands based at least partly on the level of the over-order premium, some milk dealers have put plans in motion to, in one way or another, move some part of their operations out-of-state to avoid paying the over-order premium. In so finding, the Board finds credible and persuasive the testimony of Messrs. Herbein, Conover, Mariello, and Chrastina. In contrast to the

hearing on July 30, 2002, at this hearing we found Mr. Herbein's testimony to be quite clear regarding the methodology, results, and conclusion of his study. We also find significant Mr. Conover's testimony that if a price difference becomes a fixture in the market, the incentive for processors to take advantage of that difference is increased. The Board finds, based on the testimony of Messrs. Mariello and Chrastina, that this eventuality is actually coming to pass. Mr. Mariello and Mr. Chrastina both had customers that either had already or were in the process of moving some part of their operation out-of-state to avoid paying the Pennsylvania over-order premium. Mr. Chrastina testified that Dean had lost a customer due to this factor.

18. The Board is aware of the financial stress on the state's dairy farmers. The Board is very concerned about this situation. However, we also believe that, to keep Class I business in Pennsylvania, it is necessary to adjust the over-order premium so that Pennsylvania processors can remain competitive and still pay Pennsylvania producers an over-order premium. It would be of no benefit to Pennsylvania producers to set an over-order premium at a level that would cause Pennsylvania processors, for competitive reasons, to seek ways to avoid paying it. The Board took careful note of the testimony of Messrs. Zug, Rotz, Schad, and Gallagher, and find their testimony to be credible. Despite the issues they testified about, we believe that it is better for Pennsylvania producers to receive more of a lower over-order premium than less of a higher over-order premium.
19. The Board finds it is necessary to cushion somewhat the effects of a lowering of the over-order premium. This will provide producers an opportunity to plan for the lower level of the over-order premium and allow time for Market Income Loss Contract payments to start coming in. Therefore, the Board finds that the over-order premium should be set at a level of \$1.50 per hundredweight for January 2003, \$1.40 per hundredweight for February 2003, \$1.30 per hundredweight for March 2003, and \$1.25 per hundredweight for April, May, and June 2003.

## CONCLUSIONS OF LAW

1. The November 6, 2002, 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 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 transcript of the July 30, 2002, over-order premium hearing was admitted into this record pursuant to 1 Pa. Code § 35.167 (relating to records in other proceedings).
7. The Findings of Fact, Conclusions of Law, and Order of Official General Order A-917 were admitted into this record pursuant to 1 Pa. Code § 35.165 (relating to public documents).
8. 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.
9. The attached order may be amended pursuant to the procedures set out in section 801 of the Law.

### PENNSYLVANIA MILK MARKETING BOARD

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Beverly R. Minor, Chairwoman

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Luke F. Brubaker, Member

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Barbara A. Grumbine, Consumer Member

Date: December 4, 2002

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