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Official General
Order No. A-907 (CRO1)

Posted: December 6, 2000
Effective: January 1, 2001

COST REPLACEMENT ORDER FOR THE WEST CENTRAL MILK MARKETING AREA, AREA NO. 6

NOW, this 6th day of December, 2000, the Commonwealth of Pennsylvania, Milk Marketing Board 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, 2001.

SECTION A
INCORPORATION

The attached Findings of Fact, Conclusions of Law, Schedules I and II, and Attachments are incorporated herein by this reference as though fully set forth in this order.

SECTION B
SCOPE

(a) The processing, packaging, and delivery costs, container costs, ingredient costs, and in-store handling costs adopted by the Board in this order will replace the costs for these cost centers embodied in Official General Order (OGO) No. A-907 and will be incorporated into the wholesale and retail prices of Class I price-controlled packaged products sold in Milk Marketing Area No. 6, as defined in Section B of OGO No. A-907. Wholesale and retail prices will be adjusted as well by the increase in labor, utility, and insurance costs that the Board adopted in this order.

(b) Wholesale and retail prices for Class II price-controlled packaged products sold in Milk Marketing Area No. 6, will reflect the costs adopted in this Order. Class II prices will be calculated each month in the manner set forth in Finding of Fact 9.

(c) The rate of return to dealers is maintained at 3.3%. The rate of return to retailers remains at 2.5%.

SECTION C
EFFECTIVENESS AND SUPERSESSION OF OGO A-907

All parts of Official General Order A-907 not inconsistent with section B of this order continue in effect. This order supersedes Official General Order A-907.

PENNSYLVANIA MILK MARKETING BOARD

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Beverly R. Minor, Chairwoman

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J. Robert Derry, Consumer Member

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Luke F. Brubaker, Member

Date: December 6, 2000

FINDINGS OF FACT AND CONCLUSIONS OF LAW
AREA 6 COST REPLACEMENT HEARING
SEPTEMBER 6, 2000

I. FINDINGS OF FACT

A. Procedural History

1. In accordance with section G of Official General Order A-907, the Milk Marketing Board (Board) conducted a cost replacement hearing for Milk Marketing Area No. 6 (Area 6) on September 6, 2000.

2. Notice of the hearing was published at 30 Pennsylvania Bulletin 3878 dated July 29, 2000. Notice was also mailed to all interested parties by means of Bulletin No. 1293 dated July 19, 2000. The hearing notice enumerated the scope of the evidence that the Board would receive. (PMMB Exhibits 1 and 2)

B Validity of Dealer Cross-Section

3. The cross-section used by Board staff and the Area 6 milk dealers (dealers), the only parties at the hearing to present evidence as to dealer costs, comprised Dean Dairy Products Company, Meadow Brook Dairy, Galliker Dairy Company, Inc., and Schneider-Valley Farms, Inc. Clifford Ackman, appearing on behalf of Board staff as an expert in milk statistics, testified that this was the same cross-section of dealers used in arriving at dealer costs in the past. (N.T. 12-13, 47-49, Staff Exhibit 1, Exhibit D1)

4. Mr. Ackman testified that the cross-section was representative of dealers doing business in Area 6 because the types of milk sold by the cross-section are similar to the "totality of what's being sold in Area 6." (N.T. 13) Carl Herbein, testifying on behalf of the dealers as an expert in milk accounting, agreed that the cross-section is appropriate since the four dealers included supply 61.42 percent of all Class I products consumed in Area 6. (N.T. 47) Mr. Herbein further testified that the cross-section dealers are representative based on the customers they serve --- "supermarkets, convenience stores, mom and pop stores and also institutions and schools." (N.T. 48) Based on the testimony of the two experts, the Board finds that the cross-section dealers are representative of the Area 6 market.

C. Dealer Costs and Rate of Return

5. David DeSantis, testifying on behalf Board staff as an expert in milk accounting, presented evidence of June 2000 ingredient costs per pound for flavored milk ($.0190), reduced-fat flavored milk ($.0201), non-fat milk ($.0014), and buttermilk ($.0261). (N.T. 19, Staff Exhibit 3) The dealers presented similar evidence as to the ingredient costs. (N.T. 58-59, Exhibits D4 and D4-A) The Board finds that it is

appropriate to replace the ingredient costs in the current order with the costs set out in these exhibits.

6. Board staff and dealers presented concurring evidence that the processing, packaging, and delivery costs for the 1999 calendar year and weighted by the percentage of sales method equal $.1724 per point. (N.T. 20, 56-57, Staff Exhibit 4, Exhibits D3 and D3-A) The Board finds that this uncontroverted figure should replace the existing figure for processing, packaging, and delivery of costs in the current order.

7. Board staff and dealers offered evidence as to container costs as of June 2000. Board staff and dealers presented similar blended container costs, except for the half-gallon container. (N.T. 21-22, 50-54, Staff Exhibit 4, Rebuttal Exhibits D2 and D2-A) Board staff also presented evidence for both paper and plastic container costs. (Staff Exhibit 4) Mr. DeSantis testified that the blended half-gallon container cost should be $.0973. (N.T. 21) Mr. Herbein testified that the blended half-gallon container cost should be $.0979. This discrepancy is a result of the inclusion of costs by the dealers of plastic half-gallon containers that were not manufactured by the cross-section dealer in Area 6 but manufactured by the cross-section dealer's plant located in another area. (N.T. 52) Board staff did not include this container cost because they were unable to audit this cost and it was not included in the dealer's annual financial statement. (N.T. 21, 51) Mr. Herbein further testified that schools should be allowed to buy half-pints at the paper price. (N.T. 67) The Board finds that the blending of prices for containers is appropriate and should be used since there is a migration from paper to plastic in all milk marketing areas. The Board recognizes that the additional costs incurred by the cross-section dealer relative to the half-gallon container being manufactured by one of its plants in a different area is a valid cost to that dealer and, therefore, further finds that the blended cost of $.0979 for the half-gallon container should be included in this order. The Board also finds that the paper half-pint container cost of $.0183 should be used for half-pints of milk going to schools.

8. Both Board staff and dealers presented similar evidence of updated labor, insurance, and utility costs, which were calculated by comparing costs per bottling point for the second quarter of 1999 and the second quarter of 2000, resulting in an increase of $.0063 per point. (N.T. 29-30, 57-58, Staff Exhibit 8, Exhibit D5) The Board finds that the $.0063 increase per point in labor, insurance, and utility costs shall be incorporated into the new order.

9. Board staff and dealers presented similar evidence regarding Class II product costs. (N.T. 27-28, 59-60, Staff Rebuttal Exhibit 6, Rebuttal Exhibit D7) Mr. Herbein testified that the costs listed on the exhibits for Class II products are the dealers' purchase costs rather than manufactured costs for the cross-section dealers. (N.T. 59-60) The costs for cold room, selling and average delivery costs are added to the purchase costs to arrive at the total costs for Class II products. (N.T. 27-28, 59-60) Mr. DeSantis testified as to a fixed cream add-on, which represents the difference between what it would cost to manufacture the Class II product and the purchase cost of these products. (N.T. 29, Staff Rebuttal Exhibit 7) The Board finds that it is appropriate to use the costs

presented by both Board staff and dealers to arrive at the Class II price. The Board further finds that the fixed cream add-ons in the existing order should be replaced by the add-ons in Staff Rebuttal Exhibit 7.

10. Mr. DeSantis testified that the milk in Area 6 is presently priced based on a butterfat differential and that "it would be better if we used the skim rates and butterfat rates and adjusted them monthly based on changes in the federally announced prices." (N.T. 23-24, Staff Exhibit 5) Mr. DeSantis further testified that future cost replacement hearings should include the actual butterfat and skim contents for pricing milk. (N.T. 23-24) Mr. Herbein agreed that inclusion of the actual butterfat and skim contents in future cost replacement hearings was a good accounting idea as long as the information obtained was accurate and could be relied upon. (N.T. 66) The Board finds that it is appropriate to price milk based on the skim rates and butterfat rates and adjust them monthly based on changes in the federally announced prices. The Board further finds that the actual skim and butterfat contents of products be included in future cost replacement hearings.

11. Board staff presented evidence relative to profits and losses from the sale of bulk products, cream processing costs, and the cost of shrinkage. (N.T. 25, Staff Exhibit 5) Mr. DeSantis testified that these costs should be "added into or subtracted from the price of the milk." (N.T. 25) Mr. DeSantis further recommended that these costs be included in future cost replacement hearings. Mr. Herbein agreed that these costs should be included as long as the information secured from the computer system is accurate. (N.T. 66-67) The Board finds that an adjustment for shrinkage, sales of bulk products, and cream processing costs shall be included in future cost replacement hearings in Area 6.

12. Board staff presented evidence relative to the over-price premium. (N.T. 26-27, Staff Exhibit 5) Mr. DeSantis testified that Board staff calculated the over-price premium based on 1999 prices paid by the cross-section dealers for milk to their producers. The average price in 1999 was $.29 per hundredweight. This amount included the $.20 per hundredweight dealer assessment imposed by the federal government. (N.T. 26) Mr. DeSantis recommended that the over-price premium be calculated on an annual basis at future cost replacement hearings and that the calculation should be based on the milk that is processed, packaged, and resold as Class I milk in Pennsylvania. (N.T. 26) The Board finds that the over-price premium of $.29 per hundredweight used in Staff Exhibit 5 shall be used to establish this order. The Board further finds that the over-price premium shall be adjusted on an annual basis at future cost replacement hearings and shall be based on milk that is processed, packaged, and resold as Class I milk in Pennsylvania.

13. Mr. Herbein testified as to an increase in the rate of return to dealers from the current 3.3% to 3.5%. (N.T. 60-62, Rebuttal Exhibit D6) Mr. Herbein based this recommendation on the proposition that there will be labor and fringe benefit increases after June 30 and before the next cost replacement hearing. He further testified that these labor increases would erode the dealers' profits. The Board recognizes that there may be

increases occurring between one cost replacement hearing and the next; however, these increased or decreased costs are considered by the Board at the next cost replacement hearing. The Board finds, therefore, that the rate of return to the dealers shall remain at 3.3%.

D. Validity of Retailer Cross-Section

14. The cross-section used by Board staff and the Pennsylvania Food Merchants Association (PFMA), the only parties to present evidence of in-store handling costs, comprised Bi-Lo #201, Bi-Lo #211, Giant #25, Giant #72, Giant Eagle #683, Sheetz #158, Turkey Hill #238, Uni-Mart #4079, Uni-Mart #4080, Weis #35, Weis #137, and Wilson's Meats. (N.T. 14-16, Staff Rebuttal Exhibit 2, PFMA Rebuttal Exhibit Table 1) Mr. Ackman testified that, except for one store, the retailer cross-section was the same one used in the last price hearing. The one change was the replacement of one Uni-Mart with another (Uni-Mart #4080). This change was necessitated by the fact that the Uni-Mart used last year was closed and Uni-Mart #4080 was opened approximately one mile away. (N.T. 15) Mr. Ackman testified that the new Uni-Mart was opened in a "similar type of economic environment, a strip mall." (N.T. 15)

15. Mr. Ackman testified that the retailer cross-section was representative of other retailers doing business in Area 6 because there were a wide variety of stores being offered---supermarkets and convenience stores. The stores were also geographically diverse---towns and larger. (N.T. 15-16) The Board finds that the retailers' cross-section is representative of Area 6 in that this cross-section is based on a variety and diversity of retailers in this area.

E. In-Store Handling Cost

16. Mr. DeSantis testified as to the manner in which Board staff arrived at the in-store handling costs. This methodology involved adjusting the 1999 milk costs to the 1998 levels so that there would be an apples to apples comparison and which resulted in a 94.9% comparison. (N.T. 31-32, 34, Staff Exhibit 9) Board staff made this adjustment to the $.0837 in-store handling costs included in the Official General Order A-907, arriving at an adjusted in-store handling cost of $.0794 per quart. (N.T. 32) Mr. DeSantis testified that Board staff used the most favorable ratio for each year; however, the same stores were not included in the most favorable ratio. (N.T. 35) Mr. DeSantis further testified that "if the $.0837 is a valid number, and the Board found that it was, then how do you adjust that number? Well, by changes in the cross-section stores." (N.T. 36) John Liptock, Jr., testifying on behalf of PFMA as an expert in milk accounting, utilized a methodology to arrive at the in-store handling cost that reflected a ratio based on a comparison of milk sales to total sales. (N.T. 70, PFMA Rebuttal Exhibit 1, Table 4) This ratio was then applied to the total expenses to arrive at milk expenses. That figure was then divided by the total number of quarts of milk in the cross-section to arrive at a cost per quart. In addition to these calculations, an additional calculation was made to recognize the fluctuation in the price of milk and bring the milk sales back to the level they were one year ago. (N.T. 72) The entire cross-section of retailers was used by Mr.

Liptock to arrive at a milk expense per quart of $.1175. (N.T. 75) At the last Area 6 price hearing, Board staff presented an in-store handling cost per quart of $.1040 and PFMA presented an in-store handling cost per quart of $.1037. (N.T. 76) The Board finds that the calculation of the increase in in-store handling costs for the costs presented by PFMA during the prior and current hearing result in an increase in the in-store handling costs of $.0138 ($.1175 less $.1037). This amount results in a percentage increase of 13.31% ($.0138 divided by $.1037). To reflect this 13.31% increase relative to the current in-store handling cost, the $.0837 is multiplied by 13.31% to arrive at an increase of $.0111. The Board finds that the increase of $.0111 shall be added to the current in-store handling cost to arrive at an in-store handling cost of $.0948.

17. The Board is authorized by section 801 of the Law to set a reasonable rate of return for retailers between 2.5% and 3.5%. The Board finds that, in keeping with other milk marketing areas, the rate of return to retailers shall be set at 2.5%.

I. CONCLUSIONS OF LAW

1. The September 6, 2000, hearing to set cost replacement prices in Pennsylvania Milk Marketing Area No. 6, was held pursuant to the authority granted to the Board in section 801 of the Law (31 P.S. § 700j-801), and Section G of Official General Order No. A-907, which provides for cost replacement adjustments in that order.

2. The hearing was held following adequate notice, and all Interested Parties were given a reasonable opportunity to be heard. (Finding of Fact 2)

3. The dealer cross-section used by Board staff and dealers is reasonable and representative of the dealers in the Area 6 marketplace.

4. The retailer cross-section used by Board staff and PFMA is reasonable and representative of the retailers doing business in Area 6.

5. In establishing this cost replacement order, the Board has considered all evidence and testimony presented at the hearing.

6. A reasonable rate of return for the dealers is 3.3%.

7. A reasonable rate of return for the retailers is 2.5%.

8. Adoption of the cost replacement adjustments for Official General Order No. A-907 are reasonable and appropriate under section 801 of the Law, subject to any revisions or amendments that the Board may deem appropriate pursuant to the procedures set out in the Law.

PENNSYLVANIA MILK MARKETING LAW

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Beverly R. Minor, Chairwoman

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J. Robert Derry, Consumer Member

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Luke F. Brubaker, Member

Date: December 6, 2000

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