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Official General
Order No. A-907 (CRO2)

Posted: September 5, 2001
Effective: October 1, 2001

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

NOW, this 5th day of September 2001, 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 on October 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, shrinkage and net profit and loss on sales of bulk milk and bulk cream 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) A-907 (CRO1) and will be incorporated into the wholesale and retail prices of Class I price-controlled packaged products sold in Milk Marketing Area 6, as defined in Section B of OGO 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 10.

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

(d) Section II, Subsection (b) of Official General Order A-908 relative to an increase to the wholesale and retail prices of fluid milk of \$.0031 per quart based on an energy add-on shall terminate at midnight on December 31, 2001 in Milk Marketing Area No. 6.

SECTION C
SUPERSESION OF OFFICIAL GENERAL ORDER A-907 (CRO1)

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 (CRO1).

PENNSYLVANIA MILK MARKETING BOARD

Beverly R. Minor, Chairwoman

Luke F. Brubaker, Member

Barbara A. Grumbine, Consumer Member

Date: September 5, 2001

FINDINGS OF FACT AND CONCLUSIONS OF LAW
COST REPLACEMENT HEARING FOR MILK MARKETING AREA NO. 6
AUGUST 1, 2001

I. FINDING OF FACT

A. Procedural History

1. In accordance with Section G of Official General Order A-907, the Pennsylvania Milk Marketing Board (Board) conducted a cost replacement hearing for Milk Marketing Area No. 6 on August 1, 2001.

2. Notice of the hearing was published at 31 Pennsylvania Bulletin 3657 dated July 7, 2001. It was also mailed to all interested persons by means of Bulletin No. 1304. The hearing notice enumerated the scope of evidence that the Board would receive. (PMMB Exhibits 1 and 2)

B. Validity of Dealer Cross-Section

3. The dealer cross-section used by both Board staff and the Area 6 milk dealers (Dealers), the only parties to present dealer cost information, comprised Dean Dairy, Gallikers, Meadowbook, and Schneider's Williamsport location. (N.T. 16, Staff Exhibit 1)

4. Clifford Ackman, appearing for Board staff as an expert in milk statistics, testified that the dealer cross-section is representative of all Area 6 milk dealers since they had the same types of containers, deliveries, and the same type of outlets---"mom and pop stores, convenience stores, and supermarkets." (N.T. 17) Carl Herbein, appearing on behalf of the dealers as an expert in milk accounting, concurred with Mr. Ackman that the dealer cross-section was representative in that they have 54 percent of the market coverage. (N.T. 37) The Board finds that based on the evidence presented by the two expert witnesses, the requirement of representativeness have been met.

C. Dealer Costs and Rate of Return

5. David DeSantis, appearing on behalf of Board staff, as an expert in milk accounting, and Mr. Herbein presented concurring evidence of the processing, packaging, and delivery costs of \$.1784 per point for 2000 and recommended that this cost replace the cost in the current order. (N.T. 20-21, 41-42, Staff Rebuttal Exhibit D3 and D3-A) The Board finds that \$.1784 per point is the cost of processing, packaging, and delivery and that this cost should replace the existing costs.

6. Mr. DeSantis testified that the energy add-on to the wholesale and retail prices of fluid milk products of \$.0031 per quart contained in Official General Order No. A-908 should be discontinued since the energy costs are now reflected in the processing, packaging and delivery costs presented at the hearing. (N.T. 28) Mr. Herbein agreed that the \$.0031 energy add-on should be eliminated. (N.T. 42) Mr. Herbein further testified that there had been a three-month period prior to the enactment of Official General Order A-908 where the Dealers incurred increased fuel costs which would not be recovered; however, that recovery period was to be

extended beyond the termination point set in the order. Mr. Herbein recommended that the energy add-on of \$.0031 continue three months beyond the enactment of this order and Mr. DeSantis agreed with that recommendation. (N.T. 28, 43) The Board finds that it is appropriate to eliminate the \$.0031 energy add-on to the wholesale and retail prices of fluid milk products included in Official General Order A-908. Elimination of the energy add-on will occur three months after the effective date of this order. The Board further finds that the \$.25 per hundredweight energy relief provided to producers in Official General Order A-908 shall remain in effect until the termination point set forth in that order is reached.

7. Both Board staff and Dealers presented evidence of container costs as of May 2001. (N.T. 22-23, 39-40, Staff Rebuttal Exhibit 3, Rebuttal Exhibits D2 and D2-A) Board staff showed both the plastic and paper containers as well as a blended cost while the Dealers presented just blended costs for the containers. Mr. DeSantis testified that Board staff and Dealer container costs agreed except for the combined container cost for the half-gallon where the Dealers listed a cost of \$.0993 and Board staff listed \$.1045. This discrepancy was a result of Board staff including the cost of containers coming into the market from a related dealer outside the market area. (N.T. 22) Mr. Herbein agreed with Board staff that these containers should be included and is appropriate for updating the costs of the half-gallon container. (N.T. 39-40) Mr. DeSantis testified that in the present Area 6 order, the paper price is used for half pints of milk going into schools and he recommended that this continue. (N.T. 23) Mr. Herbein agreed that the schools in Area 6 should continue to receive the paper container cost for half-pint containers. (N.T. 55) Mr. DeSantis concurred with the Dealers' use of blended numbers. The Board finds that it is appropriate to use the blended container costs shown on Staff Rebuttal Exhibit 3, except that the half-pint containers used by schools shall be at the paper half-pint container cost of \$.0191 per unit.

8. Board staff and Dealers both presented similar ingredient costs as of May 2001 for flavored milk (\$.0221), reduced fat flavored milk (\$.0240), reduced fat milk (\$.0001), low-fat milk (\$.0001), non-fat milk (\$.0022), and buttermilk (\$.0268). (N.T. 23, 43, Staff Rebuttal Exhibit 4, Exhibits D4 and D4-A) The Board finds that the ingredient costs presented by both parties to be appropriate and shall replace these costs in the current order.

9. Board staff and Dealers presented concurring evidence regarding the cost update of \$.0100 per point for labor, insurance, and utility costs between the first quarter of 2000 and the first quarter of 2001. (N.T. 27-28, 45, Staff Exhibit 9, Exhibit D5) The Board finds that the cost update for labor, insurance, and utility costs of \$.0100 per point shall replace the existing cost in the current order.

10. Board staff and Dealers presented similar evidence regarding Class II product costs as of March 2001. (N.T. 26, 45-46, Staff Exhibit 6, Exhibit D6) Board staff also presented evidence relative to a fixed cream add-on that is derived by comparing the cost to purchase the Class II product with the cost to manufacture that same product. (N.T. 26-27, Staff Rebuttal Exhibit 7) This fixed cream add-on allows for changes in prices based on the value of the Class II milk and avoids inconsistencies between container sizes or butterfat values for the Class II product. (Area 3 Transcript, N.T. 38) The Board finds that the Class II product costs presented by both the Board staff and Dealers to be accurate and that the fixed cream add-ons presented by Board staff shall replace the existing fixed cream add-ons in the current order.

11. Board staff and Dealers presented concurring evidence regarding a new methodology to calculate the advanced Class II butterfat values. (N.T. 27, Area 3 Transcript, N.T. 39-40, 73-77, Staff Exhibit 8, Area 3 Exhibit D9) This recommended method is similar to the manner in which the advanced Class II skim values are currently calculated. On or before the 15th of each month, the Board shall use the two most recent butter prices announced by the National Agricultural Statistics Service to calculate a Class II butterfat price to become effective the 1st of the following month. To the extent the Board-calculated Class II butterfat price differs from the actual price issued by the United States Department of Agriculture, the Board will make the necessary adjustment to the Class II price in the month following the federal announcement. The Board finds that the methodology recommended by Board staff and Dealers to calculate the advanced Class II butterfat values is appropriate and shall be adopted as the method used. (Area 3 Transcript, N.T. 39-40)

12. Board staff and Dealers both presented evidence relative to ingredient costs for eggnog of \$.1168 per pound. (N.T. 23, 43, Staff Rebuttal Exhibit 4, Exhibit D4) Mr. DeSantis testified that this cost was being presented since eggnog has moved into the Class I area by the current federal order. (Area 3 Transcript, N.T. 31) Mr. DeSantis further testified that eggnog is a fluid milk product that has various ingredients and is similar to flavored milk. (Area 3 Transcript, N.T. 31-32) Mr. DeSantis did not recommend whether or not to include eggnog in this order because he believed it required a legal conclusion as to whether or not the Board could set a price for the eggnog. (N.T. 23, Area 3 Transcript, N.T. 32-33) Mr. Herbein also did not make a recommendation whether or not a minimum price be set for eggnog. (N.T. 43-44, Area 3 Transcript, N.T. 69) In its brief, the Dealers recommend that a price for eggnog not be established in this order since it is a cost replacement order and there is no base price for eggnog. (Brief of Area 6 Dealers) The Board recognizes that the Dealers had ample opportunity during the hearing to object to the inclusion of ingredient costs for eggnog as being outside the scope of the hearing. This was not done. Section 802 of the Milk Marketing Law (Law), 31 P.S. §700j-802, provides that “the board shall fix, by official order,” minimum wholesale and retail prices for milk. Section 103 of the Law defines “milk” to include “fluid milk” as well as “flavored milk.” The new federal milk marketing order (7 CFR §§ 1000 – 1139) classifies eggnog as a fluid milk product. Section B of Official General Order No. A-907 (general price order for Area 6) identifies fluid milk product to be as defined by the federal milk marketing orders. The Board recognizes its duty to fix prices of milk as set forth in the Law. The Board finds that eggnog meets the definition of milk and, therefore, a minimum price shall be fixed for eggnog. The Board further finds that the minimum price for eggnog shall be set at the next cost replacement hearing for Area 6.

13. Board staff presented evidence regarding an adjustment for shrinkage, sales of bulk products, and cream processing. Mr. DeSantis testified that there are costs or profits associated with processing milk, such as shrinkage and selling off excess milk and cream. (N.T. 24, Area 3 Transcript, N.T. 33-34, Staff Rebuttal Exhibit 4) Mr. DeSantis testified that submission of a rebuttal exhibit was necessary because he discovered a “computer glitch” after the original submission. This error was corrected and all cross-section dealers in Areas 3, 5, and 6 were checked to make sure the computer glitch didn’t occur anywhere else. (N.T. 24) Mr. DeSantis testified that he believed all the numbers presented on the exhibit to be correct. The evidence presented by Board staff at the hearing showed a profit per pound of \$.0008. The Dealers presented evidence to refute Board staff’s testimony. (N.T. 50, Rebuttal Exhibit D8) Mr. Herbein testified that he reviewed the numbers relied on by the Board in coming up with the estimate of shrinkage for several of the dealers in the cross-section but there was one dealer he

didn't have an opportunity to review the number and the Board staff numbers seemed unrealistically low to him. (N.T. 52) Mr. Herbein recommended that these numbers should be left "alone until we have accurate numbers." (N.T. 52) The Board finds that the data used in preparation of the Board staff exhibit was based on audited information provided by the cross-section dealers and was reviewed closely by Board staff to confirm accuracy of the data; therefore, the cost in the current order shall be replaced by the \$.0008 per pound in this order.

14. Mr. Herbein testified that there is a need to increase the Dealers' profit margin from 3.3% in the current order to 3.5%. (N.T. 49, Exhibit D7) Mr. Herbein recommended this rate of return to allow the Dealers to deal with modernization of their plants, as well as the conversion to plastic occurring in Area 6. (N.T. 49) The Board recognizes that the cost replacement process implements increases and decreases in Dealers' costs on an annual basis. Therefore, the costs being incurred by the Area 6 Dealers will be recognized at the next cost replacement hearing. The Board finds, therefore, that the 3.3% Dealer profit margin shall be maintained.

D. Retailers Costs and Rate of Return

15. Mr. Ackman and John Liptock, testifying as an expert in milk retail accounting on behalf of the Pennsylvania Food Merchants Association, presented evidence as to a new methodology to determine in-store handling costs based on the use of the Consumer Price Index for all Urban Consumers (CPI-U) to adjust the in-store handling costs. (N.T. 17, 60-61, Area 3 Transcript, N.T. 17, 108, Staff Exhibit 2, PFMA Exhibit) Using this method to arrive at a new in-store handling cost for milk on a monthly basis would involve the following steps: (1) Determine the change in the CPI-U from a base month to the current month as expressed as a percentage and (2) increase or decrease the in-store handling cost in the base month by this percentage. Mr. Liptock recommended that November 1999 should be used as a base month since that was the month in which the data was gathered to establish the in-store handling cost in the current order. (N.T. 60, Area 3 Transcript, N.T. 111) In its brief, Board staff agreed that the base month should be fixed at November 1999. Both Mr. Ackman and Mr. Liptock agreed that this adjustment to the in-store handling cost could be accomplished on a monthly basis. (Area 3 Transcript, N.T. 108, 110) Mr. Liptock testified that the Bureau of Labor Statistics releases the CPI-U information within two weeks after the end of the month. (Area 3 Transcript, N.T. 108) Mr. Ackman recommended that the in-store handling cost used for the base month of November 1999 be \$.0948 per quart because that was the in-store handling cost contained in the current order. (N.T. 17) In the PFMA exhibit, Mr. Liptock used the in-store handling costs of \$.1175 per quart that PFMA had testified to in the prior Area 6 price hearing. (N.T. 61) The Board finds that it is appropriate to adopt the new methodology using the CPI-U to determine in-store handling costs and that the base year used shall be November 1999. The Board further finds that the base in-store handling cost shall be \$.0948 as established as the in-store handling cost in the current order. The Board also finds that the in-store handling costs shall be adjusted on a monthly basis using the most current CPI-U available.

16. No recommendation was made relative to an adjustment to the retailer's rate of return; therefore, the Board finds that the rate of return shall be maintained at 2.5%.

II. CONCLUSIONS OF LAW

1. The August 1, 2001, cost replacement hearing for Milk Marketing Area No. 3 was held pursuant to authority granted to the Board in section 801 of the Milk Marketing Law (Law), 31 P.S. § 700j-801.
2. The hearing was held following adequate notice, and all interested persons were given a reasonable opportunity to be heard. (Finding of Fact 2)
3. The cross-section used to establish dealer costs met the requirement of representativeness by section 801 of the Law.
4. In accordance with Finding of Fact 11, the Board will include the pricing of eggnog in the cost replacement process.
5. The records of the cost replacement hearings for Milk Marketing Areas 3 and 5 held on August 1, 2001, were included in the record for Milk Marketing Area 6 by reference.
6. In establishing the attached order, the Board has considered the entire record and has concluded that the adoption of this order is supported by a preponderance of the evidence and is reasonable and appropriate under section 801 of the Law, subject to any revisions or amendments the Board may make in the manner set forth in the Law.

PENNSYLVANIA MILK MARKETING BOARD

Beverly R. Minor, Chairwoman

Luke F. Brubaker, Member

Barbara A. Grumbine, Consumer Member

Date: September 5, 2001

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