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Milk Marketing Board
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Official General Order No. A-907 (CRO4)
Posted: October 1, 2003
Effective: November 1, 2003

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

NOW, this 1st day of October 2003, 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 November 1, 2003.

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, net profit and loss on sales of bulk milk and bulk cream, and cream processing costs adopted by the Board in this order will replace the costs for these cost centers embodied in Official General Order (OGO) A-907 (CRO3) 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 adopts 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 and methodologies adopted in this order.

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

SECTION C
SUPERSESSION OF OFFICIAL GENERAL ORDER A-907 (CRO3)

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 (CRO3).

PENNSYLVANIA MILK MARKETING BOARD

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Boyd E. Wolff, Chairman

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Luke F. Brubaker, Member

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Barbara A. Grumbine, Consumer Member

Date: October 1, 2003

FINDINGS OF FACT AND CONCLUSIONS OF LAW
COST REPLACEMENT HEARING FOR MILK MARKETING AREA NO. 6
JULY 2, 2003

I. FINDINGS 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 July 2, 2003.

2. Notice of the hearing was published at 33 Pennsylvania Bulletin 2565 dated May 23, 2003. It was also mailed to all interested persons by means of Bulletin No. 1331, dated May 13, 2003. The hearing notice enumerated the scope of evidence that the Board would receive.

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, consisted of Dean Foods Company – Sharpsville, Dean Foods Company – Erie, Galliker Dairy Co., Inc., and Schneider – Valley Farms, Inc. (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 sold basically the same percentages of the various types of milk as are sold by all milk dealers doing business in Area 6, and had the same types of containers, deliveries, and customers. Carl Herbein, appearing on behalf of the Dealers as an expert in milk cost accounting, concurred with Mr. Ackman that the dealer cross-section was representative of the dealers doing business in Area 6. The Board finds that based on the evidence presented by the two expert witnesses, the requirement of representativeness has been met.

C. Dealer Costs and Rate of Return

5. Board Staff and Dealers presented evidence of processing, packaging, and delivery costs. Board Staff calculated these costs to be $0.1854/point while Dealers calculated these costs to be $0.1866/point. The difference is attributable to differing methods used by the parties to account for depreciation of assets due to the acquisition of one of the cross section dealers.

Gary Gojsovich testified for Board Staff as an expert in milk accounting and milk marketing. Mr. Gojsovich testified that during 2002 the assets of one of the cross section dealers were re-valued at a lesser value and that Board Staff depreciated that new asset basis. Mr. Gojsovich further explained that Board Staff considered the difference between the old asset basis and new asset basis to be goodwill and, in accordance with Internal Revenue Service tax practices, amortized the goodwill over a 15 year period. Board Staff exhibits accounted for depreciation at the new asset basis and amortization of the resultant goodwill.

Mr. Herbein explained that the revaluation of the assets pursuant to the acquisition of the cross section dealer was occasioned by the passage by the Financial Accounting Standards Board (FASB) of two accounting pronouncements. These pronouncements required the revaluation for financial reporting purposes to shareholders and the public. The cross section dealer made the appropriate revaluation in its internal books. Mr. Herbein testified that in arriving at the processing, packaging, and delivery cost, however, he did not use the depreciation schedules as required by the FASB pronouncements. Rather, Mr. Herbein testified, he continued the depreciation of the old company in the new company, as required by the Board's regulation at 7 Pa. Code sec. 149.31(b).

The Board finds that the methodology used by Mr. Herbein in accounting for depreciation is the correct one. The Board's regulation at 7 Pa. Code sec. 149.31(b) requires that assets partially depreciated by a previous owner shall be charged to the appropriate operating expense account of a new owner in an amount not exceeding the book value of the original owner at the time of the sale. This is how Dealers accounted for depreciation when arriving at the processing, packaging, and delivery cost of $0.1866/point. Therefore, the Board finds that $0.1866/point shall replace the processing, packaging, and delivery cost in the existing order. The Board further finds that in the calculation of any other costs where the depreciation expense is involved, the cost derived by Dealers shall be used.

6. Both Board staff and Dealers presented concurring evidence of blended, or weighted average, container costs as follows: Gallon - $0.1552; Half Gallon - $0.0899; Quart - $0.1051; Pint - $0.0985; Third Quart - $0.0289; Half Pint - $0.0191; 4 Ounce - $0.0181; Bulk Per Quart (Dispenser) - $0.1055. Mr. Gojsovich and Mr. Herbein recommended that school milk be priced using the paper half-pint container cost. The Board finds that these blended container costs, as calculated by Board Staff and Dealers, shall replace the container costs in the existing order, with the exception of paper half-pints being sold to schools. The Board finds that school milk shall be priced using the paper half-pint container cost of $0.0183.

Official General Order A-922 established a methodology to adjust the costs of plastic containers on a monthly basis. OGO A-922 provided for a statewide adjustment. Both Mr. Gojsovich and Mr. Herbein recommended that the adjustments continue, but on an area-by-area basis. The Board finds that container costs shall continue to be adjusted on a monthly basis pursuant to the methodology of Official General Order A-922, but that the adjustments will begin to be made on an area-by-area basis as cost replacement orders are issued. Therefore, the Area 6 plastic container cost data shall be applied solely to Area 6 and be used to adjust the Area 6 plastic container costs.

7. Board Staff and Dealers presented identical evidence of ingredient costs as follows: Reduced Fat Milk - $0.0002/lb; Low Fat Milk - $0.0001/lb; Non-Fat Milk - $0.0015/lb; Flavored Milk - $0.0239/lb; Flavored Reduced Fat Milk - $0.0239/lb; Buttermilk - $0.0227/lb; Egg Nog - $0.1539/lb. The Board finds that these ingredient costs, as calculated by Board Staff and Dealers, shall replace the ingredient costs in the current order.

8. Board Staff and Dealers presented concurring evidence regarding the cost update for labor, insurance, and utility costs of $0.0084 per point between the first quarters of 2003 and 2002. The Board finds that $0.0084 per point shall replace the existing cost update in the current order.

9. Board Staff and Dealers presented identical evidence regarding the purchase cost of Class II products as of April 2003. Despite the depreciation issue noted above, Board Staff and Dealers also arrived at an identical value for the "additional cost" of $0.1349/point. Board Staff presented evidence and an exhibit showing the calculation of the fixed cream add-on (derived by comparing the cost to purchase the Class II product with the cost to manufacture that same product) using the processing, packaging, and delivery cost as calculated by Board Staff. (Staff Exhibit 5) The Board finds that the Class II product purchase costs and "additional cost" presented by the Board Staff and Dealers shall replace the existing costs in the current order. However, consistent with our previous findings regarding the depreciation issue, we find that the fixed cream add-on shall be calculated using the processing, packaging, and delivery cost of $0.1866/point as presented by Dealers (to replace the "Processing Cost" in Staff Exhibit 5)

10. Board Staff did not present evidence regarding an adjustment for shrinkage, sales of bulk products, and cream processing costs. Mr. Gojsovich explained that this was so because the information from monthly utilization audits for the profit on bulk cream and milk sales "were not in reason." Board Staff recommended that the value for shrinkage, sales of bulk products, and cream processing costs contained in the current order be carried into the new order. Dealers offered no contradictory evidence or recommendations. The Board finds that the existing adjustment for shrinkage, sales of bulk products, and cream processing costs shall remain and be used in the new order.

11. Dealers presented evidence regarding a rate of return on equity in requesting the rate of return be raised to 3.5%. Dealers noted that the Board takes into consideration a rate of return on equity for producers when setting the over-order premium. When issuing over-order premium orders, the Board does note in Findings of Fact that testimony is given relative to a return on equity for producers. However, the Board does not base the level of the over-order premium on a return on equity for producers, and declines to similarly raise the dealer rate of return. The Board finds that the rate of return for producers shall remain at 3.3% when calculating minimum wholesale prices.

12. Official General Order A-922 also provides for an add-on to minimum wholesale and retail prices to account for the rapid rise in fuel costs experienced by the dealers during the latter part of 2002 and early 2003. Both Mr. Gojsovich and Mr. Herbein recommended that this add-on terminate. The Board finds that the fuel add-on to minimum wholesale and retail prices shall terminate effective with this order.

D. Retailer Costs and Rate of Return

13. John Liptock, appearing on behalf of the Pennsylvania Food Merchants Association (PFMA) as an expert in retail store accounting, specifically with respect to milk pricing, offered evidence regarding the use of the Consumer Price Index for All Urban Consumers (CPI-U) to adjust in-store handling costs in Area 6. The Board finds that changes in in-store handling costs are tracking changes in the CPI-U. Therefore, the Board finds that no change in the in-store handling cost methodology is warranted at this point and it shall continue.

14. Mr. Liptock opined that the retail rate of return should be raised above the current 2.5%. He explained that the in-store handling cost recommended by PFMA when the November 1999 base in-store handling cost was established by the Board was some $0.0227/quart higher than the cost used by the Board. Mr. Liptock testified that raising the retail rate of return would

help retailers recoup some of this difference. The Board established a base in-store handling cost of $0.0948/quart because we found that to be the cost for stores in Area 6 to handle milk. We are not persuaded that this base in-store handling cost was wrong. Therefore, the Board does not believe that any change in the rate of return is necessary. We find that the rate of return to retailers shall remain at 2.5%.

II. CONCLUSIONS OF LAW

1. The July 2, 2003, cost replacement hearing for Milk Marketing Area No. 6 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 July 2, 2003, hearing was held following adequate notice, and all interested persons were given a reasonable opportunity to be heard.

3. The record of the cost replacement hearing for Milk Marketing Area 4 held on July 2, 2003, was incorporated in the record for Milk Marketing Area 6 by reference.

4. The cross-section used to establish dealer costs met the requirement of representativeness by section 801 of the Law.

5. 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

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Boyd E. Wolff, Chairman

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Luke F. Brubaker, Member

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Barbara A. Grumbine, Consumer Member

Date: October 1, 2003