



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@state.pa.us

Official General
Order No. A-911 (CRO3)

Posted: December 3, 2003
Effective: January 1, 2004

**COST REPLACEMENT ORDER FOR THE
EAST CENTRAL MILK MARKETING AREA, AREA 2**

NOW, this 3rd day of December, 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 January 1, 2004.

**SECTION A
INCORPORATION**

The attached Findings of Fact, Conclusions of Law, Schedules I and II, and Attachments are incorporated herein by 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 shall replace the costs in these categories embodied in Official General Order A-911 (CRO 2) and will be incorporated into the wholesale and retail prices of Class I price-controlled packaged products sold in Milk Marketing Area No. 2, as defined in Section B of Official General Order A-911. Wholesale and retail prices will be adjusted as well by the increase in labor, insurance, and utility 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. 2 will reflect the costs adopted in this order

(c) The rate of return to dealers is maintained at 3.5%. The rate of return to retailers is maintained at 2.7%.

SECTION C
EFFECTIVENESS OF OFFICIAL GENERAL ORDER A-911

All parts of Official General Order A-911 not inconsistent with Section B (relating to scope) continue in effect. This order supersedes Official General Order A-911 (CRO 2).

PENNSYLVANIA MILK MARKETING BOARD

Boyd E. Wolff, Chairman

Luke F. Brubaker, Member

Barbara A. Grumbine, Consumer Member

Date: December 3, 2003

FINDINGS OF FACT AND CONCLUSIONS OF LAW
COST REPLACEMENT HEARING FOR MILK MARKETING AREA NO. 2
NOVEMBER 5, 2003

I. FINDINGS OF FACT

A. Procedural History

1. On November 5, 2003, the Pennsylvania Milk Marketing Board (Board) conducted a hearing for Milk Marketing Area No. 2 to consider cost replacement pursuant to Section B of Official General Order A-911.

2. Notice of the hearing, originally scheduled for September 3, 2003, was published at 33 Pennsylvania Bulletin 3098, dated June 27, 2003. A notice canceling the September 3, 2003, hearing was published at 33 Pennsylvania Bulletin 4260, dated August 22, 2003. Notice of the rescheduled hearing for September 15, 2003, was published at 33 Pennsylvania Bulletin 4260, dated August 22, 2003. A notice postponing the September 15, 2003, hearing was published at 33 Pennsylvania Bulletin 4646, dated September 12, 2003. Notice of the rescheduled hearing for November 5, 2003, was published at 33 Pennsylvania Bulletin 4989, dated October 3, 2003. Notice of the original hearing date of September 3, 2003, was also provided via Board Bulletin 1334, dated June 13, 2003. Notice of the cancellation of the September 3, 2003, hearing was provided in Board Bulletin 1338, dated August 13, 2003. Notice of the rescheduled hearing date of September 15, 2003, was provided by Board Bulletin 1339, dated August 13, 2003. Notice of the postponement of the September 15, 2003, hearing was provided by Board Bulletin 1344, dated September 4, 2003. Notice scheduling the hearing for November 5, 2003, was provided by Board Bulletin 1346, dated September 25, 2003. The hearing notices listed the evidence the Board would consider at the hearing.

B. Validity of Dealer Cross-Section

3. The dealer cross-section utilized by both Board Staff and the Area 2 Milk Dealers (Dealers), the only parties to present evidence of dealer costs, consisted of Rosenberger's Dairies, Tuscan/Lehigh Dairies (Schuylkill Haven), and Clover Farms Dairy, Turkey Hill Dairy, and Wengert's Dairy. However, Turkey Hill Dairy and Wengert's Dairy were not included in the cross section for determining container and ingredient costs.

4. Clifford Ackman, appearing for Board Staff as an expert in milk statistics, testified that the dealer cross-section is representative of all Area 2 milk dealers since they represent the container types and sizes, types of products, types of customers, and delivery methods in Area 2. 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 2. 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 \$0.1559/point while Dealers calculated these costs to be \$0.1566/point. The difference is attributable to differing methods used by the parties to account for depreciation of assets due to the acquisition of certain 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 two of the cross section dealers were re-valued and that Board Staff used the re-valued asset basis in determining depreciation.

Mr. Herbein explained that the revaluation of the assets pursuant to the acquisition of the cross section dealers 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 depreciating the original costs of the assets so that the depreciation expense reflected in the processing, packaging, and delivery cost is arrived at via the same method year after year. Mr. Herbein also noted the Board's regulation at 7 Pa. Code sec. 149.31, and indicated that Dealers' method for calculating depreciation comported with that regulation.

The Board finds that the methodology used by Mr. Herbein in accounting for depreciation is preferable. 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. Board Staff and Dealers both accounted for the depreciation expense due to the acquisition of two of the cross section dealers in this manner, i.e., charging the appropriate operating expense account of the new owner in an amount not exceeding the book value of the original owner at the time of the sale. We find that continuing the depreciation of the former owner in the new owner is preferable to using a new asset value. By continuing the asset value and depreciation in this manner, there will be more certainty when calculating costs. Therefore, the Board finds that \$0.1566/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. Board Staff and Dealers presented identical evidence of ingredient costs as follows: Reduced Fat Milk - \$0.0002/lb; Low Fat Milk - \$0.0002/lb; Non-Fat Milk - \$0.0002/lb; Flavored Milk - \$0.0308/lb; Flavored Reduced Fat Milk - \$0.0207/lb; Buttermilk - \$0.0326/lb; Egg Nog - \$0.1029/lb. The Board finds that these ingredient costs, as calculated by Board Staff and Dealers, shall replace the ingredient costs in the current order.

7. Board Staff and Dealers presented concurring evidence of blended, or weighted average, container costs as follows: Gallon - \$0.1413; Half Gallon - \$0.1007; Quart - \$0.0491; Pint - \$0.0682; Half Pint (paper only) - \$0.0168; Third Quart - \$0.0301; 4 Ounce - \$0.0176; Bulk Per Quart (Dispenser) - \$0.0466. The Board finds that these container costs shall replace the container costs in the existing order.

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, with an August 2003 base price. 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 2 plastic container cost data shall be applied solely to Area 2 and be used to adjust the Area 2 plastic container costs, using August 2003 costs as the base.

8. Board Staff and Dealers presented concurring evidence regarding the cost update for labor, insurance, and utility costs of \$(0.0012) per point between the second quarters of 2003 and 2002. The Board finds that \$(0.0012) 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. However, due to the depreciation issue noted above, the "additional cost" calculation of Board Staff and Dealers differed, with Board Staff arriving at an "additional cost" of \$0.1011 and Dealers arriving at an "additional cost" of \$0.1014. This difference is relevant because the purchase cost and "additional cost" are added to arrive at a "Total Cost," which is used in the calculation of the fixed cream add-on. 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 and "Total Cost" as calculated by Board Staff. (Staff Exhibit 6) The Board finds that the Class II product purchase costs 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 \$0.1566/point as presented by Dealers (to replace the "Processing Cost" in Staff Exhibit 6) and the "additional cost" of \$0.1014/point as presented by Dealers in Exhibit D6 (to calculate "Purchase Price + Plant Cost" in Staff Exhibit 6).

10. Board Staff presented evidence as to an adjustment for shrinkage, sales of bulk milk and cream, and milk and cream processing costs. The cross-section dealers incurred a cost of \$0.0007 per pound in these areas. The Board finds it is appropriate to replace the value for shrinkage, sales of bulk products, and cream processing costs in the current order with a cost of \$0.0007 per pound.

11. The current rate of return to dealers is set at 3.5%. Mr. Herbein testified that there was no reason to change this rate of return. The Board finds that the rate of return to the Area 2 dealers shall remain at 3.5%.

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. 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 for Area 2 effective with this order.

D. Retailers Costs and Rate of Return

13. John Liptock, Jr., testified on behalf of the Pennsylvania Food Merchants Association (PFMA) as an expert in retail store accounting and dairy in-store handling costs. Mr. Liptock testified that the use of the Consumer Price Index for All Urban Consumers (CPI-U) to adjust in-store handling costs in Area 2 was appropriate; Mr. Liptock was in favor of continuing to use that methodology. The Board finds that changes in in-store handling costs are tracking changes in the CPI-U, which is what we intended when implementing the CPI-U method to change in-store handling costs. 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 presented an analysis showing the difference between in-store handling costs as adjusted by the CPI-U as they are currently calculated (using a November 1999 in-store handling cost of \$0.1022/quart) and as they would be calculated had the Board adopted a base in-store handling cost of \$0.1367/quart (the average of the cross-section of retailers for November 1999). Mr. Liptock concluded that, as of May 2003, the in-store handling cost for the "average store" was actually \$0.1504/gallon higher than provided for in the order. Mr. Liptock opined that this could be addressed in either of two ways: 1.) increase the retail rate of return, or 2.) increase the in-store handling cost. The Board determined that \$0.1022/quart was the cost to handle milk in stores in November 1999. As noted above, we continue to believe that the CPI-U methodology is adjusting the in-store handling cost in an appropriate manner. No evidence has been presented that would persuade us that the in-store handling cost is not appropriate; therefore the Board finds that no change shall be made in the retail rate of return or in base in-store handling costs.

II. CONCLUSIONS OF LAW

1. The November 5, 2003, cost replacement hearing for Milk Marketing Area No. 2 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 parties were given a reasonable opportunity to be heard.

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

4. Various portions of the transcript for the Area 5 cost replacement hearing held on October 1, 2003, were incorporated into the Area 2 record by reference. The transcript pages incorporated by reference were pages 20 – 22, 35, 55 – 64, 73 – 78, and 83 – 85.

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

Boyd E. Wolff, Chairman

Barbara A. Grumbine, Consumer Member

Luke F. Brubaker, Member

Date: December 3, 2003

IF YOU REQUIRE THIS INFORMATION IN AN ALTERNATE FORMAT, PLEASE CALL (717) 787-4194 OR 1-800-654-5984 (PA RELAY SERVICE FOR TDD USERS).