

[REDACTED]



Milk Marketing Board
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February 3, 2017

Luke Brubaker, Chairman
c/o Doug Eberly, Chief Counsel
Pennsylvania Milk Marketing Board
2301 North Cameron Street
Harrisburg PA 17110

Re: Cost Replacement Hearing – Area 4

Dear Chairman Brubaker and Members of the Board:

The Board sets milk prices which allow dealers to recover their costs with a profit. If the Board allows dealers to recover charges imposed within the company, when the money is not leaving the company, the result will be wholesale and retail milk prices bloated by dealers' internal transactions.

The issue is whether an intercompany charge should be an allowable expense for price setting calculations. Tr. 1:72.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] [REDACTED]
[REDACTED] [REDACTED]
[REDACTED]
[REDACTED] [REDACTED]

Board Regulations. Board regulations also support elimination of intercompany charges. Intercompany charges for hauling and rent are specifically disregarded in the regulations and are not acceptable costs. 7 Pa. Code §§ 149.25 and 149.43(b)(30). “Board Staff interprets these regulations to be a statement of the general principle that all intercompany charges (royalty included) need to be adjusted to actual expenses.” Board Staff Surr. p.1. Intercompany container charges are also adjusted to actual expenses in accordance with that principle. Tr. 1:76, 134.

Gary Gojsovich described the process. “For other related company transactions, we look at what’s been charged and that’s usually reported in the – they may send it to us, but then we disallow it. But then we go back and look at what the actual expense is ... And we’ll allow that.” Tr. 1:114.

The hauling and rent regulations were adopted in 1978. 8 Pa.B. 2672. The GAAP reporting requirement was added to the Milk Marketing Law in 1984. Act 243 of 1984. The GAAP reporting requirement was added to the statute after the regulations were adopted. A statute overrides contradictory regulations. But there is no indication that anyone has ever suggested these regulations contradict the law. Related party transactions involving rent, delivery charges, and containers have been adjusted to actual costs over the years *and that has been accepted by the dealers.* Tr. 1:76.

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

Other Board regulations also support Board Staff’s position. Board regulations define “costs” as “the amount of money actually incurred for property or services.” 7 Pa. Code § 149.2. Dean contends that these charges are an actual expense incurred by the processing plants, but it is necessary to look beyond the plant gates to the true context of these transactions. The royalty charge is a related party transaction. The royalty charge is not considered an actual “cost” for price-setting purposes. Tr. 1:75-76, 125. Board Staff’s longstanding practice is to disallow what related entities within a company charge each other, and allow the actual expenses. Tr. 1:76, 90, 111, 115.

The royalty charge is calculated without taking into consideration any actual expenses. Tr. 1:73. [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED] Board prices are based on actual expenses, not market value.

at least to the 1978 regulations – should be followed. Accepting the royalties was an anomaly which, now that it has been presented to the Board, should be abandoned.¹

Allowing the dealers to recover these self-imposed internal charges would irretrievably throw open the barn door to milk price increases. Allowing intercompany charges presents a greater threat to the dairy industry in Pennsylvania than disallowing them. This current cost could turn out to be the tip of an iceberg. This royalty charge is already expensive for Pennsylvania consumers – 5.76 cents per gallon [REDACTED]
[REDACTED]

The royalty rate was described as conservative and could have been even higher. The nickel per gallon could be closer to a dime per gallon in the future. Board Staff Surr. p.2. And that is just for this one dealer.

[REDACTED]
[REDACTED] There is nothing to prevent other dealers from setting up similar arrangements. Board Staff Surr. p.2. [REDACTED]
[REDACTED]

A decision allowing the royalty charges could become a precedent with far-reaching impact. How could other types of intercompany charges be disallowed, if royalties are allowed?

Board Staff respectfully asks the Board to disallow the royalty charge and reaffirm the principle that intercompany transactions are disallowed for price-setting purposes.

Respectfully submitted,

Andy Saylor

Staff Attorney

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