



**Commonwealth of Pennsylvania**

Milk Marketing Board  
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Official General  
Order No. A-927

Posted: June 16, 2004  
Effective: July 1, 2004

**AN ORDER ESTABLISHING DIESEL FUEL ADD-ONS TO WHOLESALE PRICES  
AND THE OVER-ORDER PREMIUM AND  
ESTABLISHING A METHODOLOGY TO ADJUST THOSE ADD-ONS**

NOW, this 16<sup>th</sup> day of June 2004, the Commonwealth of Pennsylvania, Milk Marketing Board (Board), adopts and 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 July 1, 2004.

**SECTION I**

The attached findings of fact, conclusions of law, and Exhibit 1 are incorporated herein by this reference as though fully set forth in this order.

**SECTION II**

(a) In all milk marketing areas the amount of \$0.10 per hundredweight will be added to the Class I over-order premium effective July 1, 2004. This amount shall change monthly pursuant to the methodology set forth in Finding of Fact 15.

(b) In all milk marketing areas the wholesale and retail prices of fluid milk products shall be increased by \$0.0015 per quart effective July 1, 2004. This amount shall change monthly pursuant to the calculation and methodology set forth in Findings of Fact 5 and 14.

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: June 16, 2004

## FINDINGS OF FACT AND CONCLUSIONS OF LAW

### FUEL COST INCREASE HEARING

May 5, 2004

#### FINDINGS OF FACT

1. On May 5, 2004, the Pennsylvania Milk Marketing Board (Board) convened a hearing for all milk marketing areas to receive testimony and evidence to consider whether an increase in minimum wholesale prices and an increase in the over-order premium should be made to reflect increases in fuel costs.
2. Notice of the hearing, scheduling the hearing for April 7, 2004, was published at 34 *Pennsylvania Bulletin* 1647 on March 19, 2004, and was mailed to those who have requested notice of Board hearings by means of Bulletin No. 1355 dated March 11, 2004.
3. At the request of the City of Philadelphia, Mayor's Office of Consumer Affairs, the hearing date was changed. Notice of the rescheduled hearing and rebuttal exhibit submission schedule was published at 34 *Pennsylvania Bulletin* 2144 on April 16, 2004, and was mailed to those who have requested notice of Board hearings by means of Bulletin No. 1357 dated April 5, 2004.
4. At the conclusion of the hearing, a briefing schedule was established, with briefs due May 24, 2004, and reply briefs due May 27, 2004. The briefing schedule was subsequently changed to provide for briefs due on May 28, 2004, and reply briefs due on June 4, 2004.
5. David DeSantis testified for Board Staff as an expert in milk cost accounting. Mr. DeSantis testified that, for the month of April 2004, milk dealers had experienced a delivery cost increase attributable to increased fuel costs of \$0.0013 per point. Mr. DeSantis used weighted points delivered and weighted fuel costs from all cross-section dealers in all Pennsylvania Milk Marketing Areas for 2002 (the last fully audited information available) to calculate a weighted cost per point for fuel for 2002 of \$0.0058. He then calculated a presumed fuel cost for the cross-section dealers for April 2004 by multiplying the fuel used in 2002 by the average retail on highway diesel price for April 2004 (using United States Department of Energy, Energy Information Administration data for the Central Atlantic Region). By dividing the presumed April 2004 fuel costs by the weighted points delivered for 2002, Mr. DeSantis arrived at a cost per point for fuel for April 2004 of \$0.0071. Comparing the April 2004 cost per point for fuel to the 2002 cost per point for fuel, Mr. DeSantis testified that the cross-section dealers experienced a delivery cost increase attributable to fuel of \$0.0013 per point for April 2004. Mr. DeSantis testified that the information and methodology were developed to be "accurate and reliable," but that he was making no recommendation on how the information and methodology should be used. Mr. DeSantis did testify, however, that it would be

appropriate to use the methodology to adjust prices based on fuel costs on a monthly basis. Mr. DeSantis also testified that if the methodology were used to adjust prices on a monthly basis, the base year information should be updated to 2003 at the next round of cost replacement hearings. Staff Rebuttal Exhibit 1, reproduced in pertinent part below, outlined the calculations used by Mr. DeSantis.

**Delivery Costs 2002**

1. Points Delivered	1,930,420,796	(points)
2. Fuel Costs	<u>\$ 11,153,300.74</u>	
3. Cost Per Point For Fuel (Lines 2 ÷ 1)		\$ 0.0058
4. Average Retail On Highway Diesel Cost 2002	\$ 1.4032	(per gal.)
5. Presumed Gallons of Fuel Used (Lines 2 ÷ 4)	7,948,475	(gallons)

**Delivery Costs April 2004**

6. Average Retail On Highway Diesel Price April 2004	\$ 1.7298	
7. Presumed Fuel Cost April 2004 (Lines 5 X 6)	\$ 13,749,272	
8. Cost Per Point April 2004 (Lines 7 ÷ 1)		<u>\$ 0.0071</u>

**9. Delivery Cost Increase Attributable to Fuel (Line 8 - 3) \$ 0.0013**

6. Mr. DeSantis also testified regarding the effects increased fuel costs were having on producers. Mr. DeSantis testified that dairy farmers were experiencing increased hauling costs and increased on-farm costs due to increased fuel costs. Mr. DeSantis testified that fuel cost increases from 2002 through April 2004 had caused a \$0.0320 per hundredweight increase in hauling costs and a \$0.0702 per hundredweight increase in on-farm costs, for a total cost increase of \$0.1022 per hundredweight. Mr. DeSantis arrived at the increase in hauling costs by comparing the fuel cost per hundredweight for a cross-section of haulers in 2003 to April 2004 hauling costs. Mr. DeSantis arrived at the increase in on-farm costs by calculating the percentage increase in fuel prices between 2002 and April 2004 and applying that increase to the "Fuel and Lubricants" cost for 2002 as found by the Pennsylvania Agricultural Statistics Service. Mr. DeSantis made no recommendation regarding how the information he presented relative to producer costs should be used.

7. Carl Herbein testified for the Pennsylvania Association of Milk Dealers as an expert in milk industry accounting. Mr. Herbein testified he agreed with the conclusions reached by Mr. DeSantis regarding the effects of fuel cost increases on milk dealers. Mr. Herbein opined that the increase found by Mr. DeSantis was significant because the increase actually had the effect of deteriorating milk dealers' profit margins by 6.28% on a gallon of two percent milk. Mr. Herbein recommended that the Board incorporate into the next monthly price announcement the cost associated with the increased fuel costs. Mr. Herbein also recommended that the Board develop an indexing system to provide for monthly adjustments (whether an increase or decrease) to minimum prices to reflect monthly changes in fuel costs. Mr. Herbein testified that the change in milk dealer costs due to the increased fuel costs was both material and significant, and since the technology and information were available, the adjustment to minimum prices should be done immediately and monthly, rather than waiting for cost replacement hearings. Mr. Herbein also recommended that the base year information be updated to as current information as possible at annual cost replacement hearings.
8. Mr. Herbein also testified that not all milk dealers get discounted fuel prices and that fuel prices seemed to move up and down at basically the same cents per gallon rate, whether looking at discounted prices or the average on-highway retail price; therefore, the difference in cost from one dealer to another would be essentially the same. Mr. Herbein noted that some dealers have used the futures market to hedge against fuel cost increases, but that it was not a "massive practice," due to the costs and risks involved. Mr. Herbein further testified that the use of actual cross-section dealer costs to set prices promotes efficiency because dealers have an incentive to outperform the average to increase their returns.
9. Dennis Schad testified as an expert in milk marketing and agricultural economics. Mr. Schad testified on behalf of the Northeast Milk Marketing Agency, Dairylea Cooperative, Dairy Farmers of America, Land O' Lakes, Maryland and Virginia Milk Producers' Cooperative Association, and Dairy Marketing Services. Mr. Schad recommended that the Class I price paid to producers be increased by ten cents per hundredweight to cover the increased fuel costs incurred by dairy farmers. Mr. Schad also recommended that the Class I price be adjusted monthly to provide for timely price adjustments for producers "coinciding with this highly volatile cost input." Mr. Schad recommended that the Board do the monthly adjustment based on the chart he presented as Exhibit 1 to his testimony. Basically, the adjustment recommended in the Exhibit 1 chart would provide for a \$0.01 per hundredweight Class I add-on at an average on-highway diesel fuel cost for the Central Atlantic Region of \$1.40 per gallon with the Class I add-on increasing \$0.03 per hundredweight with each \$0.10 per gallon increase in the diesel fuel cost.
10. Mr. Schad testified that the increased costs consisted of increased hauling costs and increased cost of production on the farm through higher fuel cost inputs. Mr. Schad testified that each of the cooperatives he represented in his testimony has a provision in its hauler agreements to automatically adjust its monthly payment based on changes in the price of fuel. For instance, Land O' Lakes haulers receive a half-cent per hundredweight adjustment for every five cent change in diesel fuel prices. Mr. Schad also testified that the production of milk on the farm requires a great deal of purchased

energy with the feeding and milking of cows and cooling of milk requiring large amounts of electricity, while the plowing, seeding, fertilizing, and harvesting of crops require large volumes of diesel fuel. Mr. Schad agreed with the methodology used by Mr. DeSantis to estimate the effect of the increase in fuel costs from 2002 to April 2004 on dairy farmers' cost of production.

11. Lance Haver testified on behalf of the City of Philadelphia, Mayor's Office of Consumer Affairs (MOCA). Mr. Haver testified that it was inappropriate to provide for fuel cost adjustments in addition to the regularly scheduled cost replacement hearings. Mr. Haver testified that recent increases in Federal milk prices likely reflected recent increases in energy costs (the Board notes that producer prices are not addressed at cost replacement hearings, but rather at over-order premium hearings). Mr. Haver also testified that in the period between cost-replacement hearings fuel costs may go up or down, with offsetting effect. Mr. Haver further testified that price volatility in all essential commodities is "an ordinary and regular problem for all businesses" which can be addressed by the purchase or sale of commodities futures.
12. Mr. Haver testified that the methodology used to compute the fuel cost component of dealer costs was "flawed" because it assumed an invariable link between the amount of milk delivered and the fuel consumed and because it assumed there was no change in efficiency or productivity of the milk distribution system. Mr. Haver believed that this encouraged the maintenance of older and inefficient milk delivery fleets. Mr. Haver also testified that using retail diesel fuel costs was a further problem, since commercial vehicle fleets can purchase diesel fuel at a discount to retail prices. Lastly, Mr. Haver testified that fuel consumption by trucks is variable by numerous factors other than the mass of milk distributed, including frontal area, coefficient of drag, rolling resistance, truck mass, transmission type, engine type, and driving cycle.
13. Mr. Haver was offered as an expert in consumer affairs and pricing and consumer behavior in regulated markets. The Board deferred ruling on his qualifications. Based on the information provided in MOCA's brief, we find that Mr. Haver is qualified to testify as an expert in consumer affairs and pricing and consumer behavior in regulated markets. We note that Mr. Haver and MOCA freely acknowledged that Mr. Haver was not an expert on how milk gets into stores or in dairy economics. The question for the Board is the relative weight to be given to any expert's testimony, and based on our regulation of milk marketing in the Commonwealth for 70 years, we believe that we are capable of giving all testimony the appropriate weight.
14. The Board finds that the methodology developed by Mr. DeSantis to arrive at the dealer delivery cost increase attributable to fuel is reasonable and fair and is an appropriate methodology to use to account for changes in fuel costs. The Board further finds that the methodology used by Mr. DeSantis is suitable to be used to make monthly adjustments based on changes in fuel costs, whether those changes be increases or decreases. Therefore, the Board finds that the dealer delivery cost increase (or decrease) attributable to fuel shall be adjusted on a monthly basis. At the time prices are announced each month (for the succeeding month) the most current available calendar month's Average Retail On Highway Diesel Price for the Central Atlantic Region, as published by the

United States Department of Energy, Energy Information Administration, shall replace the Average Retail On Highway Diesel Price in line 6 of the calculation shown in Finding of Fact 5. The dealer delivery cost increase (or decrease) attributable to fuel arrived at on line 9 of the calculation shown in Finding of Fact 5 shall then be included in the wholesale and retail price build-ups. The Board finds that this adjustment shall continue at least until the next cost replacement hearings in each of the Milk Marketing Areas, at which time we will consider testimony and evidence regarding the continuation of the adjustment or changes that should be made in the adjustment.

In finding that the methodology developed by Mr. DeSantis is appropriate to use to adjust fuel costs, the Board finds that basing changes in prices on actual dealer costs promotes efficiency among Pennsylvania's milk dealers. In so finding, we find the testimony of Mr. Herbein to that effect to be credible and more persuasive than the testimony of Mr. Haver. Many of the milk dealers in Pennsylvania are clients of Mr. Herbein and he examines their financial records on a regular basis, and so is more familiar with the specifics of the milk industry in Pennsylvania.

It may be true in a general sense that the likelihood of regulated businesses acting on an incentive to not control costs is inversely proportional to the number of participants in the industry, but the Board, based partly on Mr. Herbein's testimony, does not find that to be the case in Pennsylvania. The Board is also aware, due to our 70 year history of regulating milk marketing in Pennsylvania, of numerous instances where dealer costs have decreased from one year to the next, indicating that dealers are acting on an incentive to achieve lower costs and thus enhance their returns.

The Board also finds credible and more persuasive Mr. Herbein's testimony regarding the use of the on-highway retail price rather than the use of a discounted price. In the formula developed by Mr. DeSantis it is not necessarily the fuel price that is important, but rather the relative change in fuel prices, and the Board finds, based on Mr. Herbein's testimony, that the relative change is the same regardless whether one looks at the on-highway retail price or a discounted price.

The Board also finds that the methodology developed by Mr. DeSantis takes into account the issues raised by Mr. Haver regarding fuel consumption by vehicles being effected by various factors beyond the amount of milk carried. In using the total points delivered and the actual fuel costs of the cross section, the methodology takes into account the factors noted by Mr. Haver because it has considered the various trucks used for milk deliveries, from tractor trailers through small straight body trucks.

The Board also finds that it is desirable to adjust costs on as current a basis as possible. Fuel costs are amenable to more current adjustments based on the methodology developed by Mr. DeSantis. The Board believes that adjusting costs on a current basis promotes a more orderly market. The Board also finds that it is axiomatic that to set prices based on costs, we must use actual costs, rather than speculative or theoretically achievable costs.

For July prices, which will be announced on June 18, 2004, the Board finds that the fuel cost adjustment based on the methodology in Finding of Fact 5 is \$0.0015 per quart. We arrived at this amount by substituting the May 2004 Average Retail On Highway Diesel Price for the Central Atlantic Region, as published by the United States Department of Energy, Energy Information Administration (\$1.7794 per gallon) on line 6 and performing the calculation to arrive at the delivery cost increase attributable to fuel.

The Board further finds that, although the hearing was originally styled an "emergency" hearing, the delay in holding the hearing does not diminish the fact that the increase in fuel costs is having a material and significant effect on milk dealers. Despite using the term "emergency," this hearing is no different than any other single-issue hearing that the Board holds. The Board may issue orders to address any issue or issues when an interested party shows that it is necessary or appropriate. As noted above, we find that it is desirable to adjust costs on as current a basis as possible. Delivery cost changes based on fuel costs can be addressed on a current basis based on the methodology adopted in this order, regardless of what the "title" of the hearing was. What is important is that a material and significant cost can be adjusted on a current basis, to help promote the orderly marketing of milk. The Board finds that this order does precisely that regarding changes in delivery costs attributable to changes in fuel costs.

15. The Board finds that the Class I over-order premium should be increased by \$0.10 per hundredweight for July 2004, to account for increased costs of production due to increased fuel costs. The Board further finds that the Class I over-order premium shall be adjusted monthly based on the Average Retail On Highway Diesel Price for the Central Atlantic Region, as published by the United States Department of Energy, Energy Information Administration, and Exhibit 1 presented by Mr. Schad. The Board finds that increased producer costs due to fuel are quantifiable and amenable to updating on a monthly basis to be as current as possible, thereby helping to promote the orderly marketing of milk. In so finding, the Board finds the testimony of Mr. Schad to be credible and more persuasive than the testimony of Mr. Haver to the contrary (and we also note that MOCA did not argue the issue in its brief).

## **CONCLUSIONS OF LAW**

1. The May 5, 2004, hearing on increased fuel costs was held pursuant to the authority granted to the Board in sections 801 and 803 of the Milk Marketing Law (Law), 31 P.S. §§ 700j-801 and 700j-803.
2. The hearing was held following adequate notice and all interested parties were given a reasonable opportunity to be heard.
3. In adopting the attached order, the Board has considered the entire record and concludes that the order is supported by a preponderance of credible evidence and is reasonable and appropriate under sections 801 and 803 of the Law.
4. The attached order may be amended pursuant to the procedures set out in section 801 of 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

Dated: June 16, 2004

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**Exhibit 1. Proposed Fuel Cost Add-on to PMMB Class I Price**

<b>Monthly Average Diesel Fuel Price</b>	<b>Hauling Add-on</b>	<b>Farm Cost Add-on</b>	<b>Class I Add-on</b>
\$1.40 to \$1.499	\$0.005	\$0.010	\$0.01
\$1.50 to \$1.599	\$0.015	\$0.032	\$0.04
\$1.60 to \$1.699	\$0.024	\$0.053	\$0.07
\$1.70 to \$1.799	\$0.034	\$0.075	\$0.10
\$1.80 to \$1.899	\$0.044	\$0.096	\$0.14
\$1.90 to \$1.999	\$0.054	\$0.118	\$0.17
\$2.00 to \$2.099	\$0.063	\$0.139	\$0.20
\$2.10 to \$2.199	\$0.073	\$0.161	\$0.23
\$2.20 to \$2.299	\$0.083	\$0.182	\$0.26
\$2.30 to \$2.399	\$0.093	\$0.204	\$0.29
	and so on...		