



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-928

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

AN ORDER REGARDING WHOLESALE DISCOUNTS AND MINIMUM RETAIL PRICING IN MILK MARKETING AREAS 2, 3, 5, AND 6

NOW, this 16th 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 and conclusions of law are incorporated herein by this reference as though fully set forth in this order.

SECTION II

(a) In Milk Marketing Area 3 the rate of return to retailers shall be 2.6% effective July 1, 2004.

(b) In Milk Marketing Areas 2, 5, and 6 the rate of return to retailers shall remain unchanged.

PENNSYLVANIA MILK MARKETING BOARD

Boyd E. Wolff, Chairman

Luke F. Brubaker, Member

Barbara A. Grumbine, Consumer Member

Date: June 16, 2004

FINDINGS OF FACT AND CONCLUSIONS OF LAW

WHOLESALE DISCOUNT HEARING

May 20, 2004

FINDINGS OF FACT

1. On May 20, 2004, the Pennsylvania Milk Marketing Board (Board) convened a hearing for all milk marketing areas to receive testimony and evidence "concerning wholesale discounts in Milk Marketing Areas 2, 3, 5, and 6." The hearing was also convened to receive testimony and evidence "concerning the application of discounts to the computation of minimum wholesale and retail prices in Milk Marketing Areas 2, 3, 5, and 6."
2. Notice of the hearing was published at 34 *Pennsylvania Bulletin* 2655 on May 14, 2004, and was mailed to those who have requested notice of Board hearings by means of Bulletin No. 1360, dated May 5, 2004.
3. At the conclusion of the hearing, a briefing schedule was established, with briefs due June 8, 2004, and reply briefs due June 11, 2004. Due to an unscheduled federal holiday, the date for submission of reply briefs was subsequently changed to June 14, 2004.
4. John Liptock testified for the Pennsylvania Food Merchants Association as an expert in retail and store milk accounting. Mr. Liptock testified that due to the large increase that had recently occurred in the price of milk, "medium" and "small" stores were seeing less margin in their milk sales. Mr. Liptock analyzed this loss of margin for the "medium" and "small" stores in Milk Marketing Areas 2, 3, 5, and 6. Mr. Liptock calculated the margins in Areas 2, 3, 5, and 6 for the four most prominent types of milk sold (whole, 2%, 1%, and non-fat) for April 2004 and May 2004 using the discounted minimum wholesale prices and the minimum retail prices for each of the areas and types of milk. Through information compiled by Board Staff, Mr. Liptock determined how much milk was sold in Areas 2, 3, 5, and 6. Mr. Liptock also acquired from Board Staff the relative amounts of each of the types of milk that were sold. Mr. Liptock was then able to determine the decrease in margin experienced by "medium" and "small" stores by calculating the decrease in margin for each of the products in each of the areas. Mr. Liptock testified that it was an "unexpected result" to see the price of milk rise and the margin to "medium" and "small" stores decrease at the same time.
5. Mr. Liptock's analysis revealed that, from April 2004 to May 2004, "medium" and "small" stores in Area 2 had a decrease in margin on milk sales of \$12,856.50. The decrease for "medium" and "small" stores in Area 3 was \$30,705.34. The decrease in Area 5 was \$43,927.14. The decrease in Area 6 was \$19,793.07. Mr. Liptock also noted that the "large" stores in each of the Areas had margin increases on a dollar basis, but that the "large" store margins remained the same on a percentage basis.

6. Mr. Liptock opined that the decrease in margin led to the average "medium" and "small" store receiving less than 2.5% profit in May 2004. Mr. Liptock made two alternate recommendations to address that situation, both of which involved changing the rate of return in each of the Areas on a sliding scale. Mr. Liptock recommended that the change in profit percentage could be tied either to the Class I raw milk price or to the minimum wholesale price. Mr. Liptock explained that in both of his recommendations, the profit percentage would increase as the price of milk increases, thereby stopping the margin erosion experienced by the "medium" and "small" stores.
7. David DeSantis testified for Board Staff as an expert in milk cost accounting. Mr. DeSantis analyzed retail prices and margins in Area 2 only. Mr. DeSantis compared actual May 2004 wholesale and retail prices to a 16 month average from January 2003 through April 2004 for gallons of whole, 2%, 1%, and skim milk. Mr. DeSantis's analysis showed that stores receiving the largest wholesale discount (analogous to Mr. Liptock's "large" stores) had increases in margin for each of the products when May 2004 prices were compared to the previous 16 months. Mr. DeSantis's analysis showed that stores receiving the smallest wholesale discount available ("small" stores) had decreases in margin for each of the products when May 2004 prices were compared to the previous 16 months. Area 2 has two levels of wholesale discount between the largest and the smallest (termed "medium/large" and "medium" by Mr. Liptock in his exhibits); Mr. DeSantis's analysis showed increases in margin for all four products for the "medium/large" classification and increases in margin for 1% and skim milk for the "medium" stores, with decreases in margin for the "medium" stores for whole and 2% milk.
8. Mr. DeSantis recommended that the current pricing and profit structure be preserved, rather than react to what he termed a "one month extreme in pricing." Mr. DeSantis noted that retail prices are built up based on the most efficient delivery (and hence deepest discount), which he believed most retailers were receiving. Mr. DeSantis also noted that retailers receiving the deepest discount and selling at minimum are making the mandated profit and that stores selling at minimum and receiving a lesser discount are probably not making the mandated profit, regardless of the price of milk.
9. Mr. DeSantis acknowledged that he did not use actual wholesale and retail prices throughout his exhibits. Mr. DeSantis used actual May 2004 prices throughout his exhibit. Mr. DeSantis also used the actual prices for the previous 16 month period to arrive at the average for the whole milk portion of his exhibit. However, for the 2%, 1%, and skim milk, the average prices for the previous 16 month period were derived by applying the same percentage difference (24%) as Mr. DeSantis found for whole milk.
10. Mr. Liptock did not complete Tables 1 and 4 – 19 of his exhibit for "large" (and, in the case of Area 2, "medium/large") stores. Using Mr. Liptock's methodology, as explained by him in his testimony, the Board did complete the Tables for those stores. We found, as Mr. Liptock testified, that the margins for the "large" stores increased on a dollar basis. We found that, in Area 2, the margin for "large" and "medium/large" stores increased \$16,750 in May 2004. For Areas 3, 5, and 6, we found that the margins for large stores increased \$26,390, \$64,506, and \$21,755, respectively, in May 2004.

11. After completing the Tables in Mr. Liptock's exhibit, the Board also found that margins in Areas 2, 5, and 6 increased for all stores in May 2004 compared to April 2004 (\$3,893.50, \$20,578.86, and \$1,961.93, respectively). We found that the margin for all stores in Area 3 decreased \$4,315.34 in May 2004 compared to April 2004.
12. The Board determined that, had the rate of return in Area 3 been 2.6% in May 2004, the margin for "large" stores would have increased \$32,763 (\$6,373 more than the actual May 2004 increase for "large" stores in Area 3). This would have resulted in a margin increase for all stores in Area 3 of \$2,057.66 between April 2004 and May 2004.
13. The Board does not believe it is appropriate to implement the profit percentage increases recommended by Mr. Liptock. We found Mr. Liptock's testimony regarding the effect of the May 2004 price increase on "medium" and "small" stores to be credible, but we are concerned about the lack of information as to the effect on "large" stores and the concomitant lack of information regarding aggregate sales in Milk Marketing Areas 2, 3, 5, and 6. The Board feels that we simply do not have enough information to raise the retail rate of return to as high as 3.5%.
14. Given the limited information we were able to develop using Mr. Liptock's Tables regarding "large" stores and aggregate sales, the Board does believe it is appropriate to raise the retail rate of return in Area 3 to 2.6%. A 2.6% retail rate of return in May 2004 would have resulted in an increase in margin for all stores of \$2,057.66, rather than the decrease of \$4,315.34.

DISCUSSION

The Board is sensitive to the plight of "medium" and "small" stores when milk prices reach the levels they did in May 2004. However, the Milk Marketing Law requires us to set minimum prices that provide "a reasonable return on **aggregate** milk sales by . . . stores selling milk." We do not believe that we can raise the rate of return for all stores based on an analysis of what is happening to a particular subset of stores. The Board does not believe that we were given enough information regarding aggregate sales to implement the changes in the rate of return recommended by the Pennsylvania Food Merchants Association.

The Board does believe it is appropriate, however, to raise the rate of return in Area 3 to a level where the total margin for all stores would not have decreased when comparing May 2004 to April 2004 prices (the total margin for all stores increased from April 2004 to May 2004 in Areas 2, 5, and 6).

The Board also would like to note that perhaps there is some possibility that "medium" and "small" stores could be helped by changes to the methodology used to set minimum prices. It may be instructive to note that the call for this hearing was to consider wholesale discounts and their application to the computation of minimum wholesale and retail prices.

CONCLUSIONS OF LAW

1. The May 20, 2004, hearing on wholesale discounts and their application to the computation of minimum wholesale and retail prices 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

Boyd E. Wolff, Chairman

Luke F. Brubaker, Member

Barbara A. Grumbine, Consumer Member

Dated: June 16, 2004

IF YOU WISH TO RECEIVE THIS INFORMATION IN AN ALTERNATE FORMAT,
PLEASE CALL 7170787-4194 OR 1-800-654-5984 (PA RELAY SERVICE FOR TDD
USERS).
