Commonwealth of Pennsylvania
Milk Marketing Board
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Official General Order No. A-972

Posted: September 7, 2011
Effective: October 1, 2011

PRICE ADJUSTMENTS TO ACCOUNT FOR INTERACTION OF MILK PRICES AND WHOLESALE PERCENTAGE DISCOUNTS

NOW, this 7th day of September 2011, 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 October 1, 2011.

SECTION I

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

SECTION II

Adjustments shall be made to resale prices in each area based on the methodology outlined in this Order.

PENNSYLVANIA MILK MARKETING BOARD

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Luke F. Brubaker, Chairman

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Richard Kriebel, Member

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Lynda J. Bowman, Consumer Member

Date: September 7, 2011

FINDINGS OF FACT AND CONCLUSIONS OF LAW
RESALE PRICE ADJUSTMENTS
JULY 6, 2011

FINDINGS OF FACT

1. On July 6, 2001, the Pennsylvania Milk Marketing Board ("Board") convened a hearing for all milk marketing areas to receive testimony and evidence concerning the effects that changes in milk prices have on wholesale percentage discounts and dealer margins.

2. Notice of the hearing was published at 41 Pennsylvania Bulletin 2188 on April 23, 2011, and was mailed to those who have requested mailed notice of Board hearings by means of Bulletin No. 1470, dated April 12, 2011.

3. Carl Herbein testified for the Pennsylvania Association of Milk Dealers ("Dealers") as an expert in cost accounting and milk cost accounting. Mr. Herbein testified that the Pennsylvania dairy industry was experiencing significant fluctuations in the cost of raw milk, resulting in significant increases and decreases in minimum wholesale and retail prices. Each of the area orders allows milk dealers to provide various levels of percentage discounts based generally on volumes delivered or by limited service arrangements.

4. Mr. Herbein testified that discounts granted by the dealers to retail customers affect a significant portion of price-controlled Class I milk sales. Due to significant increases in minimum wholesale prices, the discounts cause the dealers significant margin erosion. This is because an increase in minimum wholesale prices causes an increase in percentage-based discounts that is not the result of increased dealer efficiency. The level of discount increases, reducing dealer revenue, but the dealer has performed the same function.

5. Dave DeSantis testified on behalf of Board Staff as an expert in milk accounting and enforcement. Mr. DeSantis agreed with Mr. Herbein's testimony regarding the effects of milk prices on percentage discounts. Mr. DeSantis and Mr. Herbein also agreed that adjustments could be made to resale prices to account for the effects of changing milk prices and percentage discounts. They also agreed on the basic calculation that should be used to determine the effects and to make the adjustments.

6. Mr. DeSantis and Mr. Herbein did not agree on two issues. The first was the reference price – the price that current prices should be compared to determine the effect of changes in milk prices and percentage discounts on dealer margins. Mr. Herbein favored using a fixed average (for 2% gallons) in each area based on a milk cycle beginning with the effective date of the base general price order in each area and ending June 2011. Mr. DeSantis favored using the 2% gallon price found in the price build-up worksheets attached to each of the area base general price orders. For the reasons below, the Board finds neither of these reference prices should be adopted and adopts instead a 30-month rolling average of 2% gallon prices as the reference price in each

area. We further find that the rolling average should be calculated through the month prior to the month for which the adjustment is being made.

7. The second area of disagreement between Mr. DeSantis and Mr. Herbein was whether the adjustment should go negative when prices dropped below the reference price. Mr. Herbein testified that the adjustment should not go negative; Mr. DeSantis testified that it should. For the reasons below, the Board finds that the adjustment should go negative when 2% gallon prices drop below the reference price.

8. Mr. Herbein and Mr. DeSantis agreed that 2% gallons were the appropriate product to use to calculate adjustments to resale prices. Mr. Herbein testified that prices for 2% gallons of milk are representative of all other Class I controlled products with respect to discounts and the effect on dealer margins. The Board agrees and finds that the prices for 2% gallons should be used. We also find, based on the testimony of Mr. Herbein and Mr. DeSantis, that each month's adjustment should be based on the prior month's minimum wholesale 2% gallon price.

9. Mr. Herbein and Mr. DeSantis also agreed that the adjustment should be added to the price build-ups before profit. We agree and find that the adjustment should be added to the price build-up before profit is calculated.

10. Chuck Turner, Jr., president of Turner Dairy Farms, testified in support of increasing wholesale milk prices to offset the negative effects that high milk prices had on his operating margin. Mr. Turner testified that milk prices had been high for several months and were expected to remain high for several more. He also testified that other input prices were high. The high costs had significantly reduced profitability. Mr. Turner further testified that an average price was appropriate to use as the reference price because it would capture both high and low milk prices.

11. Joe Carson, CEO and owner of United Dairy, Inc., also testified in support of adjusting wholesale prices. Mr. Carson testified during the last four to five years, milk prices were as high as he had seen them and that they stayed high for longer periods of time. Typically, if the Class I price spiked up, it would remain high for a two to four months, lessening the impact of the high prices on percentage discounts and dealer margins. A drop in price would then follow and an offset would occur. Mr. Carson observed that Class I milk prices had continually risen, with price decreases occurring in only two months out of the prior 18. He further testified that Class I prices were projected to remain much higher for "years to come." Mr. Carson also testified that in addition to high prices eroding his profits, they were also causing his volume to drop, due to the high raw milk prices causing higher retail prices.

12. For each of the milk marketing areas, Mr. Herbein and Mr. DeSantis analyzed the interaction of changing milk prices and wholesale percentage discounts on dealer margins. They used the same cross sections of milk dealers, which were essentially the same cross sections as used in the general price orders in each area. Without

specifically listing each of the cross sections, we find that the cross sections are representative of dealers doing business in the areas.

13. As noted above, for the reference price Mr. Herbein recommended the use of a fixed average based on various length milk cycles. Mr. Herbein testified that the discounts reflected in each of the area base orders were cost justified at the time of adoption of the base orders and that fluctuations which occur in the underlying milk cost since each of the general price hearings cause the need to adjust prices to properly reflect dealer margin. Mr. Herbein testified that the use of the fixed average price reflected the normal cycles of milk price increases and decreases and that when the original discounts were determined and cost justified that fluctuations of raw milk prices were occurring and were thus considered in developing the original discount structures. He testified that to use one month's price as the reference price, then, would cause significant variance and exaggerated differences between milk marketing areas. We agree with Mr. Herbein that comparison of the Dealers' and Staff presentations showed wide variance in the effects of percentage discounts on dealer margins that cannot be explained solely by the utilization of the discounts and is the result of using reference prices which vary only based upon when each base order was adopted.

14. Based on Mr. Herbein's credible and persuasive testimony we find that the use of an average price is appropriate for calculating the adjustment to resale prices. We were not convinced, however, that the varying length milk cycles used by Mr. Herbein in each area are the appropriate average. Additionally, based on the credible and persuasive testimony of Mr. Turner and Mr. Carson, we believe it is likely that milk prices will remain at higher than previously experienced levels for some time. To account for this anticipated higher than previously experienced price level, we find that a 30 month rolling average of 2% gallon prices should be used as the reference price for the resale price adjustment calculation in each area.

15. Mr. Herbein, Mr. Turner, and Mr. Carson all recommended that the adjustment not go negative. Their recommendations had essentially two bases – that prolonged high prices had caused lost margins over a period of time that could be made up if the adjustment did not go negative and that as prices decreased below the reference price causing margin enhancement, that margin enhancement would be zeroed out when prices increased again to and above the reference price. Mr. DeSantis recommended that the adjustment should go negative to prevent dealer margins from exceeding Board-intended and the statutory maximum profits.

    The Board finds that the adjustment should go negative. The Board makes several monthly adjustments to resale prices based on fluctuating costs. None of those current adjustments are prohibited from being negative. We were not convinced by the testimony of Mr. Herbein, Mr. Turner, and Mr. Carson that the adjustment based on milk costs is of a different character than other adjustments such that it should not go negative. We understand that dealers lost margin due to high milk prices, but do not believe that we can address that issue after the fact by providing going forward what could be a margin greater than that allowed by the Milk Marketing Law.

16. The Area 3 and Area 4 base orders were effective July 2009. Therefore, we do not have 30 months of prices under the new base order for calculating a 30-month rolling average. When the Area 3 and Area 4 base orders were adopted, the average delivery cost and the high cost delivery cost changed. These costs effect wholesale minimum prices. Changing those costs would have an effect on the minimum wholesale price of 2% gallons. Therefore, to account for this change, we find that to calculate the 30-month rolling average in Area 3 and Area 4, which would require using minimum wholesale 2% gallon prices prior to July 2009, the price used for all months in the average calculation should be net of the average delivery and high cost delivery. The Board also finds that the 2% gallon price to be compared to the rolling average for the Area 3 and Area 4 adjustment should be net of the average delivery and high cost delivery. For all other areas, and for Areas 3 and 4 effective 30 months after July 2009, the announced wholesale minimum 2% gallon prices may be used to calculate the rolling average and to compare to the rolling average to arrive at the adjustments.

17. The Board finds that the adjustment should be calculated based on the formula agreed to by Mr. Herbein and Mr. DeSantis. The formula for each area is attached to this order.

CONCLUSIONS OF LAW

1. The July 6, 2011, hearing 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 this order, the Board 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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Luke F. Brubaker, Chairman

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Richard Kriebel, Member

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Lynda J. Bowman, Consumer Member

Date: September 7, 2011

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Pennsylvania Milk Marketing Board
Milk Marketing Area 1

Methodology For Calculating Adjustment to Current Price
To Account For Percentage Discounts

a	30-month rolling average		
b	Prior month's 2% gallon price		
c	Change From Reference (a - b)	$	-
d	Current Profit (As Mandated by Board Order)		3.40%
e	Profit on Change (c x d)	$	-
f	Net Change Before Profit (c - e)	$	-

		(f x A)		(B x C)		(D ÷ E)
	A	B	C	D	E	F
Discounts	**Percentage**	**Revenue Gained / (Lost) per Gallon**	**Annualized Gallon Sales**	**Revenue Gained / (Lost) per Discount**	**Annualized Gallons Sold**	**Excess Profit / (Loss) per Gallon**
Limited Service	4.0%	-	698,373	-		
4% Limited Service + Multi 1%	5.0%	-	70,920	-		
Limited Service	7.0%	-	219,255	-		
7% Limited Service + Multi 1%	8.0%	-	63,903	-		
Limited Service	13.0%	-	2,796,549	-		
13% Limited Service + Multi 1%	14.0%	-	1,021,749	-		
13% Limited Service + Multi 2%	15.0%	-	543,063	-		
Dealer to Dealer	19.0%	-	348,411	-		
			Total	$ -	23,837,682	**$ -**

Pennsylvania Milk Marketing Board
Milk Marketing Area 2

Methodology For Calculating Adjustment to Current Price To Account For Percentage Discounts

a	30-month rolling average	
b	Prior month's 2% gallon price	
c	Change From Reference (a - b)	$ -
d	Current Profit (As Mandated by Board Order)	3.50%
e	Profit on Change (c x d)	$ -
f	Net Change Before Profit (c - e)	$ -

		(f x A)		(B x C)		(D ÷ E)
	A	B	C	D	E	F
Discounts	**Percentage**	**Revenue Gained / (Lost) per Gallon**	**Annualized Gallon Sales**	**Revenue Gained / (Lost) per Discount**	**Annualized Gallons Sold**	**Excess Profit / (Loss) per Gallon**
Limited Service	3.5%	-	284,781	-		
Limited Service	6.5%	-	377,730	-		
Limited Service	9.5%	-	189,336	-		
9.5% Limited Service + Multi 2%	11.5%	-	2,949,237	-		
11.5% Limited Service + Multi 2%	13.5%	-	278,364	-		
Dock	20.0%	-	55,899	-		
Dealer to Dealer	23.0%	-	4,066,275	-		
			Total	$ -	**9,603,486**	**$ -**

Pennsylvania Milk Marketing Board
Milk Marketing Area 3

Methodology For Calculating Adjustment to Current Price
To Account For Percentage Discounts

a	30-month rolling average		
b	Prior month's 2% gallon price		
c	Change From Reference (a - b)	$	-
d	Current Profit (As Mandated by Board Order)		3.40%
e	Profit on Change (c x d)	$	-
f	Net Change Before Profit (c - e)	$	-

		(f x A)		(B x C)		(D ÷ E)
	A	B	C	D	E	F
Discounts	**Percentage**	**Revenue Gained / (Lost) per Gallon**	**Annualized Gallon Sales**	**Revenue Gained / (Lost) per Discount**	**Annualized Gallons Sold**	**Excess Profit / (Loss) per Gallon**
Limited Service	4.0%	-	1,274,142	-		
4 % Limited Service + Multi 2%	6.0%	-	156,918	-		
Limited Service	9.0%	-	861,483	-		
Limited Service	13.0%	-	7,565,073	-		
13% Limited Service + Multi 2%	15.0%	-	2,330,754	-		
Dealer to Dealer	22.0%	-	2,194,620	-		
			Total	$ -	20,910,429	**$ -**

Pennsylvania Milk Marketing Board
Milk Marketing Area 4

Methodology For Calculating Adjustment to Current Price
To Account For Percentage Discounts

a	30-month rolling average		
b	Prior month's 2% gallon price		
c	Change From Reference (a - b)	$	-
d	Current Profit (As Mandated by Board Order)		3.40%
e	Profit on Change (c x d)	$	-
f	Net Change Before Profit (c - e)	$	-

		(f x A)		(B x C)		(D ÷ E)
	A	B	C	D	E	F
Discounts	**Percentage**	**Revenue Gained / (Lost) per Gallon**	**Annualized Gallon Sales**	**Revenue Gained / (Lost) per Discount**	**Annualized Gallons Sold**	**Excess Profit / (Loss) per Gallon**
Dock & Dealer	20.0%	-	171,372	-		
Dock & Dealer	23.0%	-	2,820,219	-		
			Total	$ -	28,051,707	**$ -**

Pennsylvania Milk Marketing Board
Milk Marketing Area 5

Methodology For Calculating Adjustment to Current Price To Account For Percentage Discounts

a	30-month rolling average		
b	Prior month's 2% gallon price		
c	Change From Reference (a - b)	$	-
d	Current Profit (As Mandated by Board Order)		3.50%
e	Profit on Change (c x d)	$	-
f	Net Change Before Profit (c - e)	$	-

	A	B	C	D	E	F
		(f x A)		(B x C)		(D ÷ E)
Discounts	**Percentage**	**Revenue Gained / (Lost) per Gallon**	**Annualized Gallon Sales**	**Revenue Gained / (Lost) per Discount**	**Annualized Gallons Sold**	**Excess Profit / (Loss) per Gallon**
Limited Service	4%	-	1,365,033	-		
4% Limited Service + Multi 2%	6%	-	1,185,306	-		
Limited Service	7%	-	1,136,019	-		
7% Limited Service + Multi 2%	9%	-	84,936	-		
Limited Service	10%	-	3,332,319	-		
10% Limited Service + Multi 2%	12%	-	15,870,849	-		
Dealer to Dealer	15%	-	1,884,132	-		
Dealer to Dealer	19%	-	224,322	-		
			Total	$ -	37,871,100	**$ -**

Pennsylvania Milk Marketing Board
Milk Marketing Area 6

Methodology For Calculating Adjustment to Current Price
To Account For Percentage Discounts

a	30-month rolling average		
b	Prior month's 2% gallon price		
c	Change From Reference (a - b)	$	-
d	Current Profit (As Mandated by Board Order)		3.40%
e	Profit on Change (c x d)	$	-
f	Net Change Before Profit (c - e)	$	-

		(f x A)		**(B x C)**		**(D ÷ E)**
	A	**B**	**C**	**D**	**E**	**F**
Discounts	**Percentage**	**Revenue Gained / (Lost) per Gallon**	**Annualized Gallon Sales**	**Revenue Gained / (Lost) per Discount**	**Annualized Gallons Sold**	**Excess Profit / (Loss) per Gallon**
Limited Service	4.0%	-	891,129	-		
Limited Service	7.5%	-	240,690	-		
7.5% Limited Service + Multi 2%	9.5%	-	335,319	-		
Dealer to Dealer	10.0%	-	332,070	-		
Limited Service	10.5%	-	2,084,451	-		
10.5% Limited Service + Multi 2%	12.5%	-	7,391,733	-		
Dealer to Dealer	15.0%	-	112,188	-		
Dealer to Dealer	22.0%	-	262,759	-		
			Total	$ -	15,570,768	**$ -**