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August 8, 2016

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Pennsylvania Milk Marketing Board
Room 110, Agriculture Bldg.
2301 North Cameron Street
Harrisburg, PA 17110

RE: Comments on Behalf of the Pennsylvania Association of Milk Dealers
IRRC # 3154, Public Comments Regarding Cooperative Costs
Regulation #47-17: Uniform System of Accounts

I. Introduction.

The Pennsylvania Association of Milk Dealers (“PAMD”) object to the Pennsylvania Milk Marketing Board’s (“PMMB” or “the Board”) proposal to adopt section 149.46 in order to “provide a framework for cooperatives to report costs they are not currently reporting” but PAMD does not object to PMMB’s proposed revisions to section 149.43. Thus, any further discussion herein of “the proposed regulation” will pertain to section 149.46.

In summary, the Independent Regulatory Review Board (“IRRC”) should understand that section 149.46 is not merely an information gathering and reporting regulation. It is the outgrowth of a several day hearing and is being developed in order to allow the Milk Marketing Board to consider whether to add a fourth tier of minimum pricing to the traditional three-tiered pricing system administered by the Milk Marketing Board for many decades. Today, the Board establishes and enforces three tiers of minimum prices: (1) a producer minimum price (the Over

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Order Premium that plants pay for Class I milk produced in Pennsylvania and sold at retail in Pennsylvania), (2) a wholesale minimum price (the price fluid plants must charge when selling packaged beverage milk to distributors or stores), and (3) a retail minimum price (the price stores must charge consumers for packaged beverage milk). The proposed regulation would serve as the basis for building up and creating a fourth tier of pricing, which would be a Cooperative-only premium (premium paid for Pennsylvania raw milk sold by coops to fluid milk plants for processing and resale in Pennsylvania).

Adopting a fourth tier of minimum prices would result in a sea change in Pennsylvania milk regulation and would disrupt the delicate balance that has been achieved in Pennsylvania. Moreover, the Milk Marketing Law makes no provision for a Cooperative-only price and instead made provisions for cooperatives to address the costs associated with marketing dairy farmer member milk, if necessary, through a provision that would authorize something known as reblending. Moreover, the regulation itself is overly vague and does not provide the guidance and instruction that would allow industry to properly comment on whether the regulation will produce accurate and reliable or appropriate cost information. In addition, the regulation leaves a great deal of discretion to Board staff, which leaves open the possibility that the cost categories could become bloated depending on the knowledge and experience of staff.

IRRC should find that many of the criteria for evaluating a proposed regulation under section 5.2 of the Regulatory Review Act have not been satisfied and IRRC is urged to object to the proposed regulation for numerous reasons outlined herein.

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II. The Pennsylvania Association of Milk Dealers

PAMD is a non-profit trade association that represents the interests of the vast majority of fluid milk processors operating in the Commonwealth of Pennsylvania. PAMD's membership includes 20 fluid milk plants of which 18 are located within the Commonwealth.

Fluid milk processors or plants are the companies that buy raw milk that comes from the farm for processing and packaging into beverage milk. PAMD fluid plants purchase raw milk from dairy farmers directly (independent dairy farmers), or from cooperatives that serve as the marketing agent for dairy farmers that choose to join a cooperative.

Although it is generally asserted that cooperatives market the majority of raw milk within the Commonwealth, more than half of PAMD's member plants purchase at least some portion of their raw milk supply directly from independent (non-coop) dairy farmers. In some cases, these plants also do business with the cooperatives. PAMD members value both supply relationships, but it is important to understand that the availability of an independent milk supply is an important check on cooperative market power.

Cooperatives, as a result of privileges afforded to the cooperative structure under the federal Capper-Volstead Act (7 U.S.C. 291), may join together to set prices notwithstanding antitrust laws. So, for instance, when GNEMMA was active as a marketing agency in common, some of the nation's largest cooperatives such as Dairy Farmers of America and Land O Lakes were permitted by law to band together with other cooperatives such as DairyLea and Maryland-Virginia to agree on the level of premiums that would be charged by each cooperative to fluid milk plants, separate and apart from government minimum pricing.

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Having an alternative source of milk supply has been and remains important to PAMD members in their ability to remain competitive relative to out-of-state milk plants that are not subject to state milk pricing regulation and which have access to independent milk supplies. Under certain circumstance, acquiring independent milk directly can be less expensive than coop milk because the plant incurs the cost of moving raw milk from farm to plant, the inspections, and the testing, and the plant has more control over that cost structure. Purchasing from a cooperative often involves service and handling charges for the middleman services that they provide. Some plants find value in the cooperative model, others find value in the independent model and still others find value in the hybrid – doing business with both sources.

III. Pennsylvania's Three-Legged Stool

In 2005, when the Milk Marketing Law was subject to constitutional challenge under the negative Commerce Clause, the Milk Marketing Board itself described the Milk Marketing Law as a three-legged stool that carefully balances the interests of producers, milk processors and retailers to ensure the continued viability of Pennsylvania's dairy farm infrastructure. Judge Yvette Kane presiding for the Middle District Court of Pennsylvania adopted the Board's interpretation of its own authorizing statute as follows:

The Board describes the Milk Law as a "three legged stool," each leg of which represents a different layer of price control: the producer price, the wholesale price, and the retail price. The Board regulates the price of raw milk by setting an "over-order premium" over and above the federally mandated minimum price. *Id.* (Doc. No. 234, ¶ 32.) Only milk that is purchased from Pennsylvania producers, processed in Pennsylvania, and sold as Class 1 milk within Pennsylvania is subject to this over-order premium. [footnote omitted] (R. 46.) The Board adjusts this premium at least twice yearly to ensure that [dairy] farmers' income remains constant in the face of droughts and fluctuating fuel and production costs. Absent the over-order premium, Pennsylvania small dairy farmers would not be viable. The Board also regulates milk prices by designating six separate

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milk marketing territories, denominated as “Area” (e.g., Area 1, Area 4). The Board periodically sets minimum wholesale price floors for the sale of milk in each area. 31 Pa. Cons.Stat. Ann. § 700j-801. To establish these price floors, the Board conducts hearings in which it examines, *inter alia*, the production costs of a representational cross section of milk dealers within each specific marketing area. (R. 559.) The Board then audits these dealers to find the average costs for raw milk, containers, and delivery of milk within the marketing area. (R. 555-85.) The Board sets a mandatory minimum wholesale price for each marketing area by adding a 2½ to 3½ percentage mark-up to the average costs within each area. (R. 587-88.) Finally, the Board regulates the retail sale of milk by establishing minimum retail prices below which milk may not be sold. Any processor or retailer who attempts to sell milk below the minimum price set within the area is subject to fines, suspension of its license, and imprisonment of no more than one year. 31 Pa. Cons.Stat. Ann. §§ 700j-404, 700j-1002.

Cloverland-Green Spring Dairies, Inc. v. Pennsylvania Milk Mktg. Bd., No. CIV.A. 1:CV-99-487, 2005 WL 6363889, at *2–3 (M.D. Pa. Mar. 30, 2005), aff’d, 462 F.3d 249 (3d Cir. 2006).

The District Court upheld the Milk Marketing Law against constitutional challenge under what is known as the Pike balancing test, which evaluates the benefits of a law that incidentally burdens interstate commerce against the burdens. One benefit the Court was persuaded by was that the three-legged stool created the infrastructure to support the continued viability of small independent dairy farmers in Pennsylvania that did not wish to join cooperatives. *Id.* at *4. Additionally, the PMMB and the Court agreed that the three-legged stool operated to provide a larger share of the retail price to dairy farmers and lower retail prices for consumers compared with states without three tiers of pricing. *Id.* PAMD agrees that the current three-tiered pricing structure provides these benefits, but believes that the proposed regulation, if used as intended by the Milk Marketing Board to adopt a fourth Cooperative-only minimum price, would undermine the delicate balance that has been struck.

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IV. Understanding The Genesis Of Proposed Regulation 149.46 Is Important To Understanding Its True Purpose And Evaluating The Proposal Under The Regulatory Review Act

Section 149.46 is not proposed in a vacuum. It is the direct result of a petition by an organization of cooperatives known as the Greater Northeast Milk Marketing Agency (GNEMMA). GNEMMA has been disbanded and replaced by the Pennsylvania Association of Dairy Cooperatives (PADC) that has a slightly different membership. The petition led to a 7-day hearing during which GNEMMA asked the Milk Marketing Board to issue an order adopting a fourth minimum price requirement that never before existed and which is not known to exist anywhere else in the country.

Specifically, the cooperatives asked the Board to adopt a Cooperative-only premium that fluid milk plants would be required to pay when purchasing Pennsylvania produced cooperative milk for resale in Pennsylvania.

The clear motivation for the Cooperative-only premium proposal was apparent. During the hearing, witnesses explained that coop dairy farmers receive a smaller portion of the Pennsylvania mandated Over-Order Premium than do independent dairy farmers and the Cooperative-only premium would tend to ameliorate this so-called competitive disadvantage cooperatives face in competing with fluid milk plants for dairy farmer suppliers.¹

However, the record made clear that cooperatives perform services for dairy farmers and have internal agreements pertaining to the retention of and distribution of profits, as well as internal agreements that allow them to reblend the Over-Order Premium internally among

¹ References to the hearing can be made available upon request through the non-confidential portions of the more than 2000 page transcript.

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cooperative members, including members in other states, all of which cause the cooperative dairy farmer milk check to look different than the independent dairy farmer milk check. More money in the cooperative pot through the Cooperative-only premium, would theoretically afford cooperatives the opportunity to pass back more of the Over-Order Premium to their dairy farmers. But the logic is faulty.

If cooperative members receive services that they value, it is rational that there would be deductions for those services from their milk check. If cooperative farmers receive year-end equity distributions that are not reflected in the milk check and they are putting their milk check next to an independent farmer's milk check, that is a faulty comparison. If they have agreed, by virtue of their membership to use the Over Order Premium to fund a premium program internal to their cooperative as many do, then there can be no comparison to an independent dairy farmer's milk check. The Legislature essentially had the foresight to recognize that the arrangement between a cooperative and its members is a private one when it acknowledged that there would be marketing costs incurred by cooperatives on their dairy farmer members' behalves and as a result provided in section 809 of the Milk Marketing Law that cooperatives were permitted to reblend the proceeds of member milk sales.

Although being able to better compete for and retain dairy farmer members emerged as the clear motivation for the Cooperative-only premium, the cooperatives sought to justify the proposal and the amount by tabulating their costs of serving the Class I market that they claimed were similar to those of fluid milk plants. As discussed herein, nothing in the Milk Marketing Law authorizes their proposal for a Cooperative-only premium. The costs they offered and the

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costs at issue in the proposed regulation go beyond the functions milk dealers perform in managing an independent milk supply and are clearly the marketing costs of a cooperative. For instance, proposed regulation 149.46 includes sales invoicing and customer relations, which are not functions traditionally involved with fluid milk plants managing an independent raw milk supply. In addition, the General and Administrative category will include costs for functions that are unique to cooperatives and which go beyond the milk procurement activity associated with fluid milk plants. See Attachment 1, Testimony of Carl Herbein (March 23, 2016). In addition, the evidence at the hearing showed that fluid milk plants already pay cooperative service and handling charges as well as other non-governmental premiums in exchange for the services the cooperatives provide to fluid milk plants.

However, the Board was able to avoid resolving the policy and evidentiary issues because the Board correctly concluded that the cost data presented by the cooperative's expert witness to justify and establish a Cooperative-only premium was not reliable and stated it would be: "appropriate to develop a framework, set of regulations, and reporting mechanism for cooperatives similar to that in place for milk dealers that will allow us to accurately determine relevant cooperative costs. When we can begin to collect such accurate and uniformly generated data, the Board can decide *if* and how to recognize cooperative costs...." OGO A-992, Nov. 5, 2015 (emphasis added).

The proposed regulations are purportedly PMMB's attempt at establishing the framework mentioned by the Board. Although the information gathering aspect of the regulations might not be unlawful in and of itself, the ends the proposed regulation is intended to serve are unlawful.

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Moreover, there are several negative legal and policy considerations that should serve as the basis for objecting to the adoption of the regulations under the Regulatory Review Act criteria in section 5.2.

V. Viewed In Its Proper Context, Proposed Regulation 149.46 Does Not Satisfy The Criteria Of the Regulatory Review Act As Set Forth In Section 5.2

A. The Proposed Regulation Would Serve A Purpose That Is Not Authorized By Law

When the Milk Marketing Board suggested that its staff should develop a reporting mechanism to measure cooperative costs, the Milk Marketing Board made clear that the data collection under the proposed regulation would be used to determine if a Cooperative-only premium mandate should be adopted. That is the only specific use that the Milk Marketing Board has articulated.

However, in explaining to the *Cloverland* court that the Milk Marketing Law created a three-legged stool, the Board has revealed its interpretation of its authority under the Milk Marketing Law. And the Board's original interpretation is the correct one. The Milk Marketing Law only provides for three levels of pricing: section 801 outlines the three levels – producer, wholesale, and retail prices. Section 803 sets out the framework for the producer minimum price, and section 802 sets out the framework for the wholesale and resale minimum prices. Nothing in the statute that gives the Board authority to regulate the milk industry through pricing and oversight of fair trade practices indicates that a fourth price level – payment by fluid plants to cooperatives only for bulk milk - is authorized.

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Instead, section 809 of the Milk Marketing Law makes clear that the Legislature knew cooperatives marketed milk for their member dairy farmers when the statute was written. Section 809 specifically identifies cooperatives engaged in “making collective sales or in the *marketing* of milk for the members thereof” (emphasis added) and provides cooperatives with a means of using the minimum price revenue (including the Over-Order Premium) that is collected on behalf of the members to offset the cost of the services provided by the cooperative by giving cooperatives permission to engage in “blending the net proceeds of its sales...” (also referred to as reblending). 31 P.S. § 700j-809.

Section 809 is the only place in the Milk Marketing Law where cooperative marketing costs are addressed. Indeed, when the Legislature developed the list of considerations for the producer minimum price, cooperative marketing costs as they were characterized numerous times during the 7-day hearing, were *not* among them. Similarly, when the Legislature developed the criteria for the wholesale minimum price, cooperative marketing costs, let alone a separate so-called wholesale price for bulk raw milk sales from coops to plants was not separately created. That makes sense because for purposes of collecting the minimum price, the cooperative has long stood in the shoes of its dairy farmer members. This is reinforced by section 809.

Accordingly, cooperative marketing costs were known to exist when the current Milk Marketing Law was enacted, but the Legislature made no provision for them except in section 809 where cooperatives were permitted to collect minimum price revenue such as the Over-Order Premium on behalf of their dairy farmer members and to retain or redistribute that revenue

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as determined internally within the cooperative. Efforts to read the statute to allow a fourth tier of minimum prices for cooperatives only are not clearly provided for in the Milk Marketing Law. While it is clear to PAMD that there is not authority for a Cooperative-only premium, the fact that a fourth tier of pricing has not existing during the decades upon decades of milk regulation in Pennsylvania, suggests that the change contemplated by this regulation is of such a substantial nature that it cannot reasonably be derived from silence without an affirmative act by the legislature

B. The Proposed Regulation Would Serve Purposes That Are Not Consistent With the Intent Of The Legislature And Not In The Public Interest

As the Milk Marketing Board suggested in its strong defense of the Milk Marketing Law in the *Cloverland* case, maintaining adequate supplies of milk for Pennsylvania consumers is part and parcel to maintaining a strong farming infrastructure, which requires, among other things, fostering the survival of smaller independent dairy farms and a diverse milk processing sector. *Cloverland-Green Spring*, 2005 WL 6363889, *3-4. Moreover, the Board touted as another benefit the fact that the farm to retail price spread in Pennsylvania is one of the strongest in the nation. *Id.* This means that the price the farmer actually receives is high relative to the price the consumer pays relative to other states.

However, adopting a Cooperative-only premium would guarantee coops additional revenue – even though they already charge plants for their services and already deduct from member milk checks for the benefits conferred – to obtain a competitive edge over fluid milk plants in attracting and retaining dairy farmer suppliers. In so doing, a Cooperative-only

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premium will enhance cooperative market power affording them greater control over the milk supply in the Commonwealth, leaving Pennsylvania's fluid milk plants vulnerable to higher cost raw milk and competition from plants outside of Pennsylvania. The anticipated result – less competitive and potentially fewer Pennsylvania fluid milk plants and higher prices to consumers.

In light of the Milk Marketing Board's explanation of how the Milk Marketing Law's three-legged stool serves the public interest by maintaining diverse and strong dairy farming and fluid milk plant sectors, the risks associated with a Cooperative-only premium are contrary to the intent of the legislature and the public interest.

C. The Proposed Regulation Does Not Provide Sufficient Detail To Bring About Accurate and Reliable Cost Figures (Section 5.2(b)(3))

At the hearing held by PMMB on March 23, 2016, Mr. Herbein, a CPA with more than 40 years of experience appearing before the Milk Marketing Board and who is undoubtedly one of the nation's most experienced milk cost accounting experts, presented testimony to the PMMB explaining that the proposed regulation was lacking in the level of detail and guidance as to bring about a high likelihood of unreliable cost figures being reported and tabulated.

Mr. Herbein first expressed his strong view that he did not believe it was necessary or appropriate for the Board to implement a Cooperative-only premium. He reminded the Board that he had studied cooperative marketing practices and that he had concluded that cooperatives were already charging fluid milk plants for the services they provided. Furthermore, he expressed concern that cooperatives perform so many functions beyond marketing raw fluid milk, that it is virtually impossible to separate cooperative raw milk marketing activity from its other functions. He also advised the Board that there needed to be a chart of accounts like the

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dealers must use in developing and reporting their costs, but the Board did not heed this suggestion. Indeed, the Board did not substantively implement any of Mr. Herbein's suggestions and left many issues up to the discretion of Board staff. Mr. Herbein's testimony is being submitted herewith and is incorporated by reference as PAMD Attachment 1. It is also noteworthy that the Pennsylvania Institute of Certified Public Accountants made a submission in this proceeding on August 3, 2016 endorsing the March 23, 2016 testimony of Mr. Herbein, which is available under public comments on IRRC's website at http://www.irrc.state.pa.us/docs/3154/COMMENTS_PUBLIC/3154%2008-03-16%20PICPA.pdf.

Mr. Herbein's concern with the lack of clarity and precision in the proposed regulation is even apparent to the layperson. Compare and contrast the clarity and precise instruction in proposed section 149.43 to the excessive delegation to the Board's staff in proposed section 149.46(a)(9) for instance. General and administrative is a broad category in and of itself as demonstrated by the first sentence of subsection (a)(9). PAMD expressed and continues to express the concern that cooperatives perform so many different functions that there is little assurance that only costs associated with procuring milk from Pennsylvania dairy farmers for Pennsylvania plants will be part of the cost calculation. In particular, Pennsylvania fluid milk dealers, if they are to have a Cooperative-only premium foisted upon them, do not believe it is appropriate to pay a premium that reflects cooperative activities in another state or with respect to a different arm of the cooperative such as manufacturing or one of the many other functions performed by cooperatives. Therefore, the allocation methodology becomes critical. However,

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the proposed regulation does not set out the allocation methodology but instead states “[t]he amount shall be a proportion of these costs which the cooperative reasonably allocates to its milk marketing activity based on an allocation method acceptable to the Board.” See Proposed Rule Section 149.46(a)(9). By providing that the allocation method for General and Administrative shall be acceptable to the Board, the proposed regulation has not ameliorated PAMD’s concern. Indeed, as written, how much G&A ends up in Pennsylvania from cooperatives doing business well beyond the borders of Pennsylvania and well-beyond supplying fluid milk plants, will depend on the knowledge and understanding of the Board staff involved at the time. A quick review of section 149.43, which is applicable to milk dealer cost centers does not have similar language deferring to Board staff. Similarly, subsection (b) calls for reporting by cooperatives on forms issued by the Board, which will include instruction and reporting deadlines. That leaves too much to the discretion of Board staff and makes it nearly impossible to properly evaluate whether the regulation will accurately measure costs. Moreover, Mr. Herbein suggested that the regulation should require compilation of the costs in accordance with Generally Accepted Accounting Principles since milk dealer costs are developed in accordance with GAAP, but the Board has opted to leave that instruction, if it is going to be given, to a later date. That is unfortunate because if the 7-day hearing showed anything, it was that costs being aggregated from different companies that are not prepared and aggregated in accordance with GAAP result in an unreliable result. Although PAMD clearly opposes a Cooperative-only premium, the only thing it opposes more is one that can become bloated because of a lack of

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precision in the cost reporting requirements and because too much discretion is left to the behind the scenes work of the Board staff.

D. PMMB Appears To Understate The Fiscal And Administrative Impact Of The Proposed Regulation

The CPA who attempted to present cooperative cost information for the hearing that preceded this proposed regulation indicated on the record that he and his company had invested approximately 800 hours by the time the hearing was wrapping up. If 800 hours was involved in arriving at an unreliable number on behalf of six operating units, it follows that the Board staff, accountants for the cooperatives and accountants for other interested parties will have a substantial time commitment in front of them. Based on rates known to PAMD for CPA accountants with the level of experience involved on behalf of the cooperatives, the food merchants and the milk dealers, the \$15,000 estimate per cooperative entity appears to be understated. Importantly, however, PMMB does not discuss the impact of the proposed regulation on staffing at the Board, which is anticipated to be significant given the newness of the data collection and audit process and as discussed more fully herein given the sea change that will result if the Board were to utilize the cost information to adopt a Cooperative-only premium.

PMMB's estimate also makes no mention of the impact on interested parties such as PAMD and the Food Merchants, each of which will bear costs associated with vetting the cost information and so-called voluntarily preparing and developing comparable cost information to the extent it is even possible. Importantly, PMMB has not proposed to add staff as far as PAMD knows. That will mean that annually there will be new and significant competition for resources between the audits that are required for the annual cost replacement process to update wholesale

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prices and retail prices, two prices clearly authorized by the Milk Marketing Law, and the updating of a potential Cooperative-only premium. The Milk Dealers urge IRRC and the Legislative Committees to consider these expenditures as a significant burden that is unjustified given that the cost collection process is simply a mechanism to accomplish an end that is not authorized by the Milk Marketing Law and which is likely disrupt the delicate balance between independent and cooperative dairy farmers and likely to increase the price of milk.

Thank you for your consideration of these comments.

Respectfully submitted,

/s/ Wendy M. Yoviene

Wendy M. Yoviene

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Testimony of Carl D. Herbein, CPA

Amendment to 7 PA. Code 149

Uniform System of Accounts

I am Carl D. Herbein, CPA, President and CEO of Herbein + Company, Inc. and my address is 2763 Century Blvd., Reading, PA 19610. I am presenting testimony on behalf of the Pennsylvania Association of Milk Dealers in accordance with PMMB Bulletin 1522.

General Comments

The timing of these proposed regulations follows the conclusion of the Over Price Premium Part II hearing (OPP II) where the Board declined to adopt a cooperative-only procurement charge payment on cooperative milk used for Class I sales. I believe the Board had good reason to decline to adopt the proposed procurement charge – the data presented was not uniformly developed, was not subject to proper allocations, was not audited and was not reliable as presented. In addition, it is not at all clear that a coop only procurement charge was ever intended by the legislature, let alone makes sense in the context of the PMMB system.

I infer that these regulations are an attempt to eliminate concerns with the financial information so in the event the cooperatives wish to petition for a cooperative-only procurement charge at some point, a potential future hearing might be streamlined to focus on policy and legal issues. I am doubtful that these proposed regulations can accomplish that. We do not know what that petition will seek and without a hearing directive regarding the scope of any potential procurement charge I cannot fully comment on whether the proposed cost centers are adequate. Just as during the OPP II hearing where we did not know until mid-hearing that the coops were seeking far more than costs that were identical to dealers, here we do not know what the data is intended to support. I cannot fully comment on the adequacy of the cost centers or the detail necessary to establish a chart of accounts specific to the cooperative cost centers. At a minimum, I can say that the proposed regulations would require a chart of accounts.

However, as I explained at the OPP II hearing, there are significant differences between cooperatives and fluid milk processors even where cooperative costs sound and look like milk dealer costs. Similarly, fluid milk plant costs that sound and look like coop costs can be different. For example, a processing milk dealer laboratory performs many services related to the manufacturing process, shelf life and finished product analysis. Also some cooperatives do not receive milk at their facilities like dealers do. Depending on the objective of the financial information this could require more regulatory guidance to properly allocate costs, to properly offset the costs using byproduct accounting and other offsets.

As I mentioned during the hearing, cooperatives perform many functions beyond procurement services for fluid milk plants and it is virtually impossible to extract those costs from categories that are similar to categories at fluid milk plants like general and administrative expenses. Even within cost categories that would seem more focused, the level of service differs among coops and fluid plants because the objectives differ among the entities and it is difficult to identify those costs associated with supplying the market and those associated with being a cooperative, which is a difference that will matter depending on the plan for the costs that would be tracked as a result of the proposed regulation.

Thus, at a minimum there is a need for very strict compliance with PMMB's System of Accounts and there is a need for guidance to the cooperatives in what is being proposed as 149.46 cooperative cost centers that will be determined by the objective of the data. But even with that, I remain concerned that this three-tiered system was not designed to specifically and separately compensate coop costs.

Cooperative Expenses – Related Revenue as an Offset

I am convinced that the cooperatives are getting their costs out of the marketplace. I reviewed, as I often do and as my colleagues often do in checking the calculation of the over price premium the invoices and calculations of premiums paid on Pennsylvania produced, processed, and sold milk for milk dealers purchasing cooperative milk. It is widely understood, and observed by me that the normal cooperative to dealer transaction includes a handling charge depending on market circumstances. This

handling charge must be applied as revenue, which in accordance with PMMB accounting regulations must offset related expenses. An example of this offset principle is how PMMB handles gains and losses on sale of bulk milk and surplus cream. Thus, if a cooperative incurs \$0.15 / cwt. of receiving, lab and fieldwork charges and collects a \$0.20 handling charge then there is no net expense to be mandated or recognized.

Comments – 7 Pa. Code 149.46 Cooperative Cost Centers

7 Pa. Code 149.46(a) Cooperative Cost Centers

(1) *Field Services* – These costs should only apply to Grade A milk. It should be noted that there appear to be differences between the level of field services (and potentially cost) provided by cooperatives and those provided by milk dealers per the testimony of the dairy farmer panel at the OPP II hearing.

(4) *Sales Invoicing* – These costs should be part of General and Administrative and it should be noted that sales invoicing is not a cost incurred by processing milk dealers for the raw milk that they receive from their independent producers for their operations.

(5) *Dispatch, Logistics, and Hauling* – These costs should be reduced by any hauling fees collected from producers.

(7) *Producer Relations* – These costs should be part of General and Administrative and would differ in nature for coops versus fluid milk plants due to the differing objectives of the organizations.

(8) *Customer Relations* – These costs should be part of General and Administrative and are not similarly incurred by fluid milk plants because fluid plants are the customer.

(9) *General and Administrative* – General and Administrative expenses must be allocated in a proportional method among all functions that exist at an individual plant and / or cooperative. The PMMB method for such allocation is to determine the percentage of expenses in each cost center and allocate general and administrative to each cost center as the cost centers are a

percentage of the total expenses. In the cooperative environment, manufacturing facilities exist and must be included in an appropriate allocation of general and administrative in order to be in compliance with PMMB policies and Generally Accepted Accounting Principles.

Additional Recommendations – 7 Pa. Code 149.1

I suggest that with the addition of 7 Pa. Code 149.46(a), there should be the addition of a new subsection (9) to 7 Pa. Code 149.1: “All expenses and costs recorded in accordance with the Uniform System of Accounts shall be recorded in accordance with Generally Accepted Accounting Principles.” This will make clear that the cost centers shall be developed in accordance with Generally Accepted Accounting Principles consistent with the requirements of section 801 of the Milk Marketing Law.

It is imperative that another cost center is created in 149.46(a) that would record the costs that are related to the other activities conducted by the reporting entity such as manufacturing operations, member services, and activities supported at the reporting entity. This cost center is necessary because these services are supported by the same individuals, functions, facilities that support the other cost centers that are proposed.

PMMB should also establish a detailed chart of accounts, which would be utilized by cooperatives in following 149.46. The chart of accounts to be established should supply direction that is similar to that which is in Section 149.41 – Chart of Accounts as followed by processing milk dealers.

Many cooperatives handle member and non-member milk. The accounting regulations should make it clear that both member and non-member milk would be included in any allocation procedure if the costs of such activity are included.

Comments – 7 Pa. Code 149.43 Cost Centers and Operating Accounts

7 Pa. Code 149.43(a) Cost Centers and Operating Accounts

(11) *Selling*

(i) Ice cream – add “and other frozen products.”

(ii) Fluid milk and fluid cream – add “and to include any product that PMMB establishes a minimum resale price.”

7 Pa. Code 149.43(b)

(6) *Worker’s Compensation Insurance* – add “any other costs of compensating employees for work related injuries.”

(62) *Market Administrator Fees* – add “administrative excluding producer settlement fund.”

Summary and Recommendation

I urge the Board not to adopt the cooperative cost centers. It will take up industry, Board and Staff resources to go through the amendment process and then only to find out that the verification process will be cumbersome and costly due to the numerous business focuses cooperatives have. It is also my opinion that when cooperative costs are accumulated in accordance with PMMB policies and regulations and properly offset by related revenue that the need for a mandated cost will be eliminated. Finally, the integrity of the PMMB accounting policies and regulations are sustained by a careful following of Generally Accepted Accounting Principles. Thank you for your consideration of my analysis and opinions.