1-1-1941

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Recommended Citation
Robert H. Griswold, The "Rate Base" in Milk Control, 45 Dick. L. Rev. 135 (1941). Available at: https://ideas.dickinsonlaw.psu.edu/dlra/vol45/iss2/5

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THE "RATE BASE" IN MILK CONTROL

Milk control legislation in Pennsylvania, as elsewhere, stems from the basic conviction that conditions in the milk industry have reached a point where their continuance would jeopardize both the health and economy of the Commonwealth. Economically, the dairy industry accounts for the largest single item of farm income in Pennsylvania, and affects the livelihood of some 78,000 or more farmers. From the standpoint of health, the dietary importance of milk is sufficiently obvious to move the Legislature to term it "the most necessary human food, vital for promotion of the public health and for development of strength and vigor in the race." Though perhaps over-enthusiastic, such an expression indicates the ultimate ground on which legislation of this sort rests. Its task is an intricate one in which the interests—unfortunately conflicting under pre-control conditions—of three groups must be balanced.

First, there is the producer whose interest is in getting for his milk a price that will meet costs of production and enable him to make a living. At the other end of the channel is the consumer whose interest is in getting milk, produced and handled under sanitary conditions, and of high nutritive value, at the lowest possible price. In mid-channel and, by virtue of strategic position, able vitally to affect the flow of the commodity from producer to consumer, is the dealer, whose interest is in buying from the producer at the lowest price possible and selling to the consumer for as much as the traffic will bear. Under laissez-faire conditions, the apparent clash of these interests was uppermost in the minds of all. Each group appears to have proceeded upon the assumption that it must drive a hard bargain, with "every man for himself." Actually, however, the three group interests are interdependent, especially those of consumer and producer. While gaining by a low retail price, the consumer will suffer if the producer receives such a low price that it is no longer profitable for him to continue in business. An unreasonable decrease in production would drive the price of milk out of reach of many consumers who need it most. On the other hand, while a high price to producers is pleasant to contemplate, the producer will lose if it is achieved by maintaining such a high retail price as to materially reduce consumption of fluid milk. Fluid milk brings the premium price, and decreased consumption necessitates utilization of the surplus in other forms, all of which sell at much

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1Supply and Utilization of Milk in Pennsylvania, Bulletin 327, Pennsylvania State College, School of Agriculture and Experiment Station.
3This is not to speak disparagingly of the dealer but merely to view realistically the position of the middleman in any comparable exchange of goods.
lower figures. It has been demonstrated that maintenance of retail prices at a relatively high level during periods of diminished buying power has hurt rather than aided the producer.

Both producer and consumer are prone to condemn the dealer for charging too heavy a toll for the passage of milk through his hands. But with present marketing facilities it cannot be denied that the dealer’s function is essential and should be compensated adequately. On the other hand, it is imperative that such compensation not be permitted to include costs resulting from needless duplication of distribution facilities or services. All three groups suffer when the retail price of milk fails to allow for legitimate distribution economies possible through sales in other than the conventional glass containers, in two-quart or gallon containers, and through sales over the counter.

Milk price-fixing legislation represents one attempt to insure the public an adequate supply of milk, produced according to good health standards, while giving proper consideration to the equitable demands of all three groups above enumerated. The hypothesis is that such a result can be achieved best by the intervention of a government agency as the nearest approach to a disinterested party. The Pennsylvania Milk Control Law adopts the price-fixing device by creating a Milk Control Commission and investing it with the power to set prices. As is usual, in its delegation of power the Legislature did not bestow unlimited discretion upon the Commission. The Act attempts to set forth certain principles and factors which must guide the Commission in carrying out its function. It is the purpose of this note to give some consideration to these legislative guide-posts, as they stand in the light of court interpretation, with a view to discovering the extent to which they may lead to a fair price structure.

Apparently recognizing the complexity of the problem, the Legislature did not attempt to establish a formula for arriving at prices. Instead, with commendable restraint, it contented itself with outlining in general terms the problem before the Commission, certain broad policies underlying passage of the Act, and the major factors to be considered in price formulation. The task of devising a set of standards, of determining in detail the factors to be weighed and the relative importance to be given each was placed on the doorstep of the Milk Control Commission, a group presumably far more competent in such matters than the Legislature.

Addressing itself expressly to the problem of a "rate base," the Legislature said merely, "The Commission shall base all prices upon all conditions affecting

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6The problems of duplication of distribution facilities, the labor factor, chain store and other means of distribution at reduced cost, and the results of several surveys and experiments in the field of milk distribution and consumption are treated in detail in the two articles cited in note 5, supra.

the milk industry in each marketing area, including the amount necessary to yield a reasonable return to the producer and to the milk dealer." Elsewhere, the language of the Act indicates a legislative intent that such prices should be set as will adequately compensate the producer without at the same time putting milk in a luxury class and therefore making it unavailable to low-income groups of the consuming public. The Commission is enjoined particularly to give consideration to the producer.

Depending upon one's philosophy of government, especially as it relates to the delegation of discretionary powers to administrative tribunals, there will be wide disagreement as to whether the Legislature should have undertaken to set out in detail the basis on which milk prices should be established. Some statutes go farther in this direction than does the Pennsylvania Act; others do not go so far. But putting aside the question of policy, it seems that the Pennsylvania Legislature left open the way for the Commission to proceed to formulate a set of standards according to which a price could be fixed that might meet the needs which the Law is designed to remedy. At least the lawmakers laid down rules sufficiently general and flexible to permit the Commission to work out the details of their application on the basis of research and experimentation.

However, as is also the custom in cases of delegation of power to administrative tribunals, the Milk Control Law provides for appeals to the courts by persons aggrieved by an order of the Commission. In the course of such an appeal, the Supreme Court of Pennsylvania undertook an examination of the price-control features of the Statute. While pointing out that the determination of a price-fixing formula is not for the courts, the Court, speaking through Mr. Chief Justice Kephart, did reserve to the courts the final word as to whether or not elements in any

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9 "Public health is menaced when milk dealers do not or cannot pay a price to producers commensurate with the cost of sanitary production, or when consumers are required to pay excessive prices for this necessity of life." Preamble, Act of 1937, paragraph 2.
10 "It is hereby declared to be the legislative intent that the benefits of any increase of prices received by milk dealers, by virtue of the minimum price provisions of this article, shall be given to producers, except . . . where the commission deems a deviation from this policy necessary in order . . . to maintain . . . markets and outlets for producers and consumers." Act of 1937, § 805, 31 P.S. §§ 700j-805. See also 89 U. OF PA. L. REV. 403, "Milk control statutes, although originally intended to protect the consumer from receiving impure milk, are today designed to assure the producer a reasonable price for his product."
11 In New Jersey, "The board shall take into consideration the varying grades of milk produced, the varying percentages of butterfat, plant volume, seasonal production, and other conditions affecting the cost of production, cost of transportation and marketing, and the amount necessary to yield a reasonable return to the producer and to the milk dealer, processor or subdealer." Act of 1939, c. 82, p. 154, § 34, N. J. Stats. Anno., App. A:8-83.
12 In the Rhode Island statute no standards are laid down to guide the board in fixing prices, except that the board is given power to impose only reasonable regulations. Chapter 2310, January Session, 1936, approved March 31, 1936.
formula worked out by the Commission are proper.\textsuperscript{16} And the opinion unequivocally sets out certain factors which must be considered by the Commission in the formulation of any price order. Consequently, under the present state of the law, the Commission's discretion in the matter of price-fixing is not nearly as broad as the language of the Statute might lead one to believe. Instead it is bound to include in price determinations the elements which will be considered hereinafter.

\textit{Marketing areas.} The wide variation in conditions of production and marketing in different localities throughout the State impelled the Legislature to provide that not a state-wide but an area price be established, \textit{i.e.} a price designed to extend over and meet the needs of a portion of the State where the character of the milk industry is fairly uniform.\textsuperscript{16} The reasonableness of such a provision becomes apparent when one considers the vast difference in such items as distribution and labor costs as they exist in a metropolitan market such as Philadelphia and in some of the northern counties where retail sales occur chiefly in communities of from 40,000 downward. Accordingly, in the consideration of a price base, the Commission looks to conditions within the confines of the designated marketing area.\textsuperscript{17}

\textit{Costs.} The primary factor to be considered in setting a price for any service or commodity is that of cost. To the milk producer it means cost of production; to the dealer it means cost of handling. The inclusion of this item is recognized as essential, both as regards producer and dealer, by the Statute\textsuperscript{18} and by the Court.\textsuperscript{9}

In the proof of costs, it is the dealer who has the advantage in actual practice. It is notorious that farmers generally keep few records capable of throwing any appreciable light on costs of operation. In consequence, they come into a hearing ill equipped to present data in support of their arguments as to cost of production.

\textsuperscript{15}"... it must be borne in mind that courts are not price-fixing bodies... We do not determine, nor should we be called upon to do so, in the first instance, what elements are proper factors in price fixing. That is a legislative matter for the Commission to decide. Its conclusion should not be disturbed by us unless the inclusion or exclusion of material items is arbitrary or capricious, and the Dauphin County court may consider whether or not proper weight has been given to the items involved. So also it may determine whether the fair return is reasonable based on a standard that is found to be legal." \textit{Ibid}, at 32, 1 A. 2d at 783.

\textsuperscript{16}"The Commission shall ascertain, after a hearing... the logical and reasonable milk marketing areas within the Commonwealth, shall describe the territorial extent thereof, shall designate such areas by name or number, and shall ascertain and maintain such prices for milk in the respective milk marketing areas as will be most beneficial to the public interest..." Act of 1937, P.L. 417, §801, 31 P.S. §700j-801.

\textsuperscript{17}"The factors entering into fair return as they relate to a particular milk area are many and varied. Prices in other areas should not be taken as a guide unless it appears from the record that there is a fair comparison under similar situations and conditions." Colteryahn Sanitary Dairy v. Milk Control Comm., 332 Pa. 15, 31, 1 A. 2d 775, 783 (1938).

\textsuperscript{18}It is implicit in "reasonable return to the producer and to the milk dealer" (§801) and is expressly mentioned in the Preamble: "Public health is menaced when milk dealers do not or cannot pay a price to producers commensurate with the cost of sanitary production..." Act of 1937, P.L. 417, 31 P.S. § 700j.

\textsuperscript{19}"The producer, as well as the dealer, should receive a price that will... compensate him for reasonable operating expenses..." Colteryahn Sanitary Dairy v. Milk Control Comm., 332 Pa. 15, 27, 1 A. 2d 775, 781.
One may even wonder whether they may not experience some difficulty in arriving at a point for argument. Fortunately, it is proper for the Commission to make its own investigation as to matters of this sort, so that its own experts should be able to provide much needed information which the producers lack. Of course, this difficulty is not nearly so great in the case of large dairies employing detailed bookkeeping methods as it is in the case of the small dairy farmer. Although frequently inadequate and conflicting, the records of the dealers as to matters of cost are far more adequate than those of the producers.

Complicating the problem of determining proper costs from which to derive a price is the fact that consideration must be given to the relative efficiency of different dealers and producers. It would be manifestly unfair to choose as allowable costs those of either the most efficient or least efficient. Somehow the Commission must strike an average which will not unduly penalize any group. The task is not an easy one, and in its performance the element of guesswork must constantly threaten to intrude.

Return on investment. It has been observed previously that the Act contemplates a price that will yield a "reasonable return" to the producer and dealer. Nowhere in the Act is there any elaboration of the term "reasonable return." Just what was meant appears to have puzzled the courts as much as the layman. However, from the beginning, the public utility concept seems to have been uppermost in the minds of everybody concerned with milk prices. It is not surprising that the Dauphin County Court, to which the Colteryahn case was first appealed, injected the theory of return on investment into the problem before it. Because of inadequate data on the record, the lower court did not in fact adopt the utility

20"... the Commission may make its independent survey of the milk industry in the particular area to acquire a just and fair understanding of the problems before it. But the result of that survey should be placed on the record of the hearing before the Commission, and the parties who made the survey should be subject to such cross-examination as is proper." Ibid, at 21, 1 A. 2d 775, 778-9.

21See Appellant's Exhibit No. 5, page 1272a of the Record before the Supreme Court in the Colteryahn case, No. 38 May Term, 1938. See also "Findings of Fact and Reasons for General Order No. A-22," Exhibit "B," page 32 of the Record before the Supreme Court in Keystone Dairy Co. v. Milk Control Commission, No. 6 May Term, 1939 (consolidated with Colteryahn case.)

22"... the Commission should not select the most efficient or the least efficient producers or dealers in the milk districts, or areas under consideration, upon whose figures of investments and costs to conclude what a fair return should be, but it should endeavor to utilize a cross-section representative of the average of the normally efficient producers or dealers in the district." Colteryahn Sanitary Dairy v. Milk Control Comm., 332 Pa. 15, 27, 1 A. 2d 775, 781.

23"The court below was considerably troubled, as we are, with the determination of the question of whether or not the order is reasonable and in conformity with law." Ibid, at 26, 1 A. 2d 775, 781.

24The underlying theory in rate determinations is that rates shall be fixed at such levels that the total revenues from them shall be sufficient to cover the cost of the service rendered, costs, as here used, including 1) operating expenses, 2) depreciation and reserves, 3) taxes, 4) return on investment. MOSHER & CRAWFORD, PUBLIC UTILITY REGULATION, p. 180.


2645 Dauph. 191 (1938).

27Ibid, at 196.
standard. But apparently it was with reluctance that the standard was passed by. The Supreme Court seemed not so sure of the efficacy of the utility rate base for purposes of milk control. Neither did it unreservedly sanction the so-called "sales dollar" standard employed in the court below. Indeed, it appears to have been studiously avoiding a commitment to any theory. But the fact remains that return on investment, under the express language of the Colteryahn decision, must constitute at least one factor to be considered.

If it be assumed that return on investment is theoretically a necessary element to be included in the price base, the question arises as to whether it can be determined for the milk industry with sufficient accuracy to make its use practical.

Reference has already been made to the average farmer's inability to produce satisfactory data as to his ordinary operating expenses. How much more difficult it is going to be to get information which will reveal investment figures with any accuracy! This is particularly true in the case of the producer who is not exclusively a dairy farmer. A farmer who owns a truck which he uses to haul dairy feed from the mill, garden produce to market, and his family to the church social will not find it easy to figure out how much of his truck represents an asset invested in the production of milk. His difficulty is equally as great in determining the extent to which his real estate represents an investment in the dairy business.

Added to this is the requirement that the price fixed must be designed to produce a reasonable return on the investments of all producers in the area, large and small, efficient and inefficient, diversified farmers and dairy specialists. The problem is far more difficult than that of determining a utility valuation for this very reason. In the utility field the task is to determine the investment in one specific property, the holdings of one company, and then to decide what rate will earn a reasonable return on that investment over and above costs of operation and maintenance. And yet it often requires protracted litigation and volumes of highly

28 "However, the testimony taken does not give us a basis for such computation, but relegates us to the sales dollar, and to investment minus depreciation." \textit{Ibid}.
29 "These (sales dollar and investment minus depreciation) are now, however, the bases on which we would have been glad to arrive at our conclusion. In our view, the proper basis would be that which is used in fixing rates for utilities, namely, fair value of the property (used) and useful in the industry, and taking also into account the fact of the milk industry being competitive in its nature." \textit{Ibid}, at 197.
30 "We do not hold this (sales dollar) theory incorrect applied to the total business of the dealer although it is a new standard and may produce a return of a very large per cent on fair value. It may be that 'fair return' should be based upon the same rules governing the return of a public utility or upon a combination of these two theories, or some other standard may be adopted." Colteryahn Sanitary Dairy v. Milk Control Comm., 332 Pa. 15, 30, 1 A. 2d 775, 783 (1938).
31 "We do not attempt to lay down any theory of fair return. It is the duty of the Commission to devise such a theory as will conform to the law, basing its conclusion on sufficient evidence . . ." \textit{Ibid}, at 30, 1 A. 2d 775, 783.
32 "The producer, as well as the dealer, shall receive a price that will not only compensate him for reasonable operating expenses, but permit a fair return on his investment." \textit{Ibid}, at 27, 1 A. 2d 775, 781.
33 Moshier & Crawford, Public Utility Regulation, p. 245.
technical evidence to arrive at a figure representing the investment in a single utility property.\(^{34}\) Furthermore, at the present time there is the utmost confusion in the utility field itself as to what is the proper method of arriving at such a figure.\(^{36}\)

The problem of placing a valuation on property used in milk distribution is also not simple. However, it is less a matter of guesswork than is the case with producers' property, for two reasons: 1) Dealers as a rule are more likely to have available statistics and records from which original cost, depreciation, etc., may be found; 2) Dealers are, by and large, essentially milk dealers and do not make the diversified uses of property found in the case of a large number of producers. There is consequently absent the puzzle of trying to estimate just what portion of one's assets are invested in each of several different lines of business. At the same time, consideration must still be given to the matter of varying degrees of size, efficiency, modernization of equipment, etc., as among different dealers. Here again the price-fixing body must attempt to strike an average investment for all dealers in the marketing area.

It seems obvious, in view of these practical difficulties, that the setting of a figure purporting to represent an average investment in property used and useful in milk production and distribution is bound to be highly speculative. One wonders whether there is practical justification for the application of utility standards to milk price control. It must be borne in mind that the milk industry is still competitive whereas the utility field is non-competitive. One should not assume that because price-fixing occurs in each, the same criteria are applicable to both.\(^{36}\) It would seem that until the production and distribution of milk are made monopolies, there will continue to exist fundamental differences between them and public utility enterprises which will necessitate substantial modifications of the utility concept of rate-making before it may be applied to the establishment of milk prices.

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\(^{34}\)"When one considers the intricate questions involved in the determination of fair value as applied to utilities and to the amount and seriousness of the litigation carried on finally to arrive at its proper definition, one is led to suggest . . . the simpler method . . . of a return on the sales dollar." Colerghahn Sanitary Dairy v. Milk Control Comm., 45 Dauph. 191, 197.

\(^{36}\)"After some thirty years of controversy, of long drawn out arguments before the commissions, the state, and federal courts, agreement as to the proper method of determining the investment upon which rewards to management and stockholders are to be computed seems to be about as remote as it was in 1898, when . . . Smith v. Ames (169 U. S. 466) was tried before the Supreme Court." Moshier & Crawford, Public Utility Regulation, p. 182.

\(^{36}\)"The basis of much fallacious reasoning on the subject of valuation is the assumption that the same conditions and inherent rights attach to all types of property, and, more specifically, that the same factors determining value apply with equal validity both to public utility and other categories of property. The chief determinant of value is generally the income that may be derived from a given piece of property, and this income, in turn, is definitely influenced, if not fixed, by competitive forces. Neither of these conditions hold with reference to the utilities." \textit{Ibid}, at 183.

"No direct parallel can be drawn between a private corporation and a public service corporation, for the reason that to a greater or lesser extent the public has acquired an interest in the use of the property devoted to public use and comparatively the company owes a duty to the public as well as to its stockholders, and must charge no more than a reasonable rate for the service rendered." Havre de Grace etc. Co. v. Towers, 132 Md. 16, 103 A. 319 (1918).
Utilization. As has been previously pointed out, milk of uniform quality may bring widely differing prices, depending upon the use made of it. Accordingly, it is the universal practice to pay producers for any given period a “blended” price which represents the average return from its utilization in the various classifications. In the appeals involved in the Colteryahn case, it was the contention of the dealers that a price should be set that would provide a fair return on each class of milk handled. The Supreme Court, however, refused to countenance a fixing of prices by segregation. Two reasons were assigned: 1) To make the price of milk for each classification return a fair amount would necessitate putting the price of surplus milk so high that products derived therefrom could not meet the competition from other states. That being the case, fluid milk which normally constitutes about 55-60% of the market, would have to sell at a price high enough to compensate for the remaining 40-45% which could not be sold; 2) It would, in most cases, be practically impossible to allocate proportionate costs and investment values to the production and handling of each separate class of milk. Consequently, the Commission must attempt to set a price which will yield a reasonable return on the basis of the utilization scheme of marketing.

The consumer. Finally, consideration must be given to the position of the consumer. In the final analysis, it is the interest of the consumer which should surmount all others, at least if one is to accept at face value the declaration that the primary purpose of the statute is to assure the public an adequate supply of wholesome milk. The Court recognized this element in price determination. The importance of relating price to consumer purchasing power has already been alluded to. Reference has also been made to surveys which seem clearly to demonstrate that when economies in distribution are passed on to the consumer in lowered prices, sales of fluid milk mount with resultant profit to the producer. On the basis of these findings, one might well ask that consideration be given henceforth to allowing reduced retail prices where distribution costs can be cut through centralized distribution, over-the-counter sales, and sales in quantities of two-quarts or over, as well as in containers other than glass.

The scope of this note does not admit of any detailed examination of the statutes of other states which have adopted price control measures. It might be said, in passing, however, that in general they are of little more aid in the ultimate determination of a price-fixing formula than is our own Milk Control Law. Nor is it feasible here to discuss the machinery of the federal-state marketing agree-
ments set up under the Agricultural Adjustment Act. The discussion has pur-
posefully been limited to the situation as it appears to stand at present in Pennsyl-
vania. Its end will have been achieved if it succeeds in calling attention to the
difficulty of the price-fixer's task, the absence of any adequate statutory or decisional
standards by which to gauge prices, and the need for extended research and study
by experts in the field of milk control, not to exclude examination of devices other
than direct price-fixing as means of achieving stability in the milk industry.

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