

STAFF TESTIMONY BEFORE THE PENNSYLVANIA MILK MARKETING BOARD
COST REPLACEMENT HEARING – MILK MARKETING AREA 5
July 5, 2017

Staff Surrebuttal Exhibit 1

Good Morning. My name is Clifford Ackman. As the Statistical Analyst for the Pennsylvania Milk Marketing Board, I collected the information for and produced Staff Surrebuttal Exhibit 1, dealing with the cross-section of milk dealers in Area 5. I have listed these milk dealers in footnote 3 along with the percentage of sales by those dealers compared to all dealers selling into the Western Pennsylvania Milk Marketing Area. As a representative sample of the entire area, these dealers were used to compile the data for the remaining exhibits.

This cross-section of dealers' used to gather 2015 information contains the same companies as presented in the 2014 Area 5 cost replacement hearing information. The cross-section dealers continue to represent over eighty percent of the area's market.

This exhibit offers the cross-section of dealers as presenting a significant portion of all sales into the marketplace. It demonstrates the comparability of Class 1 controlled product sales by all dealers (the top section of the exhibit) and the cross-section dealers (in the lower half of the exhibit). The sales of cross-section dealer products compares favorably with the sales of all dealers in the marketplace falling within statistically acceptable limits.

I also studied the size and types of deliveries of the cross-section dealers along with the types of customers served by them. As a group, the cross-section dealers serve a variety of customers: schools, restaurants, convenience stores, supermarkets, etc. which is comparable to all dealer sales into Marketing Area 5. I also found that the cross-section dealers employ all types of delivery systems (tractor-trailers and smaller, straight body trucks) which are common to this Area as well.

Based on the amount and type of milk sold by these cross-section dealers, the types of customers and the delivery techniques employed by these listed dealers, I find this cross-section to be representative of all dealers doing business in Milk Marketing Area 5.

Good morning. My name is Gary Gojsovich. I am employed by the Pennsylvania Milk Marketing Board as an Audit Supervisor. This morning I will be testifying to Staff Surrebuttal Exhibits 2 through 11.

We expect some of our exhibits will differ from those submitted by the Dealers, but as far as we know, the difference will be based entirely on our different perspectives on the issue which was presented to the Board at the Area 4 hearing.

Staff Surrebuttal Exhibit 2

Staff Surrebuttal Exhibit 2 provides information about the average weighted cost for processing, packaging and delivering milk for the Area 5 cross-section milk dealers. For each of the major cost centers listed in this exhibit, we have matched the expenses associated with the cost center with the volume of milk or other products that flowed through that cost center. The volumes in this exhibit are stated in points (where a point equals a quart or quart equivalent). All costs and points are weighted using the sales weighting method. For example, if a dealer has 25% of their sales in Area 5 then we include 25% of their costs and 25% of their points in the Area 5 cost centers.

Staff recommends that the Board replace the costs in the current Order with those costs in Staff Surrebuttal Exhibit 2.

Staff Surrebuttal Exhibit 3

Staff Surrebuttal Exhibit 3 provides information on the cost of containers for the cross-section dealers. We initially use the costs of the cross-section dealers for plastic containers, paper containers and resin as of April 2016 to calculate weighted cost per units. As was done in previous hearings, we are using controlled container sales volumes for the previous year. We are, therefore, pairing current costs with the weighted units sold in the previous year to arrive at the most current weighted cost per unit available. Where the market has both paper and plastic containers, like the half-gallon container, we have provided a combined paper/plastic price. After we established a cost for each container type in Column E, we are updating those April 2016 costs to the costs observed in our most current container surveys in Column F (May 2017). In Column G we are applying factors for container shrinkage. Column H adds the shrinkage factor to the updated container cost in Column F.

Staff recommends that the Board replace the base container costs with those found in Column C and the base weighted units with those found in Column D and continue to update these costs using the audited surveys submitted by the cross-section dealers. Staff also recommends that the Board continue the practice of providing separate plastic and paper half-pint prices through a plastic add-on.

Staff Surrebuttal Exhibit 4

Staff Surrebuttal Exhibit 4 provides information on the cost of ingredients added to the various milk products like the chocolate powder and sugar in chocolate milk. This exhibit pairs Year 2015 sales activity with April 2016 costs to get current weighted costs.

Staff recommends replacing the current ingredient costs with those found in Staff Surrebuttal Exhibit 4. Staff further recommends the continuance of updating chocolate and sweetener costs quarterly.

Staff Surrebuttal Exhibit 5

Dealers typically sell off excess bulk milk and cream they are unable to use in their own plants and they will recognize either a profit or a loss on these sales. Dealers also lose small amounts of milk as the milk moves through the plant; this loss is called shrinkage and it has a cost associated with it.

Row 1 shows the calculation for shrinkage cost. Column G shows the weighted costs using the sales weighting methodology.

Rows 2, 3 and 5 show calculations for determining profits and/or losses on diverted or transferred sales of bulk milk and cream. Dealers incur additional costs to process and sell transferred milk and cream (Column E). We add these additional processing costs to the producer costs in Column D to determine if the dealers made a profit or loss on the transactions.

The costs in the top panel are summarized in Column H. We divide these costs by the number of pounds of product sold or manufactured by the dealers (net of purchased packaged products) as represented in Column I. By dividing the costs in Column H by the pounds in Column I we arrive at a weighted cost per pound in Column J.

Staff recommends that the Board use the costs and profits in Staff Surrebuttal Exhibit 5 to replace those in the existing Order.

Staff Surrebuttal Exhibit 6

Staff Surrebuttal Exhibit 6 summarizes the components of the milk cost prior to the milk going into the container. We are using the most current announced milk prices available prior to the submission date for the Exhibits. The current fat and skim prices for Class I products are in the top numeric panel of the Exhibit. In the lower numeric panel we show the actual pounds of the Class I products (Columns A and B) sold by the cross-section dealers in this Area. We have labeled the columns A through K and show how we arrive at the cost per pound for each of the products in the table.

Staff recommends that the Board continue to use this methodology for establishing the before-bottling costs.

Staff Surrebuttal Exhibit 7

In Staff Surrebuttal Exhibit 7 we compare the costs and related plant volumes for three significant categories (labor, utilities, and insurance) for the 1st half of Year 2016 with the 1st half of 2017 to update the cost per point from Staff Surrebuttal Exhibit 2. We use bottling points as the denominator for this exhibit as they are a good measure of the plants' overall volume or activity. In columns A and B, we list the first half-year costs for 2016 and 2015 for each of the cost categories. In the next two columns, we list the bottling points for 2016 and 2015 for the first half-year. By dividing the costs by the points in columns E and F, we can compare the cost increase or decrease per point in column G.

Staff recommends replacing the first half cost adjustment in the current Order with the adjustment per Staff Surrebuttal Exhibit 7.

Staff Surrebuttal Exhibit 8

In Staff Surrebuttal Exhibit 8 we update diesel fuel costs from the previous year (Year 2015) by indexing to diesel prices for the most current month (March 2017). Line 1 shows the weighted cost for diesel fuel for the cross-section dealers for Year 2015. Line 2 is the Year 2015 average On-Highway diesel price per gallon as posted by the Energy Information Administration (EIA). Line 3 is the current EIA On-Highway diesel price. Line 4 represents the percentage of change in the diesel price from Year 2015 to the current price. Using the percentage of change on line 4, line 5 shows the current presumed diesel cost. By subtracting line 1 from line 5 we find the changed diesel cost on line 6. By dividing the changed diesel cost on line 6 by the weighted delivery points of the cross-section dealers, we find the changed cost per point on line 8.

Staff recommends that the Board continue to include this adjustment in the cost replacement process. Staff also recommends that the Board replace the Year 2014

points and costs with the Year 2015 points and costs found in Staff Surrebuttal Exhibit 8.

Staff Surrebuttal Exhibit 9

Staff has calculated the current heating fuel add-on using the same methodology as in Exhibit 8 except here we are using Standardization and Pasteurization points and the Pennsylvania Natural Gas Industrial price as posted by the EIA. Staff recommends that the Board continue to include this adjustment in the cost replacement process. Staff also recommends that the Board replace the 2014 points and costs with the 2015 points and costs found in Staff Surrebuttal Exhibit 9.

Staff Surrebuttal Exhibit 10

Staff Surrebuttal Exhibit 10 summarizes the information from all previous exhibits and data from the base Order to arrive at proposed wholesale prices.

Column A is the milk cost from Staff Surrebuttal Exhibit 6 which provides the milk cost per pound. We multiply the milk cost per pound by the number of pounds per container.

Column B lists the container costs from Staff Surrebuttal Exhibit 3.

Column C combines the first half cost adjustment from Staff Surrebuttal Exhibit 7 with the diesel and heating fuel adjustments from Staff Surrebuttal Exhibits 8 and 9. It also includes an adjustment per OGO A-972 for the 'Discount Effect'.

Column D is the container efficiency adjustment from the base order.

Column E lists the processing costs from Staff Surrebuttal Exhibit 2.

Column F is the sum of columns A through E.

Column G is profit. This percentage profit reflects the profit in the current Order.

Column H is the average price with profit.

Column I removes the average delivery. By removing the average delivery, we arrive at a cost for processing the milk and bringing it to the dock. All milk regardless of its ultimate destination will have the same cost at this point.

Column J adds back the cost of a relatively small high-cost delivery. By adding back the high-cost delivery, we have a price from which applicable discounts can be deducted.

Column K is the sum of Columns H, I and J and is our proposed wholesale price.

Column L is the wholesale price under the current cost replacement order.

Column M is the difference between the proposed wholesale price and the current wholesale price.

Staff Surrebuttal Exhibit 11

Staff Surrebuttal Exhibit 11 provides a methodology for arriving at the retail or out-of-store price for milk.

Column A is the proposed wholesale price from Staff Surrebuttal Exhibit 10.

Column B is the deepest discount from the current general price order.

Column C is the average in-store handling cost from the current general order. This in-store handling cost has been updated monthly by the Consumer Price Index. Staff recommends that the Board continue to employ this form of cost update for the retail price.

Column D reflects the retail profit in the current Order.

Column E is the sum of columns A through D and is the proposed retail or out-of-store price.

Column F is the most recently announced retail price.

Column G is the difference between the proposed retail price and the current retail price.

THANK YOU.