

STAFF TESTIMONY BEFORE THE PENNSYLVANIA MILK MARKETING BOARD
COST REPLACEMENT HEARING – MILK MARKETING AREA 3
November 6, 2019

Staff Surrebuttal Exhibit 1

Good Morning. My name is Clifford Ackman. As the Statistician 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 3. I have listed these eight milk dealers in footnote 3 along with the percentage of sales by those dealers compared to the population of all 47 dealers selling into the Northeastern Pennsylvania Milk Marketing Area. This judgmental sample was selected from available dealers as having the largest sales in the area. They account for sixty-two point six percent of Area 3's reported milk sales. The cross-section dealers are also geographically diverse ranging from Valley Farms Williamsport plant to Pocono Mountain's facility in Blakeslee to Tuscan/Lehigh Valley Dairy-Lansdale and Turkey Hill in Lancaster County.

The cross-section of dealers used to gather 2018 information has not changed from the previous Area 3 cost replacement hearing.

This Surrebuttal Exhibit offers the cross-section of dealers as presenting a significant portion of all sales into the marketplace. It demonstrates the ratios of controlled product sales by all dealers (the top section of the Surrebuttal Exhibit) and the cross-section dealers (in the lower half of the Surrebuttal Exhibit). This comparison of product sales ratios falls within statistically acceptable limits using the Chi-square goodness of fit test. This test evaluates the difference between the observed sample ratios and the expected ratios from the known population. The cross-section dealers are the observed sample, and all dealers with reported sales in Area 3 are the known population. In other words, the reported sales ratios of these cross-section dealers are very much like the reported sales ratios of all dealers in Area 3.

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 from small deliveries at schools, restaurants and convenience stores to large deliveries at supermarkets. The containers produced range from four ounce to twenty-quart dispensers. These dealers use a variety of delivery vehicles including smaller, straight body trucks and tractor-trailers. This reflects all dealer sales into Marketing Area 3.

Based on the volume, containers and products 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 3. Their data is used for subsequent Surrebuttal Exhibits.

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 12.

Staff Surrebuttal Exhibit 2

This Surrebuttal Exhibit provides information about the average weighted cost for processing, packaging and delivering milk for the Area 3 cross-section milk dealers. For each of the major cost centers 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 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 3 then we include 25% of their costs and 25% of their points in the Area 3 cost centers.

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

Staff Surrebuttal Exhibit 3

This Surrebuttal Exhibit 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 2019 to calculate weighted cost per units. As has been 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 pint 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 2019 costs to the costs observed in our most current container surveys in Column F (October 2019). 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 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 further recommends that the Board replace the current container costs with the costs found in column E.

Staff Surrebuttal Exhibit 4

This Surrebuttal Exhibit provides information on the cost of ingredients added to the various milk products like chocolate powder and sugar used in chocolate milk. This Surrebuttal Exhibit pairs Year 2018 sales activity with April 2019 costs to get current weighted costs.

Staff recommends replacing the current ingredient costs with those in this Surrebuttal Exhibit. 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 it moves through the plant; this loss is called shrinkage.

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

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) 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 this Surrebuttal Exhibit to replace those in the existing Order.

Staff Surrebuttal Exhibit 6

This Surrebuttal Exhibit summarizes the costs of the milk components. We are using the most current announced milk prices available prior to the submission date for the Surrebuttal Exhibits. The current fat and skim prices for Class I products are in the top panel. In the lower 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 method for establishing the before-bottling costs.

Staff Surrebuttal Exhibit 7

In this Surrebuttal Exhibit we compare the costs and related plant volumes for three significant categories (labor, utilities, and insurance) for the 1st half of Year 2019 with the 1st half of 2018 to update the cost per point from Staff Surrebuttal Exhibit 2. We use bottling points as the denominator 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 2019 and 2018 for each of the cost categories. In the next two columns, we list the bottling points for 2019 and 2018 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 in this Surrebuttal Exhibit.

Staff Surrebuttal Exhibit 8

In this Surrebuttal Exhibit we update diesel fuel costs from the previous year (Year 2018) by indexing to diesel prices for the most current month (August 2019). Line 1 shows the weighted cost for diesel fuel for the cross-section dealers for Year 2018. Line 2 is the Year 2018 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 shows the percentage of change in the diesel price from Year 2018 to the current price. Line 5 shows the current presumed diesel cost. By subtracting line 1 from line 5 we find the changed diesel cost on line 6. And 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 2017 points and costs with the Year 2018 points and costs found in this Surrebuttal Exhibit.

Staff Surrebuttal Exhibit 9

Staff has calculated the current heating fuel add-on using the same methodology as in Staff Surrebuttal 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 2017 points and costs with the 2018 points and costs found in this Surrebuttal Exhibit.

Staff Surrebuttal Exhibit 10

The container efficiency adjustments are made to account for the cost efficiencies of bottling and handling milk in larger size containers than in smaller size containers. Board Staff updated these adjustments by replacing Year 2017 container sales with Year 2018 container sales (Column B) and by also replacing the Year 2017 processing costs per points for the Bottling, Cold Room and Delivery cost centers with those for Year 2018.

Staff recommends that the Board replace the container efficiency adjustments per the existing Order with those found in column E of this Surrebuttal Exhibit.

Staff Surrebuttal Exhibit 11

This Surrebuttal Exhibit summarizes the information from the previous Surrebuttal Exhibits to arrive at proposed wholesale prices which are shown in Column K.

Staff Surrebuttal Exhibit 12

This Surrebuttal Exhibit calculates our proposed retail prices which are shown in Column G.

The effect of this cost replacement analysis is that the retail price of a gallon of 2% milk will decrease by \$0.03 from the current retail price in Area 3. The majority of this decrease is attributable to the updating of the container efficiency adjustment (Staff Surrebuttal Exhibit 10) which resulted in the gallon adjustment changing from -\$0.0532 to -\$0.0741 for a decrease of \$0.0209 per gallon.

Thank you. I'd be happy to answer any questions pertaining to my Surrebuttal Exhibits.