

**Rebuttal Testimony of David DeSantis  
Over-Price Premium Hearing  
June 4, 2014**

**GNEMMA's proposals** – In testimony pre-submitted by Troye Cooper (page 13), GNEMMA would like the Board to “Mandate that the costs which cooperatives incur to procure, market and balance milk for fluid milk processing plants, which are functionally identical to the costs that are incurred by plants procuring their milk from independent producers, to be invoiced by cooperatives to dealers and reported in dealer financial reports...”

My understanding of this position is that the cooperatives would like the Board to mandate that dealers pay procurement costs incurred by cooperatives as if the dealers had incurred those costs directly. That is to say that where dealers are purchasing their milk from independent producers, they are paying field personnel to monitor the farms along with administrative expenses associated with maintaining a producer payroll. Those are the same types of costs incurred by the cooperatives when they supply a dealer.

The coops would also like the Board to mandate that dealers pay the cooperatives' costs associated with balancing the milk supply. Specifically they wish to recover additional hauling costs when milk that is committed to a dealer must, during periods of low demand, be diverted to a manufacturing or balancing plant.

Board Staff takes no position as to the merits of this proposal. We did however, perform a cursory review of the data and interviewed the personnel at the cooperatives who assembled the data. Our goal was to be available to the cooperative personnel that compiled the information for questions and to provide input as appropriate. To the extent that there may have been costs which were not analogous to what a dealer might pay if they were buying an independent supply of milk, we discussed how those costs might be eliminated from the cooperative's calculation.

Due in large part to time limitations, we did not perform audits and have no opinion as to the reliability of the information in the GNEMMA presentation. We do note that after our interviews, the reporting groups seemed to have made some modifications based on our discussions.

The cooperatives would also like the Over-Price Premium to be eliminated, because as it is currently structured, it creates misimpressions about Pennsylvania milk prices. Board Staff takes no position as to this proposal either.

We will, however, present to the Board a methodology for implementing either or both of these proposals, should the Board decide to do so.

**Over-Price Premium** – For the 20 cents assessed under the Fluid Milk Promotion Act, Staff continues to recommend that this assessment be reflected as a footnote on the resale price sheet and be part of the skim and butterfat prices. By moving this assessment from the Over-Price Premium to the final skim and fat values on the resale price sheet there will be no difference in resale prices.

The Over-Price Premium could be replaced using a somewhat different methodology. If it is, there must be a new, basically revenue-neutral method to assure that the dealers would receive in the resale price an amount comparable to what they currently spend to procure milk, what I would term as an “Over-Minimum Compensation Adjustment” (OMCA).

The OMCA method I recommend is to incorporate into the resale price, the payments made to producers above the state or federal or federal-equivalent minimum prices. For purposes of this testimony, I will refer to these payments as the “Overpayments.”

For milk produced, processed and sold in Pennsylvania as Class I, this would be any amount over the Pennsylvania minimum. The Pennsylvania minimum includes the applicable Over-Order Premium.

For purchases from producers located outside the state, or for milk sold outside the state as Class 1, Overpayments would be based on amounts paid above the Class 1 plant point price. Other classes of milk would continue to be valued at the class price, and payments above that class price would be considered Overpayments.

Currently for milk purchased from out-of-state producers or for milk sold outside Pennsylvania, we recognize the amount paid as the amount due. Any overpayments for milk sold or procured beyond our borders are not now recognized when calculating the minimum producer payroll for enforcement purposes. The OMCA methodology I am proposing would incorporate all of those costs (payments above the class price) into the resale price structure on a pro-rata basis.

Board Staff Exhibit 1 is an illustration of this calculation.

By creating this separate cost center for Overpayments, you eliminate extraneous points that you find in the Receiving, Lab & Fieldwork cost center for receipts of water, liquid sugar or other non-milk receipts.

These Overpayments could be tracked by the dealers segregating all Overpayments to their cooperatives and their independent producers in a separate cost center.

**Recovery of Cooperative Milk Procurement Costs.** GNEMMA is asking the Board to require the dealers to compensate the cooperatives for costs the cooperatives incur which are comparable to the costs incurred by dealers that purchase their milk from independent producers. I will term this the “Cooperative Procurement Costs” (CPC). It would be based on the costs incurred by cooperatives for fieldwork, producer payroll, and other producer support activities, that dealers typically incur with their independent producers.

The CPC would be mandated by the Board only on milk that is produced, processed and sold as Class 1 in Pennsylvania, like the Over-Order Premium. Board Staff would simply add the CPC to the Over-Order Premium to be paid by dealers to cooperatives.

This is unlike procurement costs stemming from purchasing milk from independent producers which are currently incorporated into the dealer’s financial statements regardless of the state of origin of the producer or the ultimate state of sale or the class of use.

In order to implement such a methodology We should develop a standard reporting format that would allow the cooperatives to organize their accounting systems to segregate the specific costs deemed by the Board to be appropriate for inclusion. It should be similar to the format used by the dealers, which would facilitate audit and review of those costs for presentation at future hearings.

**Transition** – Until a reporting history is established for use in the methodology outlined above, some interim arrangement will be needed.

For the CPC, the Board could adopt the statewide rate proposed by GNEMMA. Admittedly, fluctuations in those costs would not be recognized until the Board held a hearing for Cost Replacement purposes or held a special hearing to address those fluctuations. Because the process would be so new, I would recommend that the rate

be adjusted pursuant to a hearing and order of the Board. I would expect that there will be refinements and modifications over the years.

For the Overpayments, we would continue to calculate the Over-Price Premium using the present methodology. It could continue to appear as the Over-Price Premium in the same way it is published now on our price sheet – or if the Board believes the inclusion of the Over-Price Premium on the price sheet distorts the user’s perspective of our prices, the rate could now be incorporated into the price buildup worksheets similar to the profits and losses on bulk milk. We could adjust the Overpayment rate on a semiannual or annual basis. These Overpayment costs need not necessarily be part of the Cost Replacement hearing process.

**Summary** – If the Board elects to replace the Over-Price Premium, I believe the Overpayment methodology presented in this testimony will effectively account for the dealer’s costs associated with purchasing producer milk. If the Board wishes to mandate a Cooperative Procurement Cost payment, I recommend that that mandated payment be applied in the same way we apply the Over-Order Premium.

# PENNSYLVANIA MILK MARKETING BOARD

## ILLUSTRATION OF OVERPAYMENT CALCULATION

### Over-Price Premium Hearing June 4, 2014

Receipts from Pennsylvania Producers	500,000									
Receipts from Ohio Producers	<u>500,000</u>									
Total Receipts	1,000,000									
Milk Marketing Area 5 Class 1 Rate	\$12.00									
Plant-Point Rate	\$10.00									
Pennsylvania Class 1 Sales	600,000									
Ohio Class 1 Sales	400,000									
Pennsylvania Sales Minimum Obligation	\$12.00	X	(	0.5	X	600,000	) =	\$	36,000	Pennsylvania Produced Portion of Pennsylvania Sales
	\$10.00	X	(	0.5	X	600,000	) =	\$	30,000	Ohio Produced Portion of Pennsylvania Sales
Ohio Sales Minimum Obligation	\$10.00	X	(	1.0	X	400,000	) =	\$	<u>40,000</u>	Ohio Sales all at Plant-Point Price
									\$ 106,000	
Amount Paid All Producers									\$ 125,000	
Overpayment for Resale Price Adjustment									\$ 19,000	

**PENNSYLVANIA MILK MARKETING BOARD  
BOARD STAFF  
LIST OF REBUTTAL WITNESSES**

The following individual is expected to testify at the Over-Price Premium Hearing on June 4, 2014 on behalf of the Milk Marketing Board Staff. Copies of his curriculum vitae will be available at the hearing.

David DeSantis, Chief of Enforcement and Accounting, will testify as an expert on milk industry cost accounting and regulation of the milk market in Pennsylvania, which includes determining wholesale and retail milk prices, and industry costs including procuring, processing, packaging, delivering, and selling milk. His testimony will address the subjects included in his presubmitted testimony, but it is not necessarily limited to the presubmitted testimony.

Date: May 5, 2014

Respectfully submitted,

***Andrew L. Saylor***

Andrew L. Saylor  
Staff Attorney  
Pennsylvania Milk Marketing Board

**OVER-PRICE PREMIUM HEARING – ALL MILK MARKETING AREAS – JUNE 4, 2014  
CERTIFICATE OF SERVICE**

I hereby certify that on this date, May 5, 2014, I have served true and correct copies of the foregoing by email on behalf of the Milk Marketing Board Staff to the following (all of whom will accept service by email):

**Pennsylvania Association of Milk Dealers**

Ober, Kaler, Grimes & Shriver  
1401 H Street, NW  
Washington, DC 20005

Wendy Yoviene, Esquire  
wyoviene@ober.com

Amy E. Garber, Esquire  
aegarber@ober.com

Carl D Herbein, CPA  
Herbein & Company, Inc  
2763 Century Boulevard  
Reading, PA 19610  
cdherbein@herbein.com

**Greater Northeast Milk Marketing Agency**

Marvin Beshore, Esquire  
130 State Street – PO Box 946  
Harrisburg, PA 17108-0946  
Mbeshore@beshorelaw.com

Dennis J. Schad  
Land O'Lakes, Inc.  
405 Park Drive  
Carlisle, PA 17013  
djschad@landolakes.com

Troye Cooper  
Maryland & Virginia Milk Producers Cooperative  
Association, Inc.  
1985 Isaac Newton Square West  
Reston, VA 20190  
tcooper@mdvamilk.com

Dean Ellinwood  
Dairy Marketing Services  
P.O. Box 4844  
Syracuse, NY 13221-4844  
Dean.Ellinwood@DairyMarketingServices.com

**Dean Foods Company**

Charles M. English, Jr., Esquire  
Davis Wright Tremaine LLP  
1919 Pennsylvania Avenue, NW – Suite 800  
Washington, DC 20006  
chipenglish@dwt.com

**Commonwealth of Pennsylvania, Department of  
Agriculture**

John H. Howard, Esquire  
Pennsylvania Department of Agriculture  
2301 N. Cameron Street  
Harrisburg, PA 17110

**Pennsylvania Milk Marketing Board**

Douglas L. Eberly, Esquire, Chief Counsel  
2301 North Cameron Street  
Harrisburg, PA 17110  
deberly@pa.gov

**Pennsylvania Food Merchants**

Kevin Lutkins, Esquire  
PA Food Merchants Association  
1029 Mumma Road – P O Box 870  
Camp Hill, PA 17001-0870  
klutkins@memoco.com

Thomas Price., CPA  
Herbein & Company, Inc.  
2763 Century Boulevard  
Reading, PA 19610  
tjprice@herbein.com

**Pennsylvania Farm Bureau**

John J. Bell, Esquire  
Pennsylvania Farm Bureau  
510 S. 31st Street –P.O. Box 8736  
Camp Hill, PA 17011-8736  
jjbell@pfb.com

Respectfully submitted,

**Andrew L. Saylor**

Staff Attorney  
Pennsylvania Milk Marketing Board