

SURREBUTTAL TESTIMONY OF

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Appearing on Behalf of the Pennsylvania Association of Milk Dealers

Surrebuttal testimony before the Pennsylvania Milk Marketing Board

Cooperative Milk Procurement Costs

October 5, 2020

## **Surrebuttal Testimony of Ronald W. Mong, CPA**

### **Cooperative Milk Procurement Costs**

#### **Response to PMMB Staff Rebuttal Testimony**

PMMB Staff has provided Rebuttal Testimony and Exhibits in this hearing. This is our response to that testimony and exhibits.

#### **Cooper Recovery Method**

PMMB Staff has calculated the financial impact of a cooperative procurement charge on the nineteen cross-section dealers. Using 2017 data the Board Staff computed the amount that each dealer would have paid. The Staff used the method proposed by Cooper to determine the effect on wholesale minimum prices. This allowed them to analyze the dollar amount each dealer would recover using the Cooper method. Their results are shown in Exhibit 5. We agree with Staff's calculations. Board Staff's analysis reinforces my rebuttal testimony. One of my main arguments against the implementation of a cooperative procurement charge is that there is no fair and equitable way to implement it without making some processors financial winners and other processors financial losers. I stand by my previous testimony and appreciate Staff's validation of my argument.

#### **Presentation on Price Announcements**

PMMB Staff has given us their preferred format for the presentation of a cooperative procurement charge on the monthly price announcements.

For me to fully represent PAMD's position on how a procurement charge would be presented if adopted, I would need to know what path the Board decides to take if any. If the Board adopts a new charge that is embedded in receiving lab and field work, the communication will no doubt differ than if the Board adopts a new charge that is on the producer minimum price announcement. However, if the

Board decides to adopt a cooperative only charge, PAMD agrees with Staff that it should be listed clearly on the producer price announcement.

### **Response to Pennsylvania Department of Agriculture Rebuttal Testimony**

The Pennsylvania Department of Agriculture has provided Rebuttal Testimony in this hearing. This is our response to that testimony.

### **Characterizing the Sale of Raw Milk as a Dealer to Dealer Transaction Exposes Additional Reasons to Reject the Proposed Procurement Charge**

Mr. DeSantis explains in his testimony that he believes that a cooperative meets the PMMB definition of a milk dealer. PAMD has previously submitted briefs about that legal issue and is expected to do so again. For my part, I would like to say that Mr. DeSantis' point does not speak to implementation, which is the subject of the October 5 proceeding. Nor does his point support a mandatory cooperative charge based on a cross section average. I disagree with Mr. DeSantis analogizing the sale of raw milk by a cooperative to a PMMB regulated tolling arrangement. Across the country and in Pennsylvania, the procurement services for which the cooperatives are seeking mandated compensation have not been treated as a separate dealer transaction.

As Mr. Tosi pointed out, Federal Order Minimum Prices already incorporate costs associated with marketing such milk into the Class I differentials. If Mr. DeSantis actually thinks that "the cooperatives are acting as milk dealers in this respect and must be required to charge the cost for the cooperative procurement services they provide", he had years of opportunity to present this as a petition when he led Board Staff as Director of Enforcement and Accounting.

During his leadership at PMMB the Board Staff presented many petitions for hearings. Never once was there a petition by Board Staff to regulate the transactions between cooperatives and their fluid milk customers.

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If Mr. DeSantis is correct that a cooperative selling raw milk to a fluid milk processor is like tolling and that cooperatives are just like dealers then cooperatives should have to stand on their own and charge an amount specific to their own costs like dealers do in PMMB regulated tolling arrangements.

When a fluid milk processor enters into a tolling contract the Board Staff carefully determines that the transactions are not below that particular milk dealer's costs. They don't look at the cross-section costs they look at that plant. Why should the cooperatives get any different treatment than the processors and face no competition at all?

### **Cooperative Costs**

On page 1 of his testimony Mr. DeSantis states: "These are costs that represent expenses which would have otherwise been incurred by those dealers had they purchased that milk from their own independent producers." This isn't true. Mr. Stonesifer's previous testimony as well as my own shows only a few of the costs that the cooperatives seek to include in the procurement charge are similarly experienced by Class I dealers who obtain independent milk.

### **Timing Issues**

Mr. DeSantis recognizes the financial strain placed on dealers by the Cooper method. We appreciate that. His remedy is to create hypothetical invoices for cooperative procurement for the year being used for cost replacement. I refer to these costs as hypothetical because a mandated cooperative procurement charge didn't exist during 2019. Applying a cost per hundredweight times Pennsylvania cooperative pounds purchased would be a cost that isn't real. In addition, if a mandated cooperative procurement charge had been in effect, processors might have made different decisions on raw milk supply.

PMMB has never used costs that are not actual. This is a first step down a bad path away from Generally Accepted Accounting Principles. While it is acceptable for accountants to use reasonable estimates, GAAP does not permit use of hypothetical costs.

My rebuttal testimony clearly explained the adverse financial impact on dealers if the Cooper method was implemented. Invoices based on hypothetical costs aren't an acceptable method to fix an inherently flawed cost recovery system as described by Mr. Cooper.

### **Cooperatives Operating Cross-Section Processing Plants**

Five cross-section fluid milk processors are now owned and operated by cooperatives. Mr. DeSantis on page 3 of his testimony has put forth a flawed accounting adjustment where the income from a mandated procurement charge received by a cooperative would offset the cooperative-owned plants costs in the receiving, lab and field work cost center. His comments are not addressed to the implementation question before the Board.

If a cooperative is supplying member milk to its own plant the procurement costs are either incurred at the cooperative level or at the plant level. If a mandated procurement charge shifts costs from the cooperative to the plant the costs are only recognized in the plant's PMMB-60 once – there is no duplication. There are times when revenue should serve as a reduction of cost. I've argued that in this proceeding as has Mr. Stonesifer. In this case, however, the circumstances do not give rise to that requirement.

### **Summary and Recommendation**

My conclusion remains the same as in my rebuttal testimony. I recommend that the Milk Marketing Board deny the petition to implement a cooperative procurement charge.

Thank you for your consideration of my analysis and recommendation.