

# **OVER-PRICE PREMIUM HEARING**

**AUGUST 5, 2020**

## **REBUTTAL TESTIMONY OF STEVEN ZALMAN**

Good Morning, my name is Steven Zalman. I am the Director of Enforcement and Accounting for the Pennsylvania Milk Marketing Board (PMMB). We are here today because Pennsylvania Association of Milk Dealers (PAMD) has requested a change to the calculation of the Over-Price Premium (OPP). PAMD cites the issue of cooperative-owned fluid milk plants purchasing milk from their members as the primary reason for the requested change. For Board Staff to make recommendations to the Board concerning the proposal from PAMD, we conducted a thorough analysis of their proposed changes and the effects they would have. My testimony will consist of the results of our study as they relate to the requested changes.

Mr. Mong's written testimony consistently mentions the purchase of the four PA Dean plants by Dairy Farmers of America (DFA) as the cause, and future expected cause, of an inappropriate dilution of the OPP. We are provided a hypothetical example that illustrates this dilution, and told, "it is critical to the survival of fluid milk processors that all costs incurred by the plants are reflected in the wholesale prices." Board Staff's study was not hypothetical, it was based on actual data from February 2020 and March 2020 used in published resale prices. Based on actual data, our study shows that there would be no such dilution if the current method for calculation of the OPP continues to be used. In fact, using real data, we show that the method proposed by PAMD results in dealers in aggregate recovering \$75,312 more in February 2020 and \$97,080 more in March 2020 than would be paid in OPP. Mr. Mong's testimony consists of much deliberation on the OPP amount and how it would be diluted by DFA purchases of PA member

milk, but includes no testimony on what the dealers would recover through wholesale pricing in the state if their method is adopted. We will show you both sides to that equation.

Our study consisted of reviewing actual data for February 2020 and March 2020 for the OPP cross-section illustrated in Board Staff Rebuttal Exhibit 5. For each month, we simulated the effects on the OPP as if DFA owned the four Dean plants, calculating what the OPP would have been using current methodology and the methodology proposed by PAMD. More importantly, we also calculated what the cross-section dealers would recover through adding the OPP to wholesale prices. This aspect of our study cannot be emphasized enough as results of those calculations clearly illustrate the flaws with implementation of PAMD's proposed methodology. The February 2020 results are shown in Board Staff Rebuttal Exhibit 1. When we publish resale prices, we calculate an OPP for each of the six PA areas; however, this Exhibit combines all the PA areas. There are three columns titled

- Current method (as published), This column details figures using the current method for calculation of the OPP for February 2020.
- Current method (DFA owned plants). This column contains the results of calculations using current OPP methods considering if DFA owned the four Dean plants in February.
- PAMD method. This column shows results of calculations using PAMD proposed methodology and considering if DFA owned the four Dean plants in February.

Each row in Exhibit 1 represents a specific set of variables that defines conditions under which calculations were made.

- OPP Calculation (Dealer paid)
- OPP Dealer Recoupment, and

- OPP Recoupment minus Dealer Paid.

I will explain information contained in each row in the following narrative.

**Row 1: OPP Calculation (Dealer paid)**

The row labeled, OPP Calculation (Dealer paid), represents the calculation per cwt of the OPP and what the dealer actually paid in February 2020. In the two calculations using current methods—as published and as if DFA owned plants in February—PA Produced Class I sales (lbs) are 83,676,472 lbs. PAMD’s methodology removes any PA DFA pounds sold to DFA owned plants<sup>1</sup>, and as a result misstates the PA Produced Class 1 PA Sales pounds [REDACTED]

This vast difference is not readily apparent in PAMD Exhibit D2 (last column) and is relegated to a footnote that shows no actual pounds. In footnote (2) Mr. Mong assumes all milk is supplied by members. This assumption is false. [REDACTED]

[REDACTED]<sup>2</sup>. Mr. Mong states, “These plants certainly could have a mix of supplier sources, but I did not believe it was necessary to study the mix for purposes of my impact analysis which I believe reflects a realistic picture of the potential impact.” We believe that if you do not include the mix of supplier sources being used then the analysis cannot be realistic, or accurate.

In PAMD Exhibit D3, column C, Mr. Mong labels row 6 as PA Raw Milk Receipts, but does not include the 5 million pounds of PA milk, which represents cooperative member milk received by

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<sup>1</sup> PAMD Method removes any Produced Class 1 PA Sales (lbs) in DFA owned plants by removing all DFA supplied PA producer milk pounds from the OPP calculation. DFA supplied PA producer milk pounds are not removed in non-DFA owned plants.

<sup>2</sup> [REDACTED]

a cooperative owned processing plant. These are the same PA pounds that Mr. Mong claims are analogous to out of state milk. Excluding the PA producer pounds in PA Raw Milk Receipts also results in an incorrect calculation on line 10-PA Produced Class 1, and an incorrect calculation of the OPP on line 11. The calculations in columns A and B of PAMD Exhibit D3 are done correctly.

As a compelling contrast and using real numbers, our Exhibit 1 shows an OPP of \$.11/cwt using the current method (DFA owned plants) and an OPP of \$18/cwt using PAMD's method.

### **Row 2: OPP Dealer Recoupment**

The row labeled, OPP Dealer Recoupment, represents the income received from sales of Class 1 products (lbs) in PA. These dollars are recouped by dealers because the OPP is included in wholesale pricing. The revenue generated for each method is listed in this section on the OPP Dealer Revenue line. The PA Class 1 sales pounds used here are the same for the 3 different OPP methods; however, the revenues differ as the calculated OPP rates for each method differ.

### **Row 3: OPP Recoupment minus OPP Paid**

The section labeled OPP Recoupment minus Paid represents the difference between the amount of OPP dealers pay to producers and what they recoup in their PA Class 1 sales. Using PAMD's method for calculations in February would have generated additional profits for the dealers in the amount of \$75,312, resulting from what we believe is an inappropriate elimination of cooperative PA pounds bought from members. Exhibit 1, Column 3 data clearly display effects of PAMD's proposed method for calculation of OPP, which we believe is flawed and provides unwarranted extra revenue to dealers and inflates resale prices. The flaw can also be seen in PAMD Exhibit D3. Column B in their Exhibit is the method that Board Staff believes is the

correct way to provide recovery of OPP dollars paid. Column B, line 5, shows an OPP paid of \$1,200.00 if the OPP per cwt is \$.0286. Multiplying \$.0286 (cwt) by Class 1 Utilization of 6 million pounds, line 9, equals \$1,714.29 recouped. In this illustration, the dealer recovers \$514.29 more than was paid (\$1,714.29 - \$1,200.00). These calculations reflect current PMMB methods for calculating the OPP.

Referring to Column C and PAMD's proposed method, an OPP of \$1,200 is paid using the rate of \$.10 per cwt. Multiplying \$.10 (cwt) by 6 million pounds equals \$6,000.00. Using PAMD's proposed method and their figures, the dealer recovers \$4,800.00 more than what was paid (\$6,000.00 - \$1,200.00)

### **Board Staff Rebuttal Exhibit 2**

Board Staff Rebuttal Exhibit 2 provides details for the information presented in Exhibit 1. Table 1 of Exhibit 2 shows the OPP amounts for each area for each of the methods we used in our study. I call your attention to the numbers in Columns A and C of Table 1—comparing the current method (as published) to PAMD's proposed method. Note that none of the OPP amounts for any of the six areas using the current method (as published) are the same as their corresponding figures in Column C, using the PAMD method. For comparison, PAMD Exhibit D3 shows identical OPP per cwt amounts in columns A and C. Someone unfamiliar with calculations using the actual data from our February monthly reports might be led to believe that the PAMD method properly adjusts the cooperative members' milk. Regarding OPP calculations, the use of hypothetical data has not accurately represented effects of PAMD's proposed method, which are accurately shown in Staff Exhibits 1 through 4 using real data from our monthly reports.

Table 2 shows the amount of OPP associated with PA produced Class 1 Sale pounds and Table 3 shows the PA produced Class 1 Sale pounds. These two tables show the difference between the PAMD method and the current method (DFA owned plants). The total amount of OPP paid by dealers in Table 2, columns B and C is \$95,979 using both methods, however the pounds associated with those dollars, shown in Table 3, columns B and C, are very different. The amounts in Table 2 and Table 3 are the numbers used to calculate the OPP for each area. By using less pounds in the denominator, the PAMD method has artificially created a higher OPP. The results of the flaw in the PAMD method are shown in Table 5. The dealers would be recouping \$171,291 while paying only \$95,979.

The results for March 2020 are shown in Board Staff Rebuttal Exhibits 3 and 4 and show the dealers recouping \$197,600 while paying only \$100,520.

#### **PAMD Citation of OGO A-925**

PAMD Exhibit D3 also cites paragraphs of OGO A-925, Section II. The beginning of Section II states, “In each of the six milk marketing areas, the over-price premium shall be based on milk that is produced, processed, and utilized as Class I milk in Pennsylvania and be calculated in the following manner.” The Order says nothing about deducting certain utilization (or sales) pounds or treating any pounds as if they came from out of state, as PAMD is proposing.

Section II ( e ) of the OGO states, “The average over-price premium per hundredweight for the specific milk marketing area is determined by dividing the total of all the cross-section dealers’ over-price premiums paid in that area by the total area Class I sales from Pennsylvania producers for all cross-section dealers.” Calculations that do not include all PA Class 1 sales generated by Pennsylvania produced milk provide an excessive amount being recouped than was paid. We

believe that was not the intent of the OGO, nor of the Board, at the time it was adopted. The intent was to recover the overpayments, not profit from them.

### **Minimum Due Calculation**

Mr. Mong concludes that an OPP simply does not exist for coop plants supplied by their members because PMMB minimum prices do not apply to a cooperative purchasing member milk. His testimony makes an assumption that DFA, because no minimum is enforced on what members are paid, do not pay a minimum, yet offers nothing to support the claim. The OPP has two components, a price component and a pounds component. They both exist on the milk coop members deliver to coop owned plants. The price component is zero because we do not set the amount coops pay their members. The pounds component exists just as it exists for any other dealer.

In 2015 Upstate Niagara Cooperative purchased Valley Farms Dairy in Williamsport, PA. On September 23, 2015, Mr. Mong emailed Mr. Gojsovich asking why Valley Farms had Class 1 PA pounds in the OPP calculation, but no dollars. Mr. Mong was aware of how we were treating cooperative owned plants being supplied by members' milk and had no objections.

### **Conclusion**

After reviewing the results of our study, it is clear to Board Staff that the current methodology of calculating the OPP remains the correct methodology. It would be improper to calculate an OPP rate per cwt not including all the pounds sold when the recoupment will be based on those same sales pounds. The goal of adding the OPP to wholesale prices is to allow dealers to recover amounts paid. It is not, and should not be, designed to provide additional profits to dealers. In Staff's opinion, the PAMD proposed method appears designed to achieve a specific result, not to

correct an error in the calculation. Board Staff reject the conclusion by PAMD that the acquisition of the PA Dean plants by DFA results in an inappropriate dilution of the OPP. In fact, the method proposed by PAMD clearly results in what we believe to be an unjust enrichment. Just because there will be no PMMB minimum on milk acquired by DFA members does not mean that milk is not sold in PA as Class 1. It does not mean the milk is analogous to out of state milk. It does not mean the DFA supplied PA pounds simply do not exist, as Mr. Mong suggests. They do exist, they are from PA, and some will be sold in PA as Class 1, so they must be included in the OPP calculation, with zero OPP dollars attributed to those pounds. Keeping the current methodology in place would be the appropriate and correct method. We urge the Board to maintain the current calculation of the Over Price Premium.

## BOARD STAFF REBUTTAL EXHIBIT 1

### FEBRUARY 2020 ALL PA. AREAS

	Current method (as published)	Current method (DFA owned plants)	PAMD Method
OPP Calculation (Dealer paid) {	PA Produced Class 1 PA Sales (lbs)	83,676,472 <sup>1</sup>	<sup>1</sup> [REDACTED] <sup>2</sup> [REDACTED]
	OPP Paid by Dealers	\$120,693	[REDACTED]
	OPP (cwt)	\$0.14	[REDACTED]
OPP Dealer Recoupment {	Class 1 PA Sales (lbs)	94,057,491	[REDACTED]
	OPP Dealer Revenue	\$148,596	[REDACTED]
OPP Recoupment minus Dealer Paid {	OPP Dealer Revenue	\$148,596	[REDACTED]
	OPP Paid by Dealers	<u>\$120,693</u>	[REDACTED]
		\$27,903	[REDACTED]

<sup>1</sup> Represents PA Produced Class 1 PA pounds calculated by:  
 PA Class 1 Utilization (used to calculate Over-Order Premium) X PA producer receipts / Total producer receipts

<sup>2</sup> [REDACTED]

**BOARD STAFF REBUTTAL EXHIBIT 2**

FEBRUARY 2020

A

B

C

<b>Table 1</b>		<b>OPP Calculation (cwt)</b>					
		Formula		Formula		Formula	
		<u>Current method (as published)</u>		<u>Current method (DFA owned plants)</u>		<u>PAMD Method</u>	
1	Area 1	\$0.11	A7 / A13 * 100		B7 / B13 * 100		C7 / C13 * 100
2	Area 2	\$0.20	A8 / A14 * 100		B8 / B14 * 100		C8 / C14 * 100
3	Area 3	\$0.08	A9 / A15 * 100		B9 / B15 * 100		C9 / C15 * 100
4	Area 4	\$0.08	A10 / A16 * 100		B10 / B16 * 100		C10 / C16 * 100
5	Area 5	\$0.21	A11 / A17 * 100		B11 / B17 * 100		C11 / C17 * 100
6	Area 6	\$0.39	A12 / A18 * 100		B12 / B18 * 100		C12 / C18 * 100

<b>Table 2</b>		<b>OPP Paid by Dealers (Used for OPP Calculation)</b>		
		from February 2020 OPP Excel Worksheets		
		<u>Current method (as published)</u>	<u>Current method (DFA owned plants)</u>	<u>PAMD Method</u>
7	Area 1	\$21,180		
8	Area 2	\$16,066		
9	Area 3	\$9,262		
10	Area 4	\$18,859		
11	Area 5	\$32,007		
12	Area 6	<u>\$23,320</u>		
		\$120,693		

<b>Table 3</b>		<b>PA Produced Class 1 PA Sale Pounds (Used for OPP Calculation)</b>		
		from February 2020 OPP Excel Worksheets		
		<u>Current method (as published)</u>	<u>Current method (DFA owned plants)</u>	<u>PAMD Method</u>
13	Area 1	19,921,754		
14	Area 2	8,079,173		
15	Area 3	11,170,817		
16	Area 4	23,172,179		
17	Area 5	15,357,724		
18	Area 6	<u>5,974,825</u>		
		83,676,472		

<b>Table 4</b>		<b>Class 1 PA Sale Pounds (Used for OPP Dealer Recoupment)</b>		
		PMMB62 Class 1 part 3 sales + unrelated part 4 sales - unrelated packaged purchases		
		<u>Current method (as published)</u>	<u>Current method (DFA owned plants)</u>	<u>PAMD Method</u>
19	Area 1	17,940,229	17,940,229	17,940,229
20	Area 2	9,524,729	9,524,729	9,524,729
21	Area 3	14,221,343	14,221,343	14,221,343
22	Area 4	21,434,899	21,434,899	21,434,899
23	Area 5	21,869,226	21,869,226	21,869,226
24	Area 6	<u>9,067,065</u>	<u>9,067,065</u>	<u>9,067,065</u>
		94,057,491	94,057,491	94,057,491

<b>Table 5</b>		<b>OPP Dealer Recoupment</b>					
		Formula		Formula		Formula	
		<u>Current method (as published)</u>		<u>Current method (DFA owned plants)</u>		<u>PAMD Method</u>	
25	Area 1	\$19,734	A1 * I19 / 100		B1 * B19 / 100		C1 * C19 / 100
26	Area 2	\$19,049	A2 * I20 / 100		B2 * B20 / 100		C2 * C20 / 100
27	Area 3	\$11,377	A3 * I21 / 100		B3 * B21 / 100		C3 * C21 / 100
28	Area 4	\$17,148	A4 * I22 / 100		B4 * B22 / 100		C4 * C22 / 100
29	Area 5	\$45,925	A5 * I23 / 100		B5 * B23 / 100		C5 * C23 / 100
30	Area 6	<u>\$35,362</u>	A6 * I24 / 100		B6 * B24 / 100		C6 * C24 / 100
		\$148,596					

<b>Table 6</b>		<b>OPP Dealer Recoupment minus OPP Paid</b>					
		Formula		Formula		Formula	
		<u>Current method (as published)</u>		<u>Current method (DFA owned plants)</u>		<u>PAMD Method</u>	
25	Area 1	-\$1,446	A25 - A7		B25 - B7		C25 - C7
26	Area 2	\$2,984	A26 - A8		B26 - B8		C26 - C8
27	Area 3	\$2,115	A27 - A9		B27 - B9		C27 - C9
28	Area 4	-\$1,711	A28 - A10		B28 - B10		C28 - C10
29	Area 5	\$13,919	A29 - A11		B29 - B11		C29 - C11
30	Area 6	<u>\$12,041</u>	A30 - A12		B30 - B12		C30 - C12
		\$27,903					

### BOARD STAFF REBUTTAL EXHIBIT 3

**MARCH 2020 ALL PA. AREAS**

	Current method (as published)	Current method (DFA owned plants)	PAMD Method
OPP Calculation (Dealer paid) {	PA Produced Class 1 PA Sales (lbs)	85,722,403 <sup>1</sup>	<sup>1</sup> [REDACTED]
	OPP Paid by Dealers	\$126,943	[REDACTED]
	OPP (cwt)	\$0.15	[REDACTED]
OPP Dealer Recoupment {	Class 1 PA Sales (lbs)	107,411,522	[REDACTED]
	OPP Dealer Revenue	\$172,119	[REDACTED]
OPP Recoupment minus Dealer Paid {	OPP Dealer Revenue	\$172,119	[REDACTED]
	OPP Paid by Dealers	<u>\$126,943</u>	[REDACTED]
		\$45,176	[REDACTED]

<sup>1</sup> Represents PA Produced Class 1 PA pounds calculated by:  
 PA Class 1 Utilization (used to calculate Over-Order Premium) X PA producer receipts / Total producer receipts

<sup>2</sup> [REDACTED]

**BOARD STAFF REBUTTAL EXHIBIT 4**

**MARCH 2020**

		A	B	C
<b>Table 1</b>		<b>OPP Calculation (cwt)</b>		
		Formula	Formula	Formula
	<u>Current method (as published)</u>		<u>Current method (DFA owned plants)</u>	<u>PAMD Method</u>
1	Area 1	\$0.11	A7 / A13 * 100	B7 / B13 * 100
2	Area 2	\$0.19	A8 / A14 * 100	B8 / B14 * 100
3	Area 3	\$0.07	A9 / A15 * 100	B9 / B15 * 100
4	Area 4	\$0.09	A10 / A16 * 100	B10 / B16 * 100
5	Area 5	\$0.20	A11 / A17 * 100	B11 / B17 * 100
6	Area 6	\$0.43	A12 / A18 * 100	B12 / B18 * 100
				C7 / C13 * 100
				C8 / C14 * 100
				C9 / C15 * 100
				C10 / C16 * 100
				C11 / C17 * 100
				C12 / C18 * 100
<b>Table 2</b>		<b>OPP Paid by Dealers (Used for OPP Calculation)</b>		
from March 2020 OPP Excel Worksheets				
	<u>Current method (as published)</u>	<u>Current method (DFA owned plants)</u>	<u>PAMD Method</u>	
7	Area 1	\$22,600		
8	Area 2	\$16,394		
9	Area 3	\$8,446		
10	Area 4	\$22,394		
11	Area 5	\$30,743		
12	Area 6	<u>\$26,366</u>		
		\$126,943		
<b>Table 3</b>		<b>PA Produced Class 1 PA Sale Pounds (Used for OPP Calculation)</b>		
from March 2020 OPP Excel Worksheets				
	<u>Current method (as published)</u>	<u>Current method (DFA owned plants)</u>	<u>PAMD Method</u>	
13	Area 1	19,929,392		
14	Area 2	8,735,742		
15	Area 3	11,280,030		
16	Area 4	24,275,787		
17	Area 5	15,437,110		
18	Area 6	<u>6,064,342</u>		
		85,722,403		
<b>Table 4</b>		<b>Class 1 PA Sale Pounds (Used for OPP Dealer Recoupment)</b>		
PMMB62 Class 1 part 3 sales + unrelated part 4 sales - unrelated packaged purchases				
	<u>Current method (as published)</u>	<u>Current method (DFA owned plants)</u>	<u>PAMD Method</u>	
19	Area 1	20,349,035	20,349,035	20,349,035
20	Area 2	11,449,292	11,449,292	11,449,292
21	Area 3	16,316,459	16,316,459	16,316,459
22	Area 4	24,701,294	24,701,294	24,701,294
23	Area 5	24,555,583	24,555,583	24,555,583
24	Area 6	<u>10,039,859</u>	<u>10,039,859</u>	<u>10,039,859</u>
		107,411,522	107,411,522	107,411,522
<b>Table 5</b>		<b>OPP Dealer Recoupment</b>		
		Formula	Formula	Formula
	<u>Current method (as published)</u>		<u>Current method (DFA owned plants)</u>	<u>PAMD Method</u>
25	Area 1	\$23,076	A1 * I19 / 100	B1 * B19 / 100
26	Area 2	\$21,487	A2 * I20 / 100	B2 * B20 / 100
27	Area 3	\$12,217	A3 * I21 / 100	B3 * B21 / 100
28	Area 4	\$22,786	A4 * I22 / 100	B4 * B22 / 100
29	Area 5	\$48,903	A5 * I23 / 100	B5 * B23 / 100
30	Area 6	<u>\$43,650</u>	A6 * I24 / 100	B6 * B24 / 100
		\$172,119		C1 * C19 / 100
				C2 * C20 / 100
				C3 * C21 / 100
				C4 * C22 / 100
				C5 * C23 / 100
				C6 * C24 / 100
<b>Table 6</b>		<b>OPP Dealer Recoupment minus OPP Paid</b>		
		Formula	Formula	Formula
	<u>Current method (as published)</u>		<u>Current method (DFA owned plants)</u>	<u>PAMD Method</u>
25	Area 1	\$476	A25 - A7	B25 - B7
26	Area 2	\$5,092	A26 - A8	B26 - B8
27	Area 3	\$3,771	A27 - A9	B27 - B9
28	Area 4	\$393	A28 - A10	B28 - B10
29	Area 5	\$18,160	A29 - A11	B29 - B11
30	Area 6	<u>\$17,284</u>	A30 - A12	B30 - B12
		\$45,176		C25 - C7
				C26 - C8
				C27 - C9
				C28 - C10
				C29 - C11
				C30 - C12

## **BOARD STAFF REBUTTAL EXHIBIT 5**

### **Over-Price Premium Cross Section**

Clover Farms

DFA/Dean- LVD Lansdale

DFA/Dean- LVD Schuylkill Haven

DFA/Dean-Sharpville

DFA/Dean-Swiss Premium

Gallikers Dairy

Guers Dairy

Harrisburg Dairy

Rutters Dairy

Schneiders Dairy

Turkey Hill Dairy

Turner Dairy

United Dairy - Fikes

Upstate Niagra- Valley Farms Dairy

Wawa Dairy