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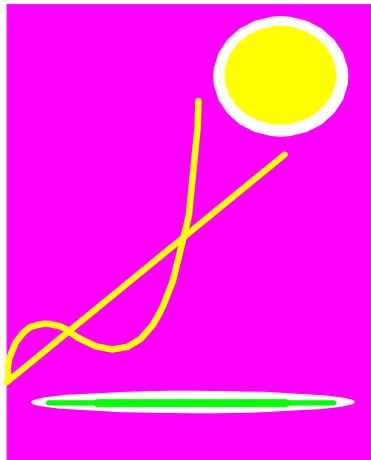
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A Preliminary Response to the Report Prepared for the Massachusetts Food Association by John Schnittker titled, “An Analysis of the Cotterill Proposal”

by

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**Presented to the Committee on the Environment
Massachusetts Legislature**

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Boston, Massachusetts

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**A Preliminary Response to the Report
Prepared for the Massachusetts Food Association by John Schnittker
titled, “An Analysis of the Cotterill Proposal”**

Late in the afternoon before this hearing we received a copy of the report, MFA/Schnittker. At this time we would like to provide a preliminary response to the Massachusetts Food Association and Dr. Schnittker. Perhaps the most egregious flaw in their report is the equation of the proposed Connecticut price law with the proposed Massachusetts price law. The two proposals are entirely different, and their impact on the market will be different. Dr. Schnittker appears willing and ready to link the Massachusetts price gouging law with the more complicated price collar approach of the proposed Connecticut law because he would like to argue that the Massachusetts law would damage consumers in the long run and especially damage low-income consumers. Neither law would necessarily do that, but the Massachusetts law most certainly will not do it.

The Massachusetts law is virtually a carbon copy of the New York State law. Quoting Mr. Charles Huff, Chief of the Licensing and Auditing, New York State Department of Agriculture and Markets from his recent presentation before the annual conference of the International Association of Milk Control Agencies in Harrisburg, Pennsylvania , “Has the law been effective? Yes! Retail prices charged by supermarkets have been very responsive in reflecting decreases in farm prices. Consumers have realized substantial savings.” Mr. Huff’s full power point presentation accompanies this response. The New York law and the Massachusetts law are clearly targeted towards supermarkets and not the other distribution channels. In the administration of the New York law if a smaller retailer violates the threshold price because of higher distribution

costs due to its small size the New York State Department of Ag and Markets provides for an appeal process and a dispensation for such violation of the law. See the attached price announcement sheets for September 2003.

Now we will analyze the executive summary of the Schnittker report and respond to several of his erroneous statements. Dr. Schnittker concludes that the Massachusetts proposal is even more restricted than the Connecticut proposal. We find this hard to understand and wish that he would explain in more detail in his report why he feels that way. We find nothing in the report to substantiate this conclusion. On the face of it the proposed Massachusetts 200% retail threshold price is higher than the proposed Connecticut 140% collar at wholesale plus a 130% collar at retail. If you multiply the two Connecticut rates together one comes up with a corresponding 182% retail price threshold under the Connecticut approach. This is more restrictive than a 200% approach. Therefore, contrary to MFA/Schnittker the Massachusetts proposal is less restrictive than the Connecticut in terms of overall consumer prices.

Dr. Schnittker states at the top of page 2 that the 200% threshold rule ignores the fact that processors pay a premium over and above the Class I price for fluid milk. This simply is not true. As the law is written it says 200% of the price paid farmers for raw milk. That price paid includes not only the Class I federal order price. It also includes any cooperative or over-order premiums that the farmer receives. At least that's the way the New York law is written and is interpreted at this time. As Massachusetts law is written the same interpretation holds.

Dr. Schnittker strongly protests our processing and delivery cost estimates which range from 52 cents a gallon to as high as 76 a gallon. Dr. Schnittker finds them to be

low and would replace them with a “conservative estimate of around 85 cents a gallon.” Permit us to explain and justify our processing cost estimates at this time. They are from a firm named Dairy Technomics. Dairy Technomics is routinely in the business of estimating processing costs and delivery costs of milk to supermarket chains. Dairy Technomics does this for supermarket buyers who use the information when negotiating for private label milk contracts and other milk pricing arrangements with processors. Dairy Technomics is an experienced firm in this area owned and operated by a former milk processor from New Jersey.

We have at least three sources of information which support our assertion that the Dairy Technomics estimates are indeed valid estimates. First this last Spring when presenting the estimates for processing to Alex Guida and his Chief Financial Officer, they responded that the estimates for their firm were reasonable and in the ballpark. A week later his Chief Financial Officer contacted Dairy Technomics and asked how they were able to estimate their processing costs with such accuracy, stating that they were right on the money. Guida Dairy asked at that time whether they could in fact employ Dairy Technomics to estimate other processors’ costs. Also last Spring the lead author of this testimony contacted and spoke with Mr. John Kaneb, the owner of the Hood Milk Company, and shared with him the Dairy Technomics processing cost estimates for the Hood Company. At that time Mr. Kaneb suggested that they were possibly a little bit low, but in the ballpark.

Finally, in 2000 the Connecticut, Massachusetts, and Vermont Attorneys General in their investigation of the Stop & Shop/Suiza milk strategic alliance used Dairy Technomics to estimate the processing costs that a potential entrant who would like to

use an agreement set up with the Dean Foods Milk Company to co-processs milk in a Dean plant. At that time the Dean lawyers came forth with a cost of processing that seemed extremely high. The attorneys general requested that Dairy Technomics also estimate the cost of processing at a Dean Plant for this potential entrant into New England. Dairy Technomic's cost estimate came in substantially lower than the one provided by the Dean's lawyers. Ultimately, at the request of the attorneys general Price Waterhouse did an extensive audit of the Dean processing facility and came back with the determination that the Dairy Technomics' estimate was right on the money and the Dean Food estimate was high. Thus we have three independent validity checks on the Dairy Technomics processing cost estimate. One for each of the three major processors in New England—Hood, Dean Foods, and the Guida Siefert milk company.

In his executive summary Dr. Schnittker says that the merchandising costs at retail are at least 45 cents a gallon. This estimate contradicts his own study where he cites the Pennsylvania Milk Board estimate of 42 cents a gallon. He also ignores or is unaware of a recent study done for the Maine Milk Commission that finds that large scale supermarkets, such as those that are targeted in this legislation, have in-store retailing costs as low as 20 cents a gallon.

Also on page 2 Dr. Schnittker says that the proposed law would in his example create an unconscionably excessive threshold price of \$2.40 a gallon. This is not correct. The threshold price in his example would be twice the Class I price plus the over-order premium of 12 cents a gallon. That gives a raw milk cost of \$1.32 a gallon multiplied by 2 gives us a threshold price of \$2.64 a gallon which is 2 cents below his estimated

grocery store cost of \$2.62 a gallon, and this cost includes his very high processing and delivery cost of 85 cents a gallon and his highretailing cost of 45 cents a gallon.

In the third paragraph of page 2 of his executive summary he says again, as with the Connecticut proposal, there is an incentive in the proposed Massachusetts law to increase the price paid to producers so that the farm retail price spread widens to allow processors and retailers to cover their cost. Frankly, many including farmers might wish this were indeed the case; however, it is simply is not true. Again, please refer to the Huff report on the New York State Law and its performance over the last 12 years. At no time have processors or retailers sought to widen their allowable margins by paying farmers over-order premiums.

In the next to the last paragraph on page 2 of the executive summary Dr. Schnittker opposes the proposed law because he maintains that it would increase the cost of processing milk and thereby increase the cost of low cost milk in the distribution limited assortment stores and club stores distribution channels which currently provide Massachusetts consumers with milk below \$2 a gallon. Again, this simply is not true for the proposed Massachusetts law. The best evidence is the New York law's performance. Examine the prices reported in our written testimony.

At the end of the next to the last paragraph on page 2 Dr. Schnittker states chain grocery stores would also be in a position to increase retail prices as long as they increase returns to producers setting up the classic case of spiraling prices and reduced fluid milk consumption. We were very concerned about this possibility when we put together the Connecticut law. Again, the Massachusetts law is different from the Connecticut law, however, in Appendix D of our report dated April 23, (available on our website

www.fmpc.uconn.edu click “price gouging” and scroll down through the reports by date until you find it) we analyzed this very issue. Under observed demand and cost parameters in the industry in New England today this simply would not be profit maximizing behavior by the retail supermarket chains. Moreover if it were, they invite further regulation. Again, the bottom line on this assertion is the performance of the New York State law over the past 12 years. We simply have not observed retailers paying over-order premiums and then spiraling retail prices up to unconscionably excessive levels, i.e., to levels such as we have in Massachusetts today.

This completes our preliminary review of the Schnittker report. Understand that we have had almost no time to respond. The detailed comments about technical details and the extent of analysis of the proposed Connecticut price collar law are also flawed. Given time we will respond in greater detail if this committee so requests.