

Pennsylvania Milk Marketing Board

August 30, 2017

Testimony by Rob Blaufuss

**On behalf of Dean Foods Company in Support of the Pennsylvania
Association of Milk Dealers' Request to Revise the Diesel Fuel Add-On to the
Over-Order Premium**

My name is Rob Blaufuss and I am currently employed by Dean Foods Company as the Senior Manager of Dairy Risk Management and Economics. My business address is located at 2711 North Haskell Ave, Dallas, Texas, 75204. Dean Foods owns and operates five fluid milk distributing plants located in the Commonwealth of Pennsylvania. I am here to testify in support of the PAMD proposal to revise the fuel-adjuster portion of the Class I premium cost build-up.

While I had hoped that my testimony would not be required in this hearing I appreciate the opportunity to come before the Board today. In recent years, it has been Dean Foods' preference to provide feedback through our cooperative suppliers potentially to find common ground with respect to requests made to the PMMB. Oftentimes, these efforts result in more streamlined, less combative and more informed requests to the PMMB. With this background, Dean provided our suppliers with feedback that PAMD was not planning to oppose the \$1.60 in the current hearing and instead was focusing on incrementally lowering the mandated premiums in Pennsylvania by bringing the fuel adjuster to a new starting point at zero. It was Dean's understanding from our communications with our suppliers that PAMD's position on the fuel adjuster would not be opposed by the Pennsylvania Association of Dairy Cooperatives ("PADC" or "Cooperatives"). As a result of those communications Dean did not make a motion to PAMD to seek more than an incremental decrease in mandated premiums by also addressing the Over Order Premium of \$1.60. We were thus surprised to see that PADC in fact opposed PAMD's fuel adjuster proposal by offering a counterproposal on August 10, 2017. That left Dean with no opportunity to pursue its original analysis that suggested the Over-Order Premium should also be lower. Since then, Dean presented its evidence to PAMD and PAMD has voted to petition for an emergency hearing, because the rebuttal period for the pending Over-Order Premium hearing closed, to be scheduled as soon as practical, but no later than November 2017, to afford the Dealers an opportunity to present a full picture of the competitive marketplace.

Dean does not take its decision to seek a new hearing lightly and I apologize for adding to the length of this hearing with my surrebuttal submission. However, this is the second time that our suppliers recently led us to believe their organization would take one position, but then took another position. At

this point, Dean concludes that we must take a more active role in shaping the Board's understanding of the marketplace since the PADC has recently pushed to maintain the Pennsylvania Over-Order Premium at a level that does not reflect marketplace realities including the actions of some of their own members outside of the Commonwealth, as was the case in September 2016.

For the past 6–12 months, major changes have occurred in both the Northeast and Mideast milk sheds as well as the retail landscape for fluid milk. These changes cannot continue to be ignored by the major industry participants who are privy to this information.

PAMD's Fuel-Adjuster Proposal is Reasonable

Dean Foods strongly supports the PAMD proposal to adjust the base fuel adjuster level from its current level of \$0.25/cwt to zero. Fuel costs have declined dramatically in recent years, with futures prices today providing little indication that a notable swing higher will occur any time soon. With the generally lower fuel costs and stability that has been shown in diesel prices for some time now, classified prices and voluntary premiums have had the opportunity to account for current fuel prices. Moreover, should prices begin to increase in the months ahead, the value of the fuel-adjuster would go up under PAMD's proposal. Should fuel prices rise to levels experienced in 2013 and 2014, the fuel cost adjuster value would reflect the fuel adjuster value set as a result of A-983 and A-988. As Mr. Herbein notes in his testimony, the objective of the fuel adjuster has been to adjust for increases in fuel costs and is not meant to reflect total fuel costs. Dean Foods can support the fuel adjuster reformulation proposed by PAMD as it results in a more competitive price premium overall.

The Over Order Premium and Fuel Adjuster Should Not Be Considered In Separate Silos

As stated in PADC Exhibit 1, the Pennsylvania Milk Marketing Board concluded in their hearing decision for OGO A-983 that “the Pennsylvania diesel fuel add-on should be set at a level that more accurately reflects surrounding market conditions.” However, setting the base fuel adjuster price to reflect surcharges in the areas surrounding Pennsylvania is fraught with issues. In a regulated premium construct, like the system today in Pennsylvania, it is important not to ignore a key fact – premium dollars have become fungible. The fuel adjuster and the over-order premium have become two separate issues under

the PMMB, while in areas which don't regulate premium levels they ultimately are not. The level of detail surrounding Class I premium invoices varies significantly around the country, sometimes being broken down into individual line items such as fuel, hauling and a base premium, etc. while other invoices just list one premium price by class. Cooperatives can adjust the various line-item premium charges as they best see fit to reduce (or raise) the total premiums being charged to processors. Regardless of what level of detail is provided with respect to the premium charged, the only number of concern is the total premium charged in any given month to the fluid processor.

Separating out the premium charges into different silos like the PMMB does today allows cooperatives, as they do in PADC Exhibit 1, to assert that the base fuel adjuster add-on should be \$0.10/cwt in order to align with the areas surrounding Pennsylvania while not having to discuss any differences between **total** over-order premiums in Pennsylvania and surrounding areas. While Mr. Rutherford states in his testimony, "The current rate charged to plants in Ohio and New Jersey ranges from \$0.0850/cwt to \$0.1700/cwt," as the basis of PADC's request to adopt a \$0.10/cwt base fuel surcharge, he (as well as Mr. Cooper) fail to provide any Class I over-order premium information for those areas referenced. I respectfully suggest that the Board should not adopt Mr. Rutherford's 10-cent proposal and then adopt the \$1.60 premium without knowing what premiums look like in surrounding areas. The Pennsylvania Milk Marketing Board should view the fuel adjuster and the Class I over order premium as one total premium. Not doing so has the potential to distort the overall premium differences between the Commonwealth and neighboring states. The gap between Pennsylvania total over-order premiums and the total over-order premiums in the surrounding areas has increased significantly over the past 12–18 months. This has made Pennsylvania fluid milk processors increasingly uncompetitive. I believe PAMD's proposal is reasonable in that it helps to address what Dean Foods believes is an excessive total premium package in Pennsylvania while also providing timely relief if farmers face diesel fuel volatility going forward.

Value of On-Farm Fuel Costs Factoring into Fuel Adjuster

As I stated in a previous PMMB hearing, to the extent on-farm fuel is presented as a cost of production factor for the Board's consideration in setting the over-order premium, it follows that on-farm fuel should not also be a factor in the fuel adjuster to avoid duplication. In his testimony, Mr. Rutherford performs crude calculations to land at what the on-farm fuel cost represents to a Pennsylvania dairy producer on a per cwt basis. His analysis has three major flaws. First, Mr. Rutherford relies on cost of production data for corn and soybeans for the "Northern Crescent" area as a reference point to estimate prices for Pennsylvania. While the Commonwealth does fit into this geographic region, so too does Maine, Vermont, New Hampshire, Connecticut, Rhode Island, Massachusetts, New York, Michigan, Wisconsin, as well as parts of Minnesota, Ohio and Maryland. There is no way of knowing with any certainty that the cost of production for corn and soybeans for this large region accurately reflect those in Pennsylvania. Next, while the exact calculation for how the on-farm fuel costs are being teased out of the feed costs are limited, I would have significant concerns regarding the accuracy of the data by using only the fuel costs and costs of corn and soybeans. Finally, while he states he is being conservative in estimating the percentage that on-farm fuel costs accounted for in the fertilizer and custom operations expenses, Mr. Rutherford has no true way of knowing if his estimates are accurate.

Class prices and premiums can and do reflect supply and demand conditions. When milk supplies are abundant relative to demand this will be reflected in changes to classified prices and premiums. The opposite will occur when demand vastly outpaces available supply. The market today is over-supplied with milk with a significant amount of milk being dumped. *See Blaufuss Exhibit 1.* Through the first half of 2017, total milk dumped (and animal feed) declined compared to prior year levels in FO 1 and FO 33, but still equaled 138.7 million pounds and 55.5 million pounds, respectively.

Changes in fuel prices over the past 6-12 months have had enough time to be reflected into premiums and class prices. Fuel prices have fallen considerably since 2013 and 2014 but have remained stable throughout the first half of 2017. In fact, the Central Atlantic monthly average price for No 2 Retail Diesel has traded in its smallest range for the time period since at least 1998. This stability in fuel

prices is a major reason why Dean Foods supports the PAMD proposal to reset the fuel price used to set the adjuster value as well as reducing the base adjuster value of \$0.25/cwt to zero. The over-supply of milk in both Federal Orders 1 and 33 have led to reduced premiums in areas around Pennsylvania, but not to Class I premiums for milk produced, processed and sold within the Commonwealth.

In conclusion, Dean Foods urges the Board to adopt the fuel adjuster proposal offered by PAMD for the reasons I have stated and for those stated by Mr. Herbein. Thank you for your consideration of my testimony.

Pounds
60,000,000

Monthly Milk Dumpage (and Animal Feed) by Federal Order

50,000,000

40,000,000

30,000,000

20,000,000

10,000,000



Submitted: August 24, 2017