TESTIMONY OF

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Appearing on Behalf of the Pennsylvania Association of Milk Dealers

Diesel Fuel Add-On to the Over-Order Premium

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Diesel Fuel Add-On to the Over-Order Premium

I am Carl D. Herbein, CPA, President and CEO of Herbein + Company, Inc. and my address is 2763 Century Blvd., Reading, PA 19610. I wish to present Testimony on behalf of the Pennsylvania Association of Milk Dealers. I attach my Curriculum Vitae, as Exhibit D1, which outlines my education, and experience in the dairy industry.

Study Conducted

On behalf of the Pennsylvania Association of Milk Dealers, I have reviewed the Pennsylvania Milk Marketing Orders A-908, A-927, A-983, and A-988. These Official General Orders all deal with diesel fuel adjusters among other factors. I have also reviewed the average retail on highway diesel price for the Central Atlantic Region as published by the United States Department of Energy – Energy Information Administration (EIA) for the years 2000 through and including June 2017. This analysis of the historic levels and fluctuation in diesel fuel prices is an important factor in updating to current conditions the Pennsylvania Milk Marketing Board's diesel add-on. My study focused entirely on the producer side of diesel fuel. The Board has properly adjusted its handling of diesel fuel for dealers by instituting the adjustment which is made at each and every area cost replacement hearing and is referred to in Dealer Exhibit D8. Unlike the producer adjuster, it is reset based on actual costs and it goes negative when our costs go down. Thus, I see no further adjustment necessary on the dealer diesel fuel cost.

Foundation for Adjustment

OGO A-908 contains Finding of Fact 1, "On March 2, 2000, the Pennsylvania Milk Marketing Board convened a hearing for all Milk Marketing Areas to receive testimony and evidence to consider whether a temporary increase in minimum wholesale prices and a temporary increase in the Over-Order Premium should be made to reflect increases in fuel costs". Thus, PMMB's objective was to make an adjustment for increases in fuel cost, not to be confused with "to reflect total fuel costs". Thus, objective in setting the fuel adjuster has been to make an adjustment for increases in fuel costs, not to be confused with to reflect total fuel costs and they have followed this objective in all producer fuel hearings.

By review of Exhibit D3, it can be seen that a sharp increase in diesel fuel prices occurred from 1999 to 2000 and that precipitous increase prompted PMMB to adopt a temporary fuel adjuster. Similarly, a fuel adjuster was adopted in 2004 following a period of volatility and fuel price increases. In 2013 fuel prices again were high and according to Exhibit D3, there was significant volatility. This gave rise to the fuel adjuster adopted in 2013 and re-adopted in 2014. Again reviewing the diesel fuel prices on Exhibit D3, it can be seen that serious volatility occurred and climaxed in 2014. In contrast, an examination of diesel prices post-2013 and 2014 as shown in Exhibit D3 shows that fuel prices have at all times been below the average prices that existed when the 25-cent fuel adjuster floor was established.

PMMB first established the current bracket system and a minimum add-on of $0.25/cwt to the Class 1 Producer price in OGO A-983 and then continued the methodology relying largely on the analysis used in OGO A-983 from 2013 to adopt OGO A-988, which is currently operative. This add-on applied to all diesel prices from $0.000 to $4.1629, thus resulting in a $0.25/cwt floor even if fuel were free. It is now that fuel prices have been persistently lower than they were in 2013 and 2014 as shown in Exhibit D3A, which includes a horizontal line that I have superimposed onto page 1 of Exhibit D3 showing where $4.073 (See OGO A-988, FOF 25) would be on the graph, that it has come into focus that the floor is not logical or supportable under current market conditions. At the time the floor was adopted, I do not think any of the hearing participants, but certainly not me on behalf of PAMD, imagined that fuel prices would decline to the levels we are experiencing today.

When the $0.25/cwt floor was adopted as part of OGO A-983, a 12-month average diesel price of $4.073 was facing the industry. See OGO A-983, FOF 25. In contrast, today's fuel prices are averaging $2.6525 (Exhibit D4), for a price drop of $1.4205 from the average of $4.073 when the floor was adopted, which reflects fourteen ten-cent bracket reductions.. Since the Board valued each 10-cent bracket change in fuel as requiring a 2-cent/cwt fuel adjustment, and given that that the 25-cent floor was established at a time when these low prices seemed inconceivable, it is my opinion that the floor should be reconsidered and removed. Although the dealers have a negative fuel adjustment, this is because the dealer adjustment is based on actual costs. Here, the fuel adjuster is not based on actual costs, but rather was developed according to the orders, to reflect the effect of changes in the diesel costs to producers. As a result, I am not proposing that the fuel adjuster go negative at this time. I do however believe that there is ample justification in the Board's own brackets to remove the $0.25 floor and set the fuel add-on at zero when the bracket reductions would start to take the fuel adjuster negative if the bracket system were applied up and down from the 2013 and 2014 starting point of fuel prices averaging $4.073.

Findings

Exhibit D2 presents bracket changes that reflect the significant decrease in diesel fuel and the corresponding fuel cost savings. My focus is on addressing the 25-cent floor, which is no longer justified. Therefore, I accept for purposes of this hearing and to minimize the complexity of this proceeding, the bracket adjusters as calculated in OGO A-988, and recommend the adjusters utilized in OGO A-988, which are a $0.02 adjustment for every $0.10 change in diesel cost. Thus, the above calculation indicates that there has been a 14-bracket reduction in diesel fuel. Thus, I recommend that the current $0.25/cwt floor built into fuel adjuster, as required by OGO A-988, be set at zero when fuel prices drop to or below $2.8629/gallon. See Exhibit D2, Panel 3. The proposal also contemplates that the fuel adjuster increases by 2-cent increments for every 10-cent/gallon increase in diesel fuel. .

Exhibit D2, Panel 3 proposes a new starting point of $2.8630/gallon. In keeping with A-988, I recommend that a $0.10/gallon diesel fuel increase above the new starting point results in a $0.02/cwt add-on to the Class I Over-Order Premium and that this bracket system not be applied in a negative direction. This has the benefit of recognizing that fuel prices have declined, but it retains the fuel adjuster such that the next time diesel fuel rises to levels averaging $4.073 the fuel adjuster would be back around $0.25-cents. Compare Panels 1 and 3 of Exhibit D2. Additionally, this proposal would ensure that as diesel rises above the trigger of $2.8629/gallon, producers would be eligible fuel adjusters before the $4.073 levels as shown on Exhibit D2_.

Summary and Recommendation

The Pennsylvania Association of Milk Dealers recommend that the Milk Marketing Board eliminate the $0.25/cwt adjustment to the Class I Over-Order Premium by simply reflecting the brackets that were adopted as part of OGOs A-983 and A-988 down to the point at which the fuel adjuster would become zero. This proposal will continue to be reactive to diesel market cost changes, but more closely tie fuel adjuster allotments with the value as determined by the Board previously of 10-cent/gallon diesel fuel price changes. Thank you for your consideration of my analysis and opinions.