

Testimony
of
Dennis Tonak
Prairie Farms Dairy, Inc
In Support of Proposals 6, 7, 8, 9, and 10
February 28, 2023
Franklin, Tennessee



My name is Dennis Tonak. I am the Senior Director of Federal Order Markets for Prairie Farms Dairy, Inc., 3744 Staunton Road, Edwardsville, IL, 62025. Prior to my employment with Prairie Farms, I was the CEO and General Manager of Mid-West Dairymen's Co., Rockford, IL. Previous employment experience includes various management and marketing positions with Southern Milk Sales, San Antonio, TX and National Farmers Organization, Ames, IA. I have a Bachelor of Science degree in Dairy Science from South Dakota State University, Brookings, S.D. I have appeared as a witness at various Federal Order hearings in the past.

Prairie Farms Dairy, Inc. is a qualified Capper-Volstead cooperative. Prairie Farms dairy producer member-owners are located in Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, Ohio, and Wisconsin. Most Prairie Farms dairy producer member-owners meet the definition of a small business. Prairie Farms pools the milk of our producer owners on Federal Orders 5, 7, 30, 32, and 33. Prairie Farms also markets the milk for a group of non-cooperative members (independents) in Texas. This includes making sure the milk is pooled and performing the producer payroll. The independent milk is pooled on Federal Order 7 and 126. Prairie Farms also operates fluid plants, Class II plants, and cheese plants throughout the Central U.S. The plants operate as Prairie Farms Dairy, wholly owned subsidiaries Eastside Jersey Dairy and Ice Cream Specialties, and majority owned subsidiary Hiland Dairy. The Prairie Farms dairy producer member-owners, other cooperatives, and independent suppliers supply the raw milk needs of these plants. There are nine Prairie Farms Dairy, Eastside Jersey Dairy, and Hiland Dairy pool distributing plants regulated under Federal Orders 5 and 7.

The southeastern United States milk supply has been decreasing for many years, while at the same time the population has been increasing. There has been an ongoing need to import milk from outside the area. Some of the earlier efforts to provide for a reliable supply of additional milk go back fifty years or more. These were primarily voluntary efforts among cooperatives. Transportation credits institutionalized in 1996 helped to more uniformly

share the costs of importing milk into the southeast region. The short supply situation has continued to worsen and has moved from a short supply in the fall and winter only, to a year around shortfall.

Prairie Farms developed five principles to guide the development of the proposals submitted for this Hearing.

- Credits for transportation and delivery to distributing plants should promote efficient milk movement. This will help save fuel, reduce costs, and benefit the environment.
- Producer milk delivering to distributing plants should receive compensation over and above that of producer milk pooled on the Order but not delivering to distributing plants.
- Producer milk supplied to distributing plants, no matter if the milk originates in the marketing area or outside the marketing area, should receive fair and equitable treatment.
- Equitable treatment means the same regulations should apply to producers in the marketing area and outside the marketing area, as long as the milk is delivering to distributing plants.
- Assembly performance credits for producer milk delivered to pool distributing plants are a preferred approach for recognizing and rewarding the deliveries to pool distributing plants.

These five principles are woven into the Prairie Farms' proposals. There is one other unstated principle we also try to follow: KISS (keep it simple). Proposals with deep layers of complexity may improve the proposals and make them more effective for today. As the supply/ demand situation changes, the complexity makes the regulations less flexible and less able to adapt for the future. The existing Transportation Credit program highlights this lack of flexibility.

The southeastern United States is short of milk every month of the year. The fluid needs of the region require imported milk from the areas outside of the southeast year around.

The available supply in the southeast region continues to shrink, especially when compared to the region's population growth. Exhibit _____ A shows the per capita milk production for eleven southeastern states - Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia- in 1997. Per capita milk production is a method of easily understanding the population and milk production relationship. The 1997 per capita production of 206.2 pounds is slightly above the 201 pound per capita fluid milk consumption for that year. Since that time, per capita production in the southeastern states has been shrinking faster than the per capita consumption.

Exhibit _____ B shows the 2021 population and milk production for the same eleven southeastern states. The population estimate is from an Economic Research Service report using U.S. Census data, updated on June 2, 2022. The milk production information is from the National Agricultural Statistics Service (NASS) February 2022 Milk Production released February 23, 2022..

For the eleven southeastern states, the 2021 per capita milk production was 98.2 pounds annually or 8.2 pounds per month. The United States 2021 annual per capita fluid milk consumption was 134 pounds or 11.2 pounds per month. We can draw a few conclusions from this information:

1. The eleven southeastern states only produces 73.3% of their fluid milk needs. By necessity, the remaining 26.7% came from other states.
2. This leaves no reserve supply to meet the variation in daily, weekly, and monthly needs of the pool distributing plants.
3. There is no milk available for Class II products or any other non-fluid products.

Exhibit _____ B also shows the removal of Virginia from the eleven states. Without Virginia, the per capita production of the remaining ten states drops to 90 pounds, or 7.5 pounds per month. This leaves the ten states producing only 67.2% of their fluid needs with the remaining 32.8% sourced from outlying areas.

The origination location of the milk delivered to East Side Jersey Dairy, Hammond, LA for the five-day period from May 2-6, 2022 and another five-day period from October 3-7, 2022 was established. For the May period, 60% of the milk came from the eastern and central Texas area and 40% came from Kansas, New Mexico, and the Texas panhandle. The Order 7 Marketing Area did not supply any of the Hammond milk during the May 2nd through May 6th, 2022 period. For the October period, 45% of the milk came from the eastern and central Texas area, 39% came from Kansas, New Mexico, and the Texas panhandle, and 16% came from the Order 7 Marketing Area. It is understandable that the High Plains area provides milk to Hammond in October when milk is in high demand. In May, milk would not move from areas of East and Central Texas and the Texas panhandle and incur significant added mileage and hauling costs unless absolutely needed to meet the milk supply demand for the region.

March, April, and May are no longer months of adequate supply. Exhibit _____ C shows just how short the region's milk supply actually is in March, April, and May. There were 335,813,596 pounds of producer milk pooled on Order 7 in March 2022 according to the Market Administrator's Order 7 website. 296,832,200 pounds of this producer milk delivered to pool plants. Exhibit _____. There were 141,328,307 pounds of milk pooled on Order 7 that originated in states or portions of states that were immediately adjacent to the Marketing Area. Exhibit _____. Removing these "adjacent area" pounds from the pooled pounds would leave 194,485,289 pounds of pooled milk. The difference between the remaining 194,485,289 pounds of producer milk and the deliveries to pool plants of 296,832,200 pounds is a shortfall of 102,346,911 pounds. This shortfall is not unique to March. There was a shortfall in all three months of March, April, and May 2022. The same calculations, using the Class I market utilization, also resulted in a shortfall of producer pounds. In March the Class I market utilization for Order 7 was 281,092,014 pounds resulting in a shortfall of 86,606,725 pounds when compared with the pooled producer milk of 194,485,289 pounds (again after removing the "adjacent area" milk). These calculations done for April and May Exhibit _____ C also show a shortfall. The same methodology was used for Order 6, Exhibit _____ D and Order 5, Exhibit _____ E.

These exhibits dramatically show just how short milk is in the southeast U.S. during the spring. If a handler pools too much of a producer's milk on Order 5 or 7 during March, April, and May, that handler is not able to claim Transportation Credits on that producer's milk in the fall, even though the market had a need for the milk in the spring.

Exhibit _____ F is a table showing the Order 7 monthly Class I market utilization on a daily basis. Daily utilization is not equal among the months, although some months in both the spring and fall do not have the variability exhibited when comparing winter and summer months. The statistics are from the Market Administrator website in the Statistical Summary section. Exhibit _____ G compares the daily average Class I market utilization for April and September for 2020, 2021, and 2022. Both April and September contain a Holiday weekend (Easter and Labor Day)

that could influence fluid milk sales, especially sales of school milk. In 2020 and 2022, the daily average was higher in April, by 50,274 pounds in 2020 and 137,232 pounds in 2022, than it was in September, indicating that more milk was needed in Class I in April. Converting the pounds to tanker loads, there were about eighty-two more tankers needed in April 2022 to meet the Class I needs than in September 2022. In 2021, the reverse was true. September 2021 was higher than April 2021 by 26,689 pounds on a daily average.

As an industry, we must take action to help ameliorate this drastic supply / demand imbalance. There are choices among the proposals at this Hearing that will provide the necessary assistance.

Proposals 9 and 10 would apply to Order 5 and 7 respectively. The proposals, if adopted, would delete a portion of §1005.82 "Payments from the transportation credit balancing fund" and the corresponding portion of §1007.82 "Payments from the transportation credit balancing fund".

The section from Order 5 is included here. I will highlight the section we want deleted.

"§1005.82 Payments from the transportation credit balancing fund

(c) Transportation credits shall apply to the following milk:

(1) Bulk milk received at a pool distributing plant from a plant regulated under another Federal order, except Federal Order 1007; and

(2) Bulk milk received directly from the farms of dairy farmers at pool distributing plants subject to the following conditions:

~~(i) The dairy farmer was not a "producer" under this order for more than 45 days during the immediately preceding months of March through May, or not more than 50 percent of the production of the dairy farmer during those 3 months, in aggregate, was received as producer milk under this order during those 3 months; and~~

~~(ii) The farm on which the milk was produced is not located within the specified marketing area of the order in this part of the marketing area of Federal Order 1007.~~

~~(iii) The market administrator may increase or decrease the milk production standard specified in paragraph (c)(2)(i) of this section if the market administrator finds that such revision is necessary to assure orderly marketing and efficient handling of milk in the marketing area. Before making such a finding, the market administrator shall investigate the need for the revision either on the market administrator's own initiative or at the request of interested persons. If the investigation shows that a revision might be appropriate, the market administrator shall issue a notice stating that the revision is being considered and inviting written data, views, and arguments. Any decision to revise an applicable percentage must be issued in writing at least one day before the effective date."~~

I will specifically reference Order 7 in the following examples and exhibits, although the same principles apply to Order 5. The deletion of (c)(2)(i) will make the producer milk from outside the marketing area that was pooled on Order 7 during the March through May period, and that is otherwise ineligible for Transportation Credits, eligible for Transportation Credits for the appropriate subsequent period during the late summer and winter months. This

proposal does not change any of the months that the Transportation Credits would be in effect or any of the other Transportation Credit provisions.

Exhibit ____ H shows the miles between selected cities in Illinois and Iowa and Kosciusko, MS. Kosciusko is the location of the last Order 7 distributing plant in Mississippi, at least to my knowledge. The locations in Illinois and Iowa were selected because of milk production and relationship to distributing plants of other orders. Carlyle, IL is the county seat of Clinton County, IL, one of the largest milk producing counties in Illinois, and relatively close to distributing plants in the St. Louis market that are regulated by Order 32. Bloomington, IL is the county seat of McClean County, IL. McClean County, though not a large milk-producing county, is home to a few producers who ship tanker load quantities of milk every day. Dubuque, IA is the county seat of Dubuque County, IA. This area of Northeast Iowa and Southwest Wisconsin is an area of relatively concentrated milk production. Dubuque is home to an Order 32 pool distributing plant.

Exhibit ____ H also shows the miles between selected cities in Texas and Lafayette, LA. Lafayette is the most southwest of any Order 7 distributing plant. It is one of the distributing plants closest to the Texas border. Texas, particularly East Texas, has served as a reserve milk supply for Louisiana distributing plants for 50 years, give or take a few years. Sulphur Springs, Texas is the county seat of Hopkins County, Texas. At one time Hopkins County was the largest milk-producing county in Texas. Even though the milk supply in Hopkins County has dwindled since those days, it is still a reliable source of milk for the southeast. Stephenville, Texas is the county seat of Erath County, Texas. Erath County became the largest milk-producing county in Texas as Hopkins County production moved lower. Dalhart, Texas is the county seat of Dallam County, Texas the most northwestern county in Texas. Part of the Dalhart city limits are in Hartley County. Hartley County is now the largest milk-producing county in Texas. Ballinger, Texas is the county seat of Runnels County, Texas. Runnels County is a rural county with limited milk production, but it can originate at least an every other day load of milk. Milk produced in Runnels County is about 200 miles from any milk plant.

Exhibit ____ I is a worksheet from the Order 7 Market Administrator's website. To estimate the applicable Transportation Credit, the mileage and zone information from Exhibit ____ H, the January 2023 Market Administrator announced fuel price, and a 48,500 pound load size was used.

Exhibit ____ J shows how handlers may change milk origination and delivery locations to minimize hauling in the spring and maximize Transportation Credits in the fall. In spring, the Carlyle, IL milk shed will supply milk needs at Kosciusko, MS. The distance from Carlyle, IL to Kosciusko is 450 miles. Milk from the Bloomington area will deliver to O'Fallon, IL. The total miles to deliver one load to Kosciusko and one load to O'Fallon in this manner is 607 miles. In the fall, as illustrated, the destinations change: Carlyle, IL goes to O'Fallon, IL, a distance of 31 miles, and Bloomington, IL goes to Kosciusko, MS, a distance of 597 miles. The total miles now traveled are 628 miles, an increase of 21 miles over the spring total. The big difference is not in the increased miles, but in the Transportation Credit. If the Carlyle, IL milk could continue to deliver to Kosciusko in the fall and receive the Transportation Credit, now prevented by (c)(2)(I), the estimated Transportation Credit would be \$290.03. Since the Carlyle milk will not receive Transportation Credits in the fall, the Bloomington milk will go to Kosciusko, with an estimated Transportation Credit of \$563.76. Under this scenario, the miles travelled increased by 21 miles, but the Transportation Credit increased by \$273.73. The \$273.73 increased Transportation Credit divided by the added 21 miles yields an incremental return of \$13.03 on the one-way mileage or \$6.515 per round trip added mile.

Dubuque, IA and Carlyle, IL are the same type of comparison. Total miles increased from 607 miles in the Spring column of Exhibit _____ J to 628 miles in the Fall column, a 21-mile increase. The Transportation Credit was \$685.79 higher than it would be if (c)(2)(i) was not in place. This calculates as a \$34.29 incremental return on the one-way mileage or \$17.145 per round trip mile.

Exhibit _____ K shows the same type of information for Texas milk delivering to Lafayette, LA.

The type of milk movements illustrated in Exhibit _____ J and K are available to handlers in both Order 5 and Order 7. Milk movement to maximize Transportation Credits are inefficient due to the increased miles travelled, though often profitable, and cost handlers money. The efficient outcome is to reduce miles wherever possible and still supply the needed milk to plants in the southeast. Fall Transportation Credits will efficiently supplement the cost of hauling in the fall when (c)(2)(i) is removed from the regulations.

The deletion of section (c)(2)(ii) will allow producer milk located in the marketing area to be eligible for Transportation Credits, using the same calculation mechanism for producer milk from outside the Marketing Area. This should enhance the stair-stepping of milk, using both the in-area and out-of-area milk, from North to South and West to East in the most efficient possible manner. The Transportation Credits are in place during the period when milk is in the shortest supply situation, and as a result, milk will still need to travel long distances.

Transportation Credits that are only available on milk produced outside the Order 5 and 7 Marketing Areas will not contribute to efficient in-area movement. Rather than continually redirect the in-area milk through stair stepping to the needed areas, the in-area milk will move to the nearby local distributing plant. The out of area milk will need to move greater distances past the local milk to supply the needs of distributing plants. There is no incentive to gradually stair-step the in-area and out-of-area milk in an efficient combination, since at this time the in-area milk does not receive Transportation Credits.

Prairie Farms has Order 5 pool distributing plants in Holland, Indiana and Somerset, Kentucky. A group of producers is located south of Holland in the Evansville, IN area. There are approximately 48 miles from Evansville to Holland. Since this milk is in the Order 5 Marketing Area, it is ineligible to participate in Transportation Credits, and delivers to Holland throughout the year. From Evansville to Somerset is a distance of 226 miles. From Bloomington, IL to Holland is 235 miles and from Bloomington to Somerset is 411 miles. If (c)(2)(ii) was removed from Order language the Bloomington milk could go to Holland and the Evansville milk could go to Somerset, a combined mileage of 462 miles. By comparison, the combined mileage of Evansville to Holland and Bloomington to Somerset is 459 miles. The Transportation Credit on the stair-step movement would be an estimated \$200.20, compared to the current Transportation Credit (Bloomington, IL to Somerset, KY) of \$288.67. There would be no mileage savings but there would be a Transportation Credit savings of \$88.47 for each load.

It is not fair and equitable for out-of-area milk to be eligible for Transportation Credits while in-area milk is not eligible. As the milk supply shrinks and the population increases in the southeast, it is more important than ever that all milk receives uniform application of Transportation Credits.

The elimination of (c)(2)(i) and (c)(2)(ii) should incentivize the most efficient movement of producer milk to the distributing plants where needed. The (c)(2) (iii) section is redundant and not needed when the (c)(2)(i) and (c)(2)(ii) are eliminated.

Proposals 6, 7, and 8 would introduce Assembly Performance Credits in Orders 5, 6, and 7 respectively. Assembly Performance Credits would reimburse handlers for a part of the cost for assembly, dispatch, and delivery incurred on producer milk received at distributing plants regulated by the Order. As proposed there would be a \$.50 assessment on all Class I milk delivered to a pool distributing plant. The \$.50 Assembly Performance Credit assessment can be adjusted by the Market Administrator without an Order Hearing. The funds are distributed on a pro rata basis to all producer milk delivered to those same distributing plants. The Assembly Performance Credit will operate on a year-around basis.

As the number of producers and the milk volume produced in the southeastern United States has decreased, milk haulers have to travel more miles to pick up the milk. Additionally, the number of distributing plants in the region have also decreased. Not only does the hauler travel more miles picking up the milk at the farm, the hauler has to travel more miles to deliver the milk to the distributing plant. This leaves either the producer paying more for the hauling and/or the hauler absorbing part of the increased cost and/or the handler absorbing part of the cost. The increased costs that the producer, hauler, or handler are paying and absorbing are not necessarily uniform among all producers, haulers, and handlers in the region.

The Assembly Performance Credit would generate a credit that would partially cover these increasing costs in a uniform manner for all, without regard for producer location, distributing plant milk utilization, distributing plant receiving the producer milk, or handler/cooperative generating the milk deliveries. The APC is fair and equitable for both handlers and producers since a uniform assessment rate is applied to the Class I milk, and a uniform credit is received on the producer milk delivered to distributing plants.

The classified pricing in the Federal Order system mandates that all regulated plants in the same Class I differential zone pay the same Class I price. The plants would have the same Class II, Class III, and Class IV prices also. However, the actual regulated cost paid by individual regulated plants can vary widely depending on the individual plants utilization of milk in the various product classes. If the Assembly Performance Credit was applied to the Class I milk and then distributed on only the Class I milk there would be much variability in the credit among the regulated plants. This is not the "fair and equitable" outcome demanded by the Prairie Farms principles.

The APC will help a handler partially recover the costs of assembling and delivering a load of milk to a pool plant. Costs of assembly include determining which producers are on a load, matching the hauler and the hauler's equipment with the load, etc. In Prairie Farms case, producers have the same hauler and pay a hauling rate to a particular delivery destination. Prairie Farms pays the hauler additional amounts, if appropriate, if the load goes to alternative locations. Other cooperatives and companies may operate differently, but there are always some costs to oversee the efficient assembly of producer milk at the farm into movable loads.

The dispatch of the milk is another cost area. The milk demands from the distributing plants and other plants in the region determine which loads should deliver to which plants in order to meet the plant's producer milk needs at the time required. This is further complicated since a plant's milk needs may vary widely day to day and week to week. Many plants do not have enough silo storage capacity to take a uniform milk delivery every day of the week. Often the weekends are the days when plants have the least raw milk storage capacity, requiring extra milk deliveries in the middle of the week. There are times when an allocation process is performed since there simply is not enough milk available for all plants to receive the milk deliveries as they requested. This all becomes part of the dispatch cost.

Delivery costs are the final piece to be partially born by the APC. Milk delivery costs for individual plants vary widely. Abundant local milk supplies delivered to a nearby plant provide that plant with lower delivery costs than a plant whose milk supplies come from a greater distance. The most efficient regional milk deliveries are likely to increase the delivery costs at some distributing plants and reduce the delivery costs at other distributing plants, with a net savings result. A uniform APC distribution will not fully recover all costs associated with assembling, dispatching, and delivering milk to the distributing plants regulated by the Marketing Order. Since the APC distribution is uniform across all producer milk delivered to distributing plants, overall efficient milk movement results.

The Assembly Performance Credit does not have a mileage-based component. Thus, there is no incentive to maximize mileage-based credits by moving milk among different milk supply locations and delivery locations. The incentive with the APC is to move milk efficiently, utilizing both the in-area and out-of-area milk.

The language proposed for the Assembly Credits did not include possible changes required in other sections of Orders 5, 6, and 7, especially in §30 and §32.

The combination of Assembly Performance Credits on a year-around basis and Transportation Credits on a seasonal basis applied to all in-area and out-of-area milk will promote the most efficient producer milk deliveries.

This concludes my testimony.