

Milk in the Northeast and Other Marketing Areas

Doc. No. 23-J-0067; AMS-DA-23-0031

Testimony of Lone Star Milk Producers, Inc.

September, 2023

This testimony is presented in support Proposal Number 7, submitted by National Milk Producers Federation, hereafter NMPF.

My name is Travis Campsey. I am the Treasurer and Chief Financial Officer of Lone Star Milk Producers, Inc., headquartered at 813 8th Street, Suite 300, Wichita Falls, Texas 76301. Lone Star Milk Producers, Inc. is a Capper-Volstead cooperative association, is qualified to market milk on Federal Milk Marketing Orders, is a member of NMPF, and fully supports Proposal Number 7.

Lone Star Milk Producers, Inc., hereafter Lone Star, regularly markets its members' milk on the Appalachian, Southeast, Central, and Southwest Federal Milk Marketing Orders.

This testimony will focus on the need for an update and improvement in the Federal Order 'Make Allowances', the adjustments to wholesale dairy product prices, that along with yield factors, allow the conversion of the wholesale dairy product prices to the Order Class and Component prices.

Lone Star supports NMPF's Proposal Number 7, as listed in the Notice of Hearing. We offer today relevant data on changes in costs of milk processing that we, as the operator of a cream, butter and nonfat dry milk processing plant, have experienced over the last five years.

Lone Star's butter and nonfat dry milk plant is located in Canyon, Texas, which is approximately 20 miles south of Amarillo, and is a relatively new plant, opened in 2017, which was subsequent to the most recent update in Federal Order Make Allowances. The plant's official name is Lone Star Dairy Products LLC, hereafter LSDP. The LSDP plant qualifies as a pool supply plant on Order 126. I worked directly as CFO of Lone Star Dairy Products from September 2021 to December 31, 2022, and have served as a Board Manager of LSDP since its inception. Regular monitoring of LSDP's financial results is an area I have been tasked with since the beginning of the LSDP business.

Seemingly, almost all newly constructed milk plants experience operational challenges when they first open. LSDP was no exception. Consequently, we determined that cost data from 2017, the year LSDP came online, would not be indicative of the costs of operating the plant on an ongoing and regularly operating basis. The data presented in Exhibit LSMP-2, compares certain costs experienced for the operation of the plant during the months of January through May 2023 to the same five months in 2018. The several cost items compared are hourly labor rates, utilities costs, and property insurance. We have expressed these time-period comparisons as percentage changes since the underlying dollar cost or per unit costs would reveal competitively sensitive proprietary information.

The data presented in Exhibit LSMP-2 are summarized from the books and records of LSDP, and are reasonable and correct to the best of our knowledge and belief.

In no surprise, costs of operating our plant have risen considerably in the five years since early 2018. For labor costs, hourly wages, depending on the operations department, increased between 27 and 49 percent, which was an average increase across the various operations departments of approximately 35 percent.

Utilities costs at LSDP overall are virtually unchanged across the five years, but only because we invested millions of dollars during this period to upgrade and significantly increase the throughput of our wastewater treatment facility. The wastewater treatment expansion increased our ability to process wastewater five-fold from when the plant was built. This substantial capital expense has had the effect of actually reducing our ongoing monthly water and sewer charges. Unfortunately, we have no such mitigation potential when it comes to the use of electricity and natural gas, and their costs both increased roughly twenty-five percent over the five-year period. It is interesting to note for natural gas, in the recent past, there have been 5-month averages where the rates were more than double those of the 5-month average of January through May 2023.

The recent real shocker in plant costs is property insurance, which increased a nearly unbelievable 378 percent, most of which occurred in March of 2023. Insurance companies' recent loss experience due to multiple milk dryer fires, hurricanes, winter storms, and other large-scale disasters across the U.S. have resulted in the massive increases in property insurance costs. We diligently shopped for insurance at the most recent renewal, and this was

the best we could do. These insurance cost increases are frightening, and we doubt we will see much moderation any time soon. The dryer fire losses experienced at other plants which caused our insurance rates to increase also forcefully reminds us that we are dealing with mechanical devices, and there is always the risk of something very bad happening, and that risk must be mitigated by proper maintenance and ongoing safety protocols, neither of which are cheap if done right. Fortunately, the more modern milk-drying equipment is equipped with many redundant safety features to lower the risk of catastrophic failures, and LSDP is so equipped. This is important for reduction of risk, but does make the cost of purchasing and operating the equipment higher than in the past.

Lone Star, through its milk products manufacturing plant, experiences on a daily basis what it costs to operate a hard product manufacturing facility, and as such sees how inadequate the current Federal Order Make Allowance values really are, because our operations costs at LSDP exceed the current Federal Order Make Allowances. However, although we suspect our experience of increasing costs is much like that of other processors, we also suspect that the way we capture cost data likely is not exactly comparable to the way other processors complete these analyses. A standard set of cost reporting and cost evaluation criteria are needed to make sure industry-wide costs are gathered and compared apples to apples, and thus provide consistent data for the industry and the Secretary to evaluate when establishing Federal Order Make Allowances. Plainly, we are not there today. Voluntary surveys, combined with potentially imprecise methods of reporting and collecting cost data brings into question the cost data's usefulness in developing Make Allowances. A better mouse trap is needed, and it needs to be an obligatory one. In other businesses, for example Medicaid and Medicare, cost

determination methods are rigid, standardized, reporting is required, and the individuals who create and file those reports are required to be trained and certified before they are qualified to submit such reports. Not that those models necessarily represent the best of the best, but the concept of using a standard method that is consistent across the industry seems a reasonable prerequisite to having valid, comparable cost data.

We at Lone Star support NMPF's proposal to make modest increases in Make Allowances as proposed. This first step as proposed by NMPF almost assuredly does not capture the entirety of the raw milk conversion cost increases experienced by dairy product manufacturers, since the last time these rates were set in 2008, but moves us in the proper direction. This cautious step recognizes both the need to make an adjustment in Make Allowances, but is reserved enough in its magnitude so as to not jeopardize the confidence the industry has in Federal Order pricing. Additionally, this measured proposed increase in Make Allowances recognizes, and accounts for, the needs of dairy farmers to not see excessively large downward changes in the Orders' Class prices, since such large changes can themselves create market disorder.

Lone Star fully supports the Make Allowance increase provided in Proposal Number 7 as a prelude to consistent, auditable, mandatory processing cost reporting which will bring confidence in the process, and support the orderly marketing and pricing of milk.

This concludes our prepared testimony. Thank you.