January 24, 2006

Public Hearing on Changes in the Class III and IV Price Formula Manufacturing Allowances

My name is Clayton Galarneau. I am the Director of Manufactured Product Sales and Operations for Michigan Milk Producers Association (MMPA). I have been with MMPA for twenty years and I am currently responsible for the operations of two manufacturing plants located in Ovid and Constantine, Michigan. MMPA is a member owned and operated milk marketing cooperative headquartered in Novi, Michigan. MMPA has about 2,400 members supplying over 3.3 billion pounds of milk per year from about 1,865 farms, located in Michigan, Wisconsin, Indiana, and Ohio. Approximately one third of the milk marketed by MMPA is processed within our own two facilities.

MMPA's two manufacturing plants produce a variety of bulk dairy products including cream, condensed skim milk, Grade A nonfat dry milk and Grade AA bulk butter. MMPA's manufacturing plants have participated in the USDA Cooperative Service survey of costs at cooperative manufacturing plants for several years, including September 30 year-end data for the 1998 and 2004 surveys. The data from the surveys from 1998 were combined with the results of a similar survey of California instate manufactures and used as the basis for determining the make allowances for Class III and IV product formulas that have been in place since 2000.

Our manufacturing costs have increased dramatically since those cost surveys were completed for 1998 and our profit margins have suffered considerably. The attached analysis summarizes the manufacturing cost increases our plants have experienced for butter and powder from 1998 to 2004. Although our accounting department has not completed the cost analysis beyond 2004, we have been able to assemble the cost per pound information for electricity and natural gas costs (fuel costs) for fiscal 2005 and for the first fiscal quarter of 2006. These fuel costs are also included on the attached schedule.

From the baseline cost per pound figures that were established in 1998, our total powder manufacturing costs per pound were 54% higher in 2004. The increase in powder cost for one year amounted to $2.1 million of additional manufacturing costs that we were not able to recover from the marketplace. During that same period, our butter production costs per pound increased 14.3 % and reduced margins by nearly $207,000. In 2005, our fuel costs for powder and butter production increased 11.6% and 13.6% respectively,

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adding an additional $174,000 of non-recoverable costs to these figures. In the first quarter of our fiscal 2006, the fuel costs for powder and butter increased 20.7% and 6.2% respectively, depleting our bottom line by another $112,000.

Our gas costs for our manufacturing operations in 2005 were nearly $2.7 million. If gas costs continue as anticipated by recent futures market activity, we expect that our gas costs are likely to increase by nearly $1.3 million dollars for 2006. For our size of organization, that will represent a significant hit to our bottom line and unfortunately the dairy pricing mechanisms do not allow us to recover these costs. Any increases we have been able to tack on to our butter and powder prices are reported to NASS and then serve to increase the raw material cost for the milk used to make butter and powder.

In the petition for this hearing, Agri-Mark Dairy Cooperative provided several examples of the necessity to adjust the make allowances for Class III and IV product pricing formulas. MMPA has two plants that together process over a billion pounds of milk per year and we have considerable experience in the production of nonfat dry milk and butter. We agree that the make allowances should be adjusted to take into consideration the increased costs manufacturers are experiencing. Due to the significant impact these increased costs have inflicted upon our industry, we believe it is imperative that the make allowance are adjusted on an emergency basis in order to provide needed relief as soon as possible. We anticipate our plants will be experiencing maximum powder production and very high levels of butter output during this coming spring flush. MMPA has a major responsibility for balancing the milk supply in the Great Lakes area and the outlook for this spring will likely bring unavoidable losses to the butter and powder operations of our facilities.

We are aware that National Milk Producers Federation has testimony recommending changes to the make allowance formulas for Class III and IV milk prices. We support their recommendations and agree with the concept of indexing the fuel costs and adjusting the make allowance on a periodic basis to account for positive or negative changes in fuel costs.

Thank you for considering our comments.

Michigan Milk Producers Association
Changes in Production Costs

	1998	2004	2005	1st Qtr. 2006
Powder:				
Mfg. cost/lb, increase	Base	57.4%	n/a	n/a
Mfg. cost variance	Base	$2,107,466	n/a	n/a
Fuel/lb increase	Base	49.0%	11.6%	20.7%
Fuel cost variance	Base	$359,189	$138,044	$105,496
% of Capacity Utilized	30.67%	22.34%	24.44	37.4
Butter:				
Mfg. cost/lb, increase	Base	14.3%	n/a	n/a
Mfg. cost variance	Base	$206,714	n/a	n/a
Fuel/lb increase	Base	71.5%	13.6%	6.2%
Fuel cost variance	Base	$109,442	$35,953	$6,872
% of Capacity Utilized	10.09%	8.31%	8.38%	12.45%
Combined:				
Mfg. cost variance		$2,314,180	n/a	n/a
Fuel cost variance		$468,631	$173,997	$112,368