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Testimony of

Jeffrey Sims

Secretary and Chief Market Analysis Officer

Lone Star Milk Producers, Inc.

Milk in the

Appalachian, Florida, and Southeast Areas

7 CFR Parts 1005, 1006, and 1007

[Docket No. 23-J-0019; AMS-DA-23-0003]



I am Jeffrey Sims. I am the Corporate Secretary and the Chief Market Analysis Officer of Lone Star Milk Producers, Inc. Lone Star's office address is 813 8th Street, Wichita Falls, Texas, 76301. My responsibilities at Lone Star include economic analysis; assistance in the day-to-day marketing of milk; supplemental milk sales and supplemental milk procurement; Federal Order market analysis and Federal Order price forecasting; non-Federal Order milk pricing matters; as well as a host of other corporate governance and management functions. I personally have worked in the Federal Order Program, and in the dairy industry, for almost forty years.

Lone Star is a Capper-Volstead cooperative association qualified to market the milk of its members on Federal Milk Marketing Orders. We regularly market milk on the Appalachian, Southeast, Central and Southwest Orders. Approximately 75 percent of Lone Star's members would qualify as a small business. Lone Star is a member of Dairy Cooperative Marketing Association, Inc.

I am here today to testify to Lone Star's full support of DCMA's Proposals 1, 2, 3, 4, and 5. More specifically, I will testify on general marketing conditions in the Order 7 marketing area, and how the existing marketing conditions require the existence, continuation and improvement of the Federal Order's transportation credit provisions to insure a sufficient quantity of pure and wholesome milk for the marketing area.

Lone Star has considerable experience with regard to the issues before the Secretary at this hearing, in that Lone Star is both a supplemental milk supplier to the southeast, and in a way, a supplemental milk purchaser within the southeast. Lone Star on occasion sells supplemental milk to other marketers of milk in the southeast, but every year we in essence act as our own

supplemental milk supplier since we must ship distant milk from our own member milk supplies in the southwest to meet the needs of our pool distributing plant customers in the Order 7 area. Thus, we see this world from both the perspective of the shipper, and also as a procurer of supplemental milk. We see both sides of this coin.

As has been adroitly demonstrated in DCMA's main proponent testimony, farm milk production inside the Order 7 marketing area is on a severe downward trend, a trend which is unlikely to substantively reverse any time soon. Class I milk pooled on Order 7 has likewise been declining, but at a slower pace than the in-area milk production decline.

This condition has resulted in more and more milk being delivered to Order 7 distributing plants from outside the marketing area to supply the Class I needs of the Order 7 marketing area. Each year the distance milk must move to supply the area increases as Order 7 becomes shorter and shorter in its relationship of supply to demand.

Also as demonstrated in DCMA's primary testimony, the cost of milk hauling has increased markedly over the last several years, and most assuredly has increased in the decade-and-a-half since the Order 5, 6 and 7 Class I differentials were last updated.

A boots on the ground view of the supply of supplemental milk for the Order 7 area shows a preference for the geographic source of supplemental milk supplies which varies based on the location of the plants the supplemental milk serves, as one would expect. Distances milk moves, and practical limits on those distances determine, for the most part, where supplemental milk moves from and moves to. Distributing plants in the north-central portion of the Order 7 marketing area, Nashville and Murfreesboro, Tennessee, represent something of a pivot point

for the preferred and most practical sources of supplemental supplies. The Nashville and Murfreesboro plants can effectively be supplied with supplemental milk from both the north and the west. Order 7 plants located in the Atlanta, Georgia area can generally best be served from the north, likely from milk produced within the Mideast Order Number 33, but milk can, on occasion, move to these plants from the Central Order Number 32 area or from the Southwest Order area Number 126 area. More rarely, but not completely without precedent, these most northern and eastern Order 7 plants can receive milk produced within the Order 1 marketing area. Experience has taught us that there is something of a practical limit for moving milk from the west to plants east of a general north-south line which follows the Alabama-Georgia state line, and extends northward from there. For plants west of Nashville, and west of Georgia, by far the most practical sources of supplemental supply would be from the Southwest Order or the Central Order area.

This is not to say that milk never moves from the Southwest Order or Central Order areas to the Atlanta area, or even to plants further east into the Order 5 marketing area, but the general preference is to supply these eastern plants from the north when the milk is available from there.

Excepting the Nashville and Murfreesboro plants, the general preference to supply milk plants located west of the imaginary line we described would be from the west, more specifically the Texas panhandle portion of Order 126, or from the southwest Kansas portion of Order 32. Also, when supplemental milk is needed there is a general preference for the Texas milk to move into the plants located in the southwest corner of the Order 7 area, that is, the Louisiana and Mississippi plants; and a preference for the southwest Kansas milk to supply the supplemental

needs of the plants in the northwest corner of Order 7, that is, the Missouri, Arkansas and Memphis, Tennessee plants.

Currently there are fifteen pool distributing plants regulated on the Southeast Order, thirteen of which likely receive substantive quantities of supplemental milk. Of these thirteen plants, eleven are located west of the imaginary separation line we described, and two of the eleven are the Nashville and Murfreesboro plants. The remaining nine plants, even though geographically closer to the western areas of reserve supply than the other Order 7 plants, the distances the supplemental milk moves to these plants is considerable. The distance from Hereford, Texas to Hammond, Louisiana is approximately 870 miles, and the distance from Cimarron, Kansas to Little Rock, Arkansas is approximately 615 miles. These represent two reasonable examples of the common lanes used for the delivery of supplemental milk to plants on the western side of Order 7.

These large distances milk must move to meet the Order 7 handlers' needs for supplemental milk create a tremendous cost to the suppliers of the needed supplemental milk.

At current diesel fuel costs, Lone Star would expect to pay a rate for hauling milk roughly in the range of \$4.85 per loaded mile to \$5.10 per loaded mile. For the Hereford to Hammond lane, on a per hundredweight basis, the cost of hauling at the low end of the range of mileage rates stated is approximately \$8.50. The difference in the Class I differential between Hereford and Dallas, Texas - which is Order 126's base pricing zone - is \$0.60, and the difference in the Order 7 and Order 126 base zone blend prices as announced at three point five percent butterfat content, averaged about \$3.20 during 2022, exclusive of the additional loss incurred from

buying milk on Order 126's protein, butterfat, and other solids prices, and selling the milk on Order 7's skim milk and butterfat prices. So, after considering the impact of the blend price gain moving from Order 126 to Order 7, and the location value impact, again ignoring the substantial MCP to Skim-Butterfat price loss, the blend price gain is about \$3.80 per hundredweight. The nominal blend price gain covers about forty-five percent of the cost of hauling, if we can obtain hauling at the most favorable rates available. Milk hauling is certainly not immune from the economic laws of supply and demand, and as demand increases for milk hauling, like during the critical Transportation Credit Balancing Fund payment months, haul rates can spike to well higher than rates available other times of the year. For the record, the MCP to Skim/Butterfat pricing loss can approach and sometimes exceed \$1.00 per hundredweight, depending in the price of protein, and this is a very real cost which handlers and suppliers of supplemental milk must bear, and there is practically no way to avoid this component based loss.

Over the course of the currently-defined eight month Transportation Credit period, using the most recent period's mileage rate factor, the expected Order 7 Transportation Credit payment proration rates, and the now-existing 85 mile adjustment, we would expect to recoup, on average, roughly \$1.38 per hundredweight from the Transportation Credit Balancing Fund for milk movements from the Texas panhandle to south Louisiana. All in, this leaves about \$3.30 per hundredweight of the haul cost uncovered by blend price gains, considering only the 3.5 percent butterfat prices, and the Transportation Credit Balancing Fund payments. The expected Transportation Credit Balancing Fund payments represent about sixteen percent of the real cost of hauling. Making up \$3.30 of uncovered hauling cost is bad enough, but absent the Transportation Credit Balancing Fund payments, the picture is profoundly bleaker.

Even though seriously insufficient, the existence of Transportation Credit Balancing Fund payments carry one benefit that cannot be overlooked. As long as there is a Federal Order Transportation Credit Balancing Fund payment, we know we are going to collect it. Such payment reliability is not so sure when it comes to over Order charges.

The gap between the cost of hauling and the potential gain in price from moving milk from the reserve supply areas to the demand area must be paid by someone. Milk haulers can be a benevolent bunch, but they tend to balk at the idea of hauling milk across half a continent for no pay. The current Order 7 transportation credit provisions cover some of the loss, but in no manner do the transportation credits pay all of it. Any remaining costs of hauling must then be made up either from over-Order prices charged to the receiving plants, or the uncovered costs must come out of the pockets of the dairy farmers who ship the supplemental milk.

Unfortunately, the over-Order prices are rarely sufficient to cover these large differences, and dairy farmers are left to pick up the tab on the remainder. The farther the distance the milk must move, the more out-of-bed the Order blend price gains are in comparison to the real hauling costs.

When reserve milk suppliers are deciding whether to sell supplemental milk to plants in the southeastern U.S., the availability of transportation credits is a very important factor in that decision, and while currently are out of touch with the reality of milk hauling costs, and do not fill the gap between the cost of hauling and any blend price gains, they do offer some level of help in making the delivery of supplemental milk something of a more feasible proposition. Absent Federal Order transportation credit payments there are two likely outcomes: (1) the supplemental suppliers of milk would have to charge additional over-Order prices in order to

cover more of the real cost of hauling, or (2) supplemental suppliers would simply choose to keep their milk at home rather than incur a loss on shipping the milk to the southeast. Neither of these outcomes is a good one.

Even if they could be obtained, and history has shown it to be a formidable challenge, garnering additional service charges in excess of the Order-regulated prices will not necessarily be borne proportionally or equally by all handers of Class I milk. The location of the respective receiving plants and the distance the plant is to a viable supplemental milk source; plants' relative access to local supplies, and their net need for supplemental milk will drive how much additional cost each plant might bear. Differing sources of milk, differing distances the milk moves, and the proportion of a plant's total milk supply represented by supplemental milk will create plant-specific costs of milk, which likely would be very different plant-to-plant. Unequal costs of milk is a recognized source of market disorder.

Alternately, running the southeast short of milk is definitely an undesirable result, and flies in the face of the basic purpose of Federal Orders. A perpetually milk-starved southeast will lead to the inevitable loss of additional milk processing plants, and will have the unhappy impact of increasing the distances milk must move within the southeast to supply whatever processing plants remain. Choking off the supply of supplemental milk to the southeast by removing, or allowing the continued degradation of the effectiveness of the transportation credit program's financial incentives to move milk to the southeast will have a tangible deleterious impact on net returns to milk producers located within the southeast Order areas. It bears noting that virtually 100 percent of Lone Star's member farms located within the Order 7 marketing area would

qualify as small businesses, and would suffer additional costs of milk hauling in the event more milk processing plants cease operation.

An additional factor making the supply of milk challenging to the southeast is simply the loss of hauling capacity. Supply chain disruptions have made the replacement and upgrade of rolling stock difficult, for both trucks and trailers. The loss of truck drivers to more-nine-to-five hauling routes and lanes is seriously crimping the supply of milk truck drivers. Combined with the U.S.'s general shortage of drivers, rules on allowable hours for trucks to run each day have stretched the bulk milk hauling supply chain to the breaking point. None of these structural and regulatory changes impacting milk hauling are the Federal Orders' doing, and no one can expect the Orders to remedy them. However, the Order program must recognize that these very real logistical challenges exist, must recognize that the costs they create are equally real, and adapt the regulated pricing, cost recognition, and partial cost reimbursement features of the Orders in this light.

It may also inform the record of this hearing with a comment about the current state of supplemental milk agreements. Mr. Hollon's testimony mentioned that some seasonal supplemental milk agreements may include a non-receipt charge whereby the buyer can decline some of the contracted quantities of milk and pay what is colloquially known as a go-away fee. These go-away fees still exist in supplemental milk contracts, but the desire is that these provision be less frequently employed than in the past. In order to secure sufficient hauling capacity for long distance movements of milk, often today, the contracting party for the supplemental milk hauling must guarantee the hauler that a fixed number of loads per day will actually be hauled during the contract period, and guarantee the specific originations and

destination points for those supplemental milk loads. Logistically, it is difficult to adjust on a daily basis how many loads move when milk is moving very long distances. Haulers establish a truck and driver rotation over the milk movement period, and any substantive variation from that schedule results in missed or late loads. As an example, when milk must travel 850 miles, that represents thirteen to fifteen hours of actual on-the-road time, and combined with the required driver rest breaks, refueling stops, meal breaks, unloading time, and the like, that means a two-day trip, each way. So, for a supplemental milk agreement of five loads of milk per day, every day there are ten loaded trucks per day heading toward the destination, and ten empty trucks per day heading back to the supplemental milk origin point get another load. When accounting for the required driver rest days between driving assignments, to supply five loads of milk per day requires at a bare minimum of twenty trucks and likely at least twenty-five drivers. Even the smallest variation in the daily delivery schedule can disrupt logistics for several days.

However, even though there is the desire to make, and perhaps the milk sales contract calls for, shipments of an equal number of loads per day, disruptions will invariably occur. A farm may have a production hiccup that causes an interrupted flow of milk, or there are weather events that necessitate changes in hauling routes, a plant has a breakdown, or there is national holiday which slows plant receiving. These can be unforeseen issues, but nonetheless disruptive to the flow of milk. No matter how hard we try, and how much we plan, and how wonderful it is to see the same number of loads of milk leave for their destination every day, there must be additional milk available to serve as buffer supplies and reserve supplies for when these interruptions occur. This is even more true for milk produced within the southeast, since

virtually the entire reserves for those supplies reside outside the marketing areas. The Orders' diversion privilege is a necessary element in the obtaining a sufficient supply of milk, so that the needed reserve supplies are available when called on.

The Federal Orders need transportation credits to facilitate the ready and orderly flow of supplemental milk into the Order 5 and Order 7 marketing areas. The Secretary must update the Orders' current transportation credit provisions to better reflect the real cost of shipping distant milk into these marketing areas, and the Secretary must increase the transportation credit assessments to fund these needed higher transportation credit payments.

Proposals 1. and 2. will do exactly that, and maintain the structured and orderly regulated pricing of milk between competing handlers. Consumers of milk will benefit from the unimpeded and orderly flow of milk into the region, and regulated processors of Class I milk will benefit from the continued surety of a milk supply and the orderly pricing of milk. Absent a properly functioning Federal Order transportation credit system, the supply of milk to the region is unquestionably threatened. The conditions we have described surpass an emergency; the marketing areas are in a milk supply crisis.

As has been demonstrated for milk moving into the southeast from areas outside the marketing areas, likewise, the Class I differential surface is woefully inadequate to compensate dairy farmers for moving their milk within the Orders 5, 6 and 7 marketing areas. The Class I differential surface within the three southeastern marketing areas has been updated once since Order Reform in the year 2000, while the rest of the country languishes under a differential price surface that is based on hauling costs a quarter of a century old. Even though slightly

more recently updated, the differential surface in the southeast in no way represents the real cost of moving milk within the marketing areas. DCMA's proposals 3, 4 and 5 address this urgent need, and will provide needed financial incentives to move producer milk produced within the marketing areas, or produced nearby, to pool distributing plants in the three Orders. Just as the supply of supplemental milk from outside the marketing areas is threatened if additional regulated funds are not made available to encourage its movement, dairy farmers inside the marketing areas will cease to be willing to supply distant plants if their financial return for that needed service, a service of marketwide benefit, fails to compensate them fairly.

Lone Star Milk Producers, Inc. supports Proposals 1, 2, 3, 4, and 5, and urges the Secretary's issuance of a decision on the shortest time frame possible.

Thank you for the opportunity to present this testimony.