Mike Durkin, President & CEO, Leprino Foods Company
Testimony for
"The Immediate Challenges to our Nation's Food Supply Chain"
House Committee on Agriculture
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Good morning, Chairman Scott, Ranking Member Thompson and members of the House Committee on Agriculture. My name is Mike Durkin. I am President and CEO of Leprino Foods Company and I'm here to testify on behalf of the dairy industry and our company. Leprino Foods, a family-owned and privately held company, is headquartered in Denver, Colorado and has over 4,500 employees in the U.S. in six states including California, Colorado, New Mexico, Michigan, Pennsylvania, and New York. Leprino is the largest purchaser of milk in the United States supporting over 1,000 dairy farms. We are the world's largest producer of mozzarella cheese, and a leading supplier of dairy nutrition products, including lactose and whey.

The supply chain challenges have significantly impacted our business, and we don't expect them to ease anytime soon. I'm here to talk about a critical component of this disruption that has not received as much attention – exports. America cannot ignore the impact this crisis is having on U.S. exports.

Exports are critical to the overall financial health of the entire U.S. agriculture sector, and in our case, the U.S. dairy industry. Leprino exports 26% of our milk equivalent volume to over 55 countries, well-above the industry average of 16%. I'm here to share our story and call on you for solutions across all aspects of the supply chain – including exports – because this is a threat to U.S. agriculture. The West Coast port disruptions of 2015 pale in both magnitude and duration when compared to those of the current crisis (see chart).

10/04/2021 – Los Angeles/ Long Beach Congestion: 2015 vs. 2020-21

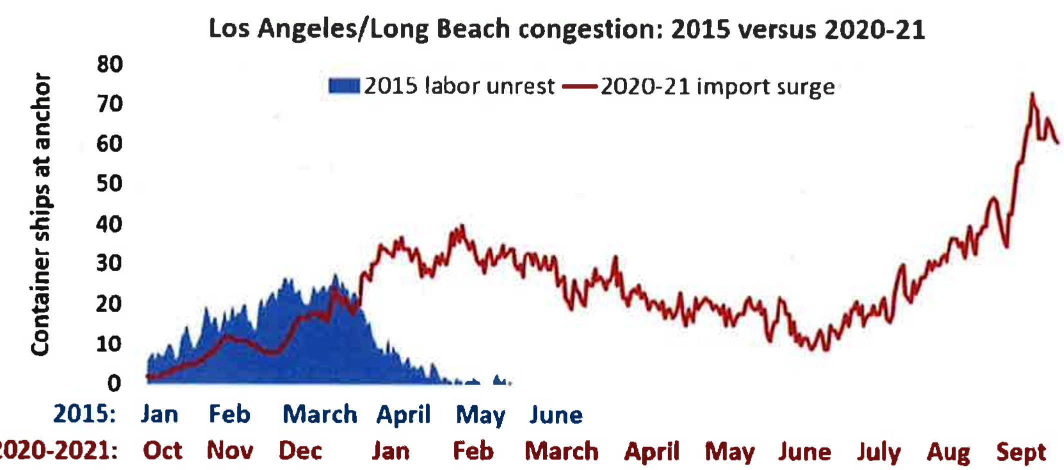
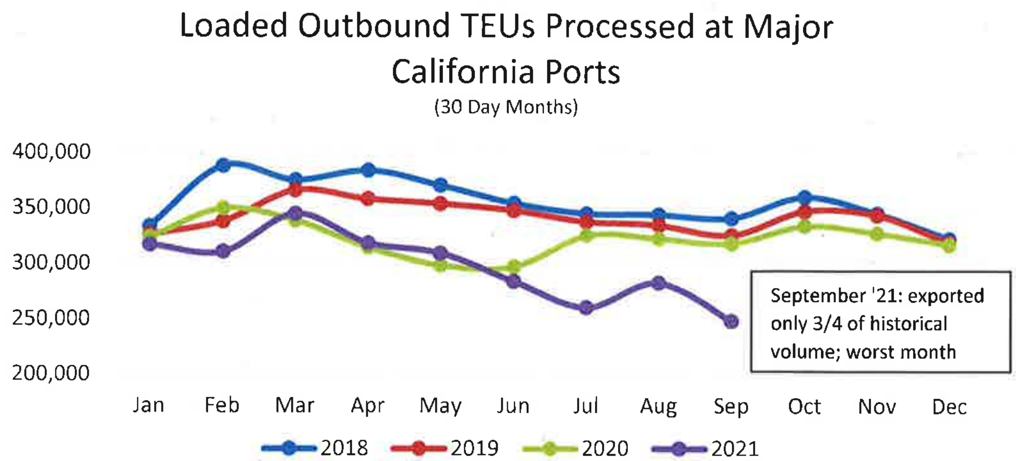


Chart: American Shipper based on data from Marine Exchange of Southern California

Source – American Shipper/ based on data from Marinr Exchange of Southern California

Freight rates from Asia to the U.S. West Coast are currently 15 times higher than freight rates from the U.S. to Asia, so there is now a clear financial incentive for ships to depart U.S. ports empty – with no U.S. goods on-board – versus waiting to be loaded. As a result, shipping companies are refusing to load U.S.

agricultural exports, and over 70% of containers are returning to Asia empty. In September alone, volume from California ports was just three-quarters of normal export volume (see chart).



Source: Ports of LA, Long Beach, Oakland

This seems to be working well for carriers. We've been told it is more cost effective to skip the Port of Oakland (one of our primary export ports) than to accept exports, and at least one carrier has reported record-breaking financial performance. U.S. agricultural exporters, however, are in crisis.

Here is what Leprino has been facing:

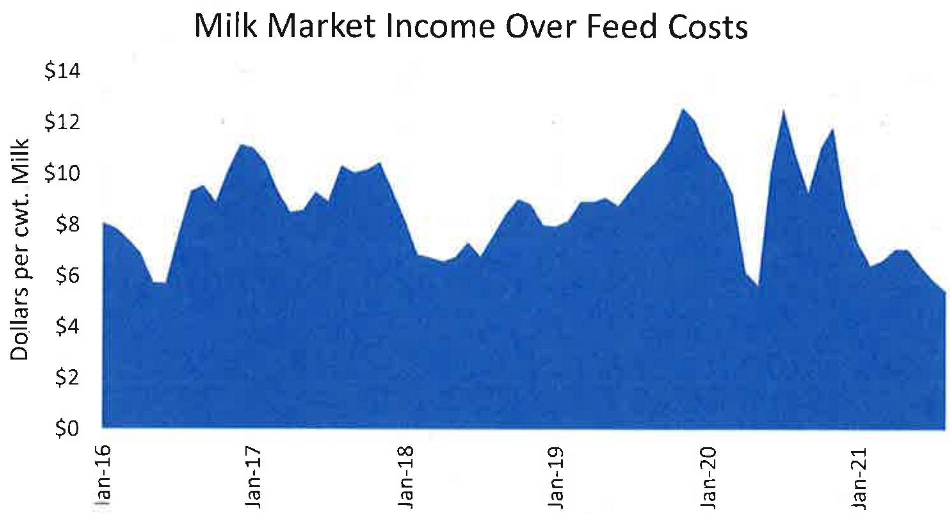
- Over 99% of our 2021 ocean shipments have been cancelled and re-booked for a later date at least once, if not twice, and in some cases up to 10 times or more.
- Over 100 bookings this year have been cancelled and re-booked 17 times. This equates to a 5-month delay for customers who depend on our products, including infant formula ingredients necessary to feed millions of babies around the world.
- We have been forced to hold loaded containers in carrier yards, using equipment already in short supply.

These delays not only put our customers at risk, but we have also experienced unprecedented increases in freight, storage, and demurrage fees. One freight bill of $5,472 was dwarfed by detention and demurrage fees of more than $20,000. In total, these costs have spiked $25 million in 2021 and we currently anticipate a similar $25 million impact in 2022.

While some believe this issue will resolve itself, this export crisis may well result in irreparable harm to American agriculture as customers around the world are questioning the U.S. dairy industry's reliability as a supplier. For example, one of our biggest nutrition customers recently informed us they now source from Europe due to shipping delays. These relationships take years to develop and will not be quickly or easily regained and the U.S. dairy industry cannot stay competitive with expensive and unreliable freight practices in markets where we are already fighting for market share because of tariff disadvantages.

These export challenges cascade through the supply chain. The loss of foreign sales pushes more product onto the U.S. market, which pressures wholesale product prices and ultimately farm milk prices.

This is no doubt contributing to the extended period of weak dairy farm margins (see chart). In response, the dairy herd is now contracting at its fastest rate since 2009.



Source: USDA

The bi-partisan Ocean Shipping Reform Act of 2021 begins to address the problem. This bill will prohibit the opportunistic carrier practice of sailing to Asia empty when U.S. agricultural exports await shipment. It has bipartisan co-sponsorship which is growing and should be passed and signed into law.

That bill is a good start, but so much more is needed.

For example, most major ports around the world routinely operate 24/7. Only recently did the Administration and certain U.S. ports agree to begin doing so temporarily. Given labor shortages and required training, however, this action is unlikely to provide any relief for at least 6 months. In addition to prohibiting foreign carriers from leaving the U. S. empty, the Administration and Congress must work together to provide all our major ports and port workers with the infrastructure and environment to operate and meet demand. That is crucial.

I urge all Members on this committee to work together to allow U.S. agriculture and our exports to thrive.

Thank you for the opportunity to share the exporter perspective.

The remainder of this written testimony was prepared by our respected industry partner, the International Dairy Foods Association. On behalf of the entire U.S. dairy industry, I ask that you consider these important additions that reach beyond the scope and time allotted for my oral testimony.

Supply chain issues have become an increasing headwind for food and agriculture over the past year and a half. Demand for dairy goods is near an all-time high, yet inputs and reliable transportation are harder and harder to come by in a timely manner while the labor market will likely remain strained for months. Our industry has shown itself to be resilient and we will continue to work hard to make sure all Americans continue to have access to affordable, nutritious, and healthy dairy foods. We are working together as an industry to ensure these products remain readily available during periods of rising demand, such as the approaching holiday season.

The International Dairy Foods Association (IDFA) represents the nation's dairy manufacturing and marketing industry, which supports more than 3.3 million jobs that generate $41.6 billion in direct wages and $753 billion in overall economic impact. IDFA's diverse membership ranges from multinational organizations to single-plant companies, from dairy companies and cooperatives to food retailers and suppliers, all on the cutting edge of innovation and sustainable business practices. Together, they represent 90 percent of the milk, cheese, ice cream, yogurt and cultured products, and dairy ingredients produced and marketed in the United States and sold throughout the world. Delicious, safe and nutritious, dairy foods offer unparalleled health and consumer benefits to people of all ages.

Our testimony will focus on supply chain challenges facing dairy companies, both in terms of our domestic operations as well as the problems processors are currently encountering in exporting our products overseas.

Farm to Table Supply Chain Challenges for U.S. Dairy

All members of our industry face similar problems impacting our domestic supply chains, including labor shortages, limiting production and difficulty moving products all the way through to the consumer, along with steadily increasingly costs for procuring inputs for our products. Supply chain pressures have persisted for so many months and at so many levels that every aspect of the dairy business now is impacted, creating a high level of uncertainty from farm to table. In our industry, the last thing we want is to be unreliable suppliers to our customers which will make us unprofitable and unable to compete globally as an industry.

Unfortunately, the reality of today's supply chain means that producing dairy products in the United States has gone from complex to difficult, and already thin margins have become razor thin. There are pain points at every link in the domestic dairy supply chain impacting all parts of the industry. Here are a few examples:

- Equipment and Ingredients: Whether ingredients are imported or domestically produced, prices have increased, and availability has significantly tightened. In some cases, our industry is having to find new supply altogether and ships cannot reliably get terminal appointments to offload imports while trucks sit empty at facilities awaiting drivers to distribute ingredients. Importantly, this is true for equipment and supplies necessary to manufacture, such as protective clothing for employees, not just ingredients.

- Product Manufacturing: As demand has increased for dairy products, many companies have expanded operations and invested in new facilities. However, because of these growing supply chain issues, we cannot find enough workers to fully operate even previously existing facilities, leading to lost shifts or running fewer product lines and making fewer products, which puts greater strain on the entire food system.

- Packaging and Storage: Packaging and storing our products has become difficult as the resins and glues required to seal our packaged goods are in short supply and prices have significantly increased. Even wood pallets, which are used for storing and sorting products for distribution, have doubled or tripled in cost. Our industry is scouring the globe for supplies while prices rise and availability shrinks, further impacting our members' bottom lines.

- Distribution: We're facing a major crisis in transportation: a major truck driver shortage and now the beginning of a truck shortage due to a lack of computer chips. Our members are providing attractive incentives to drivers, but there are only so many truck drivers and they are limited in the number of hours they can drive and the weight they can haul.

- Customers: Our customers expect the same high quality, business reliability, and consistency from our members that they've always known. Dairy companies are working to solve problems behind the scenes to deliver on time, but it's getting increasingly difficult to meet those demands, and due to the problems encountered in manufacturing, processors have fewer products to allocate to customers. In many cases, dairy companies may have contractual obligations to make deliveries, which adds another layer of distress that reverberates through our supply chain.

There are many other examples that are equally well documented—such as the increasingly empty shelves at grocery stores, missed milk deliveries at schools, or restaurants trimming their menus—but the story is consistent and worsening across our supply chain.

Not even considering foreign markets, the above start-to-finish domestic supply chain story is a constant struggle for U.S. dairy and agriculture across the board. Altogether, without accounting for significantly increased labor costs, procurement prices alone are up between 20-30% for most U.S. dairy businesses. This level of inflation is neither something processors are willing nor able to pass on to consumers nor realistic to maintain a profit margin. In sharing all these examples, our goal is to provide each member of this Committee with a clear view of the many challenges dairy processors are experiencing. These supply chain issues are severe and eroding our ability to compete. Our supply chains are stretched beyond anything we have ever experienced, and urgent action is required.

Importance of Trade to the U.S. Dairy Industry

Considering the current domestic supply chain environment, the obvious question might be, why bother trying to export? In the United States, approximately one day's worth of U.S. milk production each week goes to exports, which results in approximately $6.5 billion in U.S. dairy products being exported to over 133 countries around the world every year. Recent estimates show that the United States now exports more dairy production than we consume in fluid milk products at home. There has never been a time when trade was more important to the U.S. dairy industry than it is today.

Companies and cooperatives in the U.S. dairy exporting community are committed to doing as much as possible with as few resources as possible to support our long-term global business relationships and maintain our presence in global markets. We recognize that once lost, our market share will quickly go to competitors in producing countries such as those in Europe or New Zealand and is unlikely to be regained given their preferential tariffs compared to ours.

But the value of trade to U.S. dairy is less in what we have built and more in what we are building. Looking ahead, with continually rising production, we believe that opportunities to share in global markets abound if we can create a supply chain to service them. Given the abundant resources and tremendous ingenuity and efficiency of American agriculture, USDA predicts an additional 25 billion pounds of milk will be produced in the United States by 2030. Based on current consumption trends, we would need to export 40% of that increase in production for dairy farming and processing to remain economically viable. If we do not build our globally competitive market access now through reduced tariffs, competitive prices, and consistent shipping, our farmers will be unable to grow. There is hardly a more critical priority for the U.S. dairy industry than trade.

The Export Challenge

Unfortunately, international business has now become a significant challenge and liability as dairy manufacturers struggle to find ways to export products. At any given time in recent weeks, between 70-90 cargo ships are anchored outside the ports of Los Angeles and Long Beach, waiting to unload thousands of containers. Once unloaded, many of these ships are finding it more profitable to turn around and depart for Asia empty rather than wait to reload U.S. agricultural exports, resulting in a backlog of products waiting to be exported. Industry coalition data estimates an average of 22% of U.S. agricultural foreign sales are currently unable to be fulfilled due to shipping rates, ships departing without export cargo, and other detention/demurrage challenges.

With supply chain pressures, the U.S. dairy industry is losing its global competitiveness as exporters are grasping at any opportunities to maintain relationships with buyers and trading partners. As previously mentioned, many customers require their suppliers to enter into contracts, and many of those contracts include clauses that stipulate a product's remaining shelf life after delivery, the length of time a supplier may be the supplier of choice for that customer, and the expected level of products to be delivered over the course of the contract. Unforeseen ripples in the supply chain would be expected and manageable under normal circumstances, but when shippers are unable to obtain container space for export for multiple weeks or even months, many customers rightly evaluate their contracts. Although it's no fault of any manufacturer, the current supply chain challenges are not the fault of the customers either. Regardless, the liability for each is enormous.

U.S. dairy processors take their sales commitments seriously and as such have been evaluating every option to meet the terms of global contracts, but the export shipping crisis has made performance impossible on a consistent basis. Exporters are begging to borrow container space on outbound vessels or are losing money on products due to freight surcharges but doing so anyway to preserve a global contract. We hear reports of rail cars sitting on sidings for weeks due to a lack of other options, while shippers have tried to reroute their entire distribution chains to access new ports for export. Air freight has become one of the only reliable, albeit extremely costly, delivery tools. Additionally, U.S. importers, who have very publicly struggled to find import shipping capacity, have started leasing their own vessels, which has even further decreased the available carrier supply for exports. Surely, we can – and must – find a better, more efficient way of servicing global customers.

Brainstorming a Better Way

Across U.S. dairy we recognize that these problems are complex and will likely require a variety of solutions. We also recognize that many solutions may not be quick fixes. As a business community, we must collaboratively brainstorm with Congress and the Administration to develop ways to improve the current situation, share information, and ultimately solve these problems. IDFA supports Congress taking the following steps to benefit U.S. dairy's supply chain:

- **Pass the Ocean Shipping Reform Act of 2021 (H.R. 4996)**: Congress should pass the Ocean Shipping Reform Act of 2021 which would address unreasonable detention and demurrage charges, export cargo bookings, and other carrier practices that are currently hurting U.S. agricultural exporters.

- **Pass the Infrastructure Investment and Jobs Act (H.R. 3684)**: The current bipartisan infrastructure bill includes a provision that would help address the current shortage of commercial truck drivers. Specifically, the bill establishes a pilot apprenticeship program to train 18- to 20-year-old qualified commercial driver's license (CDL) drivers to operate vehicles in interstate commerce. Not being able to travel across state lines for drivers in this age range is one of the single biggest obstacles to having enough truck drivers. This is despite the fact that 49 states already allow 18-year-olds with a CDL to drive within their borders.

- **Increase Truck Weight Limits**: Congress should pass legislation to increase the gross vehicle weight limits for trucks that travel on federal highways from the current 80,000 pounds to 91,000 pounds with an additional sixth axle. This configuration complies with the federal bridge formula and is shown to have better braking capacity than 80,000-lb., five-axle trucks. This adjustment would allow manufacturers to transport products more efficiently while also reducing industry's carbon footprint.

In addition, here are some additional ideas we've been discussing within our industry:

- **Empty Containers for Exports**: Whether seeking additional generalized trade commitments by reopening the World Trade Organization's Trade Facilitation Agreement, or by seeking a structure of financial incentives for filling outbound containers (or disincentives for not doing so), or by establishing a code of practice on filling containers to minimum levels when goods are available, all options need to be considered to resolve the crisis of carriers exporting such high quantities of empty containers when a backlog of agricultural exports are waiting to be shipped. Beyond the economic impacts, this current practice of shipping excessive volumes of empty containers creates unnecessary carbon emissions, as well.

- **Provide Supply Chain Transparency**: Establish one or more additional advisory committees of industry representatives devoted to shedding light on problems in the supply chain to the Administration on a real-time basis before pain points become crises.

- **Discuss Options to Prioritize Perishable Goods:** It is not uncommon to give preference to perishable goods in trade scenarios; for example, the U.S.-Mexico-Canada Agreement has provisions built into its Chapter on Sanitary and Phytosanitary Measures that allow for expedited import check procedures for perishable goods. Similar provisions could be applied to loading goods for export.

- **Consider Threshold for Emergency Protocol for Servicing Exports/Imports:** Following the example of the Jones Act, consider whether emergency situations exist (e.g. food security, national security) which require temporary/provisional or permanent authorities that require carriers servicing U.S. ports to prioritize offloading or accepting certain goods for import or export, respectively.

- **Designate Responsibility for Supply Chains in USTR:** Direct the Office of the U.S. Trade Representative to immediately engage in supply chain matters, both domestically and abroad, which are impacting U.S. agricultural exporters, with a view of, for example, developing improved and enhanced trade facilitation text commitments in the future or monitoring state-owned shipping actions by China.

- **Review the U.S. Oversight of the Supply Chain**: The Federal Maritime Commission (FMC) has limited authority over ocean vessels and has moved slowly to address some of these challenges. At the same time rumors of new offices or agencies exist. Before changing existing federal authorities, consider directing the Government Accountability Office (GAO) to determine whether additional authorities, new roles, or less federal intervention is needed to support the resilience of the U.S. supply chain for U.S. agricultural exporters.

Conclusion

Chairman Scott, Ranking Member Thompson, and Members, the time for solutions is urgently upon us. As a dairy industry, we take pride in feeding global communities with nutritious and delicious dairy products, but we cannot continue to do so in the current environment. We request immediate attention to this significant escalating challenge. Here, we have suggested actions that can be taken today to address and improve our supply chains and offered longer-term solutions that require action by Congress and the Administration. Thank you for considering our views as part of today's hearing.