

UNITED STATES DEPARTMENT OF AGRICULTURE
BEFORE THE SECRETARY OF AGRICULTURE

In re:) [AO]
) Docket No. 15-0071
)
Milk in California)
)
_____)

VOLUME XXXI
TRANSCRIPT OF PROCEEDINGS
November 5, 2015

Myra A. Pish, CSR No. 11613

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BEFORE U.S. ADMINISTRATIVE LAW JUDGE
JILL S. CLIFTON

Thursday, November 5, 2015

9:00 a.m.

Clovis Veterans Memorial District
808 4th Street
Clovis, California 93613

TRANSCRIPT OF PROCEEDINGS

VOLUME XXXI

Reported by:
Myra A. Pish CSR
Certificate No. 11613

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 LAUREN BECKER, ESQ.

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 6 AGRICULTURE: Product Marketing Specialist
 LAUREL MAY, Marketing Specialist
 MEREDITH FRISIUS, Marketing Specialist

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 9 INC., DAIRY FARMERS BY: MARVIN BESHORE, ESQ.
 OF AMERICA, INC., Hanson Bridgett, San Francisco
 LAND O'LAKES, INC.: BY: JOHN VLAHOS, ESQ.

10 DAIRY INSTITUTE OF Davis Wright Tremaine
 11 CALIFORNIA: BY: CHIP ENGLISH, ESQ.
 ASHLEY VULIN, ESQ.

12 LEPRINO FOODS: SUE TAYLOR, Vice-President
 Dairy Economics and Policy

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14 DEAN FOODS COMPANY: ROB BLAUFUSS

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16 HILMAR CHEESE JOHN VETNE
 COMPANY: JAMES DeJONG

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19 SELECT MILK PRODUCERS: MILTNER LAW FIRM, INC.
 20 BY: RYAN MILTNER, ESQ.
 KRISTINE REED, ESQ.

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I N D E X - V O L U M E 31

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1 THURSDAY, NOVEMBER 5, 2015 - - MORNING SESSION

2 JUDGE CLIFTON: We are back on record on November 5, 2015.
3 It's a Thursday. It's approximately 9:00 in the morning. This
4 is Day 31 of the milk hearing. We are in Clovis, California.

5 My name is Jill Clifton. I'm the Administrative Law
6 Judge who has been assigned to take in the evidence of this
7 hearing. I would like now to take the appearances of my fellow
8 USDA employees, and then following them, the appearances of the
9 other participants, including first, teams for proponents and
10 opponents.

11 MS. MAY: Good morning. I am Laurel May with USDA AMS
12 Dairy Program, Marketing Specialist in the Rule Writing
13 division.

14 MS. TAYLOR: Good morning, Erin Taylor, Marketing
15 Specialist with AMS Dairy Program.

16 MR. CARMAN: Good morning, Clifford Carman, C-A-R-M-A-N,
17 Assistant to the Deputy Administrator Dairy Programs,
18 Agriculture Marketing Service, U.S. Department of Agriculture.

19 MS. FRISIUS: Good morning, Happy Thursday. This is
20 Meredith Frisius, F-R-I-S-I-U-S, I'm with USDA AMS Dairy
21 Programs as a Dairy Marketing Specialist.

22 MS. BECKER: Good morning, Lauren Becker, B-E-C-K-E-R, I'm
23 an Attorney in the Office of the General Counsel for USDA.

24 MR. HILL: Good morning, Brian Hill, B-R-I-A-N, H-I-L-L, an
25 Attorney with the Office of the General Counsel.

1 MR. SWENSON: Good morning, Virgil Swenson, V-I-R-G-I-L,
2 S-W-E-N-S-O-N, Assistant Market Administrator with the Central
3 Federal Order in Kansas City, and on detail with AMS Dairy
4 Program.

5 MR. SCHAEFER: Henry Schaefer, H-E-N-R-Y, S-C-H-A-E-F-E-R,
6 Agricultural Economist for the Upper Midwest Milk Marketing
7 Order Federal Order 30, on detail to USDA Dairy Programs.

8 MR. BESHORE: Good morning, Marvin Beshore, M-A-R-V-I-N,
9 B-E-S-H-O-R-E, Attorney for the Proponents of Proposal
10 Number 1, California Dairies, Inc., Dairy Farmers of America,
11 Inc., and Land O'Lakes, Inc.

12 MR. VLAHOS: Good morning, John Vlahos, J-O-H-N,
13 V-L-A-H-O-S, of the law firm of Hanson Bridgett, H-A-N-S-O-N,
14 B-R-I-D-G-E-T-T, San Francisco, co-counsel for the Cooperative
15 Proponents of Proposal 1.

16 DR. ERBA: Good morning, Eric Erba, California Dairies,
17 E-R-I-C, E-R-B-A.

18 MR. WEGNER: Good morning, Thomas Wegner with Land O'Lakes,
19 T-H-O-M-A-S, W-E-G-N-E-R.

20 MR. JABLONSKI: Gary Jablonski, G-A-R-Y, J-A-B-L-O-N-S-K-I,
21 Consultant with the Proponents of Proposal 1.

22 MR. ENGLISH: Good morning, your Honor, my name is
23 Chip English, C-H-I-P, E-N-G-L-I-S-H, I'm an Attorney with the
24 law firm of Davis, Wright, Tremaine with a law firm office in
25 Washington DC. I'm here on behalf of Proponents of Proposal

1 Number 2, the Dairy Institute of California.

2 MS. VULIN: Ashley Vulin, A-S-H-L-E-Y, V -- as in Victor --
3 U-L-I-N, also an attorney with Davis, Wright, Tremaine with my
4 principle office in Portland, Oregon -- I don't think I have
5 shared that yet. Also at attorney representing the
6 Dairy Institute of California.

7 MR. BLAUFUSS: Good morning, Rob Blaufuss, B-L-A-U-F-U-S-S,
8 with the Dean Foods Company.

9 MR. DeJONG: James DeJong. D-e, J-O-N-G, Dairy Policy
10 Economic Analyst for Hilmar Cheese, dairy farmer-owned
11 manufacturer of cheese, whey, and milk powders.

12 MR. KLUESNER: Good morning, Steve Kluesner, S-T-E-V-E,
13 K-L-U-E-S-N-E-R, with Nestle North American Procurement.

14 MR. ZOLIN: Alan Zolin, A-L-A-N, Z-O-L-I-N, representative
15 for Hilmar Cheese.

16 MR. VETNE: John Vetne, also a representative for Hilmar
17 Cheese.

18 MS. TAYLOR: Sue Taylor with Leprino Foods, L-E-P-R-I-N-O.

19 MR. RAMIREZ: Miguel Ramirez, R-A-M-I-R-E-Z, with Leprino
20 Food in Denver, Colorado.

21 MS. HANCOCK: Nicole Hancock with Stoel Rives, representing
22 the California Producer Handlers Association and Ponderosa
23 Dairy.

24 MR. VU: Good morning, Bao Vu, B -- as in boy -- A-O, last
25 name is Vu, V -- as in Victor -- U, with the law firm Stoel

1 Rives, and we represent the California Producer Handlers
2 Association and Ponderosa Dairy. Thanks.

3 MR. VANDENHEUVEL: Good morning, Rob Vandenheuvel,
4 V-A-N-D-E-N-H-E-U-V-E-L, here on behalf of Milk Producers
5 Council.

6 MR. MILTNER: Ryan Miltner, good morning, Ryan Miltner
7 M-I-L-T-N-E-R, counsel for Select Milk Producers.

8 MS. REED: Good morning, Kristine Reed, K-R-I-S-T-I-N-E,
9 R-E-E-D, co-counsel for Select.

10 JUDGE CLIFTON: Is there anyone else who has not yet come
11 to the podium who would like to be identified? Not yet. I
12 would like now to go on to announcements and preliminary
13 matters.

14 MS. MAY: Good morning. Laurel May with USDA. My
15 colleagues and I welcome you to this session of our hearing to
16 consider a Federal Milk Marketing Order for California, and
17 welcome you to participate by witnessing or by asking questions
18 of any witness that you would like to do so.

19 We are broadcasting, as you know, via live audio feed,
20 which is accessible at www.ams.usda.gov/live, and the court
21 reporter continues to take official transcripts of this hearing
22 which will be available approximately two weeks at the end,
23 after the end of each hearing week on the AMS dairy website.

24 We do have copies of some of the our exhibits in the
25 back of the room in those file boxes, and they are filed by

1 number, so if you would like to look at some of those, you are
2 welcome to.

3 Just to remind you of what our plans are, after
4 tomorrow we will move this hearing to the Piccadilly Inn at the
5 Airport, and that is located at the Northwest corner of Peach
6 and McKinley Avenues, it's kind of behind the Shell station and
7 there's a bunch of pine trees out there so you can't exactly
8 see the hotel right from the corner, but if you drive either
9 direction on one of those roads, you will see it.

10 And then Judge Clifton asked me to remind you that the
11 following week, if the hearing is still in session, we will be
12 moving to the Falls Event Center, which is at 4105 West
13 Figarden. And the way you get to that is by going straight
14 west on Bullard Avenue, and after you cross Marks, this is, you
15 know, like ten miles down there, you cross Marks and the
16 Bullard will begin to kind of loop to your left, kind of to the
17 south, and that becomes Figarden, we call it the Fig Garden
18 Loop, I think it is Figarden Drive is the actual name of it.
19 And just after Brawley, the Event Center is on your left and
20 there's plenty of parking behind the Event Center. But we will
21 continue to meet at 9:00 in the morning at both locations.

22 Yesterday when we ended we had Mr. Paris from
23 Joseph Gallo on the stand. I believe we were done with his
24 cross-examination. This morning I understand that
25 Ms. Sue Taylor from Leprino will be taking the stand, and then

1 depending on how things go, Mr. Kluesner from Nestle, and then
2 it will be up to -- we'll see what happens after that, that's
3 where I'll leave that.

4 JUDGE CLIFTON: Thank you so much. Mr. English?

5 MR. ENGLISH: Good morning, again, your Honor.
6 Chip English. So where we're going today, and this is a little
7 bit of a modification from yesterday and having talked to
8 people, apparently I was overly optimistic anyway, according to
9 the people. So we are going to start, as predicated or
10 predicted yesterday with Sue Taylor, what I have been calling
11 Part 2. And to make that clear, this is going to be pricing
12 and impacts on Leprino, and the pricing impacts on the pool
13 will be separate, and that's what I call Part 3.

14 As I said yesterday, Nestle, Steve Kluesner, will come
15 next, and that order was what I predicted yesterday. And then
16 I said after that it's a little bit up for grabs and it has
17 changed. So after Nestle and Steve Kluesner, and recognizing I
18 believe that there may be a dairy farmer at some point today,
19 we would turn to one of two things next, and the order depends
20 on production issues for one, and post-production issues for
21 another. And that is Zolin, Part 6, on Section 9(d), the
22 proprietary bulk tank handler provision; and Rob Blaufuss,
23 Part 4, on fortification. And that really is all we're going
24 to have ready today, and I have already informed all the
25 participants of that. That is to say that Sue Taylor, Part 3,

1 the pricing impacts on the pool, will go tomorrow, and
2 Dr. Schiek on quota will go tomorrow. I guess I should say
3 that depending on the drafting of regulatory language, which
4 appears to fall to one person, it could be that Mr. Zolin gets
5 on today with Part 7, the modifications to Section 7(c), but
6 that just, the language isn't drafted yet, and that person's a
7 little busy.

8 Thanks, Mr. Hollon. Oh, by the way, you didn't enter
9 your appearance yet.

10 JUDGE CLIFTON: I don't know whether he comes in just two
11 minutes late on purpose to avoid the parade, I'm not sure. He
12 does it consistently.

13 MR. ENGLISH: I might have been thinking something along
14 those lines, your Honor.

15 MR. BESHORE: He has a day job.

16 MR. ENGLISH: So do we all. Anyway, my view of this is
17 that if we had a shorter day tomorrow, you know, it's going to
18 wash out. And while we prefer to have a shorter day on a
19 Friday, I think that the reality is the quota and the
20 Sue Taylor, Part 3, are going to go tomorrow and I appreciate
21 everybody's indulgence. And we really are working very hard to
22 get all this done.

23 JUDGE CLIFTON: Those who are here know how hard it is to
24 be ready for each days' hearing. And you may think that we are
25 doddling along, going 9:00 to 5:00, and taking lunch, and

1 breaks, but it is amazing how much work has gotten done. And
2 of course, it has to get done outside the 9:00 to 5:00 hours.
3 I really appreciate very much how hard all of you are working.

4 MR. ENGLISH: Thank you, your Honor. And that's absolutely
5 true. Thank you.

6 JUDGE CLIFTON: My addition to the announcements is that
7 tomorrow is casual Friday. Please make sure you wear very
8 comfortable clothes, whatever you would like. I emphasize
9 shoes, make sure you wear your favorite footwear. All right.

10 And the docket number by which the Hearing Clerk in the
11 United States Department of Agriculture knows this case is in
12 brackets [A0] docket number 15-0071.

13 All right. Any other preliminary matters or
14 announcements? There is a little noise because they are
15 cooking right behind us, and I hope you all had breakfast.
16 Smells really good.

17 All right. I see nothing further, so we'll call the
18 first witness. Ms. Taylor, you may come to the stand.
19 Ms. Frisius, will this exhibit be Exhibit 135?

20 MS. FRISIUS: It will be.

21 JUDGE CLIFTON: I am marking my copy as Exhibit 135. 135.
22 (Thereafter, Exhibit Number 135, was
23 marked for identification.)

24 JUDGE CLIFTON: And Ms. Taylor, I'll swear you in in a
25 seated position -- well, you remain sworn. Would you again

1 state and spell your name.

2 MS. TAYLOR: Certainly. Sue Taylor, S-U-E, T-A-Y-L-O-R.

3 JUDGE CLIFTON: Thank you. Ms. Vulin, if you will identify
4 yourself and then you may proceed.

5 MS. VULIN: Ashley Vulin for the Dairy Institute of
6 California.

7 DIRECT EXAMINATION

8 BY MS. VULIN:

9 Q. Thank you, Ms. Taylor, for joining us again. I would
10 ask that you begin reading your written statement into the
11 record.

12 A. Thank you.

13 I'm Sue Taylor, Vice President of Dairy Economics and
14 Policy for Leprino Foods Company ("Leprino"), headquartered in
15 Denver, Colorado. I previously testified at this hearing so
16 will forego the company and personal background.

17 Position

18 Leprino supports the adoption of Proposal Number 2,
19 developed by Dairy Institute of California, if USDA
20 ("Department") promulgates a Federal Milk Marketing Order that
21 includes California. I previously testified in support of
22 Dairy Institute's proposal regarding pool plant definitions and
23 in opposition to the pool plant definition found in
24 Section 10 -- gosh -- it should be 51 rather than 50, carried
25 that one over from the original co-op petition .7.

1 JUDGE CLIFTON: Now, let me stop you. Do you have it,
2 Ms. Frisius? All right. And now read the section number again
3 in its entirety, please, Ms. Taylor.

4 MS. TAYLOR: It would be Section 1051.7(c) of the
5 Cooperatives' proposal, Proposal 1.

6 My testimony today will focus more broadly on regulated
7 milk price policy and specifically in support of Dairy
8 Institute's Class III price proposal (Proposal 2) and in
9 opposition to the Class III price proposal found in Proposal 1.

10 JUDGE CLIFTON: Now, I want to ask if the volume is loud
11 enough in the back. It's good. Excellent. Thank you.
12 You may continue.

13 MS. TAYLOR: Thank you.
14 Today's Dairy Industry Context

15 In today's domestic and international environments, it
16 is more critical than ever that the minimum regulated milk
17 pricing system influence be minimized. Competition across the
18 entire food complex for "share of stomach" is very high.
19 Whether innovating a new dairy product or seeking dairy space
20 as an ingredient in the development of a new innovative food,
21 it is important that dairy demand not be constrained by overly
22 burdensome price regulations.

23 The USDA dairy industry is increasingly integrated with
24 global dairy markets. U.S. exports were minimal in the
25 mid-90's before the Uruguay round of the WTO introduced

1 disciplines that led to growth and developing economies and
2 rising global prices for dairy. Over 15 percent of US dairy
3 milk solids are now exported in the form of various dairy
4 products. Leprino and many other manufacturers, along with
5 producers through their check-off dollars, have made
6 significant investments in developing exports that will drive
7 up demand for US dairy products, and along with it, the demand
8 and price for raw milk to dairy farmers. These are the
9 opportunities that will raise all ships for the industry. As
10 the Department considers its decision from this hearing, it is
11 important to ensure that the California Federal Milk Marketing
12 Order facilitates, rather than inhibits, the collective
13 industry's ability to leverage this opportunity.

14 Importance of Market Clearing Prices

15 Regulated milk price policy must be set at levels that
16 contribute to orderly marketing of milk. This necessitates
17 that the regulated minimum milk prices for the manufacture of
18 hard manufactured products be set at levels that clear milk in
19 the market in an orderly fashion. To do so, the minimum
20 regulated price of milk in California must be set at a level
21 that does not exceed values after allowing for reasonable
22 returns that are achievable under good management practices by
23 the California manufacturers.

24 Milk used for manufacturing, whether for cheeses or
25 for butter and dry milks, is the primary method for California

1 dairy farmers to market the volume of milk that is produced
2 beyond the milk required for the higher priced and more
3 perishable Class I and II products. The utilization of nearly
4 80 percent of California's milk production in classes III and
5 IV highlights the importance of these manufacturing outlets in
6 marketing California's milk production. Because of the
7 critical role that Class III and IV products play in marketing
8 producer milk components beyond the borders of California, it
9 is crucial that the price formulas be market oriented,
10 reflecting the values of California-manufactured products, FOB
11 manufacturing plant.

12 The importance of setting the regulated price at a
13 level that is not intrusive on the market is increased when the
14 regulated price is based on an end product price formula. End
15 product price formulas contrast with survey-based milk prices
16 like the old M-W and BFP price series previously used in FMMO's
17 in their rigidity. The previous surveyed milk price would flex
18 with market conditions and had the flexibility to reflect
19 changes in manufacturing costs on a real time basis. In
20 contrast, manufacturing cost allowances in the end product
21 price formulas are only changed through rule making processes.
22 The cumbersome process for adjusting these allowances
23 necessitates that regulated price formulas be set at a level
24 that allows other market forces to work and adjustments to
25 occur outside of the regulated system.

1 There is substantial risk in setting and regulating
2 prices too high. Overregulating prices results in disorderly
3 marketing by encouraging additional milk production that the
4 market does not have already outlet for, while decreasing
5 demand at the processor level. Additionally, the setting of
6 regulated prices at too high of a level discourages investment
7 in innovative technology the industry requires to develop
8 commercially viable new products. However, there is little
9 risk in setting the regulated price to low, since the market
10 compensates through the development of premiums.

11 The University BFP Committee commissioned to advise
12 USDA during the FMMO Reform process echoed the need to view
13 regulated pricing as market clearing minimums in stating that:

14 Minimum pricing reduces the need for the Secretary
15 to fine tune the price of milk to reflect local or
16 regional uniquenesses in a market setting that is
17 nation in scope. Regional price differentials for
18 manufactured products which may vary seasonally
19 and over time, can be set by market forces where
20 over order premiums are warranted.

21 Additionally, the FMMO Reform Final Decision on BFP
22 replacement and make allowances, reveals that the policy
23 decision is premised upon the ability of milk to escape the
24 application of minimum regulated milk prices. It states that:

25 Manufacturing plant operators who find the level

1 of make allowances inadequate compared to their
2 actual costs, also have the alternative to not
3 participate in a Federal Order marketable pool.

4 This ability for a manufacturing plant operator to step
5 outside of the Federal Order marketable pool that was
6 anticipated by the Department in the Reform Final Rule is not
7 provided under Proposal 1. The importance of setting the
8 regulated price at a market clearing level is even more
9 critical given that suggested change in policy.

10 BY MS. VULIN:

11 Q. And both of those quotations had foot notes with
12 citation to the source of the quote. We would ask the court
13 reporter to please incorporate those as if they were read into
14 the record, with your Honor's permission.

15 JUDGE CLIFTON: Yeah, we have a little problem with the
16 formatting the way the transcript goes in putting in. We can
17 easily have the court reporter type, for example, a website,
18 but when you get into formatting like either end notes or foot
19 notes, it is almost as difficult as charts, because it is like
20 25 lines to a page and so forth. What we could do instead, is
21 now have Ms. Taylor read those foot notes, if you would like.

22 MS. VULIN: Sure. And Ms. Taylor, could you please
23 identify which quotation the footnote is related to?

24 MS. TAYLOR: Certainly. The first quotation came from the
25 BFP University Study Committee Report entitled, "An Economic

1 Evaluation of Basic Formula Price (BFP) Alternatives". And
2 that was published in June of 1997, commonly referred to as the
3 BFP Report, and that quote specifically was found on page 147.

4 And the second quote can be found in, gosh, now I'm
5 going to have -- I might need some help with this,
6 64 Fed. Reg, I believe that would be pages 16025 and 16097,
7 okay. Now, I'm a little bit confused here on the citation.

8 JUDGE CLIFTON: You are doing fine. The first page number
9 that you read was the beginning of that particular portion of
10 the Federal Register, and the second page number you read is
11 where that quote is found. So you did it just right.

12 MS. TAYLOR: Well, thank you. And that's in column 2, and
13 that publication date was April 2nd of 1999.

14 BY MS. VULIN:

15 Q. Thank you, Ms. Taylor. I'll have you continue.

16 A. Dairy Institute (Proposal 2) Class III Formula.

17 The Class prices that apply to milk for hard product
18 manufacturing (Classes III and IV) should be set no higher than
19 the levels that are reflective of the value that can be
20 returned through good management practices in the lowest value
21 order to which the regulations apply. The promulgation of an
22 Order for California necessitates that the Class III formula be
23 revisited in the California context. My preference is that
24 USDA suspend this hearing or defer the outcome's implementation
25 until a national hearing can be held to review and revise the

1 existing Class III formula in light of today's costs and other
2 market factors, along with the potential inclusion of
3 California in the FMMO system. In the absence of a suspension
4 of this hearing until a national hearing can be held, it is
5 very important that the Class III price formula that is adopted
6 through the California promulgation proceeding be set in
7 relationship to achievable returns in California using the most
8 recent available data. It will be important to proceed to a
9 Class III/IV national hearing on a timely basis after the
10 California rule making, both because those formulas are based
11 upon nearly ten year-old data and to consider the implications
12 of the outcome of this proceeding on other parts of the
13 country. Additionally, this hearing record has already
14 revealed that the whey factor in the current Class III price
15 formula over values whey relative to what can be achieved by
16 small cheese makers. A national hearing should be held to
17 correct the factor across the system.

18 The Class III price formula can be dissected by
19 products and the price discovery reference, yields, and make
20 allowances for each. The Class III formulas that currently
21 exist in the FMMO system look to cheddar cheese, butter, and
22 dry whey to establish the minimum regulated Class III price.
23 The products represented in the formula should represent the
24 most generic commodity value within the products subject to
25 that class's price regulation. Those products must have

1 clearly identifiable specifications that can be associated with
2 prices received in cost of manufacturing products of the same
3 specifications. The product yields should represent the yields
4 that are reasonably attained by the regulated entities, and the
5 make allowances should reflect at least the cost of converting
6 milk into those products with a return on investment and
7 marketing allowance.

8 Q. Ms. Taylor, first you read that with "a" return on
9 investment. Would you like us to strike the "N" in that word?

10 A. Sure.

11 JUDGE CLIFTON: Thank you, Ms. Frisius.

12 BY MS. VULIN:

13 Q. And this paragraph, essentially what you are saying is
14 that the Class III formula needs to be set low enough so that
15 the most generic version of these products can be economically
16 feasible to produce.

17 A. Absolutely. And that is the, in my mind, a basic
18 premise of the entire milk pricing system. It should be set up
19 as a minimum regulated milk pricing system, it is not setting
20 up maximum. And you need to accommodate the most generic forms
21 that clear the market. And so that's a long-held frame of
22 reference within the regulated system. And that's something
23 that, whether it is proprietary processors or co-ops, I feel it
24 is very important. What you find sometimes even amongst the
25 co-ops is, if you get that regulated price set too high, those

1 who invest in infrastructure and assets to manufacture
2 products, those members pay the penalty, whereas those who
3 don't essentially get that higher regulated price. So that
4 basic premise is a benefit to clearing the market, regardless
5 of the ownership structure.

6 Price Discovery

7 Dairy Institute's primary proposal is to use a western
8 NDPSR price series for the price discovery mechanism for each
9 of the product prices. The proposal also contains default
10 equations to use as a surrogate if USDA determines that
11 confidentiality concerns limit the Department's ability to
12 release a western price series. Discussions with AMS staff
13 prior to the call of hearing revealed that there may be
14 confidentiality concerns. I recently learned that the
15 confidentiality restrictions may relate more to confidentiality
16 concerns in the area outside of the Dairy Institute proposed
17 geography for the western price series, than confidentiality
18 concerns regarding the release of the western area data. Dairy
19 Institute's intent, while selecting the states for inclusion in
20 the western NDPSR price series, was to start along the Pacific.
21 The inclusion of states beyond the Pacific was intended to
22 address the confidentiality concerns that USDA might have
23 regarding the release of the western price series. If the
24 inclusion of the additional states has inadvertently created a
25 confidentiality issue for the balance of the country, USDA

1 should consider defining an area that includes the Pacific
2 states of California, Oregon, and Washington, and only add
3 contiguous states, to the extent that the addition of the those
4 states contributes to the ability to eliminate the
5 confidentiality constraints. The Department should not add
6 states beyond the geography defined in the Dairy Institute
7 proposal.

8 JUDGE CLIFTON: May I interrupt? I would like for you to
9 tell us what NDPSR stands for.

10 MS. TAYLOR: I still think of it as the old NASS survey, so
11 you are going to challenge me. National Dairy Price --

12 MS. ERIN TAYLOR: Product Sales Report.

13 MS. SUE TAYLOR: Thank you for phone in from a friend.

14 JUDGE CLIFTON: That's great. So National Dairy Product
15 Sales Report. And tell me who publishes that?

16 MS. SUE TAYLOR: And that is published by AMS.

17 JUDGE CLIFTON: All right. And you said, I'm thinking of
18 the old NASS report, tell us the history of why it is you are
19 thinking of the old NASS report?

20 MS. TAYLOR: The price series that I'm referring to is, you
21 know, generally, it can be described as the price series that
22 is collected for the purposes of establishing the commodity
23 prices that are used in the milk price formula. When USDA
24 adopted end product pricing within the Federal Orders in
25 January of 2000, they needed to have, actually, I don't recall,

1 I was going to say mandatory and auditable prices, I'm not sure
2 that that existed on the very front end. But in any case, more
3 specific price series to rely upon for that calculation.

4 National Agricultural Statistics Service, or NASS, was
5 the agency that originally had the responsibility for
6 collecting that data, summarizing it, and publishing it for AMS
7 and industry use.

8 JUDGE CLIFTON: Thank you.

9 MS. TAYLOR: That was later transitioned to AMS.

10 JUDGE CLIFTON: Thank you very much. So we're back on

11 Page 6.

12 BY MS. VULIN:

13 Q. Starting at "if the Department."

14 A. Thank you.

15 If the Department determines that adjusting the region
16 defined for price discovery does not overcome the
17 confidentiality concerns, the Department should adopt the
18 surrogate formulas as defined in Dr. Schiek's testimony. These
19 factors were generally derived by comparing the relevant NDPSR
20 survey prices with CDFA audited reports of prices received for
21 the commodities in California.

22 Proponents of Proposal 1 have questioned the existence
23 of a spatial price pattern for dairy commodities that is
24 essentially West Coast plus transportation costs to the markets
25 in the East. This price surface is the market reflection of

1 the supply and demand balance where there are
2 disproportionately high volumes of production of those products
3 in the west, and the disproportionately high consumption of
4 those products in the population centers of the East. The
5 spatial relationship was reflected in the publication of
6 regional prices in the NASS price survey when they published
7 the regional data. It also is reflected in the comparison of
8 the audited prices received data published by CDFA that was
9 used by Dr. Schiek to calculate the price formula factors for
10 the respective products. And it is reflected in the spatial
11 equilibrium model results that were introduced into the hearing
12 record by Dr. Stephenson of University of Wisconsin.

13 The concept of location value of a commodity is not
14 unique to dairy commodities. It is commonly referred to as
15 basis and can be described as the difference between the local
16 market and a reference price. Basis is common in most
17 commodity markets, and it is not a new term, and it is not a
18 synonym -- not a cinnamon either -- but not a synonym for
19 disorderly marketing conditions. Most farmers are familiar
20 with the term basis, as it is common in the grain markets, such
21 as the difference between Iowa/Illinois corn prices and New
22 Orleans, etcetera, or Iowa/Illinois corn prices in California,
23 as well as the energy markets, say, Texas oil vs. Brent oil.
24 Because basis reflects local market conditions, it is directly
25 influenced by several factors, including:

1 Local supply and demand conditions. Local supply and
2 demand conditions impact basis. The prices in deficit areas
3 generally reflect the price required to attract the product
4 from the surplus supply region for the commodity.

5 USDA's Central Federal Milk Marketing -- I'll start
6 that again. USDA's Central Federal Milk Market Administrator
7 Staff publishes annually a map showing the milk production per
8 capita by state. The map from the February 2015 Marketing
9 Services Bulletin, Number 13, from the Central Milk Marketing
10 Order is reproduced below as Figure 1. The US average per
11 capita milk production shown in the map legend is 646 pounds.
12 I calculated an estimated per capita milk need to serve the
13 domestic market at 549 pounds, simply by taking the 646 pounds
14 and reducing it by 15 percent exports. States that produce
15 less than 600 pounds per capita are pictured on the Central
16 Order map in light or medium gray and are considered "deficit"
17 states. States that produce more than 600 pounds milk per
18 capita are shaded in dark gray and are considered "surplus"
19 states. It is easy to see that most of the deficit states are
20 in the Eastern part of the country, which means the efficient
21 and orderly movement of dairy products needs to take place to
22 supply the needs of the population in those areas. Although
23 specific products, particularly branded retail products, may be
24 produced in a deficit area and be distributed nationally, the
25 flow of dairy commodities is largely from the surplus area to

1 the deficit area.

2 Q. So now we're looking at Figure 1, and you had stated
3 that it would require 600 pounds per capita in order to serve
4 the local market, and anything in excess of that would be
5 surplus, correct?

6 A. Actually, the 600 pounds is the break point that the
7 Central Order has used in categorizing the shading. For the
8 domestic market, I estimated at 549 pounds, so we don't have a
9 precise match up there, but in general you can consider, and
10 they do show on the map this specific per capita milk
11 production by state, so you can look and see where those break
12 points. And generally, I think I might have seen one state
13 that, if you moved it to the 549 number, might change shades, I
14 believe Indiana.

15 Q. I see that.

16 A. Would be the one state that would flip. But otherwise,
17 you can generally say light shading and medium shading in gray
18 is deficit in terms of the production of milk to serve their
19 own population on a presumption that their consumption is at
20 national average on a per capita basis. This is a simplified
21 way of looking at where the surpluses are and where the
22 deficits are, because as I already said, product will move for
23 branded reasons, for other reasons, into different areas. So
24 for example, not all cheese consumed in California will have
25 been produced in California. But nonetheless, it gives a good

1 overview of surplus and deficit areas.

2 Q. Looking at this map it looks like the entire West Coast
3 is a surplus area.

4 A. Yeah, with the exception of Nevada. But given the vast
5 volumes of milk produced in California, if you think about how
6 it is actually Nevada can be served from the surrounding states
7 that have that surplus production, that wouldn't be an area to
8 be concerned about, nor would Montana or Wyoming.

9 Q. But also California and Washington, the Coastal states,
10 are all at a surplus?

11 A. Yes.

12 Q. Then you have another cluster of states that are some
13 incredibly high surplus including Idaho.

14 A. Yes. Okay.

15 Q. Thank you. You may continue.

16 A. Transportation Costs.

17 California is relatively isolated from the rest of the
18 country being located on the Western edge of the mainland. A
19 California manufacturing plant must compete for sales on a
20 delivered price basis with manufacturers in other parts of the
21 country. This may be manifested by the manufacturer arranging
22 the transportation and pricing the product at the customer's
23 location or selling FOB manufacturing plant at a discount
24 related to transportation costs to what would otherwise be a
25 delivered price. In either case, the all-in price of the

1 customer must be competitive with the supply alternatives and
2 the net price of the manufacturer is reflective of that
3 competition and the cost to transport the product to the
4 customer. Even many of the dairy products marketed at retail
5 within California are first delivered to converting facilities
6 to the East of California before being cut or shredded,
7 packaged and delivered to the retailer's distribution center
8 for further distribution back into California.

9 California values are lower than parts of the country
10 further east because more milk is produced in California than
11 is consumed in California, and surplus milk in the form of
12 manufactured products is cleared into the deficit areas of the
13 country.

14 Leprino's Distribution and Transportation Costs.

15 Leprino's California production is sold worldwide.
16 Over 13 percent of our California cheese production and nearly
17 90 percent of the our California whey products are exported.
18 Nearly half of our California cheese volume that is sold
19 domestically is shipped east of the Mississippi. Much of this
20 cheese is shipped into the milk and cheese deficit Southeast
21 market. The cost of trucking cheese from our California plants
22 to the Midwest, where many of our customers who produce frozen
23 foods or shred and package cheese for retail distribution
24 around the country are located, is in excess of ten cents per
25 pound, and the cost of trucking to the Northeast and Southeast

1 is roughly 15 cents per pound, plus or minus a penny, depending
2 upon location. In order to compete for those customers, our
3 pricing needs to be competitive with alternative supply sources
4 in other parts of the country, most importantly, in the
5 Midwest.

6 Q. So you said nearly half of your cheese volume is sold,
7 that's sold domestically is shipped east of the Mississippi?

8 A. That's correct.

9 Q. And on those products if they go to the Midwest, they
10 have at least a 10 cents per pound cost of trucking, and if
11 they go all the way to the Southeast, they have up to 15 cents
12 per pound.

13 A. Correct, 15. When I look at the data, most of the data
14 points were between 14 and 16.

15 Q. So on a large portion, the majority of your milk you
16 incur significant transportation costs, the majority of your
17 milk products.

18 A. That's correct.

19 Q. Thank you.

20 A. Cheese Valuation.

21 Both the current Class III formula and Dairy
22 Institute's proposal is based upon a cheddar cheese production
23 model. Cheddar cheese has formed the basis of regulated
24 cheese, milk, and end product price formula since California
25 developed a separate Class 4b milk price formula in 1989, and

1 USDA replaced the old BFP with the end product price formula in
2 2000. Cheddar cheese was historically the most common cheese
3 produced and was the market clearing product within the complex
4 as reflected by its inclusion in the Dairy Price Support
5 Program that was terminated in the 2014 Farm Bill. The
6 specifications for cheddar cheese are clearly identified in
7 FDA's standard of identity and large volumes of bulk cheddar
8 cheese continue to be produced.

9 Given the increases in Mozzarella production for which
10 the volume now exceeds cheddar production both in California
11 and in the U.S., some have suggested that the Class III formula
12 may be -- I'll start again with that phrase. Some have
13 suggested that the Class III formula be based upon Mozzarella.
14 In contrast with cheddar cheese, Mozzarella specifications vary
15 significantly in order to optimize the performance within a
16 customer's application. FDA's standard of identity breaks the
17 Mozzarella category into eight products. Attachment A is a
18 table that shows the name, moisture range, fat on a dry basis,
19 commonly referred to as FDB, wet fat, and CFR reference for the
20 various products.

21 Q. Can we turn to that Attachment A now?

22 A. Certainly.

23 Q. It's found on the second to the last page. So can you
24 tell us the information that's included in this table?

25 A. This was a summary created by some of our folks in our

1 product development group that simply, well, it's an attempt to
2 show, and this is used quite often to help walk customers
3 through the range of Mozzarella products, to summarize the
4 different kinds of Mozzarella cheeses that are described and
5 defined by FDA standard of identity. In the left column we
6 have the name that is used for that particular kind of
7 Mozzarella. Then we have, in the second column from the left,
8 the moisture content. And you will see in the top four
9 products, nonfat Mozzarella cheese, lowfat Mozzarella cheese,
10 light Mozzarella cheese, and reduced fat Mozzarella cheese,
11 that, in fact, FDA is not defining explicitly in that standard
12 of identity, the moisture content. Or the middle column, the
13 FDB, the fat on a dry basis, are not defined specifically. And
14 in those cases, they are defining a wet fat for the finished
15 product. And then on the, in the right column is the CFR
16 reference for that particular standard of identity. And in
17 some cases, the person summarizing this has pulled relevant
18 verbiage that better describes the defining aspects of that
19 particular product.

20 As you get down below the top four products into low
21 moisture part skim Mozzarella cheese, you will note that they
22 are defining specific moistures, but with significant ranges.
23 So, for example, low moisture part skim, the moisture can range
24 from 45 percent to 52. They also are defining a specific fat
25 on a dry basis. In this case, from 30 to 45 percent. But they

1 have no definition for wet fat that is explicit in the CFR.

2 Q. So between the top four Mozzarella products and the
3 bottom four Mozzarella products, not only do they have
4 different standards of identity, but they use different factors
5 to even define those standards of identity?

6 A. That's correct.

7 Q. Okay. So I'll have you return to the testimony now, I
8 believe we're on page 10, beginning with the complexity.

9 A. The complexity of using Mozzarella in the regulated
10 pricing model should be clear on its face. To satisfy the need
11 to have a clearly specified product in the Class III price
12 formula, one product, such as low moisture part skim
13 Mozzarella, would need to be selected from within the broader
14 Mozzarella group.

15 The next filter that would need to be applied to the
16 eligible product definitions is form. The product form is
17 intended to be bulk and not differentiated with value added
18 processes. This eliminates the inclusion of retail product and
19 shredded product, as well as other value added processes.
20 After narrowing the Mozzarella that would be eligible for
21 reporting to low moisture part skim Mozzarella that is sold in
22 unshredded form of bulk size, the eligible volume is much
23 smaller than that represented in the bulk cheddar category. We
24 reviewed our California production and identified the
25 proportion that would be ineligible for reporting during our

1 fiscal year 2014 fiscal year. That volume represented in
2 excess of 80 percent of our California Mozzarella production.
3 I do not have visibility to our competitor's production
4 profile, but expect that much of their Mozzarella is similarly
5 sold in shredded form, given the nature of the Mozzarella
6 market. If that is the case, the volume of Mozzarella that
7 would be reportable is roughly 60 percent of the volume of
8 cheddar cheese production in California within the same period.
9 Cheddar remains the dominant form of uniform bulk cheese
10 produced in California.

11 Q. So back in Attachment A we learned that if you are
12 looking to use Mozzarella as the standard, you are going to
13 have to narrow it to merely a representative class that is
14 quite small really, and possibly not representative of the
15 entire class of products.

16 A. That would be correct. It's important in these
17 products, because of the differences in product specification
18 have their on cost associated with them, and collecting the
19 prices, the prices are differentiated by product. If you have
20 a higher fat product, it's going to be a different price than
21 if you have a skim product. And so it is very important to
22 have very clearly defined specifications within a relatively
23 narrow range in order to have a relevant price and
24 manufacturing cost, and yield all matched together. And those
25 volumes would be, again, much smaller. You know, even my

1 analysis that I just laid out, probably is overly generous,
2 because the range within low moisture part skim Mozzarella is
3 large enough that you would probably even want to narrow it to
4 a narrower range of FDB's and moisture within that product
5 category, which if I had done that, would drop the numbers even
6 more.

7 Q. So even after we narrow for the type of product, we
8 have to narrow, if it was processed out of bulk block form,
9 which narrows it even further, so then we have a very, a sliver
10 of the product commodity space trying to be a barometer for an
11 entire commodity that really has maybe not much to do with
12 that, if we had to rely on Mozzarella.

13 A. That's correct.

14 Q. Okay. Thank you. Starting at bulk cheddar on the
15 bottom of page 10.

16 A. Bulk cheddar remains the best product upon which to
17 build the Class III price formula. The price for most
18 commodity cheeses produced within the U.S. is referenced to the
19 price of spot cheddar cheese traded with the Chicago Mercantile
20 Exchange or CME. The form of bulk cheddar that should be used
21 in the California FMMO Class III formula is 40 pound block
22 cheddar. To my knowledge, all bulk cheddar production in
23 California is produced in the block format. Additionally, most
24 other commodity cheeses, including Mozzarella, reference to the
25 block cheese, or the block price on the CME. Therefore, use of

1 the 40 pound block price is in the formula is consistent with
2 California production and returns.

3 Cheddar Yields.

4 Dairy Institute's proposal incorporates the yield
5 factor for cheddar cheese that is embedded in the FMMO
6 Class III formula. Fat capture and yields range with vat
7 configuration. The range of fat capture and yields to
8 California can be expected to be similar to that reflected in
9 the hearing records that establish the yield assumptions in the
10 current Class III formulas.

11 Cheddar Make Allowance.

12 Dairy Institute's proposed cheddar make allowance
13 should be amended from the 22.91 cents included in Dr. Schiek's
14 testimony, to 23.06 cents per pound cheddar. The 23.06 cents
15 make allowance is calculated by adding California's cost from
16 the CDFA most recent audited cost studies of 22.91 cents per
17 pound cheddar and an administrative additional marketing cost
18 allowance of -- there's a demon there -- thought we got this
19 out -- okay. I would like the record copy to delete the dollar
20 sign before the 0.15, so it is 0.15 cents per pound on a dollar
21 basis .0015.

22 Q. Less than a penny?

23 A. Less than a penny. Not even two-tenths of a cent.

24 Q. I think your overly hopeful attorneys might have
25 intervened, so apologies.

1 JUDGE CLIFTON: And Ms. Frisius has signaled that she has
2 stricken the dollar sign.

3 MS. TAYLOR: This proposed make allowance is both
4 consistent with the principle that the make allowance should be
5 reflective of the most current cost data available and is
6 consistent with USDA's methodology from the 2008 Class III/IV
7 Final Decision. Specifically, that decision adopted a cheddar
8 make allowance based upon the CDFA weighted average cost from
9 its audited cost study released September 2007m covering
10 cheddar cheese plant costs for January through December 2006 of
11 19.88 cents, plus a sales in administrative cost allowance of
12 .15 cents per pound. The sales and administrative costs is
13 added because none is captured in the underlying CDFA cost
14 study.
15 Whey Cream Valuation.

16 The Dairy Institute proposal contained in the Notice of
17 Hearing does not address errors in the valuation of whey cream
18 in the Class III price formula. The issue remains a problem
19 but the economic impact of error varies around the country.
20 This is an issue that should be addressed through a national
21 Class III/IV hearing in the near future. The over valuation is
22 rooted in both volume and value assumptions embedded in the
23 current Class III formula.

24 The current formula assumes that all of the fat
25 received at the plant that is not captured in cheddar cheese is

1 recovered and converted to Grade AA butter. This assumption is
2 inconsistent with manufacturing realities, and it is
3 inconsistent with the record from the 2006-2007, Class III/IV
4 price formula hearing. The existing Class III price formula
5 also assumes the whey cream is used to produce Grade AA butter,
6 which is not permitted by USDA's own regulations.

7 Whey cream outlets are very limited in California. Our
8 whey cream sales from our California locations are generally to
9 one of three markets. One in California that seems to have
10 very limited demand, and two in Wisconsin. Our prices net well
11 below the CME's AA butter market, regardless -- let me re-start
12 that sentence. Our prices net well below the CME AA market
13 price regardless of outlet for our whey cream.

14 JUDGE CLIFTON: Do you want us to insert the word "butter"
15 after the AA?

16 MS. TAYLOR: That would be fine.

17 JUDGE CLIFTON: All right. Thank you, Ms. Frisius.

18 MS. TAYLOR: Pricing in Wisconsin is at or below flat
19 market, that's CME Grade AA butter -- depending upon the market
20 conditions. The cost of transport on our whey cream delivered
21 to Wisconsin exceeds 54 cents per pound fat. The number of
22 buyers for whey cream nationally continues to shrink placing
23 additional downward pressure on whey cream returns as sellers
24 are forced to ship whey cream greater distances to find
25 markets.

1 While we are waiting patiently for a national
2 Class III/IV hearing to address this, the Department should be
3 cognizant in this promulgation proceeding of the over valuation
4 as they consider factors adopted in the balance of the Class
5 III formula.

6 Separate from the whey cream technical error is the
7 need to amend the Dairy Institute butter make allowance to
8 include the, again, delete the dollar sign -- to include the
9 .15 cent administrative and marketing cost adjustment. The
10 butter make allowance would be amended from 17.24 cents per
11 pound butter to 17.39 cents per pound.

12 JUDGE CLIFTON: And let me coordinate with Ms. Frisius.
13 Have you stricken the --

14 MS. FRISIUS: Yes.

15 JUDGE CLIFTON: Thank you, the dollar sign. Thank you.

16 MS. TAYLOR: Whey valuation.

17 The California cheese industry experience of 2007 is a
18 case study in the setting of minimum regulated prices above
19 market clearing levels. The cheese industry stress was
20 manifested in California by consolidation, producer payment
21 defaults, and reductions in plant throughput. Although often
22 characterized as a "small cheese maker issue" it clearly was
23 not. Several large cheese plants with whey processing capacity
24 also experienced significant challenges. Land O'Lakes was very
25 public about the financial difficulties at their CPI plant in

1 Tulare, and subsequently sold that plant. Dairy Farmers of
2 America ("DFA") was similarly quite clear that their Corona
3 plant had been a financial drain. Their August 8th, 2007,
4 press release (Attachment B) announcing the reduction in
5 throughput August 31st, 2007, and planned closure January 1st,
6 2008, indicated that, "Market conditions and operating results
7 have hindered success at our Corona plant and in our American
8 cheese division. We constantly look for ways to end losses and
9 stimulate profitability."

10 BY MS. VULIN:

11 Q. And that press release is attached here on the last
12 page, Attachment B?

13 A. That's correct.

14 Q. Thank you.

15 A. In a conversation that I had the prior day with a
16 Senior Executive of DFA, I was told that the September 1
17 reduction was designed to reduce the plant throughput to a
18 level at which the processing of their whey stream into any
19 product other than dry whey could be eliminated, thereby
20 eliminating the losses on the other more specialized whey
21 products produced at the plant. Although I'm not privy to the
22 magnitude of the losses on these other specialized whey
23 products, one can assume that they had to be very significant
24 to have justified the increased plant overhead cost per unit of
25 production that is associated with the reduced throughput.

1 Additionally, several of the petitioners at the
2 September 2007 CDFA hearing testified that they curtailed
3 cheese production due to the poor whey economics. Three cheese
4 plants struggled to fulfill producer payment obligations and
5 were placed on the ineligible list for the CDFA Producer
6 Security Trust Fund. All of these changes were reflective of
7 the stress that had been created because the Class 4b price
8 generated a milk price that exceeded the revenue stream of the
9 finished products being produced by many of the state's cheese
10 makers.

11 Whey Factor

12 The inclusion of an explicit whey factor in regulated
13 pricing had its origin with the implementation of Federal Order
14 Reform in January 2000. Similar to California, many cheese
15 plants outside California did not, and do not, have whey
16 processing capacity. However, the inclusion of the whey factor
17 within the Federal Order system was expected to boost the
18 Class III price by a modest enough amount that a small cheese
19 maker that lacked sufficient scale to cost effectively process
20 whey, was perceived to be able to cover the whey portion of
21 milk price through premiums garnered on the specialty cheeses,
22 if produced. In its first year of implementation, the whey
23 factor contributed 29 cents per hundredweight to the Federal
24 Order Class III formula.

25 The explicit inclusion of a whey factor became an

1 increasingly challenge for those without whey processing
2 capacity, as whey prices strengthened a few years later. With
3 whey driving up regulated minimums by over \$3.00 per
4 hundredweight at times in 2007, plants without processing
5 capacity struggled and soon some were shuttered. In Federal
6 Order areas, some plants that are located in dense cheese
7 production regions were able to recoup some value by the sale
8 of whey to consolidators as prices increased. But, as
9 Wisconsin cheese makers Mr. Buholzer and Mr. Stettler testified
10 earlier in this hearing, the whey factor was even problematic
11 for those cheese makers selling to whey consolidators in
12 Wisconsin. The whey factor was also problematic for
13 manufacturers of whey proteins because dry whey values in the
14 milk price formulas outstripped returns for protein in lactose.
15 It was not uncommon in that timeframe for cheese makers unable
16 to recover the whey value assumed in the Class III milk price
17 formula to negotiate with their suppliers for relief from the
18 full Class III price.

19 The existence of an explicit whey factor has been
20 problematic for cheese makers without whey processing capacity
21 regardless of whether they are operating in the Federal Orders
22 or California.

23 Q. Ms. Taylor, I would ask that you just slow down just a
24 little bit. Thanks.

25 A. However, the binding nature of the current California

1 State Order and the Cooperatives' Proposal 1, under which
2 minimum regulated prices are enforced on all Grade A milk
3 manufactured in California, limits market based approaches to
4 relief. This lack of a pressure relief valve severely limits
5 the range of milk values that can be applied to whey without
6 risking significant damage to plant capacity.

7 Much testimony has been incorporated into this hearing
8 record regarding the inability to economically process whey in
9 smaller cheese plants. Whey processing is highly capital
10 intensive. The extraordinarily high capital costs create a
11 barrier to entry for small cheese plants. In its raw form,
12 dilute whey from a cheese vat has limited value in the
13 marketplace. Skim whey, prior to condensing, is typically
14 around 6 percent solids. At this low level of concentration,
15 transportation costs quickly consume the historic market value
16 above cost of processing. Some intermediate size plants can
17 condense their whey for more economic transport for further
18 processing at a large plant. However, the returns achieved for
19 any intermediate products short of the finished whey that is
20 used in the milk price formulas, fall short of finished product
21 value.

22 The diversity of whey products also creates challenges
23 relative to explicit inclusion of a whey factor in the
24 regulated pricing system. Dry whey was historically viewed as
25 the lowest common denominator amongst all whey products. This

1 was because it is the most generic whey product requiring the
2 least advanced technology, and returns were generally lower
3 than those for the more highly refined whey proteins. It was
4 thought that so long as the milk price was based upon dry whey
5 prices, the whey contribution to the milk price would not be
6 overstated for those who process whey. This long-held
7 assumption is challenged from time to time and was proven to be
8 incorrect in 2007. As more processors invested in whey
9 fractionation technology the increased production of whey
10 protein concentrates depressed those prices.

11 Q. By way fractionation technology, do you mean further
12 processing the whey down to a usable substance?

13 A. I'm referring to the splitting of the whey stream to
14 isolate the protein from the carbohydrate, and the level of
15 isolation varies by product, but it is typically done by
16 ultra-filtration.

17 Q. Thank you.

18 A. Simultaneously, as older plants producing dry whey were
19 mothballed, the supply and demand balance pushed dry whey
20 prices up. Consequently, the portion of the milk price
21 attributable to the dry whey value outstripped the returns from
22 whey protein concentrate, particularly in operations that did
23 not also produce lactose. It was one contributing factor to
24 replacing the explicit whey factor within the California
25 Federal, excuse me, the California Class 4b formula with a 25

1 cents fixed factor in 2007. Proposal 2 --

2 JUDGE CLIFTON: I'm going to stop you there. This is
3 extremely valuable and very helpful, and I'm going to call a
4 five-minute stretch break before you resume at the very bottom
5 of page 15.

6 (Whereupon, a break was taken.)

7 JUDGE CLIFTON: We're back on record at 10:15.

8 Ms. Vulin, would you help us find our place again?

9 BY MS. VULIN:

10 Q. Yes, we are on the bottom of page 15, starting at the
11 heading, Proposal 2 Whey Valuation

12 A. Thank you.

13 Proposal 2 Whey Valuation

14 The Dairy Institute proposal appropriately caps the
15 whey contribution in the Class III formula in recognition that
16 44 Class 4b plants do not even recover a liquid whey value and
17 the viability of some of those plants will likely be threatened
18 by the increased cost burden related to a product that they
19 cannot, even under best management practices, extract a value
20 from the whey stream. Many small cheese makers have testified
21 at prior CDFA hearings that they cannot sustain their
22 operations at an incremental milk cost of \$1.50 per
23 hundredweight of milk attributable to whey. They cannot
24 achieve the plant efficiency assumed in the formula make
25 allowance for cheese, so our outsider perspective of their

1 potential margins based upon local specialty cheese sale prices
2 at retail is likely unrealistic. I cannot speak to how many of
3 these cheese makers are at risk of closing if the incremental
4 milk cost generated by the whey factor in the formula is
5 sustained at \$1.50. But I will note that based upon prior
6 testimony at CDFA hearings, even the \$1.50 per hundredweight
7 milk may challenge their viability.

8 Proposal 2 Alternative Whey Valuation

9 The Dairy Institute proposal to value the whey portion
10 of the Class III milk formula relative to its concentrated
11 liquid whey value is consistent with the philosophy that the
12 Order will value the most generic product within a product
13 group. The record clearly shows that there are scale barriers
14 to recovering full finished product value from the whey market.
15 Some plants without sufficient scale to process their own whey
16 dispose of the whey into their waste treatment solutions,
17 others sell concentrated whey either before or after
18 ultra-filtration to other cheese plants or whey consolidators.

19 The WPC 34 price index is the most common reference
20 used for the sale of liquid concentrated whey by cheese plants
21 selling concentrated whey within California. As many witnesses
22 have testified at this hearing, the prices received for that
23 liquid whey are discounted to reflect that the liquid
24 concentrated whey requires additional processing with highly
25 specialized and capital intensive equipment in order to produce

1 a full value product. If sold FOB seller plant, the price is
2 discounted by the buyer for the cost of transport. If sold on
3 a delivered basis, the net return to the selling plant would be
4 the invoiced price, less the cost of transport. The Class III
5 formula should reflect the returns achievable at the
6 concentrated whey seller's plant.

7 The Dairy Institute proposal reflects a survey of
8 cheese plants and was corroborated by Mr. Barry Murphy, a
9 consultant working with many of the cheese makers with
10 insufficient capacity to have economically viable whey
11 processing operations producing dry products at this hearing.
12 Whey Make Allowance.

13 To remedy the omission of the .15 cents per pound
14 administrative and marketing allowance in the Dairy Institute
15 proposal, the whey make allowance outlined in Dr. Schiek's
16 testimony should be increased by that amount. And I will note
17 that I added "in" and would like that added in the record copy
18 prior to Dr.

19 JUDGE CLIFTON: Prior to what?

20 MS. TAYLOR: Dr. Outlined "in" Dr. Schiek's.

21 JUDGE CLIFTON: Oh, Ms. Frisius, do you see? You're
22 inserting "IN", thank you.

23 MS. TAYLOR: The revised proposed make -- the revised
24 proposed whey make allowance is 23.10 cents before including
25 transportation and cooling costs in the formula.

1 BY MS. VULIN:

2 Q. And just to be clear, since we had a little mix up on
3 this earlier, the .15 cents per pound is less than a penny, in
4 fact .15 cents?

5 A. Right. It is midway between a tenth and two-tenths of
6 a cent.

7 Q. Thank you.

8 JUDGE CLIFTON: Would you just read that last sentence one
9 more time?

10 MS. TAYLOR: The revised proposed whey make allowance is
11 23.10 cents before including transportation and cooling costs
12 in the formula.

13 USDA should not adopt the Cooperative Class III formula.

14 The Department should not adopt the Cooperative's
15 proposal for Class III and IV pricing. In essence, the
16 Cooperatives are asking for price equality with other FMMO's
17 without allowing for equality in the way the price applies.
18 The proposal sets the Class III and IV prices in California
19 equal to what was set in the balance of the FMMO's based upon a
20 hearing in 2006/2007. This proposal was supported simply by
21 the rationale that prices should not be different. They have
22 not entered evidence specific to the relevance of the formula
23 factors to California.

24 The price levels generated by the cooperatives'
25 proposal, Proposal 1, have already proven untenable in a less

1 onerous version. The price levels exceed those that were
2 generated by the Class 4b formula, strike did, before
3 December 2007, when overvaluation led to the financial
4 difficulties in closure of cheese plants, three cheese plants
5 being placed on the ineligible list for the Producer Security
6 Trust Fund for failure to pay timely, and the sale of a
7 proprietary cheese company referenced earlier in my testimony.

8 It is not difficult to anticipate the damage that would
9 be done if Proposal 1 is adopted. The proposal, once again,
10 sets up the scenario of signals to producers to increase milk
11 production while signalling to cheese makers to reduce
12 manufacturing capacity. Based upon history, that signal will
13 be once again manifested in increased cheese plant
14 bankruptcies, plant closures, and a shift in manufacturing
15 volumes from California to other states by multi-state
16 operators. The proposal would set up a scenario in which even
17 those of us with a scale and capability to economically process
18 whey would be better off shifting production. In addition to
19 our cheese making assets, we have invested hundreds of millions
20 of dollars in capital to produce specialized whey products in
21 our California plants and continue to need to reinvest in order
22 to maintain markets in a highly dynamic marketplace. Adoption
23 of the proposal would, over the long-term, result in a loss of
24 reinvestment in California facilities and their eventual
25 obsolescence and closure.

1 Class IV Formulas

2 Leprino encourages USDA to apply the same principles to
3 Class IV price formula as are advocated for Class III.
4 Regulated prices must not provide artificial financial
5 incentives between the manufacture of Class III and IV
6 products. The very intent and nature of pooling is to mute the
7 competition for market outlets from various uses of milk.
8 However, a pricing and pooling system that completely
9 eliminates the incentive to place milk in its highest and best
10 use, or which provides an incentive to manufacture milk into
11 lowered valued uses, does not serve dairy producers,
12 manufacturers, or consumers well. To accomplish neutrality,
13 the pricing formula must be established by consistently
14 applying the same principles to both manufacturing complexes.
15 The Dairy Institute proposal takes an even-handed approach to
16 the two manufacturing classes, utilizing western-based prices
17 and California-based make allowances. Consistent with that,
18 the nonfat dry milk and butter make allowances should be
19 increased from those contained in Dr. Schiek's testimony by an
20 administrative and marketing allowance of .15 cents, resulting
21 in revised proposed make allowances of 17.39 cents for butter,
22 and of 20.12 cents for nonfat dry milk.

23 Conclusion

24 If the Department promulgates an Order that is adopted
25 through a producer referendum, the outcome of this hearing will

1 have significant impacts throughout both the U.S. and global
2 dairy industries. The production within California of 20
3 percent of the U.S. milk supply and significant volumes of
4 dairy commodities that also serve the global market makes it a
5 significant force across broad geography.

6 If the Department promulgates an Order from this
7 proceeding, it should adopt the Dairy Institute proposal,
8 Proposal 2. This proposal will allow milk for manufacturing to
9 move more freely to its higher and better use. That, in turn,
10 will lead to reduced price volatility and provide a more stable
11 plant forum with which the industry can grow demand. It also
12 sets prices at market-clearing levels that allow for orderly
13 marketing. These are critical elements that will contribute to
14 the broader industry's ability to drive demand to the benefit
15 of producers, processors, and consumers.

16 BY MS. VULIN:

17 Q. Thank you, Ms. Taylor. And is there anything else that
18 you would like to add in addition to to your written testimony?

19 A. Not at this point.

20 Q. Thank you.

21 JUDGE CLIFTON: I have a couple of coordinating points with
22 Ms. Frisius. On page 18, in the paragraph that is entitled
23 Class 4 formulas, as you read the statement, Ms. Taylor, you
24 made a couple of words plural, and I propose that we add the
25 "S" to each of those words now, but I need for you to confirm

1 that's what we should do. So four lines up from the bottom of
2 that paragraph, the line begins, "western based price" and you
3 read "western based prices". Shall we insert an S?

4 MS. TAYLOR: Yes.

5 JUDGE CLIFTON: All right. And again, the last line of
6 that paragraph begins with the word "allowance" and you read
7 "allowances". Shall we add an S to that word?

8 MS. TAYLOR: Yes.

9 JUDGE CLIFTON: All right. And then Ms. Frisius also
10 signaled to me in page 17, in the next to the last paragraph,
11 actually, the last full paragraph, we struck the word "did"
12 and she signaled to me that that has been done in the record.

13 MS. TAYLOR: Yes.

14 JUDGE CLIFTON: All right. Then, Ms. Vulin, shall we deal
15 with the exhibit?

16 MS. VULIN: Yes, we would move at this time to admit
17 Exhibit 135.

18 JUDGE CLIFTON: Is there anyone who would like to question
19 Ms. Taylor before determining whether you have any objection?
20 Are there any objections to the admission into evidence of
21 Exhibit 135? There are none. Exhibit 135 is admitted into
22 evidence.

23 (Thereafter, Exhibit Number 135, was
24 received into evidence.)

25 MS. VULIN: Thank you, Ms. Taylor, no further questions.

1 JUDGE CLIFTON: Who will begin cross-examination of
2 Ms. Taylor. Mr. Beshore.

3 CROSS-EXAMINATION

4 BY MR. BESHORE:

5 Q. Marvin Beshore.

6 Thank you, your Honor. Good morning, Ms. Taylor.

7 A. Good morning, Mr. Beshore.

8 Q. Let me, I want to start with just a few questions about
9 Leprino's operations and sales, and what's been referenced in
10 your testimony today. First of all, not to repeat but just to
11 set the background, Leprino has six plants in the United States
12 outside of California, at which six manufacture, cheese
13 manufacturing plants as you testified the other day?

14 A. That's correct.

15 Q. Okay. And they are all in the Federal Order system,
16 buy milk that's pooled in the Federal Order system.

17 A. We buy milk, the areas where the plants are located,
18 some of them that, from an -- well, first of all, they are all
19 nonpool plants.

20 Q. Right.

21 A. And from an economic incentive perspective, there's
22 some areas where I would expect that all that milk is pooled,
23 but that decision has been made by the cooperative that
24 supplies us. There are some that are located in areas where I
25 suspect that that may not be pooled full time.

1 Q. Okay. In any event, as you testified the other day,
2 the price of milk at those plants averages to be at least the
3 minimum Federal Order Class III price.

4 A. That's correct.

5 Q. Okay. What portion, if you look at Leprino as a
6 national production system and company, six plants outside of
7 California, three plants in California, what portion of
8 production of cheese is in California versus the rest of the
9 country?

10 A. There are going to be certain things that I'll be a
11 little bit more vague on because of privately-held company and
12 competitive issues. I will tell you it is significant, you
13 know, in terms of the California footprint, very significant,
14 but I will not give you a precise percentage.

15 Q. Can you give me any more than significant? Less than
16 50 percent in California of national total production?

17 A. Yes.

18 Q. Okay. Is it roughly proportional on a total plant
19 system basis?

20 A. No. Our California plants are larger on average than
21 our plants outside of California.

22 Q. Okay. That gives us something to work with there.
23 Now, Leprino's product mix in its plants, is it, do you produce
24 all of the -- by the way, this information about standards of
25 identity for Mozzarella on Attachment A of Exhibit 134 is

1 extremely useful and interesting.

2 JUDGE CLIFTON: 135.

3 MR. BESHORE: 135, I'm sorry, Exhibit 135.

4 BY MR. BESHORE:

5 Q. Does Leprino produce all those products listed on
6 Attachment A?

7 A. We do not.

8 Q. Do you produce products that are not listed on
9 Exhibit A, Attachment A to 135?

10 A. Yes.

11 Q. Okay.

12 A. We produce many of the ones that are on A.

13 Q. Okay.

14 A. But we do not produce nonfat Mozzarella cheese.

15 Q. The first one listed?

16 A. Right.

17 Q. Okay. What else?

18 A. I don't believe that we produce the bottom one, the
19 Mozzarella cheese that's defined as 52 to 60 on moisture and
20 greater than 45 on FDB. I'm not certain of that, but that's my
21 sense.

22 Q. Okay. And your sense is that you think you do produce
23 the other six?

24 A. Yes.

25 Q. Okay. Is there -- is there specialization within the

1 Leprino system in terms of production of these products, that
2 is, does one of the plants produce all the, you know, low
3 moisture part skim Mozzarella for your system, or is there
4 specialization within products at your plants?

5 A. There's some specialization where some plants are
6 dedicated to products where we can do full-day runs of a single
7 product, and there are certain designated plants where we will
8 do smaller runs for a specialized product.

9 Q. Okay. Is there, are there any products that are run at
10 only one plant for full national distribution?

11 A. I believe we do have, I have not kept up on all of our
12 flexibility across plants, but I can tell you in the past that,
13 for example, the higher level of fat reduction that was
14 required for some of those cheeses restricted those products to
15 plants that had greater separation capacity on the front end,
16 because we don't want to slow down the production process by
17 the additional separation required and so we don't have that
18 level of separation in every plant.

19 Q. Okay. Level of fat skim separation?

20 A. Right. Right. We also have some plants that are fully
21 dedicated to shredding and freezing the product, selling it in
22 that form. What we call our quality lock cheese, where we are
23 using individual quick-freezing technology to essentially lock
24 in the performance parameters of that cheese at the time it's
25 made. There are some other plants that will produce a bulk

1 product that is shredded by our customer.

2 Q. Okay. So the plants that are, could you tell us where
3 the plants that are dedicated to shredding and distribution of
4 only that product are located?

5 A. Tracy would be one of them; Lemoore East would be one
6 of them, and we have, just to clarify for the record, there is
7 no Zip code called Lemoore East. We have two manufacturing
8 facilities in Lemoore, California, and for internal
9 identification, we refer to one as west and one as east. So
10 our original Lemoore plant that we acquired in 1986, I believe,
11 is strictly the IQF production of cheese.

12 JUDGE CLIFTON: It is what?

13 MS. TAYLOR: IQF is the term that I used. And that's
14 represents Individual Quick Freezing. And it's a technology
15 that Leprino adopted from the frozen vegetable folks back in
16 the 1980's. And my understanding is that Jim Leprino figured
17 out that if the vegetable guys could freeze peas and keep each
18 as a unique pea, that, you know, at that point, if people froze
19 shredded cheese, it would come out as a big block of ice when
20 done. And so he figured that we should be able to do enough
21 research and development to figure out how to adopt that same
22 technology to cheese in a way that enhances the functionality
23 of that cheese.

24 BY MR. BESHORE:

25 Q. Okay. And if I understood your testimony, I don't want

1 to get it wrong, the Tracy and Lemoore East plants are
2 completely dedicated TO producing product with that technology?

3 A. That's correct. Lemoore West has that capability. It
4 also has capability of producing a block Mozzarella, and it
5 also has capability to produce a form that we refer to as
6 ribbon. And ribbon is a proprietary form that only we produce,
7 where we, rather than forming the Mozzarella into, say, 6 pound
8 blocks or 20 pound blocks for bulk, we extrude the Mozzarella
9 coming off the vat, but there's a mixing kneading process in
10 between. We extrude it into 1 to 2-inch thick ribbons that the
11 tech services folks would be terrified to have me try to
12 describe this, just on an eyeball basis two feet wide in some
13 cases, it varies by plant. But in any case, a long ribbon of
14 cheese that then gets cut up into sizes that we can either put
15 into thousand pound totes or into smaller packages that then
16 could be used through distribution to small independent
17 pizzerias.

18 Q. Okay. So the shredded products that are produced at
19 Tracy and Lemoore East?

20 A. Yes.

21 Q. East? Are they packaged right at the plant and then
22 sold FOB the plant?

23 A. They are packaged at the plant and the sales approach
24 will vary by customer. We have some customers who pick up at
25 the plant, and in that case it would be FOB pricing. But the

1 vast majority of our customers are priced at their location,
2 and we have a system where we don't want our customers to try
3 to dictate where their cheese is produced within the system, it
4 is important for us to retain that flexibility across those
5 nine plants. And so we will price them based on the delivered
6 price that we need to be competitive. And then, essentially,
7 we end up eating some of that transportation cost, if we are
8 delivering it from an uneconomic source.

9 Q. Okay. That's -- you -- that's a pricing -- that's a
10 product sales policy that Leprino has for its purposes, that
11 you price, that you deliver it to your customer without their,
12 without them dictating the source?

13 A. Yes.

14 Q. Okay. Okay.

15 A. Now, I should clarify that, of course, we work with our
16 customers and many customers require plant approvals and all
17 those other quality parameters and work hard to make sure that
18 they are very comfortable and we try to maintain the highest
19 standards on quality regardless of where we are producing it.
20 But the customers do have some collaboration. They generally
21 will qualify a set of plants.

22 Q. Okay. So are the plants in California, Tracy and
23 Lemoore East, are they the only two plants in the system that
24 are dedicated to just one finished product?

25 A. We have been changing so much of our plant

1 configuration, so let me think. They would not be. We
2 converted our Waverly plant to a fresh ribbon plant within the
3 last couple of years, so they don't have the capacity to flex.

4 Q. So they are producing solely the fresh ribbon that
5 Waverly, then?

6 A. Correct.

7 Q. Is that the ribbon that you described earlier?

8 A. Yes, yes.

9 Q. Okay. Is that the only other plant that's specialized
10 to one product only?

11 A. Our Greeley facility, the newest in our system, also is
12 a fresh ribbon plant, does not have the capability to flex into
13 the individually quick frozen product.

14 Q. So the fresh ribbon, let's say from Waverly, where
15 would it be distributed?

16 A. That would primarily be distributed into the Northeast
17 market. Much of it would go into that New York, New Jersey
18 independent pizzeria market. Some may go outside of that
19 further down the Seaboard.

20 Q. And the plants in Michigan, what products are, the two
21 plants there, what products or group of products are produced
22 there?

23 A. Remus is a string cheese plant.

24 Q. Strictly string?

25 A. Strictly string cheese. Allendale is primarily a fresh

1 ribbon product, but also has the capability to produce the IQF
2 product.

3 Q. Okay. So is there any other plant besides Remus that's
4 a string plant?

5 A. We also produce string cheese in Ft. Morgan, Colorado.

6 Q. Okay. Let's say you have string cheese customers in
7 Texas, where would they be supplied from?

8 A. I do not see the specific information. I would assume
9 that they would likely be supplied from Ft. Morgan.

10 Q. And if you had string cheese customers on the West
11 Coast here in California and other points, I assume they would
12 be, where would they be supplied from?

13 A. I presume also from Ft. Morgan. Now, there are --
14 there are some constraints relative to what products can be
15 made in each of those plants, though, as well. So you may have
16 national distribution from each plant, it's not strictly a
17 distance calculation.

18 Q. Okay. Right. So based on the total product mix and
19 what plant you can most efficiently and economically make those
20 products at, is it fair to just generalize and say Leprino's
21 got a national, it's got a national production system, a
22 national customer base, products that are distributed
23 nationally, and it is coordinated in the best possible fashion?

24 A. That's what we attempt to do. And of course, with the
25 addendum that it is an international customer base at this

1 point. We are focused on the national at the moment, I
2 presume.

3 Q. Right. I was, but thank you for mentioning that. Now,
4 you indicated, I think, what, ten percent of roughly of
5 California production is exported, if I remember?

6 A. I believe that it was higher than that.

7 Q. Okay.

8 A. I believe it was -- let me look.

9 Q. And I was drawing from memory, which is probably
10 faulty. Page 9, 13 percent, second full paragraph?

11 A. Yep, that makes sense. 13 percent on the cheese
12 production and close to 90 percent on the whey products, which
13 would be the combination of the whey proteins and lactose.

14 Q. Okay. Do you export cheese or whey from any of your
15 other facilities outside of California facilities?

16 A. Yes.

17 Q. What percentage, if you know, from the Federal Order
18 system of plants, if I can call them that, system of plants
19 outside of California?

20 A. I can tell you that all of the string cheese that we
21 export would come out of plants that make get Federal Order
22 milk, because that's the only, those are the only plants that,
23 in which we produce the string cheese.

24 Q. Okay.

25 A. The string cheese exported is largely used in stuffed

1 crust pizza, which we have had that benefit of having invented
2 a technology that allows the cheese to melt but not disappear
3 from inside the crust, and none of our competitors have done
4 that, and so we have been in that market since probably the
5 late '90's. And as we talk, I'm looking for my cheat sheets.
6 Could you ask your question again?

7 Q. Well, the question was what percentage of production
8 outside of California is export, cheese and/or whey?

9 A. Why don't I just give you the total company --

10 Q. Sure.

11 A. -- percentages. We're, close to 10 percent of our
12 cheese is exported, and just over 60 percent of our whey in
13 various forms is exported. As I look at the data, obviously
14 California makes up a big portion of that.

15 Q. Okay. Very good. Thank you.

16 JUDGE CLIFTON: May I interrupt just a minute, Mr. Beshore?
17 The Tracy plant, is that in California?

18 MS. TAYLOR: Yes.

19 JUDGE CLIFTON: And how is Tracy spelled?

20 MS. TAYLOR: T-R-A-C-Y.

21 JUDGE CLIFTON: And the Lemoore plants, they are both in
22 California?

23 MS. TAYLOR: Yes.

24 JUDGE CLIFTON: And how is Lemoore spelled?

25 MS. TAYLOR: L-E-M-O-O-R-E.

1 JUDGE CLIFTON: And I know you've covered some of this in
2 your prior testimony, but I would like to get it here. In what
3 state is the Waverly plant located?

4 MS. TAYLOR: Let's just call it New York, it straddles the
5 New York-Pennsylvania border.

6 MR. BESHORE: It seems to show up on Pennsylvania
7 statistics sometimes for some reason.

8 MS. TAYLOR: That's a good point. My understanding is that
9 we have had that plant since 1978. I'm not sure who, but it
10 was somebody prior to Leprino who decided it was a good idea to
11 build a plant that straddled two states. And apparently, when
12 we first started operating that plant, both states wanted to
13 apply all their inspections, etcetera. And eventually New York
14 deferred to Pennsylvania in matters of plant inspection, as
15 well as, as I understand it, reporting on the statistics.

16 MR. BESHORE: Somebody said the intake was on one side,
17 probably on the Pennsylvania side.

18 MS. TAYLOR: That's correct, the milk intake is on the
19 Pennsylvania side.

20 JUDGE CLIFTON: And how is Waverly spelled?

21 MS. TAYLOR: W-A-V-E-R-L-Y.

22 JUDGE CLIFTON: All right. And Greeley and Ft. Morgan are
23 both in Colorado.

24 MS. TAYLOR: Correct. Greeley is G-R-E-E-L-E-Y.
25 And Ft. Morgan, is typically abbreviated Ft. M-O-R-G-A-N.

1 JUDGE CLIFTON: Yes, with the Morgan being capital M and a
2 separate word.

3 MS. TAYLOR: Correct.

4 JUDGE CLIFTON: And then in Michigan, I know it's been
5 spelled in the record before, but I don't remember, how is
6 Remus spelled?

7 MS. TAYLOR: Remus is R-E-M-U-S.

8 JUDGE CLIFTON: Allendale?

9 MS. TAYLOR: A-L-L-E-N-D-A-L-E.

10 JUDGE CLIFTON: Thank you. I know you have done, someone
11 has done that before for me, but I thank you. Mr. Beshore.

12 MR. BESHORE: Okay.

13 BY MR. BESHORE:

14 Q. Do you know what proportion of your product, and I'll
15 just talk national, not export, is sold FOB the plant versus
16 delivered to customer's locations?

17 A. I do not.

18 Q. Would it be more than half, less than half? Which is
19 the greater?

20 A. I think that more than half is on a delivered basis.
21 The net effect on the economic side is pretty comparable.

22 Q. Okay. You have talked about distribution from
23 California east of the Mississippi and into the Southeast. Is
24 that, is that true? Do you distribute from California plants
25 East of the Mississippi and into the Southeastern United

1 States?

2 A. Yes, a great deal of our product flows into the
3 Southeast.

4 Q. From the California plants?

5 A. From the California plants.

6 Q. Okay. So to deliver from California to the Southeast,
7 you have a plant in New Mexico, correct?

8 A. Correct.

9 Q. And you have two plants in Colorado?

10 A. Correct.

11 Q. And you go past those plants, I mean not literally past
12 the plants, but you take product that's produced West of them
13 and deliver it to points hundreds of miles, hundreds of miles
14 east of those locations, correct?

15 A. Yes, and that's reflective of the vast consumption in
16 the Eastern Seaboard versus the vast production that we have in
17 our western network.

18 Q. Or is it based on the products that Leprino, where it
19 manufacturers its products as well?

20 A. There is an impact by product, but regardless, and we
21 have, over time, adjusted which products we're producing in
22 which plants. And even when, much of the product that's going
23 into the Southeast is in the IQF, the quality locked cheese
24 form. Even when Roswell was producing that same product forum
25 on a full-time basis, product from California was transported

1 into the Southeast.

2 Q. But less than it is now because Roswell is not
3 producing it, and therefore, you have to transport more from
4 California, correct?

5 A. I'm not sure that it's less. I have not seen that
6 data. There's a lot of California, because of the fresh
7 product that we're producing in Lemoore West, a lot of that
8 product is going up to the Upper Midwest, and so that is
9 displacing some of the QLC that we have produced otherwise
10 here, so I don't have the data to determine that. But the
11 movements are not irrational. They are -- they are, it's
12 because of the demand in the Southeast. There's a tremendous
13 amount of demand and we serve a lot of the large pizza chains,
14 and ship into their distribution centers in the Southeast.

15 Q. But it is a product of where you produce it and where
16 your customers demand it, it's a combination?

17 A. It's a combination. Yeah, we will optimize the system.

18 Q. The, what is the fresh product that you reference
19 that's produced in Lemoore West that's shipped into the
20 Midwest, Upper Midwest?

21 A. That's the ribbon product that I referred to quite
22 often, shipped into the Upper Midwest in the thousand pound
23 totes. As much as we would like to think that all customers
24 would want to have the quality locked cheese that we produce,
25 the IQF cheese, there are many customers who are food

1 manufacturers, whether they are making frozen pizza, or
2 entrees, or something else of that sort, who have shredding
3 operations within their production line. So if you can picture
4 a pizza production line, the cheese application is a very small
5 part of that. They already have the equipment that will shred
6 and dose it, so they are looking for bulk cheese rather than
7 pre-shredded cheese.

8 Q. Does anybody produce that product in the Upper Midwest,
9 any of your competitors?

10 A. Yes. A lot of those customers are buying from many,
11 many, different sources, and they will be using Mozzarella that
12 might be in block form, not ribbon, so the equipment is set up
13 so it is not constrained to only use the ribbon form.

14 Q. So is that an example of a situation where you say,
15 product is manufactured in California, shipped to converter
16 locations or processor locations outside of California, and
17 then shipped back into California for consumption?

18 A. Yes, that would be one of those cases, and it would be
19 shipped back into California. It could be shipped back in as
20 retail shredded cheese that's been packaged by those customers,
21 or it could be shipped back in in the form of a frozen pizza or
22 any number of other food items.

23 Q. Okay. Now, you have not offered any cost of
24 production. I mean, any manufacturing cost information from
25 Leprino for this hearing record. Do you intend to?

1 A. No. I know I could pull some data relative to
2 comparisons, say, of electricity or any number of other things
3 that are inputs. I can tell you that we, when I have looked at
4 that in the past, and I have challenged our production
5 accounting folks to dissect it in different ways. The
6 challenge with doing it on a plant basis is we have such
7 differences across the plants. But if you look at it relative
8 to the rate per input, our costs in California are
9 significantly higher than they are in outside of California.

10 Q. Well, the total production of cheese, these cheeses are
11 all, you know, you are different products are all specialized
12 and represent different costs among them, do they not?

13 A. For the individual cheese, absolutely.

14 Q. Okay.

15 A. And that's why you get driven toward looking at rates
16 and not rolled up numbers.

17 Q. There's also not been any price information offered
18 with respect to Mozzarella or any other Italian cheeses for
19 purposes of milk price, minimum milk pricing. Do you intend to
20 provide any for the record?

21 A. No, and quite honestly, the net returns for any typical
22 Mozzarella manufacturer equilibrate over time with a net return
23 for a cheddar maker, because there is sufficient flex capacity
24 across the country by companies who can divert milk into the
25 higher return use that will complicate the record by what is

1 the Mozzarella discount to the CME that offsets the higher
2 yield. And what's the manufacturing cost? The market forces,
3 the economics, and competition across cheese makers drives
4 those net returns to equilibrate over time, so it's not
5 necessary for the hearing record.

6 Q. So let me see if I understand this. First of all,
7 Mozzarella, or Italian, Mozzarella by itself there's more
8 Mozzarella production than there is cheddar production in the
9 United States today, correct?

10 A. As I said in my testimony, yes.

11 Q. And if you take all Italian types, there's roughly 50
12 percent more production total U.S. than cheddar production,
13 correct?

14 A. I haven't looked at all Italian.

15 Q. Okay. Well, the dairy product summary will be in and
16 shows that. And it's your position, and I take it that of the
17 Dairy Institute, that in order to have, that if you were to put
18 price and make cost information about the Italian types or
19 Mozzarella, it would just be too confusing for the Secretary to
20 figure out in coming up with minimum prices for producer milk,
21 correct?

22 A. It's my contention that it's irrelevant because it
23 doesn't represent a cheese that can be very specifically and
24 uniformly identified. If you do narrow it to that product that
25 could be narrowly identified, as I worked through in my

1 testimony, that's probably a low moisture part skim product,
2 and by the time you look at that volume, it is much smaller
3 than the cheddar production that's eligible to be reported.
4 Therefore, it's not worth looking at. On top of that, it's
5 also just inconsistent with the concept of going to the most
6 generic product. It's also inconsistent with the concept of,
7 again, the returns equilibrate.

8 Q. I understand that's your assertion, but there is
9 absolutely no information in this record in terms of financial
10 information, price, or cost information with respect to
11 production and sales of Mozzarella or any other Italian types
12 to evaluate that assertion; isn't that correct?

13 A. That's correct. But I have put into the record the
14 fact that you have much lower volume that would be eligible.
15 And, in fact, the co-op proposal does not use anything other
16 than cheddar, and so it was not something that we would have
17 even considered in the dialogue.

18 Q. But your economics, your testimony with respect to the
19 results of a minimum price with respect to cheddar are based on
20 what you assert would happen with respect to production of
21 Italian cheeses for Leprino and everybody else who does Italian
22 cheeses as well as cheddar manufacturers?

23 A. I'm not sure I understand what your question is.

24 Q. Okay. If we're pricing all cheese at one price,
25 Class III at one minimum price, when you talk about economic

1 effects, you are not, you are talking about economic results
2 for all cheese manufacturers, not just cheddar manufacturers.
3 When you assert that there will be constraints in production,
4 losses, etcetera, you are talking about everybody, not just
5 cheddar manufacturers, correct?

6 A. All producers of what I would term commodity cheese.

7 Q. Okay. Only producers of commodity cheese?

8 A. There are going to be some differentiated products,
9 whether it's on the cheese side or otherwise, that may have
10 different effects.

11 Dairy Goddess is producing cheese. Bless her if she
12 can get a much higher price at the local farm market, but in
13 California where 40 billion pounds of milk is produced, the
14 market must clear through commodity cheese.

15 Q. Okay. Your Honor, I would suggest this is a good time
16 for the morning break, at least I would make that motion.

17 JUDGE CLIFTON: I agree. And I notice that we have got
18 some new people that have arrived, and they may want to
19 testify, and this will give people a chance to greet them.

20 Ms. Vulin, did you have any extra copies of
21 Ms. Taylor's testimony? I know a couple of the gentlemen in
22 the back would like that.

23 MS. VULIN: We have one but we can make more.

24 JUDGE CLIFTON: There's some on the back chair. Okay.
25 Good. All right. Let us take a 15-minute break. Please be

1 back and ready to go at 11:17. 11:17.

2 (Whereupon, a break was taken.)

3 JUDGE CLIFTON: We are back on record at 11:18.

4 Mr. Beshore?

5 MR. BESHORE: Your Honor, there is a dairy farmer here who
6 has come to testify, and I'm certainly perfectly prepared to
7 yield to him testifying at this time, and he's prepared to go
8 forward now.

9 JUDGE CLIFTON: Wonderful. I invite you to come forward,
10 sir. And I'm going to ask that you come up on the platform
11 next to me. There are some steps at the opposite end of the
12 platform. Welcome.

13 You may be seated. I'll swear you in in a seated
14 position. What I'll do, I'll swear you in first, and then I'll
15 ask you your name, and to spell it, and then we'll go from
16 there.

17 MR. VERBURG: Okay.

18 JUDGE CLIFTON: Would you raise your right hand, please?

19 Do you solemnly swear or affirm under penalty of
20 perjury that the evidence you will present will be the truth?

21 MR. VERBURG: Yes, ma'am.

22 JUDGE CLIFTON: Thank you. Please speak into the
23 microphone rather than to me, because that way it will be
24 captured better. And state and spell your name.

25 MR. VERBURG: Okay. My name is Jacob, J-A-C-O-B,

1 V-E-R-B-U-R-G. My address is 1142 --

2 JUDGE CLIFTON: Let me stop you. We'll take a business
3 address if that's also where you operate your business.

4 MR. VERBURG: Yes, same.

5 JUDGE CLIFTON: Yes. All right. You may proceed.

6 MR. VERBURG: My address is 1142 North Hart Road, H-A-R-T,
7 Modesto, California. 95358.

8 JUDGE CLIFTON: And Modesto is less than a hundred miles
9 from here; is that correct?

10 MR. VERBURG: Yes, Stanislaus County.

11 JUDGE CLIFTON: Very good. Mr. Beshore?

12 DIRECT EXAMINATION

13 BY MR. BESHORE:

14 Q. I thank you very much for coming today, Mr. Verburg.
15 And you have some comments you would like to make and please
16 have at it.

17 A. Thank you. I have a written statement first and then
18 after a written statement, I have some comments to make about
19 our sick industry.

20 I, myself, and my son, we operate Verburg and Son
21 Dairy, and we are in support of the Federal Marketing Order
22 proposal put forward by the Cooperatives, and that's
23 Proposal Number 1.

24 My dairy operation, like I said, is in Modesto,
25 California. We milk between 950 and 1,000 cows. I have been

1 in the dairy business on my own for 53 years. Before that, we
2 were in the dairy business, of all places, in Torrance,
3 California, which is where we had a Cash-and-Carry, at most. I
4 don't know if everybody knows what a Cash-and-Carry operation
5 is, but that's where you milk the cows, you process the milk,
6 and you sold it through the front door. In those days, we're
7 talking about the '50's now, in those days you could actually
8 sell your milk for half a cent to two cents, depending on what
9 the state said, less than what the local grocer could sell it
10 for, because you were processing and selling on the premises.
11 I don't think there's a Cash-and-Carry left today. We were the
12 last dairy to leave Torrance because they passed an ordinance
13 saying we don't want anymore cows in the city. So we were the
14 last ones to leave Torrance.

15 As far as the rest of this, I'm just going to read it
16 to you. Okay.

17 Time and time again, I and other dairy producers have
18 called California Department of Food and Agriculture (CDFA) to
19 fix our state pricing system, so that I and other dairy
20 producers in our state are paid prices for our milk that are in
21 line with the rest of the country. The failure of the CDFA to
22 fix our state system has led me and other dairy producers
23 across the far state, to support joining the Federal Marketing
24 Order system.

25 I have been a dairy producer in California all my life.

1 Our state has some of the highest costs and of production in
2 the country, due to high cost of land, dairy input, cost
3 associated with environmental labor, which is really starting
4 to hurt us, and all the other many regulations that dairy
5 producers must adhere to in order to operate a dairy in the
6 State of California. Adding the unprecedented challenges
7 created by the ongoing historic drought, make the outlook for
8 dairy producers here more uncertain.

9 I and other dairy producers simply cannot afford to be
10 so significantly underpaid compared to dairy producers in the
11 rest of the country. As to the cooperative proposal states,
12 dairy producers in our state have been paid an average of \$1.85
13 a hundredweight lower average from August 2012 to May 2015. If
14 our prices are inline with producer prices in the Federal Order
15 system, we would not have seen more than 300 dairies exit the
16 last five years, and many more dairy producers questioning
17 whether or not to continue -- and my son is one of them.

18 Not only are we paid significantly less than farmers in
19 other states, we are also at a great disadvantage under the new
20 Dairy Margin Protection Program. Because our prices in this
21 state are so much lower, the Dairy Margin Protection Program is
22 much less effective in California, given the fact that all milk
23 price used for the MPPP approaching \$2.00 higher than the price
24 I and other dairy producers in our state receive. This program
25 provides no real safety net when prices are out.

1 I support the Cooperatives' proposal because it will
2 align our pricing with the Federal Order system, continue our
3 state quota program that dairy farmers have invested in over
4 many years, and bring the process of determining our prices
5 inline with the rest of the Federal Order system.

6 That's the end of my prepared written statement. Now,
7 I want to get personal.

8 I have one son that refused to milk cows. He said,
9 "Dad," he says, "I'm going to grow almonds." He said, "It is a
10 lot easier life and it pays better." I lost that son, but he
11 still, the fact remains is, my grandson is now farming those
12 almonds, and he's doing real well. Around my dairy, there is
13 no more open land, except what I own. It's all trees. When I
14 moved there in 1963, when I bought that ranch, there was 27
15 dairies on North Hart Road, which is two miles long. Today I
16 am the only dairy on North Hart Road. There are no others.

17 I know we're producing more milk today than what we did
18 in 1963, I understand that. But we have gotten more efficient.
19 The system has made us more efficient.

20 My other son today, he is saying, "Dad, why are we
21 doing this?" Because I love cows. But still, we can't
22 continue the way we're going, it's not going to work. You are
23 going to lose more and more of these producers. So I ask this
24 hearing, please consider these proposals that are before you
25 right now and today.

1 If you have any questions, please, I'll answer them to
2 the best of my knowledge.

3 JUDGE CLIFTON: Mr. Beshore.

4 CROSS-EXAMINATION

5 BY MR. BESHORE:

6 Q. Thank you, Mr. Verburg. I had just one question. I
7 don't think you covered this. Can you just tell us a little
8 bit about how you market your milk, who you sell it to, and
9 what your history's been that way. And also, I'll just throw
10 out a second question, you can get into both of them. Do you
11 have any quota and how do you look at that?

12 A. My dairy sells milk, for 40 years we sold to Berkeley
13 Farms which were the Sabbati Brothers, they sold their
14 operation to Dean Foods. When Dean Foods bought it, they
15 decided that they were going to have all their milk come from
16 DFA. I'm not a very co-op minded-type person. I'm too darn
17 independent to be co-op minded. Even my walnuts don't go to a
18 co-op, okay? And I do have walnuts.

19 So when Berkeley decided they had to have co-op milk, I
20 quit Berkeley and I went to Foster Farms, which is now no
21 longer Foster Farms, but they go under a different label today.
22 But that's where my milk goes to today, is to Foster Farms. I
23 have been with Foster Farms now for about six and a half, seven
24 years.

25 As far as my quota, I'm one of the few people in the

1 state that is covered by over 80 percent of my production,
2 which is covered by quota. If you look at the value of the
3 quota today, the value of my quota is over \$2 million, if I
4 were to sell it tomorrow morning. So a lot, I hear a lot of
5 arguments from fellow dairymen saying, "Oh, well, if I had your
6 quota, I would never go for a Federal Order because you are
7 going to lose your quota." Okay. I feel so strongly about
8 this Federal Order that it's going to work and we're going to
9 be able to keep our quota, that I am willing to sacrifice that
10 \$2 million. That answer your question?

11 Q. Yes, sir.

12 JUDGE CLIFTON: Who next has questions for Mr. Verburg?

13 MR. VERBURG: You got a pretty quiet crowd here today.

14 JUDGE CLIFTON: Yeah, but they are thinking. You just --
15 you just unloaded a lot, as you know. Ms. Taylor?

16 CROSS-EXAMINATION

17 BY MS. TAYLOR:

18 Q. Good morning, Mr. Verburg.

19 A. Good morning.

20 Q. My name is Erin Taylor. I'm with the US Department of
21 Agriculture, and I would like to first thank you on behalf of
22 the Department for coming here today and taking time out of
23 your schedule to come down here and give us your thoughts on
24 this proceeding. It is very important the Department hears
25 directly from producers, so we first want to thank you for

1 participating.

2 You said you milked about 950 to 1,000 cows. The
3 Department, in making its findings, has to consider the impact
4 on small businesses. And the way that's defined, we have come,
5 and roughly about a production of 315,000 pounds of milk a
6 month. Would you fit under that small business definition?

7 A. No, I'm over that.

8 Q. And you stated you have over 80 percent of your
9 production covered by quota?

10 A. Yes, ma'am.

11 Q. Is it your opinion that that quota and that extra value
12 you get from that is helping you keep business going when you
13 feel that the prices aren't currently aligned? You are not
14 getting an adequate price as compared to other producers in the
15 rest of the country?

16 A. Correct.

17 Q. Okay.

18 A. That's correct. The quota right now, last time I
19 checked, quota was bringing back a net return of about 16
20 percent. So nowhere else can you get an investment today in a
21 bank and get 16 percent back on your investment. Okay? So
22 quota has always been an excellent deal, and that's why I own
23 as much quota as what I own.

24 Q. How long have you owned that quota? Have you been
25 purchasing as you have been getting --

1 A. I have been purchasing over the last, almost when
2 Gonsalves Pooling Act came in, which is what created the quota
3 system, when Mr. Gonsalves created that in the legislature,
4 that's what I received, I think, something like 120, 130 pounds
5 of quota, because I was only milking at that time 72 cows. So
6 over the years, I have always, when I increased my herd, I
7 increased my quota, because it's always been a good deal. A
8 lot of guys bought new pick ups and new cars for their mother,
9 but not me. I bought quota.

10 Q. Thank you very much.

11 JUDGE CLIFTON: So, Mr. Verburg, you understand that if the
12 USDA proposes that there be a Federal Milk Marketing Order for
13 California, that the proposal would then be voted on by people
14 such as yourself?

15 MR. VERBURG: Yes. Yes, I understand that. And believe it
16 or not, I'm a citizen of this country now, so I can vote.

17 JUDGE CLIFTON: You say that as if it's not been always
18 true.

19 MR. VERBURG: Well, it's been true for the last 25 years.
20 But you got to remember, mom and dad showed up in this country
21 at Ellis Island in 1952 with ten squalling brats. Okay? And I
22 was one of the ten squalling brats.

23 JUDGE CLIFTON: You were a squalling brat in your younger
24 years?

25 MR. VERBURG: Weren't we all? Just ask your mother.

1 JUDGE CLIFTON: From what country did your parents come?

2 MR. VERBURG: We are all emigrated from Holland.

3 JUDGE CLIFTON: Holland. And is Verburg a dutch name?

4 MR. VERBURG: Oh, absolutely. Yes, it is.

5 JUDGE CLIFTON: It doesn't seem to have enough vowels to be
6 Dutch.

7 MR. VERBURG: You are talking about someone that's from
8 Friesland, not from Holland. Okay? If it's Fries, which the
9 other half of the dairy population is Fries, okay? That's the
10 province of Holland that's clear up against the German border,
11 Okay? That's Fresland. Okay. In Holland we always called
12 them a "Frases stive kopf, sic" which means a free stiff head.
13 Because they were very stubborn individuals, not that Dutchman,
14 because I think I just explained to the gentlemen back here a
15 little while ago, I said, "You know, when it comes to Dutchmen,
16 wooden head, wooden shoes, wouldn't listen."

17 JUDGE CLIFTON: Do you know how to spell Fresland?

18 MR. VERBURG: Yes.

19 JUDGE CLIFTON: How is it?

20 MR. VERBURG: F-R-E-S-L-A-N-D, freeze land.

21 JUDGE CLIFTON: Thank you. Who else would like to question
22 this producer?

23 MR. VERBURG: He's got a question, I just know it.

24 JUDGE CLIFTON: Are you talking about Mr. Hill right here?

25 MR. VERBURG: No, I don't know the gentleman's name, but I

1 can see it on his face.

2 JUDGE CLIFTON: Mr. Vetne, do you have any questions for
3 Mr. Verburg?

4 MR. VETNE: No, but I'm going to walk up here anyway. I
5 just wanted to bond with you a little bit. I was one of --

6 JUDGE CLIFTON: Identify yourself, please.

7 MR. VETNE: I'm John Vetne, I'm a representative for Hilmar
8 Cheese, and I was one of three squalling brats that arrived in
9 this country in 1952 from Norway, not too far away, ya?

10 MR. VERBURG: Yeah. But I didn't think that was your
11 question.

12 JUDGE CLIFTON: Does anyone else have questions for
13 Mr. Verburg? None. You do get off lightly, sir.

14 MR. VERBURG: I have been lucky all my life. The reason I
15 have been lucky all my life is because this country let me in,
16 and that's why I have been lucky. I'm proud to be an American
17 citizen.

18 JUDGE CLIFTON: Ms. Taylor, I know you hate to follow that,
19 but welcome back. And thank you both Ms. Taylor and
20 Mr. Beshore, for yielding the floor. And Mr. Beshore, you may
21 resume your examination of Ms. Taylor.

22 CONTINUED CROSS-EXAMINATION

23 BY MR. BESHORE:

24 Q. Marvin Beshore. Thank you, your Honor.

25 Ms. Taylor, when we left off, if I remember, we were,

1 some of the discussion was with respect to the use of cheddar
2 costs, the cheddar, cost of manufacturing cheddar as a proxy
3 for cost of making all cheeses with one Class III price, and
4 you indicated that you felt the costs of making Mozzarella or
5 Italian cheeses and cheddar would equilibrate over time, that
6 they would be close because -- is that a fair?

7 A. I think you misunderstood me.

8 Q. Okay.

9 A. It's the net returns that equilibrate over time. You
10 have different yields, different costs, different prices
11 received, but it is the margin that re-allocates milk to
12 whatever the higher margin product is.

13 Q. Are you -- is there plant capacity that can switch from
14 one to the other in terms of the higher return?

15 A. Yes. Divisco has flex capacity of significance. I
16 believe that Foremost Farms still has capacity, I believe that
17 Land O'Lakes still has capacity that can flex between cheddar
18 and Mozzarella production. Additionally, over time you will
19 see new plant investments that convert plants, if again, the
20 margin on one cheese exceeds the sustained margin on another
21 cheese.

22 Q. Okay. So as far as pricing of milk for cheese is
23 concerned, while there are at anytime different returns perhaps
24 from different products, over time you are satisfied with one
25 minimum regulated price because over time the returns will

1 equilibrate or equalize?

2 A. Yes, and specific to commodity cheeses.

3 Q. Is that what Leprino makes, commodity cheese?

4 A. Yes. I would say that the Mozzarella space, we have a
5 fair amount of specialization within that space. But we're
6 still disciplined in the marketplace relative to the
7 alternatives, like any other commodity cheese.

8 Q. Okay. You have suggested in your testimony that if
9 there is, that there's substantial risk in setting the
10 regulated price too high, over regulating prices results in
11 disorderly marketing, etc., I'm on page 3. Can you tell us,
12 since the current prices were established in the Federal Order
13 system in 2000 with Federal Order Reform, what disorderly
14 marketing has been created by the Federal Order prices?

15 A. There -- in the area of discretionary application of
16 that milk price due to nonpool plants in areas where the
17 location value is lower, there has not been disorderly
18 marketing for, because, for example, in the Pacific Northwest,
19 all the primary cheese assets are owned by cooperatives and
20 they have chosen not to be bound by the Class III formulas, as
21 I understand it. They don't use the NDPSR in their formula at
22 all because it overvalues the cheese price.

23 Similarly, in 2007, when the whey value exceeded what
24 could be returned by cheese makers who didn't have that whey
25 capacity, and in some cases cheese makers who had fractionation

1 capacity but the returns didn't meet the sweet whey assumption
2 in the formula, because they were not bound by minimum
3 regulated prices being nonpool plants, they negotiated safety
4 valve releases, and so in those cases, had they been bound into
5 the regulation, as Proposal 1 suggests, there would have been
6 disorderly marketing.

7 Relative to cases where the Class III price applied and
8 created disorderly marketing because those cheese plants were
9 in areas where essentially you have to participate in the Order
10 regulations in order to compete for milk, those areas I'm not
11 sure I can come up with a specific disorderly marketing
12 condition. Many of those also have higher value, milk higher
13 value cheese returns because they are so close to the
14 consumption areas.

15 Q. Okay. So you are saying the Pacific Northwest is an
16 area, but let's set that aside for the moment. Can you tell me
17 what other areas or plants or players you are talking about
18 with respect to the 2007 situation in the Federal Order system?

19 A. Again, we may be defining things differently and
20 precisely, because some of these are, you know, they are in
21 areas that are regulated by Federal Orders, but the Federal
22 Order price is such that either that or their ownership
23 structure is such that they are not bound to that Class III
24 price. I'm thinking of places like the Southwest, where I
25 understand that the JV between Glanbia and the co-ops drive a

1 price on a product price formula that is separate from the
2 Class III formula. And so by its nature result in prices that
3 sometimes fall below Class III. I believe that the same would
4 be considered for the plant in Dalhart, Texas. I don't recall
5 the particular situation in 2007. I have also been told that
6 there were and Utah cheese plants that, again it is, right now
7 we don't have an Order that specifically --

8 Q. There was no Order there in 2007.

9 A. -- covers that geography, but ordinarily some of those
10 plants would have paid on Class III and negotiated with their
11 milk suppliers during that period to pay a lower price that was
12 more appropriate based on their returns. And so the lack of
13 disorderly marketing in that period west of the Mississippi,
14 was largely related to the lack of a binding price.

15 Q. Now, do you have personal knowledge of the terms of the
16 joint venture between, with respect to Glanbia and Southwest
17 Cheese?

18 A. I do not have knowledge of the specifics.

19 Q. Okay. So any testimony that you are giving with
20 respect to what prices may be payable by Southwest Cheese for
21 milk at that plant, are not based on your personal knowledge?

22 A. That's correct.

23 Q. And, of course, in terms of my question was in 2007,
24 now you talked about Utah, but there was no Federal Order there
25 in 2007. You understand that, correct?

1 A. That's correct.

2 Q. So then in terms of 2007 problems in the Federal Order
3 system you are citing Southwest cheese for which you have no
4 personal knowledge of the transactions, and the Dalhart plant,
5 is that it? Are there any other, do you have any other
6 examples of issues that you would cite?

7 A. There were, my understanding again, Pacific Northwest
8 we have cheddar production made by cooperatives. And my
9 understanding is that it is not isolated to 2007 in that case.
10 But because the NDPSR price is a weighted average across the
11 country, and that average represents some location value east
12 of Washington State, that they do not pay a milk price that's
13 based on the NDPSR survey. They have that discretion, both
14 because, again, cheese in the Federal Order, typically cheese
15 milk is not obligated to be part of the regulation,
16 additionally, because they are cooperatively held.

17 Q. Okay. So because they are cooperative plants they
18 don't count basically, is your view?

19 A. Oh, certainly they count, they are an important part of
20 the market. But relative to disorderly marketing, because they
21 are not obligated to pay the price that otherwise overvalues
22 milk, it didn't create disorderly marketing.

23 Q. In terms of what was paid, what's been paid for milk in
24 the Pacific Northwest, you would agree with me, would you not,
25 that the mailbox price information that's regularly compiled by

1 the federal Market Administrator and published as part of this
2 record would indicate what's being paid to producers?

3 A. What's being paid to producers, correct.

4 Q. Okay. And if that's being paid by producers by
5 cooperatives, they are, they must be getting the money
6 somewhere to pay it to producers, correct?

7 A. Yes. And the cooperative has a range of outlets, both
8 from their own production which covers a market basket of goods
9 that goes well beyond cheese, so it can be coming from that.
10 It also could be coming from revenue on their bulk milk sales.

11 Q. Okay. So, let me ask this. Have you done any, as I
12 understand it, your testimony and the Dairy Institute position
13 with respect to pricing in the Federal Order system, is that
14 the relief valve of depooling provides a significant revenue
15 protection for purchasers of milk in Federal Order system that
16 you don't see in Proposal 1 and is a major factor in opposition
17 to Proposal 1; is that correct?

18 A. It's not revenue protection, we're talking about cost.

19 Q. Okay. Cost. That the cost that, that the depooling
20 option, from your perspective, reflects a cost of milk that is,
21 reflects a cost of milk factor that is important and not
22 reflected in Proposal 1, correct?

23 A. I'll depart from depooling because I think depooling
24 implies that the milk is normally pooled, and say that the
25 optional pooling and participation provides a relief valve

1 against regulated prices that are above market clearing levels.

2 Q. Okay. And, therefore, if it applies, if it involves
3 any relief at all, would have to mean that the buyers are
4 paying less than the minimum regulated price, the nonpool
5 buyers, correct?

6 A. Not necessarily.

7 Q. Well, if they are still paying the minimum class value,
8 what's the relief?

9 A. There are decisions to be made relative to, let's say
10 that you ordinarily pooled and you see an economic opportunity
11 for a short time, it may be that the repooling provisions are
12 such that that will impact, you know, your decision to be in or
13 out in any given month.

14 Q. Have you done any studies for this record of the
15 economics of pooling, electing not to pool, depooling, and
16 actual prices paid for milk for the manufacture of cheese in
17 any Federal Order markets?

18 A. No.

19 Q. Let me -- the map regarding production and consumption,
20 shifting topics here. I just have a couple of more loose ends.
21 On page 8 of Exhibit 135. That doesn't reflect any export
22 consumption, correct?

23 A. Correct. And that's where the middle of the page 7 I
24 noted that if you just do a kind of broad adjustment, the
25 646 pounds reduced by 15 percent exports, then the domestic

1 consumption would be implied to be 549.

2 Q. Okay. But the western states are majors, including not
3 just California, but Idaho, Washington, Arizona are major
4 exporters of manufactured dairy products, are they not?

5 A. Yes.

6 Q. With respect to the request to include a .15 cent
7 add-on to make allowances, whey make allowance, or cheddar make
8 allowance, or western-based prices, that .15 factor in the
9 Federal Order formulas is based on data from what, the Reform
10 process?

11 A. That's correct, so it's probably low.

12 Q. Okay. But it is good enough as long as we get it in
13 there?

14 A. At the moment it is, until we have such time to have
15 some broader study on the issue.

16 Q. Which might apply to prices as well, they are good
17 enough now until we had a national hearing to potentially
18 change them?

19 A. No, I wouldn't agree with that. I think that you
20 significantly risk plant capacity in the application of your
21 proposal. The magnitude of the overvaluation is much more
22 significant. If we're off on this .15 by a factor of 2, if
23 really it should be .3 at this point, just knowing our own
24 cost, I would be confident to say that that factor should not
25 be lower, if anything it's higher. We are off by less than

1 two-tenths of a cent per pound. We are not multiplying that by
2 10. Pretty minimal.

3 Q. Just so we understand, and there's no question here,
4 it's fine to be off low, but you don't want to have any
5 possibility of being the least bit high in prices, correct?

6 A. No, actually, if we're off on this, it would mean that
7 we're going to be overvaluing milk. But we're off by, we're
8 overvaluing it by a much smaller magnitude .15 to .3. Let's
9 say that the administrative and sales costs are double what
10 we're estimating here. That's a much lower magnitude of being
11 off. You know, if we corrected it, we would have a lower
12 regulated price.

13 Q. Right.

14 A. But what you are talking about is potentially a
15 regulated price that's off by, you know, north of a dollar, not
16 overestimated by --

17 Q. Right. We're talking about the dollar plus that
18 Mr. Verburg just testified about, that is the difference
19 between what he's paid for milk and what producers in the rest
20 of the country are paid for milk for the same purposes,
21 correct?

22 A. I missed his testimony.

23 Q. You did?

24 A. I did.

25 Q. That's a shame. Okay. On page 6. You have stated

1 that this is the second full paragraph, first sentence.

2 "Proponents of Proposal 1 have questioned the existence of a
3 spatial price pattern for dairy commodities that is essentially
4 West Coast plus transportation cost to markets in the East."

5 Now, are you talking about testimony there or are you
6 just making a, you know, a rhetorical assertion?

7 A. As I listened to Mr. Hollon's testimony at this
8 hearing, my recollection of his answers was that he did not
9 acknowledge any kind of a spatial price relationship for
10 commodities across the country.

11 Q. That's what you heard?

12 A. That's what I heard.

13 Q. Did you hear Mr. Schad's testimony?

14 A. I was gone from the hearing for a week, so I listened
15 part of those days, but also had a different meeting for part
16 of those days, so I'm not sure. I heard some, but not all, of
17 his testimony.

18 Q. Okay. Is it possible that, or isn't it correct that,
19 just as the USDA recognized that there are varying FOB prices
20 for dairy commodities throughout the country, whether they be
21 butter, powder, cheese, but there should be one price as a
22 policy that Proposal 1 recognizes a fact of there being
23 different FOB prices in some areas but advocates a price policy
24 of one price. Isn't that the fair representation of
25 Proposal 1?

1 A. I'm not fighting the idea of having one manufactured
2 milk price. In fact, I'm an advocate, in that must be valued
3 at the lowest value return market to which the regulations
4 apply, otherwise you imperil plant capacity.

5 Q. Okay. So the lowest one price, no average pricing, the
6 lowest narrow set of FOB prices that apply, that's your
7 recommendation?

8 That's a cross-examination question, I can ask her if
9 that's her recommendation?

10 JUDGE CLIFTON: I'll hear your objection, but I'm going to
11 allow the witness to answer. She's doing perfectly fine on her
12 own.

13 MR. ENGLISH: I think she is, but it may be perfectly fine
14 except when you start characterizing what she said before. And
15 I don't think she ever used the word narrow and I just have had
16 this concern in the past that this would have been an attempt
17 to re-characterize. And that's my objection.

18 JUDGE CLIFTON: Your objection is noted. Mr. Beshore,
19 would you ask your question again?

20 MR. BESHORE: I think I would like it to be read back.

21 JUDGE CLIFTON: All right.

22 (Thereafter, the requested testimony
23 was read by the court reporter.)

24 JUDGE CLIFTON: We're back on record. Ms. Taylor, you may
25 respond.

1 MS. TAYLOR: When you look at the Dairy Institute proposal
2 which advocates the use of commodity prices from, originally it
3 was the full western area, but as I described in my testimony,
4 the intent is, you start on the West Coast, Washington, Oregon,
5 and California, and then extend east to the point where you
6 essentially overcome some of the confidentiality issues on the,
7 on any concerns from USDA's perspective. If, in fact, USDA
8 were to find that Washington, Oregon, and California, were
9 inappropriate grouping of states, it would be very difficult to
10 argue that that's a narrow set given their total milk
11 production and also commodity production that would be included
12 in the survey.

13 MR. BESHORE: Okay. I have no other questions at this
14 time, your Honor. Thank you, Ms. Taylor.

15 JUDGE CLIFTON: Mr. Vetne?

16 CROSS-EXAMINATION

17 BY MR. VETNE:

18 Q. John Vetne, representative for Hilmar Cheese.

19 Ms. Taylor, you were -- you were asked a question or
20 two about milk going for manufactured use that is not pooled,
21 there was some concern about the terminology depooled or not
22 pooled, I'll use not pooled. And do you recall that, first of
23 all, are we on the same page?

24 A. I think there were multiple questions so as you
25 progress I should catch it.

1 Q. Okay. We're in the same neighborhood, let's see if we
2 can get to the right house.

3 And as I recall, you questioned the extension of that
4 to a conclusion that the buyers did not pay class price or an
5 equivalent non-compulsory value for the milk.

6 Do you recall your answer there?

7 A. Is this in regards to the Pacific Northwest and other
8 areas largely in the west?

9 Q. Or any market, yeah.

10 A. Yes.

11 Q. Well, any market in which milk was not pooled, and
12 there was a question about whether class prices are being paid
13 or not.

14 Do you recall that?

15 A. Yes.

16 Q. Okay. Would you agree with me that in markets to the
17 west of the equilibrium line, let me put it that way, west of a
18 point in geography where the average is reached, that from that
19 point west, and further west you go, there would be a challenge
20 to pay a regulated price because the price surface shows a
21 lower value than the average price at those locations west of
22 the midpoint?

23 A. Yes, that would be correct, particularly if it was a
24 cheese plant that had same economics as are reflected in terms
25 of yield and cost structure, as are reflected in the formulas,

1 the regulated formulas.

2 Q. So if such a plant's or such a milk supply, let's put
3 it, not the plant, milk supply, whether it is the plant's
4 producer patrons or cooperatives supplying the plant receive
5 milk that was not pooled, that usually occurs on occasions
6 where the classified price is higher than the blend price,
7 correct?

8 A. If it's depooled, it would generally be because the
9 classified price is above the plant price, there could be milk
10 that's not pooled for many other reasons.

11 Q. Yes, okay. When there is that inversion in class price
12 values versus pool price values, would you not expect that the
13 difficulty of a cheese manufacturer or pool supplier to pay
14 class prices would be even greater if during those months a
15 contribution to the pool had to be made as opposed to other
16 months in which there might be a draw?

17 A. When milk is depooled due to competitive reasons in
18 some markets, the plant may still pay out that. If they don't
19 have to pay that out for competitive reasons, then it does
20 provide a cushion to some extent for those months in which they
21 do participate and adhere to the class price.

22 Q. And there are some other regulatory factors which
23 improve the plant operators or milk suppliers' ability to pay
24 dairy farmers for milk that is not pooled, and one of those is,
25 there's a savings, temporary or otherwise, of the

1 administrative assessment, correct?

2 A. Yes.

3 Q. Okay. Does Leprino make something that I buy in the
4 store called fresh Mozzarella?

5 A. If you are referring to the Mozzarella balls in brine,
6 we do not.

7 Q. Okay. Yes, that's what I'm referring to. Is that a
8 whole milk Mozzarella? High fat?

9 A. I believe so, but I'm not specifically knowledgeable
10 about it.

11 Q. Okay. Do you make something called stirred curd
12 Mozzarella?

13 A. We do not. All of our product is pasta filata.

14 Q. Pasta filata? What's filata mean?

15 A. Taken together I can tell you that it refers to the
16 stretching and kneading process within Mozzarella cheese
17 making. I'm not sure which piece means which part.

18 Q. Okay. Your plant in, that straddles the
19 Pennsylvania-New York line in Waverly, some state, city called
20 Waverly in one of those states, does the nearby milk shed
21 extend into a portion of Pennsylvania that is not regulated by
22 a state pricing and pooling system?

23 A. We purchase all of our milk in that area from a
24 cooperative so I don't have all of the details. My
25 understanding is, in the Northeast, of course, we're nonpool

1 plant, so the co-ops decisions around whether to pool or not
2 are made on an economic basis. But largely the milk that we're
3 buying I would expect to be associated with the Northeast
4 Federal Order, and my understanding is that the Pennsylvania
5 Milk Marketing Board does not regulate Class III milk, so it's
6 not -- the milk may be procured from an area that doesn't show
7 up on the map as being part of the Federal Order but resides in
8 Pennsylvania, but I'm not sure that the pricing gets impacted
9 by the existence of the state pricing system.

10 Q. Are you aware there are some regulatory obstacles in
11 the Northeast order to bringing milk into the pool and taking
12 it off the pool on a monthly basis?

13 A. Yes.

14 Q. Okay. So you don't know whether the milk that you
15 receive from the cooperative includes milk that the cooperative
16 might elect to participate in unregulated transactions in
17 Pennsylvania, simply surplus to that market, but not priced by
18 the state authorities?

19 A. Correct, I would not know that.

20 Q. And it's also not too far from the Western New York
21 State Order, which is a pricing and pooling location, state
22 milk pricing and Milk Pooling location, correct?

23 A. Correct.

24 Q. And you don't know whether the milk that the
25 cooperative delivers to you may be milk that is priced under

1 the state system?

2 A. That's correct.

3 Q. Okay. You indicated that your cheese is marketed to
4 buyers under two major alternative pricing systems for your
5 company. One is, you make an agreement and agree to ship
6 finished cheese to location your buyer says to deliver it to
7 and you price it at that location, you take care of
8 transportation; is that correct?

9 A. Correct.

10 Q. That's one. And you also sell cheese FOB your plant.
11 A buyer will purchase the cheese, take title at that point, and
12 take care of transportation; is that the other one?

13 A. Correct.

14 Q. Okay. Would it be correct to say that the AMS NDPSR
15 system does not allow for similar marketing options for cheese
16 plants because milk is priced FOB the storage facility?

17 A. Okay. So you are bringing up an interesting nuance
18 that I think is a problem within the data collection for NDPSR.
19 My understanding is that the price to be reported if that plant
20 is being sold directly from the plant is supposed to be
21 reported FOB --

22 JUDGE CLIFTON: Start again. The price to be reported if
23 and then start again.

24 MS. TAYLOR: If it is sold --

25 JUDGE CLIFTON: If what is sold?

1 MS. TAYLOR: The cheese or any other reportable product.
2 So it would apply to cheese, butter, nonfat dry milk, and whey.
3 That if it is sold from the manufacturing plant, that the, I
4 believe the price gets reported FOB manufacturing plant.
5 However, if the manufacturing plant moves that product to a
6 storage location prior to its further distribution and
7 delivery, the price is reported FOB storage location, which, if
8 that storage location is located close to the plant location,
9 probably doesn't significantly impact its location value.
10 However, one thing that we have encountered is, for example, we
11 do produce some nonfat dry milk in our Greeley plant.

12 BY MR. VETNE:

13 Q. Greeley?

14 A. Greeley, Colorado.

15 Q. Yes.

16 A. And I became aware that because we were moving that
17 product to Michigan for storage and absorbing that cost,
18 essentially the NDPSR price that we were reporting incorporated
19 that gain in location value as we moved it East, it was
20 reported, essentially we ate the transportation to the extent
21 that that gets rolled into the survey price.

22 Q. Okay. So if you had storage of the -- to the extent
23 you have storage of that product in Colorado and you reported
24 FOB the Colorado location, you report a lower price because you
25 have not yet, the system has not yet attached a lower a

1 transportation cost to that movement.

2 A. Try to make sure I understand. The price reported in
3 Colorado would be reflective of the location value of that
4 product in Colorado. Once we move it to a location further
5 east, if it goes into storage rather than going directly to a
6 customer, the price gets grossed up effectively to the location
7 value that exists in that area where we store it.

8 Q. Okay. So let me see how I -- so powder, for example,
9 from Colorado, could be reported at two different prices; one,
10 a price at the Colorado location, FOB the Colorado location,
11 which would be a lower price than a price say in Michigan,
12 correct?

13 A. Yes. But that option is not ours the way the NDPSR
14 survey is written. Once we make that movement, we have no
15 option relative to netting out the transportation costs that
16 drove that higher value.

17 Q. So if you sold it, if you sell it FOB Colorado and your
18 buyer moves it to Michigan, you report one price, which is
19 lower than if you move it to a storage location in Michigan and
20 then you report the higher price and that higher average gets
21 incorporated into the NDPSR survey?

22 A. That's correct.

23 Q. Okay. And are you aware that USDA's questions and
24 answers on that kind of transaction is that that kind of
25 movement is or should be reflected in the make allowances part

1 of the marketing costs?

2 A. I have not had those direct conversations. I have
3 heard that some others have gotten that response.

4 Q. Okay. You had a series of questions and answers, as I
5 recall, you used the term flex movement of shifting of milk
6 supplies between different products produced by the same
7 company to cheddar or Mozzarella back and forth depending on
8 which is the highest and best return to the company at the
9 moment, correct?

10 A. Yes.

11 Q. Recall that? For a broader producer milk supply, not
12 limiting it to a manufacturing plant operator that has both
13 kinds of plants, would you not expect producers in the market
14 to respond the same way by shifting their available milk
15 supplies to the highest and best use within those two
16 categories at any given time?

17 A. I think that those adjustments, if you are talking
18 about incentives within the same product group, probably happen
19 more gradually in that when a company decides to give up milk,
20 they also have the penalty of unabsorbed overhead, and they
21 also have the constraints relative to satisfying those
22 particular customers, and so it's not something that's
23 generally done for minor disparities in returns. And I would
24 expect any disconnects on a short-term basis between, say,
25 Mozzarella production, economics in cheddar to be very minimal

1 by contrast with what I talked about the other day in Part 1 of
2 my testimony, where across product classes, the butter powder
3 complex versus the cheese complex, sometimes those disparities
4 are closer to the \$2.00 range. And so I would expect the
5 reallocation to happen more readily with those kinds of
6 disparities than on a short-term basis between, say Mozzarella
7 and cheddar. It would have to be a longer-term disconnect
8 between Mozzarella and cheddar. And I just don't see that
9 happening because of the number of companies that have the
10 internal flexibility to do that re-allocation. I don't see
11 that level of disparity between the complexes.

12 Q. Based on your observations of the market for milk to
13 those two commodities, would you say that although there may be
14 slightly different incentives to produce one over the other,
15 that the disconnect is not as great as you might see between,
16 say Class IV kind of products and Class III kind of products?

17 A. Yes.

18 Q. Okay. Okay. Finally opening your statement. And I'm
19 on paragraph, page 2, about 6 lines up, well, five lines up.
20 The lines start with the word "values". That clause is a
21 "level that does not exceed values after allowing for" do you
22 see that line?

23 A. Yes, yes.

24 Q. Okay. I inferred when I read this, that you meant
25 product values, but I want to make sure that finished products,

1 dairy product values?

2 A. I wasn't thinking that narrowly. I was thinking more
3 broadly. The, you know, the overall milk price that's the
4 combination of prices received yields and cost of conversion.

5 Q. Prices received would be received for products?

6 A. Correct.

7 Q. Cost of conversion would be manufacturing allowance,
8 correct?

9 A. Correct.

10 Q. And after that is done, you end up with the milk price,
11 correct?

12 A. Extended by a yield, yes.

13 Q. Okay.

14 JUDGE CLIFTON: I'm sorry, what was your response?

15 MS. TAYLOR: Extended by a yield, yes.

16 JUDGE CLIFTON: By a yield.

17 MS. TAYLOR: By yield.

18 BY MR. VETNE:

19 Q. I'm still not understanding why I was wrong to read in
20 the word product. The minimum regulated price of milk
21 California must be set at a level that does not exceed values
22 after allowing for reasonable returns.

23 A. My interpretation of your question was that you were
24 narrowing it to the price of the product.

25 Q. Okay. Got it. Now I'm on page 5. The paragraph that

1 ends on top of page 5. You refer to the "hearing record
2 revealing that the whey factor in the current Class III price
3 formula overvalues the whey relative to what can be achieved by
4 small cheese makers."

5 I was left with the impossible impression that large
6 cheese makers have done just fine with the whey formula. Isn't
7 it true that there have been times when it is overvalued for
8 anybody that doesn't make dry sweet whey?

9 A. Yes, that has been the case. At times, when the
10 protein the more highly fractionated whey products sometimes
11 don't achieve the same value returns as the dry whey, and
12 probably rather than refer to, in this sentence, small cheese
13 makers, I more appropriately should have referenced cheese
14 makers with insufficient scale to economically process whey.
15 Because, in fact, I think Mr. Murphy's testimony and other
16 testimony that we have had, would indicate many people who have
17 plants that are up to, say 2 million pounds of milk. I think
18 Mr. Murphy was referring to volume of whey. I don't recall
19 that it was one and a half million, but in any case, they are
20 not insignificantly sized plants that still struggle to put in
21 the equipment and efficiently process the whey.

22 Q. All right. Your testimony, as I read it, pays
23 particular attention to the importance as well as the
24 difficulty of establishing economically sound Class III and IV
25 prices, correct?

1 A. Yes.

2 Q. Okay. Now, the system regulates Class I prices, the
3 price for milk going into a package or a bottle, which is then
4 sold, but for those products, the regulations do not fix the
5 margin, correct?

6 A. That's correct.

7 Q. It doesn't come at you both from the top and the
8 bottom, it's just the bottom, the price for milk.

9 A. That's correct.

10 Q. And that is also true for Class II products?

11 A. Correct.

12 Q. Class III and IV involve unique regulatory economic and
13 policy factors, because it is based on the calculation that
14 takes a product price and produces a milk price, and in that
15 calculation, the manufacturer only has what's left in the
16 middle.

17 A. That's correct.

18 Q. And if manufacturers of any of those products that from
19 which the regulated prices are derived, first individually, if
20 individual manufacturers sought to recover some of that
21 inadequate margin or overvalued product price from buyers, they
22 would face resistance in the commodity market competition,
23 because other buyers would offer it lower. There is that
24 problem when you are trying to pass on that cost, correct?

25 A. Yes, there are two problems with the construct. One

1 is, obviously competition from alternative supply sources
2 always discipline what you can recover from the marketplace,
3 regardless of what product that you produce. But additionally,
4 it is the circularity that you point out. Where, if you do
5 have the ability, and maybe the overall market has the ability
6 to raise the prices, the rigidity of the end product price
7 formulas means that that translates into a higher milk cost.
8 It doesn't better your situation overall if the entire complex
9 goes up. If you are a first adopter and are able to achieve
10 that price, you may have a benefit for a period until the rest
11 of the market --

12 Q. So I understand. If the manufacturer's collectively
13 seek to recover their costs or inadequate margins from the
14 market, if they collectively raise their prices, does no good
15 whatsoever because the regulated price raises right along with
16 the same boat?

17 A. Correct.

18 Q. And that is a constraint that does not affect Class II
19 and Class I pricing?

20 A. That's correct. They still have the constraints from
21 the marketplace and consumer demand issues, but their milk
22 price is not tied to the finished product value.

23 Q. So if there is to be any return on investment for the
24 Class III and IV products, it has to be built into how you
25 measure the product value and the make allowance provided?

1 A. Yes. One other way to look at it is that's true within
2 that cheddar complex, if you can differentiate and get a better
3 price, a higher yield, a lower cost, any of those factors are
4 helpful. But over time, even if you get that benefit because
5 of the alternatives that manufacturers of cheese tend to have
6 to go into different cheeses, the market will still discipline
7 that margin back down to what a cheddar guy can get.

8 Q. Okay. Thank you. I move to page 12 of your testimony.
9 The first sentence, first line under the heading whey
10 valuation. Are we on the same page and the same line?

11 A. Yes.

12 Q. Okay. You refer to 2007 as "a case study in the
13 setting of minimum regulated prices above market clearing
14 levels." Lest anyone listening come to what I believe an
15 erroneous conclusion that you're pointing a finger at the
16 regulators for deliberately choosing a price that was above
17 market clearing levels, what happened in 2007 is not because of
18 the, it was the intention of the regulators to set a price,
19 when that, whenever that formula was adopted above market
20 clearing levels, correct?

21 A. Correct. They didn't understand fully the market.

22 Q. Well, maybe nobody did, but there were, the market for
23 whey products moved in a way perhaps not anticipated at the
24 time the formula was created.

25 A. I think that's necessary.

1 Q. So what we have is, in 2007, is an example of
2 unintended consequence, correct?

3 A. Correct.

4 Q. Okay. A consequence of perhaps providing a formula
5 that was too rigid in its construct by choosing one whey
6 product for which to value all uses of whey?

7 A. I would agree with that, but it goes beyond the
8 decision between dry sweet whey and fractionated products. It
9 was driven also by the fact that many cheese makers don't have
10 the capacity to efficiently process whey at all, some of the
11 testimony we have heard earlier.

12 Q. Okay. Would it be your recommendation to the
13 Department in deliberation on this hearing, to look carefully
14 for potential unintended consequences whenever the price
15 formula, however the price formula is set?

16 A. Yes.

17 Q. Thank you. And then, finally, let's see. Well, maybe
18 not finally. Page 15, two lines up from the bottom of the page
19 you refer to 44 Class 4b plants that do not even recover liquid
20 whey value. In context, this might be confusing just so we all
21 understand what you are referring to. When you say Class 4b in
22 this one place, you are referring to a California
23 classification of milk used to produce cheese.

24 A. I am. And I appreciate you focusing me in on that
25 number, because as I read it, I recognized that I did not

1 update that to the most recent data, and I believe the number
2 should be 36, if I'm doing math from the stand properly.

3 Q. Okay. The 44 plants that you were referring to came
4 off of a CDFA list of cheese plants that do not have a
5 complimentary whey manufacturing operation.

6 A. That's correct.

7 Q. And your modified number of 36 comes from a more
8 updated CDFA list of cheese plants; is that correct?

9 A. That's correct.

10 Q. Good. Thank you.

11 JUDGE CLIFTON: Ms. Taylor, shall we amend the record
12 copies accordingly?

13 MS. TAYLOR: Yes, please.

14 JUDGE CLIFTON: All right. Ms. Frisius, page 15, second
15 line up, we'll strike the number 44, and Ms. Taylor what number
16 do we insert?

17 MS. TAYLOR: 36.

18 JUDGE CLIFTON: Thank you.

19 BY MR. VETNE:

20 Q. Okay. And then finally, I have been scratching my head
21 for awhile because you and other witnesses have used, I'm
22 looking at page 16, have used the term WPC 34, and sometimes
23 that reference meant a finished dry whey product which, as I
24 understand it, the dry whey product is 34 percent protein; is
25 that correct? The finished dry whey product that is referred

1 to as WPC 34.

2 A. That is correct.

3 Q. Okay. And there's something else that is not a
4 finished product which also gets the designation of WPC 34.
5 What in the wet product does the 34 refer to?

6 A. It does become confusing because the wet product you
7 could think of the concentration of solids overall in the wet
8 volume, but, in fact, that's not what this refers to. When
9 people talk about liquid WPC 34, they are talking about a whey
10 product that where the whey stream has been pushed through
11 ultra-filtration to concentrate up the protein from, sweet whey
12 usually is about 12 percent protein, so they are splitting off
13 enough the carbohydrate stream to get the protein as a percent
14 of total solids in the solids component to 34 percent, but then
15 the concentration in terms of how many solids there are for
16 the, say a hundred pounds of wet whey, may vary from plant to
17 plant and operation to operation. So the 34 refers strictly to
18 the protein as a percent of total solid.

19 Q. Okay. Whether it is wet or dry?

20 A. Correct. Actually, there's a nuance I probably
21 shouldn't even go into. You also hear people talk about.
22 WPC 35. My understanding is that 34 is actually the protein
23 content of dry WPC 34, and it's -- the difference is that you
24 have 3 and a half percent moisture in rough terms in dry whey.

25 Q. In the finished marketable product?

1 A. In the finished -- yeah, right.

2 Q. So if we're talking about wet WPC 34, we're talking
3 about something that comes in liquid form, is delivered to a
4 whey plant that converts liquid whey into some sort of finished
5 product, and that the expected dry product from the wet
6 product, is WPC 34?

7 A. That's correct.

8 Q. Because all that's required to be done is to remove
9 water?

10 A. That's correct. And it might be that somebody uses a
11 WPC 34 liquid whey stream to further fractionate into 80 or
12 isolate, but my understanding is that even in those cases the
13 pricing between buyer and seller tends to be based only the WPC
14 34 market.

15 Q. And the WPC 34 market to which you are referring in
16 response just now is the dry WPC 34 market?

17 A. That's correct.

18 Q. Okay. And what you hope to happen as a result of this
19 proceeding, and perhaps even in a broader basis, is to find a
20 way to survey transaction prices that include wet WPC 34?

21 A. That would be the ideal.

22 Q. Okay. Thank you.

23 JUDGE CLIFTON: Ms. Taylor, I'm so glad Mr. Vetne asked
24 about this. Is there, on the Chicago Mercantile Exchange, an
25 item that relates to this?

1 MS. TAYLOR: There is not. But USDA AMS through their
2 Dairy Market News reporting, collect prices and publish them
3 every Friday in the Dairy Market News. I believe they are
4 actually available online a little ahead of that, but they are
5 contained in the weekly Dairy Market News.

6 JUDGE CLIFTON: And surely the industry has figured out a
7 way to either call the liquid liquid or to call the powder
8 powder so that when we see WPC 34 we know which is being
9 discussed, but it is not typically done, is it?

10 MS. TAYLOR: When people are generally referring to WPC 34
11 without adding the qualifier liquid before or after, you can
12 think about it as probably a dry product. If they are
13 referring to a condensed or liquid product, I would expect them
14 to use that as a modifier.

15 JUDGE CLIFTON: All right. So looking at your page 16, you
16 are talking about using the powder index to value the liquid
17 concentrate?

18 MS. TAYLOR: That's correct.

19 JUDGE CLIFTON: So I think you probably explained it
20 perfectly in this paragraph, but could you tell me again, just
21 what is it that you want to be used and how?

22 MS. TAYLOR: Okay. The ideal, going back to the basic
23 construct of minimum milk price regulation, to value the most
24 generic product form that is achievable under good management
25 practices across the regulated entities, the ideal would be to

1 value condensed WPC 34. And, you know, as I would also say on
2 the milk side, but is no longer available because of
3 limitations in volume, the ideal would be to survey the price
4 transacted on loads of liquid WPC 34 and use that as a price
5 reference. Because the concentration in terms of the solids
6 within that liquid would vary, that would have to be put then
7 onto a solid equivalent basis.

8 If a survey cannot be done, then we go to the
9 methodology that was elaborated in greater detail by Dr. Schiek
10 in his testimony that uses the WPC 34 index and translates that
11 back into a liquid equivalent basis using the normal whey
12 makes, well, it converts first over to a dry whey equivalent on
13 protein. You apply the regular whey makes, but there is also
14 an adjustment in return based on transportation cooling costs
15 which are typically incurred to get that liquid WPC 34 between
16 the originating plant and the plant that's going to be
17 processing it into the final product.

18 JUDGE CLIFTON: So if one is referring to the concentrated
19 liquid WPC 34, is the lactose still in there?

20 MS. TAYLOR: There is still some lactose left in there, not
21 all of the residual 66 percent would be lactose, but much of it
22 would be. And the extent that you then further separate the
23 protein from the lactose, WPC 80, if we ignore the fact there's
24 a bit tiny moisture in the dry product, you can say probably
25 has almost 20 percent lactose.

1 JUDGE CLIFTON: Who next has questions for Ms. Taylor?
2 Ms. Taylor?

3 CROSS-EXAMINATION

4 BY MS. ERIN TAYLOR:

5 Q. Good afternoon, Ms. Taylor.

6 A. Good afternoon, Ms. Taylor.

7 Q. I cannot wait to see the transcript of Ms. Taylor and
8 Ms. Taylor.

9 Could you -- can we first start off, you had some
10 conversation with Mr. Beshore on Leprino's cheese operations
11 mainly, but could you give us just a brief overview of
12 Leprino's footprint in whey processing?

13 A. Sure. We produce sweet whey in two plants. One is
14 Waverly, New York; one is Allendale, Michigan. Allendale's
15 whey processing also includes the condensed whey that we
16 condense in Remus and transport down to Allendale for further
17 processing. The Remus plant is a little less than a million
18 pounds of milk a day, so it falls within that plant size where
19 you cannot economically process whey.

20 As we move west of the Mississippi, we have, in our
21 newest plant, our Greeley, Colorado plant the capability to
22 produce WPC 80 and WPI in lactose. I'm going to have to double
23 check my cheat sheet. I'll move to California next as I look.

24 In California we produce WPC 80 in both Lemoore plants.
25 In our Tracy plant, we concentrate and ship the retentate to

1 Lemoore West. We produce lactose in all three plants. And in
2 a moment I will tell you what we produce in the other Colorado
3 plants. Too many papers.

4 JUDGE CLIFTON: I applaud you in bringing them, because so
5 many witnesses would just keep answering "I don't know," "I
6 don't recall," "I don't have that here," and I thank you for
7 bringing your materials.

8 MS. TAYLOR: Ft. Morgan is WPC 80 and lactose; Greeley, I
9 believe I already covered, WPI, WPC 80, and lactose; Roswell is
10 WPC 34 and lactose. I believe that covers all nine plants.

11 BY MS. ERIN TAYLOR:

12 Q. And do you solely process whey from Leprino's cheese
13 operations or do you also buy additional whey for processing?

14 A. We solely use our own whey.

15 Q. Okay. On page 5 in the middle paragraph, talking about
16 the Class III formula, you talked some about product yields and
17 that product yields should represent the yields that are
18 reasonably attained by regulated entities.

19 Is it your opinion that the yields currently in the
20 Federal Order formulas are relatively reflective of the yields
21 incurred by cheddar manufacturers in California?

22 A. Yes. As I noted in my testimony, there's a range of
23 fat captures, and the fat captures will be what move that yield
24 around primarily. There's a range that's achievable by vats,
25 and so I suspect that there's a range of yields achievable

1 within plants in California, but I believe that 90 percent fat
2 capture assumption that is embedded in the yields in the
3 existing Federal Order formula, is still reflective of the
4 yields achievable by plants with older vats, and we still have
5 some plants with older vats in California.

6 Q. You have touched on this a few times, but just to be
7 clear. When it comes to price discovery, as the Dairy
8 Institute had proposed western survey of prices to use, and
9 there were some confidentiality issues raised by USDA. So it
10 is your position of Leprino and the Dairy Institute or just
11 Leprino's position that we could look at ways to find some
12 western price series that would avoid those confidentiality
13 issues?

14 A. I have not had final conversations with the folks at
15 Dairy Institute, although they reviewed my testimony and did
16 not raise any concerns on that methodology. And having been
17 part of that discussion, my expectation is that they would
18 concur, but I can't speak on their behalf at the moment.

19 Q. Okay.

20 JUDGE CLIFTON: Do you think you would be able to answer
21 that question while we're still at this hearing?

22 MS. TAYLOR: Yes.

23 JUDGE CLIFTON: Okay. Great.

24 MS. TAYLOR: I'm getting some nods yes.

25 BY MS. ERIN TAYLOR:

1 Q. I'm sure that will show up in brief, also. On page 10
2 in your discussion of cheese valuation, talking about filters
3 on what products -- I think this is in regards to what
4 products, how you would get down to some commodity products and
5 what would or would not be included. In the middle paragraph
6 you talk about eliminating retail product and shredded product.
7 And this is a discussion, I think, on why Mozzarella would not
8 be practical to be part of the formulas because you have such a
9 small volume.

10 So when Leprino, do you sell your Mozzarella as bulk
11 and which could be considered a commodity or do you sell it
12 already with some value added to it or both?

13 A. Both. I would consider the shredding and individual
14 quick freezing process to be value added. I would consider
15 much of what we do in terms of improved functionality and
16 customizing for specific applications to be value added. So we
17 do have some that is, well, first of all, it all competes on a
18 very commoditized basis nonetheless, you have some
19 differentiation but not much, but in terms of the volume that
20 is sold unshredded, I think I have in here that essentially
21 when I narrowed down to just the low moisture part skim that is
22 sold in bulk, and that includes block or ribbon, I have
23 excluded more than 80 percent of our volume.

24 Q. Okay.

25 JUDGE CLIFTON: And what size is is the block?

1 MS. TAYLOR: Gosh, I know I should have asked that question
2 back at the office. I think it is 6 and 20's, and so some
3 people might even argue that the 6 pounders are too small to be
4 considered bulk commodities, but I believe that we do 6 pounds
5 and 20 pounds. I'm not absolutely sure.

6 BY MS. ERIN TAYLOR:

7 Q. On page 11 there is a discussion starting your
8 discussion on the cheddar make allowances, and I take this as
9 a, perhaps as in the same as before, Leprino's position that we
10 should add an additional amount on for administrative marketing
11 costs, and that might be a Dairy Institute position later, but
12 right now you are speaking just for Leprino?

13 A. I believe that Bill Schiek pointed to this during the
14 end of his testimony. I was writing mine and discovered the
15 omission while he was on the stand, so he did not have a lot of
16 time to digest it and so just signaled it in response to Chip.

17 Q. Okay. Currently, plants in California, if they don't
18 have that, if they don't have that factor currently in that the
19 make allowance as administered by CDFA, can you expand, have
20 they just adjusted to that reality and are they eating that
21 cost or have they somehow been able to account for that
22 somewhere else in their total selling of that product.

23 A. One thing that's unique to California versus the
24 Federal Order system, is California is using the CME rather
25 than a survey price. The price assumption that gets buried in

1 the California 4b formula, gets adjusted from time to time by
2 hearing based on, the Department will issue an exhibit that
3 shows, I don't recall whether it is 24-months or more, I
4 believe it is a hearing exhibit here, of price history, through
5 which then you determine what the average price received in
6 California is relative to the CME. But the fact that you are
7 not in that loop with the survey, I believe provides a little
8 bit more flexibility.

9 Q. Okay. Often we hear that the Federal Order system it's
10 that circularity, and here you are saying that circularity
11 currently might not exist in California when it comes to that
12 factor?

13 A. Correct. It is not a direct circularity, a real time
14 circularity.

15 Q. Okay. On page 11, discussing the current formula, the
16 first full paragraph, page 12, excuse me. The current formula
17 and this is Class III formula, assumes that all fat received at
18 the plant that is not captured in cheddar cheese is recovered
19 and converted to Grade AA butter, and the whey cream then is
20 also priced at the Grade AA, at the Class III butter price,
21 butterfat price. But is there not an adjustment in the formula
22 to account for the fact that not all the fat stays with the
23 cheese, and that's found in the protein portion of the
24 Class III price?

25 A. You want to get into a big ditch for --

1 Q. I don't want to get too far in that ditch.

2 A. Okay. So how it works is, you have, within the cheddar
3 yield assumptions in the protein formula, an assumption that 90
4 percent of the fat is captured in the cheddar cheese.

5 Actually, if I can come up with the formula sheet, I will be
6 more specific as to which piece of the formula.

7 Okay. So the 1.383 factor in the protein formula is
8 the pounds of cheddar cheese that are produced from a pound of
9 protein. The balance of the formula is trying to make a
10 correction for the fact that cheddar makers are using all of
11 the fat for cheddar cheese but they are paying for the
12 butterfat component at the butter value. And as you trace that
13 balance through, the 1.572 is the yield of cheddar cheese from
14 a pound of fat, and then it's reduced by the butterfat price
15 times .9. That reduction means that you have ten percent of
16 the fat that is still valued at the full AA butter price. So
17 for one, you have an assumption there's no loss in the system,
18 and as you go through cheddar manufacturing economics, you will
19 find that probably you lose at least maybe instead of
20 recovering ten percent of the fat that goes in the vat in the
21 whey cream, you might recover seven or eight percent. And so
22 that factor, that .9 probably needs to be .92 or .93. And then
23 on top of it, it leaves the rest of the fat valued at the AA
24 butter market, and the whey cream returns are much lower than
25 the AA butter.

1 Q. The whey cream, I don't know if you were here
2 yesterday, I think it was yesterday, someone talked about Pro
3 Cream. Were you here for that conversation?

4 A. I recall hearing it.

5 Q. I was just wondering if that term, Pro Cream, is
6 synonymous with your whey cream?

7 A. No, no. The whey cream is separated from the whey
8 after it comes off of the vat and before it's made into either
9 dry whey or WPC and/or WPI and lactose, or just as a permeate
10 going out to animal feed.

11 The Pro Cream that was referred to yesterday is a high
12 fat protein product that, as I understand it, is generated in
13 the production of whey protein isolate. So that's confirmation
14 that, in fact, you are not able to capture and all of the fat
15 over into the whey cream side. Some of the fat resides back on
16 the sweet whey side or whatever else you are doing with that
17 whey stream.

18 Q. Okay. There was a lot of discussion with both
19 Mr. Beshore and Mr. Vetne on 2007. And I think you have eluded
20 to it, but just so there's clarity in the record, could you
21 just explain for the record what occurred in 2007 and how you
22 feel cheese manufacturers were, from I take from your
23 testimony, harmed in that instance?

24 A. Certainly. The victim of my own preparation, I have
25 price levels that I would like to refer to.

1 As I mentioned during my testimony, I think, well,
2 actually, I'm going to backtrack a little bit to, I think that
3 one of the proponents of Proposal 1 made a comment that whey
4 valuation has been embedded in milk prices going back to the
5 1960's, and I would like to observe that to the extent that's
6 true, it's because it was a cost and constrained the ability to
7 pay. And there is lots of information out in the public
8 sector, including a fair number of papers by Truman Graf, a
9 professor at UW, or at Madison, I believe, that reflect the
10 fact that whey processing was a lost proposition in that
11 period.

12 When you get to Federal Order Reform, that was really
13 the first time whey was captured in an explicit end product
14 price formula, and it was done at Federal level. Although, I
15 will tell you that I and Leprino at the time thought that that
16 was a bad idea because there was no value for dilute whey
17 traded in the market, there was a little bit of a, I guess a
18 casual, but in truth we all fought it, an attitude that it was
19 contributing very little to the milk price. And so yes, it was
20 a bad idea. But would it cripple the industry? I'm not sure
21 anybody expected it to cripple the industry. So when you look
22 at the whey contribution to the regulated milk price, that
23 first year it was less than 30 cents a hundredweight.

24 What happened in 2007 is, you ended up with a very high
25 whey price, and part of that was related to worldwide protein

1 demand being very strong, and it got the milk price that was
2 the portion attributable to whey up above \$3.00 per
3 hundredweight. And so folks who might have been able to absorb
4 20 cents a hundredweight, were then in a position where if they
5 weren't recovering any of that whey value, they were under
6 water by a very significant margin. And so we went from this
7 no harm, no foul situation because whey prices historically had
8 been so low that they really didn't generate that much impact
9 on the milk price, to something that was crippling, and that's
10 really what drove the 2007 situation.

11 At the same time as you ended up with those without
12 processing capacity being crippled, you had a lot of folks who
13 had innovated and invested in high level whey fractionation
14 technology that were also under water because sweet whey prices
15 exceeded the returns from even the protein concentrates for a
16 period in there. Now, they were not under as much financial
17 distress as the folks who had no whey processing capacity at
18 all, and largely the folks who went bankrupt, or in California,
19 FNA cheese which had cheese plants that weren't timely, I think
20 they were up around 2 million pound a day plants, but they
21 didn't have a full whey solution, they ended up with producer
22 payment problems, and eventually were forced, under financial
23 stress, to sell. Saputo acquired those plants.

24 Q. Okay. And I think, and later in your testimony you
25 talk about how at that time, in your opinion, lots of people

1 started producing these different fractionated whey products,
2 so prices for those products went down, where less people were
3 producing dry whey so those prices went up, and that was the --
4 I'm trying to get, that's kind of a very simplistic view of the
5 numbers that you just put out there.

6 A. Yes. We have had that general migration. It's been
7 painful enough, I would say, even this year in certain
8 products, higher level products. That I am picking up that
9 there are some folks who are starting to add capacity on the
10 sweet whey side, their dry whey side. I have to apologize, I
11 always think of sweet whey, or of dry whey as sweet whey
12 because it has so much lactose. I think there was an earlier
13 witness who explained that sweet whey is produced not from an
14 acid environment to coagulate the cheese. And so dry whey can
15 be sweet or acid, so not to confuse the record. But in any
16 case, there are times this year that the returns from the
17 higher valued products have been unfavorable enough that my
18 understanding is that there are folks who are starting to add
19 capacity for dry whey just so that they can flip capacity.

20 Until now, I would say most plants, because of the high
21 expense, capital expense with whey processing, have not had the
22 capacity to move between dry whey and fractionated wheys.
23 Those with fractionation capability quite often will have
24 capacity to move between levels of protein, but with dry whey
25 versus fractionation, usually we haven't had flex capacity in

1 the industry.

2 Q. Okay. On page 14 at the bottom you have a sentence
3 which says, "however, the binding nature of the current
4 California State Order and the Cooperatives' Proposal 1 under
5 which minimum regulated prices are enforced on all Grade A milk
6 manufactured in California, limits market based approaches to
7 relief."

8 As I understand the current regulations in California
9 is that, even if a plant is isn't pooled, you still have to pay
10 minimum classified prices --

11 A. That's correct.

12 Q. -- for that milk.

13 A. That's correct.

14 Q. And I want to better understand then, how, if the
15 Cooperatives' proposal were all plants are pooled and you would
16 have to pay those minimum prices for milk as you currently do
17 under the system, how that's different than your current
18 situation?

19 A. It's the price level.

20 Q. Okay.

21 A. And that goes back to, I think that there is risk in
22 having mandatory pricing and pooling, regardless. And, in
23 fact, am aware of some companies that chose not to build plants
24 in California over the last few decades, precisely because the
25 regulatory risk that's associated with not being able to get

1 outside of that system. But in any case, if the price is set
2 low enough, then you have the ability to adjust to the market.
3 But if it's set, as the co-op proposal is in my opinion, at a
4 level above what can be achieved, then it's an even bigger
5 problem.

6 Q. Okay. So the, kind of like the main underlying problem
7 is not necessarily the fact that everyone would have to be
8 pooled, it is that the price level of which you would be pooled
9 at would be a Federal Order national price and not the
10 California specific price.

11 A. We can live, as has been shown by our investment in
12 California over the last 30 years, we can live within a
13 mandatory pricing system, don't necessarily think that it is
14 the right policy solution, but we can live within it so long as
15 the prices are set low enough. I think that there are a lot of
16 other bad market consequences of that system, as I described
17 when I talked about mandatory pooling and pricing the other
18 day, in that it retards the movement of milk to the higher and
19 better use across manufacturing classes. So it's, from a
20 policy perspective, I think it has negative consequence for the
21 industry at large. But from an economic, day-to-day business
22 operation, so long as those prices are set low enough, we can
23 have an economically viable operation.

24 Q. Okay. On Proposal 2, the bottom of page 15, when you
25 talk about the Proposal 2 valuation, you said the Dairy

1 Institute proposal appropriately capsulates contribution. Can
2 you expand on why you feel those, the floor and the cap is
3 appropriate for California?

4 A. I tried to write this section in a way where I was
5 clear that I'm not, I don't have the data to say, you know, is
6 \$1.50 as the top end, the right top end? Maybe \$1.00 is, maybe
7 \$1.75 is. I don't have that data, but the concept of a cap,
8 and a cap in a price level that we aren't jeopardizing the
9 ability to manufacture viably for those entities that can't
10 process whey I think is appropriate.

11 Q. Okay. And the number you amended to say 36 Class 4b
12 plants, and you pulled that for some updated CDFA list. I just
13 want the source of that number, what list or what year does
14 that reflect?

15 A. I believe this has already been entered into the record
16 and somebody might be able to help me with an exhibit number.
17 96?

18 Q. Thanks. One of my last questions. On page 18 you are
19 talking about Class IV formulas. In the middle of that
20 paragraph, the sentence beginning "however" reads, "however, a
21 pricing and pooling system that completely eliminates the
22 incentive to place milk in its highest and best use or which
23 provides an incentive to manufacture milk into lower value uses
24 does not serve dairy producers, manufacturers, consumers -- or
25 consumers well." That's a statement that has been said here

1 and, you know, I have heard many times outside of any Federal
2 Order rule making, so I would ask that you expand on that
3 statement a little bit and how you feel that, I guess,
4 Proposal 1 would not allow milk to move to its highest and best
5 use.

6 A. That refers to what I elaborated on relative to
7 mandatory pooling. If you apply the Federal Order regulations
8 as they are applied everywhere in the system, where
9 manufacturers are not obligated to participate, I think that
10 you will have some manufacturers who opt to stay out of the
11 system, and there will be more competition because they will
12 have that revenue to bid away milk from a lower valued use. So
13 I think over time you end up with milk moving more easily and
14 reduced volatility because you will end up with those
15 adjustments in production as a result of that movement.

16 The reference to incentivizing manufactured milk into
17 lower valued uses is a reflection of my concern, both based on
18 history and based on some questions that were asked here about
19 the balancing class. That at times have been some inherent
20 biases to favor one class versus the other. And generally,
21 that's favoring the butter powder class over cheese. And in
22 the past there was a, there was a prior Director of the Dairy
23 Marketing Branch, I believe, in California, who, in private
24 conversations, maybe even in public conversations would say
25 that, "of course you buy, you give more margin to the butter

1 powder guys rather than the cheese guys." And it was premised,
2 as I understand, a little bit on the fact that there was,
3 butter powder was perceived to be a balancing class and
4 probably less efficient plant utilization as a result.

5 I think in today's market where powders, in fact, are
6 probably traded in much greater volumes in the world market,
7 and have a tremendous amount of demand, and where manufacturers
8 are building powder plants specifically to satisfy that demand,
9 it's very difficult to justify trying to bias milk flow from a
10 milk price policy perspective one direction or the other. And
11 to the extent we do, I think we do it at our own peril and to
12 damage the U.S. industry.

13 Q. Okay. And so in your final conclusion paragraph, you
14 say, "this proposal will allow milk from manufacturing to move
15 more freely to its highest and best use," and you are of that
16 opinion because plants have the ability to not participate in
17 the pool under the Dairy Institute proposal, where they don't
18 have that ability under the Cooperatives' proposal.

19 A. That's correct.

20 Q. Okay. And just a couple clarifying questions on your
21 Attachment A. Under, for example, low moisture part skim
22 Mozzarella cheese, it gives the percentages, but there's a
23 number 46 to 52 in the brackets. What is that, if you know?

24 A. You know, that's a very good question. It wasn't until
25 I was looking at it while I was testifying that I noticed it,

1 and so I'm not sure what that's intended to be. I believe that
2 the numbers above it are the numbers from the actual CFR, but I
3 can clarify that and get back to you on that.

4 Q. And can you, just for the record, describe what the fat
5 dry basis means and the wet, define what wet fat means?

6 A. Fat on a dry basis would be a calculation of the volume
7 of fat in proportion to the volume of total solids in the
8 cheese. The wet fat would be the volume of fat in relationship
9 to the total volume of the cheese, including moisture.

10 Q. Okay. I think my colleague has a few questions for
11 you.

12 CROSS-EXAMINATION

13 BY MS. MAY:

14 Q. This is Laurel May from USDA. I have a lot of
15 questions and I think maybe it would be better for me to screen
16 them with my colleague to make sure that they aren't completely
17 dumb so that you don't all have to sit through that, and then
18 we can come back.

19 JUDGE CLIFTON: Yes, let's find out, the gentleman from
20 Nestle, let me know what your time constraints are today. You
21 are here all day? Wonderful. Good. Are you content to let us
22 complete Ms. Taylor's testimony before you testify?

23 MR. KLUESNER: Yes.

24 JUDGE CLIFTON: Good. Excellent. Thank you. The answer
25 was yes. All right. Why don't we break for lunch and

1 Ms. Taylor, I'm sorry, I know you have another presentation to
2 work on, and you probably hoped you would be able to begin, but
3 that won't happen yet.

4 Let's see. It's already almost 1:20. So please be
5 back and ready to go at 2:35. 2:35.

6 (Whereupon, the lunch recess was taken.)

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1 THURSDAY, NOVEMBER 5, 2015 - - AFTERNOON SESSION

2 JUDGE CLIFTON: We're back on record at 2:36. Ms. May?

3 CROSS-EXAMINATION

4 BY MS. MAY:

5 Q. Thank you. This is Laurel May with USDA, and I,
6 luckily for you, winnowed it down to two questions through
7 lunch.

8 Okay. So my first question is on your discussion about
9 the DPMRP prices for 40 pound blocks of cheddar cheese. And I
10 was under the impression that we also collect information on
11 500 pound barrels of cheddar cheese and that those prices are
12 considered into the average that we use for that cheddar cheese
13 price. Are you suggesting that we don't use that?

14 A. It's a starting point. I assume that what you are
15 referring to is the same thing as I referred to, the NDPSR?

16 Q. Sorry, yes.

17 A. And you are correct that we are proposing that the
18 NDPSR cheese price that includes barrels not be used in the
19 California Order. To my knowledge, there's no cheddar barrels
20 produced in California, so it's not relevant in California.

21 Q. Okay. Good thing we asked.

22 A. There is some additional basis risk that comes with the
23 NDPSR barrel inclusion and there's some technical errors in the
24 existing formula that I can elaborate on, but it might be a
25 ditch you aren't interested in inviting.

1 JUDGE CLIFTON: I would like to hear it. Yeah. If there
2 is something, if there is a glitch that causes it not to work
3 the way it is, even though that may relate to other orders, we
4 would rather know sooner rather than later.

5 MS. TAYLOR: Thank you, Judge.

6 The calculation of the NDPSR cheese price under the
7 current orders does a weighted average of the block price and
8 the barrel price, plus 3 cents. The origin of the 3 cents,
9 well, let me back up. The barrel price is adjusted from the 39
10 percent moisture price to a 38 percent moisture price, and
11 barrel cheddar is typically used for processed cheese, and the
12 buyers of barrel cheddar are interested in the solids, and so
13 it is typically priced at not per total volume, but per pound
14 solids, that's the practice in the industry. So the, as I
15 understand it, most barrel is traded in a way where they may
16 index the CME price, but the CME price is at 39 percent, so
17 they will calculate a price per pound solid by taking that and
18 dividing it by .61, the .61, 61 percent solids that would be in
19 a 39 percent moisture price, and that determines a price per
20 pound solid.

21 What USDA does in making that adjustment from 39
22 percent moisture barrel to 38 percent, is essentially they are
23 grossing it up. You can take the 39 percent price and multiply
24 it by .62 over .61, and so they are adding onto the 39 percent
25 price, a value that moves with overall cheese prices. That

1 might be relevant, but the combination of that moisture
2 adjustment to get to 38 percent, with a 3 cent add-on, is
3 doubling up the adjustment. The 3 cents was derived back in
4 the late '90's based on observations that the typical spread
5 between blocks and barrels was 3 cents, but that was using a 39
6 percent moisture barrel price. If you were to do that same
7 calculation based on 38 percent moisture barrels, you would
8 find that there's very little difference. And so there's this
9 doubling up within the current factor.

10 BY MS. MAY:

11 Q. So your use of the term "technical error" is referring
12 to this doubling up --

13 A. Correct.

14 Q. -- issue? Okay. Okay. That satisfies me.

15 Judge Clifton, did that satisfy you?

16 JUDGE CLIFTON: Yes.

17 MS. MAY: Okay, good.

18 BY MS. MAY:

19 Q. So then my other question was a real simple one, I'm
20 sure, for you. On page 17 of the very last line you say that,
21 you know, the proposal would set up a scenario in which all
22 these things make it so that it would be, you would be better
23 off shifting production. What do you mean by shifting
24 production?

25 A. I'm referring to companies with multi-state

1 manufacturing capacity. And so what I'm referring to is to the
2 extent that capacity is available within our system, in our
3 plants outside of California, and specifically plants further
4 east, shift production out of the California plants over to
5 plants in the east. And we have been building out additional
6 capacity in Colorado. I already mentioned the Greeley
7 facility.

8 The Greeley facility was planned in three phases. We
9 have completed two phases and we are very close to pulling the
10 trigger on the third phase. It will be relatively soon that we
11 will move forward with the construction on the third phase.
12 And so it would be redeploying some volumes of milk to other
13 plants.

14 Q. Where it would be more favorable conditions for you to
15 be priced and produce?

16 A. Correct.

17 Q. Okay.

18 A. If we end up paying a Federal Order price here that
19 represents, again, a location value that's further east, then
20 we would be incented to move, move that production over to the
21 areas that are closer to what's assumed in the Federal Order
22 price.

23 Q. Okay. Thank you. That's all I have.

24 JUDGE CLIFTON: Who next has questions for Ms. Taylor?
25 Mr. Beshore?

1 CROSS-EXAMINATION

2 BY MR. BESHORE:

3 Q. Marvin Beshore.

4 Just a couple of follow ups. On the block barrel
5 issue, Sue, to be fair, that issue has been fully litigated in
6 prior hearings and decided against the position you advocated,
7 by the Secretary, correct?

8 A. The arguments have been made, I'm not sure whether
9 litigated is the proper term.

10 Q. I will take that back. The arguments have been made,
11 the same ones that you made today you have made in prior
12 hearings, and the current formula has been the one determined
13 to be appropriate by the Secretary.

14 A. That's correct. And I'm not convinced that those who
15 made that decision understood the issue.

16 Q. Really?

17 A. And hopefully further elaboration in different terms is
18 helpful.

19 Q. You really don't think the Department on those hearing
20 records, which were very elaborate and argued and testified to
21 on those issues, you don't think the Department understood what
22 it was doing?

23 JUDGE CLIFTON: I think that's a little unfair. What
24 Ms. Taylor said was that she did not think that the Department
25 fully understood, and I think you just asked if the Department

1 didn't know what it was doing?

2 MR. BESHORE: Understand I think I said, what it was doing
3 in in making that decision.

4 JUDGE CLIFTON: Yeah. Well, you know, she has her opinion,
5 you have yours, and anyone has the opportunity to read what the
6 Secretary did or did not say about the issue, but I would like
7 to you reword your question if you would like her answer on
8 this.

9 BY MR. BESHORE:

10 Q. I'm not sure how I would reword it. I understood her,
11 I understood her to say that the decision was made without the
12 decision maker understanding the subject matter of the
13 decision. Is that what you said, Ms. Taylor?

14 A. What I would say is that we have it in the hearing
15 record in 2006, 2007 --

16 Q. 2000 also, I think.

17 A. I don't know whether that was the case or not. But in
18 any case, like interpersonal communication between me and you,
19 Marv, there can be some confusion along the way, and that
20 doesn't necessarily change the facts or change -- there's no
21 problem in going back and having another conversation about
22 things that you don't think are factually correct.

23 Q. Okay. I just wanted to make sure this record was clear
24 that that issue had been fully discussed in prior records.

25 A. It had been a topic within the hearing.

1 Q. Okay. Now, let me ask this. I would like to just run
2 through Leprino's plants, and if you can, tell me when the last
3 year of capacity expansion has occurred or multi-million dollar
4 substantial capital investments made in the facilities. Is
5 that -- do you understand what I'm asking there? Either, you
6 know, capacity expansion or multi-million dollar investment in
7 the facilities, and if you can't hit the year, as close as you
8 can.

9 A. Marv, I'm not sure that I can tell you off the top of
10 my head precisely. I can tell you that we update all of our
11 plants on an ongoing basis. And as I think across our plant
12 system, I'm not sure that there's a single plant that wouldn't
13 have had multi-million dollar investment within the last year.

14 Q. Okay. How about capacity expansion? You mentioned
15 Greeley, of course, which is the newest plant in the system,
16 right?

17 A. Yes.

18 Q. Okay. And that has been, that's projected for its
19 second expansion after the initial construction, if I
20 understood you correctly.

21 A. Correct.

22 Q. How about other capacity expansions, and I'm talking
23 outside of California now, or start outside of California.

24 A. We, operationally, have made some adjustments that have
25 impacted capacities in a range of plants. I can't off the top

1 of my head tell you precisely when each of those occurred.

2 Q. Okay. Has that, have those operational changes which
3 involved, would involve capital investment I assume?

4 A. Yes.

5 Q. Would they have been made at all of the other five
6 locations in the Federal Order system within, let's say, the
7 last ten years?

8 A. No.

9 Q. Some further back than that?

10 A. There are some of those that have not been extended to
11 all plants.

12 Q. Okay. What's the second newest plant, Leprino plant in
13 the Federal system? Is it the second plant in Michigan?

14 A. No.

15 Q. Roswell?

16 A. How do you define new? We completely renovated a
17 plant, had it fully shutdown, it's like new in many ways, we
18 have owned it longer than Roswell.

19 Q. Which one is that?

20 A. Ft. Morgan.

21 Q. Okay. When did you add the second plant in Michigan?

22 A. I believe 1988.

23 Q. And when was the Roswell plant built?

24 A. I might have my dates wrong, so I believe that, I
25 believe that we built Ft. Morgan originally in 1992, and

1 acquired Roswell, I believe, in 1994, and it was a cheddar
2 plant, a cheddar barrel plant I believe when we acquired it
3 from AMPI.

4 Q. Okay. Great. Thank you. To your knowledge, were
5 there any bankruptcies of cheese manufacturers in the Federal
6 Order footprint area, whether they were pool plants per se, in
7 the 2007 -- 2006, 2007, whey price run-up period?

8 A. I have a recollection of somebody telling me that there
9 were, but I don't know precisely. And I also want to circle
10 back to your last question, which was that the most recent
11 plant that was built before Greeley?

12 Q. Yes.

13 A. That would be Lemoore West.

14 Q. Okay. I was -- I was limiting my question to the
15 Federal, to the non-California system. So Ft. Morgan would be
16 correct in that -- in the -- in the outside of California?

17 A. I believe it would be Roswell if you go to actual
18 ownership, and then Ft. Morgan before it, but Ft. Morgan had a
19 substantial renovation more recently than we acquired Roswell.

20 Q. Very good. Thank you. Now, I guess I just have one
21 final question. Isn't there, in terms of price regulation
22 policy, isn't there a risk of setting regulated minimum prices
23 too low, as well as the risk you have testified to of setting
24 them too high?

25 A. I don't believe so.

1 Q. Really? No risk?

2 A. I, you know, there are a lot of areas of the country
3 and a lot of areas where the world exists in quite good harmony
4 relative to the trading of milk on a day-to-day basis, and so
5 premiums develop and they exist. There's nothing that incents
6 a processor to gut their milk supply. We ship out probably 20
7 percent of the volume that we bring in, so we have to make sure
8 that our milk supply remains healthy, and I think that that
9 keeps the system honest.

10 Q. I think you answered a different question than I asked,
11 and that, the question you answered was, I think, is it
12 necessary to have a minimum regulated price at all? And I
13 think you said, in your opinion it's not. Am I correct?

14 A. Yes.

15 Q. Okay. Now, my question was, when you do have minimum
16 regulated prices, when you set them on the low end, isn't it
17 possible to create the situation where the purchasers of milk
18 are not incentivized to be efficient?

19 A. No. If the regulated price is set too low, then
20 competition will keep the drive for efficiency.

21 Q. In other words, in your view, if it is set too low, it
22 won't be effective in the marketplace?

23 A. If it's set below market clearing levels, it won't
24 dictate the total price. What's required to bring forth a milk
25 supply dictates the total price.

1 Q. But isn't it the case that if a minimum, if purchasers
2 of milk can buy it at values that are what I would consider too
3 low, they are not, they don't have any incentive to be
4 efficient, sufficiently efficient to, as efficient as if it
5 were higher, put it that way.

6 A. Well, first of all, low and high don't have as much to
7 do with the plant decisions as what the margin is, what the
8 relative relationship is to the value they are receiving. So
9 you can have a low price that gives you a big margin or a high
10 price that gives you very little margin.

11 Q. Well, let's make them relative to the margin, low
12 relative to the margin versus high -- that is, low providing a,
13 you know, a nominally, or a, you know, a high margin, and high
14 providing a nominally low margin.

15 A. Okay. And you are asking about the scenario where it
16 would be a high margin.

17 Q. Yes, that's right. Is there not an incentive in that
18 situation, is there not built into that situation the possible,
19 a lack of incentive for efficiency on the buyers?

20 A. I don't think so. You would be a profit maximizer, and
21 so even in that scenario you would try to be as efficient as
22 you can. Additionally, if the margins are sufficient and
23 attractive, you will invite additional investment in the
24 industry as well as innovation.

25 Q. Thank you.

1 JUDGE CLIFTON: Ms. Taylor, what were you explaining when
2 you said something about 20 percent of the volume we bring in?
3 There's no incentive to gut your supply of milk.

4 MS. TAYLOR: Oh. As a cheese maker, it is important to be
5 close to your milk supply because the cost of transport of your
6 inputs far exceeds the cost of transport of your outputs. And
7 so in rough terms, the volume of our finished products is
8 equivalent to about 20 percent by the time you add up the
9 cheese, the cream, and the powders, 20 percent of the volume of
10 the milk that comes into the plant. We, our objective is to be
11 able to procure milk within a 50-mile radius of our plants.

12 JUDGE CLIFTON: Who next has questions for Ms. Taylor?
13 Mr. Vetne?

14 CROSS-EXAMINATION

15 BY MR. VETNE:

16 Q. John Vetne representative for Hilmar.

17 The history of dairy in America, as I recall, is that
18 when the AMAA was created, milk markets were very local, and
19 product markets were similarly fairly local. Do you recall
20 reading that and hearing that talking about it?

21 A. Yes.

22 Q. Okay. Today's market, product markets, are national
23 and international, correct?

24 A. Correct.

25 Q. In order to compete in national and international

1 markets, you can't be lax about efficiency. You have to try to
2 beat the efficiency of your competitor everyday, correct?

3 A. Correct.

4 Q. In fact, there is an international player in dairy at
5 New Zealand where there is no regulated price and they, in
6 fact, have produced some of the most efficient production of
7 dry milk products in the world, and market those dry milk
8 products because of their efficiency, correct?

9 A. That's correct.

10 Q. Okay. Thank you.

11 A. And they have just doubled their Mozzarella capacity.

12 JUDGE CLIFTON: Are there any other questions for
13 Ms. Taylor? Is there any redirect?

14 REDIRECT EXAMINATION

15 BY MS. VULIN:

16 Q. Ashley Vulin, Dairy Institute of California.

17 First, just a minor point. Wondering if we can look at
18 the first page and make an edit to the date. We had
19 optimistically put November 4th in case Ms. Taylor made it on
20 the stand then, but today is the 5th. So for accuracy, I would
21 ask that the Court strike the 4 and turn it into a 5.

22 JUDGE CLIFTON: All right. And, Ms. Frisius, top page of
23 Exhibit 135. Thank you.

24 BY MS. VULIN:

25 Q. Thank you, your Honor.

1 So I'm going to bounce around a little bit. First,
2 during his first cross-examination of you, Mr. Beshore asked
3 you if it was your opinion that a farmer in California should
4 be paid less than the Class III price that all other farmers in
5 the United States are paid. But not all farmers in the United
6 States are paid the regulated Class III price; is that correct?

7 A. That's correct. And I don't recall that question, even
8 up there.

9 Q. Okay. So if that was a predecessor question, then
10 that's something you would want to correct?

11 A. That's correct. They are not all paid through
12 Class III.

13 Q. Thank you, Ms. Taylor. And from Ms. Erin Taylor had
14 asked you a bit about the history of whey pricing. And is
15 there anything that you would like to add to that testimony?

16 A. Sure. I was just, I referenced, among other things, a
17 monograph from Dr. Truman Graf, and that's G-R-A-F, relative to
18 the economics of whey. And my argument was, that to the extent
19 that whey value was reflected in milk prices prior to 2000,
20 they were reflected through the survey price of manufacturers
21 in Minnesota and Wisconsin. And during much of that period,
22 and I haven't taken a full look all the way through the '90's
23 as to when that pivoted, it was reflected through a loss, and
24 so a reduction in the milk price. Which to me is very
25 different than reflecting it as an assumed profit and applied

1 across people who don't have that capacity.

2 One of the documents I was referring to is on
3 Mark Stephenson's website. It is called Economics of the Whey
4 Problem by Truman F. Graf. It is an Extension Publication from
5 November 1976, Number 117. And in that there is a table on
6 page 4 that shows the U.S. wholesale prices for dry whey from
7 1970 to '76, as quoted by ERS USDA Dairy Situation. The prices
8 are largely ranging from, it looks like a low of 4.8 cents to a
9 high of 7.65 cents, with the exception of 1974 got up to 9.41
10 cents. The rest of the prices are largely in that, you know,
11 five to five and a half cent range, plus or minus a half cent.
12 And in that same document --

13 JUDGE CLIFTON: I'm going to interrupt, I would like you to
14 give me those numbers again. Now, these numbers from '70 to
15 '76, are these showing losses or are these showing something
16 else?

17 MS. TAYLOR: I'm going to give you the prices and then
18 separately in the document there is a cost estimate. And so I
19 can give you the precise numbers for the years rather than
20 characterizing them.

21 1970 is 5.59 cents; 1971, 4.84 cents; 1972, 5.63 cents; 1973,
22 7.65 cents; 1974, 9.41 cents; 1975, 6.02 cents; and 1976, 6.25
23 cents. Again, it is a table on page 4, and then on the
24 Page 20 there is discussion of processing economies that says,
25 "USDA estimates indicate that present drying costs are 8 to 9

1 cents per pound of human grade non hydro scopic dry whey."

2 BY MS. VULIN:

3 Q. So that's an 8 to 9 cent cost?

4 A. Correct. And so that data is what led me to believe
5 that cheese manufacturers were losing money on the production
6 of whey, and therefore, to the extent that it did get embodied
7 in the survey price, it was a reduction in the ability to pay,
8 to pay, and therefore, a lower survey price.

9 Q. Thank you. So now I have turned to Attachment A in
10 your testimony, Exhibit 135. And previously we had talked
11 about these ranges. So right now I'm in the moisture column,
12 in the low moisture part skim Mozzarella cheese row, and that
13 has the 45 percent to 52 percent range, and below that it says
14 46 to 52. Were you able to figure out what this is, and do you
15 have any opinion on if we should keep it in the document?

16 A. Yes, I did discuss this with the author of the
17 document, and those ranges are internal notes. So those ranges
18 do not appear in the CFR. Therefore, I recommend that we
19 strike those numbers that are found within the parentheses. So
20 for low moisture part skim Mozzarella cheese, the moisture
21 range of 46 to 52 would be struck.

22 JUDGE CLIFTON: Let me ask you something, you know, so
23 let's read it, start, Ms. Taylor, it doesn't say 45 percent to
24 52 percent, it says greater than 45 percent to less than or
25 equal to 52 percent, right?

1 MS. TAYLOR: Correct.

2 JUDGE CLIFTON: So the 46 to 52 just interprets that,
3 right?

4 MS. TAYLOR: It was an internal interpretation, and when I
5 asked the author, given the CFR, could you have a low moisture
6 part skim Mozzarella that satisfies the standard of identity
7 that is 45.1 percent. And his answer was, he assumes you can,
8 and so I think rather than us leave our interpretation on the
9 table, we should remove that because that's not specifically in
10 the CFR.

11 JUDGE CLIFTON: I see. I see now how you have to be very
12 precise with these things. All right. So, Ms. Frisius, are
13 you on this table, Attachment A?

14 MS. FRISIUS: Uh-huh.

15 JUDGE CLIFTON: And, Ms. Taylor, we'll strike as you call
16 it, so please lead us through everything you want stricken.

17 MS. TAYLOR: Please strike under low moisture, part skim
18 Mozzarella cheese, moisture 46 to 52, and in the FDB column,
19 30 to 44. In the next line for part skim Mozzarella, please
20 strike 53 to 60; and in the FDB 30 to 44. In the low moisture
21 Mozzarella cheese whole milk, moisture, please strike the 46 to
22 52; and then in the bottom row, the Mozzarella cheese moisture,
23 please strike the range of 53 to 60.

24 JUDGE CLIFTON: Thank you.

25 MS. VULIN: Thank you, Ms. Taylor.

1 JUDGE CLIFTON: Now, while we're there, I'm just referring
2 on the very last box to the right hand side, and we have got a
3 cite to the Federal Regulations, and we all know what it is
4 looking at it, but do you want us to fix it?

5 MS. TAYLOR: Yes, please. It should be 21 CFR instead of
6 the CFR 21.

7 JUDGE CLIFTON: All right. Ms. Frisius, do you have that
8 also? Thank you. All right. Go ahead.

9 BY MS. VULIN:

10 Q. Thank you, your Honor, good catch.

11 So, Ms. Taylor, Mr. Beshore asked you a question to
12 which you responded that you recalled, it was your recollection
13 that the cooperatives did not recognize the spatial value of
14 the products.

15 A. Yes.

16 Q. And were you in attendance at this hearing on
17 September 30th, 2015?

18 A. Yes.

19 Q. And were you present that day for Mr. Hollon's
20 testimony?

21 A. Yes.

22 Q. I'm going to read you an excerpt from that testimony
23 that's currently available on the AMS website. The page is
24 1366, it will be Mr. Chip English questioning, and Mr. Hollon
25 answering the questions. So:

1 "QUESTION: So going back then, to the regulated price
2 as well, the Class i utilization in a given market will
3 influence mailbox prices, correct?

4 MR. HOLLON ANSWERS: Yes.

5 MR. ENGLISH: Does proximity to major population
6 centers, for instance, on the East Coast, have an impact on
7 mailbox prices?

8 MR. HOLLON: It may.

9 MR. ENGLISH: Isn't it a fact that major products used
10 in classified pricing such as cheese, butter, and nonfat dry
11 milk, tend to sell at higher premiums the more east they move?

12 MR. HOLLON: I'm not aware of that.

13 MR. ENGLISH: You are not aware that cheese products
14 sold, say into New Jersey, command a higher price than cheese
15 products sold in Chicago?

16 MR. HOLLON: No.

17 Mr. ENGLISH: And if I asked that question about other
18 geographical regions, the answer would be the same, you are not
19 aware of differences?

20 MR. HOLLON: Correct."

21 Is this consistent with your recollection of the
22 Cooperatives' testimony?

23 A. Yes, it is.

24 Q. No further questions. Thank you.

25 JUDGE CLIFTON: Ms. Taylor, I would like you to look at

1 page 7, and your Footnote 3 is one that we did not read into
2 the record, and I can't, just looking at Page 7, I can't quite
3 find what it is a reference -- what reference it is to.

4 MS. TAYLOR: It is intended to be a reference to Figure 1,
5 the map.

6 JUDGE CLIFTON: Okay. So it is where we could find
7 Figure 1?

8 MS. TAYLOR: That's correct.

9 JUDGE CLIFTON: Then I would like you to read into the
10 record that link so that people who want to find that can do it
11 easily.

12 MS. TAYLOR: Certainly. It's the federal, the Central
13 Federal Order website, www.fmmacentral.com/publications.

14 JUDGE CLIFTON: Thank you very much. All right. Any other
15 questions for Ms. Taylor? Ms. Taylor, thank you so much. I
16 appreciate the document and your testimony.

17 MS. TAYLOR: Thank you.

18 MR. ENGLISH: Your Honor, Chip English. Steve Kluesner
19 from Nestle.

20 JUDGE CLIFTON: Welcome. I believe we will be marking this
21 as Exhibit 136, is that correct, Ms. Frisius?

22 MS. FRISIUS: Correct.

23 JUDGE CLIFTON: I'm marking mine as Exhibit 136.

24 (Thereafter, Exhibit Number 136, was
25 marked for identification.)

1 JUDGE CLIFTON: We'll wait just a minute until everyone has
2 a copy. It appears they have been distributed. I'm going to
3 swear you in in a seated position. Would you raise your right
4 hand, please?

5 Do you solemnly swear or affirm under penalty of
6 perjury that the evidence you will present will be the truth?

7 MR. KLUESNER: I do.

8 JUDGE CLIFTON: Thank you. Please state and spell your
9 name for us.

10 MR. KLUESNER: My name is Steven Kluesner, that's
11 S-T-E-V-E-N, K-L-U-E-S-N-E-R.

12 DIRECT EXAMINATION

13 BY MR. ENGLISH:

14 Q. Good afternoon, sir.

15 Would you please read the first paragraph of your
16 statement and then I'm going to ask you a few questions.

17 JUDGE CLIFTON: And before you do that, I want Mr. English
18 to tell us again who he is.

19 MR. ENGLISH: Sorry, he is here on behalf of Nestle.

20 JUDGE CLIFTON: No, I mean you.

21 MR. ENGLISH: Oh.

22 JUDGE CLIFTON: Chip English.

23 MR. ENGLISH: Thank you, your Honor.

24 My name is Chip English and I'm an Attorney for the Dairy
25 Institute of California, Proponents of Proposal 2. And I am

1 presenting the next witness, who is Mr. Kluesner of Nestle.

2 JUDGE CLIFTON: You may proceed.

3 MR. ENGLISH: Thank you, your Honor.

4 MR. KLUESNER: My name is Steven Kluesner. I'm the Group
5 Manager for dairy responsible for Nestle North American
6 Procurement, and today I am representing all Nestle businesses.
7 In my role, I am responsible for milk and dairy ingredients
8 procurement for Nestle brands in United States and Canada.
9 This includes procurement relationships with individual dairy
10 farmers, cooperatives, and proprietary handlers and
11 manufacturers. Prior to my position I currently hold with
12 Nestle, I held positions with Nestle Global Milk Products
13 Procurement in Switzerland; Foremost Farms USA, Wisconsin; and
14 Wells Enterprises in Iowa. I hold a Bachelor's Degree from
15 Iowa State University in Agricultural Studies with an emphasis
16 in Dairy Science. I developed today's testimony in cooperation
17 with Nestle staff and present it today with authorization from
18 Nestle leadership.

19 BY MR. ENGLISH:

20 Q. So let me work up from this. You were at Wells
21 Enterprises. A number of us in the room know exactly where
22 that is, but not everybody does. Could you tell us what Wells
23 Enterprises was and what your position with them was?

24 A. Yeah, I was an Assistant Procurement Manager for Wells,
25 at the time it was called Wells Dairy, Inc., it is a

1 privately-owned ice cream manufacturer in Iowa.

2 Q. Not going to put a plug in for the blue bunny?

3 A. Not today.

4 Q. I guess not. How long were you there?

5 A. I was there for four years.

6 Q. Okay. And then where did you go next?

7 A. After that I went to work for Foremost Farms in
8 Baraboo, Wisconsin.

9 Q. What did you do for them?

10 A. I was the Director of Fluid Milk Marketing.

11 Q. And how long were you there?

12 A. I was there for five years.

13 Q. Okay. And then what was your position, what were your
14 actual positions with Nestle?

15 A. With Nestle, prior to going to Switzerland I worked on
16 the Nestle dairy team as a Procurement Manager for five years,
17 where I was responsible for the fluid dairy ingredients and the
18 hedging of nonfat dry milk and butter. And after five years, I
19 went to Switzerland where I was on the global team, now I'm
20 managing the purchasing of global powders for 43 different
21 countries.

22 Q. And how long were you in Switzerland?

23 A. I was in Switzerland on a mission for two years.

24 Q. And how long have you been back?

25 A. I have been back for four months.

1 Q. And look, you got to come to Clovis.

2 A. Not quite like Lake Geneva, but it is nice.

3 JUDGE CLIFTON: You know, so far, I want to be him.

4 BY MR. ENGLISH:

5 Q. All right. Why don't you continue with your statement,
6 sir.

7 A. Okay. Nestle in the United States includes: Nestle
8 USA, Nestle Nutrition, Nestle Purina Pet Care Company, Nestle
9 Waters North America, and is part of Nestle S.A., the world's
10 largest food company, headquartered in Vevey, Switzerland.
11 Nestle S.A. employes over 330,000 globally and operates over
12 390 manufacturing plants, of which Nestle USA is the largest
13 individual market and employs 23,000 and operates 25
14 manufacturing facilities and 43 distribution centers focused on
15 making branded food and beverages.

16 Nestle USA currently operates plants that utilize fluid
17 dairy products: Ice cream factories, California we have two
18 factories; one factory in Indiana; one in Maryland; and one in
19 Utah.

20 We have evaporated milk factory, one located in
21 California. A fluid beverage factory, one located in Indiana.
22 A prepared foods factories, one located in South Carolina; one
23 in Arkansas; Utah; and one in Ohio.

24 Nestle nutrition factory located in Wisconsin; and
25 confection factories located in Wisconsin and Illinois.

1 1. Currently, in California we are buying fluid dairy
2 ingredients for our two ice cream factories and our baking
3 factory. Each receive, excuse me, the baking factory is the
4 evaporated food factory for clarification, I'm sorry, the
5 evaporated milk factory. Each receives fluid milk and fluid
6 dairy ingredients as contracted, either from supplying
7 cooperatives or from patron supply. Nestle is not paying
8 non-cost-justified up charges for the milk we receive. Nestle
9 is testifying to the current situation of fluid dairy
10 procurement in California as being orderly.

11 2. I testify today in support of the Dairy Institute's
12 Proposal Number 2, which would operate without mandatory price
13 regulation, allowing us to purchase milk priced in California
14 as Federal Orders currently do in the rest of the U.S. Under
15 the Cooperatives' Proposal 1, Nestle plants in California would
16 be required to pay the higher FMMO class prices, while our
17 competitors in other FMMO regions are not required to do so.
18 In the Cooperatives' proposal, all plants are pool plants
19 requiring mandatory pooling. In all other Federal Orders, the
20 handlers decide whether to associate with the Order pool or,
21 excuse me, with the Order pool if it benefits them financially
22 to do so. If they do not associate with the pool, USDA does
23 not mandate the price plants must pay for Class II, III, and IV
24 usage. So if Nestle suppliers decide they want to associate
25 with the pool, Nestle will continue to pay the price negotiated

1 with the supplier when Nestle would not be required to pay the
2 regulated minimum price unless they chose to do so.

3 3. Mandatory pooling within the Order of California
4 would put Nestle's business at a competitive disadvantage to
5 competitors operating in orders that do not have the same
6 pooling requirements. These differences in competitive nature
7 would cause a change in manufacturing strategy, potentially
8 resulting in manufacturers evaluating replacing current
9 production with open capacities in other states resulting in
10 less overall demand for dairy products in California.
11 Manufacturing plants need to be competitive with plants in
12 other Federal Orders. By not being consistent with Federal
13 Order rules in all regulated areas and making all plants only
14 in California regulated, would destroy our ability to compete
15 with others located outside of the state. Nestle has a long
16 history and a huge investment in the California dairy industry.
17 With the size and scale of our operations in the state, and the
18 low margin nature of the ice cream business, we cannot function
19 in a non-competitive environment. Inconsistent rules across
20 Federal Orders would require re-evaluation of current Nestle
21 manufacturing strategies and bring focus to other parts of the
22 U.S.

23 4. Nestle purchases a large percent of the California
24 dairy, of California dairy products, from dairy commodities,
25 fluid supplies domestically to powders internationally. The

1 proposals to implement Federal Orders in California would
2 result in higher prices under the Cooperatives' proposal, also
3 making international purchasing decisions now subject to
4 reevaluation. Procurement decisions have to be driven by the
5 economics and the ability to source products at prices that
6 make our operations financially viable. Enhanced product
7 prices caused by higher regulated prices that are not present
8 in other regions of the U.S. or globally, and that are
9 unsupported by market realities, make the purchasing of
10 products from California less likely. The current system that
11 enables the development of supply for international business
12 over the past ten plus years would not be viable any longer and
13 would cause a shift of focus to other less regulated regions of
14 the world for growth.

15 We currently have a strong relationship with
16 manufacturers in California and would like very much, and would
17 very much like to continue to procure dairy ingredients in the
18 state. Nestle would like to see a consistent approach to
19 regulation across Orders allowing our businesses to continue to
20 be competitive and grow in communities we have established
21 manufacturing.

22 Q. Thank you. Now, when you discuss some of your
23 competitive situations, your plants in California, is there a
24 facility in Nevada that you feel like you compete against?

25 A. Yes, very much, yes. Very much.

1 Q. What is that facility and where is that located?

2 A. There's a competitive ice cream manufacturing facility
3 in Henderson, Nevada owned by Unilever, I believe.

4 Q. And to your knowledge, are a number of ice cream plants
5 located in Federal Orders nonpool plants?

6 A. To my knowledge, yes.

7 Q. And, in fact, you worked for Wells, and despite my lame
8 joke about the blue bunny, to your knowledge was that a nonpool
9 plant when you were there?

10 A. It was a nonpool plant, correct.

11 Q. Your Honor, I move admission of Exhibit 136.

12 JUDGE CLIFTON: Would anyone like to question Mr. Kluesner
13 before determining whether you object? No one. Is there any
14 objection to the admission into evidence of Exhibit 136? There
15 are none. Exhibit 136 is admitted into evidence.

16 (Thereafter, Exhibit Number 136, was
17 received into evidence.)

18 MR. ENGLISH: I have no further questions of this witness.
19 He's available for further examination.

20 JUDGE CLIFTON: Who will ask the first questions of
21 Mr. Kluesner? Mr. Beshore.

22 CROSS-EXAMINATION

23 BY MR. BESHORE:

24 Q. I tried to look around for other volunteers but didn't
25 work. Marvin Beshore.

1 Good afternoon, Mr. Kluesner.

2 A. Hello.

3 Q. Let's talk a little bit first about, you know, your
4 plants, and their products, and sources of supply, and sales
5 areas, that sort of thing. So if we look at the ice cream
6 factories, I'm just going to go through 136 here. Two
7 factories in California. Do they make products other than ice
8 cream?

9 A. No, they do not.

10 Q. Or other novelties?

11 A. They make novelties, that's correct, yes.

12 Q. Okay. What I think your testimony indicates, you
13 purchase fluid milk as well as dairy ingredients for those
14 plants; is that correct?

15 A. Correct. For one of them, fluid milk. The other
16 one's, the other plant does not take fluid milk directly, but
17 dairy ingredients.

18 Q. Where are there, to differentiate here, where are the
19 two located, what cities?

20 A. One is located in Tulare the other one is located in
21 Bakersfield.

22 Q. Which one takes fluid milk, which one doesn't?

23 A. Bakersfield takes fluid milk, a small amount.

24 Q. Okay. In addition to fluid milk, what other dairy
25 ingredients are used at Bakersfield?

1 A. Condensed skim, cream, whey.

2 Q. Do you use powder at all?

3 A. No.

4 Q. Okay. So what portion, you said fluid milk is a small
5 portion of the total ingredient mix there roughly, what
6 portion?

7 A. I don't know exactly the percentage, but it would be
8 less than five percent.

9 Q. Okay. Is that supplied from cooperatives or your own
10 producers or how do you get the milk?

11 A. It is supplied from cooperatives.

12 Q. Okay. Now, at Tulare there's no fluid milk received at
13 that plant, I take it?

14 A. Correct.

15 Q. So what dairy ingredients are purchased there?

16 A. Cream and condensed skim and whey.

17 Q. Any powder?

18 A. No.

19 Q. Okay. When you say whey, there's been lots of talk in
20 this record about all the various whey products and
21 formulations. Can you tell us what whey product you are
22 buying?

23 A. Just sweet whey powder.

24 Q. And that's the only whey product?

25 A. Yes.

1 Q. Okay. What is the distribution area of the products
2 that you make at your California factories? And I'll take
3 Bakersfield first.

4 A. Bakersfield is national, with not all of it, but
5 depending on what's manufactured on which line, you could have
6 national distribution.

7 Q. How about Tulare?

8 A. Tulare is national on pretty much everything they make
9 there, but there's a limit to the amounts.

10 Q. Okay. Now, are the dairy ingredients, setting aside
11 the small portion of fluid milk, which I understand would be
12 subject to minimum prices set by CDFA, correct?

13 A. Correct.

14 Q. Okay. Are the dairy ingredients that you purchase in
15 the California plant subject to minimum CDFA prices?

16 A. We pay the minimum CDFA prices.

17 Q. Okay. But are you required to pay the minimum CDFA?

18 A. Yes.

19 Q. You are?

20 A. Yes.

21 Q. For the condensed skim?

22 A. Yes.

23 Q. For the cream?

24 A. Yes.

25 Q. For the whey?

1 A. Whey, I do not recall specifically on whey.

2 Q. From what sources do you acquire the cream and
3 condensed skim for your California plants?

4 A. The majority of it is within the State of California.
5 There is a small amount from time to time that would come from
6 outside the state.

7 Q. Okay. Is it from cooperatives from other proprietary
8 handlers or --

9 A. Both.

10 Q. Okay. And it is your testimony that when you purchase
11 those ingredients from, let's just take other proprietary
12 handlers, that they are subject to minimum CDFA pricing?

13 A. Yes.

14 Q. Okay. Let's move to the ice cream plant in Indiana.
15 What dairy ingredients do you acquire, do you purchase there
16 for its production, fluid milk or just --

17 A. Cream and condensed skim, fluid milk and whey as well

18 Q. Okay. Is that a, that's a nonpool plant, I assume?

19 A. Correct.

20 Q. How much?

21 JUDGE CLIFTON: I have got to slow the two of you down a
22 little bit. Don't answer him until you know the court reporter
23 has finished typing what he said, okay?

24 MR. KLUESNER: Sorry.

25 JUDGE CLIFTON: I interrupted you, you were talking about

1 Indiana, I think.

2 BY MR. BESHORE:

3 Q. Yes. What percent of the dairy ingredients is fresh
4 fluid milk as opposed to the cream condensed --

5 A. Very small. Again, it is.

6 JUDGE CLIFTON: You are not following my instruction.

7 MR. KLUESNER: Sorry, I'm a slow learner.

8 MR. BESHORE: I'm in the same boat, I think.

9 BY MR. BESHORE:

10 Q. What products are made there?

11 A. Ice cream and novelties as well.

12 Q. And what's the distribution area?

13 A. It's mainly in the central part of the U.S., some does
14 travel back and forth depending on what was manufactured on
15 what line.

16 Q. What city is or town is, what's the address of the
17 Indiana plants?

18 A. It's Ft. Wayne, Indiana.

19 Q. Okay. The Maryland plant, where is that located?

20 A. It's located in Laurel, Maryland.

21 Q. And what are the ingredients that, what, first of all,
22 what products are made there?

23 A. Ice cream and novelties again.

24 Q. And what's the distribution area from that plant?

25 A. Mainly the East, but there is some distribution that

1 goes to other parts of the U.S., depending on the line and
2 what's manufactured there.

3 Q. Okay. So what are, what dairy ingredients do you use
4 at the Laurel plant?

5 A. Again, a small amount of milk. Less, I would say
6 again, less than five percent cream and condensed skim and
7 whey.

8 Q. And that's a, that's a nonpool plant?

9 A. Correct.

10 Q. Where is the plant in Utah located?

11 A. Salt Lake.

12 Q. And same set of questions on that plant. What do you
13 make and where do you get the ingredients?

14 A. They make mainly ice cream there. It is for specific
15 areas that at higher elevations, and it's a very, very small
16 plant, with very small lines.

17 Q. Okay. Thank you. Now, the evaporated milk factory in
18 California, where is that located?

19 A. It's in Modesto, California.

20 Q. And does it make strictly just evaporated canned milk?

21 A. Yes, it does.

22 Q. Okay. What's the distribution area from that plant?

23 A. Nationally.

24 Q. In fact, that's one of only two canned milk plants in
25 the country anymore, right?

1 A. Yes.

2 Q. The other one is in New York?

3 A. Yep.

4 Q. Okay. What are the ingredients for the evaporated milk
5 factory?

6 A. Milk only.

7 Q. Fresh milk only?

8 A. Correct.

9 Q. Okay. Is that supplied from your own producers or
10 cooperatives?

11 A. Both.

12 Q. In part 1 of your statement on the second page, you
13 make the statement, "Nestle is not paying non-cost-justified up
14 charges for the milk we receive." Is that is an interesting
15 phraseology in terms of what you pay for milk. Do you pay
16 premiums on the raw milk, on the milk you are purchasing for
17 your evaporated milk factory?

18 A. Yes, we do.

19 Q. And do you consider them cost justified premiums?

20 A. Yes.

21 Q. Okay. And so in what respect are they cost justified
22 from your perspective?

23 A. Cost justified in the fact that we would have to pay a
24 premium for our own milk supply from producers as well.

25 Q. Okay. And --

1 A. It is.

2 Q. So you pay your own producers a premium?

3 A. Yes.

4 Q. And therefore, your cooperative supply is going to,
5 going to get a premium also?

6 A. Correct. Yes.

7 Q. Okay. Does the cooperative, you know, balance your
8 needs at that plant?

9 A. Yes, that's one of the reasons that we buy outside milk
10 is for balancing the manufacturing.

11 Q. Okay. The fluid beverage factory in Indiana, what
12 location is that?

13 A. That is in Anderson, Indiana.

14 Q. Is that a relatively new plant?

15 A. Yes, it was built in, well, started production in 2007.

16 Q. And what products do you make there?

17 A. Class I milk, and coffee creamers, and nutritional
18 beverages.

19 Q. What's the distribution area for the plant?

20 A. National.

21 Q. Do you, what are the, is it solely raw milk supplied to
22 that plant? Is that the sole dairy ingredient or do you have
23 other ingredients?

24 A. I didn't understand your question, I'm sorry.

25 Q. Your dairy ingredients at Anderson, is it solely farm

1 milk or do you purchase other ingredients for those products?

2 A. It's farm milk and then there are some nonfat dry milk
3 that goes in there, other ingredients sugars, and different
4 things for manufacturing, and some MPC that's used in the
5 nutritional side of the business.

6 Q. Okay. So is that a pool plant or a nonpool plant?

7 A. It is a fully regulated plant on Order 33.

8 Q. Okay. And the milk supplies to that plant, are they
9 Cooperative or independent supplies?

10 A. They are Cooperative.

11 Q. And are those supplies acquired at a premium?

12 A. Yes, they are.

13 Q. The plant in South Carolina, where is that and what
14 products does it make?

15 A. Gafney, it's prepared foods. It would be any sort of
16 frozen meal.

17 Q. Any fresh milk purchased at that plant?

18 A. No, those are, any of the prepared food plants would be
19 cream and condensed skim. It's very small amounts.

20 Q. Okay. So that, the South Carolina, Arkansas, Utah, and
21 Ohio, I'm going over to the second page, all those prepared
22 food plants, the dairy ingredients are cream and condensed
23 skim?

24 A. Yes, used ingredients, yes.

25 Q. And no fresh milk?

1 A. No fresh milk at all.

2 Q. Okay. The nutrition factory in Wisconsin, what
3 location?

4 A. That's in Eau Claire, Wisconsin.

5 Q. The famous Eau Claire, maybe infamous. What dairy
6 ingredients do you purchase there?

7 A. That is a 2 percent milk that we buy for manufacturing.

8 Q. So is that acquired from proprietary or cooperative
9 sources?

10 A. Sorry, I have to think back. I have only been back
11 here for four months, I got to think for a minute. That I
12 believe is from a proprietary supply.

13 Q. Is the Eau Claire plant a pool or nonpool plant?

14 A. Nonpool.

15 Q. What do you make there?

16 A. It's a nutritional, a specialized nutritional beverage.

17 Q. What's the distribution in the area for that?

18 A. It's national.

19 Q. The confection factories, is that -- is that chocolate?

20 A. Chocolate, caramel, mainly condensed skim, or
21 evaporated milk, or sweetened condensed milk.

22 Q. What's the location in Wisconsin?

23 A. Wisconsin is Burlington.

24 Q. And Illinois?

25 A. Illinois is Franklin Park, that's the main one.

1 Q. I'm sorry?

2 A. Franklin Park.

3 Q. And did you say what, condensed skim and sweetened
4 condensed?

5 A. Sweetened condensed milk, correct. And there is some
6 butterfat that goes in there as well, typically AMF.

7 Q. No fresh milk?

8 A. No.

9 JUDGE CLIFTON: Butterfat typically what?

10 MR. KLUESNER: AMF, it's basically butter oil.

11 JUDGE CLIFTON: And does AMF stand for?

12 MR. KLUESNER: Anhydrous Milk Fat.

13 JUDGE CLIFTON: Thank you.

14 BY MR. BESHORE:

15 Q. Okay. Thank you for that, for that information on your
16 plants there, Mr. Kluesner. From your purchase of milk in
17 California directly from independent farmers, how, within what
18 geographic range of your plant of Modesto are your farmers
19 located?

20 A. I would guess within 40 miles.

21 Q. What's the prevailing premium on farm milk in that
22 area, pay price?

23 A. I would rather not answer that question.

24 JUDGE CLIFTON: You are not required to.

25 MR. BESHORE: I think he knows the rules.

1 BY MR. BESHORE:

2 Q. Now, you say in point number 2 on page 2 here, that you
3 would like to, I'm paraphrasing, but basically you want to be
4 able to buy milk at prices that are not subject to minimum
5 regulation.

6 A. We would like to be able to buy milk if regulated,
7 consistent with our other factories across the nation.

8 Q. Okay. Now, let's just take your, let's take the, well,
9 actually, in California which plant uses the most, obviously
10 the Modesto factory would use the most fresh milk, I assume.

11 A. Yes, in fresh milk form, yes.

12 Q. Are you familiar with the status in milk supply of your
13 only competitor in the country for that plant, what it pays for
14 milk?

15 A. Most specifically, no.

16 Q. You are not?

17 A. No.

18 Q. But you want to, if you, wouldn't that be important?
19 If you want to pay what your competitor's pay, you only have
20 one competitor for that plant in the country, and you don't
21 know what it pays for its milk?

22 A. Well, I would assume I would know if they were going to
23 pay roughly, well, I would have an idea. I wouldn't know
24 exactly what they were going to pay, but I would have roughly
25 an idea.

1 Q. They are going to pay Federal Order price plus
2 something, right?

3 A. I don't know that specifically.

4 Q. Well, you said you knew, you thought you knew roughly
5 what they would pay. What did you mean by that?

6 A. You asked me if I would know exactly what they would
7 pay. Not exactly, you asked me if I knew what they would pay,
8 and I said no, but it would probably be somewhere around a
9 regulated price. I would not know if it was higher or lower.

10 Q. Okay. Now, you have national distribution from your
11 ice cream plants in California. So do you know what your
12 competitors across the country are paying for their ingredients
13 for ice cream?

14 A. Not specifically, no.

15 Q. Do you know generally?

16 A. Again, roughly, I would have no idea if it was exactly
17 the regulated price.

18 Q. You do know that the minimum regulated price that you
19 have in California is lower than that in the rest of the
20 country, correct?

21 A. Yes.

22 Q. Now, you expressed concern in point 2 here about
23 whether you would be required to associate with the pool or
24 not. Do you, have you ever done a cost study on what the value
25 is, if any, of being pooled or not being pooled as an ice cream

1 manufacturer in the in Federal Order marketing areas?

2 A. Lately, no, I have not.

3 Q. But you say "mandatory pooling would put Nestle's
4 within an order of California's," this is point number 3,
5 "would put Nestle's businesses at a competitive disadvantage to
6 competitors operating in Orders that do not have the same
7 pooling requirements." Wouldn't that depend on what your,
8 whether, regardless of the pooling requirements, wouldn't it
9 depend, depend on what your competitors were paying there?

10 A. It comes back to price level, yes. I mean, it depends
11 what the price level would be.

12 Q. So let me ask the question again. Have you done any
13 study on what difference, if any, mandatory pooling would have
14 on your cost of milk on an annual basis?

15 A. Have I done personally? No, I have not done
16 personally.

17 Q. Has your company done such a study?

18 A. Company? No.

19 Q. Have you seen any such study presented to you by anyone
20 associated with the Dairy Institute team here today?

21 A. I have, yes.

22 Q. At cost study relating to mandatory pooling?

23 A. I saw a, yes. I saw the numbers that were put together
24 by the Dairy Institute of California that would show what the
25 difference would be between, basically between Proposal

1 Number 1 and would Proposal Number 2.

2 Q. Okay. And was it your assumption that those
3 differences were the product of mandatory pooling?

4 A. That is my assumption, yes.

5 Q. Okay. Point number 4, I have -- I'm having a little
6 trouble understanding exactly what this is about. Is this
7 mainly directed to international sales?

8 A. Mainly, yes.

9 Q. Okay. Do you sell, what, evaporated milk
10 internationally?

11 A. We do sell some internationally. We are a large buyer
12 of powders internationally of the U.S.

13 Q. For what uses?

14 A. Many different uses.

15 Q. Okay. I didn't -- yeah. And the reason I asked for
16 what uses. They are not, as a large buyer of powders, it would
17 seem from your explanation of the products made and the
18 ingredients used at these plants, that you are not buying the
19 powders for your own use, primarily.

20 A. Not in the U.S., but for our own use in the 43 other
21 countries that we do business.

22 Q. Okay. When you say in the first sentence of 4,
23 "Nestle's purchases a large percent of California dairy
24 products from dairy commodities." You are referring there to
25 your purchases of condensed skim and cream and whey I take it?

1 A. Yeah, I mean it could be condensed skim, cream, whey
2 cheese, butter, so this is, there is a multitude of different
3 things. I don't think there's any dairy product that's
4 manufactured that we do not buy.

5 Q. Okay. But you buy them, Nestle buys them for other
6 operations other than your dairy manufacturing plants?

7 A. The majority of it would go into all the plants
8 domestically that I have listed, and I have not listed the
9 international plants or needs.

10 Q. Okay. I'm only talking about the domestic plants. But
11 you are not using cheese as an ingredient anywhere though,
12 right?

13 A. Yes, we are.

14 Q. Okay. Where did I miss that?

15 A. Cheese is an ingredient that falls underneath our
16 Nestle USA business, Nestle pizza division, and our prepared
17 foods division as well. I'm sorry, I did misspoke in the fact
18 that we do take cheese into prepared foods when we were talking
19 about earlier.

20 Q. Okay. So among the plants listed here, the prepared
21 foods factories would be ones that use cheese, as well as the
22 other ingredients you mentioned.

23 A. Prepared foods, yes. To clarify what's listed on the
24 testimony here, are the factories that only take fluid
25 ingredients. We do have factories that use many different

1 dairy ingredients across the nation that are not listed here.

2 Q. Okay. And, okay. Thank you. That's all I have right
3 at the moment. Thank you, Mr. Kluesner.

4 JUDGE CLIFTON: Who next has questions for Mr. Kluesner?
5 Ms. Taylor?

6 CROSS-EXAMINATION

7 BY MS. TAYLOR:

8 Q. Good afternoon, Mr. Kluesner.

9 A. Hello.

10 Q. I'm Erin Taylor with the USDA. Thank you on behalf of
11 the Department for coming here today and expressing the views
12 of Nestle. We do appreciate that.

13 Just a few questions. I first won't ask you my small
14 business question because with however many employees, I'm
15 pretty sure you would not fall under that definition.

16 For your, since this is about California, for the milk
17 that you purchase in California, could you give us a rough
18 estimate on what is supplied by cooperatives and what is
19 supplied by independent shippers, if you don't mind?

20 A. As far as what ingredients are supplied? Is that your
21 question?

22 Q. Yes.

23 A. Okay. From, we have cooperatives would be condensed
24 skim and cream mainly, and milk. And then from independents,
25 we get cream supply from a few small ones, a few small

1 suppliers.

2 Q. Few small plants?

3 A. Well, small supply that we get from probably larger
4 plants, but it's a smaller supply.

5 Q. Okay. Under the current California system you do pay
6 California State Order minimum prices, even though your plants,
7 I think you said your plants are not pooled in California?

8 A. We pay the minimum price in California.

9 Q. You pay the minimum price.

10 A. Yeah.

11 Q. Okay. I take it from, your main concern with
12 Proposal 1 and why you support Proposal 2, it gives your plants
13 the option to pool just like in the other ten Federal Orders
14 currently, there's pooling provisions that allow plants to pool
15 if they qualify or opt not to pool?

16 A. That is correct.

17 Q. And so you don't necessarily have a concern with, or
18 maybe you do, you can explain. If you have a concern as to the
19 prices that would be in a Federal Order system, whether they be
20 the prices as proposed by the co-ops or the prices as proposed
21 by the Dairy Institute, so long as you had the ability to opt
22 whether to participate or not. Granted, I'm sure you would
23 like the lower price, but your main issue is with the pooling?

24 A. Correct. That's correct. If the price was the same
25 across the nation, it would, we would look, or it would be good

1 to have consistency across the ability to in the pool status as
2 well.

3 Q. Okay. And my final question is just about your whey
4 purchases. You purchase mostly dry sweet whey?

5 A. For ice cream manufacturing, yes.

6 Q. And how do you, there's been a lot of conversation
7 about whey purchasing. Could you elaborate generally how you
8 determine the price that you purchase that for?

9 A. It varies. Most -- it would be market indexed pricing
10 for the whey. Whether it's the report or some sort of, whether
11 it is the report that establishes a price, there would be an
12 index to that.

13 Q. Okay. Indexed off the CME or --

14 A. There's multiple. There's multiple indexes that we
15 use. There's not one specific one.

16 Q. Okay.

17 A. But they all function similar, with just different
18 indexes.

19 JUDGE CLIFTON: If I could inquire further about that. Are
20 these published indexes or do you pay some kind of service to
21 gather the pricing information for you on whey?

22 MR. KLUESNER: These are the published indexes --

23 JUDGE CLIFTON: Okay.

24 MR. KLUESNER: -- that we have been referring to. Some
25 within Sue Taylor's testimony as well.

1 JUDGE CLIFTON: Okay.

2 MS. TAYLOR: I think that's it.

3 JUDGE CLIFTON: Are there further questions for
4 Mr. Kluesner?

5 MS. TAYLOR: We have one more question.

6 JUDGE CLIFTON: Good. And there's also in the back.

7 MS. TAYLOR: I'm going to let me colleague ask you this
8 question.

9 CROSS-EXAMINATION

10 BY MS. MAY:

11 Q. My name is Laurel May. Apparently my handwriting is
12 not legible. So my question was, do you procure any California
13 milk or milk products for use in out-of-state plants?

14 A. Procure milk, you mean as far as fluid milk itself or
15 are you talking about dairy ingredients?

16 Q. Either or both?

17 A. We have taken some California dairy ingredients into
18 our Salt Lake factory, but it's very little volume that we take
19 there.

20 Q. And then do you bring any out-of-state milk into
21 California for use in your plants here?

22 A. From time to time we do, yes. Depends on what, there
23 may be a special need of some sort that we would not be able to
24 get here theoretically, and we would bring it in.

25 Q. What would be a special need?

1 A. Maybe an rBST-free type of product that wouldn't
2 necessarily be available, we would buy from whoever we could
3 get it from.

4 Q. Okay. Thank you.

5 JUDGE CLIFTON: Ms. Reed?

6 CROSS-EXAMINATION

7 BY MS. REED:

8 Q. Kristine Reed. I represent Select Milk Producers.

9 I just have a couple of questions to make sure I'm
10 understanding your testimony. I wanted to look at paragraph 4
11 on page 3, and I know you had a conversation with Mr. Beshore
12 about this. But, in general, in this paragraph you're talking
13 about, in part, about products that you purchase domestically
14 for use in your international plants; is that right?

15 A. Correct.

16 Q. Okay. So, for instance, is that mostly powders then?

17 A. Yes.

18 Q. What percentage of those, if you can tell us, is
19 purchased in California versus other parts of the country?

20 A. I can say the vast majority of it is purchased in
21 California.

22 Q. Okay. So then in the next to the last sentence when
23 you are talking about if there's an enhancement in product
24 prices, that would make the purchase of product from
25 California, continued purchases of California, less likely for

1 Nestle is what you are saying?

2 A. Exactly. Yeah. For other, say more competitive
3 regions globally.

4 Q. Okay. Would you anticipate if that were the case, that
5 you would shift your purchases elsewhere in the United States
6 to either other federally-regulated regions or non-regulated
7 regions, or would you anticipate is there enough of a market
8 globally that you would look globally for those replacement
9 products?

10 A. We would evaluate both, of course, but there is, yes,
11 there is enough of a market globally that could be replaced.

12 Q. Okay. And then finally, in your last kind of closing
13 paragraph you state, "we currently have strong relationships
14 with manufacturers in California and we would very much like to
15 continue to procure dairy ingredients in the state." When I
16 read that whole sentence, I would replace manufacturers with
17 producers, is that what you are talking about in that context?
18 Co-op supplied?

19 A. Yes, yes, correct.

20 Q. Okay. I just wanted to make sure. Thanks. That's it.

21 A. Yes.

22 JUDGE CLIFTON: Is that -- Mr. English, would you, you can
23 talk about anything, but I'd particularly like to know about
24 that particular word in that last paragraph.

25 MR. ENGLISH: I would like to explore that, Chip English, I

1 would like to explore that as well.

2 DIRECT EXAMINATION

3 BY MR. ENGLISH:

4 Q. So if you could look at your statement there.

5 A. Okay.

6 Q. You are talking about, "currently have strong
7 relationships with manufacturers in California." So let me
8 just see if I can clarify, because I think it may cover
9 cooperatives, to the extent you buy product that's produced by
10 cooperatives, such as nonfat dry milk powders or condensed
11 skim, correct?

12 A. Correct.

13 Q. Okay. But I at least thought that it was broader than
14 that, and you mentioned the purchase of cheese that you use in
15 the country, so we would also include other dairy products. So
16 it's broader than co-ops, it would also include cheese products
17 as well?

18 A. Yes, that's correct.

19 Q. Okay. So it's basically dairy product manufacturers
20 generally?

21 A. Exactly. Exactly.

22 Q. Does that help, your Honor?

23 JUDGE CLIFTON: Yeah, I, but from Ms. Reed's question, I
24 got the idea that he's talking not only about strong
25 relationships with manufacturers, but also with some producers.

1 Is that fair?

2 MR. KLUESNER: Well, it would be co-ops in general, the
3 producer part would go back to the co-ops we do business with
4 as well, I think.

5 MR. ENGLISH: I agree with you. I think it's even broader
6 than I just made it, I think it includes Ms. Reed's issue,
7 which is actually the dairy farmer element; is that correct?

8 MR. KLUESNER: Correct, yes.

9 MR. ENGLISH: But it also includes the cooperatives as
10 manufacturers of finished products, correct?

11 MR. KLUESNER: Exactly.

12 MR. ENGLISH: And then it includes those people making
13 other products for dairy ingredients like cheese?

14 MR. KLUESNER: Yes, correct.

15 MR. ENGLISH: The full spectrum?

16 MR. KLUESNER: Yes.

17 JUDGE CLIFTON: All right. Thank you. And do you have
18 other redirect?

19 MR. ENGLISH: That is my only redirect.

20 JUDGE CLIFTON: All right, then. Are there any other
21 questions for Mr. Kluesner? Actually, I want to know where you
22 are going when you leave Clovis?

23 MR. KLUESNER: Ohio via Denver.

24 JUDGE CLIFTON: Are you headquartered in -- where are you
25 headquartered?

1 MR. KLUESNER: My office is in, near Cleveland, Ohio.

2 JUDGE CLIFTON: All right. Ms. Reed, where is your office?

3 MS. REED: Cincinnati.

4 JUDGE CLIFTON: Cincinnati. Mr. English, anything further
5 of Mr. Kluesner?

6 MR. ENGLISH: No, I would thank him very much for coming.
7 And I was going to suggest our afternoon break, I think the
8 court reporter agrees, and that would give me also a chance to
9 start distributing the testimony of Mr. Zolin part whatever.

10 JUDGE CLIFTON: Yes, it is already slightly after 4:00.
11 Please be back and ready to go at 4:18. 4:18. That gives you
12 15 minutes.

13 (Whereupon, a break was taken.)

14 JUDGE CLIFTON: All right. We have Mr. Zolin in the
15 witness chair and in just a minute I'll have him identify
16 himself. We also have two documents that have been distributed
17 Mr. English?

18 MR. ENGLISH: Yes, your Honor. During the break, I believe
19 everybody should have, I made sure, and of course Ms. Frisius
20 got her four and you and the court reporter. There's is a
21 two-page document labeled Testimony of Alan Zolin, Part 6, that
22 I would like to have marked first. And then there's a, it's
23 three-pages, but it is printed on front and back, an attachment
24 I would have marked as the next document.

25 JUDGE CLIFTON: Ms. Frisius, will the testimony of

1 Alan Zolin, Part 6, be Exhibit 137?

2 MS. FRISIUS: It will be.

3 JUDGE CLIFTON: Thank you. Exhibit 137

4 (Thereafter, Exhibit Number 137, was
5 marked for identification.)

6 JUDGE CLIFTON: And then the --

7 MR. ENGLISH: We have a Dairy Institute of California
8 Modifications to Proposed Section 1051.9(d).

9 JUDGE CLIFTON: 1051.9(d) all right. We'll mark that then
10 as Exhibit 138.

11 (Thereafter, Exhibit Number 138, was
12 marked for identification.)

13 JUDGE CLIFTON: Mr. Zolin, you remain sworn. Would you
14 again state and spell your name?

15 MR. ZOLIN: Alan Zolin, A-L-A-N, Z-O-L-I-N.

16 DIRECT EXAMINATION

17 BY MR. ENGLISH:

18 Q. Mr. Zolin, why don't you proceed by reading
19 Exhibit 137.

20 A. Okay.

21 Introduction

22 My name is Alan Zolin. I have been retained by Hilmar
23 Cheese Company (HCC) to work with Dairy Institute of California
24 (DIC) to develop an alternative proposal to Cooperative
25 Proposal 1. I have worked with a task force made up of a

1 number of representatives from DIC member companies in order to
2 develop and submit Proposal 2.

3 Description of Proposal 2 Handler Definition with an Addition
4 of a New Paragraph 9(d)

5 DIC has included a new paragraph in the handler
6 definition. This new paragraph is 9(d). This paragraph has
7 been in other FMMO's in the past. The original concept of this
8 paragraph was created by USDA in a 1981 decision for a hearing
9 held to determine pooling provisions for the Southwest Idaho,
10 Eastern Oregon, FMMO 135. At the time, USDA was applauded for
11 its innovative thinking and problem-solving by the proponents
12 of changing the way supply plant handlers could qualify as a
13 handler. The new type of handler created is called a
14 "proprietary bulk tank handler" (PBTH). The concept was to
15 allow proprietary handlers to pool milk in a similar manner
16 that cooperative handlers can pool milk under the 9(c)
17 provision. The proprietary handler would not need to create a
18 physical pool supply plant in order to meet the performance
19 requirements of the Order. The requirements for a proprietary
20 handler in order to meet the definition of this section are:

21 1) The PBTH must operate a plant located in the
22 marketing area and the milk is not processed into Class I at
23 the facility.

24 2) Prior to operating as a PBTH, the Market
25 Administrator (MA) must receive a statement from the pool plant

1 operator where the milk of the PBTH is to be received
2 specifying that the PBTH will be the responsible handler for
3 the milk.

4 Back in the 1980's, proprietary handlers did not have
5 the ability to meet the performance standards via shipments
6 directly from the farm. Proprietary handlers had -- I'm sorry,
7 let me start over -- proprietary handlers only had the option
8 to meet performance requirements via the supply plant
9 definition. This methodology would require a proprietary
10 handler to accumulate Grade A milk at a supply plant and make
11 shipments (transfers) to a pool distributing plant. The
12 innovative decision recommended by USDA changed that paradigm
13 and allowed a proprietary plant to meet the performance
14 standards by moving milk directly from the farm to a pool
15 distributing plant. This concept followed -- I'm sorry -- this
16 concept allowed for the more efficient movement of milk by
17 eliminating unnecessary transportation costs and the unloading
18 and reloading milk to service the Class I market.

19 Since 1981, numerous recommended decisions from the
20 USDA created a methodology for a supply plant to meet the
21 performance standards with movements to pool distributing
22 plants directly from the farm. In testimony on the pooling
23 standards in FMMO Order 30, Mr. Henry Schaefer -- I think
24 that's a misspelling Henry, I just noticed it -- described the
25 practice of (wet the tank once a month) --

1 JUDGE CLIFTON: Are those parentheses or quotations?

2 MR. ZOLIN: Actually, they are supposed to be quotes, I'm
3 sorry. It's that shade of the microphone again.

4 As a requirement to -- okay. Let me very start.

5 In testimony of the pooling standards in FMMO Order 30,
6 Mr. Henry Schaefer described the practice of "wet the tank once
7 a month" as a requirement to demonstrate that a pool supply
8 plant is capable and prepared to meet the performance
9 standards. It is DIC's intent that with that, with the
10 addition of the PBTH that the only difference between the PBTH
11 provision and normal supply plant handler status, is that the
12 requirement to wet the tank will not be necessary, DIC believes
13 that the same market conditions that are present in California
14 were also present in the Western FMMO 135. Plus, the interest
15 of USDA in preventing uneconomic movements of milk, is as
16 important now as it was in the 1980's.

17 HCC is supportive of Proposal 2 that includes the PBTH
18 provision. Any relief that can be provided on the operational
19 efficiencies at the HCC milk intake is welcome. By not having
20 to wet the tank the HCC cheese plant can focus on milk
21 receiving efficiencies. Currently, HCC received over 250 milk
22 trucks a day and utilizes five receiving bays. The HCC
23 smallest silo size is 1.6 million pounds of milk. Milk is
24 received 24 hours per day, 7 days per week. There is little
25 room and/or time to wet the tank in order to meet the

1 regulatory requirements. These metrics represented by the HCC
2 plant are significantly greater than the milk receiving systems
3 of cheese plants in the Upper Midwest. Without any intake
4 modification, HCC would not dedicate -- I'm sorry -- without
5 any intake modification, HCC could not dedicate a silo to be
6 its pool supply plant. Therefore, the PBTH provision will
7 allow HCC to pool milk in a manner similar to the 9(c)
8 provision for cooperatives and operate its manufacturing plant
9 without needing to meet additional FMMO restrictions on its
10 milk receiving patterns.

11 And that concludes my testimony.

12 BY MR. ENGLISH:

13 Q. I want to come back to that last paragraph in 137 but
14 after we discuss 138. So the conditions and the terms that you
15 have discussed -- well, first let me say this. Were you
16 involved with Kraft Foods at the time of the original Idaho
17 Order going in?

18 A. The, I started at Kraft in 1984, so the decision that
19 put the Order promulgation I believe was 1981, so I was not
20 involved with the original decision, but I was involved in
21 decisions that put the proprietary bulk tank handler in other
22 Federal Order across the country.

23 Q. Now, when you put it, when you got it put in other
24 Orders, did you go back AND look at what the Secretary did in
25 order to put it in in the Idaho order?

1 A. Exactly. Back in the '80's we looked at what was done,
2 and I would have to say, copied the language. The one area I'm
3 specifically familiar with is a Federal Order that is no longer
4 in existence, I believe it was the Tennessee Valley Order,
5 Order 11.

6 Q. Okay. Was it your understanding, what was your
7 understanding when you looked at it, of how it developed? Was
8 it a proposal from industry?

9 A. Oh, the proposal itself was, like I said, it was
10 applauded. It was a, it was not in the hearing record.

11 Q. It wasn't in the Hearing Notice.

12 A. I'm sorry, it was not in the Hearing Notice. It was --
13 it was the Department's solution to a problem, and it was
14 better than the solution that was being provided by handlers
15 and processors in that market to address the same situation.
16 How can a proprietary plant meet the performance requirements,
17 via shipments directly from the farm.

18 Q. Now, some 20 years later, after Federal Order Reform,
19 there was a Hearing Notice for the Pacific Northwest and
20 Western Order, correct?

21 A. That is correct.

22 Q. And was the Proprietary Bulk Tank Handler Provision a
23 subject of discussion at that proceeding?

24 A. It was the subject of discussion at that proceeding,
25 yes, it was.

1 Q. Were you at that proceeding?

2 A. I was not at that proceeding, but a Kraft
3 representative was.

4 Q. Now, what had happened in the intervening 20 years or
5 more particularly after Federal Order Reform in your mind that
6 caused the Proprietary Bulk Tank Handler Provision to be
7 discussed at some length in the proceeding in 2002?

8 A. In the 20 years that the provision was in effect, I'm
9 going to go way back, Chip, I know early in the '80's, the
10 Kraft plants that operated in the Idaho Order, did use the
11 Proprietary Bulk Tank Handler Provision. Most of those plants
12 were located in the Central Idaho area. And over time, it
13 became the Kraft plants became nonpool plants and no longer
14 pooled milk in that Order, and so we kind of left the system.
15 Other manufacturers came in, other folks came in, and it's my
16 understanding that over time, there were perceived abuses of
17 the provision. One I'm familiar --

18 Q. Okay. May I interrupt for a second? Well, one thing
19 that happened was Federal Order Reform happened, correct?

20 A. Yes. Okay. And merged some Orders, yes.

21 Q. And merged some Orders, correct?

22 A. Correct.

23 Q. So the Idaho Order ended up being merged with --

24 A. I believe --

25 Q. -- great Basin?

1 A. Great Basin Order and got the name Western Order.

2 Q. Did that change the utilization of the market?

3 A. It did. It did. Because it brought more Class I
4 utilization into the marketplace.

5 Q. So what impact would that have had on the desirability
6 of using the provision to pool?

7 A. As we have talked all through the 29 days we have been
8 here --

9 JUDGE CLIFTON: Today is 31.

10 MR. ENGLISH: Well, actually, he was on vacation in Italy
11 for part of it, so --

12 MR. ZOLIN: I apologize. I lost the train of thought.

13 BY MR. ENGLISH:

14 Q. I was asking about what impact did Federal Order Reform
15 merger, which as you said, changed the Class I utilization by
16 raising it, have on the desirability of pooling milk?

17 A. And we have talked about pooling milk, not pooling
18 milk. Class I utilization of a market, in the market is a very
19 key consideration of what the blend price is going to be, which
20 is a major factor in determining whether milk is in the pool or
21 out of the pool. So with higher utilization, the draw to be
22 part of the pool would be very great.

23 Q. So then I interrupted you. You were about to talk
24 about what was discussed at the hearing, at least in your
25 understanding.

1 A. And again, I wasn't at the hearing. I remember the
2 discussion back in 2003 I think it was. But I've obviously
3 refreshed my memory by reading the recommended decision. Two
4 items come to mind. The first would be the abuse or possible
5 abuse of the diversion limitations in the Order. I believe the
6 Order had a 90 percent diversion limitation at the time. But
7 with the wording that was in the Order, it allowed for that
8 diversion to be multiplied up until almost a 98 or 99 percent
9 diversion limit, so that would be one.

10 The second item that I'm aware of that was a concern
11 had to do with minimum order pricing, and specifically, Class I
12 handlers all having the same, paying the minimum price for
13 milk.

14 Q. Okay. So what we submitted for the Dairy Institute, as
15 you, yourself, said when you went down to Tennessee, was the
16 identical language that had been put into the Idaho Order at
17 the time, correct?

18 A. That is correct.

19 Q. Okay. So since the Hearing Notice has been issued,
20 have you and the Dairy Institute had occasion to look at that
21 language and determine whether or not, in light of what
22 happened with the hearing in 2002, that there might be some
23 modifications that you want to make?

24 A. That --

25 Q. Are going to make?

1 A. That's exactly true. I'll get back to the intent. The
2 intent is to allow proprietary handlers to pool milk in the
3 same manner that cooperative organizations can pool milk. If
4 there was a flaw in the language, we should fix the flaw. But
5 the concept is a good concept.

6 Q. Okay. So -- so, for instance, under both proposal,
7 well, actually, not proposal -- under Proposal 2 there is a 90
8 percent diversion limit, correct, for cooperatives?

9 A. That is correct. A 90 percent diversion limit for all
10 handlers.

11 Q. All handlers.

12 A. Yes.

13 Q. And to the extent the Idaho language, once it was
14 merged into, with the Western Order and higher utilization,
15 could have theoretically led to a 99 percent diversion
16 limitation, that's not your intent, correct?

17 A. That is correct. That is not our intent.

18 Q. So what modification, looking at Exhibit 138, what
19 modification are we proposing to deal with that risk of
20 interpretation, meaning instead of a 90 percent diversion
21 limitation, to something like a 99 percent diversion
22 limitation?

23 A. I'm assuming, I have a colored copy in front of me.
24 And of course --

25 Q. The court reporter has a color copy, the Judge has a

1 color copy, and the official record has a color copy, everyone
2 else has black and white, but in track changes, you can see
3 stricken language and underlined language.

4 A. So the real, the real, in the very first paragraph,
5 about four lines from the bottom of the first paragraph, we
6 added the description of two types of plants where the milk
7 would be shipped to, and that would be a 7(a) plant or a 7(b)
8 plant, which are descriptions of pool bottling plants. The
9 language that was in the Order just referred to a pool plant.
10 So we are identifying the type of plant that would, the milk
11 needs to be delivered to.

12 Q. And the rest of Exhibit 138 is the Hearing Notice for
13 the Idaho Western Order proceeding in 2002. And from that
14 Hearing Notice, does your language track one of those
15 proposals?

16 A. Okay. Bear with me, yes. Proposal Number 14, which
17 would be on page 9626.

18 Q. Of the Federal Register.

19 A. Of the Federal Register. It would be, it was submitted
20 by, it would be in the middle of the page, submitted by the
21 Market Administrator. Proposal 14 was language that is, I
22 believe, identical to the language that we now have written in
23 our modification.

24 Q. And so that was actually submitted by the Market
25 Administrator's office for that Order at the time, correct?

1 A. That's correct.

2 Q. And do you know who testified in favor of that?

3 A. I didn't until coming to this hearing. It was
4 Mr. Mykrantz that testified at the hearing for that proposal.

5 Q. Okay. So the second concern that was leveled, and
6 there was obviously a lot of argument about whether it was
7 actually happening, but the second concern that was leveled was
8 the question of minimum prices, correct?

9 A. That is my understanding, yes.

10 Q. And on Exhibit 138, have you also proposed changes that
11 would address that issue?

12 A. We have added a new paragraph 3 for the Section 9(d) to
13 address that, that issue of potential under order payments to a
14 supplier.

15 Q. And that's because the milk that's actually received at
16 the, whichever plants receives it is going to have to report
17 and pay for it, correct?

18 A. Correct.

19 Q. Now, looking again at Exhibit 138, the Hearing Notice,
20 was there a proposal submitted along those lines?

21 A. Yes, in the Federal Register on page 9625, Proposal 11,
22 which I believe was submitted by, I see it now, MariGold
23 Dairies, there is language that is, as I'm looking making sure,
24 is identical to our new paragraph 3.

25 Q. And it is proposal what?

1 A. Proposal Number 11.

2 Q. Now, if you look above Proposal Number 11, MariGold
3 indicated that it was submitting multiple proposals?

4 A. That is correct.

5 Q. Any one of which would solve the problem in its view?

6 A. Correct.

7 Q. So, and the other two proposals would be proposals 12
8 and 13?

9 A. That is correct.

10 Q. Okay. Even though we have, for purposes of
11 Exhibit 138, adopted effectively at, you know, Proposal 11 from
12 that Hearing Notice, do you have a position on a preference for
13 any of those provisions?

14 A. Obviously, we picked the one we have as our preference,
15 but they are all addressing the same subject. They all handle
16 it, I think, and they accomplish the same. So as a preference,
17 no. If the Department picks one of the others, I think that
18 would be fine with, certainly with me and I think with Dairy
19 Institute.

20 JUDGE CLIFTON: While we're looking at Exhibit 138 and the
21 proposed language, shall we utilize the section number that's
22 at issue here in that final paragraph?

23 MR. ENGLISH: Your Honor, I typed this ten times and got it
24 wrong.

25 JUDGE CLIFTON: I knew it wasn't Mr. Zolin.

1 MR. ENGLISH: Well, I think I mentioned earlier that
2 someone was very busy writing order language and apparently,
3 you know, whatever.

4 Yes, your Honor, thank you very much. Paragraph 3,
5 would you agree, Mr. Zolin, that says milk defined as producer
6 milk pursuant to -- I don't know how I copied this particular
7 version. So it should be Section 1051.13.

8 JUDGE CLIFTON: All right. So Ms. Frisius, your copying?
9 Do you see where he is?

10 MS. FRISIUS: Uh-huh.

11 JUDGE CLIFTON: Would you do it again, Mr. English?

12 MR. ENGLISH: It should be Section 1051.13.

13 MS. FRISIUS: No (d)?

14 MR. ENGLISH: No (d). The reference to 9(d) is wrong, too,
15 it is supposed to reference Section 13, which is Producer Milk.

16 JUDGE CLIFTON: And then would you like to conform the
17 opening paragraph, the next to the last line, similarly?

18 MR. ENGLISH: Yes, your Honor. The scrivener copied from
19 the word document submitted to the Department, and in doing so,
20 just brought in that 50. I don't know why I just didn't use
21 50, but anyway.

22 JUDGE CLIFTON: So we're going to strike, Ms. Frisius, in
23 that one, we can just strike the 0 and put in the 1.

24 MR. ENGLISH: Yes, your Honor. Do you agree with those,
25 Mr. Zolin?

1 MR. ZOLIN: I'm not on the same page so could you point me
2 to where we are?

3 JUDGE CLIFTON: Yeah.

4 MR. ENGLISH: It is the 50 to 51 issue.

5 MR. ZOLIN: I agree.

6 MR. ENGLISH: All right. Do you accept those changes,
7 Mr. Zolin?

8 MR. ZOLIN: I do.

9 MR. ENGLISH: All right. Thank you, your Honor.

10 With those modifications to the modifications, your
11 Honor, I would move admission of both Exhibit 137 and 138.

12 JUDGE CLIFTON: This is a tiny, tiny thing, and I just
13 think we ought to go ahead and do it. We have the Arabic 1 on
14 page 1 a couple of times, and I think we want the Roman numeral
15 I, is that true?

16 MR. ENGLISH: That was a different typist.

17 JUDGE CLIFTON: The first time I see it is in the middle of
18 the page under subsection 1, we're talking about Class I at the
19 facility, and do you see, Mr. Zolin?

20 MR. ZOLIN: I see, yes.

21 JUDGE CLIFTON: Do you think that should be a
22 Roman Numeral I?

23 MR. ZOLIN: Yes.

24 JUDGE CLIFTON: All right. And Ms. Frisius, are you there,
25 too?

1 MS. FRISIUS: Yes.

2 JUDGE CLIFTON: And then the next place I see it is the
3 last line of the last full paragraph, it just says Class I
4 market.

5 MR. ZOLIN: I see that and I agree as well.

6 JUDGE CLIFTON: Okay. And then I have a question on the
7 next to the last line on page 1. You had read it two different
8 ways, "either in testimony of the pooling standards" or "in
9 testimony on the pooling standards." And it doesn't matter to
10 me, I just want it the way you want it.

11 MR. ZOLIN: Let's leave it as "of" that's the way it is
12 written.

13 JUDGE CLIFTON: "Testimony of the pooling standards?"

14 MR. ZOLIN: Correct.

15 JUDGE CLIFTON: Okay. So we'll leave that alone. And then
16 you mentioned that you thought you had misspelled Schaefer, I
17 think he has only one F in his name.

18 MR. ZOLIN: I agree. I saw that as I was reading through
19 it.

20 JUDGE CLIFTON: So we'll strike an F. All right. That's
21 all I noticed, Mr. English, and I know those are very small.

22 MR. ENGLISH: No, I appreciate it, your Honor, especially
23 because they weren't my typos. With that, I would move
24 admission of Exhibit 137 and 138 as modified by multiple
25 people.

1 JUDGE CLIFTON: Does anyone want to question Mr. Zolin
2 before you determine whether you have any objections to
3 Exhibit 137? No one. Is there any objection to the admission
4 into evidence of Exhibit 137? There are none. Exhibit 137 is
5 admitted into evidence.

6 (Thereafter, Exhibit Number 137, was
7 received into evidence.)

8 JUDGE CLIFTON: And does anyone want to question Mr. Zolin
9 before determining when you object to the Exhibit 138? No one.
10 Are there any objections to the admission into evidence of
11 Exhibit 138? There are none. Exhibit 138 is admitted into
12 evidence.

13 (Thereafter, Exhibit Number 138, was
14 received into evidence.)

15 MR. ENGLISH: So the witness will be available for further
16 examination. I just note that it is 4:45 and yesterday somehow
17 we consumed ten minutes talking about preliminary matters, but
18 I don't know how many questions there will be of this witness
19 he'll obviously be here tomorrow. But if you want to start for
20 five minutes or so, your Honor, that's clearly up to you.

21 JUDGE CLIFTON: All right. Why don't we. We'll see if we
22 can complete it. If not, we'll carry it over to tomorrow.
23 Mr. Beshore, would you go first, please?

24 CROSS-EXAMINATION

25 BY MR. BESHORE:

1 Q. At your request, your Honor, I will.

2 Marvin Beshore.

3 A. Hello, Marv.

4 Q. Hi, Al. So let me -- let me see if I can figure out
5 what's going on here. If HCC is a pool plant, such as under
6 Proposal 1, this proposal really doesn't have any pertinence,
7 right?

8 A. This is proposal language in Proposal 2.

9 Q. I understand.

10 A. There is, under Proposal 1, with mandatory pooling, all
11 the bells and whistles that we have talked about, a proprietary
12 bulk tank handler wouldn't be necessary because I understand
13 there's no performance requirements in Proposal Number 1.

14 Q. Okay. So basically, you're proposing this to be part
15 of Proposal 2 so that, because you don't want to necessarily
16 have Hilmar as a pool plant, right?

17 A. Correct.

18 Q. But you want to pool milk?

19 A. Correct.

20 Q. And under Proposal 2 you can pool milk by creating a
21 split plant, right?

22 A. I think I did testify about split plants somewhere in
23 this, but yes, that is a possibility to use a split plant, yes.

24 Q. Okay. But you don't want to pool milk at Hilmar as a
25 split plant?

1 A. That would not be our preferred option.

2 Q. And that's what -- that's what the wet the tank once a
3 month testimony is about?

4 A. Exactly.

5 Q. So you want to have a plant, you want to pool milk by
6 reporting it on paper, basically.

7 A. It is very similar to a 9(c) reporting system. And, in
8 fact, in practice, where I have seen a 9(c) and 9(d) in
9 Tennessee Valley, it is a paper transaction, both the
10 cooperative transaction, and the proprietary handler
11 transaction was filing a report.

12 Q. Okay. So the, how is it that the abuse of selling milk
13 at under Class I minimum prices, which occurred up in Order
14 135, is avoided?

15 A. First, I don't know if it was ever proven that that was
16 what was going on. I know it was discussed, and so I won't, I
17 won't agree that that was going on. But from a standpoint of
18 paragraph 3 in our modification is addressing who the, whose
19 responsible to pay the producers.

20 Q. But it's -- okay. So who would be responsible to pay
21 the producers?

22 A. It is at the pool plant where the milk is received.

23 Q. Okay. So, and you, but you have got what, a ten
24 percent, well, we don't know what your pooling standards are
25 yet.

1 A. Well, let's just go with the ten, and there is always
2 the brackets, but the ten is a good base number to use.

3 Q. So you have a ten percent performance requirement. So
4 when your proprietary bulk tank unit, ten percent of the milk
5 goes to 7(a) or 7(b) plant, and the rest of it goes to the
6 Hilmar nonpool plant, correct?

7 A. That is a very good strong possibility, yes.

8 Q. Okay. Now, so on the milk, who pays, and that's all,
9 that's a given set of producers -- who pays those producers?

10 A. It could be -- it could be the pool plant where the
11 milk's received, it could be Hilmar Cheese, it could be a
12 combination of both.

13 Q. Okay. So under this system, a producer could, it could
14 be, the Market Administrator could be obligated to look at two
15 producer payrolls to determine if one producer was getting paid
16 the minimum price or not?

17 A. I would think the more likely scenario is one party
18 could take over the payroll for the producers.

19 Q. Okay. But it would not be able to be Hilmar, it would
20 have to be the plant with responsibility under, as you have
21 described it to me, I take it.

22 A. I would think that the pool plant would be the, that
23 would be responsible for the payroll, because that's where the
24 Market Administrator would look to if there wasn't payment to
25 the producer.

1 Q. So what would, what's the difference then? So that's a
2 distributing plant, they could have their own independent
3 producers, if they were pooling them they could receive ten
4 percent, divert the other 90. Why do you need the proprietary
5 bulk tank handler?

6 A. From a standpoint of not having to wet the tank,
7 maintaining the producer milk supply at Hilmar. There's a
8 connection there.

9 Q. But if the customer, if the distributing plant has the
10 responsibility for paying them, and you have said they would be
11 likely to payroll them, you've lost the connection anyway,
12 haven't you?

13 A. The distributing plant could contract with Hilmar to
14 pay the producers to run their producer payroll.

15 Q. And then, then the Market Administrator would audit the
16 distributing plant and Hilmar anyway.

17 A. I'm not concerned about audit.

18 Q. Oh, okay. Okay. That's -- that's good. I think I
19 understand. Thank you.

20 JUDGE CLIFTON: Okay. This is probably a good stopping
21 point, and we'll continue with cross-examination of Mr. Zolin
22 on this tomorrow. And we'll leave it to Mr. English where in
23 the program you will be. And Mr. English, let's wrap up today
24 with discussion of tomorrow.

25 MR. ENGLISH: Thank you, your Honor. We certainly had some

1 slippage today. Now, tomorrow we may have a dairy farmer, I
2 understand.

3 MR. BESHORE: One for sure, possibly two.

4 MR. ENGLISH: And as always, if they are here in the
5 morning and want to go first, they get to go first. If they
6 want to wait, they get to wait, whatever they want. So
7 everything I have to say is contingent on that. But our
8 intention is to start tomorrow with Rob Blaufuss, well, it's
9 going to be Part 5 even though he hasn't done Part 4 yet, but
10 start with Rob Blaufuss, Part 5, along with Matt Williams, both
11 from Dean Foods, testifying as a panel about the
12 producer-handler, producer-distributor issue. And that's so
13 Mr. Williams, who was some other operational responsibilities,
14 can get back to those, even though Mr. Blaufuss is now
15 permanently, well, semi-permanently in Clovis. So we're going
16 to start with that, again, subject to producer-handler.

17 Then I think it would make most sense to finish what
18 Mr. Zolin has done just so we don't leave hanging shads around,
19 so I think we would go to that.

20 What we have left then, is Mr. Blaufuss on Part 4,
21 fortification, which is produced and all ready to go. And I
22 think that is most likely to be the next piece, but might move
23 this order around. We do have -- I have homework tonight.
24 Hopefully no typos. The modification of 7(c) and try to get
25 that on. Obviously we have got Dr. Schiek on quota, and I

1 understand for Mr. Vlahos, the ideal situation would be if we
2 get that tomorrow, and I'm certainly not going to push it to
3 push it, and I will try to do that, Mr. Vlahos.

4 And if I'm not missing something, we have got
5 Sue Taylor, Part 3, and that is the impacts on the pool.
6 That's a lot. And so I don't know what to say to you,
7 Ms. Hancock, although you may very well have somebody here
8 tomorrow anyway because we're putting some testimony on. But I
9 would strongly suspect that that's going to finish the day. If
10 it doesn't, as I said all along, I'm not ready to go on
11 transportation credits anyway. So if Ms. Hancock has somebody
12 ready and is able to, fine, but we didn't get the short day
13 today, that's for sure. But that's what we have got.

14 And I have to say that I would think that leaving aside
15 finishing -- well, that's just a lot.

16 JUDGE CLIFTON: You know, you got everything done today
17 that you had announced this morning except for Mr. Blaufuss on
18 fortification. It was an excellent day and I have no
19 complaints.

20 MR. ENGLISH: Thank you, your Honor.

21 JUDGE CLIFTON: You're welcome. All right. Are there any
22 other announcements? Nothing. We go off record at 4:55.

23 (Whereupon, the evening recess was taken.)

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