UNITED STATES DEPARTMENT OF AGRICULTURE

PUBLIC HEARING ON PROPOSED RULEMAKING

TAMPA, FLORIDA

Docket No.
AO-388-A22;
AO-356-A43;
AO-366-A51;
DA-07-03

MORNING SESSION

HEARING BEFORE JUDGE MARC R. HILLSON

DATE: May 22, 2007

TIME: 8:30 a.m. to 12:00 p.m.

PLACE: 4400 W. Cypress St.
Pasco Room
Tampa, Florida

REPORTED BY: Aaron T. Perkins, RPR
Notary Public, State of
Florida at Large

Pages 191 to 340

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ALSO PRESENT:

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Jill Hoover, USDA, marketing specialist
Richard Cherry, USDA, marketing specialist
Barbara Tingle, USDA, marketing specialist

I N D E X

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P R O C E E D I N G S

JUDGE HILLSON: Let's get ready to get started, please. Let's go on the record.

Good morning. It's May 22nd. And that's a good reminder for all of us to put our cell phones on vibrate or some other sound mode or shut them off.

This is the second day of our hearing in the -- concerning milk in the Appalachia, Florida, and Southeast marketing areas.

When we finished yesterday, Mr. Sims just finished his direct testimony. As I stated yesterday, and I'll say a number of times, in trying to accommodate any -- particularly any producers who are going to be in and out -- need to get out by a certain time, I have been told apparently at least nine producer witnesses that I know of so far want to get in and out today.

So the plan is that we're going to start with Mr. English, to do his cross-examination of Mr. Sims. When we take our first break, which is around 10:15, or so, at that point, I'm going to have the producer witnesses testify.

I should say for the record I'll have everyone who is here on a representational capacity to introduce themselves for the record. So I would -- if you're going to be putting on witnesses, can you just --

MS. MAGEE: No, sir. I'm not representing --

JUDGE HILLSON: Oh, you're not representing anybody?

MS. MAGEE: No, sir.

JUDGE HILLSON: Okay. They're just here on their own, basically?

MS. MAGEE: Yes, sir.

JUDGE HILLSON: Okay. Fine.

Anyway, at 10:30 or so, at that point, we will do the producer witnesses, and we'll go through them until they're done, and we'll resume Mr. Sims. Okay?

So, Mr. English, do you want to start your cross-examination?

MR. ENGLISH: Thank you, Your Honor. Good morning.

My name is Charles English. I'm here on behalf of Dean Foods Company and National Dairy Holdings.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Good morning, Mr. Sims.

A. Good morning.

Q. I want to start with a couple of questions about market administrator data and your interpretation of it, to the extent that you can answer some questions based upon both your years of experience in the market administrator's offices and with these orders.

First, how much experience do you have with the Florida order?

A. Several months. I was the -- I did have some experience when I was in the Atlanta market administrator's office. And that office took over administration of the Florida orders for some few months during my tenure in the market administrator's office. But I do have some knowledge of the operation of the Florida order since then.

Q. In the data set provided by the market administrator for total Class 2 utilization by pool handlers, there was a column called "nonfluid used to produce."

A. Yes.

Q. Do you recall that?

A. I do.

Q. Do you know what that is?

A. It's my understanding, if that definition has not changed, that would be the milk equivalent of nonfluid products used to produce Class 2 products, principally nonfat dry milk and probably some -- perhaps some condensed. And it is at the milk equivalent of those.

Q. And does that product then get upcharged as Class 2, or is it simply nonfat dry milk that's been priced as Class 4 in another order?

A. The latter. It would come in as a receipt of a -- at its milk equivalent at the plant and would be taken out and brought in as Class 2 receipt and taken out as a Class 2 disposition and would have no effect on the producer milk utilization in that plant.

Q. And no effect on the blend price?

A. Yes.

Q. Yes, no effect, right? It's sort of a negative question.

By that, you agree it will not have an effect on the blend price?

A. I agree it would not have an effect on the blend price.

Q. Similarly, under Class 3, "used to produce" would mean used to produce Class 3 products, correct?

A. Yes.

Q. And under Class 4 utilization, nonfluid used to fortify, do you recall that term?

A. I do.
Q. Do you recall what that was when you were in the market administrator's office?
A. Yes. That would be, again, the equivalent of the -- of the nonfat dry milk typically added to fluid milk products to bolster the solids content of that milk.
Q. And is that something typically done in Florida?
A. That I do not know.
Q. Okay. And do you know today what the diversion limitations are on Order 6?
A. I could -- yes. I can look them up.
Q. Okay. Well, do you know whether they are the limits that are here in the order in the Code of Federal Regulations, or are they something that the market administrator has adjusted them to?
A. They are the latter. The market administrator has exercised her discretion some several years ago and instituted diversion limits, which are different than those which are the codified limits in the -- in the Code of Federal Regulations.
Q. And to the extent they are different from those codified in the Code of Federal Regulations, are they lower limits or higher limits?

A. Lower.

Q. Okay. And your organization has made no proposal with respect to Florida diversion limits, correct?

A. Correct.

Q. Do you concur, nonetheless, the diversion limits that the market administrator is currently marketing under are accurate?

A. Are accurate?

Q. Well, are the ones that she should be using.

A. I have no comment as to the appropriateness of those -- of those diversion limits. They are what they are.

Q. I understand. But they are not, as you've just testified, actually the limits that are published in the Code of Federal Regulations. And so I'm asking you whether, as between the diversion limits that are published in the Code of Federal Regulations or the diversion limits that the market administrator has in her discretion implemented, does your organization have a position with respect to those?

A. I believe you could take the fact that we have made no proposal to change those as indicative of our position.

Q. Okay. But my problem is change those from what? We have -- we have two different versions.

A. This is no -- there is no current proposal on the table to adjust further the diversion limits in Order 6 from those which exist in actuality today.

Q. Okay. So does that mean your organization endorses the ones that are in actuality today?

A. We have made no proposal to change them.

Q. Okay. Turning for a couple of moments to your testimony. On page 1, you refer in the bottom paragraph to the percentage of milk marketed by DCMA member cooperatives. And then you have a clause that says, And when including milk marketed to other producers, more than 87 percent of the producer milk pooled on the order.

When you use the phrase "when milk marketed" -- "when including milk marketed to other producers," what do you mean by that phrase?

A. That could be any producer milk which is not member milk of those nine listed cooperatives. It could be milk of another cooperative, which is brought into the marketing area as supplemental milk. It could be marketed nonmember milk, which is marketed by the cooperatives, any other milk other than members of those -- of those nine members.

Q. Does that percentage include milk marketed on behalf of dairy marketing services?

A. Yes.

Q. Could you briefly for this record describe what dairy marketing services is?

A. Dairy marketing services is a, I guess, joint venture or an organization which markets the nonmember milk in the Orders 5 and 6 -- excuse me, 5 and 7 area.

Q. And it's a joint venture of what entities?

A. I believe Dairy Farmers of America is a member, Land O'Lakes Dairy, perhaps.

Q. But you know that Dairy Farmers of America is part of that joint venture?

A. I believe so.

Q. Approximately what portion of that difference between the 69 percent that is marketed by DCMA member cooperatives and the 87 percent when including milk marketed to other producers, what portion of that would be DMS?

A. I don't have that data in front of me.

Q. Turning to page 5 of your testimony, the first paragraph, you reference, first, changes in order marketing areas and pooling provisions flattened producer blend price relationships with somewhat lower Class 1 utilizations -- and I think you said "if" rather than "in" -- in the Southeast. And then, Combined the flatter Class 1 price surface and flatter blend surface have reduced economic incentives to move milk into the Southeast from the reserve supply areas.

With reference to the part of "changes in order of marketing areas," what were you thinking about when you used that phrase, "changes in order marketing areas"?

A. Well, there was a consolidation of order marketing areas under reform, expanded some market areas, consolidated others.

Q. In fact, in the Southeast, as, I think, you and I discussed maybe the last or maybe the one before of these kind of proceedings in the Southeast, there have already been sort of a movement towards larger orders in the Southeast and preceded federal order reform, correct?

A. Yes.

Q. Okay. But federal order reform took that a step further nationwide, and we ended up with larger federal orders, correct?

A. Yes.

Q. And so in addition -- in addition to the flatter Class 1 price, the fact that you have larger orders nationwide resulted in a flatter blend price difference between areas that existed previously, correct?

A. Could have, yes.

Q. By the way, when you use the phrase "temporary" in your proposals, how long is temporary?

A. Until otherwise amended.

Q. So how is that different from permanent?

A. It's spelled differently.

Q. I'm recalling that at one time, when I was growing up in Germany, I went to the school in the 1970s (inaudible) that had been built in the 1940s. To my knowledge, they're still there today.

Is there some schedule that you are aware of -- you've referred to the idea that USDA may be looking at a broader issue about Class 1 prices. And that's the link to this being temporary, correct?

A. Yes.

Q. Is there some schedule you're aware of for when that process will move forward?

A. I have no official knowledge of any such timetable. I can say that I think at least, perhaps, the initial data analysis may be complete sometime this calendar year, but the emphasis is on the "maybe."

Q. Okay. And that initial analysis is by way of getting an economic analysis done by an outside organization?

A. That's my understanding.

Q. And would that be Cornell?

A. That is my understanding.

Q. And to your knowledge, is that analysis going to be done in a similar manner as the Cornell model that was used as part of the federal order reform in the late 1990s?

A. I believe similar would be a -- would be an appropriate term, yes.

Q. Do you know of any differences that may be applied to it at this time?

A. I understand there may be some updates to that model, but I am not privy to what those updates would be.

Q. You are, of course, aware of the model that we're referring to?

A. I am.

Q. Okay. You were in the market administrator's office at the time that the model was examined by USDA as part of federal order reform?

A. I left the market administrator's office in 1996, which just preceded the beginning of the order reform process.

Q. Time flies.

A. Doesn't it, though?

Q. Turning to page 9 of your testimony. You refer to, The Southeast has not gone short of milk for any extended periods of time, on the first paragraph.

A. Yes.

Q. Can you tell us of any periods of time when the Southeast has gone short of milk?

A. Well, the region as a whole probably has not gone short of milk. But milk doesn't move -- this is not Star Trek. We don't move milk by blinking our eyes and teleporting it. One place may need milk when another place has milk. So the issue of a particular plant needing milk may have occurred, or desiring more milk than what was available instantaneously at that point.

Q. Going back to some of the information regarding the MA statistics.

Are you aware of -- for the Florida market area -- whether there are any operations of manufactured Class 3 products in Florida?

A. If there are, it is very few.

Q. And if they are very few, they're manufacturing very small quantities?

A. That would be my supposition.

Q. So to the extent that the statistics reveal that for 2006 Class 3 utilization was just under

103,000,000 pounds for the whole year, your supposition would be that most of that product would have been manufactured -- cheese -- outside the state of Florida?

A. Or whatever Class 3 product, but cheese principally.

Q. Yes.

A. But that would be supposition, yes.

Q. Whether it's cheese or whatever Class 3 use.

A. Yes.

Q. I was using cheese, but let's just use Class 3 product generically as opposed to any inventories or shrinkage or anything like that.

So if we're talking about any manufactured Class 3 product, you would agree, by and large, would not have been manufactured in Florida?

A. I would agree.

Q. Okay. There are relatively small volumes of Class 4 used to produce in 2006. The category is actually used to produce, slash, other uses. And other uses includes bulk ending inventory and NFMP-UTF assigned to Class 4.

First, do you know what NFMP-UTF is?

A. Can you -- where is that?

Q. If you have Exhibit 13, it is probably any of the --

A. Uh-huh (Indicates affirmatively).
Q. Exhibit 13, page 11, footnote 2.
A. I would presume the NFMP means nonfluid milk product. But UTF is --
Q. Could that be ultrafiltration of some sort, do you know, or you just --
A. I do not know.
Q. You don't know.
Okay. It is relatively modest volumes, but do you know whether Florida has -- physically in Florida -- any facilities to produce Class 4 products?
A. Which I would call a -- facilities which I would call a facility which is dedicated to the manufacture of hard Class 4 products, I'm unaware of any.
Q. Are there any facilities owned by SMI in Georgia for ultrafiltration?
A. I am aware of one I believe, yes.
Q. And without obviously revealing confidential data, does that plant use ultrafiltration and then ship the cream to one location and, conceivably, the ultrafiltration process would be somewhere else?
A. I would -- conceivably, that would be how I would expect that plant to operate, yes.
Q. Turning to Order 7, are there facilities

physically located in the marketing area of Order 7 that are dedicated to -- principally to the manufacture of Class 3 products?

A. Yes.

Q. Can you name them?

A. I can try. I believe there is a Kraft facility in Springfield, Missouri; a Kraft in Bentonville, Arkansas, a Dairy Farmers of America plant at Cabool, Missouri.

JUDGE HILLSON: Why don't you spell that.

THE WITNESS: Excuse me. Yes. C-o-b -- C-a -- pardon me. C-a-b-o-o-l, Missouri.

Dairy Farmers of America at Monett, Missouri. That's M-o-n-e-t-t. Oh, there is a plant in, I believe, Uniontown, Alabama named Southeast Cheese, U-n-i-o-n-t-o-w-n.

BY MR. ENGLISH:

Q. Southeast Cheese?

A. Yes. That, off the top of my head, represents the ones I can remember.

Q. And if they are not -- if they do not appear as pool plants, they would obviously, therefore, be nonpool plants for the order, correct?

A. Yes.

Q. Do you know whether those facilities receive fresh milk all year round?

A. Some of them may.

Q. Do you know any that do not?

A. I'm not -- I can't speak to all of them directly.

Q. Okay. Can you speak to any of them indirectly?

A. Probably not without revealing confidences.

Q. Fine.

The operation of the Southeast committees, is that what we would call a proprietary operation as opposed to an operation owned by a cooperative?

A. Yes, that's my understanding.

Q. And just for the record, Kraft operations would clearly be proprietary operations in the verbiage that you and I use?

A. I believe so, yes.

Q. Okay. For Order 7 are you aware of any facilities located in the marketing area that are dedicated to the manufacture of Class 4 products?

A. There is one, and -- that there is a Dairy Farmers of America plant in Franklinton, Louisiana, Franklinton. And, quite frankly, I can't remember whether the plant in Glasgow, Kentucky, is in the Order 5 or Order 7 area, but it has some use in Class 4.

Q. I'm going to get to No. 5 in a moment.

A. I just can't remember -- I can't remember which side of the line it's on.

Q. And I understand. So wherever that physically is located, it is either in 5 or 7, and it is dedicated to the process of Class 4?

A. Yes, sir.

Q. And is that also a DFA operation?

A. No. I think the -- what's the name of it?

UNIDENTIFIED SPEAKER: Blue Grass Dairy.

THE WITNESS: Blue Grass Dairy in Glasgow, Kentucky.

BY MR. ENGLISH:

Q. And is that a proprietary operation?

A. That's my understanding.

Q. Understanding that that may or may not be 5 or 7, any other operations dedicated to the process of Class 4 located in our area?

A. Order 7?

Q. Order 7.

A. Not that I recall.

Q. Turning to Order 5 and just sort of for completeness purposes, let's start with Class 4.

Leaving aside the Glasgow operation and its physical location, any other operations dedicated to the manufacture of Class 4 in Order 5?

A. I believe the Bally Milk Products plant in Strasburg, Virginia, S-t-r-a-s-b-u-r-g.

Q. And is that a proprietary operation?

A. It's owned by Maryland & Virginia Milk Producers.

Q. Any other operations physically located in the marketing area of Order 5 dedicated to the process of Class 4?

A. I believe that's it.

Q. Turning to the Class 3 --

A. Yes.

Q. -- products manufactured in Order 5, any facilities?

A. Yes.

Q. And the names are?

A. Bel Cheese -- that's B-e-l -- in Litchfield, Kentucky, L-i-t-c-h-f-i-e-l-d; Ash County Cheese, West Jefferson, North Carolina. There may be a couple of other small ones, but that's the principal.

Q. To your recollection, have we named all of the plants in either -- in any of the Orders 5, 6, and 7 that are dedicated to the process of either 3 or 4?

A. All that I can recall.

Q. I understand, to the best of your knowledge.

A. (Indicates affirmatively).

Q. At least the last hearing in the Southeast -- which was January of '06, correct?

A. That's my recollection.

Q. -- you and I and you and representatives of agricultural marketing services for USDA had a number of discussions with respect to private contracts in the marketplace, for instance, full supply contracts.

Since that hearing, to your knowledge, have there been any significant change in the existence or the term -- let's start with the existence of -- full supply contracts for fluid milk in the Southeast?

A. Not that I'm aware of.

Q. And by the way, when I use the term "Southeast," I'm using it like you did for your testimony, the whole region. All right?

A. Okay.

Q. Okay. And is that how you used it when you answered my question?

A. It is.

Q. Thank you.

Further, since that time -- and this may be specific to a term -- have there been any changes in the over-order premium? And I don't mean the level for a moment; I mean the way it is credited with respect to receiving credits.

A. No.

Q. Okay. What is your definition of a reserve supply area?

A. With regard to my reference in testimony, I would consider those order areas nearby and contiguous to the Southeast as the reserve supply areas for the Southeast general, plus perhaps Order 30.

Q. Okay. When you use that definition, did you examine whether or not that milk in nearby contiguous areas was actually available as a reserve to the Southeast?

A. Some of it is; some of it may or may not be.

Q. Okay.

A. It depends on the day.

Q. Are there differences between reserve supply areas when that milk may have alternative Class 1 demands in the immediate region contiguous to the Southeast?

A. I beg your pardon?

Q. Would there be a difference in the nature or the availability of reserve supplies when the contiguous area might have significant needs for Class 1 itself?

A. I would think that the demand for Class 1 in those reserve supply areas would impact its availability for Class 1 use in the Southeast.

Q. And should the secretary take that into consideration in determining whether or not that area is genuinely a reserve supply area for the Southeast?

A. Would you ask that again, please?

Q. Should the secretary take into consideration competing demands for Class 1 milk as Class 1 in a contiguous area in determining whether or not that area is genuinely reserve supply for the Southeast?

A. I would suggest that even with demand for Class 1 in those reserve areas, they do represent some potential reserve supply for the Southeast.

Q. Is there a minimum volume available in that contiguous area regardless of whether there is competition for the milk in Class 1 in the contiguous area that the secretary should look at with respect to whether or not that area is a reserve supply area?

A. I would suggest that any area which represents a, by the Southeast definition, a significant pocket of milk would be a potential reserve area.

Q. Okay. So what is your definition of the Southeast of a significant pocket of milk?

A. Two producers in one county.

Q. Whether or not I agree, I thank you for the answer.

You provided as to some, and maybe more than some, facilities a methodology in the exhibits. And I'm looking for a moment at page F, Exhibit 21. And let me backtrack for a -- one second.

When you use "miles," what was your source of these miles?

A. Map Point, closest option.

Q. Is that an Internet site?

A. That's a Microsoft product.

Q. Microsoft.

Traditionally, the department had used something called the Household Goods Carrier's Guide, at least in the hearings when we did this in the 1980s, 1990s.

Are you familiar with that --

A. Yes.

Q. -- product?

Do you know whether the results of that product would be very similar to Map Point?

A. I would presume they are similar.

Q. Going to page F, as I understand, the analysis on the top set of rows of -- which is from Miami, correct?

A. Yes.

Q. That you looked at five different supply areas, potential supply areas, for Miami, and then you chose the least expensive, most efficient, something like that; is that correct?

A. Yes.

Q. Did you do a similar analysis for every other plant in the marketing area using potential supply areas, say, for Mt. Crawford? Did you take Mt. Crawford and do an analysis for potential supply areas in Mt. Crawford?

A. With regard to bulk movements?

Q. Yes.

A. No.

Q. If I asked that question about the corporate plant in Winchester, Kentucky, would the answer be the same, that, no, you did not do a similar analysis of potential supply areas?

A. With regard to bulk milk movements, the answer is no, except to the extent that we analyzed Miami and worked our way back out, which provides an alignment with regard to those supply areas. But directly moving in, no, we did not.

Q. Okay. And so let me just understand for the record what you did do.

What you did, for the record, is you started with Miami, the furthest distant point, correct?
A. Yes.
Q. And then you worked your way back up from there, at least as a first step. I know you did some other steps, smoothing, etc.
But as a first step, you worked your way back up from Miami, correct --
A. Yes.
Q. -- rather than working your way down from potential supply areas to each and every plant?
A. Correct.
Q. Okay. And I'm really not trying to ask this about every plant, so let me just ask it generically now.
Except for Miami as a first step, did you do any analysis of all potential supply areas to a plant other than Miami?
A. With regard to this analysis, no --
Q. Okay.
A. -- with regard to bulk milk movements.
Q. With regard to bulk milk movements, no, you did not do that analysis?
A. No.
Q. Do you know where Ohio ranks in milk

production by volume relative to other states in the United States? Is it in the top 10?

A. I don't recall.

Q. Would it surprise you if it's not in the top 10?

A. It would not surprise me.

Q. Similarly, do you know where Indiana falls?

A. I do not.

Q. Would it surprise you if it fell outside the top 10?

A. No.

Q. Do you know whether the secretary, in defining reserve supply areas as part of federal order reform, included or excluded the Mideast area as a reserve supply area for any part of the country?

A. I'm counting on my very poor recollection, but I don't think it was at that time.

Q. Have circumstances changed that suggest that it should be?

A. Certainly for Indiana.

Q. Okay. And in terms of changes for Indiana, that would be the development of relatively larger milk producing dairy farms in the Rensselaer area of Indiana?

A. Yes.

Q. And whether or not such developments may happen in the future, that has not happened to the same extent in Ohio, has it?

A. I'm unaware of development to that extent.

Q. In Ohio?

A. In Ohio.

Q. Okay. Let me restate. I think what you did, you started with this analysis on page F, Exhibit 21, and calculated a price for Miami in the first set of columns. And you set it at $6.00, correct? Isn't that the calculation?

A. I would say that we started with $6.14 --

Q. Okay.

A. -- which represents the number or the price suggested by this calculation.

Q. And then how did you get from $6.14 to $6?

A. There is three plants in that South Florida area and smooth the price to represent -- Miami being the farthest south. So we smoothed the price to cover all three of those plants, which are now in the same price zone and fixed $6 as the price.

Q. They are now in the same price zone and propose them to be in the same price zone?

A. Correct.

Q. Okay. Then, as I understand it, your next

step was using Miami, to back off Miami, correct --
A. Toward --
Q. -- as the initial step?
A. As we moved south to north, yes.
Q. As you moved south to north.
And for that purpose, you did an analysis still using bulk milk movements, correct, in the first instance?
A. Yes.
Q. So that gave you, ultimately, a plot of all the plants going north, ultimately, northwest, north and northeast within Orders 5 and 7?
A. Perhaps I should clarify that these two models were basically compared simultaneously. It wasn't like we struck a price at each point based on Miami minus. They were really compared simultaneously, Miami -- moving south to north, the package milk model moving north to south. They were kind of laid on top of each other simultaneously. To say one was run and then we ran the other one and then it smoothed probably doesn't properly capture the methodology.
Q. Okay. And I appreciate that, because I didn't understand that.
So now let's talk about the second model for a moment. The second model, as you described it, is

capturing the cost of moving packaged product south, correct?

A. Plant to plant.

Q. Yes, plant to plant.

A. Plant to plant, west to east, north to south, generally.

Q. Okay. You did not do that analysis -- you did that analysis plant to plant. You did not do that analysis from a plant and in Location A and a plant in Location B selling both to a Location C, correct?

A. Correct.

Q. And just by way of saying, if A and B and C -- Point Cs are in a triangle and each one is a hundred miles -- so it's A -- it's a hundred miles from Point A to Point B. And it's, furthermore, a hundred miles from Plant A to retail location C, or wholesale location C, and, similarly, it's a hundred miles from Plant B to the same wholesale location C. You did not do an analysis of that wholesale location C?

A. Unless wholesale location C had a plant there.

Q. Okay. And so unless -- if it did not have a plant there, you did not do an analysis in that Location C, correct?

A. Correct.

Q. To the extent two plants -- Plant A and Plant B, today with the same price, both selling to retail location -- wholesale location C that's a hundred miles from each location, to the extent that a Plant B now has a higher price, it will have less of a competitive ability to sell to wholesale location C if your proposal is adopted, correct?

A. All things being equal, I presume that to be true.

Q. Okay. Thank you. A good economist, all things being equal.

A. Is there a good economist?

Q. I'm presuming.

Are you aware of USDA ever adopting Class 1 price surface using your dual models of starting in the farthest point and backing off for raw milk and starting closer and working out using packaged milk to establish Class 1 prices?

A. I'm not aware of that as a -- as absolute methodologies were used. I suspect that those dynamics -- in fact, I believe that those dynamics are weighed in any development of a Class 1 price surface. The movement of both -- the cost of moving bulk milk and the cost of moving packaged milk are weighed. Although, they might not have been done in the specific way that we did it, I think the methods that we used are indicative and useful and common in the development of a Class 1 price surface.

Q. Recognizing the inherent limitations that those of us in the private industry may have as opposed to Cornell, it is nonetheless the case that the Cornell model used in federal order reform used multiple locations of reserve supply and a spatial analysis for the delivery of the milk in order to calculate a relative Class 1 price surface, correct?

A. That's my understanding.

Q. And you did not do an analysis like that?

A. Our analysis, I would say, is not as sophisticated as a Cornell analysis would be.

Q. Okay.

A. I don't think the results would be a lot different, but it's not as sophisticated.

Q. One thing your analysis does is it assumes that the sale or the -- I'm sorry, the movement, the cost of the movement of packaging, is just as linear as the cost of moving raw milk, correct?

A. I would agree with that.

Q. Do you know whether it is true that the cost of moving packaged milk are just as linear as the cost of assembling and moving raw milk?

A. Our presumption was that the base rate per mile to move milk was roughly the same between bulk milk movements and packaged milk movements, the difference being the size -- the amount of milk on a bulk milk load versus a packaged milk load.
Q. So you're not aware that USDA as a part of federal order reform made a determination that the cost of moving finished product, that is to say, packaged milk, is actually nonlinear?
A. I do not recall that.
Q. And, therefore, you don't recall that the Department concluded that not only is it nonlinear but at a certain distance it is actually cheaper to move packaged milk than bulk milk?
A. I do not recall that.
Q. And that was then -- maybe you don't recall. But that was then the methodology by which USDA, as part of federal order reform in adopting the Cornell model, concluded that one would have to look at shadow pricing.
Do you remember that term, shadow pricing --
A. I do.
Q. -- as part of federal order reform?
A. I do.
Q. Do you know what it was defined as?

A. I believe it represents the marginal value of moving one more hundredweight of milk.

Q. And if the marginal value of moving one more hundredweight of milk would change the entire pattern of assembly and product transportation costs, did the Department have an opinion as to what would happen then?

A. That I do not recall.

Q. Okay. Do you recall whether the Department believed that if the regulated price is set higher than shadow price at a particular location then a lower cost solution could be found by processing more milk at another location?

A. That would make sense.

Q. Okay.

A. I don't recall that, but I can see the logic to that statement.

Q. And if that were to happen, that is to say, if as a result of adoption of the proposals it would make more sense to produce milk at a farther location and truck it down, that would be an inefficient result?

A. I beg your pardon?

Q. If adoption of a Class 1 price surface, not your proposal, but your adoption of a Class 1 price surface, were to lead to the situation where a marginal cost of the unit encouraged milk to move from a farther location -- packaged milk, now -- from outside these areas, that would be an inefficient result?

A. I'm not following. I'm sorry.

Q. All right. I note that on pages L1 through L8, this is your analysis of plant-to-plant movement of packaged milk, correct?

A. I wouldn't characterize it that way.

Q. Why don't you characterize it for the record rather than my characterizing it.

A. This represents, at the current price, differences between plant locations and the proposed differences between plant locations, the difference in those prices per ten miles comparing plants, which are at the same or less Class 1 price proposed and are within 200 miles.

Q. And so your final column was a proposed difference per ten miles.

And what were we supposed to take from that final column?

A. That in each -- in each circumstance, those plants which are within 200 miles and have comparable price, or less prices, none of those cost -- none of those differences exceed the real cost of moving packaged milk.

Q. And the real cost of moving packaged milk was?

A. In my understanding, approximately five and a half cents per ten.

Q. But that analysis is limited, first, to 200 miles, correct?

A. Yes.

Q. You did not look at plants, say, 219 miles away?

A. That's correct.

Q. And it was limited to plants located in Orders 5, 6, and 7, correct?

A. Correct.

Q. So you did not look at plants under 200 miles competing with plants along the borders of 7 and 5?

A. That analysis was the initial stage of the packaged milk movement analysis, those plants outside the marketing area to establish the first price on the plants inside.

So that's what that page H analysis did. It started with plants outside and then prepared their low cost packaged milk movement to plants inside. So that was -- that was the first step in that package milk model of movement process.

Q. Did you do this analysis for page H for every plant that's located just outside, compared to every plant that's located just inside?

A. I believe so, yes.

Q. Is that contained in your documents anywhere?

A. It is not.

Q. Are you prepared to share that?

A. We don't have -- I don't have that report.

Q. Nonetheless, neither Analysis H nor Analysis L took into consideration a nonlinear analysis for moving packaged milk, correct?

A. Agreed.

Q. In your analysis, did you consider the impact of plants located outside the marketing area having a new or different incentive for moving sufficient quantities of milk into one of these areas, getting cooled, and the benefit of the change in the blend price being used to subsidize the haul?

A. No.

Q. Do you agree that that would be one of the things that ought to be done by USDA in considering whether or not prices set here are reasonable?

A. You might want to repeat that.

Q. Okay. Let me break it down.

Do you agree that, if your proposals are adopted, there will be a new blend price relationship

relative to Orders 7 and 32?
A. Yes.
Q. Okay. And that is that Order 7 blend price will go up relative to the Order 32 blend price?
A. Presumably, yes.
Q. Similarly, the Order 5 blend price would go up relative to Order 32, correct?
A. Yes.
Q. And similarly, the Order 5 blend price will go up relative to Order 33, correct?
A. Yes.
Q. When those relative blend prices in Orders 5 and 7 go up relative to Orders 32 and 33, does that not create the incentive for facilities located near the borders of Order 5 and 7 to alter their route positions so as to gain the benefit of that higher blend price?
A. Only if that benefit exceeds the additional -- the additional cost of moving milk further in order to qualify.
Q. And you did not do the analysis of whether that would be the case, correct?
A. We did not.
Q. So assume for a moment that it did exceed the cost. You would agree that in such an event, an incentive would be created for plants located

physically outside of 5 and 7 to move the -- to change their route disposition in order to get pooled under 5 and 7?

A. I would say that from a fluid milk plant standpoint, they desire at equal Class 1 prices to be in whatever highest price pool they can be in.

Q. So that's my way of saying yes?

A. My way of --

Q. You just can't quite bring yourself to say it, correct?

A. Correct.

Q. Turning back to the market administrator statistics for a moment and, for a moment, to Exhibit 16, 2006 annual statistics.

Do you know how far it is from O'Fallon, Illinois, to either Order 7 or Order 5?

A. I analyzed that, but I do not recall.

Q. A relatively short distance?

A. It is not a long, long distance, no.

Q. You would agree there are -- you know, looking at the exhibit that is Exhibit 16, there are plants in Orders 32 and 33 that are within a hundred miles of Orders 5 and 7?

A. I would agree with that.

Q. Going a little farther away and thinking for a moment about Order 30 -- with a relatively low blend price, correct?

A. Yes.

Q. -- did you do any analysis of the economic incentives that might exist for a facility located in Order 33 -- I'm sorry, in Order 30, to sell a sufficient quantity of milk into 5, 6, or 7 so as to pool on those orders as a result of adoption of your changes?

A. No.

MR. ENGLISH: Just one second.

(A pause was had in the proceedings.)

BY MR. ENGLISH:

Q. Turning to my example of a plant in O'Fallon, Illinois, that may -- I emphasize "may" -- if these proposes are adopted, look to pool sufficient quantities of milk in Order 7 to be pooled in Order 7 because of blend prices, correct?

A. It would not change their Class 1 price as a -- as a pool plant, so any -- the change that -- I guess a perceived benefit to that plant would be as a result of blend price changes, yes.

Q. But you agree that the Class 1 price for that plant isn't going to change?

A. I would agree with that.

Q. Okay. So they pick up -- if they do this, they pick up the blend price benefit -- and yes, there is a cost, but cost is the haul, correct?

A. The haul of the package -- the additional packaged milk necessary to meet the in-area sales -- in-area route disposition requirement of Order 5 or 7.

Q. And that's an important distinction, because it's the additional sales. Because as we already know from the statistics, they already do have some sales; we just don't know how many. Correct?

A. Correct.

Q. Okay. So it's only the marginal cost on those additional sales, because they've already decided to make the sale in the market?

A. Agreed.

Q. Okay. But plants that are competing with physically Order 7 that may be no more than 100 miles away will have a Class 1 price increase, correct?

A. Yes.

Q. So the relative benefit to that new plant will also have to take into consideration that higher cost that its competitor has, correct?

A. I would suspect that would be a decisional point, yes.

Q. Okay. Did you, when you did your analysis, on page H or on pages L1 through L6 -- well, let's start with page H.

When you considered page H, did you consider differences in over-order premiums?

A. No.

Q. There are differences in over-order premiums?

A. Yes.

Q. They are higher in the Southeast than, say, in Texas?

A. Yes, generally.

Q. Generally or specifically?

A. I'd say generally. Yes, they are.

MR. ENGLISH: Your Honor, I have questions on different areas, but I am further prepared to sit down and give people an opportunity. I mean, there is the transportation credit section, and there is the diversions. And I'm happy to sit down. If you want me to keep going, I can keep going.

JUDGE HILLSON: I was going -- my plan was, unless it was delayed, to go until 10:15, or so, and take our morning break.

MR. ENGLISH: Well, I candidly -- the witness and I got along so well that I got things faster on this section than I expected. But, you know --

I think the witness is unhappy with me in that characterization, but --

JUDGE HILLSON: I think the producers all agreed to that. They start at 10:30.

MR. ENGLISH: Okay. Well, I assume there are other people who might want to cross on this potential section.

JUDGE HILLSON: Oh, yeah, I don't want to start bouncing back and forth.

MR. ENGLISH: Okay.

JUDGE HILLSON: You do your whole thing.

BY MR. ENGLISH:

Q. All right. Let me turn to diversion limits, then.

What is Florida doing that is working so well?

A. I beg your pardon?

Q. Well, we have -- it looks to me as if, whether it's over-order premiums, or whatever, you have milk moving to Florida with relatively modest volumes of milk being diverted, would you agree?

A. The diversion limits would require relatively modest amounts of diversions.

Q. So the diversion limits are working as intended and are maintaining a rather tight pool in

Florida, correct?

A. I don't know if that's the intent or not.

Q. But is that the result?

A. I would agree that those are tight diversion limits.

Q. And nobody in your organization has asked the market administrator to relax the limits from where she has with her discretion put them, correct?

A. Correct.

Q. So why not adopt diversion limits similar to those in Florida for Orders 5 and 7?

A. Well, I think the first reason is that the secretary has already adjusted diversion limits in Orders 5 and 7 with regard to the milk which earns a transportation credit.

If you look at the amount of milk which moves in the tight supply months, which is transportation credit eligible, one third or more of the milk in Order 7, for example, none of that milk earns a diversion.

If you applied the Florida percentage of ten percent in the tight diversion limit months and then take another third of that away from -- because the milk earns a transportation credit, now you've got a diversion limit of six to seven percent. I think that's Draconian.

I believe that our -- that the DCMA proposal of 25 percent and with zero diversion limits on a transportation -- a third of the milk because it earns a transportation credit is appropriate.

Q. Now, that limitation you just referred to was a result of the hearing last January that -- January 2006 --

A. Yes.

Q. -- that we talked about, correct?

A. Yes.

Q. And your organization is content with that limitation of transportation credits?

A. That's what exists in the order.

Q. It was something that was actually testified to by others and the secretary adopted?

A. Yes.

Q. Okay. And you're not proposing changing it now?

A. There is no proposal to change that provision.

Q. In fact, the others who supported that, the list started with Dean Foods, correct?

A. I believe Dean was a supporter of that, yes.

Q. A supporter and the original proponent, correct?

A. My recollection was the original proposal was somewhat different, and the secretary flipped it around and did it a little different way.

Q. Nonetheless -- and I was trying -- I'm trying to divorce the two, but I see you put them together, so we'll have to talk about them together.

Florida does not have transportation credits, does it?

A. Correct.

Q. And no one is proposing having transportation credits for Florida, correct?

A. At this point, correct.

Q. Okay. So I come back to my question: Why not look more at the Florida model, which appears to be working, than the Orders 5 and 7 model, which we seem to have a hearing about every 16 months?

A. I don't think that you could just -- you know, if all you're going to look at is the provisions in a continuous order and whether or not they, quote, unquote, work, you can look just as easily at the other orders which are contiguous to 5 and 7.

I think the, you know, the issue in Orders 5 and 7 is contingent upon the data we have analyzed. The daily variation, the necessary reserve in Orders 5 and 7 requires a reserve and a diversion limit as proposed. And even it's -- the practical end is even tighter than the codified limit we've proposed, because you don't get a transportation credit on transportation -- excuse me, you don't get a diversion on transportation credit eligibility.

I believe the data is clear that what is necessary in Orders 5 and 7 is that which is proposed. And I don't think just simply saying, Well, Florida does it this way; therefore, Orders 5 and 7 should do it this way, carries any weight.

Q. Well, let me backtrack, because the first part of that said that, as I understood it, that there is no better reason to Compare 5 and 7 to 6 than to compare 5 and 7 to, say, 1, 32, 33, and 126.

Is that what you essentially said?

A. Yes. That just because they're next door does not mean that one applies necessarily to the other.

Q. But you yourself have testified that they are much more similar in they are the deficit areas. They are -- 5 and 7 are almost as much deficit as area 6, correct? I mean, they're all deficit?

A. Orders 5 and 7 are more like Order 6 than they are --

Q. Okay.

A. -- 126, 33, 32, and 1.

Q. Okay. Thank you.

A. But not identical.

Q. Nonetheless, your organization has recognized a number of pieces. And one of those pieces is if you increase Class 1 prices, you're at least -- you are proposing lowering the diversion limits from their current levels in 5 and 7, correct?

A. Correct.

Q. And you're doing that because your organization recognizes if all you did was raised the Class 1 price and made no change to the diversion limits, you are going to encourage additional milk to pool on the order whether or not it actually shifts, correct?

A. I don't know if I agree with that or not. It depends on the handler. It depends on whether or not they are maximizing their diversions now. It may not change their ability to pool another drop.

Q. Why did you link the increase of Class 1 price to lowering diversion limits?

A. All three parts of the proposal are linked.

Q. I understand all three are linked. But what is the linkage between Class 1 price and the diversion limits?

A. They both tend to increase the uniform price to producers, therefore, encouraging a supply -- a sufficient quantity of milk to be attracted to the marketing areas.

Q. And the reason that the diversion lowering increases the uniform price to producers is it discourages excess pooling of milk that does not actually get received at plants in the marketing area, correct?

A. It doesn't discourage it; it eliminates it. If you can't -- if you can't pool it, you can't pool it.

Q. So I take it your goal, then, is to increase the uniform prices to dairy farmers shipping to Orders 5, 6 and 7?

A. Yes.

Q. So why not lower the diversion limits further?

A. I believe that the combination of the Class 1 price increase in Orders 5, 6, and 7 with the lowered diversion limits in 5 and 7 creates a blend price incentive which will attract -- help attract milk to Orders 5 and 7.

However, I believe that the tightening of the diversion limits in Orders 5 and 7 certainly, if it's a tradeoff with the Class 1 price increases, would then now allow us to Class 1 prices in Order 6.

So taken as a package, lowered diversion limits raise 5 and 7 blend prices. Higher Class 1 prices raise Order 5 and 7 blend prices. The higher order -- the higher Class 1 prices in 5 and 7 allow us to raise the Class 1 prices over 6, thereby tying all those together.

Q. Did you bring the market administrator's statistics, Exhibit 9, up with you?

A. Yes.

Q. Would you turn to page 13 of 13, please?

A. Yes.

Q. Do you agree that for 2004, for the relevant months for diversion, limitations would be lowered if proposals were adopted, that for 2004 the adoption of your proposals would not actually eliminate any milk from the pool for Order 7 -- I'm sorry, Order 5?

A. Based purely on the data presented on page 13 of 13 in Exhibit 9, that is the implication. I would remind the record that the market administrator did not go back and remove the milk which would have been removed from the pool as a result of the diversion limitation on transportation credit of milk. So this data does not really capture what now is in effect in terms of the diversion limits.

Q. And what's now in effect went into effect in what month?

A. December 2006.

Q. So for the one month that is provided by Order 5 that we actually have data, we see 61,379 pounds that would have been removed in addition to the effect of transportation credits, correct?

A. I presume that that is the way they calculated that, yes --

Q. Okay.

A. -- for that single month.

Q. Not a very large quantity removed, correct?

A. No. Yes, whatever. Not a very large quantity.

Q. It's a load and a half?

A. Load and a third, yeah.

Q. Load and a third?

A. (Indicates affirmatively).

Q. Let's talk about the transportation benefits for a few minutes.

What is the rationale for including payment of the transportation credit on the full load of milk and not just the Class 1 value?

A. As indicated in the testimony, the delivery of milk to a plant supplies the total need of that plant, pool distributing plants. The deliverers of that milk don't really have any control over the classification and use of the -- that plant. And it had -- it cost exactly the same to move the Class 2 portion, Class 3 portion, Class 4 portion of that load as it does the Class 1 portion, and, therefore, paying for the transportation credit on the whole load provides an incentive to deliver milk to that plant where now it's a smaller incentive.

Q. Do you charge premiums on Class 2?

A. There are over-order prices on Class 2.

Q. Do they take into consideration the need to price that haul?

A. That would be one element, I would think, yes.

Q. Okay. There is no proposal to alter the payment in by handlers. That is to say, only Class 1 milk will pay into the transportation credit pool, correct?

A. Correct.

Q. So plants that have significant Class 2 will, in essence, be subsidized by plants that are close to 100 Class 1 in terms of the haul if you adopt it on the full load?

A. Full load would be paid.

Q. Which is to say that --

A. And the assessment is on Class 1.

Q. So would you agree with me that all things being equal, in your own phrase, if you have a plant that's basically 100 percent Class 1 and a plant that is 70 percent Class 1 and 30 percent Class 2 in the same volumes, that the plant that is 100 percent Class 1 will essentially be subsidizing the haul to the plant that is 70 percent 1 and 30 percent 2?

A. The plant that is nearly 100 percent Class 1 would pay more transportation credit assessment than the one who is 70 percent Class 1, yes.

Q. Even though the volumes are the same?

A. Exactly, yes.

Q. Should the federal orders be in the position of encouraging the production of Class 2 using fluid, as opposed to my first set of questions about producing nonfluid, in areas that are so deficit that you need transportation credits, higher Class 1 prices, and lower diversion limits?

A. I don't know that that proposal to -- will encourage Class 2 use.

Q. It won't discourage the continued use of

Class 2 used in fluid, will it?

A. In and of itself, it would not.

MR. ENGLISH: Just give me a moment. I'm not saying I won't have follow up, but that's all I have for now.

JUDGE HILLSON: Thank you.

Does anyone else wish to cross-examine this witness?

Mr. Stevens, does the AMS group have questions?

MR. STEVENS: Yes.

JUDGE HILLSON: Make sure to put the mike on and make sure to identify yourself.

MR. ROWER: I'm Jack Rower with the AMS theory programs.

THE WITNESS: Good morning.

CROSS-EXAMINATION

BY MR. ROWER:

Q. Jeff, would it be accurate to characterize your testimony concerning emergency conditions addressed by Proposals 1 and 2 and 3 as addressing the situation where the provisions, the current provisions of Orders 5, 6, and 7, are inadequate to sufficiently bring an adequate supply of milk to the marketing areas?

A. Yes.

Q. Okay. Would the proposed amending of the delivery date requirements in Proposal 1 -- let me start again.

Would the proposed amending of the delivery date requirements in Proposal 1, for example, to one day per year for producer milk pool in the Appalachian order, streamline the administration of the marketing of milk in Order 5 for DCMA?

A. Did you say one day per year? I believe the Proposal 1 one --

Q. I'm sorry, I meant one day per month.

A. It would streamline.

Q. It would streamline?

A. Yes.

Q. That's the question.

A. Yes.

Q. Okay. Jeff, do you expect any savings from the streamlining in terms of savings in administering your milk marketing operation?

A. There certainly could be an administrative savings and certainly hauling savings, yes.

Q. Okay. If the touchbase portion of Proposal 2 is adopted -- I'll withdraw that. Excuse me.

Actually, that's it. Those are my questions.

Thank you.

JUDGE HILLSON: Anyone else at the USDA table have any questions of this witness?

Is there any other cross-examination? Mr. Beshore, do you have any redirect at this time?

MR. BESHORE: I do, but I wonder if this would be a good time to break.

JUDGE HILLSON: Well, depending on how long your redirect is going to be. Do you think -- I mean, I can go 25 minutes until the next break, unless -- if you think you'll be done by then, or else we can stop now and start the producers and do the redirect afterwards.

MR. BESHORE: I'd prefer to do that.

MR. ENGLISH: I'm sure you do.

JUDGE HILLSON: Okay. In that case, it's about 10 minutes before 10:00. Let's take a 15-minute morning break, and we'll come back with the -- I think we have nine producer witnesses to testify, so that's what we'll do.

(Brief recess was taken.)

JUDGE HILLSON: I understand the next witness is going be Mr. Jefferson.

THE WITNESS: That's correct.

JUDGE HILLSON: Let me swear you in.

ROGER JEFFERSON,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Could you please state and spell your name for the record.

THE WITNESS: My name is Roger P. Jefferson. Do you need me to spell it?

THE COURT REPORTER: No.

THE WITNESS: Okay.

JUDGE HILLSON: Okay. You have a statement that you want to read; is that correct, sir?

THE WITNESS: Yes, sir.

JUDGE HILLSON: I'm going to mark that. I'm assuming you want it in evidence. I'm going to mark that as Exhibit 22.

Okay. You have -- may proceed, sir.

STATEMENT BY ROGER JEFFERSON

THE WITNESS: Thank you. My name is Roger Jefferson, and I'm the owner and operator of Mountain View Farms of Virginia, LLC, in Chatham, Virginia, and we produce over 5,000,000 pounds monthly.

I'm the president of Cobblestone Milk Cooperative, Inc., a cooperative that was formed in January of this year. Cobblestone's membership is comprised mostly of large volume, quality-conscious shippers that implement the newest technologies at the farm level.

My milk and the Cobblestone milk is marketed in the Southeast and Florida markets and pooled on Federal Orders 7 and 6.

I'm testifying today on behalf of Cobblestone Milk Producers, Inc., and Mountain View Farms of Virginia.

I support the proposal submitted by DCMA to change the Class 1 differentials in Orders 5, 6, and 7, and modify some of the pooling rules, but I would like to see some modifications to the proposal.

The supply and demand situation in the Southeast region covered by the three federal orders is at a critical point. Milk production has declined throughout the region to the point that our market can no longer serve the demands of the consumers in the region.

Based on data from the National Agriculture Statistic Service, milk production in the Southeast states has declined by an average of 122,000,000 pounds or 3 .6 cents annually since

2000.

Similarly, milk production in the Appalachia states has declined by an average of 143,000,000 pounds or three percent annually since 2000.

And I have a graph in the presentation showing that.

Going back to 1998 through 2005, the production trend is shown more clearly. Southeast production has declined 6.5 percent while the national production has increased 1.2 percent since 2000. This spread is almost eight percent.

As we know, farms located in the Southeast have unique challenges that farms located in other areas do not face. We have the highest production costs due to heat stress, which causes large swings in production and high land prices.

Significant periods of low producer pay prices have led to rapidly declining production that is not being replaced by new farms or expansion on existing farms. Simultaneously, population in the Southeast is at record levels, and the projections by the census bureau are shocking.

Florida's population is projected to increase by 79.5 percent from 2000 to 2030 and move ahead of New York State to become the third most populous state.

Georgia's production is projected to grow by 46.8 percent during the same period and become the eighth most populous state.

Relationships among milk sheds, production centers, and population concentrations have changed rapidly and significantly over the past 15 years. The popular and current solution to reconciling production, processing centers, and consumption within the Southeast is to import fluid milk from distant sources to cover the supply shortage. This solution is short-sighted.

The result of this action only adds to the long run supply and demand problem in the Southeast. Higher revenue generated by milk sold to a primary Class 1 market is spread over producers in 15 states to producers with dissimilar production costs.

Producers in the Southeast markets ultimately end up sharing the costs to import the milk into the Southeast, sharing the cost to find homes for the milk in the remaining months and sharing the revenue pool.

While this is all acceptable and equal in theory, it has been taken to a new level that is no longer equitable. Local producers have been forced out of the business because they cannot compete with farms that have lower production costs and receive transportation and financial subsidies at the expense of the Southeast producers.

Local milk does not have the value that I believe it should have. Local milk should be priced at the same level of outside milk that is imported plus delivery cost.

We urge the Department to take a long-term approach to addressing the supply demand problem in the Southeast. As operators of large farms, we must make long-term financial investments in our operations to address the challenges in the Southeast, and we expect that the Department would take the same long-term approach.

While we support the changes in the Class 1 pricing surface, we do not believe that the projected increase in producer pay price is enough to affect or reverse the production trends. Federal Order 5 is projected to receive an additional 28 cents in the uniform price.

What I would also like to add here, which I don't have in the written document, is the majority of that is in one state, in South Carolina, which brings that average up to the 28. If you look at North Carolina and Virginia, it would be far less than the 28.

The pay price to the producer is comprised of two significant pieces: one, uniform price and, two, over-order premiums. DCMA sets the over-order premiums charged to the processing plants and uses a counter-cyclical pricing method that lowers the premium when the uniform price is expected to increase and increases the premium when the uniform price decreased. When the Class 1 pricing surface is modified, we are not guaranteed to see any increase to the producer pay price.

The Class 1 premium may be adjusted in the manner in which plants are accustomed to experiencing to compensate for a higher uniform price, leaving the producers with a net of zero price increase in Order 5. While Orders 6 and 7 have higher projections, the net impact may be much less than anticipated or projected by the Department.

If the desired result is to increase the net price to producers to stimulate production, let us ensure that the regulated change that we are making will accomplish this goal. The USDA cannot regulate over-order premiums, but the impact from the premiums must be considered when discussing net pay prices to dairy farmers.

Although some interested parties are concerned that increasing the Class 1 differential in counties bordering other federal orders, we do not share this concern.

Although this may generate more packaged product sales from outside sources within the order, this is milk that local producers do not have to share in importing costs prior to processing.

If outside packaged product sales reach critical levels, the processing plant will ultimately be regulated by the Appalachia or Southeast orders. We suggest that the pricing surface must be increased in the bordering areas of the Southeast and Appalachia marketing areas and stepped up east and south of the bordering states. We believe that the desired result will not have achieved with Class 1 differentials contained in this proposal.

The relationship between milk shed and production centers have changed rapidly and significantly over the past 15 years in the entire United States.

In the Southeast alone, we see that the average distance milk travels to Class 1 distributing plants has increased by 74 percent in the Southeast order during the spring and 40 percent during the fall.

And I have a graph showing that.

While the proposal seeks to decrease the diversion limitation percentages in Order 7, the proposal requests a significant change in the delivery day requirement. These two provisions work in tandem and is a change -- and a change to one affects the other.

Under current conditions, it is difficult to maximize the percentage diversion limitations due to the restrictions on the delivery day limitations. The proposal requests more liberal delivery day requirements, making it easier to associate more milk with the order and sharing revenues over even larger areas.

As I see it, this change in delivery day requirements will continue to drive down market utilization in the Southeast and the Appalachia orders. More milk that does not perform for the market will be associated with the order and priced into the pool as Class 3 and 4, lowering the uniform price to producers.

Effective September 1, 2006, the milk market administrator made an administrative modification to the producer milk definition known as market association policy in order to lessen the burden of meeting the strict diversion day requirements in the order.

The administrative change made it easier to associate more milk on the order and stay within the regulations. Many producers, including myself, were upset with this change. The current proposal will all but eliminate, by reducing to one day per month the delivery day requirement, will be detrimental to the local producers.

With the change implemented in September 2006, the current delivery day requirements are reasonable and easily met. We do not need to reduce this delivery day requirement further.

The local producers that supply the market all year will not benefit from this portion of the proposal, and we are opposed to the delivery day change.

We propose that the current delivery day change -- let me start over.

We propose that the current delivery day requirements be tightened to ten days year-round and additionally support lowering the percentage diversion limiting during all month -- limitations during all months.

Any type of regulatory change that makes it easier to associate more milk with the order may temporarily allow for ample supply of Class 1 markets but, in the long run, only serves to further eliminate local production.

Milk production has expanded in areas west of the Southeast in record percentages over the last ten years due to changes in the Southeast orders that have allowed higher pay prices to those producers at the expense of local producers.

While we believe that the change in the Class 1 pricing surface is a step in the right direction, we do not believe that this addresses the dynamic relationship among consumer population centers, farm locations, and processing centers.

If we continue only to modify existing provisions or rules that are not currently working, we will not solve the problems. We, as producers, can help address these issues to keep -- and keep pace with consumer demands only if we are financially healthy and allowed to compete on a level playing field. We must have net higher income to producers in the Southeast markets to sustain and grow their dairy industry. Rules that allow the manipulation and exploitation of producers must be prohibited.

We regret that the proposed changes are not adequate to completely address the milk marketing problems in the Southeast. We request that further efforts be made and new initiatives be taken to enhance milk production and pay prices within the marketing area in order to ensure an adequate supply of local fluid milk in the future.

JUDGE HILLSON: Thank you. Don't leave just yet. They have an opportunity to ask you any questions.

Does anyone have a question for Mr. Jefferson? Mr. Beshore?

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good morning, Mr. Jefferson. I'm Marvin Beshore. I'm representing DCMA in this hearing.

A. Okay.

Q. Okay. Can you tell me a little bit more about -- tell us a little bit more about Cobblestone.

How many members does Cobblestone have?

A. I think it's nine.

Q. Okay. How many pounds of milk per month do you market?

A. Can I ask you what the relevancy of this hearing would be -- the question to this hearing?

Q. I'm asking questions.

JUDGE HILLSON: He gets to ask, and you get to answer.

THE WITNESS: Okay.

JUDGE HILLSON: Unless there is something proprietary or confidential type of information --

THE WITNESS: Okay.

JUDGE HILLSON: -- you need to answer questions.

THE WITNESS: What was the second question?

BY MR. BESHORE:

Q. Roughly, what's your monthly volume of milk at the cooperative markets?

A. Roughly 20,000,000.

Q. Now, are you responsible for the full supply of any -- any Florida milk plant?

A. Not that I'm aware of.
Q. Okay. So that being the case, Cobblestone does not have -- have itself any responsibilities for balancing supply and demand as needed by any plants?
A. No. DFA has all the market, so we just have to work around it.
Q. Well, in terms of your thoughts with respect to what milk has pooled on the order, you understand, of course, that when milk isn't needed by a plant or when lesser volumes of milk are needed by distributing plants on Saturdays or Sundays, for instance, that milk may have to go to nonpool plants?
A. I think I understand the basics of that.
Q. Okay. Were you here yesterday when the market administrators testified?
A. No.
Q. Okay. Let me just represent to you that they showed an analysis of the daily requirements of the fluid milk plants in the orders, how much milk they order in aggregate from day to day -- okay? -- and that there are variations in -- substantial variations from day to day during the weeks of any given month.
Are you familiar with those dynamics and the market --
A. No. I'm not an expert with that, no.

Q. Okay. I'll just ask you one other question.
You made the comment on page 3 of your testimony that the DCMA -- I'm right at the top of page 3 -- sets the over-order premiums charged to the processing plants and uses a counter-cyclical pricing method that lowers the premium when the uniform price is expected to increase and increases the premium when the uniform price decreases.
Now, what is the basis for that statement?
A. As I understand it, as the price goes up on the blend price or the Class 1 price, the over-order premium goes down penny for penny to a point. And the reverse, when milk prices are low, the order -- the over-order premiums higher, and it goes up penny for penny as the price goes down.
Q. Okay.
A. That's the way I understand it.
Q. Okay. And my question was what is -- you're not a member of DCMA?
A. We haven't been allowed that yet, no.
Q. And you're not on the board of DCMA or involved in its operations, correct?
A. No.
Q. Okay.
A. But I was on the board with

Maryland & Virginia, so I understood it a little bit at one time.

Q. Okay. If I represented to you that the DCMA has not used a counter-cyclical program in this area on prices in several years, would you have any factual basis to disagree with that?

A. Not with me, no. Not with me, no.

Q. Okay. Do you think that's not correct? Are you asserting that what I've represented is not correct?

A. I don't think it's made a change in the last year. But my understanding was prior to -- well, actually, in 2005, I thought it worked that way --

Q. Okay.

A. -- is my understanding.

Q. So your understanding is that several -- some years ago, perhaps --

A. It hasn't this year. Okay? But I guess the question is it doesn't mean it won't.

Q. Okay. But you asserted that it, present tense, uses a counter-cyclical pricing method. Now you're backing off of that, I take it?

A. I'm not sure I'm backing off of that, because I think that system -- that regulation is still in place. It's just you guys, the board on DCMA, has convinced the processors, I guess, at this point to not reduce over-order premium to this point. And I think the question comes in is if we increase the differential, then will the plants demand for new folks, DCMA, to decrease the over-order premium? That's the question, I guess, I have, the statement I was trying to make.

Q. Okay. So your statement is you're concerned that if the Class 1 differentials are increased, as DCMA has requested and as you support --

A. Uh-huh (Indicates affirmatively).

Q. -- you're concerned that the processors may say, We're going to reduce the over-order premiums?

A. Uh-huh (Indicates affirmatively).

Q. Okay. Fair enough.

JUDGE HILLSON: You said "uh-huh." Can you just answer that one yes or no, please?

THE WITNESS: Yes.

JUDGE HILLSON: Thank you.

MR. BESHORE: Okay. Thank you.

THE WITNESS: You're welcome.

JUDGE HILLSON: Does anyone else -- Mr. English, come on up.

MR. ENGLISH: Charles English for Dean Foods Company and for National Dairy Holdings.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Sir, you've referenced that your members' milk is pooled on two orders, Orders 7 and -- Orders 7 and 6.

Do you know what plants the milk goes to?

A. I can give a little bit of it. I'm not sure I know where all of it goes. But some of it goes to Atlanta Dairies.

JUDGE HILLSON: Speak up a little bit.

THE WITNESS: Some of it goes to Atlanta Dairies. I know some of it has gone to Publix. And I can't answer where the rest of it goes.

BY MR. ENGLISH:

Q. I'm on page 3 of your testimony, when you say you don't share the concern with respect to increasing the Class 1 differentials in counties bordering other federal orders, you have the statement, If outside packaged milk product sales reach critical levels, the processing plant will ultimately be regulated by the Appalachia or Southeast orders.

Do you understand that even if the plant outside the marketing area is regulated by the Appalachia or Southeast orders, that its Class 1 differential will not as a result actually go up?

A. I think I understand that, yeah. I think I do.

Q. So once it reaches critical levels and it gets pooled on Orders 5 -- or 5 or 7, it would get the benefit of the blend price in Orders 5 or 7 but not be contributing a higher value, correct?

A. I think that's correct, as I understand it. But, also, it would cost the producers less money because it's less milk we have to pay to supplement to come to the market.

Q. Now, what if that plant outside, in order to become pooled on Order 7, takes sales away from Atlanta Dairies and, as a result of lost sales, Atlanta Dairies comes to Cobblestone Cooperative and says, We no longer need your milk?

A. Probably not a good thing.

MR. ENGLISH: Thank you.

THE WITNESS: All right.

JUDGE HILLSON: Does anyone have any questions for Mr. Jefferson?

Okay. Mr. Jefferson, I'm going to receive your written statement as Exhibit 22.

(Exhibit No. 22 received.)

JUDGE HILLSON: You may step down.

THE WITNESS: Thank you.

JUDGE HILLSON: My understanding now is that Mr. Smith is going to call the next group of witnesses, so call your next witness, Mr. Smith.

MR. SMITH: Bill Holliday.

JUDGE HILLSON: Would you please raise your right hand, sir?

WILLIAM E. HOLLIDAY,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Okay. Can you please state and spell your name for the record?

STATEMENT BY WILLIAM E. HOLLIDAY

THE WITNESS: My name is William E. Holliday. Holliday is spelled H-o-l-l-i-d-a-y. And I'm testifying on behalf of myself and Federal Order 5, DFA producer, and the North Carolina Department of Agriculture, where I serve as a board agricultural member.

As a dairy producer, I support the proposal submitted by the DCMA to change the Class 1 differentials in Order 5, 6, and 7 and modify some of the pooling rules.

I wish to call your attention to the trends in production and population in the main states located in Order 5.

USDA data shows a persistent decline in milk production in the region. Figure 1 shows, which I have graphs in my handout, shows production trends in five states that lie mostly within the boundaries of Federal Order 5, Kentucky, North Carolina, South Carolina, Tennessee, and Virginia.

1989 is used as the starting point because this was the year when we first saw a significant increase in the volatility of farm milk prices. I should point out that significant amounts of milk from Tennessee and Virginia moves into other markets.

The population of these states is increasing. Population has grown from 24.9 million in 1990 to 31.1 million in 2006, an increase of 25 percent. Milk production has decreased 35 percent over this same period.

Order 5 is a deficit market. Per capita, milk production is low and decreasing, from 332 pounds in 1990 to 172 pounds in 2006. This is not enough to meet the fluid product needs of the market, which is around 180 pounds per person. It requires almost 600 pounds of milk per person to meet the total dairy product needs of consumers.

Figure 2 shows the sharp decline in per

capita milk production in each of these states from 1990 to 2006.

Local milk is worth more now than it was in 2000 when Order 5 was created. An increase in the minimum Class 1 price are justified. Transportation costs have increased approximately 20 percent from January 2000 to the present, based on the Bureau of Labor Statistics producer price index for general freight in truck load lots. There is no index specifically for milk hauling, but I would expect these would have increased by a similar amount.

While the proposed changes should put some more money in producers' pockets, the proposed changes are not enough. Based on DCMA's prediction of the financial impacts in Order 5 of 26 cents, I can tell you as a producer that more is needed to slow or reverse the trends in production we are seeing.

Based upon my dairy operation of 175 cows, my mailbox price has averaged around $14.75 since January 2001. My cost of production for that same period of time to produce 100 pounds of milk was around $15.25. If the proposed changes were in place during that same period of production, my dairy operation would still have been in the red 24 cents a hundredweight.

From the initial data from a survey of dairy farmers earlier this year, which was administered by USDA-NASS, for the 10 commissioners of agriculture in the southern region, I am not alone in my financial struggles. 1,782 producers from all ten states returned the survey instrument at an amazing response rate of 64 percent.

Dr. Benson at NCSU is analyzing the data, and he provided me with the following preliminary result approximates.

Producers were asked about their views and plans for their future. Their response clearly show that they expect farm numbers and cow numbers to continue to decline over the next five years.

Some farms do intend or expect to continue and some of these plan to expand. However, these expansion plans only partly compensate for the loss of cows from the farms planning or expecting to stop milk production.

When asked about the major problems they face, the overwhelming response was related to milk prices, price volatility, cost of production, and cash flow problems. It is clear from this survey that we need to improve the financial returns from dairy farming and do so right away. The DCMA proposal provides some help, but it is not enough. Additional efforts must be made to support local milk production.

Furthermore, based on some information provided by Dr. Benson, the production response to this change in income is likely to be minuscule. Therefore, further efforts should be made and new initiatives taken to enhance milk production within Order 5 and the whole Southeast in order to ensure an adequate supply of milk.

In addition to the supply and mailbox price issues I have raised, I would also note that Class 1 utilization in Order 5 has remained unchanged since this order was created in January of 2000.

During this period, Class 1 sales in the order have been fairly constant, based on data from the market administrator's office, and local production has declined dramatically, as I have already described.

However, the proportion of milk going to Class 1 use has not changed. This raises the issue of whether the order is fulfilling its intended purpose.

In short, we believe that the situation in Order 5 and, indeed, in the region served by all three orders is serious, and I urge the USDA to conduct or sponsor an in-depth study in order that problems can be identified correctly, to identify additional measures that might be taken, and to evaluate the impact of these measures. This study should be conducted right away and the results should be made publicly available.

Thank you for allowing me to testify before you today.

JUDGE HILLSON: Mr. Smith, do you have any direct questions of your witness?

MR. SMITH: To clarify a couple of --

JUDGE HILLSON: Before you ask, I don't know if -- I'm going to mark as -- Mr. Holliday's written statement as Exhibit 23. I'm assuming you want it in evidence.

MR. SMITH: Yes.

THE WITNESS: Yes.

JUDGE HILLSON: I've marked it as Exhibit 23.

MR. SMITH: That was the first order of business.

I'm Dan Smith, and I'm here representing the

Kentucky Dairy Development Council, the Georgia Milk Producers, the North Carolina Dairy Farmers, and U.S. Milk.

DIRECT EXAMINATION

BY MR. SMITH:

Q. Mr. Holliday, just a couple of quick clarifications.

On page 3 of your statement, you referred to a survey being administered by USDA and NASS.

A. Right.

Q. Okay.

A. Right, that's correct.

Q. And on page 4, you indicated that you had been provided some information by Dr. Benson.

Could you just identify Dr. Benson, and who he is with?

A. He's an economist at North Carolina State University.

MR. SMITH: Thank you. I have nothing further.

JUDGE HILLSON: Okay. Does anyone have any questions of this witness?

MR. ENGLISH: (Indicates affirmatively).

JUDGE HILLSON: Mr. English?

MR. ENGLISH: Charles English, Dean Foods and

National Dairy Holdings. I just have a question about how something was prepared.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. You have Figure 2 attached to your statement, Exhibit 23?

A. Yes.

Q. Do you understand how this was prepared?

A. I think so.

Q. Okay. Could you tell us?

A. It was prepared by the production in the states and the population and how much milk had been used in those states per person.

Q. Is it consumption?

A. Consumption.

Q. So is it milk -- it's labeled, sir, Per capita milk production. I wonder if it's milk production or is it milk consumption, or do you not know?

A. I do not know that. I will be honest.

JUDGE HILLSON: I understand it's on the website. Presumably, the website might explain.

MR. ENGLISH: Well, it may or may not.

JUDGE HILLSON: Well, I'm sure that --

MR. ENGLISH: I mean, I'm not going to object to its admission, but I think that if it's used, it needs to be, you know --

THE WITNESS: We can try to clarify.

JUDGE HILLSON: The AMS folks, whenever they make the final decision, will give it the weight it's worth based on the --

MR. ENGLISH: Yes.

All right. Thanks.

JUDGE HILLSON: Does anyone else have a question of Mr. Holliday?

I'm going to admit Exhibit 23 and receive it into evidence.

(Exhibit No. 23 was received.)

MR. SMITH: Excuse me, Your Honor.

THE WITNESS: It says production.

MR. SMITH: Again, the graph is clearly labeled per capita at milk production, source for the graph -- the chart. Excuse me, the source for the chart is milk production disposition and income.

JUDGE HILLSON: I think when he answered the question, though, he said consumption rather than production.

THE WITNESS: I did. I did.

JUDGE HILLSON: Reasonably seek a

clarification.

MR. SMITH: And Mr. Smith is reasonably seeking an opportunity for Mr. Holliday to perhaps reconsider if he might like to.

THE WITNESS: It was definitely on production. The graph definitely says that, so --

JUDGE HILLSON: Anything else?

MR. SMITH: No.

JUDGE HILLSON: Mr. English, do you have --

THE WITNESS: I should not have answered that.

RECROSS-EXAMINATION

BY MR. ENGLISH:

Q. I'm sorry, this is Charles English. I just -- do you know how it was actually calculated?

A. Off that website. That's all I can tell you.

JUDGE HILLSON: You have your answer, Mr. English.

MR. ENGLISH: Thank you.

JUDGE HILLSON: You may step down.

THE WITNESS: Thank you, sir.

JUDGE HILLSON: Mr. Smith, you may call your next witness.

MR. SMITH: Bill Newell.

JUDGE HILLSON: Do you have a copy of his statement and for the reporter?

MR. SMITH: Yes.

JUDGE HILLSON: Good morning, Mr. Newell.

Let me swear him in before you ask any questions. Okay. Can you please raise your right hand, sir?

BILL NEWELL,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Okay. Can you please state and spell your name for the record?

THE WITNESS: Bill Newell, N-e-w-e-l-l.

JUDGE HILLSON: Okay. Go ahead, Mr. Smith.

You can ask your questions.

MR. SMITH: Mr. Smith, again. Mr. Newell, you've prepared a statement.

THE WITNESS: Yeah, I have.

MR. SMITH: Your Honor, can we mark the statement? We're up to --

JUDGE HILLSON: Twenty-four, is what I have.

MR. SMITH: Twenty-four.

JUDGE HILLSON: Okay. I've marked your statement as Exhibit 24.

MR. SMITH: Would you like to read your statement for the record?

STATEMENT BY BILL NEWELL

THE WITNESS: All right.

I am Bill Newell, a dairy farmer from Maysville, Kentucky. My son and I milk a small herd of registered Holsteins on our 560-acre family farm.

There has been milk shipped from this farm every day since 1928, when my grandfather started milking cows. I have been doing the majority of the milking since 1970. I'm a DFA council person and was on the Mid Am division board prior to the merger that formed DFA. I'm a member of the Board of Directors of the Kentucky Dairy Development Council, and a past director of the Kentucky Holstein Cattle Club. I have provided leadership to young people with 4-H and FFA dairy projects.

There was, at last count, 145 dairy farms in my district. Many of them are small, similar to mine, with the cows being milked and cared for by their owners and very little hired labor.

Nearly 100 percent of the milk produced in my district is processed at the Kroger bottling plant in Winchester, Kentucky.

I am here today representing the views of the Kentucky Dairy Development Council. The KDDC was formed in 2005 through the efforts of dairy farmer leaders, allied industry friends, and many other individuals who shared a vision of improving the Kentucky dairy industry. Our mission is to educate, promote, and represent dairy producers and foster an environment for the growth of the Kentucky dairy industry.

The initial funding for the organization was provided through a grant from the Kentucky Agriculture Development Board, ADB. The ADB invests 50 percent of the Kentucky's Master Settlement Agreement proceeds into agriculture and rural enhancement. In addition to the ADB funds, KDDC has secured financial assistance from allied industry members through sponsorships.

The KDDC board is composed of 12 producer directors representing districts throughout the commonwealth. Also, eight individuals serve as allied industry board members representing various related businesses.

The KDDC board determines policy issues, working with the Kentucky Department of Agriculture, the education community, regulatory agencies, and other agriculture organizations, such as Kentucky Farm Bureau.

The efforts undertaken in the past months include conducting federal milk market order informational sessions to better educate our producers concerning federal order issues. We also held numerous barn meetings throughout the state focusing on federal order updates, improving milk quality, and increasing production.

KDDC has also worked with other state dairy producer organizations in the Southeast. Through the Southeast Producers Steering Committee, KDDC worked jointly with the other producer organizations to submit a proposal requesting changes in pooling provisions for Federal Order 5 and Federal Order 7.

We suggested lower diversion limits and increasing touchbase requirements with the goal of higher Class 1 utilization in both orders.

That specific proposal was denied. But we believe the efforts of KDDC and the steering committee helped bring us to this tipping point for the dairy industry in the Southeast, this emergency hearing. I have attended and testified at hearings in the past and appreciate the opportunity to be here.

KDDC supports the proposals being made at this hearing. We have reviewed them and have arranged for a third party to review them on our behalf. We also understand that Kentucky, as a border state for the Southeast region, and our producers, especially those in Federal Order 5, will not see the benefit financially as producers farther south in the three orders.

However, we do believe it is a small step in the right direction, and we anxiously anticipate more aggressive steps to turn production around in the Southeast.

The dairy industry in Kentucky is composed of just over 1,100 licensed dairy farms that produced over 1.3 billion pounds of milk in 2006. Kentucky dairies are challenged by the climate conditions and other factors but many are attempting to address those challenges by improving their facilities with a focus on cow comfort.

Positive changes to pooling provisions, reducing the cost of balancing the market, and enhancing Class 1 price will encourage facility upgrades resulting in improved production in Kentucky and the Southeast.

Our industry sits near good markets and transportation arteries and is in a good logistical position to supply milk to the growing population of Orders 5, 6, and 7.

KDDC is interested in this hearing because the proposals affect the margins that can be generated by Kentucky dairy farmers, and they will be -- better able us to serve the growing Southeast markets.

These proposals affect both the revenue from milk sales and provide some offset to marketing costs. Our organization views these proposals as a step in the right direction, but we would like to see them made stronger.

We understand that the transportation credit system has been improved. Markets must be supplied and balanced. Seasonal variation in milk production doesn't match the way the consumers always buy milk at the stores. There is not enough milk produced in the Southeast to meet the high demand days of consumption, and we must bring milk into our market to satisfy demand. Farmers generally find that overall price levels are the highest and market service costs the lowest if they manage the process cooperatively.

They look to the order for a market structure to help recover a portion of those costs. The order transportation credit system, more importantly, help us keep up with volatile gas prices. Energy costs affect all the levels of my business. I regularly see fuel increases in my milk hauling bill and at the gas pump when I drive my car.

However, it is difficult for the dairy industry to pass along all the short-term increases in fuel prices as quickly as they change. This is why the transportation credit system is so important.

We support the payment being made on the entire load of milk and for more months out of the year. The costs of delivering a load of milk to a customer is the same no matter if the load is composed of Class 1 volume or otherwise.

Now that the transportation credit system changes with changes in fuel costs, we can better recover our costs as fuel prices rise. Also, consumers are protected because the credit system adjusts down if fuel prices drop.

The changes in the Class 1 differentials are very important. The differentials are supposed to help draw a milk supply and help move it to processing plants. They have not been adjusted in many years. We understand that this is a difficult topic.

It gets different reactions in different regions of the country, in different areas of the Southeast and even on different sides of the room in the KDDC meetings. But difficult or not, this is our system, and it has to keep pace with costs and efficiencies, or the users of the system will lose faith in it.

Kentucky is on the outer edge of the Southeast marketing area. This means that increases in differentials in Kentucky, even if warranted, will be tempered by the differential levels in surrounding markets where there is no hearing being held and no differentials can be changed.

We will certainly benefit from the entirety of the proposals being presented here today, but we will not see the level of positive price impact that other producers in the Southeast may experience.

For this reason, we are hopeful that the nationwide review of the differential surface moves its way through USDA swiftly. Kentucky dairy farmers are stressed by the supply demand imbalance east of the Mississippi River and think a review of this price surface nationally may help.

The package of proposals being discussed here does bring some assistance to the producers in Federal Orders 5, 6, and 7. The blend estimates of approximately 28 cents per hundredweight in Order 5, 75 cents per hundredweight in Order 7, and $1.20 per hundredweight in Order 6 will be a positive step.

We will keep a watchful eye on the impact of the change in the diversion limits. And if they need additional modification, we will urge the market administrators to make those adjustments since those provisions can be adjusted on a local order basis.

We look forward to a more comprehensive review of differentials from the Department. We urge the USDA to do its work here quickly, as all of the same factors that caused the differentials to need a review and proposed change that resulted are present in the remainder of the eastern United States.

Thank you for the opportunity to be here today.

JUDGE HILLSON: Mr. Smith, do you have any further questions of this witness?

MR. SMITH: I do not, Your Honor.

JUDGE HILLSON: Okay. Any cross-examination of this witness?

I guess the answer to that is no. You may step down. And I will admit your written statement as Exhibit 24, receive into evidence.

THE WITNESS: Thank you.

(Exhibit No. 24 received.)

JUDGE HILLSON: Okay. Mr. Smith, you may call your next witness.

MR. SMITH: Norman Jordan.

JUDGE HILLSON: Raise your right hand.

NORMAN JORDAN,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Okay. Can you please state your name and spell it for the record?

THE WITNESS: My name is Norman Jordan, Jr. That's J-o-r-d-a-n.

JUDGE HILLSON: Okay. And I'm going to mark Mr. Jordan's written testimony as Exhibit 25.

MR. SMITH: Thank you, Your Honor.

JUDGE HILLSON: And do you have any other preliminary questions of him?

MR. SMITH: Other than, Mr. Jordan, if you wish to read your statement for the record.

STATEMENT BY NORMAN JORDAN

THE WITNESS: Okay. I am Norman Jordan, Jr., a dairy farmer from North Carolina, and I am testifying as a representative of the Southeast Producers Steering Committee.

This committee is composed of representatives of the North Carolina Dairy Producers Association, the Georgia Milk Producers Association, the Upper South Milk Producers Association, the Kentucky Dairy Development Council, the North Carolina Department of Agriculture and Consumer Services, and the North Carolina Farm Bureau Federation.

The Southeast Producers Steering Committee supports the proposal submitted by DCMA to change the Class 1 differentials in Orders 5, 6, and 7 and modify some of the pooling rules.

I wish to call attention to the supply and demand situation in the region covered by the three federal orders.

USDA today shows a persistent decline in milk production within the region. Figure 1 shows production trends in the region as defined by

USDA. Appalachia is Kentucky, North Carolina, Tennessee, Virginia, and West Virginia. Southeast is Alabama, Georgia, Florida, and South Carolina. Delta is Arkansas, Louisiana, and Mississippi.

1989 is used as the starting point, because this was the year when we first saw a significant increase in the volatility of farm milk prices.

From 1989 to 2006, Appalachia declined from just over 8,000,000,000 pounds of milk produced to just over 5,000,000,000 pounds per year, a 35 percent loss of production. The Southeast declined from 4.8 billion pounds to about 4,000,000,000 pounds, a 16 percent loss of production. The Delta declined from 2.5 billion pounds to 1,000,000,000 pounds, a 60 percent loss of production.

The population of the Southeast is increasing. Figure 2 compares population changes and changes in milk production and shows population growth relative to those production changes.

As you can see, we are experiencing strong population growth, especially in the Southeast and Appalachia, while the greatest decline in milk production is occurring in all three regions covered by Orders 5, 6, and 7.

The Southeast is a deficit market. Figure 3 shows the relationship between milk production and population for various regions compared to the U.S. as a whole. Population is highly correlated with the consumption of dairy products. Per capita milk production is the lowest in the Southeast.

In short, production is decreasing and population is growing leading to an increasingly deficit situation. The steering committee is concerned about the growing deficit, both in terms of the added cost of bringing in milk from distant sources and the possibility of supply disruptions caused by weather, animal diseases, terrorism, and the like.

While we appreciate that the proposed changes are expected to have a positive effect on the uniform prices in the three orders, we believe strongly that the proposed changes are not adequate to fully address the milk marketing problems in the Southeast.

Therefore, the Southeast Producers Steering Committee request that further efforts be made and new initiatives be taken in a very timely fashion to enhance milk production within the market area in order to ensure an adequate supply of milk.

In addition, we believe that the situation in the region served by the three orders is serious, and we propose that an in-depth study be undertaken or sponsored by USDA as soon as practical in order that problems can be identified correctly, to identify additional measures that might be taken, and to evaluate the impact of these measures. The result of this study should be publicly available.

Title 7 of the U.S. Agricultural Code states that one of the functions of milk marketing orders is to assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs.

The Southeast, a net importer of dairy products, is deficient even for fluid milk and soft product needs as reported by the Hoard's Dairyman Magazine.

Thank you for allowing me to be here this evening.

JUDGE HILLSON: Mr. Smith, do you have any further questions of Mr. Jordan?

MR. SMITH: I don't at this moment, Your

Honor.

JUDGE HILLSON: Mr. English, do you have some questions -- or at least one question?

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Turning to the last page of your testimony, you have a quote that you say comes from Title 7. Quote, assure a level of farm income adequate to maintain productive capacity sufficient to meet anticipated future needs.

Where did you get that quote?

A. That was in a report that was put together when we made an initial request to USDA to have a study done. And it was used as justification for the request.

Q. Do you know whether that language expired in 1999?

A. No, sir, I could not tell you that.

MR. ENGLISH: Okay. Just for the record -- I'd like the record to reflect that language did sunset in, actually, 1996. And, in fact, that issue was litigated recently in federal court. And a federal judge said, while it was in dispute, he concluded that, indeed, that language expired.

JUDGE HILLSON: If this is something you want me to take official notice of --

MR. ENGLISH: I will try to get you the name of the lawsuit, the citation. But this is an issue that the office of counsel is well aware of. I don't think they'll dispute it. The fact of the matter is that language has expired.

JUDGE HILLSON: Any other questions of this witness, Mr. Smith?

MR. SMITH: Dan Smith. It's my understanding, Your Honor, that that issue is not as boilerplate clear as Mr. English represents, and --

JUDGE HILLSON: Well, that's the great thing. You're all going to get to write briefs.

MR. SMITH: Right. For the record at this point, we will --

JUDGE HILLSON: Okay.

MR. SMITH: -- endeavor further clarification.

JUDGE HILLSON: Okay. And I will admit Mr. Jordan's statement as Exhibit No. 25 as received into evidence.

(Exhibit No. 25 received.)

JUDGE HILLSON: And you may step down. Thank you for that.

Okay. You may call your next witness.

MR. SMITH: Dr. Ben Shelton, I believe.

I would like, Your Honor -- at the present time, it's my understanding Mr. Shelton has just completed his statement this morning. And we had hoped to be able to just read his statement into the record as he has it, but he has not had a chance to make copies.

JUDGE HILLSON: It's your privilege to put it in, if you want to. Otherwise, he can read his statement.

MR. SMITH: Sure.

JUDGE HILLSON: Please raise your right hand.

BEN SHELTON,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Can you please state your name and spell it for the record?

THE WITNESS: My name is Ben Shelton, S-h-e-l-t-o-n.

JUDGE HILLSON: Sounds like Mr. Smith wants you to read a statement that you have in front of you, so you may proceed.

STATEMENT BY BEN SHELTON

THE WITNESS: Okay. I'm a veterinarian in

North Carolina, started in 1981, been there, practiced there. I started in the dairy business in 1985 in a partnership with 80 cows. Currently, my partners are my wife and Farm Credit. I'm milking about 1,250 cows.

I've seen a lot of changes over the last 20-something years in the dairy industry. I've seen a lot of people go out of business.

I remember back in the eighties, mailboxing over $15 for our milk. And last year in '06, we had five months that we didn't break $13. So I think the game has changed a lot, but we haven't changed the rules.

It wasn't many years ago sitting in a co-op meeting it was talking about surplus versus deficit. And it was kind of concluded that, from a co-op standpoint, you were better to be a little bit short than a little bit long. It was easier to bring in milk when it was needed than it was to get rid of too much milk when you were really long.

And all that has changed now. So when I say the game has changed but the rules have stayed the same, it's kind of like in baseball when they got to hitting all those home runs. They started looking if they need to change the ball or the bat or the height of the pitchers mound. So I think that's kind of where we are today.

I have some clients who moved into North Carolina about five years ago. They had family that had dairied in Michigan. So they knew what the price was in Michigan. They came to North Carolina, and they looked at what the price was in North Carolina. They said this looks like the place for us to dairy, about a $2.50 to $3 advantage in price to be in North Carolina versus being in Michigan.

Now after they've been here for five years, that $2.50 to $3 -- and they have a way to monitor price in Michigan because they still have family there.

So some months their family in Michigan actually outpays them from what they get in North Carolina, and some months they are higher. Overall from what they tell me in comparing the prices, there is about a 70 to 80 cent advantage of North Carolina over Michigan now, whereas five years ago it was $2.50 to $3.

So with dairy farmers in our area seeing these kind of changes -- and I think the frustration that it brought -- and I will admit that myself and a lot of producers don't understand the complexities of diversions, pooling, touchbase, a lot of these things that were talked about here.

But we do understand the difference between the order paying on 82 percent Class 1 utilization and paying on 62 percent Class 1 utilization. We know that that's a lot of dollars in the pocket.

We talk about how much money is really needed to make a difference. I think that's really the bottom line. Of course, everybody has their opinion as to what that is.

In my opinion, you've got to make a move of at least a dollar to a dollar and a half in the mailbox price before you're going to stimulate production in our area. And I'm sure we can get some economists, and we can work that out with a lot of graphs and analysis.

After sitting here today, I'm just really glad I'm a dairyman and not an economist or a lawyer. But I'm sure you all can work that out.

So with the frustration and the lack of knowledge, I think from that a group of us got together, and we started talking about it. We started trying to educate ourselves. And from that, we formed what we called Upper South Milk Producers Association, which in reading -- or in hearing the testimony about Kentucky Dairy Council, I think we really had very similar goals and ideas in mind.

We need to learn about the system. We need to educate ourselves; we need to educate the producers. And if we can do that, then we can at least ask the right questions, so then we can start asking the questions, and then we can start trying to drive some change in the right direction.

One of the things that we try to do is we sponsored a school on federal milk marketing, brought in Dr. Tommie Shepherd from the University of Georgia, Dr. Benson from North Carolina State University, got some producers together. And they spent a day trying to explain to us how the federal milk market system worked so that we would know a little bit more about it.

From that, the Southeastern Steering Committee was formed, because through that we kind of got the idea that, yeah, there were some rules that needed to be changed to catch up with the game.

So the steering committee was formed. We made a trip to Washington, met with the USDA officials. We were very impressed that they were willing to spend three-plus hours with us with a lot of people in the room and asking a lot of questions and really seemed to understand our concerns and our plight and where we were trying to go.

They suggested to us that we submit a proposal, and so we did. We worked on that. We submitted the proposal, trying to change diversion limitations and touchbase. And it was rejected. I know it went through the normal process of comment, and it was rejected. But I do feel that through this process, hopefully we had some influence on how -- on why we got here today.

I got in last night and was talking to some people. And I came to find out that -- and you can correct me if I'm wrong -- but my understanding was that Dean Foods requested a study from the market administrator's office to look at what some of these proposals would have done specifically related to changing diversion limitations.

I saw the one last night on Order 5. I have the one here on Order 7 that we got off the table back there, but I didn't see the one on Order 5.

The one on Order 7, the way I read it, would have changed average price by about 25 cents for Order 7. I think for Order 5 it was about 50 cents by changing those diversion limitations.

If we could consistently add 50 cents from diversion limitations to Order 5 producers, we would be making an impact. And I guess myself as an Order 5 producer, that's certainly what I'm going to refer to primarily today.

The differential adjustment that has been proposed is certainly much more helpful for Order 6 and 7 than it is for Order 5. So when we get down to, really, the proposal at hand, we have today for what's it's going to do for Order 5, as it's been alluded to already, maybe we'll add 25 cents in the North Carolina area where I'm from, and then the Kentucky area may not add anything, if very little.

As a veterinarian, when I'm going to go out on the farm in the next few months -- maybe this has been past -- and someone, a client, is going to ask me when we get through with our work that day, Well, I read that this DCMA proposal has gone through. What is that going to mean to us?

And I say, Well, I think it might mean 25 cents, but we're not really sure about that.

But thinking in what Mr. Jefferson alluded to, if we do get a high -- higher differentials, we really are not assured that we will not lose over-order premium at the same time. So in net mailbox money, which is what really matters, we're really not sure how much this is going to do for Federal Order 5.

I'm not really sure -- we're pretty certain it's not going to do enough to change production trends in Federal Order 5. So we're going to be back faced with the same situation. And the way the situation works right now, the way I understand it -- and, like I say, a lot of us don't understand the whole thing.

But I think most people -- most producers do understand that as the more deficit we become, the less producers there are, and the more milk has to come in, and we have to pay for our share of that to supply the market, the last man standing is going to have a pretty heavy burden there. He's going to have to milk a whole lot of cows to be able to cover and survive in the system that we operate under today.

U.S. Milk, in representing the Southeast and in its involvement with the Southeastern Steering Committee, does support the proposal. We're not here to say we don't support it, because it is doing something. I think it's a move in the right direction. I think specifically for Federal Order 5, it's not doing enough to really get where we need to be.

So in my opinion -- like I say, we can get some economists to analyze this, but I think you're really going to have to do something that's going to get a dollar to a dollar and a half consistently in the mailbox price through the hard times.

Now, we're going to approach some $18 or $20 milk here for the next little bit, and everybody is going to be real happy and quit complaining about everything. But we usually know what happens shortly after $18 or $20 milk. We have some $12 and $13 milk, and everybody wonders how they're going to make it to the next milk check.

So my concern is that most dairyman in Order 5 will be told, you know, this proposal has really done something for us, and we're approaching these high prices, and we really haven't done that much.

If the USDA really wants to fix the problems, I think the diversions is the only way we're going to really tighten it up. We're going to try to get back to a level playing field. I think producers in my area would say that's all they want.

If we know milk 500 to 1,000 miles away, wherever it's got to come from to supply this market, we know that price there, and we know what it costs to get it here, then we're looking to get -- that our local milk should have somewhere close to that value. Okay?

That's the way everything else I buy is. If I've got to buy hominy out of Indiana, they price it to me there, and they tell me how much freight it's going to be to get here. The same way with alfalfa hay . I think milk would be the same way. And that's the market. That's the price that we pay in our area for it. So it looks like our milk should have the same value in our local market just like any other commodity.

Thinking of Mr. Sims' comments, a lot of what he said was that the market is here to attract to the market. And that's true. We are attracting milk to the market.

My point is I would like for us to try to look for the way that we grow the local market from the price that local milk is worth versus taking dollars to bring milk from 500 to 1,000 miles away.

I thank you for this opportunity to be here. I appreciate your efforts. I don't want to downplay them. I just feel like we're going to have to do more, specifically for Federal Order 5 for me to be able to go back home and tell those producers that I think we've done something that's really going to make a difference.

JUDGE HILLSON: Mr. Smith, do you have any questions?

MR. SMITH: I do not.

JUDGE HILLSON: Does anyone else have questions? Go ahead, Mr. English.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Thank you, Mr. Shelton, for being here. My name is Charles English, and I represent Dean Foods Company and National Dairy Holdings.

You referenced a proposal that your organization made regarding diversions that was rejected by USDA.

A. Yes.

Q. What was your proposal, do you remember?

A. I could get a copy of it for you. But we are -- we proposed that we change the diversion limits to be -- I can't tell you if I know that they were identical to Federal Order 6 but I know they would be more in line with Federal Order 6 in terms of touchbase and diversion limitations.

Q. And did you do that because you believe that what Florida was doing was working for Florida?

A. That's our opinion, yes.

Q. Okay. When did this happen?

A. We met with the USDA, if I'm not mistaken, in October of '06. I believe we had our proposal in, I believe, by December of '06. I do have a letter here dated December 22nd from Sue Mosley, where she sent it out to interested parties of the Southeastern marketing area concerning this proposal.

So we got it in December. Comments were to be submitted by February the 16th of '07. I don't have the letter, and I can't tell you the date that it was rejected. It was sometime, if I'm not mistaken, March or April.

Q. Do you recall whether you were asking for a hearing or asking the market administrator to exercise discretion to lower --

A. My understanding of the process, we were asking the market administrator to make that decision.

Q. Okay. Do you understand that today the issue of diversions is open?

A. The way I understand it -- now, I don't claim to have -- know this specifically -- but I understand that, yes, a diversion proposal has been made, but it is not as tight a diversion proposal as what we proposed in our proposal.

Q. Do you understand that modifications of existing proposals are permitted?

A. I guess I did not realize that, no.

Q. Okay.

A. I thought this was kind of a cut-and-dry deal here.

Q. Okay. Well, we hope it's not.

A. Okay.

Q. But --

A. Well, we --

Q. And the Department will tell you it's not a cut-and-dry deal.

A. Well, we hope we're going to make a difference, then?

Q. Well, I think that that's why people are here.

A. Okay.

Q. And so if you understand, now, that you are permitted to actually speak to diversion limits that are different from what is actually proposed, would you like the Department to consider the material that you submitted back in October as part of this hearing?

A. Yes. I would like for the Department to review the proposal that we admitted initially, study that. Of course, it looks like we've already got -- it looks like we've already got a study of it. We've got, from the market administrator's office, the way I understand it from Federal Orders 5 and 7, what this would do by changing the diversion limits.

Q. Assuming that what you proposed was similar to what Dean is suggesting now as a modification, then that would be correct.

A. And if I'm -- if I'm not mistaken, I think the proposals are very similar.

Q. So the bottom line is you support diversion limits even lower than those proposed by DCMA?

A. Yes.

MR. ENGLISH: Thank you, sir.

JUDGE HILLSON: Mr. Beshore?

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good morning, Dr. Shelton. My name is Marvin Beshore, and I represent DCMA in this hearing.

Can you tell us a little bit about Upper South Milk Producers Association? Is that -- is that -- what type of organization is it?

A. It's strictly an association. We do not market milk. I would compare it to Georgia Milk Producers Association, North Carolina Dairy Producers Association, Western United Dairymen Association in the California area.

As I stated, our goal was really to try to educate ourselves. We have looked into, similar to Kentucky Dairy Council, dairy development council, a way to attract milk to the Southeastern area. We obviously have not made a lot of headway on that at this time, but it's still on the radar.

Q. You also mentioned an organization called U.S. Milk.

A. U.S. Milk is the same as -- we refer to that as Upper South Milk Producers, yes.

Q. So they're one and the same?

A. Yes, sir.
Q. Okay.
A. Yes.
Q. Now, do you understand what you -- what a diversion is under the order?
Or let me ask you, What do you understand the diversion to be under the order?
A. Well, understanding -- my understanding of the pooling and diversion concept is that milk that is really not sold in our area still receives our price. It's the ability of that milk to -- from what I glean from our federal order study that day was that the dollars are moving east to west due to diverted and pooled milk.
Q. Okay. So your understanding of diversions are milk movements outside your area, which nevertheless capture -- are capturing the blend price in your area?
A. Yes. I've never understood why milk that stayed in Texas needs to be benefitted by me being in North Carolina in a deficit market. Maybe I don't understand it more or less, but I know from what people that seem to know a lot more about it than I do tell me it costs me money.
Q. Are you aware that there may be diversions

within your area and that there are diversions within the area?

A. I can't say that I really understand that concept enough to comment on it.

Q. Okay. One of the -- some of the information that's been provided by market administration in Federal Order 5, in Exhibit 9, page 2 of 13, it shows the differences -- it shows the daily demands for milk of all the distributing plants in Order 5. And it shows the variations from day to day.

Have you seen --

A. I have not seen that, no.

Q. Okay.

A. I understand there is quite a bit of variation in supply and demand from the plants, yes.

Q. Okay. Let me just -- I'm just taking the first month of the data, which is January of 2004.

On the 9th of January 2004, the distributing plants of Order 5 required 15,510,769 pounds of -- pounds of milk, and that was the high demand point in the month. Okay?

A. (Indicates affirmatively).

Q. And on the 25th of the month -- this is January 2004 -- they only required 10,022,289 pounds of milk, according to the market administrator's data.

Now, that's only about two thirds of the milk on the low day as required on the high day.

You're not involved in marketing, but somebody is, cooperatives primarily. You understand that something has to happen to the milk that's not required under the 25th by the distributing --

A. Well, I would understand kind of a simplistic approach. This may not be the way it is. You usually have to store it or you have to take it to a balancing plant.

Q. Okay. And storing fresh milk, you can't store it for very long?

A. Not too long.

Q. Okay. By the way, cows' production is generally equal from day to day --

A. Yes.

Q. -- correct --

A. (Indicates affirmatively).

Q. -- on the farm?

Okay. Would you be aware that those movements to a balancing plant are typically diversions?

A. No, I did not understand that as a diversion.

Q. Okay. You would agree, would you not, that the milk of the producers who happen to be involved in not being needed on the low day of demand, nevertheless, are entitled to be part of a pool?

A. Say that again.

Q. That when the milk from whatever farms it comes from, the milk that's not needed on the low days by the pool plants, by the handlers, that milk is nevertheless part of the -- of the supply for the order, or the pool?

A. That's the way it is. I'm not sure that I really understand the real economics that it really needs to be that way. If I don't need hominy, I don't need it, so I don't pay for it out there.

Q. Well, let's just -- let's just look at this month.

Say all the milk supplied to a given plant in Order 5 is coming from North Carolina -- I'm sure that might happen in some plant -- and that North Carolina plant only needs two thirds of the North Carolina farms on one day --

A. Uh-huh (Indicates affirmatively).

Q. -- and it needs all of their demand on another day.

A. Uh-huh (Indicates affirmatively).

Q. Okay? Now, let's -- assume with me that the concept of diversions allows all of the milk of all the farms to be pooled for the month, to share in blend price for the month, because they're needed some days to meet the market at least. Okay?

A. Uh-huh (Indicates affirmatively).

Q. Is that a fair system in your view? That's the way it works now.

A. Yeah, that's the way it works now. And if we can only supply half the plant's production, I don't really see that as my problem. Maybe I should see it as my problem, but I really don't.

If they need a lot of milk and I've got -- and I'm sending them all the milk I can make and they still don't have enough, then I'm not sure that's really my problem.

Q. What if they don't need your milk one day? Whose problem is that?

A. That's my problem.

Q. Okay. And is it your view that you shouldn't be -- if your milk is needed five days and not needed two days, then two days worth shouldn't be part of the order?

A. I better find a home for it.

Q. And if that home is not a pooled plant, you will take a Class 3 or Class 4 price?

A. I guess if we were to that situation, that's what I would have to do.

Q. Okay. Is that what you're advocating for the -- advocating for this, for Order 5?

A. Well, I'm saying that I think we're still operating on the rules of when we had too much milk in our area, and now we don't have enough milk in our area. Is that -- is that -- you know, that may not fit the economic deal there, but, you know, from a simple veterinarian standpoint and a dairy farmer, that's kind of the way it works.

Q. Let me ask just one other question. Do you know -- your acquaintances or family in Michigan --

A. My client's family, yes, in Michigan, yes.

Q. Client's family in Michigan?

A. Yeah.

Q. You've compared bulk price, and whatnot, between them. And sometimes they're quite close to prices in North Carolina, as you indicated?

A. Yes. Sometimes higher, sometimes lower, but pretty close.

Q. Do you have any idea what the diversion limits are on the pooling of milk in Michigan?

A. I have no idea.

Q. If I represented to you that they're much more liberal, lenient than they are in your order, would that change your thinking at all about the diversion?

A. Well, I guess the difference I would see in Michigan is they have too much milk, and we don't have enough. So they probably do need a different set of rules than we do.

Q. But their price under that separate -- separate set of rules is comparable to yours. So the rules might not be -- diversion rules don't necessarily generate lower prices, fair?

A. I really don't know. All I know is that it doesn't make sense to me when there is not enough milk you get less money. It looks like if you're in a deficit market, it should have value. Local milk should have value if you're in a deficit market.

Q. Okay.

A. When my milk is 50 miles from the plant, it looks like it would be worth just as much, if not more, than milk that is 5- or 600 miles away from the plant.

Q. Are you asserting that it's not worth more today under the orders? Is that your understanding?

A. If the people in Michigan can get just about as much as I can get 5- or 600 miles away, it seems like there is something a little bit out of whack there.

Q. How about your order, I mean, your -- the milk that's distant from your order that gets pooled, it gets less. Do you understand that?

A. The milk that's distant from my order?

Q. I'm sorry. Distant from your location. Milk that's in Virginia, let's say --

A. I understand --

Q. -- gets a lower price.

A. I realize there is differences in the differentials getting across there, yes.

Q. They get a lower price?

A. *Uh-huh (Indicates affirmatively).* I understand that.

MR. BESHORE: Okay. Okay. Thank you.

JUDGE HILLSON: Any further cross-examination of Dr. Shelton? Any redirect?

MR. SMITH: No, Your Honor.

JUDGE HILLSON: Okay. Thank you, Doctor. You may step down.

THE WITNESS: Thank you.

JUDGE HILLSON: Mr. Smith, you may call your next witness.

MR. SMITH: Dan Smith. The next witness is Leigh Lane. Mr. Lane will also express his statement for the record without a written statement.

JUDGE HILLSON: Raise your right hand.

LEIGH LANE,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Would you please state your name and spell it for the record.

STATEMENT BY LEIGH LANE

THE WITNESS: My name is Leigh Lane. And that's L-e-i-g-h, L-a-n-e.

My name is Leigh Lane. I'm testifying on behalf of North Carolina Farm Bureau as the chairman of the Dairy Advisory Committee and also as DFA producer in North Carolina.

My wife and I own and operate a 170-cow dairy, have for the last 22 years. We ship mostly -- or all the plants regulated under Order 5, and we support the proposal submitted by DCMA for changes in the Class 1 differentials in Order 5, 6, and 7 and to modify some of the pooling rules.

JUDGE HILLSON: Sir, will you talk more in the microphone, please?

THE WITNESS: I'm sorry.

I wish to call attention to the trends in production and population in the main states located in Order 5, which are Kentucky, North Carolina, South Carolina, Tennessee, and Virginia.

USDA data show a persistent decline in the milk production in the region. And using 1989 as the starting point, because that year was the first year we saw a significant increase in the volatility in farm prices, the decline has been dramatic.

I should point out that significant amounts of milk in Tennessee and Virginia move into other markets.

The population in these states is increasing. The population has grown from two-point -- 24.9 million in 1990 to 31.1 million in 2006, which is an increase of 25 percent. And the milk production has decreased 35 percent over the same period.

Order 5 is a deficit market. The per capita milk production is low and is decreasing. It's decreased from 332 pounds in 1990 to 172 pounds in 2006.

This is not enough to even meet the fluid needs in the market, which is around 180 pounds per person. It requires almost 600 pounds per minute to meet the total dairy product needs of the consumers.

There has been a sharp decline in the per capita milk production in each of those states from 1990 to 2006. I feel like the local milk is worth more now than it was 2000, when Order 5 was created, and increases in the minimum Class 1 price are justified. The transportation costs have increased approximately 20 percent from January 2000 to the present based on the Bureau of Labor Statistics, producer price index for general freight in truck load lots. While the index did not specifically cover milk hauling, I would expect the cost would be similar.

While the -- we realize that proposed changes should put some money in the producers' pockets, the proposed changes are not enough.

Based on DCMA's prediction of the financial impacts in Order 5 of 26 cents, I can tell you as a producer that more is needed to reduce or reverse the trends of production we are seeing.

My son, my oldest son, went to college and always claimed that he wanted to be a dairy farmer. He came back to the farm after college and spent four years with us. During the downturn of 2002, 2003, he became quite discouraged about his future prospects to be able to stay on the farm for the next 30 or 40 years, which would be his career. And he's now an officer in the U.S. Army.

So in order to change these production trends, we're going to have to be able to encourage young people to stay on the farm. And I don't think we're getting it done right now with the prices that we're seeing and the price -- the trends in production are not going to be improved with the 26 cents.

In addition to the supply issues, I'd also like to note that Class 1 utilization in Order 5 has remained unchanged since this order was created in January of 2005. During this period, Class 1 sales in the order have been fairly consistent based on the market administrator's office.

While the local production has declined dramatically, however, the proportionate milk used in Class 1 uses has not changed. This raises the issue of whether the orders are fulfilling the intended purpose.

In short, we believe that the situation in

Order 5 and, indeed, the region served by the three orders is serious, and we urge USDA to conduct or sponsor an in-depth study in the order -- in order that the problems can be identified correctly to identify additional measures that might be taken and to evaluate the impact of these measures. We feel like this study should be conducted as soon as possible and the results be made publicly available.

For these reasons, I support the DCMA proposal but would like to see further changes made in the future.

Thank you for allowing me to testify.

JUDGE HILLSON: Any further questions, Mr. Smith?

MR. SMITH: No, Your Honor.

JUDGE HILLSON: Anyone wish to ask questions of this witness?

Okay. Mr. Lane, you may step down. And thank you for testifying.

THE WITNESS: Thank you.

JUDGE HILLSON: And you may call your next witness, Mr. Smith.

MR. SMITH: Bill Crist.

JUDGE HILLSON: Raise your right hand.

WILLIAM L. CRIST, SR.,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Please state your name and spell it for the record.

THE WITNESS: It's William L. Crist, Sr., and it's C-r-i-s-t.

JUDGE HILLSON: Okay. Do you have any questions you want to ask him or do you want him to read the statement?

MR. SMITH: Shall we mark his statement?

JUDGE HILLSON: Okay. I'll mark Mr. Crist's statement as Exhibit 26.

MR. SMITH: Mr. Crist, would you like to read your statement for the record?

THE WITNESS: Certainly.

STATEMENT BY WILLIAM L. CRIST, SR.

THE WITNESS: My name is Bill Crist. I have served as an extension professor and dairy extension specialist with the University of Kentucky since 1978 and am still in a dairy specialist position one quarter time until my replacement comes on board in January 2008.

I received a Ph.D. in physiology of reproduction from the Ohio State University in

1970. My professional areas of emphasis are mastitis control, milking management, and dairy facility layout.

I'm testifying today primarily in my capacity as a Kentucky dairy farmer, however, rather than as an extension dairy specialist.

My son and I are partners on two dairies that we lease near Glasgow, Kentucky, and my son is the primary manager on these farms.

The first dairy we have 230 cows, milking around 200 of those, and we have 200 heifers that are being custom raised for us. We own the cows and the feeding equipment. We lease the parlor, the feed barn, and the pasture. All of our feed is purchased.

We started leasing the second farm in March of this year, and we have 340 cows on this farm and about 300 of those cows are being milked. Again, the parlor, free stall barn, and pasture are leased, and all the feed is purchased.

We sell milk to Lone Star Milk Producers and are pooled in Federal Order 7.

I'm also testifying on behalf of the Kentucky Dairy Development Council. KDDC represents all elements of the Kentucky dairy industry and has as its mission to educate, promote, and represent dairy producers and foster an environment for growth of the Kentucky dairy industry.

I am here to testify in support of the proposal by the Dairy Cooperative Marketing Association, Inc. The proposal will increase the producer income and begin to rationalize the pooling structure of the three market orders that control pricing and pooling for our dairy marketplace in the Southeast. Both of these are critical, vital steps towards enabling the South's dairy farmers to stay in operation and continue to supply the market and thereby assuring the continued vitality of our region's dairy industry for the future.

Also, as developed further below, we believe that the circumstance warrants emergency action by the Department.

It goes without saying that the dairy industry is in crisis here in the Southeast. As noted in the DCMA proposal, during the period 1986 through 2006, milk production in the 12 Southeastern states has declined from 18.3 billion pounds to just under 12 billion pounds. Simply put, we are experiencing a decimation of the region's milk supply.

Certainly, the Southeast has historically been a deficit region and depended on the importation of milk from surplus regions to ensure the stability of its milk supply. Yet, the stability of the very base of the South's milk supply is now under grave threat.

The situation is nothing less than dire in Kentucky. Between 1990 and 2004, milk production in Kentucky declined from 2.25 billion pounds to 1.42 billion pounds, for a decrease of fully one third. This reduction in supply runs completely contrary to the basic economic laws of supply and demand.

If ever there are such laws in operation and if they are, indeed, supposed to act as the underpinning for the federal order system, a decline in supply should be precipitated by, or at least correspond somehow with, a decline in demand. Yet our region has experienced instead a period of explosive population growth and so a tremendous corresponding increase in the region's demand for milk. In Kentucky alone, the population increased fully 10 percent between 1990 and 2000.

In combination, the reduction of local supply and increase in demand has placed tremendous pressure on the region's surplus supply areas and, hence, the need for this hearing. DCMA's proposal, on page 3, identifies the structure problems with current federal minimum pricing as follows.

Simply put, the Class 1 price surface as currently established under the orders is failing to offer sufficient economic incentives to move milk into the Southeast from the reserve supply areas and is failing to encourage local production within the Southeast.

The proposal directly confronts these problems with amendments to pooling and transportation provisions, as well as increases in the region's Class 1 price surface. These are critical first steps toward restoring the stability and a proper balance of the pool. And KDDC supports them for these reasons.

Most importantly, KDDC supports the proposal because it has as a central premise the restoration of the region's ability to provide its own basic milk supply.

Under the proposal, the Class 1 price surface is raised in the region as a direct incentive to encourage greater local production. Revision of the pooling provisions also has this incentive as its aim by the attempt to eliminate uneconomic incentives for the irrational importation of milk.

These changes place the proper emphasis on the production of local milk as being the most rational basis of stability for the region's base supply.

KDDC also welcomes the proposal's suggestion that this hearing be used to determine the most appropriate level of allowable diversions. See page 5 of the proposal.

As noted, the proper amount of diverted or supplemental milk needed to balance the market has been the subject of much discussion leading up to the hearing. Based on the formal testimony now received, the Department will be in the right position to best sort out this issue.

The KDDC also notes that DCMA's proposal identifies the importance of the market administrator's continued authority to adjust diversion limits.

Once again, this makes clear that the proper levels for diversion needs to be constantly monitored and adjusted as necessary to eliminate the uneconomic incentives for bringing milk into the Southeast marketplace.

We also understand the rationale for the proposed reduction in touchbase provisions. The market order administrators will still retain their authority to review these requirements, and we believe, nonetheless, that this is still important.

KDDC also supports that the transportation credit provision amendments, recognizing the importance of these amendments to the overall proposal or the necessity to rationalize the process for bringing in surplus milk in addition to enhancing incentives for local production.

I close with a particular note of caution for the future of the Kentucky dairy industry, which should be of particular concern for this hearing. The subject of this hearing is the continued maintenance and adequacy of the region's supply of milk for processing plants regulated under the Southeast orders. A substantial portion of this processing base is located in Kentucky.

Kentucky processors provide upwards of 20 percent of the total output of the two Southeast orders most immediately associated with Kentucky. They are packaging more than twice the volume of milk consumed by Kentuckians.

The long-term stability of the Southeast's supply of milk, in other words, is largely dependent on the ability of these primarily exporting plants to continue to source a stable supply of milk in the region.

Yet Kentucky dairy producers, being located closest and thereby best suited to supply these plants under the basic principles of milk marketing regulation, continue to be forced out of business in droves by inadequate minimum pay prices established under our federal orders.

The current proposal promises only marginal relief to Kentucky producers, and this is of great concern to KDDC.

Being on the northern edge of the region, the closest to a key part of the region's processing base, the net return for the proposed changes to the Class 1 surface will yield a very limited return to our producers.

We certainly recognize the need to retain alignment between the southern orders and the adjacent orders to the north and understand how being on the border puts us in a precarious position.

We also understand from the Department's notice, however, that this hearing is for the purpose of temporarily adjusting the Class 1 pricing surface for each county within each of the three milk marketing orders until such time that the Department is able to comprehensively address the Class 1 pricing surface on a national scale.

Much as we urge emergency action on the DCMA proposal, we further urge the Department to proceed without delay with its plan for comprehensive review of the national pricing picture. There is certainly no time for delay in Kentucky and, I believe, through the Southeast.

In closing, I would note that the Kentucky Department Dairy Council Board of Directors, on behalf of approximately 400 Kentucky producers and allied industries, has voted to support the concepts contained in the DCMA proposal being considered in this hearing. The board also expressed the hope that the proposal could be enhanced in a way that would be of greater benefit for Kentucky producers.

Thank you for very much for your

consideration of my testimony, and I'd be happy to try to answer any questions anybody might have.

JUDGE HILLSON: Okay. Mr. Smith, do you have any questions?

MR. SMITH: I do not. Thank you, Your Honor.

JUDGE HILLSON: Does anyone else have any questions? Mr. Beshore?

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good morning, Dr. Crist. Thank you for your testimony and support.

A. Good morning.

Q. I have just a couple questions for clarification.

On the third page of your testimony, about the middle of the page, the paragraph that begins, KDDC also welcomes the proposal suggestion that the hearing be used to determine the appropriate level of allowable diversions.

Do you see that paragraph?

A. Yes.

Q. Okay. Then the next sentence, it says, See page 5 of the proposal.

What are you referring there in terms of when you say the proposal on page 5, just for clarification?

A. That was a DCMA proposal, I believe, is where that came from.

Q. What document? Is that -- was that like Mr. Sims' testimony statement, or is that a different document?

A. I believe that was. Can I ask for some --

Q. Sure. I just want the testimony to be clear with respect to what you are referencing here.

MR. THOMAS: Judge, I'm Roger Thomas with the Kentucky Dairy Development Council, executive director. Could I --

JUDGE HILLSON: If you can answer without having to be sworn in, if it's -- just as a point of reference.

MR. THOMAS: Sure. That language was contained in the original draft that we had possession of, and it was on page 5.

JUDGE HILLSON: Whose original draft are you talking about?

MR. THOMAS: Not the proposal presented at this hearing.

MR. SMITH: It's the draft letter submitted by DCMA to the secretary. That was then --

MR. BESHORE: It was in the letter requesting the hearing?

MR. SMITH: Yes.

MR. BESHORE: Okay. And that's on the -- on the USDA -- on the hearing website, I think.

JUDGE HILLSON: That's something that's part of record, I think, in this case.

MR. SMITH: Yes. It's on the website.

JUDGE HILLSON: If it's not, the record will take official notice of it.

MR. BESHORE: Okay. It's the request for hearing.

JUDGE HILLSON: Okay.

MR. BESHORE: Okay. That's helpful in clarifying the reference there.

BY MR. BESHORE:

Q. Now, on the next page, page 4, Dr. Crist, you make the comment that Kentucky processors provide upwards of 20 percent of the total output of the two Southeast orders most immediately associated with Kentucky.

Can you tell us a little more about how you -- how you made that calculation or what the basis for that calculation is?

A. Well, just in the two federal orders, 5 and 7, that they provide upwards of 20 percent of the total output of the Southeast orders.

Q. Was there -- is there some publication by the market administrators which indicated how much of the processing volume was originating with Kentucky?

A. Well, just the volume of milk from Kentucky is all. I don't know what milk goes to particular plants but just the volume of the milk from Kentucky. So maybe that's an overstatement. I'm not sure about that.

Q. Okay. In any event, you're referring to the production volumes --

A. Yes.

Q. -- at the farm level --

A. Right, right.

Q. -- at the farm level in Kentucky?

A. Yes, uh-huh (Indicates affirmatively).

MR. BESHORE: Okay. Thank you.

JUDGE HILLSON: Mr. English?

MR. ENGLISH: Charles English for Dean Foods Company and National Dairy Holdings.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Dr. Crist, just a few questions here.

First, do you know where your milk is marketed, what operations?

A. I think most of it goes to Dean plants in

Nashville.

Q. Okay. And what led you and your son to lease a second farm in March of this year in this market that's a disaster?

A. Yes. My reason for leasing a second farm is because I have a son that is energetic and wants to milk more cows and needs to milk more cows in order to make enough living to send my three granddaughters to college some day. That's my -- that's my reason. That's my primary reason for doing it.

I asked my son that the other day. I said, Son, why did we do this? That's after we had started this operation. In the first week of March, we brought in 340 cows. And the next three weeks, I lost ten pounds, and so, see, it's good for you. It's very -- it's very good for you.

But I asked my son, Son, why did we do this?

And his response was, Well, Dad, I thought you had to have something to do when you retired.

So we had a little communication problem there. But, no, I -- it's from the fact that he is energetic. He wants to milk more cows. And it's the fact that we sincerely believe that we can make money on the operations, but you have to milk more and more cows all the time in order to make a decent income.

And, of course, it's a challenge. It's one that I'm certainly looking forward to as well.

Q. Was this --

A. Excuse me. 2006 was a very difficult year.

Q. Sure. Yeah. Was this a brand new dairy farm, or did you purchase -- or lease this from somebody else who had been dairy farming?

A. We leased this from somebody else. It's about three miles from our other dairy that we lease. We don't own any land. And I'd love to own land. We looked at a farm this last fall to purchase, and -- but by the time you purchase the farm and then you add buildings and then cows, you don't have any money to buy cows. No money to -- you can't even --

But, anyway, no. The second farm is a lease farm. And the reason that the dairyman sold his cows last December was the fact that he was just really upset. He was tired with the price of milk being up and down so much and, certainly, 2006 being a very difficult year for him. And he just decided to sell his cows. And he's an excellent dairyman. He was an excellent dairyman.

Q. Did he sell his cows in the hundredweight program?

A. No, no. They went -- they went north

somewhere, but he sold them as an entire herd.

Q. But -- so you didn't buy his --

A. No. We didn't -- we weren't even considering leasing his facility at that time when he sold. That came about since then.

Q. Do you know any dairy farmers in your area who have participated in the hundredweight program?

A. No. I had heard that there was a couple in the northern part of Kentucky, but I don't even know who those are. We have very few that have gone out in the CWT program.

Q. And just for clarity of the record: What is the CWT program, to your knowledge?

A. Well, that's the program where producers -- many producers are paying in like -- I think it's 10 cents a hundredweight now. It was a nickel. And now it's 10 cents a hundredweight now. And then cattle are then purchased every so often. They'll have a program where dairy farmers can bid in terms of being able to sell their cows for beef to reduce the number of cows, to reduce the production level in the country, to try to maintain our price level.

Q. And is some of that reduction also done through Lone Star? Does Lone Star participate in the hundredweight program?

A. It's not required, but we do participate in it, I mean, we as a farm. The Crist farm --

Q. Right.

A. -- does participate in it, yes.

Q. And does Lone Star as a cooperative participate in it?

A. I think that they do. Now, it's not -- to my knowledge, it's not required that you have to.

MR. ENGLISH: Okay. Thank you very much.

JUDGE HILLSON: Any further questions of this witness?

MR. SMITH: (Indicates negatively).

JUDGE HILLSON: Okay. I'm going to receive Exhibit 26 into evidence.

(Exhibit No. 26 received.)

JUDGE HILLSON: You may step down. I note that it's noon. I don't know -- everyone thinks it's a good time for lunch.

I'm not sure about what's around here, but would an hour and a quarter be a reasonable time for lunch and come back at 1:15? Do you think that will work for everybody? We'll come back at 1:15.

And, Mr. Smith, you have one more witness to call?

MR. SMITH: One more witness, yes.

JUDGE HILLSON: And then we'll finish with Mr. Sims, and then, I guess, it will be Mr. English calling your witnesses.

MR. ENGLISH: If they're here.

MR. BESHORE: We have two more.

JUDGE HILLSON: You have two more after that.

MR. BESHORE: Yes.

MR. ENGLISH: We're going fast.

JUDGE HILLSON: Okay. Back at 1:15.

(A lunch recess was taken.)

REPORTER'S CERTIFICATE

STATE OF FLORIDA
COUNTY OF HILLSBOROUGH

I, Aaron T. Perkins, Registered Professional Reporter, certify that I was authorized to and did stenographically report the above proceedings and that the transcript is a true and complete record of my stenographic notes.

I further certify that I am not a relative, employee, attorney, or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

Dated this 28th day of May, 2007.

Aaron T. Perkins, RPR

AARON T. [illegible]
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Expires 12/11/2007
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UNITED STATES DEPARTMENT OF AGRICULTURE

PUBLIC HEARING ON PROPOSED RULEMAKING

TAMPA, FLORIDA

Docket No.
AO-388-A22;
AO-356-A43;
AO-366-A51;
DA-07-03

AFTERNOON SESSION

HEARING BEFORE JUDGE MARC R. HILLSON

DATE: May 22, 2007

TIME: 1:15 p.m. to 5:12 p.m.

PLACE: 4400 W. Cypress St.
Pasco Room
Tampa, Florida

REPORTED BY: Aaron T. Perkins, RPR
Notary Public, State of
Florida at Large

Pages 341 to 515

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I N D E X

CONTINUED:

WITNESS INDEX CONTINUED:

E X H I B I T S

P R O C E E D I N G S

JUDGE HILLSON: Okay. Let's get seated so we can get started, please. Okay. We can go back on the record.

Mr. Smith, you have one more witness that you wanted to call; is that correct?

MR. SMITH: Dan Smith.

Tom Thompson, Your Honor.

JUDGE HILLSON: Did Mr. Thompson have a written statement that he wants to --

THE WITNESS: I have a written statement.

JUDGE HILLSON: A written statement. Okay. I'll mark this up front as Exhibit 27. And I'll swear you in.

TOM THOMPSON, JR.,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Okay. Could you state your name and spell it for the court reporter.

THE WITNESS: Yes. I'm Tom Thompson, T-o-m, T-h-o-m-p-s-o-n, and that has a junior at the end.

JUDGE HILLSON: Okay. Do you want to ask him any preliminary questions?

MR. SMITH: Yes.

DIRECT EXAMINATION

BY MR. SMITH:

Q. Mr. Thompson, one question before you get started. Towards the middle of your statement, there is a Table 4.2. It looks --

A. I believe you'll find that right behind the references that are the references on the elasticity of supply.

Q. If you could explain why it is that you've put in the statement with the smudges, more particularly which part of the statement you intend to refer to.

A. Correct. The only -- the only pertinent part of that page is the farm supply response, the elasticity farm supply response. And this follows the references on the preceding page that refer to this page, and it gives you the numbers for the various sources for those elasticities. But that top line is the only one that we need to be concerned about.

Q. So the remainder of the table is not relevant to your testimony?

A. It is not.

JUDGE HILLSON: Okay. You may testify.

STATEMENT BY TOM THOMPSON

THE WITNESS: Thank you.

Thank you for the opportunity to appear

before you to discuss a subject vital to all of Georgia's dairy farm families.

I am Tom Thompson, president of the Georgia Milk Producers, as well as a dairyman from Eatonton, Georgia.

Georgia Milk Producers represents all of Georgia dairymen and speaks on their behalf in matters such as we are here to address today. It is in this role that I also represent all Georgia dairymen on the Southeast Steering Committee, joining other members of this committee speaking at this hearing.

We applaud USDA for holding this emergency hearing to address matters of grave concern to those of us trying to produce milk in the Southeast. We support the proposals made by DCMA at this hearing as a first step in addressing the federal order rules and regulations that appear to be at the heart of the economic plight of the Southeast milk producer.

The Southeast is a unique region. On one hand, it contains one of the fastest increasing populations in the U.S. On the other hand, its milk production is decreasing at one of the highest rates in the country and is now deficit year-round. Georgia alone imports more than 1,000 tanker loads per month. We need to attempt to understand this seeming paradox.

The Southeast has the highest cost of production in the United States. Contributing to this cost is high heat and humidity, causing wide swings in cool versus hot weather milk production. Since production cost is high, the Southeast is not able to produce milk intended for manufacturing purposes, instead trying to operate in a niche market supplying milk primarily for the needs of local bottling plants.

Another factor contributing to our high production cost is a lack of proximity to abundant grain and forage production. We have neither the vast rich soils of the corn belt nor the federally subsidized irrigation of the west.

In the Piedmont region of Georgia where our dairy is located, there is no aquifer to supply water so desperately needed to grow the forage crops that are currently being decimated by the second year of drought.

Let's look a little closer at the region's declining milk production. Since federal order boundaries do not exactly follow state lines, we will use USDA's production figures for Georgia, Alabama, Mississippi, and Tennessee for annual milk production trends from 2000 through 2006.

These states have experienced a 3.6 percent annual decline in milk production between 2000 and 2006, beginning in 2000 with 3,727,000,000 pounds and falling to 2,997,000,000 pounds in 2006. These numbers have been translated into trend lines by the market administrator's office in Atlanta and would indicate that virtually no dairies will exist in the Southeast in ten years.

One of the proposals that is part of the DCMA package we support here today addresses the out-of-state differentials that are supposed to reflect the cost of moving milk from areas of plentiful supply to deficit areas.

The differentials in place today were done in an era of gas in the dollar-per-gallon range, when stainless, over-the-road tankers and the tractors that pulled them were far cheaper, and a truck driver's pay was less than one and a half of what is paid today. Adjusting differentials to reflect changes in transportation costs is long overdue. We strongly support that much needed change.

Can the Southeast dairymen be economically viable in supplying the needs of the Southeast, primarily fluid milk plants, whose outputs are typically 90 percent Class 1? I would suggest that the answer is it all depends.

In my economics courses at Emory University's School of Business, we learned that the price of a commodity in a deficit area was the FOB price of this commodity in a plentiful area plus the true cost of freight to the deficit area.

There was no concept that the producer in the deficit area should have his reduced by the cost to deliver additional amounts from a distant area, whether this cost occurred through pooling, transportation credits, reblending, or some other means.

In order to put this in perspective, let's review a little history. In the late 1960s, Georgia's milk commission was ruled unconstitutional, and Georgia subsequently got its own Georgia federal order. Unlike today, where the co-ops controlling the majority of milk in the Southeast have their majority membership living outside the Southeast, co-ops in Georgia were local, represented Georgia dairymen, and the Georgia federal order served the industry well.

Class 1 utilization was normally in the high eighties and low to mid nineties. Subsequent years added a state here and a state there to the order that soon became the Southeast order.

Each geographical increase in the order resulted in small declines in Class 1 utilization. However, USDA's 2000 inclusion of southern Missouri and an additional portion of Arkansas resulted in no small -- in no small decline. This time, the Southeast saw a drop of 15 to 20 points in utilization.

Instead of utilization that typically ranged from the eighties to nineties, we now saw utilization hovering in the fifties to sixties, with its corresponding transfer of milk revenues from the dairymen serving the needs of bottling plants in their close proximity every day, to those dairymen far distant who were qualified by touchbase and diversion rules.

Since January 2000, my partners and I have estimated this change in utilization has cost our 800 cow dairy hundreds of thousands of dollars. We cannot continue to operate our dairy under these adverse economic conditions.

Therefore, we and other Georgia milk

producers applaud and support DCMA's proposal to place a cap on diversions as a first step need to raise utilizations.

Since this is an emergency hearing, USDA has not had the time to do a study to determine how much stand-by capacity is required to supply the Southeast's deficit needs. We suggest that USDA should conduct this analysis and initiate subsequent changes that their study might deem warranted in order to more closely approximate the real economics I was taught years ago.

It is my belief the purpose of this hearing is an attempt to address the economic issues that are forcing Southeast dairymen out of business. With the Southeast becoming increasingly dependent on milk transported many times more than 1,000 miles from where it is produced to where it is needed, this has vast implications of increasing demands on foreign oil, air pollution, congested highways, vulnerability to bioterrorism, in addition to the insidious economic bleeding of the Southeast milk producer.

According to DCMA's estimates, the combined impact of additional Class 1 pooled revenue and lower diversion limits would increase federal order minimum blend prices. Based on 2006 annual data, the estimated increase in blend prices at various order base zones are -- and I quote and only use this particular one -- 75 cents per hundredweight in the Atlanta base of Federal order 7. And I reference the proposed Federal Orders 5, 6, and 7 amendments talking points by DCMA.

Other locations and orders vary from these numbers.

Now, I would like to reference projected increases in the milk production resulting from the proposed price changes compiled by Dr. Tommie Shepherd, University of Georgia, and Dr. Geoff Benson, North Carolina State University.

And now if you will flip to the next sheet, I will read from the title of this, The projected increases --

JUDGE HILLSON: Wait, Doctor.

THE WITNESS: Yes.

MR. BESHORE: Your Honor, if I might, I would object to Mr. Thompson proposing to read the publication of Dr. Shepherd and Dr. Benson. It's not his testimony. It's not his work product, and I don't think it's appropriate for him to read it as his testimony. Dr. Benson and Dr. Shepherd are not here to answer any questions concerning it, and that's beyond the type of testimony should be accepted.

JUDGE HILLSON: Okay. It's not unusual to attach articles to be relied on by the testimony.

MR. BESHORE: Well, yes and no. I would say that in testimony of the economist in these proceedings typically reference works in their field with which they may be familiar and may have used. Experts rely on other expert testimony.

It's not typical for dairy farmers or persons who are not in the field of expertise to attach or present as their statement the publication of experts in other fields. And I don't -- I don't feel it's appropriate. I object to it.

JUDGE HILLSON: Mr. Stevens, does the AMS have any position in this?

MR. STEVENS: Well, we've had this issue come up before. And I think many times the documents accompany the record, are admitted or accompany the record, and the Department -- the secretary gives it the weight to which it's entitled, you know. It is something that, you know, can accompany the record, and the people in Washington, when they look at the record, they'll *decide what weight they give the testimony and the* exhibit.

JUDGE HILLSON: Mr. Smith, do you want to --

MR. SMITH: Dan Smith.

Thank you, Your Honor. I think Mr. Stevens' point is well taken. The Department can provide whatever weight to the statement as necessary. I don't think it's relevant whether it's attached to a farmer's statement or not. If the witness wishes to submit a scholarly article, which is certainty sourced as an attachment to his testimony, then that ought to be within the purview of the testimony.

JUDGE HILLSON: Well, Mr. Beshore's objection is based on the fact that there is no cross-examination in terms of the contents of the article. I mean, if this was an adversarial hearing, I guess I would just -- I would sustain the objection. But at this point, I will allow him to introduce it with the understanding that the government is going to give it the weight that it thinks it deserves, which if there is any questions on it, with nobody to ask about it, then it's -- it should not be entitled to much weight.

MR. SMITH: Mr. Beshore, obviously, has the opportunity to brief whatever concerns he has.

JUDGE HILLSON: Right. But he's still -- in terms of whatever facts come out of here -- obviously, I'm seeing it for the first time -- he's at a disadvantage, because he's -- he has Mr. Thompson here, but Mr. Thompson is not the one to cross examine on what is in this -- in this article, which is pretty pertinent, I guess, to some of -- which may be pertinent to some of the issues in this case.

I'm going to allow it in, but I just don't think it's entitled to that much weight. I can't tell AMS, because I'm not the deciding official in this case, how much weight to give it. But I would think that they wouldn't give it that much weight because there is no -- they don't have anybody to cross examine. So I'm going to let it in, but with the understanding that I don't think it should be given much weight.

So you can proceed.

THE WITNESS: The title of the compilation of the research data that is presented here in this summary by Dr. Tommie Shepherd and Dr. Geoff Benson entitled, Projected Increase in Milk Production Resulting from Proposed Price Changes.

And the first portion of this is, Farm Milk Supply Elasticities.

The primary reason cited for the proposed changes to the Southeast, Appalachian, Florida federal milk marketing orders is concern over the declining milk production levels in these areas.

To assess the impact on DCMA's proposed Class 1 differential increases and diversion limit decreases on milk production in the Southeast and Appalachian, it is beneficial to understand how changes in farm level milk prices impact production.

In addition to the price of milk, numerous other factors may influence production, including feed prices, land values, replacement heifer prices, and government programs, to name a few.

Extensive research has been conducted in the area of farm level milk production responses to changes in milk prices at a national level, yielding a wide range of estimated price elasticities.

Price elasticity is a measure of the expected percentage change in the quantity of a commodity produced given a one percent change in its price. A review of current peer-reviewed academic research reveals estimates ranging from .07 to .59.

This includes estimates from sources including the United States Office of Management and Budget, OMB, the Food and Agriculture Policy Research Institute, FAPRI, as well as other authors listed in references at the end of this paper.

Little, if any, work has been published in the area of estimating supply response functions for the Southeast and even less specifically related to individual states.

The next area is milk production trends in the Southeast and Appalachia.

Figure 1 shows annual milk production for selected states for 2000 through 2006. Since federal order boundaries do not exactly follow state lines, the states of Georgia, Alabama, Mississippi, and Tennessee are referred to as the Southeast. And North Carolina, South Carolina, Virginia, and Kentucky are referred to as the Appalachia.

Based on data from the National Agriculture Statistics Service, NASS, milk production in the Southeast states has declined by an average of 122 million pounds or 3.6 percent annually since 2000. Similarly, milk production in the Appalachian states has declined by an average of 143 million pounds or 3.0 percent annually since 2000.

And at the top of the next page, you will see a graph indicating those production trend lines.

Estimated supply -- milk supply response.

A widely circulated set of talking points compiled by proponents of the proposed states that the combined impact of additional Class 1 pool revenue and lowered diversion limits would increase federal order minimum blend prices.

Based on 2000 annual data, the estimated increase in blend prices at the various order base zones are approximately 28 cents per hundred weight in Federal Order 5, parentheses, Charleston, Winston-Salem, and approximately 75 cents per hundredweight in Federal Order 7, Atlanta, Dacula.

Blend price increases in other cities would vary up and down from the above values based on each city's proposed increase in Class 1 prices, end quote.

Combining these estimated price increases with the aforementioned estimated milk price supply elasticities offers a projection of how much milk production in the Southeast and Appalachia may be expected to increase as a result of the proposed federal order changes.

A range of milk supply increases is derived based on the low and high elasticity estimates cited above. The low estimate, .07, is attributed to the FAPRI, and we consider it a short-term or partial response. The high estimate, .59, is attributed to Suzuki and Kaiser, and we consider it a long-term or full effect.

Dairy farmers have limited options to respond to price increases in the short-term run. Milking cow numbers cannot be adjusted easily except by less rigorous culling. Options to boost milk production per cow are similarly limited in a well-managed herd.

In the longer term, some additional heifers can be raised and the rate of dairy farm exits may slow, slowing or reversing the long-term trend in cow numbers.

Between 2000 and 2006, the average mailbox milk price, which is the price actually received by farmers for their milk, as published by USDA, was $14.72 per hundredweight for the Southeast federal milk marketing order and $14.27 for the Appalachian order.

The proponents estimate of a 75 cent per hundredweight increase represents a five percent increase in the average Southeast federal order uniform price.

The estimated 28 cents per hundredweight increase represents a two percent increase in the Appalachian federal order uniform price. The results of applying these estimated price increases to the indicated supply elasticities are shown in Figure 2.

Figure 2 is a table showing that at the short term in the Southeast, a 75 cent change in milk price would be expected to have a .35 percent increase in production. And that's the short term.

The long-term would be 2.95 percent. And in the Appalachia, an increase of 28 cents would be expected in the short run to give .14 percent and in the long run 1.18 percent.

Table 2 demonstrates that given the estimated price increases and supply response elasticities, production in the Southeast can generally be expected to increase by less than three percent and production in Appalachia can generally be expected to increase by less than 1.2 percent.

These are lower than the average annual rates of decline of 3.6 percent and 3.0 percent experienced since 2000 by the Southeast and the Appalachian states respectively.

Applying these estimated percentage increases to 2006 production levels in the two regions yields the expected milk production increases shown in Figure 3.

And that table shows that for the Southeast, based upon the 75 cents, the short-term or partial effect would be 10,489,000 pounds. The long-term would be 88,411,500 pounds. And the Appalachian, the increase of 28 cents would yield a short-term effect of 6,011,600 pounds and a long-term effect of 50,669,200.

Based on these estimates, the expected increase in milk production in the two areas as a result of the anticipated price increase is less than the current average annual rate of decline, suggesting that these modest price increases will have a very limited impact on the current milk production trends.

The next page are the references that these numbers were based upon. And then the previously mentioned smudge sheet that Mr. Smith asked me about is the things that would clarify and follow. And it gives you an Excel spreadsheet showing those various ranges and the sources from where they came from.

Given the limited impact on current milk production trends that this analysis indicates would be expected from DCMA's proposal, this underscores our position that, although we fully support DCMA's proposal to address the Southeast's economic plight, it is but a first step to correct the economic inequities that have plagued the Southeast's ability to continue local milk production.

It is my belief that USDA first needs to implement DCMA's proposal and then use the data and qualified economists at its disposal, becoming proactive similar to the federal reserve board as opposed to reactive.

After implementation of the DCMA proposal, USDA should also monitor the results.

If the goal is to achieve a reversal of the present trends in the Southeast, USDA needs to give serious thought to a partial decoupling of

Class 1 pricing from manufacturing milk prices set primarily by western overproduction, production that controls our fluid milk price but which is physically unrelated to our market.

The need for this review is underscored by the current lack of confidence in the veracity of the pricing data provided. Price volatility may be acceptable and understandable in manufacturing prices. Volatility and fluid pricing typically robs both the consumer and the dairyman. Georgia and other Southeast dairymen are tired of being robbed.

Given the dismal track history of reform inflicted on the Southeast since 2000, nothing less than a review and readdress by USDA is needed to achieve true economics. Only then will there be a chance to stop the cannibalization of the Southeast.

Thank you, and I appreciate the opportunity.

JUDGE HILLSON: Any further questions of this witness, Mr. Smith?

CONTINUED DIRECT EXAMINATION

BY MR. SMITH:

Q. Dan Smith.

Tom, if we could just go back to the smudge chart for a minute. Just to clarify the footnotes, if you can. Do you have a clear copy to read what the footnotes identify?

A. I do not.

Q. And if you could clarify the two spreadsheets you referenced following that -- the numbers that -- did you -- did you prepare these spreadsheets or --

A. No, I did not. That was a part of the data that Dr. Shepherd and Dr. Benson used in preparing this analysis.

Q. Are the circles made by you or by him?

A. They were made by Dr. Benson and Dr. Shepherd.

Q. And can you explain the relevance of these numbers as it relates -- does it relate to the table?

A. It relates to the table that they calculated their numbers from, the response. If you remember, they referenced both FAPRI as well as Suzuki and Kaiser. They used FAPRI as the initial response on the low end. That was what they considered to be an initial response. They used Suzuki and Kaiser at the high end at .59, as .59 of one percent response in supply expected with a one percent change in the milk price.

Q. And can you point to where the two tables, the two spreadsheet tables, fit into that?

A. If you look at -- if you look at the Figure 3, you will notice there they used a .07. They took the low end of FAPRI as their short term or partial effect, and then they took Suzuki and Kaiser at .59 for the long-term or full effect.

MR. SMITH: Okay. I don't have any other questions, Judge. Thank you.

JUDGE HILLSON: Anyone else have questions of this witness, Mr. Thompson? Mr. English, go ahead.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Good afternoon, Mr. Thompson. My name is Charles English. I'm here for Dean Foods Company and National Dairy Holdings. And I guess this is déjà vu all over again. I remember talking with you back in 2004.

A. You and I have both been around a while.

Q. And at that time, there was a proposal being submitted that would merge the Southeast and the Appalachian orders.

A. That's correct.

Q. And your organization opposed that?

A. That's correct.

Q. And in addition, there was a proposal that had been submitted -- but the secretary decided not to hear it -- that would break up the orders.

A. That's correct.

Q. And your organization supported what wasn't on the table, but you nonetheless supported that concept, correct?

A. That's correct.

Q. And the positions you took at that hearing were very much consistent with -- and looking at your testimony on page 2 today, a very long paragraph in the discussion of what happened every time you added more territory. Your position then was consistent with that as well?

A. Yes, sir.

Q. So when you asked the secretary to conduct a study and analysis of what might be the proper standby capacity, should the secretary also look at what size these orders should be?

A. We certainly think so, yes, sir.

MR. ENGLISH: Thank you.

JUDGE HILLSON: Mr. Beshore, do you have any questions?

MR. BESHORE: I do have one question.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Mr. Thompson, with respect to the Shepherd and Benson paper, do you know -- do you know what the test of the mailbox prices was, what the butter fat test was?

A. No, I do not.

Q. Would you agree or disagree that if your calculating percentage changes in price, you ought to be using the same butter fat test for that?

A. I would agree. And I suspect that they did, but I cannot say that for sure.

Q. Okay. Just one other question. You used pretty strong language here, Georgia dairymen being robbed.

A. I thought you might ask that.

Q. I mean, we appreciate your support for the proposal. If the proposals are adopted, are you still being robbed?

A. Well, part of the money that we feel that has been removed from the market will be -- will be replaced. We do not think that all of it will be with the proposals. And that's the reason we urge that a study be conducted to properly put in perspective the role of the Southeast dairymen in this market.

MR. BESHORE: Okay. Thank you.

THE WITNESS: Thank you.

JUDGE HILLSON: Anything from the government table?

MR. ROWER: No.

JUDGE HILLSON: Okay. I'm going to admit Exhibit 27 into evidence.

(Exhibit No. 27 received.)

JUDGE HILLSON: And, Mr. Thompson, you may step down. Thank you for testifying.

THE WITNESS: Thank you, sir.

JUDGE HILLSON: I guess the next step is to have Mr. Sims come on back up.

Before I turn over to Mr. Beshore for redirect, I just want to make sure that everyone in -- see if there is any other cross-examination, any other questions the other parties want to ask before I turn it over to Mr. Beshore?

Mr. Rower, do you have a question? Let's wait until he gets up there.

MR. ROWER: Sure, just one question.

JUDGE HILLSON: You can ask more than one. It's okay by me.

MR. ROWER: Thanks.

JUDGE HILLSON: You can go ahead, Mr. Rower.

CROSS-EXAMINATION

BY MR. ROWER:

Q. Welcome back, Jeff.

A. Thank you.

Q. Jeff, my question is could you please expand on the discussion in your testimony -- and it was also raised by Dr. Shelton in his testimony earlier -- concerning the impact of increased Class 1 prices on the existing premium structure, as what Dr. Shepherd was saying, as Class 1 prices increase, it seems that premiums will decrease.

A. In the past in the Southeast, there was a -- I guess a formula based process by which over-order prices did decline when the -- what we typically refer to as the mover -- if Class 1 price mover exceeded to certain benchmark prices, and the over-order prices would come down. Conversely, when the Class 1 price mover moved below certain benchmark prices, the over-order prices would increase.

That system has not been in place in at least a year and a half, perhaps longer.

Q. So that's no longer the practice?

A. That has not been the practice for some significant number of months. We've had a -- we have had, roughly, the same over-order price, except for adjustments in fuel, surcharges, for quite some time now --

Q. Okay. Thank you.

A. -- even with the increases in price that occurred recently.

MR. ROWER: Okay. Thank you.

JUDGE HILLSON: Mr. English, do you have anything else?

MR. ENGLISH: Sure.

Charles English for Dean Foods Company and National Dairy Holdings.

RECROSS-EXAMINATION

BY MR. ENGLISH:

Q. Mr. Smith, with respect to your organization's proposal to alter the touchbase requirements from their current levels to one day a month, how is it that lowering the touchbase requirements will make the market more efficient?

A. It provides greater flexibility in providing supplies.

Q. What about the current touchbase requirements is reducing flexibility or reducing the ability to supply the market?

A. Just requires on those very odd occasions where a producer might have to come more often than the one day, producers of that necessity.

Q. You say it's a very rare occasion?

A. Somewhat rare, yes.

Q. But you're reducing it from as many as six days down to one, correct, depending on the month?

A. Depending on the order --

Q. Depending on the order and the month.

A. -- it would be as many as ten days in the Order 7. I believe the current provision is ten days in the tight supply months.

Q. If it's rare, why do you need to go down all the way to one rather than going to 6 or 5? What is it that got you to go to 1?

A. Well, that provides the -- every month, it provides the certainty those dairy farmers can supply the market when required. That makes them remain associated every month and provides sufficient evidence that those producers can supply when needing more.

Q. To the extent a month is a month in which transportation credits are available, if the milk is coming when it's not needed and it is nonetheless drawing -- not needed in the sense that it's -- you said the rare instance when you don't really have to have it, correct?

A. Yes.

Q. Okay. If it's coming, it's going to draw money from the transportation credit for the purpose of touching base; is that correct?

A. If a transportation credit is requested. And if it is delivered to a pool distributing plant, it then would be eligible for a transportation credit.

Q. And so if you reduce the touchbase requirement for those rare instances in which a producer is merely shipping in order to stay pooled and if a transportation credit is requested and provided, we're not only having inefficient movement of milk into the market, we're paying for it extra with the transportation credit?

A. Would you say that again?

Q. Okay. As I understand it, your concern is that there are times in which milk is being delivered merely for the purpose of meeting the touchbase requirement and is not necessarily needed; is that correct?

A. That could happen on a rare occasion, yes, sir.

Q. Okay. Are there other circumstances you're concerned about?

A. I think that's the primary one.

Q. Okay. So on those rare occasions when that is occurring, if that milk is coming from outside -- I assume that's milk that's coming from outside the market primarily, correct?

A. Not necessarily. The touchbase days and diversion limits apply equally to producers inside the marketing area as outside.

Q. Is it difficult to find a home at a pool distributing plant for farms located in the marketing area for ten days out of the month?

A. It depends on where the plant is and where the producers are. I wouldn't think difficult would be the right word, but they generally can be touched some number of days.

Q. Would it be more rare for a dairy farmer within the marketing area to need, quote, unquote, need, the day to touchbase than for a producer outside the marketing area?

A. I beg your pardon?

Q. We've been talking about the rare circumstance in which it is necessary in order to maintain pooling for a dairy farmer to touchbase merely to keep pooling, correct?

A. Yes.

Q. And you said it's a rare circumstance, but sometimes that's what happens, correct?

A. Yes.

Q. In terms of relative rareness --

A. Medium rare or well done?

Q. No. I was referring to, you know, the rare hearings that we have in the Southeast.

In terms of how rare it is that that happens with respect to a dairy farmer located inside the marketing area versus a dairy farmer outside the marketing area, would it be logical to conclude that it is more rare for it to happen for a dairy farmer inside the marketing area?

A. The efficient use of milk requires that -- or provides or requires, suggests that the local producers are used first; the more distant producers are used last. So based on that -- predicated on that axiom, it would be more rare for producers inside than outside.

Q. Okay. So, now, given that if under the rare circumstance the milk is coming from outside and a transportation credit would normally be requested and now your proposal is adopted and, as a result of its adoption, that milk no longer has to come in that inefficient way, have we also saved for the transportation credit pool the transportation credit on that milk that otherwise wouldn't be needed to move?

A. If you -- if I understand your question --

Q. That's quite a caveat.

A. -- if you had moved it six days and now you're moving it one and you're paying a transportation credit on six days versus one, you would save transportation credit costs on those five days that didn't move, if that was the question.

Q. Now, if you reduce the touchbase requirement from six to one day, are you increasing the number of dairy farmers outside the marketing area who can be pooled and thus -- let me stop that -- stop there.

Are you increasing the number of dairy farmers who can be pooled, because now you only need to touchbase one day a month?

A. I don't know that it increases the number. The producers who are economically viable to come to the marketing area, I don't know it would change.

Q. Does it increase the volume?

A. Does it increase the volume that could be pooled?

Q. Yes.

A. No, since you can touch every -- all 65,000 dairy farmers in the country one day at pool plants. And the limit on diversions is the percentage limit in effect in the order. Those touchbase days do not define how much milk can be pooled. The limiting factor is the percentages.

Q. And that's why you've proposed simultaneously, with reducing the touchbase requirements, reducing the diversion limits?
A. That is one reason, yes, sir.
Q. One. Thank you. One reason.
Why is it that supplemental milk not delivered to the marketing area needs -- and I mean in an economic sense -- needs to share the pool?
A. I think we have a basic question about what forms a marketwide pool, and we need to maybe explore that a little.
If local producers can only supply 60 percent, 70 percent, you pick the number of the milk necessary to supply a marketing area. Just because they are local or just because a producer -- let me say this better.
Just because a producer is more distant, if you have a need for a certain amount of Class 1 milk, the fact that a producer is more distant does not make their milk less valuable, nor does it make it less needed. It just has to go farther.
So if you're going to have a market wide pool then the people who are providing the milk necessary to supply the marketing area should share in that blend price and truly provide the amount necessary.

Q. Can you get supplemental milk without pooling it if it stays home in a distant market?
A. Can you get it without pooling it?
Q. Yes.
A. Absolutely. Yes, you can. How is that? It can be -- it can happen.
Q. And, in fact, Florida does that to a significant extent, correct? It gets supplemental supplies that are not pooled?
A. Not pooled?
Q. Not pooled.
A. Well, I think it's pooled.
Q. To the extent that -- well, it's pooled, but it's not pooled on the Florida order?
A. I believe that is true, that they might get some supplies sometimes here that are not necessarily pooled on Order 6.
Q. And they do that more than, the percentage matter, than Order 5 or 7 do?
A. Probably.
Q. And they don't have transportation credits, correct?
A. Correct.
Q. But they have lower diversion limits, correct?

A. Correct.

Q. Turning to over-order premiums, do you know what the over-order premiums are today in the Markets 5, 6, and 7?

A. I can get real close.

Q. Well, why don't you tell me how close you can get for Order 5. This is Class 1. Start -- let me backtrack.

Are the premiums different for different classes?

A. Yes.

Q. For instance, are they different for Class 1 than Class 2?

A. Yes.

Q. Okay. Is Class 1 the highest?

A. Yes.

Q. Okay. So what is the Class 1 premium for Order 5?

A. For the base city of Charlotte, I believe for the month of June, it's $2.64 a hundredweight net after receiving credits.

Q. Okay. And for Order 6?

A. I'm calculating in my head.

Q. Okay.

A. $3.81, I believe, for Central Florida.

JUDGE HILLSON: Did you just imagine that number out of the air or what?

THE WITNESS: Sometimes things just come to me.

MR. ENGLISH: I think it came over my right shoulder.

JUDGE HILLSON: Just a vantage point for the record, you were lip reading from one of your colleagues.

THE WITNESS: But -- yes. I concurred with that statement.

BY MR. ENGLISH:

Q. All right. And Order 7?

A. Atlanta is the same as Charlotte, and then Birmingham is five cents less than Atlanta, and New Orleans, Little Rock, Memphis is 20 cents less than Atlanta.

Q. So $2.44?

A. Yes. $2.64 minus 20 is, I believe, $2.44. That sounds about right.

Q. Do you know what Class 2 premiums are in these markets?

A. I can speak for Orders 5 and 7.

Q. Okay.

A. I believe it's $1.75 net.

Q. And does your organization have any plans regarding the level of the premium should your proposals be adopted?

A. Plans?

Q. Yes. Like changing of levels.

A. At this point, since we have no decision, it would be presumptuous to make any assumption on that. So the answer on plans is no.

Q. Turning for one moment to the question of emergency.

We have at the moment an open proceeding regarding how the Class 1 or 2 price formulas will be calculated based upon a hearing that was held in Pittsburgh in December of 2006; is that correct?

A. That sounds right.

Q. And your calculations and your analysis have not taken any consideration of the results of that hearing, correct?

A. The calculations by the market administrator used the Class 1, 2, 3, 4 prices in effect in 2004, 2005, 2006. And I am confident that they did not insert any assumption regarding any changes resulting from some other proceedings.

Q. And you've done no assumptions about that or any other proceeding --

A. Correct.
Q. -- correct?
A. I have done no other calculations.
Q. And we've heard a little bit of testimony, but so far not a whole lot, about current marketing conditions.
It's true we are in a period of relatively high and rising milk prices, correct?
A. Yes.
Q. Does your organization -- does your organization have a projection -- well, first of all, what will be the Class 1 price mover for June? It was announced last Friday, wasn't it?
A. $17.82? I believe it was $17.84, or thereabouts.
Q. Have you done any projections as to what the blend price might be for June?
A. No, I have not, other than my usual little back of the envelope. But, no, I don't have those with me.
Q. Little back of the envelope, what was your little back of the envelope?
A. It will increase from May to June, depending on the order.
Q. And does your organization have any view on

the likely price mover in July relative to June for Class 1?

A. I don't know about my organization, but I personally expect that the mover for July may very well be higher than June.

Q. And at the moment, the industry expects those numbers to continue to go up or at least stay where they are for the month of June, correct, for some period of time?

A. They will either go up, go down, or stay the same.

Q. And is it not the case that most industry observers believe these prices will remain high at least to the fall of 2007?

A. That is correct. I was facetious before. But, yes, we are in a condition where generally people believe prices are rising and continue to rise for some period of time.

Q. And unlike previous periods, part of that is there is a shortage internationally for milk solids?

A. That's my understanding, yes, sir.

Q. And no immediate prospects for alleviating the supply as opposed to the demand?

A. I'm unaware of any of those prospects.

MR. ENGLISH: Just one second.

(A pause was had in the proceedings.)

MR. ENGLISH: I have no further questions. Thank you very much.

JUDGE HILLSON: Mr. Smith, do you have cross-examination? Come on up.

CROSS-EXAMINATION

BY MR. SMITH:

Q. Dan Smith. I just have a couple of questions about your Exhibit 21, page B3 --

A. Yes.

Q. -- and B4.

A. Yes.

Q. You used this to calculate out the volume -- the deficit production for the combined two orders; is that correct?

A. Yeah. A presumed deficit. It's -- I don't hold this out to be the actual deficit. And it is -- in fact, since you've broached the question, these data on B3 and B4 probably do not recognize the full enormity of the deficit in that these are monthly data. And we all know that milk produced on the first day of the month, if it's not needed for Class 1, is not available on the -- for using Class 1 on the 8th, 9th, 10th, etc.

So when you look at months as a snapshot, they kind of tend to wash out those daily effects, and you tend to -- when you look at a month, it looks like milk produced on the first day of the month is available on the 8th or 9th. So these numbers represent, in essence, from a practical standpoint, a conservative estimate of the deficit.

Q. I guess I'm happy to ask a question for Mr. Beshore.

MR. BESHORE: Thank you.

BY MR. SMITH:

Q. My question relates to the factor that you used between the two pages on the fourth column at the top on B3 for orders for the Appalachian and Southeast orders. You factored 125 percent, as you explained yesterday, to reflect the additional volume necessary to supply the basic supply. And on page B4, you used 115 percent.

Could you explain the difference between the two?

A. Yeah. The primary difference is the use of Class 2 milk in the Florida order, which is somewhat less than the milk used to produce Class 2 products in Orders 5 and 7. That represents the basic difference between those factors.

MR. SMITH: Okay. Thanks.

JUDGE HILLSON: Cross?

Okay. Time for redirect, Mr. Beshore.

REDIRECT EXAMINATION

BY MR. BESHORE:

Q. Mr. Sims, I would first like to address a question related to Mr. English's most recent questions concerning the quest for expedited consideration of this hearing, or so-called emergency consideration.

The fact that we're for the time being in a period of rising prices, as described in response to Mr. English's questions, does that alter in any way DCMA's view and your view of the need for emergency or expedited actions on this hearing record?

A. Absolutely not.

Q. Why not?

A. Several reasons.

No. 1, prices, even if they are going to increase at least in the short term, will not remain above long-term averages forever. So these proposals would provide those economic incentives beyond, hopefully, this current price environment.

Secondly -- and I guess this is in respect to the emergency issue -- one of the cruel ironies for the Southeast is that rising prices make attracting milk to the Southeast more difficult, in that the prices in the reserve supply orders whose prices are -- whose blend prices are generated more in response to changes in the Class 3 and Class 4 prices tend to move up faster than the blend prices in Orders 5, 6, and 7, whose prices are driven by the Class 1 price.

And since we have a lag in the classing -- or, excuse me, we have an advanced Class 1 pricing system, those blend prices escalate in the reserve areas faster than the blend prices escalate in the -- in the Southeast.

Milk moves on differences in price, not total price level. So as we move through these price increases, actually, the economic incentive to move milk from the reserve supply areas to the Southeast diminishes in the short term even though we have rising prices.

Q. Does the fact that there is an open hearing from last December on the national milk proposal to adjust Class 1, 2 pricing formulas, does that in any way change your request for expedited or emergency consideration of this hearing?

A. It does not.

Q. Why not?

A. Well, these issues are, I believe, separate and address the price relationships within the

Southeast and with -- between the Southeast and the reserve supply areas and would not be impacted by, I think, I'm sure -- I think that proceeding.

Q. Okay. Let me get to the question of the one-day touchbase and transportation credits, which Mr. English was also just asking a few questions about.

Milk that is subject to transportation credits may not be diverted under the present order regulations, correct?

A. *The actual provision is that when milk which* is delivered to a pool plant for which a transportation credit is requested, the actual pounds of allowable diversions are reduced so that, in essence, milk which is requesting a transportation credit, which is by definition milk which is delivered, does not earn an allowable diversion.

Q. So that being the case, isn't it, you know, a non sequitur in talking about leveraging touchbase and transportation credits, as I understood it to be, the premises of some of those questions?

A. There are many dynamics regarding how diversions are earned and how much, you know -- and those things. But I think the salient point is that when a transportation -- when a load is delivered and a transportation credit is requested on that, that particular delivery to a pool plant does not earn any diversion without any regard to the codified percentages in the order.

Q. Okay. I guess theoretically it could -- it could earn a touchbase?

A. Not theoretically; that would be a touchbase.

Q. That would be a touchbase?

A. Yes.

Q. But it doesn't earn any diversion credits?

A. Correct.

Q. Okay. Now, earlier on in your cross-examination -- again, it was probably in response to questions from Mr. English -- you used the colorful terminology of teleporting milk or Star Trek'ing milk, or something to that effect. Okay? And I want you -- I want to -- I want to ask you to elaborate a little bit about that, because I think it's an extremely important point to be understood in this record.

What were you talking about and why?

A. Analogous to the answer I just gave to a question, milk which is -- which is produced and available on the, you know, one day in a month is just basically not available three, four, five days later.

The same is true of milk of, you know, a load available in the Shenandoah Valley of Virginia can't be moved instantaneously or free when it's needed in Charleston, South Carolina. You know, there are time, dollars, and miles which create daily variations in need, and you can't use every available load to cover every available need simply because time and space don't allow it.

Q. And what does that, you know, factual dynamic of everyday marketing in the order, what does that mean in terms of interpreting statistical data in this hearing record?

A. Those data are also masked -- or those realities are also masked in taking a snapshot of a monthly picture. It presumes that every pound that is available at one spot is available for the entire marketing area, which is not true.

And, also, certainly it increases the need for a reasonable reserve in terms of how much milk is attached to an order and available -- made available and remains available to service the Class 1 needs.

Q. So if monthly data such as in pages B1 through B4 of your Exhibit 21, if monthly data of that nature is masked by the spatial and temporal dynamics that you've discussed, what does that tell us about those data? Are they understated or overstated?

A. They would understate the real day -- you know, the real deficit, which occurs day to day, would be greater than that calculated for a month in total.

Q. Because the spatial and temporal dynamics are masked by the aggravation of numbers?

A. Correct.

Q. With respect to DCMA's -- your proposal to reduce diversion limits in the orders but not to in Orders 5 and 7, not to the -- to any greater level, to any greater degree, is it your view, in view of the day-to-day realities, the masking of the numbers in terms of needs from aggregate data, is there any way you can serve those markets and reduce those diversion levels lower?

A. I believe the data are beyond compelling with regard to the day-to-day needs for balancing and reserve supplies and that the diversion limits proposed by DCMA, particularly as practically impacted by the zero limit on transportation credit delivery of milk, represent the barest minimum diversion limits that would accommodate a market wide pool and a reasonable reserve.

Q. And your point with respect to the zero credit for transportation, zero effect on diversion for transportation credit of milk is, as you described earlier, that those percentages in reality must be reduced by, roughly, a third to be real hard percentages?

A. In the month when transportation credits are affected, yes.

Q. In those months, yes.

Okay. Let me ask you a question or two about Class 2 prices, which have come up. That subject has come up a number of times most recently in Mr. English's questions about Class 2 premiums.

First of all, do you have any of the market administrator's annual summary? I'm looking at eight, which is Order 5 for 2006.

A. Yes, I have that.

Q. Okay. Can you just turn to Table 1?

A. Yes.

Q. Okay. First of all, in terms of the basic economics of Class 2 and pooling, in 2006, in Order 5, the Class 2 price was $11.76, correct?

A. That is the average for the year, yes.

Q. Average for the year.

Okay. Did the Class 2 volumes in the order add to the overall producer value? Are they higher or lower than the blend price?

A. They're lower.

Q. Okay. Which means that every hundredweight of Class 2 utilization in the market, the producer's blend price is reduced by some amount?

A. Yes.

Q. So the Class 2 average value for 2006 was, what, $3? And do the math. Class 1 minus Class 2. $3.22 less?

A. Yes, that's how I calculated it.

Q. So when you're delivering milk to a distributing plant which has both Class 1 and Class 2 uses -- which is common, is it not?

A. Yes, yes.

Q. Okay.

-- the producer, the suppliers have no control over how that milk is going to be used, correct?

A. Correct.

Q. But in Order 5, for instance, there was a $3.22 per hundredweight average difference in the value of the milk at the plant?

A. Yes, between one and two.

Q. Between one and two.

Okay. And for whatever reasons, whatever market factors are involved, you're unable to -- the DCMA agency is unable to make up that difference in value in over-order pricing, correct?

A. Have not up to now.
Q. Okay. In fact, your $1.75 premium on Class 2, setting aside any cost to get any milk there reflected in the, you know, that the premium is needing to defray, it doesn't even make -- it makes a little more than half the gap in value?
A. Well -- and since it's less than the Class 1, it even falls further behind, the Class 1 over-order price.
Q. Less than a Class 1 over-order price, it even falls behind?
A. (Indicates affirmatively).
Q. So is it fair to say that the supply in Class 2 milk in these orders in not a like lucrative enterprise for --
A. Generally not, yes.
Q. In that context, is it appropriate in your view that -- and it's a DCMA proposal, so I assume that it is -- that all of the volume that needs to be brought into the market from great distances subject to transportation credits should receive pay?
A. Yes.
Q. One final question on diversions.
Could Order 5 and 7, in your view, be served if the Florida diversion limit, which have been

referenced here, were applied in those orders?

A. No.

Q. I would like to request, Your Honor -- I have a copy of Mr. Sims' Exhibit 20, which have been annotated with the blanks for exhibit numbers, page numbers that he read into his testimony, being filled in. I would like to ask your permission to have him just look at it and make sure it's correct --

JUDGE HILLSON: That's fine.

MR. BESHORE: -- the complete version of Exhibit 20, and then substitute this one for the official record, so that when we all look at the exhibit on the Internet copies and everything, we have a document which has all the blanks filled in.

JUDGE HILLSON: That's fine. I haven't admitted 20 at this point, anyway. I was going to ask you about that if you wanted him to look at that.

MR. BESHORE: Okay.

JUDGE HILLSON: You can approach. And why don't you look at it, if you want to look at it. The only difference between that and the copy that we're working with are the blanks were filled in?

MR. BESHORE: Correct. I wanted Mr. Sims to confirm that so there is no question about that.

JUDGE HILLSON: I'm assuming yesterday's reporter took the exhibits with her.

MR. STEVENS: That can be replaced.

JUDGE HILLSON: Okay.

MR. STEVENS: We can work that out.

THE WITNESS: It appears to be correct.

MR. BESHORE: So I would request that Exhibits 20 and 21 be received, and I have no further questions.

JUDGE HILLSON: I will receive Exhibits 20 and 21 into evidence.

(Exhibit Nos. 20 and 21 received.)

JUDGE HILLSON: And I'll ask you, Mr. Beshore, to put a little tab on it, a yellow sticky or something, that they'll know that that's the official one to replace the one that the reporter took yesterday.

Is there anyone who wants to recross?

MR. STEVENS: Mr. English, what a surprise.

MR. ENGLISH: I promise a true recross.

RECROSS-EXAMINATION

BY MR. ENGLISH:

Q. If the Class 2 value is so much less than the Class 1 value and, indeed, less than the blend price, why deliver milk to plants with Class 2 use?

A. Because the deliverers can't make that decision. The plant operator determines what the use of that plant is and demands volumes that fill their needs. The deliverer doesn't get to choose which classification they deliver to. In fact, the market administrator provides a proration through a practical sense of that utilization to all suppliers.

Q. Doesn't this come back to the problem, though, that was testified about at the last -- at least the last -- not the last two hearings -- and you have knowledge that you haven't changed full supply contracts at any time. The full supply contracts provide for the milk, correct?

A. They have not been changed, to the best of my knowledge.

Q. Did we hear you correctly? Did you say that if the Florida diversion limits were adopted for Federal Orders 5 and 7, that Orders 5 and 7 would not be supplied?

A. I probably answered that a little too quickly.

Q. But that's what we heard, right?

A. Yes.

Q. Okay. Would you like to change that a little bit?

A. I can -- I'm not going to -- I'm not going to make a declarative statement that they would not be supplied. I believe they would be supplied inequitably. If they were supplied, there would be an inequitable sharing of the cost and an inequitable sharing of the Class 1 revenue and not a true market wide pool which would supply those. I can't say -- I won't declare that they wouldn't be supplied, but a lot of bad things would happen if they were.

Q. You're certainly not saying that in the absence of regulation, milk wouldn't flow to the plants?

A. I would not say that, that's correct. I probably spoke a little quickly with that answer.

Q. But you've said that you believe you've provided for a reasonable reserve. What is the reasonable reserve for these orders?

A. The reasonable reserve I provided -- that is provided based on our testimony is roughly 25 percent --

Q. Okay.

A. -- of pooled plant deliveries in the short season, and then it allows for the additional ten percent in the flush in December.

MR. ENGLISH: Thank you.

JUDGE HILLSON: Anyone else? Any more redirect?

You may step down, Mr. Sims. Since we're going to go until 6:30 tonight, I suggest two ten-minute breaks instead of one 15-minute break. And I suggest we take that break now.

(Brief recess was taken.)

JUDGE HILLSON: Let's get seated, and we can get started. All right, sir. Let's go back on the record.

Mr. Beshore, you may call your next witness, please.

MR. BESHORE: Thank you, Your Honor. We call Mr. Dale Lawson.

JUDGE HILLSON: Okay. Please raise your right hand.

DALE LAWSON,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Okay. Can you please state your name and spell it for the record?

THE WITNESS: My name is Dale Lawson, D-a-l-e, L-a-w-s-o-n.

MR. BESHORE: Your Honor, I would ask that

Mr. Lawson's statement be marked for purposes of identification as Exhibit 28.

JUDGE HILLSON: Okay. So marked.

MR. BESHORE: Okay. And there are marked copies available in the room for -- hopefully enough for everyone that may wish to follow along.

JUDGE HILLSON: Okay. Do you have any questions of him or --

MR. BESHORE: No, I do not.

Mr. Lawson, could you proceed with your statement, and then I may have a question or two after.

THE WITNESS: Thank you.

First off, I want to say I'm appreciative of being here today.

My name is Dale Lawson. I'm from Pauline, South Carolina. My farm consists of 300 cows. We raise 500 acres of crops, corn, hay to support the dairy.

I'm a member of Maryland & Virginia Milk Producers Cooperative Association, Inc. I serve as an elected member on the board of directors. And as part of my responsibilities of that board of directors, I serve on executive finance and milk marketings committees.

In addition, I serve as an alternate director for the Dairy Cooperative Marketing Association, and the Southern Marketing Association.

My milk is generally pooled on the Appalachian order. But like my neighbors, it could be pooled on Southeast or the Florida orders. Generally, my milk goes to the Class 1 plant in Spartanburg, but some days it moves many miles, as the market dictates and what needs to be done.

It would be a benefit to the producers, to the plant, and the consumers that the federal order price surface reflect more of the real cost for moving milk in the Southeast. For that reason, I'm here to testify in support of Proposals Nos. 1, 2, and 3 as offered by DCMA of which Maryland & Virginia Milk Producers is a member.

I testify today on behalf of Maryland & Virginia Milk Producers whose board of directors fully supports the hearing proposals offer by DCMA.

In my area, the northwest corner of South Carolina, we have seen the dairy farm rapidly decline. Ten years ago, we were the third largest producing counties in South Carolina. Today, there are five dairies left, and we are on the verge of losing two of those.

This same situation is true throughout South Carolina. And according to USDA numbers, productions from '06 to -- from '05 to '06 declined 3.45 percent. Milk production in South Carolina peaked in 1985 and today is approximately half that number.

Based on the information that I receive regularly from the cooperative, I don't think the whole -- the region as a whole fares any better than this.

People are moving into the Southeast. Milk production is declining. It's the cooperatives members, such as myself, that balance these supplies in the Southeastern order marketing areas.

The burden of balancing becomes greater for every person we gain and every pound of production we lose. The proposals offered by DCMA at this hearing will hopefully stem the tide of milk production declines in the Southeast and hopefully, possibly encourage new production.

Even if they do not, the price signal will be sent by increased producer blend prices through higher Class 1 prices, and reduced pooled diversions will make getting milk from the outside region into the Southeast easier.

The change in the transportation credit system will give my milk marketers an improved tool to use in getting supplemental milk to the Southeast.

We have seen on our farm what the increase in fuel costs have done to the hauling of milk. And these costs do not just apply to my farm; they apply to the cost of moving milk, whether we're moving them into the Southeast or among or around or in the Southeast.

The Class 1 price surface in the Southeastern orders need to be updated to take into account these large costs of moving milk.

Other parts of the country continue to see increases in milk production or at least not the decrease we're seeing in the Southeast. The federal order should be updated to keep them current with the cost of getting milk into the Southeast from the reserve supply region, as is the purpose of the order program.

We support the level of diversions and

touchbase days proposed by DCMA for the Appalachian and Southeastern orders. Milk which makes up the regular reserve supply for the order area deserves to be pooled and shared in the order's blend price, even if it doesn't deliver to a Class 1 plant every day.

Since Class 1 plants don't receive the same volume of milk every day, not every producer can deliver it to a plant every day. The reserve supplies are generally the furthest from the marketing area and should be the last ones moved into the marketing area for a Class 1 use.

It just makes sense for these reserve supplies to be able to share in the blend price if they truly are standby reserve supplies when the market needs the milk. It only adds to the balancing costs to require these producers to deliver extra days even in the short period when the milk is not needed.

Based on data I have seen introduced at this hearing, I can understand why the order needs diversion limits and touchbase days that the DCMA has proposed.

I heard another producer say that the diversion limits proposed by the DCMA, even though they are less than the current provisions, remain too loose and would continue to allow too much milk to be pooled on the Appalachian and Southeast orders by diversion, lowering Class 1 utilization on the order.

I also would like to participate in the federal order pool with the highest Class 1 utilizations possible, but I recognize that the diversion provisions need to be realistic and reflective of the need to balance supplies and Class 1 plants.

Since these receipts at the Class 1 plants vary so much day to day and week to week by substantial amounts, which was testified to earlier, I believe the DCMA proposal strikes a reasonable balance between the need to make pooling provisions not too wide yet allowing them pooling for the needs and justifiable reserve supplies.

Where I live in South Carolina, it is very costly to get milk to the Class 1 plants because South Carolina is simply not close to any reserve supply. The consumers of my state need and deserve a reliable supply of milk, and the order program should provide the pricing signals and or adjust the diversion limits, and touchbase requirements, and update the transportation credit provisions of Orders 5, 7 but utilizing his authority to take emergency action.

This concludes my statement. And, again, I appreciate the opportunity to testify.

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Now, Mr. Lawson, could you just -- you're a dairy farmer by occupation today, correct?

A. That's correct.

Q. Could you just tell us a little bit about your educational background and what, if anything, you did before you went into dairy.

A. I am -- I have a bachelor's degree from the University of South Carolina in business. I have a major in accounting. While at Carolina, I was a member of the honor accounting fraternity. I only worked one tax season with a CPA, and I thought I would get rich milking cows. Some things work, some things don't.

Q. Okay. With your accounting background and training and your business degree, could you just look at the exhibit that goes with your testimony, the last page of 28?

Now, you talked about this a little bit in your testimony, but can you just, perhaps, go over it a little bit with me.

A. Anybody that has a copy of it, if you look at the top portion of this sheet, it takes the current rules of the order system, and it takes the distance from my farm to given markets. It takes the hauling cost, and it takes the 2006 federal order blend price, and it projects what the net return is.

Under the top portion of it here, which is the current order, my milk will go to Spartanburg, which is about 15 miles away, which is where it should go. But in order to maximize the net returns from my milk, the next place that it should go is to Asheville, which is direct, Asheville, North Carolina, which I presume would be milk code, which is directly north, moving milk into the absolute opposite direction it needs to go.

And then you can see on across here, I believe Charleston is the -- is next to the lowest return. And that's the most deficit area that we have in the state of South Carolina.

Q. Okay. If you can hold there just for a minute. The line that is captioned at the left, preference rank, is that what you were just referring to?

A. Yes. Preference rank is ranked according to the net dollars received from my milk by the cooperative.

Q. Okay. So under the top half of the table, this shows that under the economics of the present location prices in the order, it shows the relative ranking and returns to those various plant locations?

A. That is correct. The closest plant ranks No. 1, and where my milk should go at the second rank is actually ranked No. 5.

Q. Okay. And when you say where your milk should go, you mean where you know that it's needed most?

A. That is the next closest, really, deficit market.

Q. Okay. Now, what's the bottom half of --

A. The bottom half is the same analysis with the proposals overlaid on it, which means my milk still -- they still take the same distances, and everything. They take the location adjustments and the net dollars, and then they rank it in highlights down here at the bottom.

My milk will still go to Spartanburg as it is -- as the No. 1 choice, but the No. 2 choice will be Charleston, which is where it logically should go if we're going to supply a market in an orderly fashion.

Q. So this shows, in essence, for your farm, how the proposals would change and make more logical, as you've described, the incentives to move milk within the Southeast to where it's needed?

A. That's correct.

Q. Okay. And you're familiar with the -- generally with the distances and the numbers and the data reflected in the exhibit?

A. That is also correct.

MR. BESHORE: Okay. I have no other questions for Mr. Lawson.

At this time, Your Honor, I would ask that Exhibit 28 be received.

Let me ask you just one final question.

BY MR. BESHORE:

Q. Mr. Lawson, the document that has been marked Exhibit 28, when you read it, there may have been some places where you -- your statement from the witness stand was not verbatim to what's in the exhibit.

A. Yes.

Q. Is the exhibit and the statements there, nevertheless, part of your intended statements of testimony?

A. They are. This is my first time here. I just had to ad-lib a little bit.

MR. BESHORE: Thank you.

JUDGE HILLSON: Does anyone else have questions of Mr. Lawson? Mr. English?

MR. ENGLISH: Charles English for Dean Foods Company and National Dairy Holdings.

THE WITNESS: I'm pleased to make your acquaintance.

MR. ENGLISH: I'm sorry?

THE WITNESS: I'm pleased to make your acquaintance.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Does your farm participate in the hundredweight program?

A. Yes, we do.

Q. Does Maryland & Virginia participate in the hundredweight program?

A. Yes, we do.

Q. And the hundredweight program, as a matter of policy, after it collects money from the voluntary participation of dairy farmers, uses that money to buy cows out including within the Southeast region, correct?

A. That is correct. I understand there are limits on the Southeast.

Q. But, nonetheless, they -- there is a limit, but there is also a lower limit. There is a regional basis to make sure that the cows are being removed nationwide, correct?

A. That is my understanding, yes.

Q. So how is participation in the hundredweight program consistent with the statement that you made on page 2: The burden of balancing becomes greater for every pound of production lost and every person that moves into the area?

Doesn't that just add to the burden?

A. It probably adds to the burden, but in reality, we probably would be better off if the hundredweight just drew cows out of the, really, pockets of the milk and did not pull them out of the Southeast.

Q. Okay. But, nonetheless, your organization participates even though it pulls out of the Southeast, correct?

A. Yes.

Q. On page 3 of your testimony in the first paragraph, you say, It just makes sense for these reserve supplies to be able to share in the limit price if they are, indeed, true standby reserve supplies for the market needs of the milk.

Are you saying that if such milk is not entitled to the pool benefits, you, your organization, the plants in the Southeast would be unable to attain it?

A. Say again?

Q. Are you saying in the absence of pooling those reserve supplies, that your organization, Maryland & Virginia and the plants that you supply would be unable to obtain that supplemental milk?

A. I don't know that I have the expertise to answer that question.

Q. Okay. Thank you.

And turning finally to your last page. That's not a separate exhibit number.

MR. BESHORE: No.

MR. ENGLISH: It's --

MR. BESHORE: Part of 28.

MR. ENGLISH: -- part of 28. Thank you, Mr. Beshore.

BY MR. ENGLISH:

Q. One of the significant changes from the present to the proposed, as you see it, is that Charleston moves up from being the first -- the fifth preferenced rank to the second, correct?

A. That's correct.

Q. Now, presently, the plant -- plants in Charleston have the same price as a plant fairly nearby in Florence, correct?

A. I think that would be correct.

Q. If a plant in Charleston is competing against a plant in Florence and now has a 30 cent per hundredweight disadvantage and loses sales as a result, what happens to the preference if the Charleston plant no longer needs your milk?

A. I'm sorry, say that again. I have to think through what you're asking me.

Q. What I'm asking is what happens to the efficiency of the movement if, as a result of changing the relationship between Florence and Charleston, Charleston loses a sale and no longer needs milk from Pauline, South Carolina?

A. I think as deficit the Charleston area is, that is not likely to be the scenario.

Q. Charleston --

A. There is not a dairy farm within 60 miles of Charleston, I don't think there is.

Q. There is also not a customer east of Charleston, is there?

A. Not that I'm aware of.

Q. So if you raise the price and the Charleston plant loses its ability to compete to the north and to the west -- and actually, as I remember, Charleston is sort of on the coast and to the south it's a little hard, too, to sell -- who do you expect Charleston to pick up as customers once you've increased their price?

A. I don't know that I'm privy to that information.

MR. ENGLISH: Thank you very much, sir.

JUDGE HILLSON: Does anyone else have any questions of Mr. Lawson?

I will receive Exhibit 28 into evidence.

(Exhibit No. 28 received.)

JUDGE HILLSON: And thank you for testifying. You may step down.

THE WITNESS: Thank you.

JUDGE HILLSON: Mr. Beshore, you may call your next witness.

MR. BESHORE: I call Mickey Childers.

JUDGE HILLSON: Please raise your right hand, sir.

MICKEY CHILDERS,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Please state your name and spell it for the record.

THE WITNESS: Mickey Childers, M-i-c-k-e-y, C-h-i-l-d-e-r-s.

JUDGE HILLSON: And, Mr. Beshore, I assume you want me to mark that as Exhibit No. 29?

MR. BESHORE: I would, yes.

JUDGE HILLSON: Okay.

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Your statement, Mr. Childers, has been marked for identification as Exhibit 29. Would you care to present it?

A. Yes, sir.

Q. Would you proceed, please?

A. Yes, sir.

STATEMENT BY MICKEY CHILDERS

THE WITNESS: My name is Mickey Childers. My wife and I live at 277 Blue Springs Road, Somerville, Alabama 35670.

Judy and I operate Burden-Childers Farms, a 700 milking cow dairy in partnership with her father, and my two sons, Jim and John. Our farm spans four generations that began milking cows in 1945. It goes without saying that we have witnessed numerous changes in the dairy industry, from the days of milking in the flat barn into pails, pouring the milk into ten-gallon cans, cooling it in the spring water, hauling the ten-gallon cans 20 miles to meet the Carnation truck to be shipped off to be processed.

Today we milk 50,000 pounds of milk onto a trailer, and it will be processed tomorrow. Times have changed.

I'm a member owner of Dairy Farmers of America, Incorporated, DFA, and market all my milk through that cooperative. I am a director representing local dairy farmers on the DFA Southeast Area Council Board, and also on the corporate board of directors.

Our cooperative board actively discusses marketing issues at every board meeting, and my testimony reflects not only my own opinion but also those of the producers I represent. Our board has discussed the proposals being presented here today and endorses the position of DCMA.

I have attended and testified at federal order hearings in the past and appreciate the opportunity to be here today to represent the views of more than 2,900 producers in the Southeast, the largest single block of producers in the region.

I do not claim to have all of the technical expertise of Mr. Sims and some of the other witnesses, but I do have some understanding of how orders work and how they are supposed to benefit producers, processors, and consumers.

I understand that the federal order system does not guarantee my neighbors or me a profit or even a market. But it should determine and enforce the provisions to market milk in the most economical and equitable way.

This should mean that the consumers get a good product at the most reasonable price possible, that processors get adequate supplies at prices and terms that are transparent and reflective of the market conditions, so they can focus their businesses on processing and delivering products, and that dairy farmers share in the market returns equally, and that those returns reflect a competitive cost to supply milk to consumers and are shared among all farmers.

In the Southeast, production conditions are stressful to cows, making milk production a difficult enterprise. This fact is pretty clear when you consider that there have been few large scale western style dairies planted in the Southeast. There are several in the lake states and many in the western Kansas and New Mexico and west Texas. There, conditions are just more conducive to these types of operations.

Because of my interaction with the DFA boards and our attempts through the DCMA to source supplemental milk supplies, I am aware of more than one such operation that has considered a Southeast farm site and simply chosen to locate somewhere else, where the profit margins were more predictable and the dairy conditions better.

We have excellent markets, a growing population, and a good product to sell in the Southeast, but a difficult time making margins high enough to maintain production to meet the needs of the area.

My farm generates more production per cow than ever before. But the Southeast industry will be hard pressed to achieve the continuous high levels of output per cow that are in other regions of the country simply due to the climatic conditions in the Southeast.

Because our local milk production continues to shrink, the Southeast brings milk into the market nearly every day of the year. This is an expensive process. I review and discuss these costs monthly at our board meetings. Because of the difficult production conditions in the Southeast, our seasonality is more severe than many other areas, and this affects our costs to supply the market.

Rising fuel costs have a big impact on our balancing costs, because we import milk from long distances every day. Our plant customers, many of them are sitting in the hearing room today, also deal with efficiencies.

There are fewer milk plants now than when I started dairying, and most of them are much larger. When they break down or face a holiday or reduce their volume because of a change in school schedule, the pounds of milk they don't need becomes a lot of milk to take care of.

My co-op has taken steps to improve our situation. We have made better strides in controlling our marketing costs. We coordinate dispatching activities from New Mexico to Indiana to Miami to Pennsylvania every day. We attempt to bring the most economical supplies first and the most costly last.

Where we make commitments for milk volumes, we attempt to balance them in the home market, not here in the Southeast. Bear in mind it is not easy to get commitments for 200 loads for milk in one day. You must be a steady buyer and commit for the whole year to secure that much. There are days when we need the whole 200 loads and days when we need much less.

If we get an order, we assume our customer wants the load, and we certainly want to sell it. Also, the members of DCMA work together to move our own local milk supplies as efficiently as possible.

My farm produces approximately one load of milk a day. My milk may be sent to Winter Haven, Florida, Dothan, Alabama, or Birmingham, Alabama, on any given day depending on where the milk is needed.

We work together to reduce marketing costs, but we are not the whole market. And I know that while everyone gets to share the order benefits equitably, after all the blend price is announced for everyone, not everyone shares in the marketing costs.

This is one of the reasons why we are here today, to ask the secretary to look at the Southeast orders and the costs of serving them and determine if the proposals we have made are a fair way to address the costs and serve the market.

I'm not an expert in order language, but I do understand the basics of what we're doing. The provisions that deal with touchbase will help us in saving delivery costs. I know it is hard to estimate how much, because in spite of the number of times I've asked Mr. Sims or Ms. Mosley how much, they can't figure it out. They won't give me an answer. I don't think they know.

But intuitively, we know there is a benefit. For those that claim it will expose the market to more milk than it needs, we can tell them the diversion limits will help control that.

The data from the market administrator shows that less milk can be attached to the pool than before and blend prices will be increased. Also, both of these factors are adjustable by the market administrator, and we have great faith in her ability to keep things under control.

The changes in the transportation credits will also help us to offset marketing costs by being better able to recover haul costs. Both the higher rates of assessment and the pay back on full loads will cover more of the costs, but not all. And as a local producer, I don't want it to cover them all.

Finally, the changes in the differentials will help put more dollars in dairy farmers' pockets. The look at differentials is long overdue. I realize changes like this are hard to make, but they should have been made sooner. Price changes are never 100 percent accepted. Ask any of the dairy farmers in the room today about costs to feed, and you will quickly get an education.

But our marketing and sales personnel have studied them, discussed them with the market administrator personnel, and we are satisfied they are a good package. They are higher the deeper one travels into the Southeast, matching the areas that are more costly to supply.

We trust that AMS, Agricultural Marketing Service, personnel listening to the testimony here today can make sure the right price changes take place in the right cities.

The combination included in this package do not please everyone, including some who may be speaking here this week. It is not perfect in the eyes of all my dairy farmer neighbors either. It does not address all of our key needs, but it does improve many of the day-to-day marketing situations our organizations face.

We have to make compromises to move forward. If every complaint stopped the process, we would never get any changes. I know from my associations in the industry that some dairymen think some of these proposals go too far, while others of them think not far enough. But I have not seen a comprehensive set of proposals offered by anyone else that does not -- that does as much good as these.

If those here who are negative have a complete set of proposals to offer, they would have been considered. But I did not see one, and this is the one that we have before us today to deal with.

My neighbors and the producers I represent think these proposals are a step in the right direction.

Changes in the Southeast have been slow in coming. Most of us would like to see this package of proposals happen as soon as possible, so we support moving the hearing along quickly.

Thanks for the chance to give you my views. I'll take any questions you may have and pass the hard ones on to Mr. Sims.

MR. BESHORE: Okay. Thank you, Mr. Childers.

The witness is available for cross-examination.

JUDGE HILLSON: Okay. Anyone have questions of this witness? Mr. English, come up.

MR. ENGLISH: Charles English for Dean Foods and National Dairy Holdings.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Sir, you stated that you have not seen other proposals. I take it that means you have not seen proposals that Dean Foods submitted at the beginning of this month that the secretary received on or about the same day that this emergency hearing notice was signed.

A. No, sir, I have not.

Q. Okay. And that the secretary indicated, except for one of those proposals, they could all be considered. So you have not seen that; therefore, your testimony here did not consider that. Correct?

A. No, sir.

MR. ENGLISH: Thank you, sir.

JUDGE HILLSON: Any other questions?

Okay. Mr. Childers, thank you very much for testifying. You may step down.

And I will receive Exhibit 29 into evidence.

MR. BESHORE: Thank you.

(Exhibit No. 29 received.)

JUDGE HILLSON: That was the last witness you wanted to call?

MR. BESHORE: Yes. We have no further questions.

JUDGE HILLSON: I guess it's your turn, Mr. English. Do you have a witness?

MR. ENGLISH: I have a motion, first. I've got to make a motion.

JUDGE HILLSON: Make your motion.

MR. ENGLISH: Your Honor, on behalf of Dean Foods Company and National Dairy Holdings and pursuant to 7 CFR 900.7, which is an oral motion before a judge, as long as you haven't certified the transcript yet, we have a motion to terminate this proceeding for lack of evidence consistent with the secretary's policy concerning the adoption of Class 1 differentials.

Dating back at least to the decision in the Fifth Circuit -- I'm sorry, the D.C. Circuit in

1979, in Schepps Dairy vs. Bergland, with respect to the establishment for a proper mechanism for the establishment of Class 1 differentials, when the secretary argued, and prevailed, some of the mechanisms presented today are not appropriate for setting prices. And that is the mechanism of packaged milk between plants.

Moving next to the fact that in April of 1985, the secretary issued a decision in order 126 in Texas with respect to the establishment of differentials within the then Texas order; that is to say, an increase in the class of differential between Dallas and Houston of 36 cents -- from 36 cents to 54 cents.

And the handlers in that order in Houston promptly sued. And Mr. Stevens and I were down in -- before Judge Hughes in Houston. And in that proceeding, the secretary took a position that the proper mechanism for determining relative prices was to compare a plant location to -- and other plant locations, to their relative reserve supply areas.

From there, the secretary repeatedly, in Indiana, in New Mexico, and in Arkansas, was consistent with that kind of formulation. And that culminated in the spatial model adopted by Cornell and used by the secretary in federal order reform in 1999.

The proponents, by their own testimony, have not done an analysis consistent with that to which the secretary has said is the proper mechanism for determining relative Class 1 prices.

The proponents have not provided any analysis with respect, for this record, with respect to the treatment of plants outside the order -- orders and plants inside the orders.

The proponents have used as a smoothing mechanism, which we may appreciate but it may not be lawful, a mechanism for recognizing plant-to-plant values for packaged milk.

And by their own admission, without precedent, the proponents have started at the end, Miami, and worked their way backwards to work out what the prices are, none of which is consistent with the secretary's position in the Schepps vs. Bergland case and in all of the hearings that preceded thereafter, whether they were the 1985 Farm Bill, whether they were the 1990 hearing, whether they dealt with Clovis, New Mexico, with Goldstar in Little Rock, with Schepps Dairy in

Dallas. None of that is consistent.

And, therefore, the Class 1 differential portion, which they say is linked to everything else, must fail and the hearing should be immediately terminated.

Thank you very much.

JUDGE HILLSON: I'm presuming that some proponents want to speak to that. I'll let you go first, Mr. Beshore.

MR. BESHORE: Thank you, Your Honor.

Your Honor, the motion made by Dean and NDH has no merit whatsoever.

First of all, the packaged milk -- as Mr. Sims clearly testified, delivery of packaged milk was not a price establishment issue. It was a check, in essence, with respect to the prices established primarily from the bulk milk movement. And that's clear in his testimony. So as far as the Schepps, either the D.C. Circuit case or the, you know, the Texas case are concerned, we're not doing what was, you know, what was advocated in those cases.

More importantly, or significantly, the policies that, you know, are reflected for interpretation of prices -- the setting of prices at location points which is what the act permits, the establishment of location prices, the policy that the secretary has established for that can be adjusted by him over time with changes in time.

There is certainly nothing in the Marketing Agreement Act that says that the Cornell, you know, metric model developed sometime in the 1990s is cast into the -- into the fiber of the act, which was written in '37.

I mean, the secretary has more than enough authority to promulgate prices on the basis of a record which reflects current realities, current technologies, current competitive conditions, current supply and demand.

And the proposals of DCMA and the testimony of Mr. Sims and others here are -- provide a basis that's fully within the authority of the secretary to adjust these prices. And the motion should be denied, without any merit whatsoever.

JUDGE HILLSON: Mr. Stevens?

MR. STEVENS: With all due respect to my eloquent colleague --

JUDGE HILLSON: Which one is?

MR. STEVENS: Well, they're eloquent, certainly. But Mr. English is the one I'm speaking to at this time.

I have to agree with Mr. Beshore. There is some history on this certainly, but the secretary is free to change his position in these matters.

This record is going to be reviewed. Certainly, the parties are able to make any legal arguments they want in briefs. And those are subject to your review until such time as you certify the transcript and then they're subject to review by the administrative officials who have the final authority to rule on any motions that are filed in these hearings, as they do when they issue the decisions.

So I agree with the points made by Mr. Beshore. This record should continue. The hearing should continue. The legal positions can be staked out in the briefs, considered, and dealt with during the course of this proceeding.

JUDGE HILLSON: Well, given that the secretary has decided to go ahead with this hearing in the first place and full well knowing the type of evidence that was already existing, I believe, I'm going to deny the motion.

Certainly, the secretary can -- the secretary decided to hold the hearing; the secretary is the one who makes the decision in this hearing. And I think we're going to continue with the hearing, so I'll deny the motion.

And you're invited, Mr. English, to call your first witness.

MR. ENGLISH: Thank you, Your Honor.

Actually, as I stated at the outset, two of the people whose names I provided are not my clients, but I certainly asked for the opportunity to put their names out. I think Mr. Hitchell wanted to go next, and he is not my client.

JUDGE HILLSON: I see.

MR. ENGLISH: But, therefore, he is not really my witness, although he's on my side.

JUDGE HILLSON: You gave me a list of witnesses that --

MR. ENGLISH: Yes, I think I did. But at the outset, I made it clear that I represented Dean Foods and NDH, and I didn't want the record to reflect otherwise.

JUDGE HILLSON: So Mr. Hitchell will be testifying on his own, then?

MR. ENGLISH: Yes. Mr. Hitchell --

JUDGE HILLSON: He has a written statement, and he'll be reading that?

MR. ENGLISH: Yes.

JUDGE HILLSON: Okay. Thank you.

Come on up, Mr. Hitchell.

JOHN HITCHELL,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Can you please state your name and spell it for the court reporter?

THE WITNESS: My name is John Hitchell. J-o-h-n, last name is H-i-t-c-h-e-l-l.

JUDGE HILLSON: And, Mr. Hitchell, you have a written statement which, I assume, you are going to read and you want it in evidence. I'm going mark it at this point as Exhibit 30. And you may testify.

STATEMENT BY JOHN HITCHELL

THE WITNESS: Thank you.

I'm employed by the Kroger Company Manufacturing Group as a general manager for Raw Milk Procurement. I'm appearing in opposition to the proposed Class 1 differentials in Proposal No. 1.

The Kroger Company operates four fluid distributing plants that are regulated handlers in the federal orders under discussion at this hearing.

Winchester Farms, located in Winchester, Kentucky, and Westover Dairy, located in Lynchburg, Virginia, are regulated in Order No. 5. Heritage Farms Dairy, located in Murfreesboro, Tennessee, and Centennial Farms Dairy, located in Atlanta, Georgia, are regulated in Federal Order No. 7.

The Kroger Company believes that the implementation of the proposed Class 1 differentials will disrupt traditional pricing relationships dating back to the Class 1 differentials mandated in the 1985 Farm Bill and reestablished during the federal order reform in 1999 between fluid handlers located inside and outside Federal Order No. 5 and Order 7 and place our dairy plants in an unacceptable competitive situation.

Winchester Farms has operated since 1982, and the plant has serviced the Cincinnati markets and part of West Virginia within Federal Order 33 and the Louisville Order No. 5 market since its inception. The Order 33 sales represent approximately 53 percent of the plant's sales, Class 1 sales, and the sales of Order 5 represent

44 percent.

The relationship between Winchester Farms and their competitors located in Louisville and the Cincinnati market has remained unchanged since the increase in the differentials mandated in the '85 Farm Bill and the adjustments in the Class 1 differentials implemented in 2000, with the conclusion of the federal order reform process in 1999.

The proposed increase in Class 1 differentials contained in this hearing would raise the differential at Winchester 40 cents a hundredweight. The Louisville differential would be increased only 10 cents per hundredweight, and the differentials in the Cincinnati markets are untouched by this proposal.

Implementation of these differentials would place Winchester Farms in an unacceptable, uncompetitive position compared to their fluid competitors located in Order 33 and Louisville.

The Kroger Company is requesting that the Class 1 differential for Winchester Farms and Louisville, Kentucky, remain at the current level of $2.20 per hundredweight in order to maintain the traditional spread in Class 1 differentials between Winchester and their competitors in Cincinnati, West Virginia, and Louisville.

At the minimum, the Kroger Company requests that the Class 1 differential increase at Winchester be no greater than the proposed Class 1 differential increase at Louisville of ten cents per hundredweight. The proposed increase in the Class 1 differential at Westover Dairy is 40 cents per hundredweight.

Westover has serviced a Class 1 fluid customer located in Order 1 for over six years. Implementation of these proposals would place Westover in an uncompetitive position compared to the fluid processors located in Order No. 1, which is not being addressed at this hearing and will not receive an increase in Class 1 differentials.

In addition, dairy farmers located in Mid Atlantic states produce the vast majority of the raw milk supply to Westover Dairy. The current pricing structure is generating a sufficient income to dairy farmers to supply the majority of Westover's raw milk requirements.

Implementation of the proposed differential at Westover Dairy will place the plant in an uncompetitive situation compared to fluid processors located in Order 1 who are in a position to service their customer. In addition, the current pricing structure has maintained the local milk supply for the plant. For these reasons, the Kroger Company requests that the Class 1 differential remain at current level $2.80 per hundredweight.

The Kroger Company has operated Heritage Farms since 1980. When Heritage Farms opened, the plant serviced the Atlanta market. The sales within the Atlanta market continued to increase to a level that justified the Kroger Company making a significant capital investment in 1996 when we opened Centennial Farms Dairy.

Part of the justification for the facility was based on the traditional spread of Class 1 differentials between Murfreesboro, Tennessee and Atlanta, Georgia, of 50 cents per hundredweight.

The proposed increase in the Class 1 differential at Heritage is 30 cents. The proposed increase in Class 1 differentials at Centennial Farms is 70 cents per hundredweight.

If adopted, as proposed, the spread of Class 1 differentials between Heritage Farms and Centennial will increase from 50 cents to 90 cents price levels between plants regulated in Order No. 5 and/or Order No. 7 and produce competitive inconsistencies where none exist today.

For these reasons, the Kroger Company requests that the secretary not adopt the proposed changes in Class 1 differentials in Order No. 5 and Order No. 7.

Thank you.

JUDGE HILLSON: Does anyone have questions of Mr. Hitchell?

Go ahead, Mr. Beshore.

EXAMINATION

BY MR. BESHORE:

Q. Good afternoon, John.

A. Good afternoon.

Q. I just have a couple of questions.

The references to the '85 Farm Bill in prices that were set at that time, is your memory the same as mine that that bill said something to the effect that the prices that went into effect then were good for two years and after that the secretary could hold hearings and make adjustments in them?

A. Certainly, they have made -- I don't know about the two years. That I do not recall. As we all know, adjustments were made in 1999, 2000. And as we know, the basic spread between the plants within the markets did not change between the 1985 numbers and the 2000 numbers. The level certainly increased in all of the markets, but the basic spread between the plants remained basically unchanged, maybe a penny or two here, but nothing drastic.

Q. Okay. With respect to the Lynchburg sales into Order 1: Now, Order 1 is north of Lynchburg?

A. That is correct.

Q. Okay. And you have a plant in the Order 1 area itself, do you not?

A. That is correct.

Q. Okay. Couldn't you just service those accounts from your plant in Pennsylvania rather than the plant in Virginia?

A. That is the account that is serviced.

Q. But you've got a plant -- you've got to help me with that. You're servicing your Turkey Hill stores with certain products out of Lynchburg?

A. Fluid milk, yes, that is correct.

Q. Okay. Has Conestoga been closed?

A. No.

Q. Okay. So you're servicing it both out of the plant in Order 1 in Pennsylvania, Conestoga, and out of Lynchburg?

A. That's correct.
Q. Okay. Couldn't you service it completely out of Conestoga?
A. No, could not.
Q. Lack of plant capacity?
A. That's correct.
Q. When were the -- you refer to investments in the Centennial Dairy in Atlanta. When were those investments made?
A. 1996 is when the plant was open. The plant was purchased in 1995, I believe.
Q. Okay. So that was an existing plant?
A. It was an existing plant that was not operating. It was -- it was a plant that had been a dairy plant, was closed, and we purchased it from the previous owner.
Q. Okay. And when you bought it in '95, it certainly wasn't in reliance upon what you knew to be the prices in 2007, right?
A. That is correct.
MR. BESHORE: Okay. Thank you.
JUDGE HILLSON: Does anybody else have questions?
Mr. English. Go ahead.

EXAMINATION

BY MR. ENGLISH:

Q. My name is Charles English. I'm here for Dean Foods Company and National Dairy Holdings.

Mr. Hitchell, how long have you been in this business?

A. When I had hair. I have been in the business -- I've worked for Kroger since 1980. I've had this job since 1987.

Q. And you've attended a number of federal order hearings, correct?

A. Yes, I have.

Q. And testified in a number?

A. Yes, I have.

Q. And a lot of the issues that you considered are competitive conditions both vis-a-vis other plants and the ability to get milk into your facilities, correct?

A. That's correct.

Q. And could you foresee circumstances if the proposals are adopted where an operator of a plant nearby Federal Orders 5 or 7 but outside 5 or 7 in, say, 32 or 33 would look at -- and by the way, let's say it's a plant that already has sales in the Orders 5 or 7 or both.

And do you think if these proposals were adopted, such facilities would have an opportunity to look at being pooled under Orders 5 and 7 as an alternative to be pooled under 32 and 33?

A. Certainly. They would certainly have to be given the opportunity to do so, or there would be the temptation to do so.

Q. And temptation to do so would involve, of course, looking for accounts to serve at competitive prices, correct?

A. That's correct.

Q. And the adoption of Proposals 1, 2, and 3 would provide such opportunities because, as you testified, your facilities would face higher costs but theirs would not, correct?

A. That is correct.

Q. And that's what you mean, near the end of your statement, when you say, As we have attempted to illustrate the increasing Class 1 differentials in the Southeast in isolation will generate competitive discrepancies with the surrounding market; is that correct?

A. That's correct.

Q. And that's not just theoretical; that's what happened in the past. We've seen that in this industry, correct?

A. Yes, that is correct.

Q. With respect to any emergency, do you believe there is an emergency here?

A. I believe this situation has taken literally the time that I have had this job in 20 years to get to the point we are today. So this is not something that's happened overnight. I questioned the emergency basis of this hearing, and I would certainly think that we could spend some more time thinking of some -- of some other situations and some other potential ways to solve this problem than to put pooled plants in an uncompetitive situation versus facilities, especially on the edge as I've said in my testimony, which are not going to get Class 1 differential increases and will put us into competitive -- put us in an uncompetitive situation.

We are sensitive to the plight of our suppliers and dairy farmers' situation. But I would hope that everyone sitting in this room would not want to put their customers in an uncompetitive disadvantage. And implementation of these proposals will embark -- especially Winchester and Westover -- will put us in that position.

Q. And it would not surprise you if plants operated by other entities had similar situations as you've described for your operation?

A. I certainly don't want to testify or base it on anyone else's other situation. But my guess is other people will be testifying that to have plants that are in close proximity to ours, they would have similar concerns.

MR. ENGLISH: Thank you very much. That's all I have.

JUDGE HILLSON: Any questions from the AMS table?

MR. ROWER: No.

JUDGE HILLSON: Do you want to redirect, Mr. Beshore? I mean, not redirect.

MR. BESHORE: Not redirect. Just one other --

JUDGE HILLSON: All right.

MR. BESHORE: -- detail or two about the Lynchburg sales in Order 1.

FURTHER EXAMINATION

BY MR. BESHORE:

Q. For clarification of the record, the Turkey Hill stores are Kroger stores?

A. Turkey Hill is a wholly owned subsidiary of the Kroger Company. It's an LLC. We own -- we have the majority ownership, that's correct.

Q. Okay. And they're convenience stores throughout the Mid Atlantic area?

A. That's correct.

Q. And are the majority of those in Pennsylvania?

A. I really don't know. I believe so, but I'm not real sure.

Q. In any event, that's where the Turkey Hill plant, which is a Kroger plant, is, is in Pennsylvania?

A. That is correct.

Q. Okay. And it's a pool plant under Order 1?

A. Yes, it is a pool plant under Order 1.

MR. BESHORE: Okay. That's all. Thanks.

JUDGE HILLSON: Go ahead, Mr. English.

MR. ENGLISH: I'm sorry, Your Honor. I've got one.

FURTHER EXAMINATION

BY MR. ENGLISH:

Q. Mr. Hitchell, the proposals are described as temporary. And leaving aside how long temporary might be, to the extent the competitive situation that you described results in lost sales, are lost sales temporary?

A. Generally, no. Generally lost sales are fairly permanent.

MR. ENGLISH: Thank you.

JUDGE HILLSON: Any questions, Mr. Smith?

MR. SMITH: Yes.

JUDGE HILLSON: Come on up.

EXAMINATION

BY MR. SMITH:

Q. Good afternoon.

A. Good afternoon.

Q. My name is Dan Smith. I'm representing the Kentucky Dairy Development Council, the Georgia Milk Producers, and North Carolina Dairy Farmers Producers Association, and U.S. Milk.

I'd just like to ask you if you could explain in a little more detail the competitive disadvantage that the plant in Winchester will be placed at, how raising the Class 1 price 40 cents in the market would affect the sales of milk in Cincinnati and surrounding areas?

A. The Class 1 differential would remain unchanged for our competitors that are based in Cincinnati, less than 100 miles away. We will be receiving a 40 cent per hundredweight increase in Class 1 differential that we will pay on the milk since we're pooled on Order 5.

Our competitors in Cincinnati and our

competitors in the market surrounding the Federal Order 5, they could also have a lower Class 1 price potentially, can shift milk into the market area, will not have that type of price increase. That is a substantial price increase of well over two cents a gallon.

Q. That's the base of the change. How do you think that would affect sales percentage-wise if you could just fill out the picture of how the milk would move into the Cincinnati market and the degree to which you think the sales will be affected by that two to three cent increase?

A. The sales -- it would be difficult to tell you how the sales would move out. Basically, we would be in an uncompetitive situation and then not be able to meet the same type of raw cost that our other competitors would have in Cincinnati. Hence, in that case, we could lose sales out of our plant in Winchester going into Cincinnati. And the percentages, I really don't know. I hope we don't have to face that. That's the point of my testimony.

Q. You described a theoretical impact, which you've also described that you've had stable marketing environment for over 20 years. And so the question is whether the -- your established relationships with your customers would be so affected by this amount of change in the base price. That's the question.

A. It would be.

MR. SMITH: Okay. Thanks.

JUDGE HILLSON: Another question?

MR. BESHORE: Just a follow up.

FURTHER EXAMINATION

BY MR. BESHORE:

Q. Your customers are your own stores; is that correct?

A. That is correct. Not totally. We also have sales outside of the company as well.

JUDGE HILLSON: Did you have a question, man in the back? Come up here and identify yourself, please.

THE WITNESS: Gladly. My name is Blake Sumners, and I'm a dairy farmer.

Can I go ahead?

JUDGE HILLSON: You want to ask him a question?

THE WITNESS: Yes.

EXAMINATION

BY MR. SUMNERS:

Q. Aren't there over-order premiums that can maybe be used that could be negotiated with the co-op supply in your plant --

A. There are over-order premiums.

Q. -- so you can keep competitive with other plants? Isn't this one of the things that co-ops do for milk plants all the time, make sure that they're in a competitive situation with other milk plants --

A. Well --

Q. -- credits, and so forth?

A. There are credits, yes.

Q. Well, wouldn't that take care of 40 cents?

A. I guess that's something I'll have to discuss with my milk supplier depending on the outcome of the hearing.

Q. So raising the Class 1 differential when you've got over-order premiums a lot more than 20 or 40 cents, isn't there negotiating room to take care of all that?

A. Historically, credit has not been granted on differences in over-order in Class 1 differentials.

Q. The competitive credit has been granted, hadn't they?

A. Not on Class 1 -- not on differences in Class 1 differentials. Historically, no, that has not happened.

Q. Well, can you explain how they work?

A. Yeah. If the over-order premium is different from one market that we sell into than another, we get a credit base on the difference of over-order premium.

Q. But it has nothing to do with the --

A. Historically, no.

Q. -- federal order structure.

A. Historically, no.

Q. But that is possible?

A. We'll see.

MR. SUMNERS: That's all.

JUDGE HILLSON: Do you have a question, Mr. Smith?

MR. SMITH: I'd just like to follow up.

FURTHER EXAMINATION

BY MR. SMITH:

Q. I'm aware -- and I'm a Yankee from the north, so it takes me a while to get my mind here in the south, but I'm aware that you supply your own plant. So the real question is whether the margins between the relative stores are enough to absorb this two to three cent increase taking into account premiums as well as the need for more milk.

And is it your testimony that -- let me ask you that, as I ask beyond theoretical to the actual, how the price increase would play out. It's against your competitors in the supermarket business; is that correct?

A. My raw cost would be higher than the processing competitors by 40 cents than it would in Cincinnati. That's my answer.

Q. And translated to per gallon, that amount is?

A. Two, two and a half cents.

Q. And how that amount of milk -- that amount of increase, your testimony is, would -- is enough to move customers between supermarkets?

A. Yes.

MR. SMITH: Thank you.

JUDGE HILLSON: I'll receive Mr. Hitchell's written statement as Exhibit No. 30. That's received into evidence.

(Exhibit No. 30 received.)

JUDGE HILLSON: And you may step down, Mr. Hitchell.

THE WITNESS: Thank you.

JUDGE HILLSON: Before I forget, I've been -- I do want to make sure I accommodate any other producer witnesses who haven't spoken up yet and will only be here today.

Who is next on the list of witnesses, Mr. English?

MR. ENGLISH: Your Honor, as it turns out, Mr. Rutherford, from International Dairy Food Association, has gotten here. And notwithstanding the fact that we thought he would go tomorrow, he is prepared to go today.

JUDGE HILLSON: Are you calling him, or is he --

MR. ENGLISH: He's on his own behalf. I'm just handing out his statement, but I am -- and there are -- there are -- because of time constraints, because we did not expect him to be on today, we have a limited number of copies. But we have a copy for the folks at the government table, a copy for you and the court reporter, and --

JUDGE HILLSON: Okay.

JOHN RUTHERFORD,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Please state your name and spell it for the record.

THE WITNESS: My name is John Rutherford, R-u-t-h-e-r-f-o-r-d.

JUDGE HILLSON: And, Mr. Rutherford, I'm marking your written testimony as Exhibit 31. And you may testify.

STATEMENT BY JOHN RUTHERFORD

THE WITNESS: My name is John Rutherford. I have worked for the International Dairy Foods Association for nearly seven years and currently serve as senior economic research analyst, where I conduct analyses of economic policies in dairy markets.

The Milk Industry Foundation is a constituent organization of IDFA. The 115 member companies of MIF process, distribute, and market approximately 85 percent of the U.S. fluid milk, yogurts, cottage, sour cream, soft cheeses, eggnog, cream, dairy dressings, and dips in the U.S.

I'm appearing today on behalf of MIF to voice opposition to the portions of Proposals 1, 2, and 3 of the hearing notice which seek adjustments to the Class 1 differentials for many, if not all, of the counties of the Appalachian, Southeast, and Florida milk marketing areas.

In addition, proponents ask USDA for consideration on an emergency basis. For the reasons to follow, MIF is opposed to all of the increases and differentials contained in these proposals and strongly disagree that an emergency situation exists.

No. 1, these proposed changes are not necessary.

The key of the Federal Milk Marketing Order, FMMO, system is to ensure an adequate supply of milk for Class 1 needs. Before making a change to these orders, USDA must determine that an adequate supply of milk could not be found to supply Class 1 needs in the Appalachian, Southeast, and Florida marketing areas. I believe you will find this not to be the case.

MIF has many members doing business in and around these marketing -- these three marketing areas. None of the MIF members responding to our survey about this hearing indicated they are having trouble obtaining an adequate supply of milk for these areas.

To be sure, there are periods of when it is necessary to source milk from more distant locations. But this has been the case for many years -- but this has been the case many years in these marketing areas.

When milk is brought in, its price will be at least the FMMO minimum but may very well include additional charges or over-order premiums to compensate the seller for giving up that milk. This over-order money is paid to the entity supplying the additional milk and affects only the milk supplied.

No. 2, the federal order system is the wrong policy option.

The proponents cite declining milk production in the Southeast as evidence that the differentials in that order should be raised. For a couple reasons, this fact should not even be considered.

One reason is that when milk is needed -- is that when milk is needed and only at that time, it is identified, purchased, and transported to the plant where it is needed.

For USDA to consider whether or not a problem exists in obtaining sufficient milk for Class 1 needs, the question is not the location of the source, but, rather, is milk of any origin available for those Class 1 plants.

There is no question that milk production has been declining over many years in the states which are part of the Appalachian, Southeast, and Florida marketing areas.

But we have a national market, meaning milk is available to move across states and regions. A reduction in local production does not necessarily mean a short supply if milk is from -- if milk from a more distant location is readily available to replace it.

The second reason for looking past decreases in milk production in a specific region is the false implication that federal order regulations are the appropriate tools for addressing that issue.

Lloyd Day, administrator of the Agricultural Marketing Service, speaking recently before the house committee on agriculture subcommittee on livestock, dairy, and poultry stated it very clearly, in quotes: The marketing order program is not a price or income support program, end quote.

He adds, quotes: USDA operates the milk price support program and the milk income loss contract, MILC, for price and income support purposes, end quote.

The federal orders are not the policy outlet for any group seeking to alter broad based structural changes in regional milk production due to the underlying economics of producing milk in any one region.

No. 3, Class 1 differentials cannot be changed in one region of the country without affecting milk marketing in another.

It is important for USDA to remember that ours is a national market for milk. Farm milk can be transported over large distances before processing. Manufactured dairy products, whose values form the basis for federal order regulated minimum milk prices, are sold all over the country and, indeed, the world.

Fluid milk is bottled in larger plants, distributed over wider areas, and generally has a longer shelf life than even ten years ago.

The Class 1 differentials used to determine minimum price paid by plants reflect this national market. Every differential must -- repeat, must -- align with the market reality of sourcing milk for that specific location versus that marketed in neighboring states and regions.

The lengthy process of creating the differentials to be adopted during the federal order reform process implemented on January 1, 2001, involved years of study and debate among a number of market participants, consultants, and academics over alternatives for the structure of the current differentials.

The changes proposed for this hearing violate almost every aspect of this prior spirit of study and analysis. The most obvious is that the fact of a national market has been left aside for an arbitrary selection of these three marketing areas.

These changes will alter the competitive relationships that exist between various plant locations within and outside of these orders. The most egregious of these impacts will be along the outside boundaries of these orders taken as a whole.

Historical market factors have led to the structure of Class 1 plants at their current locations. Analysis of differentials on a national scope would include these factors and propose changes that would reflect and complement the current relationships.

In fact, if a problem really existed, the proposed changes should be correcting them. But as already noted, MIF members have not had a problem sourcing a sufficient supply of milk for Class 1 needs in these three marketing areas.

In addition, the MIF members will testify to with specific examples.

And I will add that one just did testify to this.

These changes create problems by significantly altering price relationships and interfering with markets that have co-existed for years.

Four, these proposals will discourage Class 1 sales.

The proposed changes to the Class 1 differentials will be detrimental to Class 1 sales volumes for processors within these regions. As stated above, milk is moved from more distant production areas only when it is needed for Class 1 use. The additional costs enticing the seller to give up that milk and get it to the plant are the only incremental costs in the system.

If the differentials are raised, as Class 1 plants at all locations throughout these orders will be forced to pay more for all milk used in Class 1 all the time. Remember, increasing the differentials by as much as $1.70 per hundredweight means adding 14.7 cents to the cost per gallon of milk. But any increase in Class 1 differentials means additional costs for milk.

I'm not aware of any study of fluid milk sales that does not find a decline in sales volume when prices rise. Per capita consumption of fluid milk has been declining for many years, and these changes will add pressure to accelerate that trend.

Even though ensuring an adequate supply of milk for Class 1 needs is an objective of the federal orders, USDA should consider if achieving this goal is worth accomplishing at the expense of suppressing Class 1 sales.

Five, there is no emergency.

I stated this earlier, but I will reiterate that MIF member company plants are not having trouble obtaining an adequate supply of milk for Class 1 needs in the Appalachian, Southeast, and Florida marketing areas. Because there is an adequate supply readily available, there obviously is no emergency.

Remember, it is producers/cooperatives who are seeking these increases, not the companies that actually buy milk to supply the Class 1 products for these markets.

Summary.

The key purpose of federal orders is to ensure an adequate supply of milk to satisfy Class 1 needs. It is not about promoting milk production or supporting farm milk income in any specific region of the country.

While the proponents return to the theme of eroding milk production in the Southeast and the need, through various aspects of these proposals, to increase milk prices, they offer no evidence that an adequate supply of milk cannot be obtained.

Class 1 differentials cannot be selectively altered without disrupting the existing relationships in the marketplace. USDA should require a comprehensive analysis of the national market before considering increases to any Class 1 differentials.

In addition, these proposed changes will discourage sales of the very products they are intending to supply. The consequence of reduced fluid milk sales volume is another company of the scope of analysis that should be undertaken when considering changes to differentials.

The changes to Class 1 differentials in

proposals 1, 2, and 3 should not be adopted by USDA, and it almost goes without saying -- but I will once more -- that this hearing should not be considered on an emergency basis.

Thank you.

JUDGE HILLSON: Questions for Mr. Rutherford. Any questions? Mr. Beshore, proceed.

EXAMINATION

BY MR. BESHORE:

Q. Mr. Rutherford, what would -- what would it take in IDFA's eyes to establish a situation where there is problems in having an inadequate supply of Class 1 milk?

A. Class 1 plants saying they are having a hard time getting milk.

Q. Saying they're having a hard time getting milk?

A. Well, outside of auditing them, we're taking them at their word. If they say they're having trouble getting milk -- if we're discussing the situation and they say, We are not able to get the milk; we need to maybe -- maybe we should do something in the federal order system to make sure we can get milk, that's what I mean.

Q. So you took your survey. Did you take that after the hearing notice was issued?

A. Before the hearing notice, we didn't have much reason to.

Q. Okay. So the answer is yes --

A. Yes.

Q. -- after?

A. Yes.

Q. So your survey consisted of, Okay, here is a hearing notice that says the price of milk is going up; we want to take a position at the hearing. Can you tell us whether you're having any trouble getting milk?

Is that what the survey was?

A. Not even close.

Q. Okay.

A. The premise of your question was not -- is not how we asked it. We presented the fact that a hearing had been announced.

Q. All right.

A. And we wanted to know what our members -- what they were planning to do as a group about it, because often a group of proposals will be out that some members are for and some members are against. And in those cases, IDFA will stand aside and let the membership determine what's going to happen.

So we were pooling our membership to see what they -- whether they thought we should be part of this hearing or not.

Q. Okay.

A. And they said, yes, testify we are not having a problem.

Q. Okay. When there was a hearing notice that said the price of milk -- minimum prices are proposed to go up, and you asked your members whether they wanted to support or oppose that proposal, correct?

A. No. It was a little more subtle than that. It was that we wanted to gauge their support for our testifying or not, maybe is a cleaner way to say it.

Q. Okay. Did you suggest to them what you would testify if they -- did you tell them what the testimony was going to be before you asked them whether they wanted you to give it or not?

A. No.

Q. Okay.

A. It would have surprised us, to be sure. But if they all said, Sure, go ahead and do it, we would have been -- I would have been saying much different comments.

Q. If they told you to come and support the proposals?

A. Right. Or if, like I said earlier, if there had been a split in the -- how the membership felt about the proposals, then I would not be here at all.

Q. Okay. Now, so nobody wants their -- nobody wants their regulated price of milk to go up, minimum price of milk to go up, is what you're telling us, correct, none of your members?

A. None of them said do not testify against the raising of the differentials. They didn't state it the way you said.

Q. Okay. So is that how it was put to them? Do you want us to testify against raising the differentials?

A. No, that is not.

Q. Okay. It sounds like it from the way you answered the question. You said none of them told you not to testify against raising the differentials.

JUDGE HILLSON: Is that a question? Is that --

MR. BESHORE: (Indicates affirmatively).

JUDGE HILLSON: I guess you can answer it.

THE WITNESS: We surveyed on whether they thought we should testify against the differential increase -- actually, against the proposals. And the only one that I'm really testifying against is the differentials decrease.

BY MR. BESHORE:

Q. Okay. You're not testifying against changing the transportation credit provisions?

A. No, I am not.

Q. Okay. Or the changes in the diversion requirements?

A. Correct.

MR. BESHORE: Okay. That's all the questions I have.

JUDGE HILLSON: Anyone else have questions for Mr. Rutherford?

Nothing from the government table, nothing back there?

Mr. Rutherford, I'm going to admit -- receive into evidence your written statement as Exhibit 31.

(Exhibit No. 31 received.)

JUDGE HILLSON: You may step down.

Why don't we take that second ten-minute break right now.

MR. ENGLISH: Okay.

JUDGE HILLSON: We'll come back at about 12 minutes -- make it a quarter after 4:00.

(Brief recess was taken.)

JUDGE HILLSON: Let's go back on the record.

And who is the next witness?

MR. ENGLISH: Rob Cottet, R-o-b, C-o-t-t-e-t, with National Dairy Holdings.

JUDGE HILLSON: Okay. He's not going to have a written statement.

MR. ENGLISH: He's not going to have a written statement.

JUDGE HILLSON: Okay. Would you please raise your right hand?

ROB COTTET,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Could you please state your name and spell it for the record?

THE WITNESS: Rob Cottet, C-o-t-t-e-t.

JUDGE HILLSON: Okay. Your witness, per hundredweight.

DIRECT EXAMINATION

BY MR. ENGLISH:

Q. Mr. Cottet, by whom are you employed?

A. I'm employed by National Dairy Holdings.

Q. And what is your title?

A. Executive vice-president for development.

Q. And where is National Dairy Holdings located?

A. We're based out of Dallas, Texas.

Q. And could you briefly describe your background in the dairy industry?

A. Yes. When I left school, I was -- went to work for a Kraft Dairy Group of Philadelphia. I worked for them until 1998 and went to work for -- 1988.

Kraft Dairy Group sold to General Foods, and I went to work for, at that time, a company called Morning Star, which owned dairies, which was, about 1992, was purchased by Suiza Foods. I was employed by them until the purchase of Dean Foods in 2002. And National Dairy Holdings was formed at that time.

I was president of Velda Farms at the time of the sale, and Velda Farms became part of National Dairy Holdings, and I worked for National Dairy Holdings.

Q. And could you briefly describe National Dairy Holdings?

A. It's a national -- a quasi national dairy processor. We have facilities in different parts of the country. We're financially backed -- or half owned by Dairy Farmers of America. However, we're managed independently by a private management group. And DFA is not involved in our day-to-day decision-making process.

Q. And what facilities would be impacted by a proposal in consideration for today?

A. Velda Farms of Florida, Coburg Dairy in Charleston, South Carolina, Flav-O-Rich Dairy in London, Kentucky, and UC Milk Company in Madisonville, Kentucky, and Dairy Fresh in Alabama.

Q. And do you, for National Dairy Holdings, recognize that there are problems in the Southeast?

A. We recognize there is problems with milk production and due to population growth, geographic issues. We don't necessarily agree with the process of fixing the problem by sharing or pooling purposes. If there is a need for dollars, we think it should go directly to the area that's concerned or directly to the farmer in that area that needs the relief.

Q. And do you have any position on the size of federal orders?

A. Currently, we think they are probably too large, and they probably should be addressed due to the fact I just stated, geographic and population growth areas. It probably should be addressing the size of these orders and make them smaller.

Q. Has National Dairy Holdings had any difficulty getting raw milk in the Southeast?

A. No, we haven't.

Q. And by the "Southeast" -- I know you haven't been here the whole hearing. But we've been using the terms "Southeast" to mean all three orders that have been discussed at this hearing.

A. In the facilities that I mentioned, we had had no difficulty getting fluid milk.

Q. Okay. Do you have any further comments you would like to make?

A. I think one of the main issues on the -- that I would like to address is the flow of milk from one order to the next. And we feel that it should be on a point-of-sale size than a point-of-origin size based on where our facilities are at. We ship a lot of product to the north out of most of our facilities, which can go into different marketing orders. And these -- some of these areas where there has been an increase in the proposal orders, the increased price directly impacts going north with milk.

Q. In fact, what's your -- where are your plants in Florida?

A. Miami and Winter Haven.

Q. And if you don't go north from Miami, can you -- do you have any sales from that plant?

A. Not particularly.

Q. What about price relationship issues as they relate to the proposals, are there some price relationship issues that concern you?

A. In what regard?

Q. With respect to plants and their relationship to other plants.

A. Other plants? It concerns us with the new increases that are on there. There is a couple in particular that concerns us as a company. We'll use Jacksonville coming into the Miami market. The production facility in Jacksonville does ship into the Miami market. Currently, there is a 60 cent differential, which is rising, which would make it very easily for them to ship milk into our area, into the Miami market and be more competitively priced for the product than we can be in that particular area.

Also, in the Coburg area, Charleston, South Carolina, which is the Coburg Dairy, we have a facility in -- we compete against Florence and one that's in Spartanburg. Coburg is currently going to go up a dollar. Those areas are going up -- I believe it's 50 cents -- I left my paper back at my desk there, but I think it was 50 cents. We sell a lot of customers in the Florence/Spartanburg area, and that would have a direct impact on us.

Q. So you're already competing against those facilities in Jacksonville --

A. Correct.

Q. -- to the north for Miami and for Charleston. I think there may be a 30 cent difference.

A. Thirty, I think, is Spartanburg.

Q. Thirty for Florence and 50 for Spartanburg?

A. Right.

Q. All right. Nonetheless, you already compete against those operations?

A. Correct.

Q. Okay.

A. Correct.

Q. So an analysis that compares a plant-to-plant sale isn't what you -- is not the reality you deal with. The reality you deal with is wholesale customers out of the marketplace, correct?

A. Correct, correct.

Q. What about any commentary you have on the emergency situation?

A. We're struggling to understand what the emergency situation is right now. We've had no supply issues with milk. We're not opposed to rate increases; we're just opposed to them not being fairly implemented in the marketplace to keep it competitive.

Q. In addition to Florida and South Carolina, do you have a situation of -- about relationship in Alabama?

A. We have one in Alabama where much of the milk is heading north, which competes with Nashville Milk coming south, which is -- I don't have it exactly in front of me, the numbers. But it has -- with the impending change, it could create a competitive imbalance also.

Q. So those are the reasons why you're against --

A. Ours is strictly a competitive balance, which could directly impact the financial stability of our -- of some of our facilities, Coburg being one, just as I believe the person that was up here, the dairy producer from South Carolina stated. He didn't want to go against the grain. He wanted to ship his milk to -- follow the flow of milking because of the pricing.

We have the same issues as a processer, if we have to ship into another that is competitively unbalanced. We acknowledge the freight cost it takes the product to go up there. But we also have to pay a difference in premium. That creates a double whammy on the costing effect, which would make us noncompetitive.

Q. When you say "premium," you mean Class 1 differential?

A. Class differential. I'm sorry.

Q. That's all right.

And you're not here to testify about the diversion limitations or the transportation credits, correct?

A. No, I am not.

MR. ENGLISH: Okay. The witness is available for cross-examination.

JUDGE HILLSON: Does anyone have questions of this witness?

Go ahead, Mr. Beshore. Come on up.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Mr. Cottet?

A. Cottet, correct.

Q. Cottet.

Do I understand your concerns with respect to the competitive effects of the proposal how it would -- your concern is how it would impact your sales of the packaged product at the wholesale level?

A. Correct.

Q. What products are made at the Madisonville plant?

A. Fluid milk product, juice drinks, all sizes, gallons, half gallons, quarts, pints, half pints.

Q. You're not -- you didn't have any comments on transportation credits. Is that because you're satisfied with the way that that works?

A. Correct.

Q. Okay. I think I heard you say you'd like to see point of sale rather than plant-point pricing?

A. Correct.

Q. Okay. But you understand the federal order system has never worked that way?

A. Yes, I understand that. The point of sale has worked that way in the over-order premiums, which in some cases helps us. But what happens in these -- with the differentials being larger now than they were before, now you're allowing milk to ship from another part of the country into a shipping area that competes directly with us.

The freight doesn't offset the difference in the federal order, where prior to that, it used -- it kind of was six and a half. It was very close. But when you're shipping a product from Asheville, North Carolina, now into Miami, with that differential change sitting there, it creates a different price in any competitive situation, I should say.

Q. With respect to the packaged milk?

A. I'm strictly talking packaged milk, correct.

MR. BESHORE: Okay. Thank you.

JUDGE HILLSON: Any other questions for

Mr. Cottet?

Mr. Smith, come on up.

CROSS-EXAMINATION

BY MR. SMITH:

Q. Hello, Mr. Cottet.

A. Hello.

Q. I'd like to ask the same question that I asked of the representative of Kroger. If you could walk through a little more detail what the translation is cents per gallon of packaged milk and how the market will move.

A. If we took -- I'll use Charleston, South Carolina. We can use that as an example. It's a dollar per hundredweight. It's roughly, in our calculation, eight or nine cents a gallon on the price per product.

If Florence, which is very close to Charleston, South Carolina, ships in the same competitive market, if that is a -- I forgot if it was 50 cent or 30 cents. If it's 50 cents, then it's -- they are going up four, so there is a price differential of six cents a gallon sitting there, approximately, that we have to now compete with. That would directly impact with bids, government bids, things like that.

We already have the freight which we had before, which we have no problem with. But when you take the raw milk price and you change that price to make it uncompetitive -- you know, such as school bids, we could no longer be competitive, because that's a pretty large amount of a number on a product. And that's the issue we have with it, is trying to remain competitive in our prime areas where the differential is different.

Q. So your primary concern is with school bid prices?

A. That's an example. Governments are --

Q. I understand.

A. Yeah. Government bids or any bids of any national chain require us to be very close on our pricing. If we're not pricing from the same boat, basically, on the milk, the same base, then we have an issue.

Q. I'm not asking for proprietary information, but there is theoretical argument, which is transparent on its face, with how it actually translates to your actual company.

A. Uh-huh (Indicates affirmatively), yes.

Q. Are government contracts a substantial percentage of your basis as opposed to --

A. I would probably --

Q. -- private sales?

A. -- say 15 to 20 percent of our business, generally speaking, give or take a few percentage points, depending on the company. Some of our companies have a much higher percentage of bids, school bids, government bids, stuff like that than other companies. But I would say 15 to 20 percent of our business is government bids.

Q. And how about for your plants more in the central part in Kentucky, as you get closer to the margins of the orders, how is that market affected where the amounts are less?

A. I believe London and Madisonville, we don't have a major argument there. There is price competitive differences with some of the companies that we compete directly with on some of the, say, warehouse customers we have. A penny or half a penny is a big difference in the bid process. And if you have -- London, I believe -- if you go to Winchester, now instead of -- correct me if I'm wrong on the numbers -- but I think it was a 20-cent difference, and now it's moving to a 30 or 40-cent difference between those two companies. If we're bidding on the same customers, it creates a difference.

Q. In the half penny?

A. Right. I'm using -- half penny may not be the accurate number, but I'm just -- it creates a difference in bidding on the warehouse type customers.

Q. Do you have any comments on the provisions for smoothing the amounts in terms of location that is in the proposal? Have you had an opportunity --

A. I really have not had the opportunity.

Q. So your testimony is just straight off the proposed increases in the differentials?

A. Correct.

MR. SMITH: Thank you.

JUDGE HILLSON: Mr. Rower?

CROSS-EXAMINATION

BY MR. ROWER:

Q. Mr. Cottet, does National Dairy Holdings purchase milk exclusively from cooperatives?

A. No. We buy some independent milk.

Q. You buy some independent milk?

A. Yeah.

MR. ROWER: Okay. Thank you.

JUDGE HILLSON: Mr. English?

MR. ENGLISH: A quick recross, Your Honor.

REDIRECT EXAMINATION

BY MR. ENGLISH:

Q. In your experience, whether it's a government contract or otherwise, isn't it the case that the wholesale level contracts change what we call mil?

A. Correct.

Q. And what is a mil?

A. In most cases, it can be a penny a gallon.

Q. Or a tenth of a penny?

A. Or a tenth of a penny or half a penny. A school bid can be decided on -- a $10,000,000 school bid can be decided on a thousand dollars in price. So, I mean, it can be very minute when you get it down there.

If you're competing against lower cost milk coming into your milk order and you don't have that benefit or the freight doesn't offset it coming down, it creates a problem, enough of a problem, when you look at the situation like Coburg, where you actually can have a situation where the processer could have financial problems keeping a viable company running in that area.

MR. ENGLISH: That's all I have, Your Honor.

JUDGE HILLSON: Any further questions for this witness?

Okay. Mr. Cottet, you may step down.

THE WITNESS: Thank you.

JUDGE HILLSON: Did you have another witness you want to call, Mr. English?

MR. ENGLISH: No. I think the market administrator has some data, and then was a proposal for -- Mr. Kinser would prefer to go tomorrow morning, Your Honor.

JUDGE HILLSON: You don't --

MR. ENGLISH: No. That's it. Mr. Kinser is the only other witness that I have.

JUDGE HILLSON: Okay. No other witnesses that you know of other than --

MR. ENGLISH: I don't -- no witnesses that are either my clients or that have informed that they wish to testify.

JUDGE HILLSON: I thought you said a woman was here that was going to testify. I might have misunderstood you.

MR. ENGLISH: No. I think -- I thought maybe we were talking about the market administrator's office. I apologize.

JUDGE HILLSON: Okay. Are you ready to proceed?

MR. STEVENS: Yeah. Jason Nierman.

JUDGE HILLSON: You are already under oath, so you can testify.

THE WITNESS: All right.

JUDGE HILLSON: Go ahead, Mr. Stevens.

JASON NIERMAN,

the witness herein, being sworn on oath prior, was questioned and testified as follows:

EXAMINATION

BY MR. STEVENS:

Q. Jason, you were asked by, I guess, Mr. English to prepare -- to look at your records and to prepare some updates on some exhibits that you previously entered into evidence.

A. Yes.

Q. And you've done that?

A. Yes.

Q. And you've brought copies of the results of that work with you?

A. Yes, I have.

Q. And you had them in the back of the room, and you distributed them around for people to use during the hearing?

A. Yes.

MR. STEVENS: Okay. Your Honor, I'd like to mark for identification the one-page document, which, I guess, has the title, Total Diversions to Plants Located Outside the Southeast and

Appalachian Marketing Areas.

JUDGE HILLSON: Okay. I'll mark this as Exhibit 32.

BY MR. STEVENS:

Q. Okay. Now, as a preliminary matter, this was prepared by you or pursuant to your supervision in the office --

A. Yes.

Q. -- from official records of the Department of Agriculture?

A. Yes.

Q. And, again, like the other documents, it's not presented for or against any proposal?

A. No, it is not.

Q. You prepared this at the request of Mr. English?

A. Yes.

Q. Okay. Could you briefly go over the document and tell us what it contains?

A. For January 2004 to December of 2006 on a monthly basis, it's the total diversions pooled on the market. That's the first column. The second column is the diversions that were delivered to plants located outside of the Appalachian or Southeast marketing area.

Q. Okay. So maybe just give us an example of what's on there. Monthly and then it has a couple columns. What does it depict?

A. The first column would be the total diversions pooled on the order, and then the second column would be the portion of those total diversions that were diverted to a plant located outside of the two marketing areas.

Q. Okay. Anything else you'd like to say about it?

A. No.

MR. STEVENS: We submit the exhibit, Your Honor. I ask that it be marked for identification.

JUDGE HILLSON: It's been marked.

Anyone have questions? Mr. English, you're raising your hand.

MR. ENGLISH: Charles English for Dean Foods Company and National Dairy Holdings.

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. First, let me thank you for getting this done. I know that being away from your area it was difficult.

Do I understand that this is an update of an exhibit that was presented at another hearing?

A. The second column was presented in the hearing in January '06 -- through the date it was presented, January '04 through, I believe, November '05.

Q. Okay. And I made actually a number of requests that went beyond this. And to the extent I made those requests, your office was unable to do it either because of confidentiality or simply logistics because of the short time frame; is that correct?

A. That's correct.

Q. Okay. Let me just take the first line for one moment.

If there were total diversions of 105,397,742 and diversions outside of the Appalachian and Southeast marketing area 85,238,426, one could conclude that there are 20,160,00 approximately million pounds of milk that were diverted in Appalachia and Southeast orders; is that correct?

A. That's correct.

MR. ENGLISH: That's all I have. Thank you.

JUDGE HILLSON: Does anyone have questions of this witness?

MR. BESHORE: Yes.

JUDGE HILLSON: Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Mr. Nierman, are -- if pooled milk -- can pooled milk be diverted to other order plants?

A. Yes.

Q. And would this include such diversions?

A. Yes.

Q. Are there such diversions?

A. Yes.

Q. And so that, for instance, there was -- are there any counties in Indiana that are part of the marketing order?

A. Yes.

Q. Okay. But if there were diversions to -- from Indiana sources to points north of the counties of Indiana that are in your order, they would be -- and even if they went to pooled plants in another order, that would be considered diversions outside the area for these purposes?

A. That's correct.

MR. BESHORE: Thank you.

JUDGE HILLSON: All right. Mr. Smith?

EXAMINATION

BY MR. SMITH:

Q. Dan Smith.

Can you explain for the three months, March, April, and May '04 as compared to the equivalent periods in the '05 and '06 profile, why there was such a tremendous volume in the latter two years as compared to the first year?

A. I believe due to price differences within the classes, there was milk that was elected not to be pooled in those three months.

Q. So that was the period of time of that market development?

A. I believe so.

MR. SMITH: Okay. Thank you.

JUDGE HILLSON: Well, I'll receive exhibit 32 into evidence.

(Exhibit No. 32 received.)

JUDGE HILLSON: You may step down. Thank you.

Do you have another witness?

MR. STEVENS: Steven Duprey.

JUDGE HILLSON: You're still sworn in.

I'm going to mark this as Exhibit 33.

Mr. Stevens, go right ahead whenever you're ready.

STEVEN DUPREY,

the witness herein, being duly sworn prior, was questioned and testified as follows:

EXAMINATION

BY MR. STEVENS:

Q. Steven, you were asked -- we conferred and you prepared certain documents at the request of Mr. English --

A. Correct.

Q. -- that you brought with you?

And do you have copies that you distributed to the judge and the reporter and available for the parties to use?

A. Correct.

MR. STEVENS: Your Honor, I'd like to mark for identification as, I believe --

JUDGE HILLSON: Thirty-three.

MR. STEVENS: -- thirty-three. It's a one-page document titled, Producer Milk Deliveries Prepared for Dean Foods, 2004 through March 2007, Federal Order 7, Southeast Marketing Area. It's a one-page document.

Let me ask him about this.

JUDGE HILLSON: Uh-huh (Indicates affirmatively).

BY MR. STEVENS:

Q. This was prepared by you pursuant to your supervision?

A. Yes, it was.
Q. And from documents from the official records of the United States Department of Agriculture?
A. Yes.
Q. And it's not presented for or against any of the proposals?
A. No, it's not.
Q. You prepared it at the request of Mr. English?
A. I did.
Q. Okay. Could you briefly go over the one-page document, maybe describe what's in it the first column or two to just describe what information is contained in that document.
A. Sure. Essentially, it shows milk that was pooled on Federal Order 7 that was delivered inside the geographic area, marketing area, of the Southeast order. That would be the third column. The fourth column shows milk that was delivered to the outside marketing area. And the last column is the total producer milk that was pooled in that given month.

There is one footnote, milk that was delivered inside the marketing area includes all milk delivered to the pool plants, partially regulated plants, and any other nonpool plant.

Q. So it's producer milk?
A. It's all producer milk, yes.
Q. And maybe go through a column or two and just describe -- I see the year and the month, and that. Why don't you describe a couple of the entries there.
A. For example, the first line is January 2004, pooled on Order 7, delivered inside the Southeast marketing area of 557,000,000 pounds. Delivered outside the marketing area was 98,000,000 pounds for the grand total producer milk pool during January 2004 to cover 655,000,000 pounds.
MR. STEVENS: Okay. We submit the exhibit, Your Honor. It's been marked --
JUDGE HILLSON: It's been marked as 33.
MR. STEVENS: Thank you.
JUDGE HILLSON: Questions? Go ahead, Mr. English.
MR. ENGLISH: Charles English for Dean Foods and National Dairy Holdings.

CROSS-EXAMINATION

BY MR. ENGLISH:
Q. Thank you, again, Mr. Duprey, for getting this done.
The column delivered inside Southeast marketing area, that includes pooled diversions where

the milk, nonetheless, ends up in a plant located in the Southeast, correct?

A. Yes.

Q. And then the second column, delivered outside of the Southeast marketing area, that would be diversions to plants outside -- in other words, diversions to plants outside the Southeast marketing area, correct?

A. Yes.

Q. So there is some element on this table -- and maybe we'll figure it out somewhere else. But there was some element on this table in column three, the 557,104,419 pounds for January of '04, there is some element that you're unable to tell us today is diversions within the marketing area?

A. Correct.

Q. Okay. And, of course, the diversions outside the Southeast marketing area could, of course, include diversions to any plants in Order 5 in your exhibit, correct?

A. Correct.

MR. ENGLISH: Okay. That's all I have. Thank you.

JUDGE HILLSON: Does anyone else have questions of this exhibit?

Hearing none, I will receive Exhibit 33 into evidence.

(Exhibit No. 33 received.)

JUDGE HILLSON: You may step down. Thanks for coming back.

Mr. Stevens, I know the government has -- supposed to have witnesses for 5, 6, and 7, Proposals 5, 6, and 7. I may be off by a number there.

Are you ready for that tonight? If not, we can do that tomorrow?

MR. STEVENS: Give me a minute and let me look.

JUDGE HILLSON: 4, 5, and 6.

MR. STEVENS: 4, 5, and 6.

JUDGE HILLSON: I want to understand, you just have -- Mr. Kinser is your only remaining witness?

MR. ENGLISH: That's correct.

JUDGE HILLSON: He's not going to be on for a huge length of time.

MR. ENGLISH: That's not my plan.

JUDGE HILLSON: Okay.

MR. ENGLISH: He doesn't have a 61-page statement.

MR. STEVENS: We're ready to go on Proposal 4.

JUDGE HILLSON: Okay. Call your witness.

MR. STEVENS: Sue Mosley.

SUE MOSLEY,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Please state your name and spell it for the record.

THE WITNESS: My name is Sue Mosley, M-o-s-l-e-y.

JUDGE HILLSON: Okay. This is your witness, Mr. Stevens?

MR. STEVENS: Yes. We would like her statement -- her testimony marked as Exhibit 34.

JUDGE HILLSON: Okay. So marked.

MR. STEVENS: And the witness will go ahead and read the statement into the record, if that's okay.

STATEMENT BY SUE MOSLEY

THE WITNESS: My name is Sue Mosley, and I am the market administrator for the Florida order, Federal Order 6, and the Southeast order, Federal Order 7.

I have worked for the federal milk order program for over 36 years and have been the market administrator for 13 years. I have been the market administrator for the current Florida order and the current Southeast order since their formation on January 1, 2000. I am here today to testify in support of Proposal Nos. 5 and 6.

Proposals 5 and 6 would increase the maximum administrative assessment rate for both the Florida and Southeast orders provided for in Section 7 CFR 1006.85 and 10074.85, from five cents per hundredweight to eight cents per hundredweight. Currently, the administrative assessment for these orders is provided for in 7 CFR 1000.85.

The administrative assessment language in Sections 1006.85 and 1007.85 simply point to Section 1000.85. Proposals 5 and 6 would amend Sections 1006.85 and 1007.85 to provide for all of the administrative assessment language pertinent to the Florida and Southeast orders and discontinue the reference to Section 1000.85. Under Proposals 5 and 6, the administrative assessment would continue to apply to the same milk as in the past.

It should be noted that if Proposals 5 and 6 were adopted, the eight cent per hundredweight rate would be the maximum rate allowable, not necessarily the actual rate charged. The actual rate charged would only be as high as needed, as determined by the market administrator, with approval by the deputy administrator for dairy programs, agricultural market services, United States Department of Agriculture.

The increase in the maximum assessment rate is necessary to ensure that the market administrator has sufficient funds to carry out the responsibilities for administration of the orders. Administering order functions including pooling, auditing, and providing market information requires staff and financial resources.

In addition, the market administrator is required to maintain a specified level of operating reserves. The level of the required operating reserve is determined by a formula set forth in MA Instruction 207 issued by the deputy administrator for dairy programs.

The purpose of the reserve fund is to cover the necessary costs of closing out an order, such as completing pools and audits, paying severance pay to employees, and terminating leases in the event that an order is terminated. The market administrator is primarily dependent on income from the administrative assessment to fund the operations of the orders.

This assessment, provided for in Section 1006.85 for the Florida order and Section 1007.85 for the Southeast order, through reference to Section 1000.85, is collected each month on pooled producer milk. The assessment is also collected on certain types of other source receipts assigned to Class 1 and certain route disposition in the marketing area by partially regulated distributing plants.

The vast majority of the administrative assessment income is, however, from pooled producer milk. Since 2000, the administrative assessment for both orders has contributed over 80 percent of the total income of the market administrator office.

In 2000, the first year of operation of the consolidated orders, pooled producer milk on the Florida order averaged 238.9 million pounds per month and 623.9 million pounds on the Southeast order, for a total monthly average of approximately 862.8 million pounds.

In 2001, monthly average producer milk on the Florida order was 231 million pounds and 647 million pounds on the Southeast order for a total monthly average of approximately 878.4 million pounds.

In 2002, monthly average producer milk on the Florida order was 224.4 million pounds and 660.6 million pounds on the Southeast order, for a total monthly average of 885 million pounds.

At a three cent per hundredweight assessment rate for the Florida order and a 3.5 cent assessment rate for the Southeast order, the volumes of producer milk generated sufficient revenue to fund the order operations and to maintain the mandated reserve funds for these years.

In 2003, while producer milk on the Florida order increased by about five percent, producer milk on the Southeast order, with a pool almost 2.5 times the size of the Florida order, decreased 11 percent. This resulted in a significant decrease in the administrative assessment collections and required the market administrator to use operating reserves to cover expenses, thereby dropping the reserve level to near the mandated minimum.

On December 19, 2003, the market administrator issued a notice to handlers in the Florida order that, effective with January 2004 milk deliveries, the administrative assessment rate would increase one cent to four cents per hundredweight. The market administrator also issued a notice to handlers in the Southeast order with the same effective date increasing the administrative assessment rate one cent to 4.5 cents per hundredweight.

In 2004, the producer milk on the Florida order increased by about five percent over 2003, and producer milk on the Southeast order rebounded slightly, increasing about one percent.

In 2005, producer milk on the Florida order increased about 8.8 percent over 2004, and the producer milk on the Southeast order increased five percent.

In 2006, producer milk on the Florida order was approximately the same as 2005, and producer milk on the Southeast order increased 6.8 percent over 2005.

With the increase in producer milk in 2004, 2005, and 2006, in conjunction with the market administrator's efforts to control costs, the administrative assessment rates implemented in 2004 have been sufficient to cover expenses and to build an adequate reserve level.

Control cost measures from 2000 to 2006 have included a 15 percent reduction in staff through attrition and a reduction in force in 2006, increased use of technology to hold meetings and conduct audits, a reduction in travel expenses, and a decrease of almost 33 percent in communication costs primarily due to a change in long distance carriers.

The market administrator will continue to take measures to hold down costs while meeting regulatory responsibilities and maintaining a high quality of service.

While the market administrator is not currently charging the maximum assessment rate, Proposal No. 2 seeks to limit by an average of 12.3 percent allowable diversions for the Southeast order.

If adopted, this proposal would likely reduce the producer milk on the Southeast order, thereby reducing the value of the administrative assessments used to fund order operations.

A decision effective in December 2006 also limits the ability of handlers to divert milk by reducing the allowable diversions by the volume of transportation credit claims.

In addition, the long-term downward trend in milk production for the southeastern United States and marketing decisions of handlers present an increased potential for variability in the market administrator's revenue stream.

This regional hearing officers an opportunity to increase the maximum administrative assessment rate for the Florida and Southeast orders to provide the market administrator with the flexibility to set the appropriate administrative assessment rate needed to effectively administer order operations and to maintain the required operating reserves.

Again, I would like to reiterate that these proposals are to increase the maximum administrative assessment rate to eight cents per hundredweight.

This is not necessarily the rate that would be charged. As always, the actual rate charged would only be as high as needed to cover expenses and to maintain the mandated reserve level, as determined by the market administrator with approval by the deputy administrator for dairy programs, agricultural marketing services, USDA.

This concludes my testimony.

DIRECT EXAMINATION

BY MR. STEVENS:

Q. Now, let me ask you, If you deviated from the written testimony here by reversing a word or two or misstating part of it, do you want the record to reflect your statement as submitted?

A. As written, yes.

Q. As written?

A. Yes, as written.

MR. STEVENS: With that, we offer the -- it having been marked, we offer the witness for cross-examination.

JUDGE HILLSON: Does anyone have any questions of this witness?

I will receive Exhibit 34 into evidence.

(Exhibit No. 34 received.)

JUDGE HILLSON: Ms. Mosley, you may step down. Thank you very much.

Mr. Stevens, is there another witness, or is that it?

MR. STEVENS: Can we have a minute?

JUDGE HILLSON: Okay. Let's go off the record.

(Brief recess was taken.)

JUDGE HILLSON: Let's go back on the record.

MR. STEVENS: Jeff Gooch.

JEFF GOOCH,

the witness herein, being first duly sworn on oath, was questioned and testified as follows:

JUDGE HILLSON: Okay. State and spell your name for the record, please.

THE WITNESS: Jeff Gooch, G-o-o-c-h.

JUDGE HILLSON: Your witness, Mr. Stevens.

DIRECT EXAMINATION

BY MR. STEVENS:

Q. All right. Mr. Gooch, you prepared some testimony for the hearing today?

A. Yes.

Q. You brought copies of that with you and distributed them to the judge and the reporter and various people in the hearing and conference room?

A. Yes.

Q. Let me ask you as a preliminary matter: Your testimony is based on material that you prepared or prepared at your office and reviewed by your supervisors?

A. Yes.

Q. And it's from your official records there at the department that you keep in Louisville?

A. That's correct.

Q. It's not offered for or against any proposals, except your proposal, right?

A. Correct.

Q. With that, could you read your statement into the record, please.

STATEMENT BY JEFF GOOCH

THE WITNESS: My name is Jeff Gooch, and I am the assistant market administrator for the Appalachian federal order, Federal Order No. 5.

I have worked for the federal milk order program for nearly 23 years and have been the assistant market administrator for the Appalachian federal order, Federal Order No. 5, since January 2006.

Prior to being appointed assistant market administrator, I was an assistant to the market administrator for 11 years. I am here today to testify in support of Proposal No. 4.

Proposal No. 4 would increase the maximum administrative assessment rate for the Appalachian federal record, Federal Order No. 5, provided for in Section 1005.85, from five cents per hundredweight to eight cents per hundredweight. Currently, the administrative assessment for the Appalachian order is provided for in section 1000.85.

The administrative assessment language in Section 1005.85 simply points to Section 1000.85.

Proposal No. 4 would amend Section 1005.85 to provide all of the administrative assessment language pertinent to this order and discontinue the reference to Section 1000.85.

Under Proposal No. 4, the administrative assessment would continue to apply to the same milk as in the past. It should be noted that if Proposal No. 4 were adopted, the eight cent per hundredweight rate would be the maximum rate allowable, not necessarily the actual rate assessed.

The actual rate assessed would only be as high as needed, as determined by the market administrator with approval by deputy administrator for dairy programs, agricultural marketing Service, United States Department of Agriculture.

The increase in the maximum administrative assessment rate is necessary to ensure that the market administrator has sufficient funds to carry out the responsibilities for administration of the federal order. Administering order functions include administrative, accounting, human resource, economic, pooling, and auditing staffs.

In addition, the market administrator is required to maintain a specified level of operating reserves. The level of the required operating reserve is determined by a formula set forth in MA Instruction 207 issued by the deputy administrator for dairy programs.

The purpose of the operating reserve is to cover the necessary costs of closing out an order, completing pools and audits, paying severance pay to employees, terminating leases, etc., in the event that an order is terminated.

The market administrator is primarily dependent on revenue from administrative assessments to fund the operations of the order. The administrative assessment, provided for in Section 1005.85, through reference to Section 1000.85, is collected each month on pooled producer milk.

The assessment is also collected on certain types of other source receipts assigned to Class 1 and certain route disposition in the marketing area by partially regulated distributing plants.

The vast majority of the administrative assessment revenue is from pooled producer milk. The current administrative assessment rate is four cents per hundredweight of milk with a maximum cap of five cents per hundredweight. This administrative assessment rate has remained unchanged since January 2000.

For the years ending 2000, 2001, and 2002, producer milk pooled on the order averaged about 547 million pounds monthly. At the four cents per hundredweight assessment rate in effect throughout this period, these volumes of producer milk generated sufficient revenue to fund the Appalachian order operations and maintain the mandated operating reserve.

For the years ending in 2003, 2004, and 2005, producer milk pooled on the order averaged 525 million pounds month.

For the year ending in 2006, producer milk pooled on the order averaged 520 million pounds monthly.

When comparing the firs four months of 2007 to the first four months of 2006, producer milk pooled on the Appalachian order is down 3.45 percent.

The southeast United States continues to experience losses in milk production. This situation of declining volumes of milk pooled and the difficulty in predicting producer milk volumes in the future endangers the market administrator's ability to carry out order operations while maintaining a legally mandated operating reserve. The Appalachian federal order was in an operating deficit position in 2003, 2004, and 2006.

In 2005, the order had a balanced budget. At the four cent per hundredweight assessment rate in effect throughout this period, 2003 through 2006, these volumes of producer milk did not generate sufficient revenue to fund the Appalachian order operations, thus lowering the level of the mandated operation reserve.

It should also be noted that an interim final rule effective December 1, 2006, established a zero diversion limit standard on eligible Class 1 milk receiving transportation credits in the Appalachian order.

Specifically, that decision limits the amount of milk that may be pooled on the Appalachian order, thus reducing the amount of the administrative assessment revenue throughout the period of July through December on these volumes of producer milk generated.

If Proposal No. 1 is adopted, the transportation credit payout months would include January and February, further reducing the amount of milk that may be pooled on the Appalachian order.

Proposal No. 1 would also reduce the volume of milk which may be pooled by diversion on the Appalachian order. This action would further reduce the amount of administrative assessment revenue.

The proposed tightening of pooling provisions on the Appalachian order impacts the amount of producer milk pooled on the order. While the market administrator's office strives to control costs and become more efficient in carrying out its work, the efficiency gains cannot compensate for further reducing the amount of revenue derived from reducing milk volumes pooled on the market.

The market administrator's office makes every effort to improve the operating efficiency and effectiveness of this order -- the order. Actions taken to control expenses include reducing the size of the office statute by 29 percent through attrition since 2003, contracting with outside computer services, negotiating a telecommunications contract, consolidating a field office, and reducing travel to conferences and meetings.

Advancements in information technology systems are allowing the exchange of handler information, thus reducing travel and mail expenses.

About $215,000 in administrative assessment income is needed per at to cover basic operating expenses. And a four cent per hundredweight assessment rate, this equates to about 538 million pounds of producer milk needed monthly to cover expenses.

This hearing offers an opportunity to increase the maximum assessment rate to eight cents per hundredweight to assist the market administrator in administering order functions and maintaining the required operating reserves.

Again, it should be emphasized that the eight cents per hundredweight rate would be the maximum rate allowable, not necessarily the rate assessed.

As always, the actual rate assessed would only be as high as needed, as determined by the market administrator, with approval by the deputy administrator for dairy programs, agricultural marketing service, USDA.

This concluded my testimony.

CONTINUED DIRECT EXAMINATION

BY MR. STEVENS:

Q. To the extent that you've deviated from the statement in any regard in your testimony, you want the statement as written to be entered into the record; is that correct?

A. Yes.

JUDGE HILLSON: I'm going mark this as Exhibit 35, by the way, so --

MR. STEVENS: Thank you. We submit the witness, Your Honor.

JUDGE HILLSON: Anyone have any questions of this witness? There is no indication.

I will receive the Exhibit 35 into evidence.

(Exhibit No. 35 received.)

JUDGE HILLSON: And, Mr. Gooch, thank you for testifying. You may step down.

Is that it for today? You don't no have any more witnesses, do you?

MR. STEVENS: I do not, Your Honor.

JUDGE HILLSON: And tomorrow at this point we have one witness scheduled, and that's it. Unless some other producers show up, that will be it.

Okay. It's 5:10. I'm going to adjourn the hearing until 8:30 tomorrow morning.

(Hearing was adjourned at 5:12 p.m.)

REPORTER'S CERTIFICATE

STATE OF FLORIDA
COUNTY OF HILLSBOROUGH

I, Aaron T. Perkins, Registered Professional Reporter, certify that I was authorized to and did stenographically report the above proceedings and that the transcript is a true and complete record of my stenographic notes.

I further certify that I am not a relative, employee, attorney, or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

Dated this 24th day of May, 2006.

Aaron T. Perkins, RPR

NOTARY PUBLIC
Comm#
Expires 12/11/
Bonded thru
Florida Notary