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UNITED STATES DEPARTMENT OF AGRICULTURE

In the Matter of:) Docket Nos.
PROPOSED CHANGES TO) AO-368-A32
WESTERN AND PACIFIC NORTHWEST MILK) AO-271-A37
ORDERS) DA-03-04

TRANSCRIPT OF PROCEEDINGS

BEFORE: MARC R. HILLSON
Administrative Law Judge

VOLUME IIIA

(Pages 649-792)

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USDA

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I N D E X

EXAMINATION

E X H I B I T S

RECESSES

TRANSCRIPT OF PROCEEDINGS,

taken on September 25, 2003, commencing at 8:30 a.m., at the Sheraton Airport Hotel, 1600 South 52nd Street, Tempe, Arizona, before Elaine M. Cropper, a Certified Court Reporter, Certificate No. 50491, in and for the State of Arizona.

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P R O C E E D I N G S

speak.

JUDGE HILLSON: You're welcome.

Let's get Mr. Herbein's direct testimony and then we'll break for lunch.

(Witness excused.)

MR. BESHORE: I call Carl Herbein.

CARL D. HERBEIN,

a witness herein, having been first duly sworn by the Judge to speak the truth and nothing but the truth, was examined and testified as follows:

JUDGE HILLSON: I'll ask you if you could please state and spell your name for the reporter.

THE WITNESS: Carl D. Herbein, C-A-R-L, middle initial D, Herbein is spelled H-E-R-B-E-I-N.

MR. BESHORE: Before we go into Mr. Herbein's testimony, I would note that I've asked the court reporter to mark for the record and I would represent -- Your Honor, you need four copies?

JUDGE HILLSON: Right. It's four copies of -- well, the four copies. One goes to the court reporter, you, me, and the witness. Four copies total. And I think the first one will be number 24. How many exhibits do you have?

MR. BESHORE: I have two exhibits. I would like number 24 to be Mr. Herbein's curriculum vitae and number 25 a ten-page set of exhibits, the first page entitled Cost

Structure of Fluid Milk Plants of Various Sizes.

JUDGE HILLSON: Exhibit 24 is the curriculum vitae and Exhibit 25 is the table.

(Exhibit Nos. 24 and 25 marked for identification.)

EXAMINATION

BY MR. BESHORE:

Q. You've stated your name. Did you provide us your address?

A. I did not.

Q. Could you tell us your business address?

A. Yes. 401 Oley, O-L-E-Y, Reading, Pennsylvania.

Q. And you are a certified public accountant by profession; is that correct?

A. Yes, sir.

Q. Is the document that has been marked as Exhibit 24 a copy of your curriculum vitae?

A. Yes, it is.

Q. Would you please provide us with some highlights of your profession, background, and experience as it relates to the testimony you're going to give today?

A. Yes. I'd be delighted to.

First of all, my current position is managing partner of Herbein & Company, a CPA firm with approximately 100 employees. We are headquartered in Reading, Pennsylvania. As I mentioned earlier, I'm a CPA in the

Commonwealth of Pennsylvania. As to my particular experience in the dairy industry, beginning in the mid-'70s, I have been the partner in charge of services for all of our dairy clients. I've worked extensively with the dairy processors in Pennsylvania in the rate-making process which is managed by the Pennsylvania Milk Marketing Board.

I've previously testified before USDA at federal milk hearings. I visited on site and have provided various types of accounting services to more than 150 dairy plants.

I've been a frequent speaker at dairy association meetings, including the Pennsylvania Association of Milk Dealers, the All-Star Dairy conventions, Quality Check Dairies national conventions, Master Dairies meetings, the

New York State Dairy Foods annual meeting and also the International Association of Milk Control Agencies.

I've published three articles on agriculture and milk: One, "Financing Agribusiness Growth," a second one concerning product costing in a volatile environment, and my most recent article was entitled "Milk Costing and Regulation -- Is There a Conflict?"

I also developed, in conjunction with the International Dairy Foods Association, the Dairy Cost Accounting Workshop which is presented -- which I present annually to the industry.

I've also been engaged by several state agencies to provide consulting services in the cost of production at the processor level. The State of Colorado and the State of New Jersey are those two examples.

Q. I don't think there has been -- or I don't know that there will be a witness from the International Dairy Foods Association in this hearing.

Could you just identify for the record what that organization is and who its constituency is?

A. Yes. The IDFA, as we call it, is a trade association, the members of which are the vast majority of milk and ice cream and dairy product manufacturers in the United States and the suppliers to those companies. It's headquartered in Washington and involved with providing

educational services to their members, trade shows, and also very actively involved with the regulation of the industry from monitoring change in the orders and so forth.

Q. Okay. For how many years have you presented that dairy cost accounting workshop for IDFA?

A. At least 10.

Q. And did you, in fact, design and create that program for IDFA?

A. Yes, that's a Herbein creation.

Q. Mr. Herbein, to your knowledge, do you know any other CPAs in the United States that have done as much work with dairy processing plants from coast to coast as you have?

A. I've not encountered anyone.

MR. BESHORE: Your Honor, at this point, I would offer Mr. Herbein as an expert in dairy plant cost accounting and to testify in that capacity and express opinions as an expert in that capacity.

JUDGE HILLSON: Do you want his CV moved into evidence?

MR. BESHORE: Oh, absolutely. Yes.

JUDGE HILLSON: Any objection?

Okay. He can testify as an expert and, as well, Exhibit No. 24 is admitted into evidence.

MR. BESHORE: And Mr. Herbein has been recognized

as an expert for his testimony?

JUDGE HILLSON: Yes. That's fine. I mean, it's up to the Administrator to weigh the testimony in any event. He's qualified as an expert.

MR. BESHORE: Thank you.

BY MR. BESHORE:

Q. Now, Mr. Herbein, have you prepared a statement, a brief two-page statement, which summarizes the work that you have done for this hearing?

A. Yes. It's a three-page statement.

Q. A three-page statement. Could you proceed with that statement?

A. Yes. I'd be glad to.

I've been engaged by Dairy Farmers of America to analyze the value of unpriced raw milk to a large producer-handler and to compare that value with the cost of milk to regulated processors. I've also been asked to compare the economic impact of a regulated handler competing with an unregulated producer-handler.

The scope of my engagement: I utilized our firm's proprietary database of dairy manufacturers' operating costs to conduct my comparison. This database is maintained on a confidential basis utilizing financial information extracted from the financial statements and other accounting data of our clients. We are authorized to utilize this information

on a confidential basis for this engagement. Additionally, our use of client data is required to be confidential so as to be in accordance with the Code of Professional Conduct of the American Institute of Certified Public Accountants.

My findings: The results of our analysis are presented on Exhibit 25.

The first exhibit presents, for dairy plants of six sizes, the costs of processing and packaging raw milk into fluid milk products. The data depicts the actual costs of 20 dairy plants from our database selected to provide a representative set of plant costs of various sizes. The costs have been adjusted, using a regional CPI adjustment index, to show the costs for both the Order 131 and Order 124 areas.

The data show that as plant volumes increase, the cost of processing decreases on a per-unit basis. The change in cost per unit is greatest at the low end of the volume spectrum. Column A shows the costs of a producer-handler in the 90,000 pound per month production range, a volume which approximates the median size of producer-handlers in the Federal Order system. Column B shows the costs for a fully regulated pool plant, with 2 million pounds per month of package fluid milk products. Columns C, D, E, and F, show the costs of plants of 5 million, 12 million, 18 million, and 30 million pounds

respectively.

The slope of the curve on this exhibit is quite steep at the lower volumes and flattens out as volumes increase. The difference in the cost of processing 100 pounds of producer milk into fluid milk products decreases by between $4.40 and $4.75 per hundred pounds between columns A and B, an amount far greater than the cost advantage of being unregulated.

At the 2 million-pound-per-month size, a producer-handler can be fully competitive with regulated pool plants on a cost-of-processing and packaging basis. At this point, the competitive interaction between these handlers in the marketplace will be determined by their respective cost of raw milk.

Q. Could I interrupt you there just a second, Mr. Herbein?

A. Yes.

Q. Could you, for purposes of identifying the set of 10 tables and graphs in Exhibit 25 -- have you labeled them with letters A to K?

A. I have not but I will.

Q. Okay. If you would, when you go back to your statement, then, indicate which page, by letter, of Exhibit 25 you're referring to.

A. Continuing, Exhibit E is a comparative analysis of

the cost of serving a warehouse store count by fluid milk plants and a large producer-handler. The starting point for the study is the actual retail sales prices of a gallon of 2 percent milk in the Phoenix area during January to June of 2003 from warehouse stores.

From that point, by accumulating and subtracting the store markup, and the processing, packaging, and delivery costs to service such an account, I've calculated the value of the raw milk to the handler and compared those values to the minimum Federal Order Class I price and the statistical uniform price for producers.

The exhibit shows that a large producer-handler can service such an account and return a substantially above-market premium over the uniform producer price; however, the handler paying the Class I price for its raw milk supply will have little or no margin, even under the specific cost assumptions I have utilized.

When the average cost of processing and packaging milk in the representative plants as summarized on Exhibits -- this would be F through K.

Q. Exhibit 25, pages F through K?

A. Yes. -- Exhibit 25, F through K, are compared to the actual costs of servicing these warehouse stores in Phoenix, each plant would suffer a large loss in supplying the account.

In other words, the producer-handler's cost advantage on value milk enables it to serve these stores quite profitably at an into-store price that cannot be matched by pool plants. This analysis could be repeated for any type of customer which the producer-handler chooses to serve and the result would be the same.

The large producer-handler is in a position to acquire any account which it chooses to service by offering a price which the regulated plant could not possibly meet while staying in business.

My conclusion: The current Federal Order regulations provide the unregulated producer-handler with the significant cost advantage that cannot be matched by handlers that are regulated. The type and size of producer-handler that has developed utilizing these cost advantages is not at all comparable to the small producer-handler with a retail outlet located at the farm. Today's largest producer-handlers are vertically integrated competitive forces in the fluid milk industry serving large wholesale customers. The elimination of the unfair economic advantage of the large producer-handler, while protecting the integrity of the small producer-handler, is easily accomplished by providing the specific control points requested at this hearing.

Q. Now, I'd like to turn to Exhibit 25, Mr. Herbein,

and ask you to review that in more detail. You have it available on PowerPoint. I want to just take a minute and have that set up so we can have it on the screen and discuss it.

MR. RICCIARDI: And, Your Honor, one point. This is Al Ricciardi. We did receive the first two pages of the prepared statement. I haven't seen the third page and I'm assuming that that is going to be made available.

MR. BESHORE: It will be made available. Apparently, the reproduction process didn't pick up the third page. I will make that available. We'll get it done and have it available for everyone.

BY MR. BESHORE:

Q. Let's look at page A, the first page of Exhibit 25. Could you just review the information you've presented in that document, Mr. Herbein?

A. Yes, I will. And just to -- for the participants, my intention will be to review each of these exhibits highlighting what we did, what we're showing, and explaining briefly the content of the exhibits.

Q. Okay.

MR. BESHORE: Before you go any further, can we turn down the lights a bit, Your Honor, to assist --

JUDGE HILLSON: I don't have any problem with that. Don't ask me where the switches are.

This is not going to be real easy to see. I guess you can follow along in your charts. If people need to move up, do what you have to do.

THE WITNESS: The handouts are exactly the same as the PowerPoint presentation. Please use whichever you're more comfortable with, Mr. Beshore.

Should I continue?

BY MR. BESHORE:

Q. Yes, please do.

A. The first exhibit -- in this first exhibit, which is actually a two-page exhibit, we're going to compare and present the cost structure for fluid milk plants of various sizes. The first line, monthly volume, it's important to note that this is Class I pounds only. Beginning with a producer-handler, as I mentioned in my prepared statement, with 90,000 pounds per month we are showing both the costs for both Order 131 and 124.

It's important to note that we've adjusted our database, that we have costs that are applicable to the two areas so that we are making an apples-and-apples comparison for the Secretary.

The first page we show the producer-handler. Then the next size is a 2 million-pound-per-month plant, processing 2 million pounds of Class I product. Group C is a 5 million-pound-per-month Class I.

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Included in these groupings, the producer-handler also in the B and C group, we have multiple entities whose information I've extracted from our database. There are two producer-handlers. There are four B size companies. There are four C size companies.

Now focusing on the rest of the exhibits, the first item we are going to see after the monthly volume will be to show a per-gallon basis and how many gallons per day to show the production volume. Then it's important to note the container. That's a very large and important component of the cost of the dairy product. And the container source, as you'll see, is of two types. We are either purchasing our dairy containers or we're blow-molding them at the site of the dairy itself.

Then we have our costs on a per-gallon basis for plant processing; the packaging cost, which is the container; and then we have our product shrink, which is the amount of milk that does not end up in a container because it's lost during the processing of the plant -- in the milk in the plant. Some milk goes down the drain. Some milk remains in the fillers at the end of the day, inaccuracies of production and so forth. And that's what, in the industry, we call shrink.

Then we're going to see a per-gallon number and we've converted that to a per-hundredweight number, which is

what's pertinent.

Let's take a look at the results. For the producer-handler in 131, his costs, on a per-hundredweight basis, are $11.71. In 124, that number is $12.55.

Moving on to the results in the B size, for 131 the cost is $7.31 and in 124, $7.80. For the C type, 5 million pounds per month, the cost is $6.88 in 131 and $7.33 in 124.

Now we'll go to Exhibit 25B and review the larger processors. Again, the same headings, the same information. I won't repeat that, just simply focus on the result.

The per-hundredweight cost at 12 million pounds Class I monthly is $6.45 in the 131 area. In the 124 area, it's $6.87.

In the 18 million pound per month, we have a $5.54 cost per 100 in 131 and in 124 $5.91.

Now, here's an important break point as far as what happens with the container.

When a plant has volume of 12 million pounds or less, it's not economically feasible to blow-mold bottles, and those companies purchase their bottles. You'll see in the packaging cost area that they cost 14.2 cents at this point in time.

When we blow-mold the bottles, much more efficient, you make the bottles on site. The cost drops to

11.3 cents. Almost three cents per gallon in cost saving at that point. That's very significant in the dairy industry.

In our largest group, the 30 million pounds per month, we see that the cost in 131 is $5.32 and in 124, it's $5.67.

A few other comments.

The plant processing costs that are reflected here are actual costs. They are not theoretical engineering studies but the costs that have been extracted from the annual financial statements for the plants that are in the various cost sizes.

And shrink is another point to highlight. As you review the shrink from the smallest group to the largest group, the shrink on a per-gallon basis decreases because of the increased efficiency in the dairy plants as they get larger. Typically, that results from longer production runs, less changeover going from 1 percent to skim milk and back to chocolate milk and things of that sort. That's called changeover and that results in product loss.

Q. Now, the information that you have depicted on pages C and D of Exhibit 25, is that the information on A and B in a graphic fashion?

A. Yes. There are two graphs which I will just highlight quickly.

I like to -- in my line of work, I'm stuck with

numbers all the time. When I get an opportunity to look at something with a picture, I would like to do that.

And this first graph, which is C, shows the -- on this axis, we're looking at the per-gallon cost and the Class I pounds is the horizontal axis.

Area 124 is the top line, the light-colored line. 131 is the bottom line.

And, again, the slope ties in with -- as we get larger, essentially our costs go down, a big drop from the producer-handler down to the 2 million group.

Let's now look at this on a per-hundredweight basis which is designed for this hearing. And, again, the same order. 124 is the top line. 131 is the bottom line. Again, the same slope as you would imagine because all we've done here is converted the per-gallon cost to a per-hundredweight.

What I'd like to do next is move to 25F and then a series of exhibits that follow really for each sized plant for which we present costs.

Q. You would be starting with 25E, right, I think?

A. Yes. Thank you.

Q. And 25E is titled Comparative Analysis of Return to Producer-Handlers and Regulated Distributing Plants Supplying a Warehouse Store; is that correct?

A. Yes.

Yes. Thank you. I shuffled a page out of order.

This Exhibit 25E is a Comparative Analysis of Return to Producer-Handlers and Regulated Distributing Plants Supplying a Warehouse Store. We're going to walk through the preparation of this exhibit so we can all understand the -- what the exhibit demonstrates.

First of all, the information as to the prices that we're going to see in just a moment are January to June 2003 for a reduced fat 2 percent two-gallon package. It's important to remember that it's two gallons of milk of 2 percent. The average was arrived at by simply taking the retail prices for January through June and adding them together and divided by 6. So it's a simple average of the prices.

The average retail out of store -- this is the -- what a consumer would pay going into a warehouse store, which is $3.29.

Q. Now, where did you obtain that information, Mr. Herbein?

A. That information came to me, and I'll go in reverse order, from you, Mr. Beshore, who received it from Mr. English, who received it from Shamrock Farms.

Q. And is that the information that Mr. Krueger indicated yesterday was collected by his employees?

A. Yes.

Q. Okay. And what stores did the -- were the prices applicable to? Where were they charged?

A. These were the prices charged by Sam's and Costco. And I included both chains in the calculation of my average.

Q. And that was in Arizona?

A. Yes. In the Phoenix market.

Q. Okay. And from January to June 2003, actual out-of-store prices?

A. Yes, absolutely, actual out-of-store prices.

The next part of the exhibit -- and there are two items that I would like to next discuss which are very important, the warehouse store markup -- and I've calculated it under two scenarios, one being 8 percent and the other being 14 percent.

In reviewing this part of our -- performing this part of our project, we've reviewed actual client cost studies for clients that were selling and are selling fluid milk products to warehouse accounts.

The lowest store markup in the information that we reviewed was 8 percent and the largest was 14 percent.

So that we could cover the spectrum of profitability and cost and value of milk, I've made calculations under oath of those scenarios at 14 percent and at 8 percent.

The next line entitled Price Paid to Dairy

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supplier is arrived it by subtracting the 14 percent discount, 14 percent discount -- excuse me, 14 percent markup from the out-of-store price to arrive at 2.8294. And the same mathematics, the 8 percent markup is subtracted to give the dairy supplier invoice amount of 3.0268.

So at that point, what we have is on the processor end, what the processor would be invoicing the warehouse store for a delivered product in their store.

The next part of the project was to develop dairy supplier costs, because what we're doing is we need to present what are the costs to get a gallon of milk to a store, and that involves plant costs, packaging costs, distribution costs, shrinkage, and our milk PEP fee. And the total for the 14 percent analysis of those costs is 1.1372 and, in the 8 percent, it's 1.1372 also, same cost structure.

Now, it's important to understand the basis upon which these costs were determined. First of all, the plant costs are the result of specific cost studies in plants with dedicated departments to process this type of milk, this -- a product being placed in two-gallon packages with a blow-molding operation on site.

The packaging is two blow-molded gallons but the labels and caps and the box that holds the two gallons. Distribution? Very efficient and somewhat unusual distribution. All on pallets delivered to these warehouse stores. In many cases, tractor-trailer loads to a store. So it's very efficient, low-cost distributions.

Shrinkage is appropriate. Shrinkage for a large plant processing a high-volume gallon item, which is a very efficient product, and milk, PEP, again is the 20 cents a hundredweight that is paid to support what I call the milk mustache program.

Q. That's the Milk Processors Education Program?

A. Yes.

Q. That's the same program that's been referred to and handlers 3 million and above are obligated to pay the 20 cents per hundredweight and handlers below the 3 million volume are exempt?

A. That's correct. And that's a cost that the processor has to pay, again, when they are above that 3 million level.

So at this point, what we have is we have the net -- the invoice going to the warehouse store in the 14 percent column, 2.8294. And then we've accumulated and accounted for all of the costs that are in that package of milk except the raw milk.

So the next item, the next line, is to simply subtract from the invoice to the warehouse store from the -- from 2.8294 we subtract all of the costs. 1.6922 -- and we arrive at the value of the raw milk at 1.6922 or 1.8896.

Q. Those are all per-gallon figures?

A. That's two gallons.

Q. Per two gallons?

A. That's two gallons.

And then the next line, Mr. Beshore has converted to one gallon and there we have .8461 and .9448, and then we've converted that to hundredweight and that's $9.83 and $10.97 on the 14 and 8 percent scenarios.

Q. Can you just stop right there for a second?

On the basis of the actual known retail prices from these wholesale warehouse stores, warehouse stores, in Phoenix for the period January to June, comparing -- we don't know the markup. You do know, from your database of information of prior studies, that warehouse stores market fluid milk in two-gallon packages up at least 8 percent and in some cases as high as 14 percent, so that gives us the full range of possibilities --

MR. BERDE: 14 percent?

THE WITNESS: Yes. 8 to 14 percent.

BY MR. BESHORE:

Q. That gives us the full range of possibilities, and you, from your information in the database of plant cost information, you've calculated the costs of providing that particular package to those stores, distribution costs, plant costs, packaging costs, shrinkage cost and milk PEP as you've indicated. That leaves a residual value for the processor to pay for raw milk ranging from 9.83 per hundredweight to 10.97 per hundredweight; correct?

A. Yes.

Q. And that's a 2 percent butterfat level?

A. 2 percent. I neglected to mention why we selected 2 percent.

In reviewing the Market Administrator's information for 131, and this is a calculation based upon Phoenix, 131, the average butterfat test for fluid milk products is almost dead on 2 percent.

So that was the appropriate package to use.

Q. So that's the blended -- if we can use that terminology here, the blended fat percentage of fluid milk products in the market?

A. That's correct.

Q. Okay. Now, what did you do with that -- the figures of the value of raw milk?

A. The next step was to compare the value of the milk on a per-hundredweight basis with our Class I cost for FO 131 of $10.53. And, again, this a six-month average so that we're comparing apples to apples. We've taken a Class I cost of butterfat, adjusted it to a 2 percent package and it's $10.53.

We then also compared both columns, 14 and 8, with the Federal Order 131 uniform price. Again, that's a six-month average, butterfat adjusted. And that number is $8.79. And then the results are when we compare in the 14 percent column to Class I, we find a 70-cent under Class I value at the 14 percent margin and an excess over the uniform price of $1.04 for the 14 percent column. And in the 8 percent approach, when we compare with Class I, we have an excess of 40 cents; and at the uniform price, $2.18.

Q. Now, is there any profit margin in these figures at the plant level?

A. No, there's not. This is strictly a cost-base approach.

Q. I take it your analysis shows that if the markup is 14 percent, the handler paying Class I costs is providing the product at a loss approximating 70 cents per hundredweight?

A. That's correct.

Q. Somewhere in between the 8 percent and 14 percent you get close to a break-even point for the regulated handler without any profit -- any margin whatsoever; correct?

A. Yes. And that's something that I considered for this presentation, Mr. Beshore, is the inclusion of profit, because it's my opinion that without profit in a dairy processing plant, we have no future.

But I decided to not confuse things or complicate things with an artificial profit number because that would have just been my judgment.

These are actual, hard numbers that are not at all judgmental. They are real.

Q. For a handler that is not required to pay the Class I price, the producer-handler to account to the pool and its suppliers at the minimum Class I price, the return over the uniform price which all other producers in the order get ranges from a minimum of $1.04 per hundredweight to $2.18 per hundredweight; correct?

A. Yes. And that's a sizable advantage over the uniform price. That's very material in my opinion.

Q. Could you proceed to the next page of Exhibit 25, then.

A. 25F is the analysis of supplying a warehouse store for the producer-handler, and the results of this are losses of 1.23 per two-gallon or $7.16 per hundred pounds of milk.

So this shows a real loss. And, again, this is a raw milk cost that is calculated at Class I values.

Q. So Exhibit F is a comparison or an analysis of the viability of supplying that product to the warehouse store at the prices it pays by a small producer-handler, the column A group in Exhibit 25, page A; correct?

A. That's correct.

Q. So the costs that are based upon your actual financial information from small producer-handlers and said if they were going to supply the warehouse store at what it pays for milk, here's how viable it is and it shows that they can not economically do it except at a massive loss; is that correct?

A. That's correct. I would just like to emphasize that we gave them one fairly sizable break in this analysis and that is in distribution. The distribution cost that's presented here at .296 per two-gallon package is the efficient delivery system, the producer-handler and the rest of the processors convert their normal distribution into a warehouse distribution scenario, tractor-trailer pallets.

So if we used average delivery costs to their average customer, we would have a much more dreadful result.

Q. Okay. Could you proceed, then, to the next page, G, which is the analysis of a warehouse store being supplied by the pool distributing plant, B?

A. Yes. And this supplied -- we'll get the entire thing here.

We have to make a correction to this -- to the overhead. The handout has the correct numbers but there's a typographical error in this -- in the slide. The milk PEP of .03 should not be here. This milk is not subject to the

milk PEP at a 2 million pound-per-month level. The total cost number on the exhibit is 3.502. The loss per two gallons is .475 and the loss per hundredweight is 2.76.

Again, the handout is correct. It's the PowerPoint that is not correct.

Q. Would you proceed through the rest of Exhibit 25 then?

A. Yes. Again, the loss here per hundredweight was $2.76.

Moving on to plant C, again, we'll conserve some time here and go to the very end. Here, this distributing plant C would have a loss of $2.53 per hundred, 43.5 cents per two gallons. Again, a sizable loss for an even larger plant.

Moving on to the next category, plant D, plant group D, again, going to the results, we have a loss per two gallons of 36.1 cents for every two gallons or $2.10 per hundred. So, again, not at all economically viable to serve that account.

Q. And plant D is at the 12 million-pound level?

A. That's 12 million.

The next group, E, is the 18 million-pound-per-month group, and the results here, again, we have a loss per two gallons of 21.5 cents and a $1.25 per hundredweight. So, again, a loss far too large to make it

feasible to serve that account profitably.

The last category, the 30 million-pound group, the results here are that we have a loss for every two gallons of .177, 17.7 cents and, on a per-hundredweight basis, $1.03.

Q. Now, the costs in the columns A through F of 25A and 25B as they have been portrayed in pages F through K, those costs are average plant production costs for plants of those size ranges; is that correct?

A. Yes, from our proprietary database.

Q. But the distribution costs have been tailored strictly to the two-gallon package in the warehouse store?

A. Yes. That's correct.

Q. Packaging costs are queued to the type of package being produced, being produced to the warehouse store?

A. That's correct. The product being studied here in this analysis is a two-gallon package of 2 percent milk.

Q. And your conclusion, Mr. Herbein, from your study is that -- let me just ask you. Is it possible for regulated plants of any size to compete with the unregulated producer-handler at the prices analyzed for serving this warehouse account?

MR. RICCIARDI: Let me object to that opinion, Judge. I don't think he's established that he has the expertise to be able to give us, based upon CPA -- based

upon his background, that type of an opinion.

JUDGE HILLSON: I'll let him answer the question and then I'll ask his reasons to support his opinion. Before I do, just in terms of breaking, how much longer do you anticipate you'll have, that the direct testimony will be?

MR. BESHORE: I'm about complete.

JUDGE HILLSON: Okay. In that case, we'll continue.

BY MR. BESHORE:

Q. Do you recall the question?

A. The question that I recall is do I believe it to be possible for a regulated handler of any size to compete for this type of customer.

Q. Yes.

A. And my opinion, based on my study and the -- really, the economic results, I believe that it's self-evident when looking at the exhibits that when you have a loss on the bottom line, when you've accounted for all of your costs in accordance with Generally Accepted Accounting Principles and you have a loss, it doesn't make sense, from a business standpoint, to pursue that sort of business because you are losing money, and that's -- you can't pay your bills if you lose money.

Q. One final question, Mr. Herbein.

In your experience working with fluid milk plant owners and operators, do they have knowledge of the accounts that their competitors service and the volumes supplied to those accounts?

A. Yes.

Q. What is your basis for that statement?
A. The basis is my practical experience in providing accounting advice to fluid milk -- in this case, we're talking about fluid milk to fluid milk plant operators including the most recent example that I've seen and I've seen it in a couple of scenarios.

The first time I saw this was a client called and was very excited. They had an opportunity to bid on a chain of stores, supermarkets, and it was going to be pretty much a blind bid. The milk buyer really didn't want to change suppliers but went out on bid because of pressure from upper management. So he didn't supply very much information. So I was called in to help analyze and review the study that the cost accountants and salespeople had put together.

And they had store locations and sales volumes for every store. I inquired as to where they got that. They developed that themselves by sending their sales force to visit all of the stores. They counted the returned milk cases that were on the loading dock. They just asked questions of people and they came up with estimates.

So the estimates turned out to be surprisingly accurate. That was the first time I saw that. Maybe 10 years ago.

About six weeks ago, our firm was engaged by a fluid milk processor that was very interested in acquiring another dairy.

There was a business intermediary involved representing the seller. There were confidentiality agreements which my staff and I had to sign and all of the people involved from our client's end signed. We got a great big book from the business intermediary which included a lot of confidential information.

I had it at my office and spent a weekend studying it and then we had a very important meeting on Monday morning, just a few weeks ago, and included in this information was -- were customer names and volumes.

So we got to our client's location and the president of the company came in and he had a schedule that they had prepared based upon their knowledge of the market. And the study that their sales force had and the customer names, the products being sold and the volumes were almost identical to what was shown by the business intermediary and they didn't copy from one another; it was developed by the sales staff. And the margin of error was probably about 1 percent. It was a very eye-opening experience.

We discussed this and my client's personnel said, "Our competitors know exactly who our customers are."

And we heard some testimony here yesterday -- I think it was about the plant code that is on the bottom of -- on each container. And it's pretty easy to see who is supplying the product. And if you're a knowledgeable milk salesperson, one of your jobs -- most milk salespeople have either territories or specific customers. Where there is a territory, you're expected to know every milk outlet in your territory and who is supplying it if you're not and develop an estimate of the volume for sales leads and market programs.

MR. RICCIARDI: Is there going to be a question in our lifetime, Judge?

JUDGE HILLSON: I don't know what the question was but I think he's finished his answer.

MR. BESHORE: The record will show he's answered the question.

MR. RICCIARDI: And it will show it has nothing to do with what the question was.

JUDGE HILLSON: You didn't move that exhibit into evidence.

MR. BESHORE: I move Exhibit 25.

JUDGE HILLSON: In the absence of an objection, I will allow --

MR. YALE: Your Honor, there are some numbers that are very suspect based on our knowledge. We think before it's admitted, we have a right to voir dire on that exhibit and the contents of that exhibit because it has the surface of having some truth to it that we believe will not be there. And just admitting it -- until that's done I think it's premature.

JUDGE HILLSON: Go ahead, Mr. Beshore.

MR. BESHORE: We think the same rules that apply to everybody else ought to apply to our exhibits. That is, they have been admitted subject to being examined by and the Secretary considering them for the full weight that they present.

MR. YALE: None of my exhibits have been admitted under that statement, Jim.

JUDGE HILLSON: At this point, I'm going to admit it. You're going to have a full opportunity to cross-examine him on it and show it's worthwhile or nothing as the case may be. I'm going to admit Exhibit 25 into evidence.

MR. RICCIARDI: Subject, Your Honor, to cross-examination, to showing the veracity of the information, and I'm assuming we would have the opportunity to move to strike the exhibit and I'll ask you to do that.

JUDGE HILLSON: You can move it, yes. You will

have that opportunity.

It's just after 12:30. Let's take an hour for lunch and be back at 1:30.

MR. YALE: Your Honor, because of the nature of this testimony and this exhibit, we would request that we have an hour and a half in order to eat and prepare the cross-examination.

JUDGE HILLSON: I don't think we have that much time. I promised we would try to work a full day today.

Was this exhibit available last night?

MR. YALE: I saw it, basically, just before he presented it. I mean, this is really, in all honesty, it is the first time that we've had something now that is starting to get to the issue two days into the hearing. This is a very, very important witness for them. It's a very important witness for us to cross-examine. I would suggest that an hour --

JUDGE HILLSON: We'll recommence our hearing at 1:45; okay?

MR. YALE: Thank you, Your Honor.

(Whereupon, these proceedings were recessed at 12:31 p.m.)

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STATE OF ARIZONA)
) SS.
COUNTY OF MARICOPA)

I, Elaine M. Cropper, hereby certify that I was present at the captioned proceedings; that I made a shorthand record of all oral matters had and adduced at said proceedings; that thereafter, the transcript of said proceedings, pages 1-792, inclusive, were reduced to typewriting under my direction, and that the material contained herein is a true and accurate accounting of said matters, all to the best of my skill and ability.

DATED at Phoenix, Arizona, this 30th day of October 2003.

Elaine M. Cropper
Certified Court Reporter
Certificate No. 50491

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UNITED STATES DEPARTMENT OF AGRICULTURE

In the Matter of:)
)
PROPOSED CHANGES)
WESTERN AND PACIFIC NORTHWEST)
MILK ORDERS)
______________________________)

TRANSCRIPT OF PROCEEDINGS

BEFORE: MARC R. HILLSON
Administrative Law Judge

VOLUME IIIB

(Pages 793 through 984)

Tempe, Arizona
September 25, 2003
1:47 p.m.

Prepared By:

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I N D E X

EXAMINATION

E X H I B I T S

EXHIBITS

Number		Admitted Page	Line
27B	Document entitled "Fluid Milk Processing Costs: Current State and Comparisons," authored by Dalton, Criner and Halloran	910	1
27C	Document entitled "An Analysis of Processing and Distribution Productivity and Costs in 35 Fluid Milk Plants," by Erba, Aplin and Stephenson, 2/97	910	1

RECESSES

	Page	Line
(Recess at 3:20; resumed at 3:34.)	860	23
(Recess at 5:15; resumed at 5:30.)	933	7

TRANSCRIPT OF PROCEEDINGS,

taken on September 25, 2003, commencing at 1:47 p.m., at the Sheraton, 1600 South 52nd Street, Tempe, Arizona, before Lorena Marin-Garcia, a Certified Court Reporter, Certificate No. 50541, in and for the State of Arizona.

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TRANSCRIPT OF PROCEEDINGS

JUDGE HILLSON: Let's go back on the record.

Before we resume, before we start the cross-examination of our witness, I just wanted to make a couple of announcements.

One is that, when we're done today, we're going to next reconvene in Seattle on November 17th. We already have a room at the -- for the hearing at the Doubletree Airport -- Doubletree Hotel at the Seattle airport. We can Xerox that and put all that information in the back of the room.

I plan to start on Monday morning, November 17th, at 8:30 in the morning and go until we finish or Thanksgiving, whichever comes first, okay? I'm hoping that we can finish by Thursday, the 20th. We have the room reserved until about noon of the 21st.

If for some reason we can't finish by then, we may just have to wrap up the last day or two, if it goes that long, in Alexandria or somewhere in the D.C. area just to do the final wrap-up.

The other thing is that there were plans that Mr. Mykrantz would testify again today. He's prepared a number of documents on request that are in the back of

the room. I'm trying to ascertain whether people actually want him called again today or whether they just want to see the information in the back of the room or if they have any other ideas that they want to discuss with respect to Mr. Mykrantz, so you can think about that in the next short while.

The schedule I have today that we're going to try to get through is, after Mr. Herbein is done, the proponents are going to call Mr. Cryan and Mr. Hollon and try to get through those two witnesses.

That's about the best we can hope for today; is that correct? That's the optimistic view?

MR. BESHORE: Quite optimistic. That's the order.

JUDGE HILLSON: Our court reporter is willing to go late, but I promised her that if we go -- if we're going to think about going late, I'm going to call a break every hour and a half just to give her a little break. Instead of having one 15-minute break, we probably may have two or three or four, depending how late we go, 10-minute breaks just to give her a chance to recharge her batteries, figuratively, and literally in the case of her machine.

So anyone have any thoughts about calling Mr. Mykrantz? Do you just want to see the documents

prepared, or do you need him to come up and say what he did for five minutes?

These documents wouldn't be -- certainly wouldn't be put into evidence today. They were just prepared. They wouldn't be put into evidence at this time unless people want him to testify and get them into evidence. They're mainly here at the request of various parties, various calculations, and as long as you have them, I would think that that might be good enough for now. I could call him just to get them marked or not. I just don't have a preference in that.

MR. YALE: Calling him to be marked is not worth the while, okay? And I guess if we get time, maybe he might be a nice one to fit in. We may not have time for Mr. Hollon. If we've got time left over, we can deal with him.

JUDGE HILLSON: At this point, the documents he prepared are in the back of the room. Feel free to take whatever you need.

And at this point, I guess it's time for the cross-examination of Mr. Herbein.

Who's our first cross-examiner?

MR. YALE: Go ahead.

MR. RICCIARDI: Okay. I will.

CARL D. HERBEIN, CPA,

a witness herein, having been first duly sworn to speak the truth and nothing but the truth, was examined and testified as follows:

EXAMINATION

BY MR. RICCIARDI:

Q. Mr. Herbein, Al Ricciardi on behalf of Sarah Farms.

When were you first called to consult on this matter?

A. I'm not sure of the exact date. 30, 45 days ago.

Q. And did you prepare an engagement letter?

A. Yes, I did.

Q. Okay. And was an engagement letter signed by someone?

A. Yes. It was executed between our firm and DFA.

Q. What are you being compensated for your time?

A. I'm being compensated on an hourly basis.

Q. And at what rate?

A. The rates vary for different people that have worked on this engagement with me, with a range of 150

to 250 per hour.

Q. And 250 an hour is your rate?

A. Yes.

Q. How many hours have you spent on this project so far?

A. I'm not exactly sure. My personal time is probably 60 hours.

Q. Can you give us the amount that you have -- your firm has billed to DFA thus far for the work you've done?

A. Yes. Zero.

Q. You haven't billed it yet?

A. No, I have not billed anything.

Q. Okay. Can you give me an estimate as to what the amount has been that's been expended in hourly time and costs?

A. Actually, I can't. I haven't checked our time and billing system in the last week. I've been busy getting ready for this hearing.

Q. That I understand.

You keep billing records for your time; correct?

A. Yes, I do.

Q. And the people who are working for you on your project would also keep billing records?

A. Yes. We all individually enter our time into our computerized time and billing system.

Q. You'd be willing to provide the engagement letter and your billing records to us prior to the time we convene again?

MR. BESHORE: Your Honor, why do you need all this? He said what the compensation rate was. Why do you need to know the exact total of that?

Object to the question on the grounds of materiality.

JUDGE HILLSON: Okay. I'm just curious myself.

MR. RICCIARDI: Your Honor, if we're going through any kind of a regular piece of litigation when we're doing what amounts to deposition testimony, which is effectively what we're doing here, we're certainly entitled to get the engagement letter. We're certainly entitled to get the billing records to confirm the information that the witness is providing.

And this witness is telling me at this point that he has no idea as to the amount of time that's been expended. I think it's information that should be in the record for the Secretary to look at so that the Secretary can look at issues about bias and prejudice and amounts being paid, et cetera.

MR. BESHORE: This is -- I would remind Mr. Ricciardi that this is not a regular piece of litigation being conducted pursuant to the Federal Rules of Civil Procedure relating to expert depositions, et cetera. This is an administrative proceeding before the Secretary of Agriculture, simple rules of practice, and this type of information is not material.

MS. DESKINS: Judge Hillson, maybe I can help out with this just a little bit.

If he thinks it's relevant, of course, he can inquire into it, but I think for the Secretary's purposes, once he's established they have been compensated that they have particular biases. I don't know the need for additional information to establish that because I think he's established it on the record.

JUDGE HILLSON: I think -- you have his hourly rate. You have a general number of hours. I think as far as -- based in large part on his representations, I think the administrator and the Secretary have all they need to know in terms of that, so why don't we just move on.

MR. RICCIARDI: Fair enough, Judge.

Q. BY MR. RICCIARDI: Have you in the past provided consulting services to DFA?

A. Yes, a few times.

Q. How many times have you provided such services to DFA?

A. The work that we've done with DFA prior to this engagement has been with some of their operating subsidiaries, and there are -- there was one ongoing engagement where DFA was a partner in a joint venture where we were the regular accountants and auditors. That engagement continued for many years, more than 10.

There was another engagement that we did a special accounting study for one of DFA's joint venture partners. That was one engagement and done. And that really, I believe, in my memory, is the extent of our DFA work.

Q. Can you tell me approximately, prior to this engagement, how much your firm has been compensated by DFA for work that your firm has done?

MR. BESHORE: Your Honor, could I just interpose an objection at this point? The testimony, as I heard it from Mr. Herbein, did not indicate any direct engagement by DFA, but apparently by some joint ventures involved in DFA in the past, so I don't think --

JUDGE HILLSON: This was dispositive to the question. You could answer the question, but generally, it's clearly established that you say he's done a lot of work with DFA over the years and he's getting

compensated for that.

How much does the Administrative Secretary need to know about it? I guess not too much. So if you -- you can answer that last question if you know what it was. It was how much compensation --

THE WITNESS: Yes. And I have no objection to answering that.

The ongoing audit and tax work for one of their joint venture partners amounted to about $25,000 a year. That continued for perhaps about five or six years.

That's over now because the ownership has changed. The once-and-done accounting system engagement was $15,000, and that was a few years -- it was about three years ago.

Q. BY MR. RICCIARDI: How many clients do you have that are in the dairy business?

A. Presently, my estimate would be 75.

Q. How many of those 75 are members of DFA?

A. Really, other than DFA as a client, none.

Q. Okay.

A. We currently have no work other than this engagement with DFA or any of its affiliates.

Q. Are any of your clients producer-handlers?

A. Yes.

Q. In what area of the country?

A. Pennsylvania.

Q. And can you tell us the name of your producer-handler client in Pennsylvania?

A. No. As I said in my prepared statement, the existence and the identity of our clients is considered to be confidential -- required to be confidential.

Q. I understand from your statement that, in order to prepare Exhibit 25, that you utilized information in a database of dairy manufacturing operating costs; correct?

years.

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Q. Okay.

A. We currently have no work other than this engagement with DFA or any of its affiliates.

Q. Are any of your clients producer-handlers?

A. Yes.

Q. In what area of the country?

A. Pennsylvania.

Q. And can you tell us the name of your producer-handler client in Pennsylvania?

A. No. As I said in my prepared statement, the existence and the identity of our clients is considered to be confidential -- required to be confidential.

Q. I understand from your statement that, in order to prepare Exhibit 25, that you utilized information in a database of dairy manufacturing operating costs; correct?

A. Yes:

Q. Can you tell me how many dairy manufacturers were included in that database?

A. I can give you an approximation.

Q. That'll be fine.

A. There are at least 50 active participants in that database as of this time.

Q. Does your firm currently have as a client any dairy manufacturer in Order 131?

A. No.

Q. Does your firm currently have any dairy manufacturer in Order 124?

A. Yes.

Q. How many?

A. One.

Q. You indicate that you're authorized to utilize this information on a confidential basis for this engagement. Did you actually get the authorization of all of the dairy manufacturers that you do represent as clients that are in the database?

A. Yes, but let me just explain the methodology employed.

When we utilize a company's records in our database for cost benchmarking or for whatever purpose, we tell our clients that we're doing that and we give them our assurance that their identity and the identity of their individual information will not be disclosed to anyone. And we've been following that policy for more than 20 years without any problems.

Q. In terms of the underlying data for the operating costs, about how far back does that data go?

A. One year. It's the -- this information that was utilized is the most recent year, calendar year 2002 or fiscal years ending during 2002.

Q. Would those be yearly financial statements?

A. Yes.

Q. And would there be data to accompany the yearly financial statements to ensure the authenticity of the information?

A. We enter information -- yes. And we enter information into our database and use the information only when we understand it and we've worked with the data in some other capacity.

There's no survey-type situation here that we call Dairy X and ask them to send us their information. It's not that at all. It's where we're regular accountants for the company or we've done an engagement for them, so we understand the information.

There is a lot of information in addition to the financial statements that one needs to utilize, volume of production and that type of information, which we also gather.

Q. Do you have other clients that are dairy manufacturers that you did not include in your database?

A. Yes.

Q. Who made the selection as to the companies or entities or individuals that would be in the database?

A. I did.

In the database?

Q. Yes.

A. I review and approve all of the companies that go into the database, and I made the individual selections that were utilized in this engagement.

Q. Did you say -- and I apologize. I'm not

trying to trick you. I don't remember. Is it 15 or 20 that you used?

A. 15 or 20 that were used in this project.

Q. And how many do you have overall?

A. Approximately 50.

Q. Okay. So you selected 20 out of the 50?

A. Correct.

Q. And what was the criteria that you used to select the 20 out of the 50?

A. Size and the nature of their process, what they -- what products they'd manufactured. We were looking -- since this is a fluid milk matter, we were looking for fluid milk manufacturers in our database. We have ice cream companies, ice cream mix companies, novelty, cottage cheese, yogurt. And that, of course, isn't pertinent to what we're doing here, so we selected fluid milk companies.

Q. What are the sizes of the dairy manufacturers within the 20?

A. The 20 are -- the sizes of those companies are shown on 25A and 25B as to monthly Class I volume in terms of pounds. So, for example, looking at Group C where we say 5 million pounds per month, the four companies that are in that category, where that information was gathered, would have approximately

5 million pounds of Class I business per month.

Q. Okay. So what you've got is, if we look at Groups A through F, they're going to have volume -- of the 20 that you used for the database -- within the range; is that correct?

A. Yes, that's correct.

Q. And are they equal in number?

A. The 20 are comprised of two producer-handlers, 2B and four in each one of the other categories.

Q. Is one of the producer-handlers in the 124 area?

A. No.

Q. Is there a reason why you decided not to use the producer-handler in the 124 area as part of the database?

A. I didn't have access to producer-handler information from 124.

Q. And can you tell me, then, in what area of the country the producer-handler information came from in Section A?

A. Yes. Pennsylvania.

Q. Is Pennsylvania regulated by a Federal Order?

A. Parts of Pennsylvania are regulated; parts are unregulated. And the entire state is regulated by

the Pennsylvania Milk Marketing Board.

Q. And the producer-handlers that are used in Section A, are they from the regulated or unregulated or state regulations?

A. State regulated.

Q. Is there a reason you chose the state regulated versus the federal?

A. No.

Actually, I was looking for what I considered to be representative producer-handlers and based the information that Mr. Beshore and Mr. Hollon extracted from or requested from the market administrator as to what's average. That played a part, a big part in what I was looking for, and I felt fortunate to find these handlers who fit the average size, so I thought that was a fair representation for these proceedings.

Q. Let me go to a different topic, and I'll get back to where we were headed.

If you were engaged by a dairy manufacturer to conduct an audit of its operating costs, what would you do?

A. That's a good question.

First of all, an audit of one's operating costs, as opposed to an audit of the financial statements, would be a special assignment. It would be

a special scope engagement, as opposed to an audit like we do for Wall Street.

But under the concept of auditing and under today's professional guidance and responsibilities, you would verify the existence of the expenses on a test basis to make sure that, if the utilities in a plant are shown as $100,000, that in fact $100,000 was paid. And you do that for all of the major expense categories.

Then you would also do what I guess professionally isn't called a smell test, but I call it a smell test. You do a comparison of the operating costs of that organization with industry norms to see if things are normal. And if they're not normal, then you investigate any abnormality. And that would be what I call cross-benchmarking.

At the end of all of that, if you were satisfied that everything was as it was presented, you'd issue a report that would say, "I've examined the cost of X, Y, Z and my findings are A, B, C, and things have been done in accordance with Generally Accepted Accounting Principles."

Q. And let me follow up on what you just said.

You're required to comply with GAAP, Generally Accepted Accounting Principles; correct?

A. Yes.

Q. And you're also required to comply with GAAS?

A. Yes.

Q. And that is what?

A. Generally Accepted Auditing Standards.

Q. Okay. That's what you would have to do in the special type of engagement that I've asked you about; right?

A. Yes.

Q. One of the things you would do is you would attempt to verify the underlying costs, and that would be a request of the client to "Let me see," for example, "some documents to show me the costs that you've expended"; correct?

A. That would be one of the procedures that you might employ. There's a lot of professional judgment that's employed in doing that sort of an engagement, but that would be one procedure that's normally employed.

Q. And you'd also probably go ahead and visit

the operating plant yourself; correct?
A. Yes, to the extent that there was examination of evidential matter that's necessary, it would be highly unusual not to do that at the place of business, wherever the headquarters of the company would be.
Q. And if I change the scope of your engagement now for a moment, instead of auditing the costs,

auditing the financial statements, how would that change what you do?
A. Well, the financial statements involve many aspects that are not in operating costs. For example, in an audited financial statement, you have a balance sheet, the assets and liabilities and equity in an enterprise. And an audit requires the auditor to verify that all of the assets are properly stated and that the liabilities are all recorded and recorded at the right amounts.
There's also a requirement to produce a statement of changes in financial position and cash flow to be able to have the user of the financials see where the money came from and where it went to.
And then probably the most difficult part of an audit, frankly, are the footnotes, explaining the financial statements and the accounting principles and disclosing other important information for the users of the financials.

So it's a much more comprehensive engagement than just auditing, in your initial question, the operating expenses.

Q. The 20 people that are -- companies that are used as part of the database that form the basis for your opinions in Exhibit 25, you've got financial

statements with footnotes that comply with GAAS and GAAP in your file somewhere; correct?

A. Yes, for the vast majority. There are one or two out of this 20 where the financial statements are not audited. They're reviewed or compiled.

And I believe there's one that is a tax return, that the only formal document that we issued or that we were involved with is a tax return. But the majority of them are audited financials.

Q. Now, you did not do any type of an audit of Sarah Farms in this case; correct?

A. I did not.

Q. You did not do an audit of any of the dairies in Order 124; correct?

A. I did not.

Q. And you are not allowing me, in order to take a look at the information in Exhibit 25, to explore the underlying data that you utilize because you claim it's confidential; correct?

A. My statement, my written statement disclosed my responsibilities to our clients, and they are as I said in my direct testimony, and that is that that data and their identities are confidential.

Q. You won't provide to me the 50 dairy manufacturers that you chose, that was the universe you

chose from to pick the 20; correct? I'm not going to get those to look at?

A. No, sir.

Q. I'm not going to get the 20 financial statements that you utilized as part of the universe that you used for Exhibit 25; correct?

A. That's correct.

Q. And I'm not going to be able to determine whether or not the information that you put in this document is verified; correct? I'm going to have to accept what you said; right?

A. No, I wouldn't agree with that. I would say that the -- your ability to ask questions about this data and how it was put together is -- and I've gone through this before, and I think that you have adequate ability to ask questions.

And I think there's also the issue of the -- my explanation of where the information comes from. And as someone said earlier in this proceeding, I'm testifying under oath. I've spent my life working in the dairy industry, and I assure you that these are real numbers from our files.

Q. Well, you know, I appreciate that, sir, and I appreciate that you're here being paid for the time that you've spent as an expert.

But you understand that I'm not going to get to take a look at the underlying data that forms the basis of Exhibit No. 25, and my client is not going to have the opportunity to allow me to explore that data, and I guess my question is, do you think that's fair?

A. My response to that would be that I'll just tell you my thought process on accepting this engagement with DFA.

When one accepts an engagement, you need to understand the rules of the game. And I talked with Mr. Beshore as to, you know, what were we doing, how were we going to do it, what was the proceeding going to be like. And based upon that, I accepted my engagement to go forward, knowing what the rules of the game were, and I think that's frankly what you and your client need to look at as well.

Q. Well, for Sarah Farms, this isn't a game. This is important to its business. And I would like the opportunity to review the underlying data to make sure that I agree with your conclusions, and without having the underlying data, I have to accept it at face value and I don't think it's fair. But let me go on.

Does your firm do any work for Dean Foods?
A. Yes.
Q. How much, in the last year, has your firm

received from Dean Foods?
A. Something around $100,000.
Q. Would that also include work for any subsidiaries of Dean Foods?
A. Yes. That would be the work we've done at the corporate level, and we also -- excuse me -- do work for Dean Foods in Pennsylvania, in the Pennsylvania Milk Marketing Board work. But my recollection would be it would be about $100,000.
Q. Same question with regard to Kraft Foods.
A. Unfortunately, zero.
Q. Okay. Land O'Lakes?
A. Unfortunately, zero. I'm working on it.
Q. Okay. I don't want to spend time to go through the Dairy 100 with you.
A. We have some clients on that list, I'm happy to tell you.
Q. Well, I'm happy for you.
Let me ask you a question. You indicate in your C.V. that you -- and I'm going to quote here -- you lead the firm's engagements in industry consolidation, including due diligence, valuation and consolidation benefit analysis, closed quote. I hopefully read that

correctly.

A. I think you did.

Q. Okay. What does that mean?

A. Well, industry -- so we are on the same page, industry consolidation is, as we heard some discussion about that subject earlier this week, is where one company acquires another and there were two and then after the consolidation, there's one.

There's a lot of that that has taken place in the dairy foods manufacturing business, and we -- sometimes we have normal ongoing audit and tax dairy clients that sell their business and we assist them in the sale.

In other cases, our clients -- and I like this better, frankly, when our clients are going out buying someone else.

And so I'm involved with those engagements either directly leading our engagement team or, at a minimum, reviewing our findings, providing consulting to my partners, whoever would be working on that.

Due diligence is what I call kicking the tires. If somebody is -- if one of our clients is buying another dairy, we want to make sure we don't get a "pig in the poke." We do audits and review, you know, the financial part of due diligence. We're not checking bacteria counts in their product. We're not scientists.

We're CPAs.

Valuation would be, a client comes to me and says, "Carl, my son's sons became lawyers. They don't want to run this dairy. I think I want to sell it. What do you think it's worth?"

And benefits of consolidation would be when a client is looking at acquiring another business and we're going to close a plant, close depots and consolidate things in a more efficient manner.

We do a lot of work of that sort. It's very interesting work. And, you know, it helps our clients know what their financial opportunities are if they're fortunate enough to bring the transaction to completion.

Q. I appreciate that.

I've got a lot of questions based upon your testimony, but as an aside, I will tell you your example of going from a dairy field into being a lawyer is an example of frying pan and fire, so I'd stay away from that.

A. Neither of my sons became CPAs, so I'm not sure what that tells us.

Q. Yeah, I understand.

Let's talk about industry consolidation for a moment because we have heard some testimony during the course of these last few days.

Would you agree with me that in the last 10 years that there has been a significant amount of consolidation in the dairy industry?

A. Yes. And my yes comes from the manufacturing end. I'm much more familiar with that end than any other part of the industry.

Q. And has that consolidation had an impact on the dairy industry in your view?

A. Yes.

Q. And in what way?

A. Well, there are less entities. There were hundreds of dairy plants, thousands of dairy plants in the United States, and now we're in the hundreds. So there are less plants. They're bigger.

Frankly, I think we have better -- we've been able to modernize and become more efficient through this consolidation process. I think we have -- I see a higher level of sophistication scientifically in the plants. Lower product shrink is one example that we quantify on a regular basis.

We see research and development now in the larger companies because they have the financial wherewithal to do that. It's something lacking in the industry.

So as much as it, I guess from my personal standpoint, hurts to see a family-owned business be acquired, from the industry standpoint and the long-term viability of the industry, I think consolidation was inevitable.

And my final thought on that is that there still are some amazingly successful small dairy manufacturers that have developed product, customer or geographic niches that will survive for many, many years into the future that are not giants like Dean.

Q. Let me follow up on that response with some questions and conclusions that I think I've drawn from your testimony and my experience in this hearing.

Would it be true that as we reduce the size of the number of processors, for example, in the industry, that as consolidation increases, that the market share of the larger consolidator is also going to increase?

A. Yes, that would be a conclusion that you would reach just by the mathematics.

Q. And that's what's happened in the dairy industry, for example, with Dean Foods, which now has somewhere in the -- 20 to 25 percent of the market in the country; is that right?

A. I'm not sure -- I've seen industry publications where statistics like that are presented. I'm not sure that I can recall the precision.

One of the things that does give the country some comfort -- and we'll just continue to pick on Big Brother Dean -- when they do an acquisition of a certain type or size in a certain part of the country, the Justice Department is involved.

The Justice Department reviews these transactions and requires Dean to do certain things that they believe maintains the integrity of competition.

Q. The Justice Department may have some comfort, but the small independent operator in the area where Dean makes an acquisition and has its market strength behind it, it then goes out of business. It's not going to have any comfort, will it?

A. That would be a case-by-case situation. I've certainly seen -- like I said, I've seen some small family-owned businesses that they'd love to have Dean as a competitor because they can outmaneuver them. They can just zip around their decisions and come up with creative ways of doing things, finding customers that Dean's not interested in because they're too small, and can prosper in that respect.

Q. And they could also, in your example, be able to provide better quality or better service to their customers given the fact that they are owner-operated, versus a conglomerate like Dean; correct?

A. That's a case-by-case situation. I've seen big and bad and I've seen small and wonderful.

Q. Let's talk for a minute, then, about your second issue on due diligence.

As I understand it, and you'll correct me if I'm wrong, what happens in this area of your business is someone may make a decision that they're interested in making an acquisition, and they ask you to assist them in the due diligence as to whether or not financially it would make sense for that acquisition; correct?

A. Yes, that's a good generalization.

Q. And one of the things that you would do is you would look at the financial statements -- audited, hopefully; unaudited if you have them -- to be able to make that determination; correct?

A. That would be one of the things that we would utilize.

The financial statements to an organization like ours, with our experience in the dairy industry, we actually utilize other information perhaps more in some cases than the balance sheet of a dairy, which is a pretty boring thing. It doesn't tell you very much. There are a lot of other statistics and circumstances and facts that are more important than the traditional financial statements in due diligence.

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Q. As a CPA charged with the request to conduct due diligence for a potential acquisition, or as a reasonable person, and it may be mutually exclusive or it may be combined, if, in the circumstance I'm going to ask you, what happened was you had somebody come to you and say, "I want to buy a company. They won't give me the financial statements. They're just going to give me a statement that says, 'I have a database regarding the financial statements. Trust me. Everything is okay,'" would you allow your client to go ahead, based upon that information, to acquire that company?

A. Well, I wouldn't -- your hypothetical isn't as hypothetical as you might think. I've been faced with circumstances just like that in the beginning phases of an acquisition, where somebody's not sure if they want to sell, so they don't want to disclose much of anything, so what you do is you take whatever information you can gather about the company.

And I've worked on -- some of this is almost -- certainly not direct accounting, but, for example, if you take a knowledgeable dairy person and we want to find out what the sales are for that company, we'll send someone out to the area where the trucks are parked at night and we'll count the trucks and the size of the trucks, and then the next day or two, we'll see how many trucks leave the yard. And we know how many cases of milk go in a truck and what the approximate load of a truck would be, and you can get a pretty good idea of what the sales level would be of that company.

You then do a market survey, as I mentioned earlier. You go into the supermarkets and convenience stores and look at the packages and see what the retail out-of-store price is. That'll give you an idea of what the into-store price is, because retailers have very similar markup percentages.

So you can do some "what if" calculations and you get certain information, like sales, cost of sales, and then we would apply to that our industry benchmarks to say, "If this plant is operating at normal efficiency, the cost in the plant would be X. The cost to deliver the product would be Y." And we can come up with a hypothetical P & L. We've done that a number of times over the years. It's not the preferred way by any means, but you can get a pretty good comfort level.

Q. Let me ask you a follow-up hypothetical.

Let's assume that, again, you're asked to do due diligence on a potential acquisition. Rather than financial statements, all you get is a statement from the president or CEO of the publicly traded, or privately held company in my example would be better, that simply says, "We have a database. The financial statements are all good. We're making this much money." And you have the opportunity in the next 24 hours -- you can't do anything else. You've got to rely upon this by the company. What would you advise your client to do?

A. Well, that wouldn't happen in real life.

Q. I asked in my hypothetical to go ahead and answer it.

A. If that was all we had to do, I would say to my client, "This guy's a nut. Stay away from him." But that wouldn't happen.

Q. I don't consider you to be a nut.

A. Thank you.

Q. Okay. I have some questions on Exhibit 25, if you've got it there.

A. I do.

Q. As I understand your testimony with regard to the container source for Sections A through D, you determined that there would be a purchase of the container for E and F, that what would happen is you'd go out and get your own blow-mold and make your own containers; correct?

A. Yes. And I would only change the tense in your statement. These are actual numbers, so it isn't you would go out and get it. They've already done it.

Q. Okay. Well, let me ask you a question.

Let's assume -- and I think your testimony was, and you'll tell me if I'm wrong about this, that you didn't believe it would be cost effective in A through D of Exhibit 25 for someone at that value to go out and actually purchase a blow-mold machine or operation; correct?

A. It typically is not.

Q. On the other hand, people could do that?

A. They could. It would also depend upon their product mix, what percentage of their business is in gallons, because gallon and half-gallon are the predominant plastic packages that are blow-molded, so you could probably justify, if you were a gallon and half-gallon shop, only at something lower than 18 million, but not much lower.

Q. Well, let's assume for a moment that somebody that was at 2 or 3 or 4 million decided that they were going to expend the capital cost to buy the blow-mold operation or machine.

Would they after a period of time be able to have a reduced cost in terms of a sale of their milk based upon their initial capital acquisition costs?

A. Well, the way that would work in the books of that company that purchased the blow-molder and as

they -- and let's just think about the depreciation expense and the capital cost for a million dollars to put a blow-molder and the related equipment and building.

So we spent a million dollars and we manufactured bottles that cost us a fully loaded cost of 20 cents a bottle and we could have bought it for 14, so after 10 years of losing 6 cents a gallon, the depreciation expense is gone. The loan is paid off if you had capital -- money from other sources of your business. Then you would have a cheaper bottle in that eleventh year, but you've lost a lot of money in the intervening ten.

So I typically -- the typical dairy, we've done many studies of "Should we blow-mold or shouldn't we," and the smaller companies have much better alternatives today, and those alternatives are two:

One is to enter into a joint venture with companies that are experts in operating blow-mold operations, and in some cases they'll build a plant adjacent to your plant or you'll build one for them. They'll rent it from you. You get through-the-wall blow-molding and then that company, that management company will sell the excess capacity to other bottlers.

And the other alternative is to join up with

one of the buying co-operatives. There are a number of dairy buying co-operatives that collectively put their volume together and can buy bottles for a lower cost than you can manufacture, so that's the basis of my statement, my opinion.

Q. Do you know if Sarah Farms has a blow-mold machine or operation?

A. I know -- I do not know that. I have no idea how they do their bottles.

Q. And you don't know what the amount of monthly volume is for Sarah Farms; correct?

A. The monthly volume?

Q. Yes, sir.

A. The only thing I know is what I heard at this hearing.

Q. And you don't know, assuming they did purchase a blow-mold machine, when they purchased it, at what volume?

A. No. I have no information on that subject.

Q. And you don't know for Sarah Farms what its plant processing costs are; correct?

A. Their actual costs, I do not know.

Q. You do not know the actual packaging costs; correct?

A. I do not know their actual packaging costs.

Q. You don't know their actual transportation costs; correct?

A. I don't know their actual transportation costs, no.

Q. In fact, to cut through all of this, you don't have any actual cost figures for Sarah Farms; correct?
A. That's correct.
Q. Now, let me ask you, on Exhibit 25, page E, your comparative analysis document --
A. I have it.
Q. Thanks.
Since they're identical for both, it makes no difference whether you're using the 14 percent or the 8 percent, based upon my question, anyway.
The distribution that you have listed for dairy supplier costs for distribution at .2960, what does that actually work out to in dollars?
A. It's 29.6 cents, the distribution cost for every two-gallon package that is delivered.
Q. And how can -- can you give me what that would equate to for one truckload, please?
A. Depends on the size of the truck.
Q. Well, did you assume a particular size in looking at your document?

A. We assumed trailer-load deliveries.
Q. And trailer load is usually how much?
A. I'm not sure, without checking my files, as to the exact number of two-gallon packages that are on a skid. Obviously, that's part of the study we did. I

don't recall. There's a lot of details in that.

Q. Would that equate to about 5,000, 5,400 gallons?

A. That's pretty close, I think.

Q. Okay. So if that's the case, then -- and these are approximate numbers because I didn't have a calculator when I did this.

Your freight figure for a load is around 700, $750; correct?

A. I'll accept that.

Q. Okay. So if in fact the actual freight per load is closer to 400 to 450, then your cost figures on this document are overstated by that figure; correct?

A. There's more to these cost figures than just the truck.

Q. No. I understand that. But obviously your cost figure's overstated, because if I'm correct that it's closer to 4- to 450 and you've got 750 for transportation, then it's overstated by that much; correct?

A. No, I don't agree with that at all.

Q. Okay. So if you would, then, figure for transportation, rather than 750, as you have actual -- actually, 450, and then recalculate for me the actual cost, if you can.

A. I don't agree with your 450.

JUDGE HILLSON: That isn't the point. He's saying, assuming it's 450, what is the effect of that?

Q. BY MR. RICCIARDI: That's exactly right. I'm asking you to assume.

JUDGE HILLSON: If he's totally wrong on the 450, that's not the point. What he's saying is, what's the impact of 450 instead of 7?

MR. BESHORE: I think he's misunderstood Mr. Herbein's testimony with respect to the total transportation cost. It's not just trucking. It's not just the cost of the truck.

MR. RICCIARDI: I don't need to be educated. I'll ask my questions.

MR. BESHORE: The question was misleading.

MR. RICCIARDI: It wasn't at all.

JUDGE HILLSON: The question was transportation cost as 450, instead of 700.

Q. BY MR. RICCIARDI: That's all I want to know.

A. And I don't recall your estimate of the

gallons.

Q. I didn't go back and do that.

A. Well, we can't recalculate the $300 difference without knowing the gallonage.

Q. I understand. But go along with me on this.

If you assume my figure is correct, that it's closer to 450 as opposed to 750, which you have on your document, would you agree with me that your costs on this document are overstated by whatever that figure is?

A. Well, that's as obvious as your mustache.

Q. And you know what? I can't make it obvious on the record until you say it. So yes, it's obvious, isn't it?

A. If the number that I've calculated, which I stand by and we've done a study, and the .2960 per two gallons, if that is overstated by some amount, then my results would be overstated. I mean, that's just simple math.

Q. It is simple math. And, actually, it follows from A to B, and so, therefore, if in fact your study gives you the figure for transportation and that figure is wrong, then we have to challenge the veracity of your study at least with regard to transportation costs; correct?

A. Well, I'm certainly not going to agree with

you that my study is wrong, because my study is very precise.

JUDGE HILLSON: He's not asking you that.

Q. BY MR. RICCIARDI: I'm not asking that.

JUDGE HILLSON: He said if --

Q. BY MR. RICCIARDI: I'm not asking that. I want you to assume for me that what's going on is you have overstated the transportation costs, and I'm asking you then to conclude, as night follows day, your study -- I have to question the veracity of your study; correct?

MR. BERDE: Your Honor, may I make an objection?

JUDGE HILLSON: Sure.

MR. BERDE: That makes about as much --

JUDGE HILLSON: Mr. Berde, you need to say who you are.

MR. BERDE: Sydney Berde.

That makes about as much sense as requesting the witness to assume that 2 and 2 is 5 instead of 4.

MR. RICCIARDI: In the milk regulation area, Mr. Berde, it may be.

JUDGE HILLSON: Okay. Look --

MR. BERDE: I don't know what school you went to, but 2 and 2 is 4 no matter what industry you're in.

JUDGE HILLSON: Okay, guys. Come on. Look, the administrator and the Secretary, who's making the final decision here, I think will understand that if the costs are less than what he says, then the study is incorrect to that degree. If that's the point you're trying to make, it is a very basic point, and I can't believe you just spent about eight minutes on it, to tell you the truth.

MR. RICCIARDI: If in fact I got some quicker answer as opposed to --

JUDGE HILLSON: I understand.

MR. RICCIARDI: -- the right side of the room applauding when they don't understand the fact, that's the way it goes. Apparently you did.

Q. BY MR. RICCIARDI: Now, also, with regard to the Costco prices that you utilized as the other portion of your report, you never actually went into a Costco store in the Phoenix area to get those figures; correct?

A. I did not.

Q. Okay. As I understand it, and I don't mean to make this a double-play combination like Tinkers to Evers to Chance, but it went like this: Some unknown person at Shamrock to Kroger to English to Beshore to Herbein. That's how you got the figure for Costco?

A. Yes.

Q. And there's nothing in your file as an accountant to confirm that pricing; correct?

A. I have a document that was transmitted in that sequence which shows the dates and the prices for the two -- for Costco and Sam's.

Q. I understand. And that was from one of the individuals I named in that group; correct?

A. Yes.

And we did have discussion about how the data was gathered, and it was my -- it is my opinion that it was a legitimate way of gathering the data, didn't appear unusual or out of line in any way, and I've accepted it as valid.

Q. Do you have any clients that are selling to Costco?

A. Yes.

Q. Where do they sell to Costco?

A. We have in two locations, in the Pacific Northwest and also in Colorado.

Q. And the client in Colorado, is that a regulated entity as opposed to a producer-handler?

A. Yes, regulated.

Q. And do you know what Costco in Colorado was selling the milk for?

A. No.

Q. Do you know what your client is selling to Costco for?

A. No.

Q. Do you know what the costs of your client in the sale to Costco in Colorado are?

A. Not -- no, not as I'm -- I mean, I didn't look at that as part of this project.

Q. In anywhere on Exhibit 25, did you factor in for a producer-handler the cost of balancing milk?

A. No.

Q. Would you agree with me that the cost of balancing milk for a producer-handler is a real cost?

A. I've never studied the balancing cost for a producer-handler, and I heard the discussion here the last two days about it, and I do know from the producer-handlers that our firm represents, where they produce milk and ice cream, that that's a pretty nice combination. And I think we heard some of that from the gentleman from Braum's, that you build ice cream inventory as part of your balancing, so --

But I've not made any analysis, and there is -- I want the record to be clear -- there is no balancing cost included in my analysis.

Q. Have you ever done any analysis of balancing costs at a co-operative?

A. In the co-operative? Yes, sort of. And the "sort of" is, co-operatives provide balancing in a couple of different ways. The most common way is that they have controlled outlets that manufacture butter and powder, powdered milk.

And the operation of those butter and powder plants can either make or lose money, depending upon what happens to the balancing costs. So if that powder plant is losing money, then that means there's a cost to balance the supply. And I've been involved with some projects over the years in that regard.

Q. So you'd agree with me that the co-operative has balancing costs that it has to deal with in terms of trying to balance its milk source; correct?

A. Yes.

One of the things that we want to be clear about in this record, and I'll answer your question, is there are certain elements that we're talking about in this hearing that are material in size and there are others that are rather immaterial in size.

And the cost of balancing is not one of those big numbers. It's not like the cost of a plastic jug. We're talking about pennies per hundred pounds divided by 11.62 to get to a gallon equivalent, as opposed to 10, 13, 15 cents a gallon for a container. So it's a

relatively small number.

Q. But there is a cost?

A. There is a cost.

Q. And to confirm, you didn't include that cost in your study; correct?

A. That's correct.

Q. Did you assume, in terms of looking at the cost on Exhibit 25 for packaging, that the producer-handler in that circumstance -- in any of the circumstances would use a foil seal underneath the regular plastic seal for a gallon jug?

A. The gallon -- the two gallons that are included on 25E do not include the foil seal.

Q. Okay. So if there is a foil seal that is used by a producer-handler, then we'd have to add that cost into your figures; correct?

A. Yes. That would be -- that was -- that's a nuance that was not in our study. We used a normal 58-gram bottle with a cap and a label and the box to hold it, and that's the cost.

Q. And in terms of the container for the two gallons, did you assume that it was a cardboard container?

A. Yes.

MR. RICCIARDI: Okay. I don't have any

further questions. Thanks.

JUDGE HILLSON: Anyone else?

I thought so.

EXAMINATION

BY MR. MILTNER:

Q. Mr. Herbein, my name is Ryan Miltner. I represent Smith Brothers Farms, Mallorie's Dairy, and Edaleen Dairy in the Pacific Northwest.

JUDGE HILLSON: I'm sorry. Ryan, I didn't catch your name.

MR. MILTNER: It's Miltner, M-i-l-t-n-e-r.

Q. BY MR. MILTNER: If I could start, I have a couple questions on Exhibit 25, and I'm looking at pages

A and B.

I first wanted to confirm -- because I think you mentioned in your answers to Mr. Ricciardi's questions, but I wanted to make sure I have this correct -- the number of plants in your groupings here. Two in A, two in B, and four for the remainder of the categories. Is that correct?

A. That's correct.

Q. I'm looking at the Group C and Group E.

A, C and E.

Q. C and E, okay?

And I'm looking under the column for 124. I want to make sure that I'm interpreting this correctly.

The bottom line, literally the bottom line demonstrates, I assume, that the cost for processing a hundredweight of milk in Order 124, if you produce 5 million -- if you process 5 million pounds per month in Class I is $7.33?

A. For a hundred pounds, yes.

Q. For a hundred pounds.

And in the same Order, at 18 million pounds, the cost per hundredweight is $5.91; right?

A. Yes.

Q. So there's an added efficiency, cost savings of 1.42 per hundredweight between those two plants?

A. I believe your math is right.

Q. Okay. Good. My subtraction isn't so good.
And that would mean that a 5 million pound a month processor has a disadvantage compared to an 18 million pound per month processor of that amount?
A. Yes.
Q. Okay. And should a processor want to increase their production from 5 million to 18 million pounds a month, he would have to add capacity to his plant one way or another by adding to his capital investment, I would assume; right?

A. No, not necessarily.
Q. Okay.
A. You would have to have a baseline of what is the capacity of the existing facility. There's two ways -- some plants are operating at 50 percent of capacity and have the ability to add volume. That's a lot less expensive than if we're operating at 75 percent of capacity and we need to build a building and add fillers.
Q. Okay.
A. So you'd have to know the specifics of the circumstance.
Q. So in some cases, it can be capital investment, capital expenses; but in other cases, if they're operating at under capacity, they would be expenses, but not necessarily capital expenses?

A. That's correct. You'd have variable costs, and you may have little change in your fixed costs.
Q. Okay. Now, if a producer-handler wanted to make that change, the producer-handler would have that change in either their capital expenses or their variable costs, but they would also have to add additional capacity or additional cattle at the farm end of the operation; correct?
A. Sure.

Q. And that would be an expense that a regulated handler would not have if they wanted to increase their capacity to realize that 1.42 efficiency?
A. I've thought a lot about that, because that subject came up yesterday, and I think we're missing something in the testimony and the colloquy that's taken place here, and that is, when a producer-handler adds cows, yes, that costs him money. But one has to compare the cost of that cow with the revenue that that cow produces.

And I believe that if the producer-handler is efficient with his production that he increases his cost by adding cows and borrowing money and building a larger barn and hiring more people, but the value of that milk produced feeds that, so I think it should be, at best, a push.

And maybe even you could make a profit

because farming has a lot of fixed costs, and if we have -- if we expand our herd but we don't have to buy more land because we can bring in the feed, I mean, I could see -- I think that's something that was missed in the analysis over the last two days.

Q. I guess what I'm hearing in your answer is, there are a lot of variables that have to be taken into account, then?

A. Yes. And the variables are not all expenses on the producer-handler side. There is the revenue for the value of the milk that those extra cows produce that must be considered in that study.

Q. Okay. And you're assuming that the value of the additional milk produced is offset by the income from selling that milk?

A. Yes, or utilizing it in the -- you know, in your example, in a bottling facility at the farm in a producer-handler scenario.

Q. I'm curious. Have you had the opportunity to, in any of your consulting, examine the additional -- the marginal benefit of adding an additional cow to a producer-handler operation?

A. Not for a producer-handler. But we just did a fairly major project for one of our old dairy farmer clients. One of my partners handled this study, and I consulted with he and our client on the results.

And the study was designed to land a bank loan to add 500 cows to their herd, and the -- and I was actually thinking about that study early this morning and thought about the discussion yesterday.

And that analysis took the cost of the cows, the interest expense to borrow the money. There was a need for another barn. That cost was included. And

then the expected production per cow and the estimated value of that milk and the butter fat of 3.7 and all of that was in my partner's study to show that they could afford, even at today's low milk prices, to service that debt for those 500 cows, so I think it would be -- that would be the approach that you should use in analyzing that circumstance.

Q. That's your opinion as to what approach you should use?

A. That is my opinion as to --

Q. Okay.

A. -- the approach that should be used.

Q. And that was for a pooled handler and not a producer-handler?

A. Yes, that study happened to be for a pooled handler.

Q. And even so, that pooled handler did have additional capital costs to expand the size of his dairy?

MR. BESHORE: I think you were talking about farmers, not handlers there.

Q. BY MR. MILTNER: I'm sorry.

A. I was talking about a farmer.

MR. MILTNER: Thank you, Marvin?

Q. BY MR. MILTNER: But even so, that farmer did

have additional capital expenditures that were associated with the expansion of his dairy?

A. Yes.

Q. And that -- and, of course, you mentioned that he had debt service costs, which, of course, involves a certain degree of risk that would be reflected in the interest the bank was charging him and whatnot?

A. There's risk every time you borrow money and there is always risk in business.

Q. Thank you.

I wanted to -- I think Mr. Ricciardi got answers to these questions. I want to make sure that I got mine, if I wrote down accurately what you had said.

The 20 --

JUDGE HILLSON: You're not going to ask him the exact same questions to check your notes, are you?

MR. MILTNER: No. I'm not just checking my notes. Thank you, Your Honor.

Q. BY MR. MILTNER: The 20 plants that you selected for Exhibit 25 were hand-picked by you and not randomly selected; is that correct?

A. That's correct.

Q. Okay. And did you provide us with the Class I utilization of the plants that were included in

the study? Can you provide us that information?

A. I certainly would have in my files their utilization. I don't know that as I'm sitting here, other than to say that, in the selection, these are high utilization Class I plants. In other words, this isn't 40 percent Class I and 60 percent cottage cheese. These are predominantly fluid milk operations.

Q. Okay. So these plants in this study wouldn't necessarily have large ice cream production facilities or anything of that nature?

A. Not in the financial information. There are companies in here that have ice cream subsidiaries, but not in the plant.

Q. Not in the plant information you used?

A. That's correct.

Q. If you have that information in your file, would you be willing to provide the average Class I utilization of those plants to us?

A. I think that would have to follow the confidentiality discussion that Mr. Ricciardi and I had.

Q. Okay. Would the -- whatever that Class I utilization is, would that not be something useful in determining whether your model applies to another subject dairy, whether it's an accurate predictor of their costs?

A. I considered that. And I'll just repeat what I said before because it's in a little different context.

My engagement for this proceeding was to present financial information for, as we say in the headings, fluid milk plants, so that's what I've selected.

Now, when you say "utilization" and we think about the federal market administrator's report, every plant has utilization other than Class I. There's always something else: bulk sales, bulk cream, Class II products. But these products are predominantly fluid milk. And the utilization -- I mean, it would be more than 70 percent, I'm sure.

Q. Okay. And the study is based on a model for producing one gallon 2 percent white milk in a plastic jug; is that correct?

A. That depends which exhibit you're referring to. And the answer to that is yes on 25F through K.

Q. Including E?

A. Including -- E is a 2 percent two-gallon package, yes.

Q. Okay. And does it -- do pages A through D assume that the plant is bottling that same type of milk, white milk, 2 percent?

A. I'm sorry. Which plants?

Q. The first four pages. You're saying that the cost of processing a gallon of milk for these 6 or 12 categories, however you want to look at it --

A. You're looking at 25A and B?

Q. 25A and B.

A. Okay. Yes, I'm with you.

Q. -- is that based on putting that raw milk into plastic one-gallon containers, and 2 percent?

A. No.

Q. Okay.

A. The plant costs on 25A and B are the plant costs for those plants, and they produce more than gallons. This is their plant cost for gallons and half-gallons and half-pints to go to schools.

Q. Okay. And the information as to each of these plants, what their breakdown is as far as how many gallons, half-gallons, half-pints they're producing is also proprietary information from your database; is that correct?

A. Yes, it is.

Q. And you're not -- as such, you're not going to provide that information?

A. That's correct.

Q. So if a plant produced a higher percentage of

For public distribution

half-pint containers than those used in your study, would that change the applicability of your estimates to that particular subject plant?

A. It would if I had selected plants with a predominance of half-pints. Again, that's part of why Herbein judgment selection was used out of our database as opposed to my laptop's random number table.

So I selected plants that fit the mold of what I was doing, which is looking for volume product production; however, all those -- all of these plants, the 18 nonproducer-handlers in my study do more than gallons. Every one of them has a full product line.

Q. Okay.

A. But the predominance would be in the volume products.

Q. But the predictive value of your conclusions is dependent somewhat on the particular mix of products produced by the plant you're trying to analyze?

A. Yes, there is an effect, and the effect -- there is an effect.

Q. I just want to shift gears a little bit and kind of leave the exhibit for a second.

In your background, do you have any work or consulting that would provide you with specific knowledge about the operating efficiencies of

producer-handlers in the Pacific Northwest?

A. No.

Are we talking about their plant operation?

Q. I'm talking about the specific efficiencies of any particular dairy, not in general, but have you worked with any of the producer-handlers in the Pacific Northwest that gives you specific knowledge of their efficiencies?

A. No.

Q. This information you've provided us in Exhibit 25, again, is primarily based on processing costs? It doesn't include any of the costs and expenses of producing raw milk at the farm level. Is that accurate?

A. That's correct.

Q. In one of your answers to one of the questions Mr. Ricciardi asked you, you corrected him in referring to Exhibit 25 in the future tense, at least as to the blow-molds that a plant in Order 124 would use a blow-mold. You suggested that these were past tense hard figures and that it was more correct, more accurate to say that these plants in Order 124 did have blow-molds.

How many plants in Order 124 did you analyze that had greater than 30 million pounds per month?

For public distribution

A. We need to be sure the record's clear on what the 124 and the 131 column are.

These are statistics from our database. And just to look at column F, the four plants that are in the 30 million pound range are plants from our database that may or may not be located in 124. They're not all located in 124 or in 131.

We took our database of information and made regional CPI adjustments so that we have the costs adjusted to the local market. It's a very accepted accounting practice to do that so that we're not comparing Mississippi wages with North Jersey wages.

Q. Okay.

A. So that's how we've localized the results.

Q. So -- and, actually, I think I remember you stating that you only -- in this pool of 20, there was only one Pacific Northwest plant; right?

A. That's correct.

Q. Okay. And if I could ask you about the use of the CPI to adjust the results or to, I guess, make the results more accurate. Is that --

A. Localize the results --

Q. To localize the results?

A. -- is how I would describe them.

Q. CPI is the Consumer Price Index; right?

For public distribution

A. Yes.

Q. As determined by the federal government?

A. U.S. Department of Labor.

Q. Is there a particular reason you chose to use the Consumer Price Index as opposed to the Produce Price Index?

A. Yes. I believe that the CPI was the appropriate index to use --

Q. For these --

A. -- for this study.

Q. For these producers, these producing facilities, you used the consumer index?

A. These plants, yes.

Q. And because you've only used one plant that's actually physically located in the Pacific Northwest, again, this is a -- this is for predictive value only? This doesn't reflect the actual costs, necessarily? Because we have six different categories in the Pacific Northwest and one plant. It doesn't reflect the actual costs of processing milk in the Pacific Northwest? It's whatever its predictive value is?

A. I believe that the application of the CPI index to the data that I've used for both 131 and 124 is an accurate reflection of the costs in those markets for these plants.

For public distribution

Q. Okay. And by the way, the methodology that you used, was this just based on averages, or was it like a statistical regression analysis? How did you -- how did you blend the four plants for C, D, E, and F to arrive at these rather specific and precise figures?

A. Okay. Good question, and that should be in the record.

There was a three-step process. The first step is to identify these four plants, where are they and what is their CPI index. And then I adjusted each one of their statistics, up or down, to Phoenix, to 131. And then I adjusted the 131 statistics to the Pacific Northwest. And I did that for each one of the categories.

Q. So you took your plant data, adjusted it to Phoenix, and then you adjusted Phoenix to the Northwest?

A. Yes.

Q. So it's two steps to get there?

A. Yes, actually.

Q. I just want to make sure I have it correct.

A. Yes, you didn't miss anything.

Q. Okay. But I want to get this. You had four plants, and you've now scaled the data using the Consumer Price Index for these four plants. And let's just look at D, okay?

For public distribution

A. I'm sorry. D?

Q. D. I mean, it could be any of them, but we'll just pick D. And you've determined that the cost per gallon for plant processing in the Northwest is 43.4 cents; right?

A. Yes.

Q. Plant processing?

A. Yes, I'm with you.

Q. Now you have four plants. You've scaled it. You add them up and divide by four?

A. Weighted average.

Q. Weighted average?

A. Weighted average.

And the weighting is very similar to a simple average because the plants are all approximately the same size.

Q. Did you do any statistical analysis of that formula to see what the confidence of its predictive value is?

A. No.

Q. So these aren't necessarily statistically significant figures? You didn't do anything to guarantee -- not that they couldn't be, but you didn't check on their statistical significance?

A. My approach was not to use statistics to verify the numbers. I've used my experience in the industry, my knowledge of the plants that are in this study to know that they would be representative, and my knowledge of the dairy industry, so it's my professional judgment as opposed to a regression analysis.

Q. Okay. So there was no -- just to make it clear, no analysis of standard deviation and confidence intervals or anything of that nature?

A. I made no such analysis.

Q. Okay. Finally --

JUDGE HILLSON: "Finally," that was the word I was looking for.

Q. BY MR. MILTNER: Yeah, finally, I just want to ask a couple questions about the producer-handlers in the Northwest.

As I've stated, I represent Smith Brothers Farms and Mallorie's Dairy and Edaleen Dairy. Have you had the opportunity to work with any of those operations?

A. No, I have not.

Q. Okay. Are you at all familiar with the specific processing costs of any of those dairies?

A. No.

Q. How about the packaging costs of any of those dairies?

A. No.
Q. The distribution costs of any of those dairies?
A. No.
Q. Their shrinkage rates?
A. No.
Q. And their specific cost of balancing?
A. No.
Q. And you made --
MR. MILTNER: I'm sorry, Your Honor, one very last thing.
Q. BY MR. MILTNER: You stated that in your estimation the cost of balancing was insignificant and you estimated it was pennies per hundred pounds; correct?
A. Yes.
Q. Okay. And you represent one producer-handler -- or you've consulted with one producer-handler in Pennsylvania?
A. No. Several.
Q. Several. I'm sorry.
There's one in this study?
A. There are two in this study.
Q. Two in this.
Where's the one besides Pennsylvania?

A. They're both in Pennsylvania.

Q. They're both in Pennsylvania.

And did you also state that the difference in the packaging costs between a purchased container source and a blow-mold container source was 3 cents per gallon?

A. It's the difference between 14.2 and 11.3.

Q. 3.9 per gallon?

A. 2.9.

Q. And I think you characterized that couple cent difference as significant in the dairy industry. Would that be accurate?

A. Yeah, that's per gallon. And the 6 cents is per hundred.

Q. I understand.

A. Sorry.

Q. Those couple cents you said were significant?

A. Yes, those few cents in relation to the bottom line in the dairy industry is significant.

MR. MILTNER: Okay. Thank you, Your Honor. I don't have anything else.

JUDGE HILLSON: It's break time, 10-minute break time.

(Recess at 3:20; resumed at 3:34.)

JUDGE HILLSON: We can go back on the record now.

Mr. Marshall.

MR. MARSHALL: Thank you.

Doug Marshall, Northwest Dairy Association.

EXAMINATION

BY MR. MARSHALL:

Q. A couple very quick points.

If I understand the graph that you've shown in Exhibit 25 on page D or C -- I'm looking at D, the data on the first -- from the first point -- the category A volume are for producer-handler plants and the data from the remaining plants are to the right of the cost curve, as you testified earlier.

My question of you, Mr. Herbein, is whether the nature of the plant, as being a producer-handler plant or a fully regulated plant, is at all relevant to the numbers that show on this page, or alternatively, would these numbers be the same to reflect bottling costs without regard to the ownership structure or the regulatory structure of the plants?

A. The information shown on 25A and B and on graphs 25C and D are reflective of the costs of manufacturing, the costs per gallon or per hundredweight, and are simply that. There's no adjustment made for regulated, not regulated, pooled or

not pooled.

Q. Would it be a fair interpretation of your data that you would expect, if either of the two producer-handlers in your category A were to expand their volume to the 2 million pound level of category B, that their cost structure would look more like those in category B than their current cost structure?

A. Yes.

Q. This is a cost curve that shows declining costs as you move from left to right?

A. That's correct.

Q. You're an accountant. Perhaps you've also studied microeconomics at some point along the way.

A. My first major in college was economics, and then my adviser, at the end of my freshman year, asked me what I was going to do for employment as an economist, and I was stumped. And he recommended accounting because I'd always have work. He was right.

Q. So I take it you do recognize the concept of a microeconomic cost curve model?

A. Yes, at least the basic elements of it.

Q. If you had a lot of data points -- you only have 20 firms in this survey. If you had a hundred or a thousand, would you expect the numbers that you're showing here to look more like a traditional cost curve,

that is to say, a smoothed cost curve when you did a regression or other analysis?

A. I think the curve would become smoother. The direction and the overall slope I would believe would be the same.

Q. And these are averages, are they not, that are reflected in that line and not necessarily the precise costs that one would expect at any given volume on that?

A. These are averages for the groupings.

MR. MARSHALL: Right.

Thank you very much, Mr. Herbein.

THE WITNESS: You're welcome.

JUDGE HILLSON: Anyone else?

MR. YALE: Real short, yes.

EXAMINATION

BY MR. YALE:

Q. Good afternoon, Carl. How are you doing?

A. I'm fine, Ben.

Q. I just want to make a couple quick questions dealing with -- you took, I think, the retail that somebody gave you some numbers from a store, right, or stores or whatever?

A. Yes, we talked about that earlier.

Q. Right.

And you also testified sometime earlier this afternoon -- I don't remember when -- something about you had this benchmark or smell test or something like that, right --

A. Yes.

Q. -- on other numbers? Right?

A. That was in response to some cross-examination by Mr. Ricciardi.

Q. Okay. Are you aware that the USDA does a sampling of retail prices of 2 percent and whole milk in a number of markets throughout the United States on a monthly basis?

A. I've seen some of that information.

Q. Did you check that for the period of 2003 for the Phoenix market?

A. I did not.

Q. But you know that it's out there; right?

A. I know that the market administrator does some survey. I didn't see any of that information. I simply relied upon what I've described.

Q. And as I understand it, I mean, the assumption is that the store is not using this as any kind of a loss leader, that they're going to get an 8 or 14 percent markup; right?

0

A. I didn't -- I don't think that the -- strike that.

The information that I saw would not include enough information to allow me to have an opinion if we have a loss leader situation here or not.

Q. So the point, if we don't know whether or not your analysis actually proved that this is what a PD or a processor was selling it for, it's a theoretical value that, if there was a markup and all this, if it was sold at this, a producer-handler, if his cost for his milk was blend, would make a profit, where a handler who's Class I would not. Is that, in a sense, what you're saying?

A. I wouldn't say it that way at all in that the out-of-store price for a warehouse store is not hypothetical or theoretical. It is actual. So -- and the 8 and 14 percent margin markup is not hypothetical or assumed. That's actual. I mean, I know that is -- that's the range.

And so I believe that the line that says "Price Paid to Dairy Supplier" is a very accurate representation of what would be on the invoices from the supplier.

Q. Assuming that the store is selling it at a markup and not doing loss leader sales during that

period; right?

A. That's correct.

Q. Okay.

A. And we saw in this -- the price survey that I utilized to have the average of 3.29 didn't have any

1.29s or 2.29s. It was a very flat price throughout that six-month period.

Q. Now, I take it, then, under that analysis that milk was sold. The consuming public bought it; right?

A. Yes.

Q. And it was a good and wholesome product? There's no assumption that it wasn't good milk; right?

A. I've heard -- I mean, I didn't make any scientific --

Q. We have to assume that; right?

A. Yeah. It was in the store. It was sold. And I've heard of no product recalls in this market, so --

Q. You're not suggesting, are you, that the price of Class I -- or Class I differential in the Phoenix market is too high, that a processing plant cannot pay that differential and supply the market as it demands to pay the price in this market, are you?

A. No. No. Analyzing the correctness of the

differential was beyond the scope of what I was asked to do.

MR. YALE: And just a follow-up.

No. I think we've got that. I'm going to leave it the way it is. Thank you.

EXAMINATION

BY MR. RICCIARDI:

Q. Couple follow-ups.

Al Ricciardi again.

I thought we got this during my portion of the examination, but I was unsure based upon some recent testimony, so let me ask this specific question.

In Exhibit 25, there is no actual data from any plant physically located in Order 131; correct?

A. Yes.

Q. And one last question. If you take a look at Exhibit E, the comparative analysis of the return to the producer-handler --

A. I have it.

Q. -- when you say the "Price Paid to Dairy Supplier," you did not have any physical invoices to determine what the actual price paid was; correct?

A. That's correct.

MR. RICCIARDI: Nothing further.

JUDGE HILLSON: Any further questions?

Go ahead.

Mr. Ritchey was on his way first.

EXAMINATION

BY MR. RITCHEY:

Q. Just two questions.

In any of your plant costs, was any adjustment in there for closing down another plant that they might have bought or a plant that inflated prices just to get the business, or was this, you know, actual just for land, building, and equipment?

A. The plant costs do not include any write-offs for acquisition costs, and for a couple of reasons: one, that would distort the study; and two, the accounting rules for writing off goodwill and things of that sort have changed and we no longer have amortization expense, so the concerns over the inclusion of those things are gone as of December 31st of 2002, so there's nothing of that sort in here.

Q. And the plant cost was relatively new plants that hadn't transferred ownership?

A. No, they're not -- they're certainly not in this group of 20, the 18 processing plants. There are no brand-new plants in here. These are all companies

that have been in business for many years.

Q. But has ownership changed in the last five years?

A. In two of the 18, there has been ownership change.

MR. RITCHEY: Okay. Thank you.

MR. ENGLISH: Charles English.

EXAMINATION

BY MR. ENGLISH:

Q. Mr. Herbein, questions were asked about a USDA-sponsored price survey. Are you aware that that price survey is limited to specific size containers?

A. I'm not very familiar with that study and -- I'm not familiar with it. I know that it exists.

Q. Regardless if it's a price survey, it would not, to your knowledge, survey specifically only warehouse distribution, correct, warehouse-like stores?

A. I would be very surprised if that's what the survey would include. If their intention is to show a market price, you would have to go to more than warehouse stores.

Q. And you, as opposed to what that might show, were trying to show a specific warehouse store price; correct?

A. Yes. When I began my study, I began asking if this information for the warehouse out-of-store prices existed, and that led to the relay that resulted in me getting the information.

MR. ENGLISH: Thank you. That's all I have.

JUDGE HILLSON: Anyone else?

Hold on. Mr. Beshore first, please.

MR. BESHORE: I'll wait. I have redirect.

JUDGE HILLSON: Okay. Go ahead.

EXAMINATION

BY MS. DESKINS:

Q. I just wanted to clarify some things. You said that this data is based on 20 dairy -- I'm sorry, dairy clients that you had data related to them?

A. Yes.

Q. Okay. And just to clarify, were any of them located within Order No. 121 or 131?

JUDGE HILLSON: You mean 124?

Q. BY MS. DESKINS: 124.

A. One is from 124.

Q. But there's none from 131?

A. Correct.

Q. Does your -- what's in Exhibit 25, does it take into account any regional differences in the cost

of dairy suppliers?

A. The regional differences have been accounted for by the regional CPI adjustments that I have made, and so in that way, we have localized the statistics to these two marketing areas.

Q. Okay. And, also, you said the data that you used had one producer-handler?

A. There are two producer-handlers in column A on 25A and B.

Q. I'm talking about the data that you used to prepare this. Was it based on information you got from one producer-handler?

A. Two producer-handlers.

Q. Were any of those located within Orders No. 131 and 124?

A. No. They were both located -- they're both located in Pennsylvania.

Q. And are they in the federally regulated part of Pennsylvania?

A. No. The state-regulated part.

Q. Okay. Under the Pennsylvania state program, do they define a producer-handler the same way as any Federal Marketing Order?

A. I would suggest -- I'm not sure. I think Mr. Beshore could help you with the legal definitions.

No, maybe not.

My -- let me just answer it this way.

These producer-handlers that I used in column A were not part of the Federal Order and they're free to sell their milk out of store without regard to the Pennsylvania minimum prices. And I think -- and they have to balance their own supply, so that's what I know about the rules as they apply in Pennsylvania.

MS. DESKINS: Okay. I have no further questions.

JUDGE HILLSON: Go ahead, Mr. Beshore.

Oh, Mr. Rower, do you have a question?

MR. ROWER: No.

JUDGE HILLSON: Go ahead, Mr. Berde.

MR. BERDE: Sydney Berde.

EXAMINATION

BY MR. BERDE:

Q. Mr. Yale asked you whether the prices reflected -- the out-of-store prices reflected on your exhibits, whether you know whether they're loss leader prices. Do you recall that?

A. Yes, I recall that.

Q. You know enough about the food industry to know what a loss leader is, do you not?

A. Yes, I've seen them.

Q. And do you know whether the marketing strategy of the warehouse stores that you've talked about -- Costco, Sam's, et cetera -- ever use loss leaders in their operations?

A. I don't think they do, but I'm not 100 percent sure of that. What I've seen has been level low prices, as opposed to prices that are high on Tuesday, Wednesday, Thursday, and down on Friday.

Q. As compared, for example, with what Safeway, Kroger, et cetera, would use?

A. That's correct. I did not see that type of pricing at all in the information that was provided to me for the six months that we studied in June. It was a level price.

MR. BERDE: Thank you.

EXAMINATION

BY MR. BESHORE:

Q. Mr. Herbein, I want to first ask you a couple of questions about your firm and your firm's clients to make sure we have a full picture. Mr. Ricciardi asked you a number of questions about that.

How many employees are there in your accounting firm, Herbein & Company?

A. About a hundred.

Q. And of those employees, how many work in a department or section called the Dairy Group?

A. The Dairy Group.

Q. How many of the hundred are in the Dairy Group?

A. Seven.

Q. And the other 93 work with clients that are not in the dairy industry?

A. That's correct.

Q. You were asked whether you had done work for DFA, and you talked about two projects that were on behalf of entities in which DFA was a joint venturer.

A. That's correct.

Q. And the current engagement today is the only, correct, DFA engagement that you have?

A. That's correct.

Q. You may have been asked -- I'm not certain, but I don't want there to be any inaccuracies or misinterpretations in the record.

You may have been asked whether you had done any work for members of DFA. Have you done work for co-operatives which are co-operative members of DFA?

A. Yes.

Q. Okay. And for which co-operative that is a

co-operative member of DFA?

A. Dairy League, Syracuse, New York.

Q. Now, on Exhibit 25, there were some questions from Mr. Ricciardi with respect to the distribution line, and I'm looking at 25E.

A. I have it.

Q. Does the cost line labeled Distribution, is that strictly a transportation expense line?

A. No.

Q. What did you include in distribution functions in that line?

A. The proper accounting for distribution cost is to include all of the costs of maintaining that function within your company, and that would include, for this sort of customer, things like the pallets that are used to deliver the product, an allocation of the garage service department that maintains the fleet of trucks. Every company has some spare trucks or trailers, tractors and trailers. They're allocated over the routes. That is included, along with all of the direct operating costs of the driver's labor, all of his fringe benefits. Those types of expenses are all in this cost.

Q. And that's reflected on the distribution line of 25F through K, the pages after 25E; correct?

A. Yes. Correct. Same methodology, same number throughout.

Q. Did you study -- in Exhibit 25, did you study the cost of producing milk on the farm side of the equation in any respect?

A. No, no study on the farm production side whatsoever.

Q. However -- okay. But you did testify to having some farm clients for which you've done -- some dairy farmer clients for which you've done some work in other respects, such as the feasibility study for a 500-cow expansion.

A. Yes. Yes.

Q. Now, let's just talk about the production side for a minute in that -- you know, in that study.

When you were analyzing, evaluating the feasibility of that expansion, what revenue stream did you project for cattle?

A. The revenue stream was produced by taking the number of cows times an assumed annual hundred pounds of milk per cow times the market blend rate.

Q. The blend price?

A. The blend price, yes.

Q. Going back to Exhibit 25, then, I think it is your testimony, and I want it to be clear, that the

costs of balancing of milk supply were considered by you to be on the producer side and were not calculated in any way in Exhibit 25; correct?

A. That's correct.

Q. Because it just reflects plant handler costs?

A. Plant handler costs. And when we looked at the value of milk, we used the class price for the blend price.

Q. Okay. When you used the class price just for comparative purposes in Exhibit 25E, you didn't include -- it's the minimum class price and you didn't include any premiums or handling charges that these 20 handlers may have paid?

A. That's correct. This is the base announced prices, the advanced prices.

Q. In fact, in calculating the plant costs in

Exhibit 25, you didn't utilize their costs for raw milk in any respect, did you?

A. That's correct.

Q. You were asked, I think by Mr. Miltner, whether if a handler wanted to go from a volume of 5 million to a volume of 12 million, that it may or may not have to add plant capacity.

A. I recall that.

Q. You indicated it may or may not have capital

expenses for plant capacity. Do you recall that?

A. Yes, I recall that line of questioning.

Q. Now, if this were a producer-handler on the producer side, the farm side, wouldn't the same thing apply, that is, if it had additional Class I sales, it would only have to add cows if its present herd was tailored precisely to its Class I sales?

A. Yes. I think those -- I agree with that. And I think those principles that I was attempting to explain as to capacity would fit on the producer-distributor side. In addition to the cows, the rest of the operation, the milking parlor, the barns, if they are less than 100 percent utilized, you could bring in additional cattle to increase your production with variable costs only. It's a case-by-case situation.

Q. So if a producer-handler had surplus production, it would not have -- it could add Class I sales without capital expenses for additional raw milk production?

A. That would be a great thing for their P & L.

MR. BESHORE: Thank you. I have no further questions for Mr. Herbein.

JUDGE HILLSON: Okay. I'm not sure if anyone else does.

EXAMINATION

BY MS. DESKINS:

Q. I've got a couple more questions.

This database that you used to prepare Exhibit 25, you said what's in 25 is based on 20 of the companies that were in that database?

A. That's correct.

Q. Did you specify how you picked those 20 companies?

A. I did.

Q. Okay. And, also, were the majority of the 20 you picked, were they located east or west of the Mississippi?

A. Of the -- we've identified the producer-handler -- I'm thinking out loud. Producer-handler, the two are in Pennsylvania.

Q. Okay.

A. Of the 18 remaining, more than 50 percent are east of the Mississippi.

MS. DESKINS: Okay. All right. Thank you.

JUDGE HILLSON: Mr. Ricciardi's next.

MR. RICCIARDI: Al Ricciardi.

EXAMINATION

BY MR. RICCIARDI:

Q. Mr. Herbein, if you would go back to

Exhibit 25E. Based upon some response that you gave to Mr. Beshore, I had a couple more questions on our distribution issue.

I think you told him that as part of the distribution, which is about the middle part of the page under Dairy Supplier Costs, that you included a pallet cost. And this was for a warehouse store; correct?

A. Yes.

Q. And I assume the warehouse store was hypothetically called Costco?

A. Yes, that would be one of the warehouse stores in this analysis.

Q. And how much did you include in distribution costs for the pallet?

A. I don't have that information, the details of that in my -- it's a small number.

Q. Okay. But it's an ongoing distribution cost each time; correct?

A. Yes. The pallets -- the dairy supplier has to supply the pallets.

Q. But if you assume for me that there is what's called a pallet exchange program at Costco where you only pay for it once and then you exchange it from that point forward if you continue to deliver, then, again, your distribution costs would be overstated in my

example; correct?

A. If your hypothetical is correct.

Q. If my facts are correct, then --

A. Yes.

Q. -- your number's overstated?

A. Yes.

MR. RICCIARDI: Thank you.

JUDGE HILLSON: Do you have a question, Mr. Yale?

MR. YALE: Yes, a follow-up.

EXAMINATION

BY MR. YALE:

Q. You made -- Mr. Beshore asked this question in the example of going from a 5 million -- let me back up.

Mr. Miltner asked you a question of going from a 5 million to an 18 million plant, and you indicated that the capital costs on the plant side will change depending on what existing capacity's there and some things can be used at 5 million and 18 million. You don't need any size adjustments, so on and so forth. I mean, that was part of your comment. You don't know what it is. There would be some, but it may not be as much; right?

A. Yes, that's a pretty decent generalization.

Q. So Mr. Beshore comes over and says that if you're going from 5 to 18 million on the producer side, you may not have to do anything because you may already have the cattle; right?

A. Yes, I think he said something like that.

Q. All right. So if you've got a Class I producer-handler with 5 million in Class I sales and 13 million in non-Class I sales, then there would be a significant balancing cost associated with that operation; right?

A. I believe the problem that we have here, so the record doesn't get confused, I didn't take Mr. Beshore's question to be 5 million pounds to 18 million pounds. I don't believe that he mentioned a volume.

Q. Okay. So really the issue is, though, is that there is -- for a producer-handler to grow, they have capital costs that may vary depending on existing capacity and the like on both the plant side and the producer side; right?

A. If they're at maximum capacity in both of those parts of their business the moment before the expansion begins, then there would be capital costs for sure.

Q. And there might even be some if they're not quite at capacity?

A. There's always some.

Q. Right.

A. There's always some. I agree.

Q. But a processor only, they don't want have to worry about any capital costs on the producer side for growth whatsoever; right?

A. On the producer side, no. If they're -- if they have either a co-operative supply or independent milk available, they just buy more.

Q. And that additional capital makes -- can be a significant difference in operating costs and decisions, right, and risks?

A. It is -- a part of the decision process should always be -- as I think I said earlier, I believe on the producer side, one of the things that we have to consider when we look at that capital for expanding a herd from 2,000 cows to 3- is that, yes, we have to buy cows, and yes, we may need another barn and more silos and, you know, more employees, but there's revenue or milk that's produced that has a value, so that has to be in that equation.

Q. As it does on the processing side?

A. Absolutely.

MR. YALE: All right. No other questions.

JUDGE HILLSON: Is that it?

Mr. Herbein, you may step down.

Sorry, Mr. Tosi. Please proceed.

EXAMINATION

BY MR. TOSI:

Q. Mr. Herbein, to the extent that your analysis -- cost analysis that you presented here in Exhibit 25 is geared towards warehouse stores, would your same conclusion be true with respect to producer-handler advantages? Would they be similar if we were talking about producer-handler sales versus regulated handler sales to, say, other types of milk outlets, like a regular grocery store?

A. Yes.

Q. Also, you make a conclusionary statement in your written testimony that that producer-handler's cost advantage on raw milk enables it to service these stores -- and "these stores" meaning warehouse stores -- quite profitably at an in-to-store price that cannot be matched by pool plants.

In trying to understand the particulars of your Exhibit 25, could you just quickly point out, what is it that the Secretary should look at in this exhibit

that supports that conclusionary statement?

A. Yes. And let's utilize 25E.

Q. Okay.

A. And 25E, if we look at, beginning in the middle of the page, value of raw milk. This is the value of the raw milk that the -- and I'm looking at the 8 percent column -- the value of the raw milk that the producer-handler would have, $10.97 per hundred.

And when we compare that with the Class I price, it's higher than the Class I price, so the producer-handler is able to generate value for his milk even above the Class I value. And when we compare that to the uniform price, which is what a regulated producer would receive, we have a $2 advantage in that value of milk compared to the blend.

So the problem that a regulated handler has is then shown if we go to 25K. The most efficient largest regular processor serving a warehouse store at their costs -- and we've gone through enough with the costs. I plugged in for raw milk the Class I price and there is no premium in here. And that handler would lose 17.7 cents on every two gallons, or the equivalent of 1.03 on every hundred pounds.

Q. Maybe that's where I got a little lost.

But in table 25K, what is it that I should

look at that's representative of the Class I price?

A. The raw milk, the $1.836 in the lower third of the page.

Q. Okay.

A. That is the raw milk price for 2 percent at the Class I price for June of 2003, butterfat adjusted. It's your announced price adjusted to a 2 percent level, so that's what a regulated handler would have as their cost for the raw milk. And these are the other costs that they incur.

The money that they're going to receive from the warehouse is 3 dollars and .027, and their costs are 3.24 -- 3 dollars and 20.4 cents, so they have a loss. So my advice to this Plant F, if this were one company, would be you can't sell to this customer because you're going to lose money.

Q. Okay. Now, if we compare that, then, to what you're showing on 25F as it would relate to a 90,000-pound producer-handler.

A. Now, again, if you notice, up on 25F, I have shown for raw milk the Class I price for the producer-handler to have the analysis for all of the handlers be done in the same way so as to not cause a distortion by using blend or their value. I used Class I.

So this says, for this producer-handler, this small producer-handler who has very high costs, he would lose $7.16 per hundred, so he's really way out of the ball game as far as being able to serve a warehouse account at his size. Too small.

And this also shows -- if I can just add one other thing. I don't mean to lecture here late in the day. I believe that this is also very strong proof that the small traditional jugger, as I call them, on-farm store, isn't a competitive threat in the market, doesn't have a cost advantage and probably should not be regulated. It's when the size makes them a competitive force and they have an unfair advantage. This small producer-handler does not.

MR. TOSI: That's all I have. Thank you very much. I appreciate it.

JUDGE HILLSON: Anyone else?

Mr. Herbein, you may step down.

THE WITNESS: Thank you.

(Parenthetical)

JUDGE HILLSON: Mr. Cryan is next on the list.

Mr. Cryan, would you please raise your right hand.

Cost Structure of Fluid Milk Plants of Various Sizes

		Producer Handler- A		B		C	
		131	124	131	124	131	124
Monthly Volume	Class 1 Lbs.	90,000	90,000	2,000,000	2,000,000	5,000,000	5,000,000
Convert to Gallons		10,465	10,465	232,600	232,600	581,400	581,400
Gallons Per Day	(6 Days/WK)	400	400	8,900	8,900	22,400	22,400
Container Source		Purchase	Purchase	Purchase	Purchase	Purchase	Purchase
<u>Cost Per Gallon</u>							
Plant Processing Costs		0.806	0.878	0.466	0.508	0.432	0.471
Packaging Costs (Container)		0.160	0.160	0.142	0.142	0.142	0.142
Shrink		0.042	0.042	0.021	0.021	0.018	0.018
Per Gallon		1.008	1.080	0.629	0.671	0.592	0.631
Per CWT		11.71	12.55	7.31	7.80	6.88	7.33

Exhibit #: 25
Wit:
Date:
Cropper & Assoc., Ltd.
E. Cropper # 50491

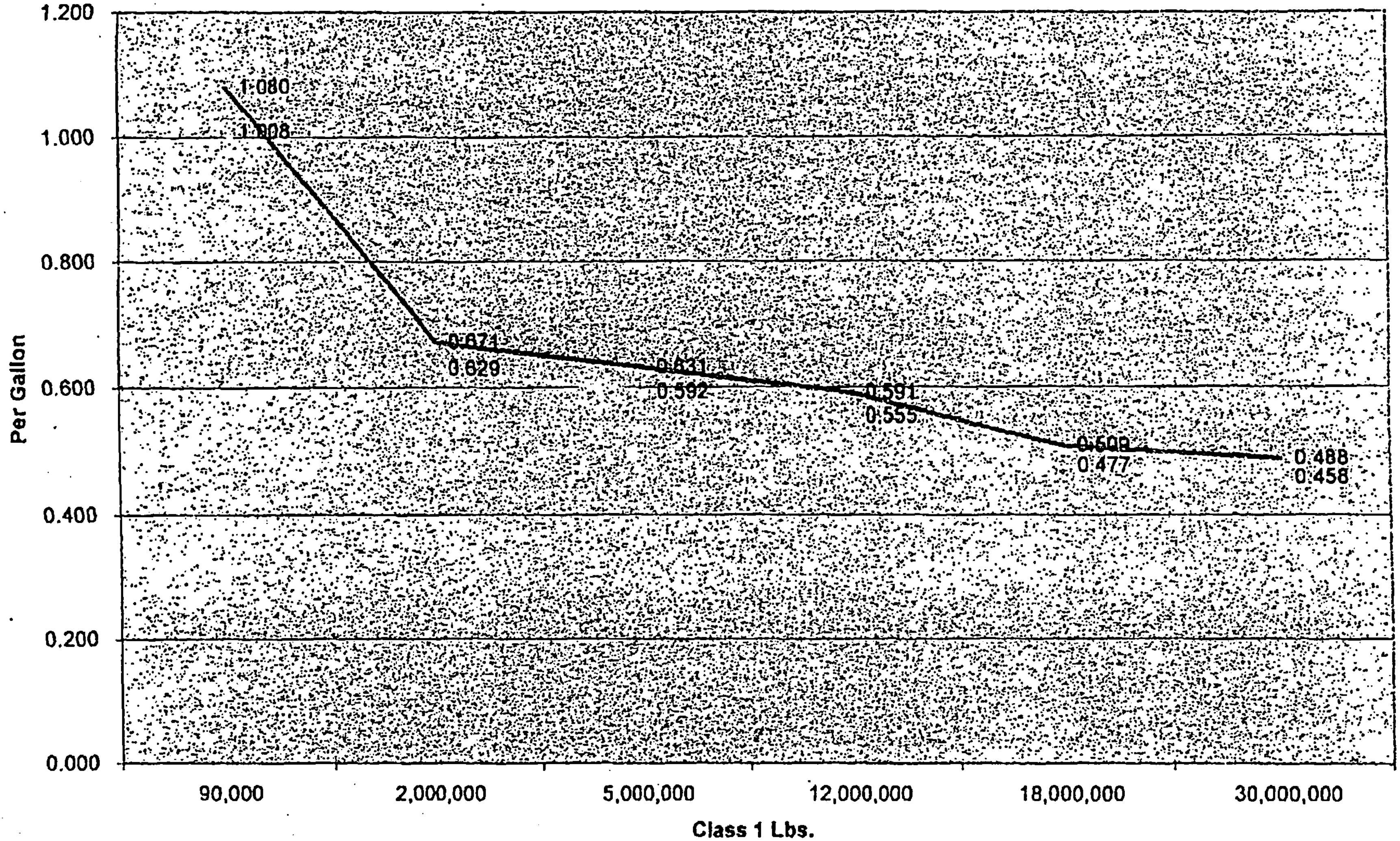
EXHIBIT A

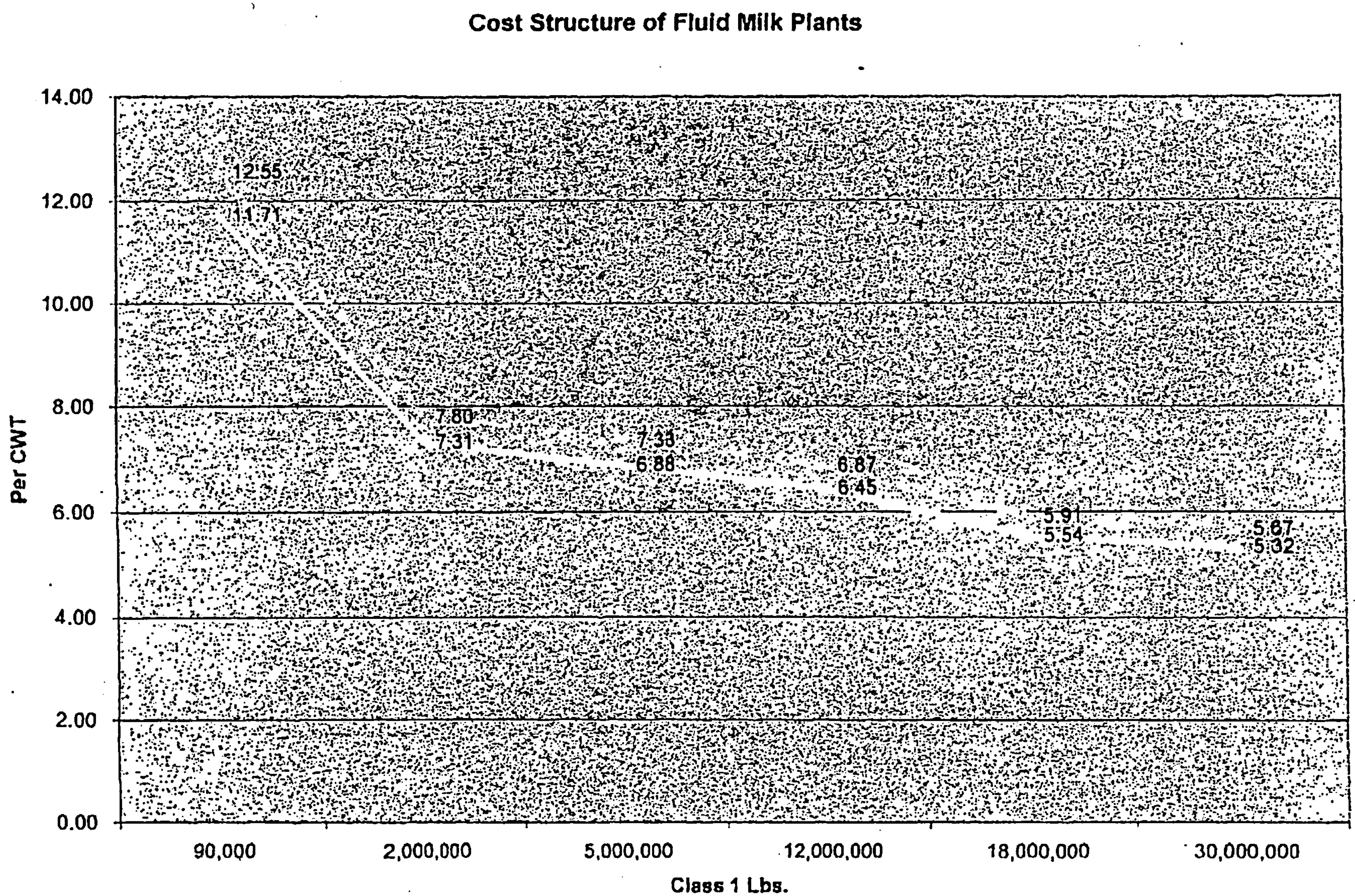
Cost Structure of Fluid Milk Plants of Various Sizes

		D		E		F	
		131	**124**	**131**	**124**	**131**	**124**
Monthly Volume	Class 1 Lbs.	12,000,000	12,000,000	18,000,000	18,000,000	30,000,000	30,000,000
Convert to Gallons		1,395,300	1,395,300	2,093,000	2,093,000	3,488,400	3,488,400
Gallons Per Day	(6 Days/WK)	53,700	53,700	80,500	80,500	134,200	134,200
Container Source		Purchase	Purchase	Blow-Mold	Blow-Mold	Blow-mold	Blow-mold
<u>Cost Per Gallon</u>							
Plant Processing Costs		0.398	0.434	0.350	0.382	0.335	0.365
Packaging Costs (Container)		0.142	0.142	0.113	0.113	0.113	0.113
Shrink		0.015	0.015	0.014	0.014	0.010	0.010
Per Gallon		0.555	0.591	0.477	0.509	0.458	0.488
Per CWT		6.45	6.87	5.54	5.91	5.32	5.67

Exhibit 6

Cost Structure of Fluid Milk Plants





Cost Structure of Fluid Milk Plants
Per CWT
14.00
12.00
10.00
8.00
6.00
4.00
2.00
0.00
12.55
11.71
7.80
7.31
7.33
6.88
6.87
6.45
5.91
5.54
5.67
5.32
90,000
2,000,000
5,000,000
12,000,000
18,000,000
30,000,000
Class 1 Lbs.

D

Comparative Analysis of Return to Producer Handlers and Regulated Distributing Plants Supplying a Warehouse Store

January to June 2003.		Reduced Fat 2% - 2 Gallon Package
Average retail (out of store prices)		$3.2900
Warehouse store markup at	8%	0.2632
Warehouse store markup at	14%	0.4606
	14%	**8%**
PRICE paid to dairy supplier	2.8294	3.0268
Dairy Supplier Costs:		
Plant	0.4302	0.4302
Packaging	0.3480	0.3480
Distribution	0.2960	0.2960
Shrinkage	0.0290	0.0290
Milk PEP	0.0340	0.0340
TOTAL COST	1.1372	1.1372
VALUE OF RAW MILK	1.6922	1.8896
Convert to one gallon	$0.8461	$0.9448
Convert to CWT	$ 9.83	$ 10.97
Analysis of Implied Return per CWT:		
Class I cost - FO 131	10.53	10.53
FO 131 - Uniform Price	8.79	8.79
Compare to Class I (under)	(0.70)	0.44
Compare to Uniform Price	1.04	2.18

EXHIBIT E

Warehouse Store By Producer Handler - A

		2 GALLON Package
January to June 2003	Product	Reduced Fat
	Butterfat Test	2.00%
Price Paid to Dairy Supplier	2 Gallons	3.027
Cost Per 2 Gal Box		
Plant Cost		1.612
Packaging Cost		0.432
Distribution Cost		0.296
Shrinkage Cost		0.084
Raw Milk		1.836
Total Cost		4.260
(Loss) per 2 gallons		$ (1.233)
(Loss) per CWT		$ (7.16)

EXHIBIT F

Warehouse Store By Pool Distributing Plant - B

January to June 2003		2 GALLON Package
	Product	Reduced Fat
	Butterfat Test	2.00%
Price Paid to Dairy Supplier	2 Gallons	3.027
Cost Per 2 Gal Box		
Plant Cost		0.932
Packaging Cost		0.396
Distribution Cost		0.296
Shrinkage Cost		0.042
Raw Milk		1.836
Total Cost		3.502
(Loss) per 2 gallons		$ (0.475)
(Loss) per CWT		$ (2.76)

EXHIBIT G

Warehouse Store By Pool Distributing Plant - C

		2 GALLON Package
January to June 2003	Product	Reduced Fat
	Butterfat Test	2.00%
Price Paid to Dairy Supplier	2 Gallons	3.027
Cost Per 2 Gal Box		
Plant Cost		0.864
Distribution Cost		0.296
Packaging Cost		0.396
Shrinkage Cost		0.036
Milk Pep		0.034
Raw Milk		1.836
Total Cost		3.462
(Loss) per 2 gallons		$ (0.435)
(Loss) per CWT		$ (2.53)

EXHIBIT H

Warehouse Store By Pool Distributing Plant - D

		2 GALLON Package
January to June 2003	Product	Reduced Fat
	Butterfat Test	2.00%
Price Paid to Dairy Supplier	2 Gallons	3.027
Cost Per 2 Gal Box		
Plant Cost		0.796
Packaging Cost		0.396
Distribution Cost		0.296
Shrinkage Cost		0.030
Milk Pep		0.034
Raw Milk		1.836
Total Cost		3.388
(Loss) per 2 gallons		$ (0.361)
(Loss) per CWT		$ (2.10)

EXHIBIT I

Warehouse Store By Pool Distributing Plant - E

		2 GALLON Package
January to June 2003	Product	Reduced Fat
	Butterfat Test	2.00%
Price Paid to Dairy Supplier	2 Gallons	3.027
Cost Per 2 Gal Box		
Plant Cost		0.700
Packaging Cost		0.348
Distribution Cost		0.296
Shrinkage Cost		0.028
Milk Pep		0.034
Raw Milk		1.836
Total Cost		3.242
(Loss) per 2 gallons		$ (0.215)
(Loss) per CWT		$ (1.25)

Exhibit J

Warehouse Store By Pool Distributing Plant - F

		2 GALLON Package
January to June 2003	Product	Reduced Fat
	Butterfat Test	2.00%
Price Paid to Dairy Supplier	2 Gallons	3.027
Cost Per 2 Gal Box		
Plant Cost		0.670
Packaging Cost		0.348
Distribution Cost		0.296
Shrinkage Cost		0.020
Milk Pep		0.034
Raw Milk		1.836
Total Cost		3.204
(Loss) per 2 gallons		$ (0.177)
(Loss) per CWT		$ (1.03)

Exhibit K