BEFORE THE SECRETARY OF AGRICULTURE

Milk in the Upper	)	Docket No. AO-361-A39;
Midwest Marketing	)	DA-04-03
Area; Hearing on	)	
Proposed Amendments	)	HEARING TRANSCRIPT
to Tentative Marketing	)	
Agreement and Order.	)	Before Judge
	)	Victor W. Palmer

DAY TWO OF THE FEDERAL ORDER 30 HEARING

The following is day two of the Federal Order 30 Hearing, taken before Kelly E. Hanna, Court Reporter, Notary Public, pursuant to Notice of Taking Hearing, at the Sofitel Hotel, 5601 West 78th Street, Bloomington, Minnesota, commencing at approximately 9:08 a.m., August 17th, 2004.

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APPEARANCES:

On Behalf of Mid-West Dairymen's Company, et al.:

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Present for USDA, AMS Dairy Programs:

H. Paul Kyburz
Gino Tosi
Carol S. Warlick
Erin Feuillet
Henry Schaefer
Harold Ferguson

APPEARANCES:

Also Present:

Doug Peterson - Minnesota Farmers Union
Sue Beitlich - Wisconsin Farmers Union
Robert Carlson - North Dakota Farmers Union
Michael Brown - Northwest Dairy Association
Evan Kinser - Dean Foods
Paul Christ - Dean Foods
James D. Oberweis - Oberweis Dairy
Neil Gulden - Associated Milk Producers
Richard Lamers - Lamers Dairy
Ryan Miltner - Continental Dairy Products
Michael Reinke - Kraft Foods, Global Inc.

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WITNESSES:

EXHIBIT INDEX

P R O C E E D I N G S

Whereupon, the Federal Order 30 Hearing was commenced at 9:08 a.m. as follows:

THE COURT: This is the second day of the hearing on the proposed amendments to the Midwest Marketing Order. Yesterday we heard Proposal 1, and we heard some other witnesses, and I presume today we'll start with Proposal 2, and who speaks for Proposal 2?

MR. BESHORE: Marvin Beshore. We're ready to go forward with Proposal 2, Your Honor. Just by way of a preliminary, we have six short witnesses and two longer witnesses, and the first witness I would call is Adrian Pehler.

THE COURT: All right. Sir, could you face me.

ADRIAN PEHLER,

after having been first duly sworn by,

the Court, says under oath as follows:

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MR. BESHORE: Mr. Pehler does have a statement. We did not propose to mark it as an exhibit. I do have a few copies available for a few participants, but the witness has been sworn.

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Would you proceed, please.

A. I am Adrian Pehler, Controller for the Procurement division of Swiss Valley Farms, Company located in Davenport, Iowa.

Swiss Valley Farms, Company is a farmer-owned cooperative and represents approximately 1,000 farms in the states of Illinois, Iowa, Minnesota, and Wisconsin. Our milk is pooled primarily in Federal Order 30, the Upper Midwest marketing area. We operate one bottling plant and four manufacturing plants. Besides supplying fluid milk to our own distributing plant, we supply fluid milk to other bottling plants in Federal Order 30.

Swiss Valley Farms, Company supports all parts of Proposal No. 2.

Whenever the producer price differentials are negative, our company and its members are at an economic disadvantage when compared to companies and their producers who are able to depool large amounts of milk, which primarily go into cheese plants. This inequity was very event during the months of April and May of 2004. As we all remember, these two months had very high negative producer price differentials. The majority of milk that we pooled in these two months went into the bottling plants. The value of the pooled milk was less than the milk that was depooled. The economic difference was $4.12 and $1.97 per hundredweight for the months of April and May compared to the Class III price for these respective months. As a result of this large dollar spread between milk that was required to be pooled and milk that elected not to be pooled, the pay prices to our farmers after adding the producer price differentials and component values were below the Class III price.

In summary, Swiss Valley Farms, Company was required to pool a substantial share of their milk, our farmers received less for their milk than their neighbors who shipped their milk to cheese plants that can depool their milk.

In conclusion, we support Proposal No. 2, because we feel that this proposal will lessen the possibility of negative producer price differentials, reducing the inequities between pooled and depooled milk, and that concludes my statement.

THE COURT: I must tell you, I have a

little trouble understanding what the economic difference of $4.12 and $1.97 per hundredweight means, I'm not sure.

MR. BESHORE: Okay. Let me just ask Mr. Pehler to elaborate on that a little bit.

BY MR. BESHORE:

Q. Could you explain, you referred to the economic difference in $4.12 and $1.97 per hundredweight in the depooling scenario of April and May, how does that work?

A. That represents the negative producer price differentials on the old staff down in Chicago, and that would have basically been the value of the milk that was less than the Class III milk, and basically the uniform price was below that amount, below the Class III price for those two months.

Q. Okay, so let's see if we can break that down just a little bit more. You've referred to the fact that some of your competitors who are cheese plants were able to depool their milk fully during those months; correct?

A. Correct.

Q. Okay, and when they were able to depool, then is it your testimony that their Class III value was $4.12 or $1.97 respectively in the months of

April and May, higher than the pooled value of your milk to your Class I plants?
A. That's correct.
Q. The uniform value for the pooled?
A. That's correct.
Q. Okay. Now, did you depool all the milk you could to try to stay competitive?
A. Yes, we did.
Q. But nevertheless, you were not able to be on the same competitive power with the cheese plants that were able to totally depool?
A. That is correct.
Q. Did you lose some producers?
A. Yes, we did lose some.
Q. Because of those price differences?
A. Correct.
Q. Is it your testimony, Mr. Pehler, that that circumstance of negative PPD's and depooling, loss of producers, is a disorderly market condition, which Proposal 2 would help address?
A. That is correct.
THE COURT: Other questions? Mr. Vetne?
CROSS-EXAMINATION
BY MR. VETNE:

Q. Mr. Pehler, I'm John Vetne, counsel for AMPI and other cooperatives in this proceeding. What portion of Swiss Valley Farms' producer milk, member milk goes to Class I?

A. Are you referring to Class I bottling plants?

Q. Class I, yes.

A. Probably what we ship to bottling plants or one of the outside plants are probably in the neighborhood of 35 percent, 40 percent, somewhere in that ballpark.

Q. Does Swiss Valley include in its pool reports milk of other cooperatives or nonmember producers?

A. Yes, we do.

Q. You do that for purposes of helping those producers or other cooperatives qualify milk?

A. Yes, we do.

Q. Do you receive a fee for that?

A. Yes, there's a pooling fee.

Q. Is there a pooling fee charged for milk that ordinarily goes to Class I? Maybe I can ask that better. Is the pooling fee charged for purposes of associating the portion that doesn't go to Class I with the market?

A. That would be correct.
Q. What is the amount of the pooling fee?
A. I feel that's confidential information.
Q. Okay. Can you tell me if it's more than a quarter or less than a quarter?
A. Less than a quarter.
Q. Is this charged every month?
A. No. Only the months they pool milk.
Q. During the months -- So whenever there's milk pooled as an accommodation for your cooperative, there's a pooling fee?
A. That is correct.
Q. It's not charged in months when it's not necessary?
A. Correct, yeah, when milk is not pooled for them, we do not charge them any fees.
Q. Have you undertaken to compare your long-term revenue to your members from charging pooling fees versus what you believe is a short-term gain for depooling?
A. No, I have not.
Q. When you speak in terms of the economic difference on Page 2 of your statement, you're not referring, are you, to the difference between what you are able to pay your members versus what your

competitors who could depool more are able to pay their members?

A. What I refer to basically here was the uniform price of the Federal Order compared to the Class III price for people that did not pool their milk.

Q. I understand that. The uniform price applies to all milk, correct, all pooled milk?

A. All pooled milk, correct.

Q. Right, and the uniform price during those months did not apply to all of your milk, because you had depooled some?

A. That is correct.

Q. Okay, and the Class III price applies to some milk?

A. That was pooled?

Q. Applied to some milk that was pooled and some milk that was not pooled?

A. That's correct.

Q. It's not enforced with respect to the milk that was not pooled. For your competitors who depooled, is it not ordinarily the case, as it is for you, that some of their milk was pooled?

A. Some competitors may have pooled some milk and some may have not, you know, I'm not privileged to that information.

Q. Do you have any information upon which you can express a belief that there were players that depooled 100 percent of their milk?

A. I would think that there were some that are -- that probably would have been able to depool 100 percent of their milk.

Q. Can you cite an example?

A. There's probably a number of cheese plants in Wisconsin that did that, that just are 100 percent cheese.

Q. Plants?

A. Plants.

Q. Okay. Let me talk about your competitor, Cooperative Associates. Ordinarily there is a mix of use of milk; correct?

A. Correct.

Q. The economic difference between your organization and other organizations that were able to depool a bit more would be the blended difference between the volume of milk that was depooled and the volume of milk that was pooled?

A. That would be correct.

Q. Do you have any information on the actual blended value difference between your organization and organizations that depooled?

A. Just offhand, approximately, I would say in one month it was probably around $2.00, and in the other month it was probably a little less than a $1.00 per hundredweight.

Q. And it's not the case that a negative PPD by itself causes economic disadvantage, is it?

A. I feel it would be, because basically the value of your milk sold to, like, a bottling plant, when there's a negative PPD, the company or producers that go into that plant do receive less for their milk than a company that can depool their milk.

Q. My question did not presuppose that there was depooling. My question was, a negative PPD by itself is not a source of economic disadvantage?

A. I still feel it would, because your returns are less than, you know, plants that can depool their milk.

Q. If 100 percent of Class III milk were pooled in this market last April, there still would have been a negative PPD of $1.14, according to Table 5B of Exhibit 9?

A. That would be correct, because the Class I price was lower than the III.

Q. So that's what I mean. It's not the

fact that there is a negative PPD by itself that creates economic disadvantage. Can you describe -- You don't think there's an economic disadvantage if all the Class III milk were pooled, and there's a negative PPD of $1.14?

A. As far as, I guess the way I look at it is, if all the milk was pooled, the uniform price would have been the same for everybody going into everybody's plant, similar to how it works when there was full depooling.

Q. I mean, there was no negative PPD in Order 7, was there?

A. That, I'm not sure. I don't know.

Q. In other words, they don't have a PPD, they have a blend price, at least they used to. The negative PPD results from regulated pricing on a current basis of the value of milk going into -- estimated value of milk going into Class III and retroactive or advance pricing of Class I. Did you undertake any consideration of whether it might be better on a regulatory basis and equity basis to address the source of the problem, that is the difference between the timing of the prices versus solution of depooling restrictions?

A. No, we have not.

Q. You indicate that most of your milk is pooled on Order 30. Where are other portions of your producer milk pooled?
A. We have milk pooled in Order 32.
Q. Do you operate a bottling plant that's regulated in Order 32?
A. I'm sorry?
Q. Do you operate a bottling plant that's regulated under Order 32?
A. No, we do not. Our bottling plant is regulated under Order 30.
Q. So you supply other folks in Order 32?
A. We supply one party with some milk.
Q. Bottling plants?
A. Yes.
Q. Do you supply that plant through any other supply organizations?
A. Yes, we do.
Q. Who is the other supply organization?
A. Basically we supply it through DFA.
Q. Do you pay a fee for that?
A. No.
Q. Do you perform balancing functions for that milk?
A. No.

Q. Are you able to pool the maximum volume of Class III, IV, the manufactured uses as a result of that supply?

A. No, we have not.

Q. So the milk you pool goes just to the bottling plant, and you don't --

A. We don't send any to the bottling plant. We do divert a very little portion of it.

Q. Is that part of your agreement?

A. No.

Q. Why would you not divert the most you can for the benefit of your producer?

A. Basically this milk was on the common road route where their producer and our producer, they're on the same truck, so it's more of an agreement of convenience.

Q. It maximizes efficiency for both of your organizations?

A. Correct.

Q. Do you -- Have you undertaken or are you aware of the undertaking of others in your coalition of any study as to whether in the foreseeable future there will be conditions similar to those that we observed last spring?

A. I'm not aware of any.

Q. Have -- Swiss Valley has pooled milk in the Midwest for many decades, correct, in some Federal Order?
A. In some Federal Order, that's correct.
Q. And for several decades has there not been depooling of some milk during areas of price inversion?
A. Yes, there has been depooling by Swiss Valley.
Q. The difference between -- Well, is there a difference between circumstances creating depooling ten years ago or twenty years ago and those today?
A. Twenty years ago I was not in the industry.
Q. For your -- During your experience, then.
A. I -- During my experience I, like I said, I'm not aware of what happened twenty years ago, but I don't know. I didn't think there would be too much depooling going on, because the fact that your prices were very stable, you didn't have wide fluctuations in prices like you have in the last ten, fifteen years.
Q. Ten, fifteen years there's been

fluctuating pricing which has encouraged or simulated depooling?

A. It has caused negative producer price differentials.

Q. And during those periods when we reported a blend price rather than a PPD, or a producer price differential, there have been Class III prices that exceeded the blend price?

A. I believe that is correct.

Q. And that's the equivalent, isn't it?

A. Correct.

Q. And during those past periods when there has been depooling in the past fifteen years that you referred to, similar conditions, in your opinion, of economic disadvantage, were created on a short-term basis?

A. Yes, they would have been.

MR. VETNE: Thank you.

THE COURT: Other questions? Mr. English?

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Good morning, Mr. Pehler. Charles English for Dean Foods. To clarify a couple more things, based upon your testimony of questions by

Mr. Beshore and Mr. Vetne, and the question that was asked by Judge Palmer. On the second page of your statement, you referenced milk that was required to be pooled and milk that elected not to pool. Is it fair to say that milk that was required to be pooled is another way of saying the milk that went to pool distributing plants?

A. Yes, that would be correct.

Q. And --

A. Pool distributing plants or pool supply plants.

Q. Well, but you don't have to pool milk that goes to pool supply plants, do you?

A. If there were pool supply plants the milk goes into, you would have to pool it.

Q. It could go into the split plant portion, though; correct?

A. It could, correct.

Q. So to the extent it goes to a pool distributing plant or that portion of a pool supply plant that isn't around the corner and part of the same plant, then it has to be pooled; correct?

A. That's correct.

Q. And to the extent to which Swiss Valley Farms provides 35 or 40 percent of its milk to Class

I, by definition that 35 to 40 percent has to be pooled; correct?

A. That is correct.

Q. Whereas, a supply plant with only 10 percent shipments may only be pooling 10 percent of its milk?

A. It depend what would go into that supply plant.

Q. Again, which side of the plant it goes to --

A. You would have to pool the entire amount that would go into the pool supply plant.

Q. Were you here yesterday?

A. Yes, I was.

Q. And you were here for the testimony of the Market Administrator's Office?

A. Yes, I was.

Q. Would you agree that many supply plants in the Order 30 area have split plants?

A. I would think that there's a fair number.

Q. Turning, and I'm not sure if you brought it up with you, but Exhibit 5, Table 3, for the Market Administrator --

THE COURT: I don't know if he has a

copy.

BY MR. ENGLISH:

Q. Well, I'll just give you the number for a moment. For the month of April of 2004, the statistical uniform price was $15.55, all right, and the producer mailbox price was $19.75. To the extent you had 35 or 40 percent Class I, is it fair to say that you were able to return for your farmers that $15.55 on that milk?

A. On the milk that we pooled?

Q. Yes.

A. Yes, the $15.00, we would have paid more than that.

Q. But in terms of what Class I operations would have contributed to the pool, effectively to you, as dairy farmers, for shipping that milk, you received $15.55; correct?

A. The uniform price we would have received --

Q. Yes.

A. -- yes, we would.

Q. And the uniform price for April was $15.55, that's what you received on that month; correct?

A. Correct.

Q. But the producer mailbox price was $4.20 more for that month. How did you, Swiss Valley Farms, assuming you competed for that $19.75 or somewhere thereabouts in the -- and maybe that's not a safe assumption. How would you on that Class I volume of milk, 35, 40 percent, be able to compete at a mailbox price of $19.75 when you received only $15.55 for the milk?

A. We would have had to take out funds from our other operations to compensate for that price.

Q. But someone who was able to elect to not pool their milk, would not have to; is that correct?

A. That is correct.

Q. And that is what you mean by inequity?

A. That is correct.

Q. And as the amount of the depooled milk increases, and as this producer price differential gets larger in a negative fashion, that increases the inequity to Swiss Valley Farms?

A. That is correct.

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

THE COURT: Other questions? Mr. Tosi?

CROSS-EXAMINATION

BY MR. TOSI:

Q. Hi, Mr. Pehler. I'm Gino Tosi. I'm with Dairy Programs in Washington, D.C., USDA, and I want to thank you for appearing today. Are you of the opinion that the current marketing situation in light of depooling and these inequities that you speak to rise to the level that the Department should act on in an emergency basis? And usually what we mean by that is, that we would write a decision that would be put to a vote to producers and then we could implement something without going through the process of a recommending and then a final decision.

A. Yes, I do.

Q. Okay. Would you explain, in your opinion, a little bit about why you have that opinion.

A. Basically, you know, I feel like these situations could happen again if some of the problems aren't addressed, and I feel that the people that would supply the bottling plants and basically the Class I is basically what produces the producer price differentials when they're positive, I feel that those parties are being penalized or not treated fairly, because my feeling was that one of the purposes of the Federal Order was to make sure that all parties serving the market receive the same uniform price, and this is an example of where that's not happening.

Q. Okay, and along that theme there, serving the market, I think maybe what you're saying is that during times of a price inversion, then, that the notion of equitable sharing of revenue of everyone that's in the market, if it turns out that for that month that the cheese value is adding more value to the pool, than, say Class I, that there should be an equitable sharing of all of that revenue as well?

A. Yes. I would think the closer they could get so that the uniform price, if the milk goes into a cheese plant, a bottling plant would be closer, I think would be much more fair economically for all the parties involved.

Q. Okay. Do you have any opinion about to the extent that if there are future decisions to depool, organizations like yourself choose to depool because of price relationships, do you have any opinion about the rate at which or, you know, a consequence to depooling would be in Proposal 2, there would be a rate at which milk could come back to the pool, so you sort of support the notion, then, that we should have a consequence to depooling with respect to how fast milk that was depooled could rejoin the pool in the future months?

A. As a company, we support Proposal 2.

MR. TOSI: Okay. All right. Thank you very much. Carol Warlick has some questions to ask you as well.

CROSS-EXAMINATION

BY MS. WARLICK:

Q. Good morning, Mr. Pehler. Carol Warlick from Dairy Programs. I just had one question. I was wondering if you're familiar with the definition of a small business? With a handler, a small business is a handler that has fewer than 500 employees, and I was wondering if you could let me know if you consider your business a small business.

A. Swiss Valley Farms, Company, I don't think it meets the requirements of a small business.

MS. WARLICK: Okay. That's all I have right now.

THE COURT: Ms. Deskins?

CROSS-EXAMINATION

BY MS. DESKINS:

Q. Good morning. I had a question about what you said on Page 2 of your statement. I don't think you quite explained this. Why are you required to pool a substantial amount of your milk?

A. All the milk that we ship to the bottling plants are required to be pooled under the Federal Order System, so that milk given to a pool supply plant, that milk is required to be pooled.

Q. So you don't have any choice about not putting it into the pool, it has to go in?

A. I'm sorry?

Q. You don't have a choice about it going into the pool, it has to go into pool --

A. It has to be pooled if we ship it into a pool distributing or a pool supply plant.

Q. Okay, and can you explain to us why the cheese plants don't have to do that?

A. Cheese plants are basically, it would be an unregulated plant, where they don't meet the definitions of a pool supplier, pool distributing plant, so they can elect to divert milk into that plant, or not pool it, I should say.

MS. DESKINS: Okay. Thank you.

THE COURT: Just to follow-up on that. I take it your contracts with bottling plants require you to supply them with milk, you cannot elect not to supply; is that correct?

THE WITNESS: That is correct. They are usually yearlong agreements.

THE COURT: You'd have yearlong agreements, so for one year from the agreements, you must supply them, or you'd be in breach of contract.

THE WITNESS: That is correct, and our plants, we have no a choice, we have to supply those plants.

THE COURT: All right. Mr. Beshore?

REDIRECT EXAMINATION

BY MR. BESHORE:

Q. Just one or two short questions here in the follow-up. Of course, one of your main bottling customers is your own physical plant; right?

A. That is correct.

Q. Okay, so you're not going to leave it dry?

A. No.

Q. Okay. With respect to the definition of a small business, or what small business interests are involved in this proceeding, the definition for a small business for farmers is less than the gross income of less than $750,000 per year. Would you expect, Mr. Pehler, do you know, that from the 1,000, approximately 1,000 dairy farms that are members and owners of Swiss Valley, would most of those be small businesses?

A. Yes, they would be.

Q. Do you have any feel for what proportion?

A. I would probably say, just based on the milk volumes that we see, not knowing if they have other income from crops or beef, I would guess probably 95 percent.

MR. BESHORE: Okay. Thank you.

THE COURT: Very well. Mr. Vetne?

RECROSS-EXAMINATION

BY MR. VETNE:

Q. Mr. English asked you some questions referring to Table 3, Exhibit 5. These are statistics of the Market Administrator, and specifically to addressing for the line of April 2004, the difference between the statistical uniform price of $15.55 and the reported mailbox price of $19.75. you didn't have that in front of you, did you?

A. No, I did not.

Q. Okay. I'll put it in front of you now. Are you familiar with what the reported mailbox price consists of?

A. Somewhat.

Q. You were here yesterday when the Market Administrator's witness explained it, yes?

A. Yes, I was.
Q. Okay, and you're aware that it is a reported figure that includes all revenue to producers, minus some marketing costs; correct?
A. That's my understanding.
Q. And the number there, the statistical uniform price, the $15.55 for the month, would you agree with me that that does not represent all revenue received by producers?
A. That would be correct. There would be other revenue.
Q. There would be other revenue. There are premiums?
A. Correct.
Q. You charge premiums when you sell your milk for Class I to other Class I handlers; correct?
A. That is correct.
Q. You pay premiums to others that supply Swiss Valley? Are there others that supply milk to Swiss Valley?
A. Yes, there is. We pay premiums to them also.
Q. What is the level of premium that you have received in suppling Class I milk to others during the past six months? A range if it varies.

A. We basically go through CMPC, so the premiums that they would announce is what we receive there.

Q. And are you familiar with what those premiums are?

A. I think the last couple months they've -- just the uniform distribution, that's been $1.50 range, I believe.

Q. That's how the premiums are distributed?

A. From CMPC, and that's including Class I, II, III and IV premiums now, that go into distributing plants.

Q. Is that the amount that comes back to the participants, or the amount that's charged to the processor?

A. That would come back to the participant.

Q. And the $1.50 coming back to participants is reflective of what amount charged to processors for Class I?

A. As a -- Let me think here. As I previously -- like I said, that represents the value of Class I, II, III and IV milk. I believe the premiums on the Class I milk were probably in that

$2.00 range, but then there were also some negative producer price premiums that occurred in the last few months.

Q. Is the Swiss Valley -- Are the Swiss Valley plants made available to CMPC for purposes of associating the system of supply plants that participate?

A. Would you want to repeat that question?

Q. One thing that CMPC does is to accommodate milk through a system of supply plants; correct?

A. That's correct.

Q. And they assume responsibility for performance for those plants?

A. Uh-huh.

Q. Correct? Yes?

A. Yes.

Q. Okay, and suppliers pay a fee to CMPC for that association; correct?

A. It's based on what percentage they ship.

Q. Okay, and if a supply plant, a Class III manufacturer wants to retain all of its milk, they pay a fee of 16 cents a hundredweight; correct?

A. That's -- I'm not sure, but I would

have to look at the schedule. Is this the most recent copy? According to this schedule, that would be correct.

Q. And now you looked at the schedule, the CMPC schedule, and you recognize that as the schedule of CMPC?

A. Correct.

Q. And the rate is 16 cents a hundredweight for supply organizations that want to retain all of their milk?

A. That's correct.

Q. For a -- And that's a fee to participate in the pooling, to be able to draw the blend price?

A. That would be the fee being part of the unit.

Q. There is no comparable cost to you as a Class I handler and supplier of Class I plants to participate in the pool? That comes automatically as a result of the nature of your customer; correct?

A. That is correct.

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

THE COURT: Anything further? Mr. Lamers, is it?

CROSS-EXAMINATION

BY MR. LAMERS:

Q. Good morning, Mr. Pehler.

A. Morning.

THE COURT: Just give your name one more time. I know it's Mr. Lamers.

MR. LAMERS: My name is Richard Lamers, Dick Lamers, Lamers Dairy.

BY MR. LAMERS:

Q. The whole, basically, of your description of the market, including the qualifying fees, the depooling, and so on, would you describe that as orderly marketing or disorderly marketing?

A. I would probably describe it more as orderly when everything works as far as a positive producer price differential, because it does provide an adequate supply of milk to the bottling industry, which is one of the main purposes of the Federal Order system.

Q. Okay. Do you believe that a 400 percent reserve is an adequate supply?

A. I've never thought much about that, to be very honest with you.

Q. Okay, and so, then, the depooling of milk during price inversions is orderly marketing by your definition?

A. No, it's not.

Q. It's not orderly marketing. So then essentially the depooling does not comply with provisions of a declared policy of the act to provide orderly marketing?

A. I feel it doesn't comply with all.

MR. LAMERS: It doesn't comply. Thank you very much.

THE COURT: Any other questions? I think you're excused, sir. Thank you very much.

MR. BESHORE: Our next witness is Keith Pagel.

THE COURT: Is he one of the shorter witnesses too?

MR. BESHORE: Yep.

THE COURT: After he finishes, we'll take a break.

KEITH PAGEL,

after having been first duly sworn by

the Court, says under oath as follows:

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MR. BESHORE: Mr. Pagel does have a one-page statement that we would like to have marked and identified.

THE COURT: All right. We'll mark that as 18, Exhibit 18.

(Whereupon, Exhibit No. 18 was marked for identification.)

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Would you proceed to give your statement.

A. I'm Keith Pagel, and I hold the title of President and General Manager of Cass-Clay Creamery, Incorporated. Cass-Clay Creamery, Inc. is a farmer-owned dairy cooperative headquartered in Fargo, North Dakota. Forty-five percent of our volume is in Class I, 9 percent in Class II, 42 percent in Class III, and 4 percent in Class IV, with most of our growth coming into Class I market.

The Board of Directors and management of Cass-Clay Creamery support Proposal No. 2 and the testimony that will be presented by Dennis Tonak of Mid-West Dairymen's.

In April of 2004, Cass-Clay Creamery started pooling distant milk for a fee for service. This milk, which is not part of the normal market, has a potential of creating negative PPD. With the fee for service from the pooling of distant milk, we will be able to offset some of the negative PPD's. It has also been instrumental in supporting our mailbox prices for members, as we have direct competition for our member's milk from processors that are pooling distant milk for a fee. Cass-Clay Creamery is not in favor of pooling Idaho milk, but we see it as a method of business survival in a very competitive marketplace. With that, I would like to defer all questions regarding Proposal 2 to Dennis Tonak, who is representing the proponents of Proposal No. 2.

THE COURT: Do you want to offer Exhibit 18?

MR. BESHORE: I would, yes.

THE COURT: We'll receive it.

(Whereupon, Exhibit No. 18 was offered and received into evidence.)

BY MR. BESHORE:

Q. Thank you. Now, just a few other questions, Mr. Pagel. How many member-owners does Cass-clay Creamery have?

A. We have around 250 members.

Q. Okay, and where are they located?

A. They're located in South Dakota, most of North Dakota, Western Montana -- Eastern Montana and also Western Minnesota.

Q. Does your cooperative have plants of its own?

A. Yes, we do.

Q. Okay. Can you describe those facilities, please.

A. Sure. We have a partially regulated plant in Mandan, North Dakota, which does 100 percent to Class I. We have a specialty cheese plant in Hoven, South Dakota, that does hard cheeses, which is Class III, and we have our primary plant's located in Fargo, North Dakota, which is Class I, II, and some IV.

Q. Now, of the member owners of Cass-Clay, taking into account the definition of a small business with gross receipts of less than $750,000, do you have an estimate for how many of those farmers would be considered small businesses?

A. About 90 percent.

Q. Okay, and Cass-Clay Creamery itself, does it have in excess of 500 employees?

A. No, it does not.

Q. So it would be a small business as well?

A. Small business.

Q. Is it -- Do you compete, does Cass-Clay compete with processors who are able to depool, essentially, all of their production in periods of negative PPD's?

A. Not all of it. We do compete with them, but they don't depool all.

Q. Larger proportions than Cass-Clay?

A. Larger proportions, that's correct.

Q. Does that create a difficult competitive situation for Cass-Clay when that occurs?

A. Yes, it does.

Q. When you've got 45 percent Class I and additional volumes that are -- by the way, the additional Class II and Class IV volumes at your distributing plant, and your primary plant in Fargo, you can't depool those volumes?

A. That is correct.

Q. So they're pooled regardless of the PPD?

A. That's correct.

Q. Does that put you in a competitive disadvantage with respect to those who can depool larger proportions of their milk in the event of a negative PPD?

A. Yes, it does.

Q. Are you requesting as the other proponents of Proposal 2 that the Secretary take emergency action with respect to these proposals?

A. That would be appreciated.

MR. BESHORE: Okay. Thank you.

THE COURT: Questions? Mr. Vetne?

CROSS-EXAMINATION

BY MR. VETNE:

Q. Mr. Pagel, John Vetne for AMPI, etc. Where does Cass-Clay market its milk that's in Class I?

A. In the four state region that I mentioned, Minnesota, North and South Dakota, and Eastern Montana, primarily.

Q. Is there a -- In terms of proportion of Class I, can you rank those? North Dakota, Montana Minnesota?

A. Yeah. It's probably a small percent, probably 1, 2 percent Montana, North Dakota/South Dakota is probably -- North Dakota is probably 50 percent, and the balance in between South Dakota and Minnesota.

Q. Okay. Who are your customers for that -- regular customers for that Class I milk?

A. There's number of retailers and

wholesale chains.

Q. I'm sorry, for your Class I producer milk, from farm to plant.

A. Basically ourselves as a company.

Q. Do you -- Does Cass-Clay also market the milk of members of other cooperative associations, excluding the Idaho milk program?

A. A small amount.

Q. In the area in which you're located, is there a large amount of production looking for a pool home?

A. A substantial amount, yes.

Q. What portion of the -- Well, where are your producers located? Mostly in --

A. Mostly in North Dakota. North and South Dakota, and western Minnesota.

Q. Northwestern Minnesota?

A. And, yeah, northwestern Minnesota, yes.

Q. Who are your primary competitors in those areas, cooperatives?

A. Cooperatives? Associated Milk, and LOL, and NFO.

Q. So your competitors --

A. DFA, excuse me.

Q. And DFA. Do your competitors market to plants that are as close to their supply as the plants are to your supply?

A. Probably closer.

Q. What plants would those be?

A. I'm -- Our competitors probably market their milk closer to their supply than we do.

Q. What plants do your competitors supply?

A. I'm guessing probably the Dean's facilities and Kemps.

Q. In Minneapolis?

A. Uh-huh.

Q. Is your milk supply closer to your plants than to the Minneapolis area plants?

A. No.

Q. So your plants are the most efficient haul for your members?

A. That's correct.

Q. And the cooperatives that compete with you in the same procurement area, plants that they supply are farther?

A. I would assume that, yes.

Q. Okay. Thank you. In April of 2004, you started pooling distant milk, that is, milk from Idaho and nearby?

A. That is correct.

Q. Would it be correct to say that in April 2004 there was substantial volumes of milk in the mountain states that no longer had a pool home that during March and prior months did have a pool home?
A. That's probably correct.
Q. That's because the mountain states' marketing Order was -- western marketing Order was terminated at the request of DFA?
A. That's correct.
Q. Did that, in your opinion, cause disorderly marketing?
A. I guess I would have to say it did.
Q. And would it be correct to say that the timing of the commencement of your pooling of distant milk was related to the termination of the Western Marketing Order?
A. No.
Q. It would not be?
A. No.
Q. Do you know whether the milk that you were pooling was previously, some, any part or all of it was previously associated with the Western marketing area?
A. I believe it was associated with Order

135.
Q. So it had a pooled home --
A. That's correct.
Q. -- in the prior months, it didn't have a pooled home in April?
A. Uh-huh.
Q. Is this a supply of milk that you solicited or that came to you and solicited a pooled home?
A. I solicited it.
Q. When did you commence soliciting?
A. March.
Q. What part of March?
A. It was probably the first part of March.
Q. When you solicited that milk, did you make a pitch that this milk's not going to be pooled next month, we'll provide a home for you?
A. Would you repeat that question?
Q. Did you make the pitch to the effect that your milk's not going to be pooled next month, we'll provide a pooled home for you?
A. No, I did not.
Q. What was the essence of your pitch?
A. My pitch was, is that due to the

competition for producer milk, that we needed to provide as much in revenue as possible to be competitive in the marketplace and offset the negative PPD's.
Q. Whose milk are you pooling, by the way?
A. Northwest Dairy's.
Q. Anybody else?
A. Not outside the Order.
Q. I'm not sure I understand the answer.
A. We're pooling another proprietor's that's located within Order 30.
Q. Proprietor as opposed to a cooperative?
A. Yes.
Q. And who is that?
A. Valley Queen Dairies.
Q. The recent data shows that there's Montana milk pooled on Order 30, is that through you also?
A. That's through us also, yes.
Q. And whose milk is that?
A. That's Class-Clay Creameries.
Q. That's member milk in Montana?
A. That's member milk.
Q. Is that member milk that would otherwise be delivered to Montana Class I plants?

A. No.
Q. Where is that milk normally --
A. That's a new startup.
Q. Pardon?
A. It's a new startup.
Q. Startup farms?
A. Yes.

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

THE COURT: Other questions? Anybody over there at all? No. All right, sir, I guess you're excused. Thank you so much. We're going to take a break now for 10 minutes.

(Recess taken from 10:06 to 10:30 a.m.)

THE COURT: We'll start again with Mr. Beshore, you have another witness?

MR. BESHORE: Yes. Bill Averback.

THE COURT: Mr. Averback?

BILL AVERBACK,
after having been first duly sworn by
the Court, says under oath as follows:

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MR. BESHORE: Your Honor, Mr. Averback

has a three-page statement, which we would like to have marked for identification as the next consecutive exhibit.

THE COURT: All right. That will be Exhibit 19, and it's so marked.

(Whereupon, Exhibit No. 19 was marked for identification.)

THE COURT: Mr. Averback, I have a feeling you'll do this anyway, but the court reporter told me that she was having a little trouble hearing some of the witnesses. You do have to talk into the microphone, so go ahead.

THE WITNESS: Thank you, your Honor.

DIRECT EXAMINATION

BY MR. BESHORE:

Q. You may proceed, Mr. Averback.

A. My name is Bill Averback. I operate Century Farms with my wife Mona and my two sons. We farm 500 acres and milk 220 cows. I am a member-owner of Dairy Farmers of America, and I get all my milk through the cooperative. I serve as a Director for Dairy Farmers of America on both the Central Area Council and Corporate Board of Directors. Both boards have reviewed and approved Proposal 2. I currently serve as District Director for the Wisconsin

Federation of Cooperatives, and I'm actively involved in my community. My wife is a director of Wisconsin Milk Marketing Board. The Averback family earns its livelihood and participates off the farm in the dairy industry. Our farm has an active risk management program as part of our overall management practices.

Even though I have been actively involved in my cooperative for several years and have heard many reports on Federal Order activities, I do not claim to be a Federal Order expert. However, I feel I have a fair understanding of how they work and why there are important to farmers. I have been to other hearings and often discuss milk-pricing issues with my neighbors and other dairy farmers.

I would like to briefly address the depooling and distant milk issue, and also I'd like to discuss how these two issues affect my ability to use risk management tools on my farm.

The dairy industry is always front-page news in Wisconsin. Issues commonly termed "distant milk" and "depooling" are well known there. Most every dairy farmer has seen the recent headline that the top milk production county in Order 30 is not located in Wisconsin. It would be more reasonable if it were in Illinois or Minnesota, but unbelievably that it is in Idaho.

Every dairy farmer understands that they produce a product, deliver it to the market, and expect the remaining dollars to show a profit, they are and we are businessmen. All of us understand that there's no way that milk can be delivered from as far away as Idaho to Order 30 regularly and return a profit to dairy farmers who produced it. Even though I'm not an expert on pooling rules, I think the Secretary needs to review them to see if they make sense and are fair. The Order rules should reflect economic reality.

On the issue of depooling, I also feel that the rules should be reviewed. All dairy farmers supply a market. That may be a Class I market or a Class III market, that is their choice, but no market is willing to have suppliers that deliver only when they want to. Buyers demand, as they should, steady performance from their suppliers. I also expect that from my dairy farm suppliers. The fluid milk market has a steady regular demand. If any dairyman wants to share in the returns from that market demand, you should be prepared to deliver every month and not bounce in and out. It is not unreasonable for all the producers who supply the same market and share in the market returns to get the same minimum price.

Even though Class I utilization is lower in Order 30 than other markets, it is still a component of my farm's returns. Dairy farming is not a high-margin business. While all parts of the revenue stream are important, my neighbors and I are concerned about these issues, because we pay attention to every dollar that comes into our milk check.

Finally, I would like to express a concern related to risk management. Our farm regularly forward contracts our milk to try to assure our business of a profitable price. I'm not here to debate the pros and cons of contracting, I'll do that out in the hallway if anyone wants to do that. Our accountants, county agents, university professors, and bankers, and USDA representatives are always urging us to use all the management tools we can to make us better businessmen. Contracting is one of those tools. In general, we look at the difference between our farm mailbox price and the Class III price to establish a relationship that we can expect in the future, we call that basis. Predicting the future about milk prices is much like predicting the weather, a lot of variables have to be accounted for, but this is still a tool we are learning to work with.

However, when negative PPD's occur at the rate of this past spring, all of the historical relationships we have observed in the past get way off and adversely affect our basis. The price relationship we have tried to achieve was destroyed by factors we could never have foreseen or predicted.

If we want to try to account for them at rates that we have experienced recently, the variation could be so large that contracting would likely become useless.

I realize the Federal Order system is not a place for me in forward contracting my milk price, but the abnormality of depooling certainly damages the usefulness. Congress instructed USDA to take an active role in educating and encouraging dairy farmers to use risk management tools, such as forward contracting. The situation we find our farm in now seems counter-productive. I think the Secretary should take that into consideration in her decision.

I thank you for listening to my concerns and would answer any questions that I can at this time. Thank you.

Q. Just a couple of additional questions, Mr. Averback. Is Century Farms a small business?

A. Yes, it is.

Q. Okay, within the definition that has been stated here with respect to $750,000 or less gross income?

A. Yes.

Q. Okay. Do you know whether the other members of Dairy Farmers of America in Wisconsin, what approximate portion of them in Order 30, I should say, might be in that same category?

A. The best information I have is about 95 percent.

Q. And approximately what number of DFA members are involved in the Central Area Council of which you are a Director?

A. About a thousand members that are affected.

Q. Now, you've testified that the Central Area Council and the DFA corporate Board of Directors discussed and endorsed Proposal 2; is that correct?

A. That's correct.

Q. And the dairy farmers, and only dairy farmers, are members of those groups; is that correct?

A. That's correct.

Q. Okay, and let me just go on to one other area. Can you just break down for us a little bit how depooling and the negative PPD's we've heard about affects, you know, your operations and your milk check there at Century Farms, in, perhaps, these spring months when we've seen these quite pronounced negative PPD's?

A. Well, the actual negative PPD with impacts of pooling was quite large. However, when I -- In my testimony that I've just read, you'll see that I have determined in my own particular operation a basis. That basis is unique to my operation. There are other dairymen in this room that will have a basis, whether they know that number or not, they do have one, and in our case you would typically expect an 80 cent basis in the month of April, and as you know, the PPD was zeroed out. The 80 cents that I'm referring to is the PPD, the normally expected PPD portion of my basis. In that case, it was 80 cents. It amounted accumulatively to about $3,000 to my operation.

MR. BESHORE: Your Honor, I would move for the admission of Exhibit 19?

THE COURT: Yes. It's received.

(Whereupon, Exhibit No. 19 was offered and received into evidence.)

THE COURT: Can you explain to me, by your basis, you testified about it, and it was 80 cents, but just how do you come to that?

THE WITNESS: Your Honor, my basis in my operation in particular, if we want to be specific to a month, in April would be approximately $2.00. That consists of a normal PPD of somewheres in the area of 80 cents. There are volume premiums that each producer -- is unique to each producer, depending on how much milk production they have for a particular month. There are also quality issues that affect that, so, and there may be a particular market function at that time that exposes me to some fluctuation in what I would call by basis.

THE COURT: Are you saying that this is what you expect to receive in your milk check, that's what you mean by basis?

THE WITNESS: The basis would be the portion over and above the minimum announced price or the Class III price for that month, either one.

THE COURT: And that is to you, not to the co-op, but to you directly as a farmer?

THE WITNESS: That's what the co-op -- That's what my co-op -- That is what I would expect from my co-op on a particular month, yes.

THE COURT: All right. Any questions? Mr. Vetne?

CROSS-EXAMINATION

BY MR. VETNE:

Q. Morning, Mr. Averback.

A. Good morning.

Q. John Vetne, counsel for AMPI, et al. The Central Area Council of DFA represents producers in what markets of the states?

A. 30, and 32, and I believe we have -- and possibly another Order that we're involved in, but may not be a part of the Central Area Council.

Q. Possibly 33?

A. 33, actually is east of our Council boundaries.

Q. Okay. What's the other possible Order that you're not sure about?

A. I think I have -- rather than be incorrect, I would like probably you to ask that question of staff, so they could be more specific to your question.

Q. Okay. Does the Central Area Council establish paid prices for DFA members in the Central area based on adequate revenues from all of the operations?

A. They're basically, to my knowledge, it's basically like any other cooperative or business, it's a pool of dollars that is distributed to the membership, depending on which Order they may be in, yes.

Q. Okay, and that distribution is independent of national DFA revenues, or does it include some --

A. It could.

Q. -- cross area Council?

A. It could include some, yes.

Q. It could include some cross area Council?

A. Well, basically because of the structure of the company, there are other revenue streams, yes.

Q. Is it not the case that DFA has depooled milk to maximize revenues to producers?

A. Yes.

Q. And you would expect DFA to do that, because of its fiduciary duties to its members; correct?

A. Absolutely.

Q. And you expect DFA to continue to do that in markets that would be unaffected by a rule limited to the Upper Midwest?

A. I'm not sure that I understand your

question.

Q. If depooling were limited only in Order 30, and DFA could generate revenues to its members by depooling in other markets, you would expect DFA to exercise its fiduciary duties by maximizing revenues in that depooled opportunity?

A. I think that that speaks to the issue of the fact that every Order does have certain uniqueness, and I think when you operate across Federal Order boundaries, I think that's the way any business can do smart business, would operate, yes.

Q. The difficulty that you experienced with your particular forward-contract arrangements, you attribute to a negative PPD?

A. Yes.

Q. Because your forward contract predicted a certain relationship between Class III and the PPD or the statistical uniform price?

A. Yes.

Q. And you're aware that the unique problem to you of a negative PPD would still be there if all of the Class III milk had been pooled?

A. The -- It's my understanding that rather than $4.00 in particular in the month of April, that it would have been somewheres around a $1.00, that's my information.

Q. The problem would still exist for you, though perhaps not to the same degree?

A. Exactly.

Q. You're aware that a negative PPD results from the fact that Class III milk is priced on current values, while Class I milk is priced on past values?

A. That's true.

Q. And if Class I milk were priced on current value, competitive value of milk, you would always have a positive PPD, wouldn't you?

A. Either that or the normal Class III/Class I relationship that existed month to month, which in recent history it's demonstrated that it doesn't always do that.

Q. Only if they're not based on the same competitive market for the same period of time?

A. I think just to clarify, if I might, you know, the question that you're asking me, does at some point in time the relationship get out of whack, for example, yes, and that's exactly what we've experienced this spring.

Q. That is not the question I'm asking you.

A. Okay.

Q. The question that I'm asking you is, if Class I and Class III fluid and manufacturing --

A. Yes.

Q. -- were all based on the current value of milk, rather than one retroactive and one current, there would always be a Class I price higher than Class III?

A. That's certainly true.

Q. Did either Central Area Council or the corporate Board of Directors in examining a solution to this problem, to your knowledge, consider coordinating the Class I manufacturing prices in terms of their announcements and competitive reference point?

A. It was discussed.

Q. Was a vote taken that was rejected to suggest that solution?

A. I don't think that at this point in time, that might be considered confidential, but we did discuss it.

MR. VETNE: Thank you. That's all.

THE COURT: Questions? The gentleman back there. Sir, could you come forward up to the lectern and state your name.

MR. OBERWEIS: Yes. It's Jim Oberweis. I have to admit that I'm pretty unknowledgeable about this, so my question may be very naive, but --

THE COURT: Give your affiliation.

THE WITNESS: I'm chairman of Oberweis Dairy, it's a small handler in Aurora, Illinois, North Aurora, Illinois.

CROSS-EXAMINATION

BY MR. OBERWEIS:

Q. Mr. Averback, if I can just repeat it, I believe you answered the question that was asked with a statement that Class I would always be higher in price than Class III if they were based on current pricing, did I understand that correctly?

A. That's right, but it's not done that way today.

Q. Yes, I understand that, and let me ask this also, if prices were set freely by the market and there were no Government-established relationships between Class I and Class III, are you convinced that Class I would always, in fact, be higher than Class III, or is it possible that there might be times when demand for cheese or demand for other manufactured products would force the price higher for milk being used for manufactured products than Class I price, at least for a limited period of time?

A. I'm not sure that what you're asking me is, would I predict that would be the case, and I don't think I'd be prepared to predict that.

Q. No, that's not what I'm asking. What I'm asking is, are you sure of your statement that Class I milk would always be higher than Class III under all circumstances, if the Government were not involved in pricing, in other words, if the free market were pricing it?

A. And again I'll answer, that's a hypothetical that I don't think I'm prepared to answer at this time. Is there certain uniqueness between the Class III, which is manufactured milk, and Class I, there is, and that relationship probably would still exist. Therefore, in my mind the probability exists that Class I would always carry somewhat of a premium to the market.

MR. OBERWEIS: Thank you.

THE COURT: Thank you, sir. Any other questions? Ms. Deskins?

CROSS-EXAMINATION

BY MS DESKINS:

Q. Yes. Sharlene Deskins, Office of the General Counsel, USDA. I just wanted to ask you to clarify some things. You use the term forward contracting?

A. Yes.

Q. Can you tell us what you mean by that?

A. Forward contracting is basically a contract that you set, in my case it's with Dairy Farmers of America, to deliver a certain volume of milk on a particular month of the year. It may be six months out, it may be one month next year, it's whatever I deem, and whatever the market at that particular time would offer me.

Q. Okay, and when you do this forward contracting, do you know what the price of milk is going to be that following future?

A. Absolutely not.

Q. So I'm just trying to understand your testimony. So when you do that, you're just relying on historical data to figure out what it might be six months in advance or a year in advance?

A. My -- The reason that I use forward contracting, and whether it be forward contracting or using the future markets with puts and calls, you use them for the very same purpose, and that is to protect a certain volume of milk to insure that you can make a profit on that, because you would assume that, as I've explained my basis, you would take, for example, a Class III of next March or April at 12.5 and add a basis that I would typically expect of about anywheres from $1.80 to $2.00, and that you would effectively assume that if you contracted, that would be your milk price, and if that exceeds your cost of production, it's worth considering whether you want to risk not being at that point next March, or whether you want to protect your, at least a portion of your milk supply. The one advantage over using puts and calls, would be the fact that you could probably protect 100 percent of your milk supply, whereas I have chosen in the past to only protect a portion of it, possibly 50 to 75 percent.

Q. Okay. Now, what do these negative PPD's do to your forward contracting, how does that affect you?

A. Well, a negative PPD is basically, they're becoming a little more normal to the market, if I might say, because of the volatility, as previous questions have indicated, but the basic premise of my statement is that when you look on the average at historical records, going back three years, now I have data going back five years, basically would say that in a certain month of the year, you would establish a basis, and a PPD would have an affect on that. It's a portion of your basis, so if you come up with a negative PPD, that subtracts from the basis. It does not subtract from the minimum price or your contract price, it only affects your basis, which is over and above both.

Q. Okay, and then also you testified about the milk that's coming in and it's causing problems from Idaho?

A. Yes.

Q. Okay, and under Proposal 2, from my understanding of it, and tell me if it's correct, Proposal 2 wouldn't prohibit Idaho milk from coming in; correct?

A. That's correct.

Q. Okay, and what it would do is just, if someone did not pool their milk a certain month, than if they wanted to get back in, there would be percentages that they could put back into the pool?

A. Well, I don't know if you're not jumping back and forth from one issue to the other, either the depool or the distant pooling. Distant pooling, in my opinion, is basically everyone has a right to sell milk as long as they have a market within an Order, and that's certainly the case with

Order 30. It's the cost of supplying that market that is probably the biggest deterrent sometimes to considering that, so if you look at the, what I would call relaxed rules in Federal Order 30, allowing that situation to happen, because the milk actually doesn't have to travel that distance, it's paper pooling.

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

THE COURT: Other questions? I'm not sure that I do understanding your forward contracting, but when you say you're trying to keep that in your risk, do you take forward contracts for some milk and not for others, just incase the market might be better, is that how that works?

THE WITNESS: I guess that's the way I would look at it. Do I want to take some protection on all of my milk, or do I just want to protect a portion of it, and you may not make that decision on all on one day, and you may say, "Well, at this particular point I might want to protect 25 percent of my milk supply in March," and further on down the road you might say, "Well, I think the price is advantageous enough to protect another portion of that milk in that same month," so it's basically an individual decision. I don't know if I'm answering the question, but.

THE COURT: Well, when you're forward contracting, do you get a specific amount per hundredweight that you're going to know you're going to get --

THE WITNESS: That's the absolute point of contracting and protecting the milk price --

THE COURT: It doesn't matter what the Order does, you're going to get a certain amount per hundredweight?

THE WITNESS: What you're basically doing is protecting your base price, which would be your Class III or your minimum prices that are discovered by the Order. The basis part of it is the part of it that is probably most affected, is the most affected in my case, by the depooling and the distant pooling.

THE COURT: Would the contract say as of April 2005, I shall pay Mr. Averback, I don't know what the number would be, a certain number per hundredweight, or does it say I'm going to pay him the Class III, whatever that happens to be, plus? How does that work?

THE WITNESS: No. It would have a stated price.

THE COURT: A stated price. Now, you, in your mind, have looked at what you feel the Class III would be and what your basis would be to decide whether or not that's a good price?

THE WITNESS: That's true. As I have been in attendance of several marketing programs, and what you do is you determine what is a mid-range price, and what is a high-range price based on historical pricing. In the month of April, I think any previous -- in this past month of April, any previous information that you would have or any previous history that you would have, would be -- you'd basically have to throw that out, because it was -- it was actually a counter-seasonal price impact.

THE COURT: And how would you use puts and calls, or how did you use puts and calls? Did you offer milk at a certain price and buy other milk, supposedly, on the market at a lower --

THE WITNESS: No, I'm not a speculator. I'm just a hedger, Your Honor, and I'm basically trying to protect my input costs and try to keep my feedmen happy.

THE COURT: Well, how do you do that using puts and calls?

THE WITNESS: You could use puts and

calls, but the affect would be the same, because you're still only protecting the Class III portion, which is your blend price or your minimum price is what you're trying to protect.

THE COURT: So you would go in the future's market and say, I could provide milk at a certain price, is that it?

THE WITNESS: Yes. I would say that, let's just say in a pure example, that I have an opportunity to lock in a minimum price of $12.50, and my basis would be $2.00, so I'm basically saying that I have a possibility of having $14.50 for my milk that month.

THE COURT: So you would take a contract to sell your milk in advance for $14.50 on the future's market?

THE WITNESS: Actually $12.50. The basis part of it is all of those things that I explained to you before in developing the basis. That's over and above the $12.50, that's where that $2.00 -- that's where the PPD, the minus PPD all has its impact.

THE COURT: All right. I think the records is clear now. Any other questions? Yes, Mr. Beshore.

REDIRECT EXAMINATION

BY MR. BESHORE:

Q. At the risk of muddying up what may have become clear there --

THE COURT: Well, it may not have been if I was asking the questions.

BY MR. BESHORE:

Q. When you're forward contracting or using puts and calls, as you've indicated, to protect a portion -- or to build some predictability into a portion of your revenue stream at some future time, is it fair to say that you -- let's say you've got a $15.00 per hundredweight contract price for some portion of your milk. When you enter into that contract, you know you're going to get that $15.00, plus or minus whatever your basis happens to be at that time in the future?

A. That's correct.

Q. So the basis is the unknown variable in your bottom line for that month, let's say April 2005; correct?

A. That's correct. Recent -- You would basically -- History would probably develop that figure in your mind, that doesn't necessarily mean that that's exactly what's going to happen.

Q. And if I've understood your testimony correctly, in your case, history would have indicated that in the month of April or May, your basis would have been approximately, what, what did you say, plus --

A. -- plus $2.00.

Q. Plus $2.00?

A. In that range.

Q. Okay. Now, what happens when the PPD happens to be minus $4.00 for that month when you had projected your income on the basis of -- when you had projected your income estimating a basis of plus $2.00?

A. Well, I think, in effect, if you would normally assume that your basis was $2.00, and if you had a minus PPD, your basis would essentially be wiped out, and you would end up with probably, I'm trying to do the math in my head, but I would expect that you'd be somewheres around $3.00 lower than the $15.00, so it would impact it negatively, and that would be -- your net pay price would be $12.00, instead of possibly expecting $17.00.

MR. BESHORE: Okay. Thank you.

THE COURT: All right. Did I see somebody's hand up? I guess not. All right. Thank you, sir. Thank you very much.

THE WITNESS: Thank you.

MR. BESHORE: We call as our next witness Randall Geiger.

THE COURT: Could you raise your right hand.

RANDALL GEIGER,

after having been first duly sworn by the Court, says under oath as follows:

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MR. BESHORE: Mr. Geiger has a two-page statement, which I would ask to be marked for purposes of identification, Your Honor.

THE COURT: We're marking this as Exhibit 20.

(Whereupon, Exhibit No. 20 was marked for identification.)

THE WITNESS: Thank you. My name is Randall Geiger. I live at 4227 Hickory Hills Road in Reedsville, Wisconsin. My wife and I own and operate Ran Rose Dairy Farm, and I've been engaged in dairy farming my entire life. I'm currently President of Manitowoc Milk Producers Cooperative in Manitowoc, Wisconsin. Manitowoc Milk Producers Cooperative is a bargaining and service cooperative that serves over

2,900 dairy producers. The services we provide are required by the Federal Order system and include established or verification of producer component tests, verification of weights and measures and others.

The greatest share of our members' milk is pooled on Order 30, with smaller amounts on Order 32 and 33. We represent producers in both cheese plants and fluid operations.

I am here today to testify on behalf of our Cooperative in support of Proposal No. 2. On the issue of distant milk pooling on Order 30, our Cooperative currently has a small group of members in Idaho. Even though this group is small in numbers, it represents a significant amount of milk. If Proposal No. 2 is adopted, it may significantly lower the bottom line of our cooperative. Why did we accept these members into our Cooperative? There are two similar cooperatives that provide the same service as Manitowoc Milk Producers Cooperative. If we would not have taken them on as members, I'm sure one of the other two would have. Our cooperative has a 2 cent per hundredweight check-off on member milk for services we provide. I do not know how much milk -- how much the milk from Idaho or other regions has reduced the producer price differential, but even if it was the same 2 cents as our members pay into the cooperative, when calculated overall over members' milk, it would be a considerable amount of money. Is it better for our cooperative to have 2 cents per hundredweight on our bottom line with the Idaho members or have our producers have that same amount in their pockets? We feel it would be better in all our members' pockets.

In the next item, there's a little bit of a typo there. As far as pooling and depooling, I currently ship to a fluid dairy plant. When the $4.11 negative producer price differential was announced, I waited anxiously for my check to arrive. Fortunately, my dairy plant was able to absorb this negative. Can they continue to do this? I personally do not think they can. It is my understanding that one of the functions of the Federal Order is to provide producer equity. If my plant would not have absorbed a negative producer price differential, a producer living next door to me shipping to a cheese plant would have received an additional $4.11 due to their plant's ability to pool or not to pool their milk. With the cheese plants' ability to pool when times are good and not to pool at times of negative producer price differential, in my eyes, this is not producer equity.

Thank you for your time, and this concludes my testimony.

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Mr. Geiger, how many cows do you milk, Ran Rose Dairy Farm?

A. We have approximately 140 head, half of which are dairy producing cows.

Q. Would you be in the category of small business?

A. Most definitely, yes.

Q. To your knowledge, are the majority of the 2,900 dairy producer members of Manitowoc Milk Producers Cooperative small businesses?

A. Well into the 90 percent is.

Q. Now, let's talk about Manitowoc just a little bit. You've stated in your testimony in Exhibit 20 that Proposal 2 is not in the self-interest of all Manitowoc members, in particularly the ones in Idaho, for instance; correct?

A. Yes.

Q. And you have members of Manitowoc who supply cheese plants in Wisconsin, I'm sure?

A. 90 percent of our milk goes to cheese, yes.

Q. And at least in some cases supporting Proposal 2 is not what your customers would like, the cheese plant customers would like you to be doing; isn't that correct?

A. Yes.

Q. Okay, so it's not a simple thing for you, as President of Manitowoc, to come here and say we support this because it's right, even though it's not in our own interests all the time, among all our members, and it is not in -- not what our customers want all the time either?

A. For sure. I mean, it's going to affect our bottom line in the organization.

Q. But you think it's right for the market?

A. Yes. Oh, yeah. I think for the producers in the majority of our membership area, yes.

MR. BESHORE: Thank you.

THE WITNESS: Thank you.

THE COURT: Questions? Mr. Lamers?

CROSS-EXAMINATION

BY MR. LAMERS:

Q. Mr. Geiger, you made a point of stating

that the depooling was not equitable for producers, and also you stated in your statement that the plant that you ship to was able to overcome having to pay that $4.11 premium instead of applying the negative to the price of your milk. Is it then your opinion that the Orders in the depooling is not equitable as among handlers as well?
A. I would think, but I would like to defer that to Mr. Tonak's testimony later and comments.
MR. LAMERS: Okay. Thank you.
THE WITNESS: Thank you.
THE COURT: More questions? Mr. Vetne?
CROSS-EXAMINATION
BY MR. VETNE:
Q. Mr. Geiger, does Manitowoc re-blend its cooperate-wide proceeds in payments to producers?
A. No.
Q. So you might receive a different price to the market you supply milk, than a neighbor, also a member of Manitowoc, who supplies the cheese plants; is that correct?
A. Most definitely, yes.
Q. The dairy plant that you ship to absorbed the negative $4.11 PPD, does that mean that

the premium was increased to $4.11, or that --

A. You mean the premium that I was paid?

Q. Yes.

A. No.

Q. It was something less?

A. Yes, and I'm sure it was -- came out in the mailbox price.

Q. I'm not sure I understand. You received an additional premium from your buyer when the PPD was negative?

A. No.

Q. How was this absorbed in that case?

A. I wouldn't have that -- I don't have any direction over the pricing of my product.

Q. I'm talking about the price you received. Was the price adjusted to offset the negative PPD?

A. No. No, I wasn't. It was -- The mailbox price reflected that. I mean -- I don't want to get into how plants price their product and how they come up with their bottom line, but I'm sure in the mailbox price it was affected, my plant.

Q. You ordinarily receive a premium above the class price or above the blend price --

A. Yes.

Q. -- from the plants that you sell milk to?

A. Yes.

Q. And that premium remained the same in April as it had been --

A. No. There wasn't any.

Q. There wasn't any?

A. As I stated earlier, there wasn't any. It was zeroed out.

Q. Pardon?

A. It was zeroed out.

Q. It was zeroed out. It was zeroed out as a function of the statistical uniform price?

A. In you -- As Mr. Averback stated, in your base price and your price over and above the base price, there was no additional dollars in price premiums in there.

Q. Do you market milk on a forward basis?

A. Very little, but I have, yes. Only as -- and only as the Judge referred to earlier about percentage, I never -- I very seldom go over 50 percent of my product.

MR. VETNE: All right. I have no more questions. Thanks.

THE COURT: Very good. Other

questions? Mr. Beshore?

REDIRECT EXAMINATION

BY MR. BESHORE:

Q. Just one follow-up question, Mr. Geiger. I want to see if we can make clear what happened with your April milk check, okay. Ordinarily you've got on your milk check the Order 30 minimum component values are showed; correct?

A. Yes, yes.

Q. And then from that there would be a PPD adjustment?

A. Yes.

Q. Normally positive?

A. Yep.

Q. And premiums that might be paid by --

A. Yes.

Q. -- the plant you supply? Okay. In April you've got the component values, and then the minus $4.11 PPD was zeroed out by your plant?

A. Yes.

Q. And there were no premiums?

A. Yes.

Q. So you got the minimum component values, period?

A. Yes, for the Federal Order, yes.

That's all we got, we received, yes.
Q. Right.
A. No additional premiums.
Q. Minimum producer component values --
A. Yes.
Q. -- and no additional premiums?
A. Yes.
MR. BESHORE: Okay, thank you.
THE WITNESS: Thank you.
THE COURT: I was a little confused as to whether or not the $4.11 negative PPD -- whether that negative $4.11 was less than the premium or more than the premium?
THE WITNESS: Well, for sure more than the premiums.
THE COURT: So you actually -- your milk check did go down?
THE WITNESS: Yes.
THE COURT: It wasn't all absorbed by the plant?
THE WITNESS: No, no.
THE COURT: All right. Good enough. Other questions? I opened it up for you, again?
MR. VETNE: Yeah.
RECROSS-EXAMINATION

BY MR. VETNE:

Q. Your milk checks went down, but it went up from prior months; correct?

A. Yes.

Q. Okay. It was just less than you had hoped it would be?

A. Oh, yes, yes.

THE COURT: That's what I meant. Thank you, Mr. Vetne.

THE WITNESS: It was considerably higher than the previous month.

THE COURT: All right. Thank you, sir. There doesn't seem to be any more questions. Oh, no, I'm sorry, there does.

CROSS-EXAMINATION

BY MS DESKINS:

Q. Sharlene Deskins, Office of the General Counsel, USDA. In response to one of Mr. Beshore's questions, you said that Proposal 2 would help the entire market. Could you elaborate on how Proposal 2 would help the entire market.

A. You mean, in our membership area?

Q. Yeah. Why don't you do membership, how would Proposal 2 help your membership?

A. Because, I would -- I think I should

refer this question this afternoon to Mr. Tonak's testimony, because that's more of his area, so if you want to defer that to Mr. Tonak.

Q. That's fine, I will ask Mr. Tonak.

THE COURT: Any other questions? Thank you, sir.

THE WITNESS: Yep, thank you.

THE COURT: Let's go off the record for a second while we bring our next witness up.

(A discussion was held off the record.)

MR. BESHORE: Our next witness is Steve Matthees.

THE COURT: All right.

STEVE MATTHEES,

after having been first duly sworn by the Court, says under oath as follows:

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MR. BESHORE: Your Honor, we would like to ask that the three-page statement of Mr. Matthees be marked as the next exhibit.

THE COURT: Exhibit 21.

(Whereupon, Exhibit No. 21 was marked for identification.)

THE COURT: And I'm not sure we received Exhibit 20, but we will.

MR. BESHORE: Oh, I would like to move that that be received.

THE COURT: It's received.

(Whereupon, Exhibit No. 20 was offered and received into evidence.)

DIRECT EXAMINATION

BY MR. BESHORE:

Q. And would you proceed with your statement, please, sir.

A. Okay. Thank you. Thank you, Your Honor, and members of the USDA. My name is Steve Matthees. My address is 23216 County No. 9 Boulevard, Goodhue, Minnesota. Goodhue is located in the southeastern part of Minnesota, about 70 miles from the Twin Cities.

I operate a family dairy with my son, my daughter, and my brother. We farm 760 acres of land and milk about 200 cows. My family and I are active participants in the dairy industry, both off the farm and on our farm. Amie, my daughter, is a Chairperson currently of the Goodhue County American Dairy Association, ADA, and I am a member-owner of Dairy Farmers of America, DFA, and we market all of our milk through our co-op.

I serve on the Corporate -- as a Corporate Director for Dairy Farmers of America, and our farm is located in DFA's Central Area Council, which spans portions of Order 30 and Order 32. Our Council Board of Directors, of which I'm Chairman, has reviewed Proposal 2 made by our cooperative in conjunction with several other Upper Midwest cooperatives, and we support its intent.

I'm not a technical expert in the inner workings of the Federal Orders, and do not expect to be able to answer many of the technical questions there may be about them or about the proposal.

Because of my industry involvement, I do get many questions from other producers in my area, both that are a DFA member, as well as farmers from other cooperatives asking me to explain to them negative PPD's, and why do they occur. I do the best I can by trying to explain the volatile pricing conditions, and why they happen, and how that makes pricing of milk very difficult. To some extent farmers understand volatility and can make some sense of it. After all, we deal with it in the grain markets, as well as the input costs of farming.

When commodity prices, like cheese and

butter, are low, our milk prices are low. When cheese and butter are high, milk prices go up. When milk production is up, milk prices go down, and when milk production decreases, the price of milk goes up. Sometimes that all happens pretty fast and even unexpectedly, that much I can explain fairly well.

But I struggle to explain why when production is tight, commodity prices are high, why some part of our milk check blend is a negative number. When I try to explain to my neighbors that there are buyers of milk, who whenever it is to their advantage financially, they can simply choose not to be in the pool, but they can get right back in it when there's money to be shared. They'll ask me, "Is this really fair," and I usually have to answer, "Probably not."

I do understand that my cooperative does depool whenever we can so that we can try to have as competitive a pay price as possible in the country, but we are here today trying to change the rules to a more reasonable position, one that will affect DFA as well. Most of my neighbors and fellow DFA members agree that if you want to share in the fluid market returns, you should be a regular supplier. The fluid market demand is every day and fairly constant. If you want to share in it, you should commit to the market every day, and not just when it happens to be convenient or profitable. If a dairy farmer chooses to supply milk only to a manufacturing market, well that should be his decision, but it seems unreasonable to be able to pick and choose, and no buyer would expect to have a regular supplier relationship like that.

I also support the proposal that has been made which attempts to better define how dairy farmers, who live a long ways away from the market, can share in the pool. It seems unreasonable that a farm located in Idaho can be a regular supplier. I do not think that the price is high enough to justify making that delivery every day, and I don't think any farmer would regularly supply a market if he lost several dollars per hundredweight on every load. It seems amazing that the largest county for milk supply in Order 30 is in Idaho right now. Surely the Secretary can see that the rules need to be reviewed to see if this practice really makes sense and is fair. I understand that this milk rarely delivers to the market, and would not be considered by any buyer as a regular supply.

I do thank you, Your Honor, for

listening to my concerns, and I'll try to answer any questions.

THE COURT: Do you move for the admission of 21?

MR. BESHORE: Yes, I do, Your Honor.

THE COURT: It's received.

Whereupon, Exhibit No. 21 was offered
and received into evidence.)

BY MR. BESHORE:

Q. One additional question, Mr. Matthees, is your home farm, your home family farm a small business as it's described in these proceedings?

A. Yes, it is.

MR. BESHORE: Thank you. The witness is available for other questions.

THE COURT: Anyone? You have frightened them all, sir, they don't want to take you on. Thank you very much.

MR. BESHORE: I call Marvin Anderson.

MARVIN ANDERSON,
after having been first duly sworn by
the Court, says under oath as follows:

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THE COURT: We'll mark this as Exhibit 22, Mr. Anderson's statement.

(Whereupon, Exhibit No. 22 was marked for identification.)

THE COURT: And he's sworn.

MR. BESHORE: Thank you, your Honor.

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Mr. Anderson, your three-page statement has been identify as Exhibit 22. Would you proceed with it, please.

A. Yes. Okay. My statement for Proposal -- support of Proposal 2, Marvin Anderson.

My name is Marvin Anderson, and I'm a dairy producer from Hillsboro, Wisconsin. My wife Helen and I began our farming career back in 1967, and five years later we purchased my father's family farm. Our life on the farm includes working 520 acres of cropland and caring for 85 head of registered Holstein cows, as well as the livestock. Producing lots of good, quality, healthy milk for our consuming public remains the top priority in our operation.

Our rolling herd average stands at over 22,000 pounds per animal with a monthly average quality count of 200,000 cell and a bacteria count of

15.

I serve on the Board of Directors of Milwaukee Cooperative Milk Producers, and have done so for the past seven years, currently in the capacity as Treasurer. Milwaukee Cooperative Milk Producers is a milk marketing and service cooperative organized way back in 1916. We are the oldest bargaining milk cooperative in the Upper Midwest.

One of our qualified cooperative duties is to ensure proper test weight verification on raw milk sales for members in accordance with the Federal Order provisions. Our membership consists of over 900 dairy producers located primarily in Wisconsin. We also have members located in Indiana, Illinois, Iowa, and Nebraska. Our family dairy owners ship their milk and receive payment through 38 different proprietary plants and cooperative handlers in the Midwest. We also provide various other services for our members; such as state and national legislative representation, health insurance options, water testing services, a milk loss disaster assistance program, and Federal Order involvement, such as this hearing.

I'm also on the Board of Directors of Lakeshore Federated Dairy Cooperative, a group consisting of Mid-West Dairymen's Company, Milwaukee

Cooperative Milk Producers, and Manitowoc Milk Producers Cooperative. In the past I've also served two terms as a Board Member of the Wisconsin Federation of Cooperatives.

I feel very honored to appear at this hearing to express my views in support of Proposal No. 2, which, in essence, limits the pooling of distant milk on this Order, and to offer a solution to minimize the amount of repooling of milk after depooling in this market to help increase monetary returns and restore equitable treatment to hard-working dairy producer families throughout the Upper Midwest milk marketing geography. I've read many articles over the past three months on this subject, talking about the need to limit large swings in the PPD pool, which values not only I have experienced, but also other members of our cooperative who have been negatively impacted.

My milk for the past five years is delivered to Westby Co-op, a manufacturing plant located about 30 miles from my farmstead. The plant produces primarily cottage cheese, along with some other cheeses, and sells a portion of its supply to the fluid market and other cheese manufacturers.

When I went to my mailbox on June 20th,

my May final milk payment check was there. Milk prices, as you know, have been very favorable these past four months, and boy we sure needed it to recoup our losses over the prior year-and-a-half -- a year-and-a-half of painfully low prices, but upon opening the check, I was not only surprised, but also thoroughly disappointed when I saw a negative $1.97 as my PPD value of my check. I calculated this negative PPD cost to me about $1,900 and almost feel like it was taken right out of my pocketbook. I contacted several of my neighbors who ship to other markets and compared what their milk payments for the month were. Well, low and behold their PPD amounts were at zero. I feel this great variance has disadvantaged me price-wise.

Our cooperative has always been strong proponents in recognizing the value that the Federal Orders play in stabilizing and propping up prices to producers. I feel strongly that changes have to be made in the Federal Order system that now, due to unfavorable conditions, allows this type of unfair competitiveness between handlers to evolve.

My understanding of Proposal 2 is that it will help correct this situation. In regard to the growing distant milk issue, I feel that if these distant handlers want to collect money from Order 30 pool, then they should ship and serve our market.

In closing, I feel the large amounts of depooling has to be addressed by limiting the amounts of repooling and the pooling of distant milk on Order 30, when virtually no shipments to fluid markets are made. I implore the USDA to right an inequity that exists in our marketplace that is taking dollars away from all local producers supplying the fluid market.

I appreciate the opportunity to give my views, and thank you for your consideration of this proposal.

Q. Okay. Mr. Anderson, is your 85 cow dairy herd in Hillsboro, Wisconsin, a small business operation as it's defined in these proceedings?

A. It sure it.

Q. And to your knowledge, as a member of the Board of Directors of Milwaukee Cooperative Milk Producers, are the majority of the 900 members of the cooperative also small businesses?

A. It would be 90-plus.

Q. 90-plus percent?

A. Yes.

Q. Okay. Now, you've testified that Milwaukee Cooperative Milk Producers supplies some 39 proprietary cheese plants; is that correct?

A. That's correct.

Q. Okay, and I would assume that a number of those handlers have depooled their Class III milk as most handlers with Class III that could, did in recent months?

A. Yes.

Q. And, perhaps, some of your customers don't necessarily agree with the cooperative's position on Proposal 2 in this hearing, would that be fair?

A. That's fair.

Q. But it's your cooperative's position that this is what's fair and right for the market as a whole, and that's why you're supporting Proposal 2?

A. Exactly.

MR. BESHORE: Thank you.

THE COURT: And you move for the admission of Exhibit 22?

MR. BESHORE: I do.

THE COURT: It's received.

(Whereupon, Exhibit No. 22 was offered and received into evidence.)

THE COURT: Questions? Mr. Vetne?

CROSS-EXAMINATION

BY MR. VETNE:
Q. Mr. Anderson --
A. Yes.
Q. -- John Vetne. The calculation that you refer to on the bottom of Page 2 of your testimony, referred to a cost to you, because it was a negative PPD. Is that simply your milk volume or your component volume times $1.97?
A. It -- State that question again.
Q. Yeah. Is the cost of $1,900, did you calculate that simply by multiplying the negative PPD times your milk volume?
A. Correct, that's correct.
Q. And you're aware, are you not, that even if all Class III milk had been pooled, there would have been a negative PPD for that month?
A. Yes.
Q. And you're aware, are you not, that a PPD is simply, you know, for this purpose, the arithmetic difference between the Class III price and the average value of milk in the market, the blend price?
A. Yes, that's right, except that particular month it was such a wide spread that it really affected producers like myself.

Q. Okay. Do you believe that there wouldn't have been a negative PPD if the proposals had been adopted?

A. Yes, I do.

Q. Okay. Do you understand that the data that's shown on Exhibit 5D would produce a negative PPD regardless of all milk --

A. As I've stated earlier, yes.

Q. Okay. Is there a problem that you perceive with the way milk is priced that in some months produces a Class III price that is higher than the Class I price, or higher than the blend price?

A. I guess that goes back a long ways in my own mind, and this is my personal view --

Q. Yes.

A. -- when I first started producing milk it was Class III, and I took quite a lot of pride in the fact of getting to a Grade A or to a Class I market, and with that in mind, I always felt that anyone shipping Grade A or Class I should receive a little more, because of the extra efforts, and I guess over the years, it's worked that way. Even last year my local plant had some negative PPD, but it was much less than a dollar, and when we get up to -- when it was $4.11 and yet the plant absorbed half of it, or mine was $1.97, that's when I knew that this here Order, or this here market was going to have to be updated or corrected.

Q. Okay. Would it be your preference to change the Orders in such a way so that Class I is always higher than Class III?

A. I -- I think that it should be -- they should be close, even if there's more demand for III, it should be very close. There's more work upon the producer's part and even on the handler's part for Class I.

Q. Are you talking about the difference between Grade A and Grade B milk?

A. In a sense.

Q. In a sense. Okay. Let's go back to my question. Do you believe that the Order should be changed so that Class I values, regulated Class I values are consistently higher than Class III values, so that there will never be a negative PPD?

A. I don't believe -- no, I think that this has to happen at times, but I don't think it should be as wide of spread as what has happened in this past spring.

Q. It has to happen because Class III values are current values and Class I are past values?

A. I understand.

Q. My question is, do you prefer to see Class I values be the current values, just like class III?

A. I think I'd have to leave that to someone that's more versed on this, and I'd have to leave that to Dennis Tonak.

Q. I mean, you haven't studied that and your organization haven't considered that as a remedial option; is that correct?

A. That's correct.

MR. VETNE: Thank you.

THE COURT: Any other questions? Yes, Ms. Warlick.

CROSS-EXAMINATION

BY MS. WARLICK:

Q. Hi. Carol Warlick, with Dairy Programs. I just wanted to ask you one question here. When you said that your neighbors who shipped to other markets had a PPD that was zero, do you know -- you have any other information about who they sell their milk to and how it turned out that it was zero?

A. Well, I can name a couple of them. One neighbor ships to NFO, and, of course, the papers, both the State and the local papers was playing up this big milk check that the producers were going to receive for the May milk, and so we got to talking about it, as neighbors will talk, and he says, well, his was going to be minus, at least he thinks it was going to be minus and very comparable to what Westby Creamery was, which was $1.96. something, and when he received the check, of course, the same day I did, why, it was zero, and yet mine, like I stated, was $1.96. something. And as I stated before, that with the amount of milk that I shipped, I calculated that out at about $1,900.

Well, then that evening, I visited with a friend that's a director for Foremost Farms, and he says, "Well, we planned on having a negative too, but when we seen in order to be competitive, we had to absorb it in other ways," and so there's was zero. Well, about that time I was thinking, "What am I doing sending to Westby Cheese," you know, but, after about a week, and I had a Lakeshore meeting, and I get visiting with the people that are the directors on Lakeshore, and I find that most of them had zero, but there was three of us, I believe, out of the ten that were minus, and mine was one of the higher ones. So I hope I answered your question to that.

MS. WARLICK: You did. Thank you,

Mr. Anderson.

THE COURT: No other questions? Thank you, sir. Off the record.

(A discussion was held off the record.)

THE COURT: Mr. Schaefer, is he available? Mr. Schaefer, do you have the materials? Why don't you just take the stand. You're still under oath and affirmation.

(Whereupon, Henry Schaefer was brought back to the stand.)

MR. BESHORE: Why don't we make Class III, 23, and then Class IV, 24.

(Whereupon, Exhibit Nos. 23 and 24 were marked for identification.)

THE COURT: Go ahead, Mr. Schaefer. As I say, you're under oath and affirmation from yesterday, and we've marked two exhibits, one is Exhibit 23 and another is Exhibit 24, and if you would proceed, Mr. Beshore, with your examination.

EXAMINATION

BY MR. BESHORE:

Q. Mr. Schaefer, thank you for preparing these exhibits and coming back. I want to ask you first, the documents that's been marked as Exhibit 23 is entitled "Upper Midwest Order. Producer Price Differential. Actual versus Estimated by Including No Eligible Class III Producer Milk if Pooled." Can you tell us what that shows.

A. That table, one-page table, contains the actual PPD's for July 2003 through May 2004, and it contains an estimate of the PPD if no Class III milk was included in the pool for those respective months.

Q. And that would, in essence, that is an extension of -- to another column of zero percent of one of the tables that was in an exhibit yesterday?

A. That is correct. It is an extension of Table 5D in Exhibit -- I believe it's Exhibit 6, isn't it?

Q. Exhibit 5.

A. Exhibit 5, I'm sorry.

Q. The yellow covered exhibit?

A. In Exhibit 5, in which there were percentages of 25 percent, 50 percent, 75 percent, and 100 percent, and this would include, then, a zero percentage.

Q. Okay. Now --

MS. DESKINS: Marvin, the yellow covered exhibit is 9.

MR. BESHORE: I'm sorry, yeah. It's a gray covered exhibit, which is Exhibit 5, I think. It's actually 5B of 9, okay. I've totally confused this record, but it's an extension, I think, of table 5B, which is the yellow cover, which is Exhibit 9?

THE WITNESS: That is correct.

BY MR. BESHORE:

Q. Now. Could you tell us, then, what Exhibit 24 is, which is entitled "Upper Midwest Order. Producer Price Differential. Actual Versus Estimated by Including No Eligible Class IV Producer Milk in Pool"?

A. This table contains two columns. One, the actual producer price differential for the Upper Midwest Order, January 2003, February 2003, March 2003, and October and November and December of 2003. It also contains an estimate of the producer price differential with zero eligible Class IV producer milk included in the pool. This is also an extension of Table 5C in Exhibit 9, in which four other percentages, 100 percent, 75 percent, 50 percent, and 25 percent were included.

Q. Okay, so Exhibit 24 is an extension of Table 5C in Exhibit 9?

A. That is correct.

Q. And I think I misspoke with respect to 23. 23 is an extension of Table 5D?

A. Correct.

Q. 5D?

A. 5D, dog.

Q. Okay. In Exhibit 9.

MR. BESHORE: Thank you, Mr. Schaefer. We move the admission of those two exhibits.

THE COURT: They are both received.

(Whereupon, Exhibit Nos. 23 and 24 were offered and received into evidence.)

THE COURT: Questions? Any questions? Everybody clear on them? Ms. Warlick?

EXAMINATION

BY MS. WARLICK:

Q. Mr. Schaefer, Carol Warlick with Dairy Programs.

THE COURT: Move that microphone a little closer to you.

BY MS. WARLICK:

Q. Could you explain these tables a little bit, interpret them in a factual way?

A. Basically what we've done is we've taken our PPD --

THE COURT: Move your microphone a

little bit closer to you too.

THE WITNESS: What we have done is we have taken the producer price differential calculation on an aggregate basis and removed the Class IV portion of that computation based on the respective percentages that the request was made for, so in, for instance, in Table 24 where we have no eligible producer milk in Class IV, we have recomputed the producer price differential with no Class IV in the pool.

MS. WARLICK: Thank you.

THE COURT: Other questions? Mr. Vetne?

EXAMINATION

BY MR. VETNE:

Q. If handlers in Order 30 did everything that they possibly could and saved pooling milk around, etc., to eliminate all Class III and IV from the pool, there would nevertheless be some Class III and IV resulting as a -- in the pool, because of the way milk was reported in distributing plants, for example?

A. That is correct.

MR. VETNE: Thank you. That's all.

THE COURT: Other questions? All

right. I think all the experts understand that testimony, I don't, but. All right, let's go to lunch. We'll be back at one o'clock.

MR. BESHORE: If I might, just before everyone -- we are going to make available the statements of Mr. Holland and Mr. Tonak and a few exhibits that they'll also be presenting for any interested participants to consume over the lunch hour.

(Lunch break taken from 11:52 a.m. to 1:10 p.m.)

THE COURT: Let's go on to the Dairy Farmers of America witness. We're on the record, then. Mr. Beshore.

MR. BESHORE: Yeah. I call Elvin Hollon.

THE COURT: Mr. Hollon.

ELVIN HOLLON,

after having been first duly sworn by

the Court, says under oath as follows:

***

MR. BESHORE: Your Honor, I would like to have marked as the next consecutive two exhibits --

THE COURT: All right.

MR. BESHORE: -- the statement which Mr. Hollon will present, and the exhibits, which will accompany the statement. The documents are separately stapled and available to everyone, and we've provided one for the reporter and for Your Honor.

THE COURT: I have three papers up here, somehow, which is which?

MR. BESHORE: The first one, the document that says at the top, "Testimony of Dairy Farmers of America."

THE COURT: All right. We'll make that 25.

MR. BESHORE: And then there's, "Exhibits of Dairy Farmers of America."

THE COURT: The exhibit will be Exhibit 26.

(Whereupon, Exhibit Nos. 25 and 26 were marked for identification.)

THE COURT: And what's this other one that says, "In support of Proposal 2," is that for later, or?

MR. BESHORE: That's later.

THE COURT: Oh, that's later. Did Dr. Jesse, did he just come in? Did Dr. Jesse come in?

MR. ENGLISH: No, I'll watch for him.

THE COURT: Very well. You're under oath, and we've marked your testimony as Exhibit 25, and the other one as 26.

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Mr. Hollon, before you proceed with your statement, would you identify yourself and give us a brief recitation of your professional background and experience.

A. My name is Elvin Hollon. I'm employed by Dairy Farmers of America, as the Director of Fluid Marketing and Economic Analysis. I've been employed in the dairy industry for 25 years. I have a Bachelor of Science Degree from Louisiana State University in dairy costs and manufacturing, and a Master's Degree in Agriculture Economics. My industry, job responsibilities has included economic analysis, providing information for cooperatives' efforts to work with the national agriculture policy, I've had day-to-day marketing roles where I've bought milk, sold milk, managed surpluses, shortages, worked with over-order pricing programs in all areas of the country, except the extreme northeast and east of the

Rockies -- east of the Rockies expect extreme northeast. I've participated in many Federal Order hearings as either a witness or as a part of the team to put together information, and my current job duties involve at this moment working with DFA's operating or area councils, which are day-to-day operating units, with their marketing programs, and I work with the marketing personnel in those councils in dealing with Federal Order issues.

Q. And you have testified previously in Federal Order hearings as an expert witness in agriculture economics and milk marketing?

A. I have.

MR. BESHORE: I would ask that Mr. Hollon be recognized as an expert in his fields for his testimony today, Your Honor?

THE COURT: I think so. Is there any objection? Doesn't appear to be any. You're certainly an expert.

BY MR. BESHORE:

Q. Okay. Now, Mr. Hollon, and you have a written statement and a set of exhibits to present today in support of Proposal 2. Could you first of all describe the Exhibit 26, which is your exhibit set.

A. That exhibit set is composed of nine tables, eight tables of comparison and data and one table that's a summery, and then an excerpt from a 1961 decision in the then Indianapolis Federal Order. I have to admit, I don't remember the number of the Indianapolis Federal Order.

Q. 49.

A. I think it preceded 49, and specifically there's a single page out of that decision, Page 76, and that page is the entirety of a discussion in that decision on the location differentials.

Q. The nine tables of Exhibit 26, could you just -- you discuss them in your testimony, but could you just describe how they have been compiled? Did you prepare them, by the way?

A. I prepared them.

Q. Okay, and take Table 1, and tell us what that --

A. Okay, the Tables 1 through 8 operate under the same, I guess, global level of assumptions, being it's designed to measure the net value of a milk supply that originates in the Twin Falls area of Idaho and delivers in the Minneapolis area in Order 30. Some of the givens is a transport volume 47,500 pounds, and I've just been talking with our day-to-day marketing people for a load that makes that haul, they tell me that you can't always assume a larger truck is going to be able to get into every state, so I assumed a 47,000 pound load.

Also in talking with our day-to-day folks, they tell me that a current basis of $2.10 per loaded mile is a reasonable haul charge. The distance from the Market Administrator's exhibit was 1,283 miles. If this particular load of milk were to get full advantage of the transportation credit, 400 miles, it would get a payment from the pool of $1.12, or a net rate per hundredweight of $5.44.

I then went month, by month, by month, and so the first four exhibits, or first four tables start off with the basis of a measurement against the PPD that's driven by Class III, which is the standard base announced PPD adjusted by 20 cents for the Idaho location. That would be what something pooled at that point would collect, and from that I subtracted the haul to get a net, so, for example, in January of 2000, if you had 23 cents in income and a haul bill of $5.44, you'd be $5.21 in the hole, negative. This assumes a million-pound producer or a million-pound, if you will, sale, so if you had that million-pound sale, you would be at the end of a month $52,064 in the hole, if you delivered that load every day.

And then the column three takes that comparison and said, well, if you only had to deliver it one time, in essence, you had the one-time touch base, then that particular month you would be $518 ahead, and in month two you would already have met your minimum touch-base pool requirements, so you would have the entire, you know, pool draw or PPD in your hands.

This assumption does not include any estimates for any type of pooling fees or arrangements that may or may not be available, and so then I took that logic, and I ran it through each month in existence since Federal Order Reform, so there are 54 monthly comparisons, and you can note that if you delivered all the time, every day, in every instance that's a negative number, and that's not unexpected when you have a haul rate of $5.44 against the largest income, I think, is $1.23 in November of 2000, and if you have the one-time touch-base requirement, those returns are positive most every month, under this scenario.

At the bottom of each page I've attempted to provide a summery of each calendar year with the total dollars available from that particular set of assumptions and a rate per hundredweight, and so the global assumptions I mentioned are constant across all eight tables, and the first four of these tables deal with PPD driven by Class III and IV, as a comparison, and I also created a PPD driven by Class IV, which is nothing more than the statistical uniform price minus the class IV value.

So Table 2 would be the same comparisons, only assessing a requirement against that million pounds on a 10 percent delivery, which is what the minimum or the requirement is for a supply plant for a pooled milk supply would have to deliver, 10 percent of its milk to a pool distributing plant, so all of the other arithmetic comparisons are the same, except you would have to deliver a greater volume each month. So with that, column three, in many cases, most cases, that value turns from a positive to a negative.

Table 3 does the same computation, and in this case the assumption is that you have a once-and-done touch-base requirement, but you can depool any time that the PPD is negative, and you run that calculation through each month. Again, that would give us 46 months, instead of 54, and the return would be positive in each month.

Q. Can I stop you there just for a minute?

A. Yes.

Q. Is that the table which most closely approximates the status quo?

A. For return that's Class III base, yes, and I guess the majority of the distant milk that this comparison is set up against the Class III.

Q. Class III based milk in Idaho, that approximates the status quo?

A. Yes, yes.

Q. Okay.

A. Table 4 would take that same comparison, but instead of a once-and-done pooling touch-base requirement, it would be a 10 percent delivery requirement, and, again, you can see, run your finger down column three, and the majority of those numbers are negative.

Then the analysis is repeated on tables 5, 6, 7, and 8, with the only difference in the scenarios being what would happen if you had a Class IV delivery in which you would compare, again, Class IV PPD would be the statistical uniform price, subtracted from the -- no, I'm sorry. Class IV price subtracted from the statistical uniform price, and for a once-and-done return, it would not -- a handler would not have chosen to do that for the first third of the time period, but for the remainder of the period that would have been a good decision.

Table 6 uses that Class IV PPD compared against a 10 percent shipping standard, and the majority, but not all, of these returns are negative.

Table 7 uses the Class IV PPD and says, what about if you could depool any time you wanted to and get back in without any penalty, like current regulations provide. You would have the one-time touch base, that return generates 28 months where that decision would be made, positive returns, and some, I think, are substantial.

And finally, Table 8 makes that comparison against a 10 percent delivery standard, and the majority, but not all, of those returns are negative.

Table 9 is simply a summation of the bottom comparison on each of the eight tables in a little bit larger print and runs through the comparisons that I've just outlined.

Q. Okay. With that introduction to your exhibits, would you proceed with your statement?

A. I just want to touch base on the

last exhibit --

Q. Oh, I'm sorry.

A. Again, is a single page, Page 76, out of a 1961 decision, that is 7 CFR, Part 25, Docket A0-319. "Milk in Indianapolis, Indiana, Marketing Area. Decision on proposed Marketing Agreement and Order," and Page 76, about two-thirds of the way down, the first column in italics, "Location differentials," and this page covers the entire, well, that one-third column, the entire middle column, and about half of the third column is some information that I'm going to refer to in my statement.

Q. Okay, and those are excerpts from the Federal Register for January 5th, 1961?

A. That is correct.

Q. Okay, now would you proceed with your statement, please.

A. Dairy Farmers of America, Inc., DFA, is a qualified Capper-Volstead cooperative that represents 13,445 farms located in -- and it's a typo, my fault -- 49 states. In 2003, DFA marketed 56.5 billion pounds of milk of its member-owners, for other cooperatives, and for nonmember dairy farmers. Our primary market is selling bulk milk to other milk processors.

We support the Federal Order system, because we believe it is the most fair and equitable manner to market dairy farmers' milk that will insure them of a reasonable price and common terms of trade. We have participated in nine Federal Order hearings and several subsequent court proceedings since the implementation of Federal Order Reform, in an effort to make Federal Orders function the best way possible for dairy farmers. This is why we are here today to participate in this hearing.

We pool milk on Federal Order 30. We are appearing here in coordination with the other proponents of Proposal 2; Cass-Clay Creamery, Inc., Land O'Lakes, Inc., Manitowoc Milk Producers Cooperative, Mid-West Dairymen's Company, Milwaukee Cooperative Milk Producers, Plainview Milk Producers Cooperative, Swiss Valley Farms Cooperative -- Swiss Valley Farms Company, Westby Cooperative Creamery, and Woodstock Progressive Milk Producers Association.

We agree that the issue of better defining the performance standards for milk that is located so far from the market it can never be a regular supplier to the market and providing a solution to the depooling issue are important problems to solve in Federal Order 30. We note that nearly all participants in the hearing support tightening the performance standards for distant milk and most support an elimination or reduction in the ability to depool. We also note for the record that we participate in both activities in an effort to have sufficient revenue streams to pay our members' milk prices equivalent to that of our competitors. While we feel that both practices need to be corrected in some way, we cannot disregard day-to-day impact of the revenue stream in our business operations.

Our management and Board of Directors at both the corporate and area council level have reviewed the issues that will be discussed at this hearing. We have also reviewed the issues in several member communications with the entire DFA membership. We support Proposal 2 as the best solution to remedy the problems.

"Discussion of DFA Exhibits 1 and 2. Exhibit 1. Freight Mileage/Return Tables." Exhibit 1 is composed of nine tables. Tables 1 through 8 are similar constructs, and Table 9, a summery. The purpose of this exhibit is to show the economic results obtainable from attaching milk produced in Idaho to the Order 30 pool under various pooling and classification alternatives.

All alternatives have the following identical assumptions:

The comparison is for a hypothetical 1 million pound producer; The distance from Twin Falls, Idaho, to Minneapolis is 1,283 miles; The haul volume is assumed to be 47,500 pounds; The haul rate is based on $2.10 per loaded mile; The haul cost calculation includes the benefit of 400 miles of transportation credit from the Order 30 pool as currently allowed; The PPD calculation is reduced by 20 cents to reflect the $1.80 versus $1.60 difference in location adjustment between the Order 30 base zone and Twin Falls County, Idaho; The time period covers the 54 months between January 2000 and June 2004; No consideration is given for a pooling-fee arrangement.

The scenarios vary as follows:

Assume once-and-done touch base, pool every month and a Class III PPD; Assume 10 percent touch base, pool every month and a Class III PPD; Assume once-and-done touch base, depool the maximum amount when the PPD is negative and a Class III PPD; Assume 10 percent touch base, depool the maximum amount when the PPD is negative and a Class III PPD; 5, assume once-and-done touch base, pool every month and a Class IV PPD; 6, assume 10 percent touch base, pool every month and a Class IV PPD; 7, assume once-and-done touch base, depool the maximum amount when the PPD is negative and a Class IV PPD; 8, Assume 10 percent touch base, depool the maximum amount when the PPD is negative and a Class IV PPD.

The calculations show that if the milk were to deliver every day to meet the market demand, it would never ship, because the return (columns I and II of each Tables, 1 through 8) would be negative. This is totally logical, since the haul is $5.44 per hundredweight and the PPD is never larger than $1.23.

However, if one considers the once-and-done touch base situation (current Order 30 provisions), the return is very attractive, totaling $79,018, or an average of 14.6 cents per hundredweight for pooling in each of the 54 months (Table 1). Whenever the distant milk must perform based on its own deliveries and at the 10 percent standards that other milk performs, it would never pool because the return would be negative $212,767, or an average of 39.4 cents per hundredweight (Table 2).

When the option to depool at will is factored into the equation, the once-and-done calculation is even more lucrative, totaling $194,418, or an average of 42.3 cents per hundredweight for the

46 months of positive PPD's only (Table 3). When depool at will is combined with the 10 percent shipping standard, the result remains negative at negative $53,875, or an average of negative 11.7 cents per hundred weight (Table 4).

Shifting the comparison to a PPD driven by a Class IV utilization, the once-and-done pool every month return is $31,018, or an average of 5.7 cents per hundredweight for the 54-month period, reflecting the many months early in the period when Class IV prices were very high (Table 5). Retaining the Class IV PPD calculation and combining it with a 10 percent shipping standard, the return and pooling every month yields a negative $260,767, or an average of negative 48.3 cents per hundredweight (Table 6).

Finally, retaining the Class IV PPD calculation on a once and depool at will ability yields the most profitable return of $302,100, or an average of $1.079 cents per hundredweight. Year to date, 2004, the monthly gain from this strategy would return an average of $1.99.2 cents per hundredweight gain (Table 7). Requiring this supply (Class IV PPD and once-and-done and depool at will) to deliver at the 10 percent shipping rate would still yield a positive return for the 28 months of positive PPD's of

$149,880, or an average of 53.5 cents per hundredweight, shown in Table 8.

The conclusions drawn from these tables would be:

One, If milk from Idaho delivered to the Order 30 fluid market every day, it would never choose to be a market supplier; if the distant milk supply is able to continue to access the market via the once-and-done touch-base requirement, it will continue to draw funds away from the pool at a large rate. Yet this milk will not ever become a regular supplier, because it is too far away; If the distant milk is required to perform on its own merit (ship at the 10 percent rate) it will likely not choose to pool on Order 30; Anytime the milk can depool at will, the return potential increases dramatically. Thus, without addressing both problems together, the prospects for improved returns for local regular market suppliers are limited; To the extent the distant milk is Class IV based at 2003 and 2004 price relationships, it may continue to pool on Order 30.

Other provisions should bear resemblance -- I'm sorry. Order provisions should bear resemblance to real world economic consequences. Current provisions yield results that are far too --

that are too far from actual economic reality to be effective and equitable. The provisions should be changed. Proposal 2 is a reasonable way to correct the current inadequate performance provisions.

"Exhibit 2. Location Economics and Location Adjustments for the Indianapolis Marketing Area, 1961." The Von Thunen Theorem is a theoretical construct for describing the relationship between production costs, market price, and transportation costs. The most productive activities or those with the highest transport costs are located closest to the market. Conversely, activities that have lower transport costs are located further away from the market. While there are many classroom explanations, it is frequently described using an agricultural example.

In the case of a dairy farmer, Von Thunen would say that on farm profit would be defined by market price, less the cost of production, less the transport cost to the market. For Federal Order pricing, this is the underpinning logic for having market prices vary by transport costs. That is, milk supplies located closer to the market have a higher value than supplies located further away. Location adjustments accomplish that purpose. They attempt to recognize that milk has a value, depending on its relative distance to the market.

When there is not a commensurate price adjustment between the supply location and the demand point in the Federal Order, the other factors of the value-sharing mechanism of the Order need to be adjusted to recognize the still existing economic reality of location value.

The "Decision on Proposed Marketing Agreement and Order for the Indianapolis Marketing Area," published in the January 5, 1961, Federal Register explains the rationale and logic for the institution of location adjustments and zone out in the promulgation of the Indianapolis Order. We call attention to this Decision because the logic presented is a good description of why such adjustments are needed. Simply said, there should be some relative adjustment factor to account for the increased distance that a milk supply lies from a market. Note, there are no proposals in this hearing for the institution of zone outs, and we have no intentions to make any or support any. That is not our intent.

However, our proposal aims for a similar economic result, a relative relationship between the market return and the distance from the market that a milk supply must travel in order to supply that market.

This decision recognizes; and I quote, "A schedule of location differentials should be incorporated in the Order to provide an appropriate adjustment of order prices at the location of any plant from which milk in -- from which milk is moved into the marketing area."

The reasons for the need for the price adjustments are; quote again, "Unless provision is made in the Order for the application of location differentials, producers delivering milk to plants located at some distance from the marketing area would be paid the same uniform prices as producers delivering to plants in the marketing area.

It is economically more feasible to meet the needs of the market for fluid purposes from those farms or plants nearest the market before bringing in milk from more distant plants. The value of milk to the marketing -- to the market for fluid purposes is greater at the location of the plant in the marketing area which packages it for distribution than at a plant from which milk must be moved to the market for Class I use. Recognition in the Order through the medium of a location differential should be given to this difference in value."

The decision noted that economic theory and practice were common in the marketplace and should be reflected in the Order language.

Again, quote, "It is customary in both regulated and unregulated markets for handlers to pay dairy farmers delivering milk to farther removed from the market at a lesser price per hundredweight, than is paid to dairy farmers delivering directly to plants in the marketing area. To the extent that this represents a lower price because of the location of the milk, such a difference in value should be recognized under the Order."

Furthermore, the Decision noted that "Not all location adjusts are created equal," and some should have a variation in scale, reflecting some combination of an absolute difference in value and a relative difference in value.

Quote, "Accordingly, the Class I price should be reduced by 10 cents for 80 miles and 1.5 cents for each additional 10 miles or fraction thereof with respect to approved milk received at a plant which is no less than 70 miles from Monument Circle in Indianapolis."

Finally, the Decision noted that the

above price adjustments, which were for Class I milk, should be reflected in prices paid to producers as well and for the same reasons:

Again, quote, "Prices paid producers supplying plants at which location differentials apply should be reduced to reflect the lower value of such milk f.o.b. the point to which delivered."

These points support our contention that there must be a better measure for the relationship of milk value and distance in Federal Order 30. This principle is well grounded in economic theory, a standard practice in Order language and operation, and needs attention here as part of the discussion of how best to decide what performance standard should apply in Order 30.

Q. Okay. Now, Mr. Hollon, I would like to go to your prepared statement, which is Exhibit 25, and since it was prepared and the exhibits were prepared before we had numbers and exhibits in the hearing, I want to make sure that we have referenced the documents together correctly.

A. Okay.

Q. On the second page of Exhibit -- I want to make sure when we're looking at the record, there's no confusion about what we're talking about. On the second page of your statement, which is Exhibit 25, when you refer to DFA Exhibits 1 and 2, you're referring to the set of documents that are part of Exhibit 26 in the hearing record now?

A. Right.

Q. And so when you refer to Exhibit 1, you're referring to the set of tables, 1 through Table 9 in Exhibit 26?

A. That is correct. It was a poor choice of titles on my part.

Q. And later on in your prepared statement at Page 5 where you referred to Exhibit 2, that would be what's labeled as the excerpt --

A. Yes.

Q. -- from the Federal Register in Exhibit 26; correct?

A. Correct.

Q. Okay. Now, one other thing, on Page 3 of your statement, Exhibit 25, at the bottom of the -- the second set of numbered sentences is 1 through 8, do those -- and they're a set of assumptions, so they all start out assume --

A. Uh-huh.

Q. -- okay. Do those numbers, that set of assumptions, 1 through 8, correspond with the assumptions and identify the assumption you made in Table 1 through Table 8?

A. Yes.

Q. Okay, so number 1, "Assume once-and-done touch base, pool every month and a Class III PPD," that's the set of assumptions for Table 1 of Exhibit 26?

A. Yes.

Q. And 2 through 8 for the same set of tables?

A. Yes.

MR. BESHORE: Thank you, and I have no further questions on the record for Mr. Hollon.

THE COURT: All right. Questions? Mr. Vetne?

CROSS-EXAMINATION

BY MR. VETNE:

Q. Mr. Hollon.

A. Good afternoon, Mr. Vetne.

Q. Is this the only statement you expect to give in this hearing?

A. At this point in time it is.

Q. Okay. Are you familiar with the sales area of what's been referred to as the Central Area Council of DFA?

A. The sales area?
Q. Yes.
A. In general.
Q. The areas in which the Central --
A. My day-to-day responsibilities do not necessarily include day-to-day marketing functions, so there would be a person in the Central Area Council, for example, who would have those responsibilities, so I have some general knowledge of that.
Q. Central Area Council milk is marketed in Order 30 and 32, also in Order 7, Order 5 --
A. Yes.
Q. -- and 33?
A. Yes.
Q. And when that milk is marketed from the Central Area Group of DFA, those revenues flow back to the Central Area of producers, rather than the area, for example, the Southeast area?
A. For the most part, yes. It may have been that the sales price may be structured so that 100 percent of the revenues don't flow back, but in general, the answer to your question is yes.
Q. There may be some circumstances in which the revenue crosses from one area to the other?
A. As a part of that particular negotiated

transaction. Milk sales between council areas are negotiated between council areas.

Q. All right. You refer repeatedly in your testimony to deliveries at, and I'm look at Page 4, for example, first full paragraph, delivers at the 10 percent standard that other milk performs, and you're referring to the 10 percent supply plant shipping requirements, 10 percent versus 90 percent diversion?

A. Yes.

Q. Okay, and yet there are some differences in what's proposed for distant supplies beyond the 10 percent; correct?

A. Why don't you work on your question a little more.

Q. Sure. Minnesota, Wisconsin, North Dakota, South Dakota producers can ship, can perform for the 10 percent purpose by milk coming directly off the farms to the customer?

A. Yes.

Q. Okay, and your proposal is that that option be eliminated for Idaho producers, or distant producers?

A. For milk outside of the described area, yes, that's, the proposal reads and works that way.

Q. And producers within the Midwest region that you've identified can perform as part of a system of other organizations that are performing; correct?
A. When you say Midwest system, are you talking about our Order-proposed language area?
Q. Yes. I'm talking about the existing system and the post-amendment system if your proposals are adopted. A system of plants can combine for performance purposes?
A. There are rules in Order 30, and Order 32 for that matter, but in Order 30 that call for a unit or a system of plants, and it has some pretty specific rules that, for example, all plants have to be located in the marketing area to be in it. If those rules were met, then a system of plants can perform together.
Q. So the answer is yes?
A. Yes.
Q. And that's different from performance for plants outside of the region?
A. I think currently a plant outside the marketing area cannot be in a system, so I don't think that I would think that would be different.
Q. It's not something that you propose to change, but it's a difference in the manner in which

performance is made?

A. We don't propose to change the used system, but I think the affect on a plant outside the marketing area is the same.

Q. Okay. And part of the proposal is a proposal to amend Section 13, producer milk. To define the diversion area as the states of Illinois, Iowa, Wisconsin, Minnesota, North Dakota, South Dakota Wisconsin, and the Upper Peninsula of Michigan. I haven't heard that particular aspect discussed, so I'll ask you. Is the intent of that proposal to define milk that is diverted outside that region as not producer milk?

A. I don't think so. We identified that particular area as states in the marketing area and any state in which there was a county in that state in the marketing area.

Q. Section 13D, diverted by a pool plant operator to not pool plants in those states. It would seem to me, and perhaps I'm wrong, and tell me if I'm wrong and why I'm wrong, that if that proposal were adopted and someone diverted milk to Colorado, the Southern Peninsula of Michigan, Montana, Idaho, wherever, that it would, by definition, not be producer milk, because it couldn't be included on the diversion report?

A. Yeah, you're correct. I misunderstood when you got started, sorry. I agree.

Q. You're not -- You didn't talk about that provision, somebody else is going to; is that correct?

A. Yes.

Q. The -- Within the Upper Midwest geography, the states that we've just read, there is a considerable volume of milk that has touched base once, and from there on goes to a manufacturing plant day in and day out; correct?

A. Yes.

Q. And the purpose of Proposal 2, as it deals with distant milk, is to create costs and conditions to cause that milk to withdraw from the pool?

A. I don't think I would phrase it that way, that the purpose of Proposal 2 is to define the performance standards more accurately than they are at present.

Q. DFA and other coalition members asked the Market Administrator to prepare certain exhibits?

A. Yes, we did.

Q. And some of those exhibits deal with

what would the pool look like without Idaho milk?

A. Yes.

Q. Okay, and you requested that data to show what you believe the pool would look like if your proposals were adopted; correct?

A. Yes, that's correct.

Q. Is it not the case that if all of the conditions that you propose to apply to distant milk, also applied to milk within the Upper Midwest, that Upper Midwest participates, many, would find it too economically discouraging to participate in the pool?

A. We didn't examine that in particular, so I can't answer that directly. I suspect there may be some who would, there may be some who would not. It may depend on, you know, the day, month, customer arrangements, price, so I don't have all of the details to answer that.

Q. All the details. There is producer milk that is being diverted, for example, directly from the farm to a distributing plant for which the cost of receiving/unloading/reloading may be too great to make the economic decision to pool if that were required?

A. There could be.

Q. There is milk that participates in a

system of supply plants that also pays, perhaps, someone for performance that goes every day to a cheese plant that for whom it would be too economically discouraging if that milk had to perform on its own and didn't have a system to perform through; is that not correct?

A. Was that a question or a comment?

Q. Is that not correct, that was my question.

A. I'm going to answer this substantively. Are you asking with regards to CMPC supply systems, is that the framework for -- of your question?

Q. That's one of the systems, yes.

A. Okay, and is that the framework for your question?

Q. Right.

A. Okay, and within that system of supply plants there are, I don't know the exactly count, let's just say for hypothetical purposes 20, and each of those plants have made a set of economic decisions to be in that unit and the rules, if you will, for that have a schedule of fees and performance, and they've elected to some combination of those, so some may have elected for the reasons you outlined, it could have been, you know, delivery issues, it could have been that they wanted -- they felt like their returns were better keeping the milk in their plant, and there was a fee system of, I think you identified early, 16 cents all the way to zero, and so they chose up and down that scale for various sets of economic reasons, and, again, while I don't have any day-to-day access, I did ask, and I think there are very few that are at the 16 cent no shipments level.

Q. And another difference between what local milk supplies can do and what you propose for distant milk supplies, is the identity of the plant to which shipments have to be made in order to qualify, the local milk can go to any number of pool plants, pool supply plants, pool distributing plants; correct?

A. In order to touch base?

Q. In order to touch base, and in order to -- well, in order to touch base, yes.

A. Well, I think there's kind of a two-stage answer, which is that a producer can touch base at a pool distributing plant, a producer can touch base at a pool supply plant, but that pool supply plant has to ship 10 percent to a pool distributing plant in order for that to count.

Q. And there are plants to which Upper Midwest suppliers can ship in addition to the plants described in Paragraph (c)(1) relied; correct?

A. Are there plants --

Q. Yes.

A. You need to work on your question again for me.

Q. Section 1030.7. The proposal proposes to limit qualifying shipments for distant milk only to plants described in paragraph (c)(1)(i).

A. Okay. Are you talking about Proposal 2 or Proposal 1?.

Q. Proposal 2.

A. For which there's no difference; right?

Q. Pardon?

A. For which there's no difference?

Q. Proposal 2.

A. Yep, and Proposal 1.

Q. And Proposal 1, whatever. I'm just talking -- I'm looking at Proposal 2.

A. Okay, which in that respect is identical to Proposal 1, and, yes, that qualifying shipments by plants located outside the area are only to pool distributing plants.

Q. And what would that exclude for outside area milk that inside area milk may make qualifying shipments to?

A. A qualifying shipment, again, to touch base as a producer can deliver to a pool distributing plant or a pool supply plant, and that supply plant has to qualify. Outside the area, that qualifying shipment has to be to the pool distributing plant.

Q. And it cannot include, for example, a Class II plant that's part of a pool distributing plant?

A. I think that's correct, but I think (c)(1)(i) does not include that.

Q. And it can't include a locked in UHT plant?

A. I think that's correct also.

Q. And both of those would be plants to which local supply organizations can ship and qualify?

A. Again, I think that's correct.

Q. The cost factors that you described on Page 3 of your testimony, encapsulating the economic discouragement that your proposals would impose on distant milk, it did not include a cost of transportation from a farm to a supply plant, the cost of unloading, the cost of reloading; is that correct?

A. That's correct, it did not.

Q. And that also has a cost?

A. Yes.

Q. Do you know, from your experience, what the range of that cost would be?

A. I don't have a specific number, I'm sorry.

Q. Okay. Was there -- Prior to the notice of hearing, you had discussions with the Dairy Programs personnel about these proposals?

A. Yes.

Q. Did you discuss other regulatory options to address the problems, the things that you have identified as problems?

A. With?

Q. With Dairy Programs personnel.

A. We had both discussions within our group, we had discussions with folks who were not in our group, and discussions with the folks at the Market Administrator's Office, and we discussed a wide range of options, some of which we did not include in our proposal.

Q. Okay. Did you discuss the possibility of zoning out the producer milk?

A. I can't say that we discussed that possibility with everybody in that group, but, yes, we had some discussions about the possibility of zoning out.

Q. Were you told by USDA that they wouldn't consider that?

A. I can't say with certainty if in that particular discussion I was told that, but I had been lead to believe that in other discussions that I've had with USDA that that was just not something that they felt would be heard.

Q. All right, and you also had discussions with USDA on the depooling, that you described as depooling problems prior to the Notice of Hearing?

A. Yes. Again, with Market Administrator personnel, persons in our group, and persons not -- or groups not part of our group.

Q. Did you find those discussions helpful for purposes of preparation of this hearing?

A. In many cases.

Q. The DFA has made a similar proposal on depooling for Order 32?

A. Yes, that's correct.

Q. Okay. Is there a proposal pending or under consideration for other Orders?

A. At this time, no, there are not.

Q. Are you aware that by limiting the depool proposal, having it noticed and limited to this market, that other parties, by virtue of the ex parte rule, are denied the benefit of preliminary discussions on extension of that rule elsewhere, discussions with USDA?

A. I would have to say, I'm not fully aware of that. I'm not sure if I agree to that, but I'm not aware of it, anyway.

Q. You're not aware that USDA has --

A. Well, I understand ex parte rules, I'm just not certain that it is limited Order to Order to Order, but.

Q. Okay. Are you including the excerpt from the 1961, Order 25 -- I looked up the Order Number --

A. Well, thank you.

Q. -- Hearing Decision as an opinion on the way things should be, if they could be?

A. I think the way I would answer your question is that, I was looking for a good description of the application, of what I would say is location economics to Federal Orders, and that there was a relative value of milk caused by transportation and this happened to provide a good description of that, and I actually looked long and hard. It took me a while to find this, but it's distinctive. It covers all the points I was wanting to cover, and I think it makes a good, logical explanation.

Q. The philosophy that, or policy described in that decision, you espouse as a description of relative value of Idaho milk, for example, in relation to Minneapolis?

A. Yes. That's a fair characterization, yes.

Q. And there would be a different relation of Idaho milk to Denver or Houston or Ohio?

A. There's a relative difference in value based on distance to marketing, so when you pick different spots, there's going to be different relative values, yes.

Q. What portion of the 56.5 billion pounds marketed by DFA in 2003 was for producers other than DFA members?

A. Did you say what percent?

Q. What portion. There's 56.5 billion marketed by DFA, how much of that was not DFA --

A. I think roughly 36 million was -- or billion, I'm sorry, was DFA members, and the balance was some degree of market affiliation from other cooperatives who are members of DFA to marketing arrangements that we have with other cooperatives and individuals.

Q. Would that include, for example, BMS members?
A. Yes.
Q. And similar organizations, federations, or common marketing agencies in other parts of the country?
A. Yes.
Q. Is there a similar marketing agency of which DFA participates in the Upper Midwest?
A. You mean, are there common marketing agencies in the Upper Midwest that DFA participates in?
Q. Yes.
A. Yes, there are.
Q. What are those?
A. The Upper Midwest Milk Marketing Agency, Central Milk Producers Marketing Agency, Iowa Milk Marketing Agency, and I think there is also the Regional Milk Marketing Agency, which is a CMA that encompasses all of those groups.
Q. It's cross --
A. Umbrella.
Q. It's cross Order? It includes Order 32?
A. No.

Q. It doesn't?
A. No.
Q. Is the Iowa Milk Marketing Agency dedicated to marketing Order 30 milk, or?
A. You know, I can find the answer. I just don't know it off the top of my head, but I don't think it's only Order 30. In fact, it may not be any Order 30, now that I think of it. It may just be CMPC and Upper Midwest, out of the Order 38.
Q. Okay. Does the umbrella organization, nevertheless, include the Iowa Marketing Agency milk?
A. It would include milk that would be produced in Iowa. I can't tell you if it includes the Iowa Marketing Agency milk or not, I'm not familiar enough to answer the question.
Q. Is it your believe that it would include milk produced in Iowa that is pooled in Order 30?
A. Yes.
Q. And you don't know if it includes milk in Iowa that's pooled elsewhere?
A. I don't think that it is.
MR. VETNE: Okay. Thank you.
THE WITNESS: I'm sorry, but I have one question for you, is that, can you tell me, again, who

it is that you're representing, so that I know who's asking the questions?

MR. VETNE: John Vetne is asking the questions, that's all you need to know.

THE WITNESS: No. I think I'm entitled to know who you're representing.

THE COURT: Well, he gave his identification early on. We can look it up. I don't remember at this point, but he represents a number of families.

MR. VETNE: It works this way, I ask questions.

THE COURT: You ask the questions, he answers them. All right. Good enough. Anyone else? Mr. English?

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Charles English for Dean Foods.

A. Good afternoon, Mr. English.

Q. First off, I want to maybe clarify one thing. Mr. Vetne took you through an examination of that portion of Proposal 2 that's identical to Proposal 1, and asked some questions about what kind of plants could be qualified if proposals were adopted. Do you remember that discussion?

A. I do.

Q. Now, maybe I misheard, but I thought he had you conclude that a UHT plant -- that shipments to a UHT plant would not be qualified to shipments from outside?

A. That was what I said, and it was based on my thought that that's in a different subsection than the one referred. Obviously if it's in the one that is referred in the order language, it would be acceptable.

Q. Okay, so if I read you (c)(1)(i) in whole for 1030.7 and it said, pool plants described in 1030.7 (a), (b), and (e), your answer would be different from the answer you gave Mr. Vetne?

A. Yes, that's correct.

Q. Let me see if I can understand what Proposal 2 is getting at, that part that is identical to Proposal 1. There's a amendment, proposed amendment to 1030.7 and a proposed amendment to 1030.13; correct? There's two different sections within that part of the Proposal 2; correct?

A. Yes.

Q. Now, presently, looking back to the Market Administrator's statistics, are there any supply plants located outside the states of Illinois,

Iowa, Minnesota, North Dakota, South Dakota, Wisconsin, and Upper Peninsula of Michigan that are -- are there any supply plants on this Order from outside that area?
A. Not to my knowledge.
Q. Would it be fair to say that this change is made in anticipation of the change in .13? Let me backtrack, I'm sorry. You agree, then, that there would be no present plants affected by this part right now?
A. Yes, that's my understanding.
Q. But the purpose of the change in 1030.13 will be to prohibit diversions to such plants that are located outside the marketing area?
A. Yes, that's correct.
Q. And today that is occurring; correct? That is occurring, there are diversions?
A. That is correct, yes, that's correct.
Q. For instance, we have the marketing Administrator data that makes it plain that milk is being diverted back to Idaho; correct?
A. Yes, that is correct.
Q. And since we already discussed that none of those plants are supply plants by definition, those are plants outside the Order to which diversions

must be made; correct?

A. That is correct.

Q. If you only made the change in .13, and did not make the change in .7, that is to say the Secretary, I mean, if the Secretary makes the change in .13, which prohibits the diversions back to the Idaho plant, is it your conclusion that those plants would, based upon your Tables 1 through 9 in Exhibit 26, have some economic incentive to then qualify the whole plant as a pool plant?

A. That could be true. There would be some months that that would be the case.

Q. Or a split plant?

A. Or a split plant, yes, that would be a bigger case.

Q. So the purpose of the change, proposed change in 1030.7, is to get ahead of that game if the change in .13 is made?

A. Both would need to be made, because they have a dovetail relationship. One needs the other in order to be effective.

Q. And then that connects up to your conclusion that furthermore, and, again, looking at the Market Administrator's statistics, some of the negative PPD is from distant milk; correct? Some of the increased negative PPD is because of distant milk?

A. Yes.

Q. And some of it is because of depooled milk?

A. Yes, that's correct.

Q. And so similarly as dealing with both .7 and .13, it's your conclusion you need to make both changes in order to dovetail?

A. That is correct.

Q. Have you reached a conclusion as to which is more important, depooling or the distant milk?

A. It's kind of like beauty, it seems to be in the eye of the beholder in our group, but we all are under the opinion that both need to be addressed in order to be effective, and I'm not sure if it would be effective if one were addressed and the other were not, either, and different members would have different views on that, but I'll agree that both need to be addressed.

Q. And both need to be addressed, because it is your group's conclusion that both lead to disorderly marketing conditions?

A. Yes, that is correct.

Q. You were here early today for the

testimony of the other proponent witnesses for Proposal 2?

A. I was.

Q. Would you agree that when an entity such as yours, or Land O'Lakes from yesterday or any of the others, such as Cass-Clay Creamery, that supplied greater than the 10 percent to the Class 1 market, assume that for a moment, that those entities, even if they depool milk, are going to be at a competitive disadvantage against supply plants that depool milk down to the 10 percent or lower?

A. That has been our firsthand experience.

Q. And that competitive disadvantage is what you have measured as one of the disorderly market conditions?

A. Yes.

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

THE COURT: All right. Questions? Any questions? Ms. Deskins?

CROSS-EXAMINATION

BY MS. DESKINS:

Q. Sharlene Deskins, Office of the General Counsel, USDA. Mr. Hollon, I just wanted to ask you about these numbers in 1030.13, the 125 percent and the 135 percent?

A. Yes, ma'am.

Q. I was just wondering, why were those particular numbers picked?

A. We entertained quite a range of possibilities, and in some ways they were our compromise, what different members wanted, but once you begin to sit down and work through the application of those numbers with your own individual business, you begin to establish some framework that you're comfortable with, and we had a large group of participants, so we looked at things like seasonal changes in milk production. It would be unreasonable to have a number that would cause somebody not to be able to pool their milk simply because February has 28 days and March has 31, so you needed to accommodate, changes in days of the month, changes in seasonality in milk production, you need to be able to accommodate changes in production in sales patterns from spring to fall, and so those became the initial framework, and those are, I'd say, an analytical, you can take a number, there's 28 days in February, there's 31 days in March, and you can just get some historical perspectives.

We also looked historically at month,

to month, to month changes in the Order and where those fell, and as we begin to do each of those, we got to the end of our period or our discussions and felt like 125 percent was a number that worked best for, you know, our group, and we thought the market as a whole. Some wanted more, some wanted less, and but we felt like that provided some improvement in the present situation. It did allow for some flexibility, and it was not as stringent a requirement as in other parts of the country, and was more reflective of the market conditions here.

Q. I've got a couple more questions for you. Okay. There's a part that refers to continuously pooled on any Federal Milk Order. Okay, when you use the term continuously pooled, can it be on, say, two different Federal Milk Orders or a combination of milk Orders?

A. Yes, ma'am, it could be.

Q. Okay, and then also in terms of continuously pooled, how would someone prove that to the Market Administrator? What type of evidence do you see them coming up with?

A. I suppose you could start out with the honor system, backed up by an audit. Obviously, at pool time it's going to be pretty hard to have an absolute determination, so I think each handler is going to have to, you know, file their information with the thought process that that represents what happened, and that, you know, if I have a producer that I said was, you know, on a different Order last month and is on this Order now, so they've been continuously pooled, that's going to have to be accepted, but there will be an audit of that, and there is anyway, because each Order has requirements for, you know, where you deliver, where that producer is actually pooled at, so over time that information would be known, so, but at pool time it's going to have to be accepted. It's just like, you know, any other reports are at pool time are accepted.

Q. Okay, so you would see it as the handler files a report saying this is where they've been continuously pooled, and then later on if the MA needs more information, they ask for it, or you just wait for an audit and then you check those numbers?

A. And I would venture a guess that once the Order changes were in place, that it would not be overly difficult to -- for computerizing for that to happen reasonably quick. I think that most handlers, or many handlers, let me say, provide detailed information on computer, you know, electronically about every one of their receipts every day, so it shouldn't be too hard to follow that through.

Q. And I've got another question about these numbers, 125 percent and 135 percent. Are there any other numbers that you think would fulfill the requirements that you were talking about earlier when we looked at this section?

A. Again, we discussed a range, and in our view this was the best fit, so that was the proposal that we made.

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

THE COURT: Other questions? Mr. Tosi.

CROSS-EXAMINATION

BY MR. TOSI:

Q. Elvin, I just want to clarify an intent.

A. Yes.

Q. In your Proposal 2's description for pool plants where you're naming the states that are a part of those states that are included within the geographic marketing area, the Upper Midwest, and then when we come to the end, you're saying that cooperative associations may not use shipments pursuant to (9)(c), to qualified plants located outside the marketing area. Is it your intent to mean outside the states that are listed above?

A. That is correct, and that will be -- Dennis's statement, next statement, has some comments on that to make that verbiage change.

MR. TOSI: Okay. All right. Thanks, Elvin, I appreciate it. That's all.

THE COURT: Yes, Ms. Warlick.

CROSS-EXAMINATION

BY MS. WARLICK:

Q. Mr. Hollon, I'm Carol Warlick with Dairy Programs. In proposal 2 on (f)(2) where you -- in that same paragraph that Sharlene Deskins was talking about?

A. Yes.

Q. When you refer to continuously pooled in any Federal Order for the previous six months, are you talking about -- and you say it's intended to mean that it is eligible to be pooled -- do you mean if it is, like, degraded from A for a week, but it's continuously pooled before and after that week, it would still be considered to be continuously pooled?

A. Yes.

Q. Okay, and I have another question. In Exhibit 25, on page 3, your number 5.

A. Is 25 the exhibits or the statement?
Q. It's Exhibit 25.
MS. FEUILLET: Statement.
THE WITNESS: Statement, okay. Thank you. All right.
BY MS. WARLICK:
Q. Page 3, number 5.
A. Okay.
Q. You state, "The haul cost calculations include the benefit of 400 miles of transportation credit from the Order 30 pool as currently allowed."
A. Right.
Q. Would you agree that under current Order provisions there is no limit --
A. Yes.
Q. -- on miles allowed for transportation?
A. You're correct. That would be as proposed.
Q. Okay. Okay. One other question. I just want to clarify, I'm not positive that this was clear before. When you say continuously pooled in any Federal Order, does this mean it has to be the exact same Federal Order, or can it be two months in one Federal Order, four months in another Federal Order?
A. It can be a multiple of Order, so it

does not have to be one Order for the entire six-month period.

MS. WARLICK: Okay. Thank you, Mr. Hollon.

THE COURT: Anything else? Ms. Deskins?

RECROSS-EXAMINATION

BY MS. DESKINS:

Q. Mr. Hollon, one thing that the notice talks about was that there was emergency conditions that would require an expedited decision. Would you like to address if there are any emergency conditions and what they are?

A. Again, I think that Dennis will cover that subject.

THE COURT: Other questions? Mr. Beshore?

REDIRECT EXAMINATION

BY MR. BESHORE:

Q. I just have one or two additional questions, Elvin. The question was posed to you, I think by Mr. Vetne, with respect to the two issues here, depooling and distant pooling, whether there was some premise. Do your tables, in fact, Tables 1 through 8 of Exhibit 25, analyze, in essence, the way that both of those issues play into the paper pooling problems we're presented with?

A. Yes, it would. It indicates, for example, when you depool at will, there's a much greater return potential than if that option is not available, and sometimes those numbers are pretty large, except from the standpoint of performance standards being decided -- being a decision factor on who shares in the pool revenues, but it can be a big share.

Q. Is there any proposal in this hearing notice which is very similar, if not identical to Proposal 2 with respect to distant milk?

A. Proposal 1 is almost verbatim and is operationally identical, to the best of my knowledge.

Q. And that's the proposal that Mr. Gulden presented a statement in behalf of yesterday?

A. Mr. Vetne's clients, I think, are supporting that proposal.

MR. BESHORE: Thank you.

THE COURT: Very good. Other questions at all? All right, sir. I think you're excused. Has your witness, did he arrive?

MR. ENGLISH: Dr. Jesse is now here,

Your Honor.

THE COURT: Please call him to the stand.

MR. ENGLISH: I call Dr. Ed Jesse.

EDWARD JESSE,

after having been first duly sworn by

the Court says under oath as follows:

***

MR. ENGLISH: Your Honor, I have a sixteen page document entitled, "Marketing and Policy Briefing Paper, Paper No. 85," dated June 2004. I've got a few extra copies.

THE COURT: We'll mark that for identification as Exhibit 27.

(Whereupon, Exhibit No. 27 was marked for identification.)

THE COURT: Incidentally, Mr. Beshore, I don't know if we received 25 and 26.

MR. BESHORE: I would like to move their receipt.

THE COURT: Okay. They're both received.

(Whereupon, Exhibit Nos. 25 and 26 were

offered and received into evidence.)

THE COURT: I just hope that we keep up to date so that we don't wonder later on if we received those exhibits.

MR. BESHORE: I appreciate that.

MR. ENGLISH: So, I'm sorry, Your Honor, this was marked as what?

THE COURT: 27.

MR ENGLISH: I'm sorry, has he been sworn?

THE COURT: He's been sworn.

DIRECT EXAMINATION

BY MR. ENGLISH:

Q. State your full name for the record.

A. My name is Edward Jesse.

Q. And could you briefly describe your professional background, sir.

A. Okay. I'm currently an Extension Dairy Marketing Specialist at the University of Wisconsin, Madison, I'm also professor of the Department of Ag and Applied Economics at the University of Wisconsin, Madison.

Q. And for how long have you been associated with the University of Wisconsin?

A. I've been at the University of

Wisconsin, Madison since 1984. Prior to that I was with the Economic Research Service of USDA for sixteen years.

Q. Would it be fair to say that you've testified before at Federal Order proceedings as an expert?

A. Yes, several times.

MR. ENGLISH: Your Honor, I would ask that Dr. Jesse be recognized as an expert in the Federal Milk Marketing Order.

THE COURT: He is so recognized.

BY MR. ENGLISH:

Q. Now, sir, you have a document that's been marked as Exhibit 27 in front of you, called "Marketing and Policy Briefing Paper" Paper No. 85, June 2004, entitled "Federal Milk Marketing Order, Pooling, Depooling, and Distant Pooling: Issues and Impacts"?

A. Yes, I do.

Q. And are you one of the coauthors of that?

A. Yes, I am, along with Professor Bob Cropp.

Q. Now, prior to a brief discussion yesterday and a brief discussion today, have you and I discussed this Exhibit 27 at all?

A. Not at all.

Q. And other than discussing, just putting you on the witness to have you authenticate the document, have we had any discussions about this matter?

A. None.

Q. Is anybody compensating you for this testimony today?

A. No.

Q. You just happen to be a victim, just sitting in the audience, and I found you; right?

A. I'm an interesting observer in this hearing.

Q. Could you briefly describe what Exhibit 27 is.

A. Yes. What Professor Cropp and I did in this paper was try and identify some of the issues with respect to the issues of distant pooling and depooling. It's more or less an academic piece. We tried to look at what the problem was, describe it in hopefully somewhat laymen's terms, and analyze some of the impacts, economic impacts of depooling and distant pooling on producers in particular, and more specifically on the producer price differential.

MR. ENGLISH: I move for admission of Exhibit 27, Your Honor.

THE COURT: I look to the audience. Is there objections? Does anybody want to voir dire or question before we receive it? We will receive it.

(Whereupon Exhibit No. 27 was offered and received into evidence.)

MR. ENGLISH: And I have no further questions.

THE COURT: All right. Are there questions for the witness? Let me ask -- yeah, go ahead. Do you want to go, Mr. Vetne? I was just going to ask, are you supporting any positions here, or is your paper basically just background?

THE WITNESS: Right, absolutely not. I want to make it clear, I'm not supporting or opposed any of the proposals that have been submitted at this hearing. This paper was prepared, in fact, before the hearing had been announced.

THE COURT: So your paper basically, and I've not had a chance to really look at it, other than just flipped through it a little bit, It basically looks at things that have happened with respect to the pooling in the Upper Midwest Order recently?

THE WITNESS: Right. It was motivated in large part because of the termination of the Western Order on April 1st of 2004, and because of the extremely large negative PPD that occurred in April of 2004. As you might expect, we're receiving a lot of questions from county agents, from producers about what was going on, and the purpose of this paper is to try and explain what was happening and to look at some of the depooling and distant pooling issues.

THE COURT: Mr. Vetne, do you have questions?

CROSS-EXAMINATION

BY MR. VETNE:

Q. Dr. Jesse, on page 10 of your paper you explain that the incentive to depool arises because of a difference in timing for the regulated Class III or IV price and the Class I price; correct?

A. That's correct.

Q. There would not be that difference and there would not be that incentive if both prices were derived from market value of milk for the same reference period?

A. Yes. If the Class I price was based upon the Class III price, it derives in the same fashion, then obviously the difference would be only to Class I differential.

Q. And you and many other people have been asked about the concept of negative PPD and positive PPD and so forth. The PPD is simply the result of arithmetic Class III price versus a blend price?

A. That's correct.

Q. It would be incorrect to say that when the blend price is below the Class III price, that there's a negative end number?

A. That's correct.

Q. There's not necessarily a loss, it's just a reference point sometimes shown on a producer's check; correct?

A. That's correct.

Q. And producers have sometimes read their milk checks or the lines on the milk check to conclude that some money has been taken away from them when it has not?

A. Yes, but for obvious reasons. If it shows up with a negative on the milk check, they look upon it as a negative on their milk check, and view it as a loss, but you're absolutely correct, the PPD is a mathematical calculation. It can be positive or negative, and does balance out over the long-term.

Q. It's correct, is it not, that plants in the Upper Midwest and in other markets have depooled milk for many decades when there's been a surge in manufacturing milk products?

A. Certainly. I would add to that that the shortening of the lag between the announcement of the Class I and the Class III price probably went a long ways towards alleviating the problem of price inversion. Unfortunately, not anticipated was the extreme price volatility that has occurred since that time, which has contributed to the possibility of a negative PPD.

Q. Okay, and that assumed price volatility, as you're referring, primary would have occurred between March and June of this year?

A. Well, yes, but it's been occurring since roughly the early-1990s when the support price no longer was the mover of market prices.

Q. It occurred when Class IV milk was the moving factor for Class I also, in the early-'90s?

A. That's true.

Q. Have you made some observations on the response of producers nationally or regionally to high prices?

A. Have I done any supply response work?

Q. Response on -- Have you observed

differences or changes in production, changes in cow numbers, that kind of thing?

A. Yes, I have.

Q. And you've observed that approximately 21,000 cows have been added to the national milk supply?

A. Yes.

Q. And ordinarily over the past several decades, the number of cows that are milking in the system decline a little bit year by year as the efficiency of production for cow increases?

A. Well, that would certainly be the long-term trend. As we've increased milk productivity at the rate of about 2 percent annually, milk demands have not increased that greatly, so the number of cows has gone down to compensate for the greater productivity. However, there have been cycles, there have been movements up and down in cow numbers that have been around that trend line.

Q. Would you predict, based on recent observations on producer response -- well, getting new cows, maybe milking some cows longer, that that will also have an affect on future prices?

A. I'm not sure what you're referring to, Mr. Vetne. Are you referring to the current situation, or something that's occurred over a long period of time?

Q. I'm referring to what you observed for the past few months, whether the producers response to prices of the past few months, which we're now seeing in some of the reports, will, in your opinion, have an impact on the market prices in future months?

A. Certainly, but the response has been much slower than typical with these kinds of high prices we've experienced over recent months. Due to a large number of factors, availability of milk cows, availability of replacement cows, availability of RVSB, poor quality in some parts of the country, so we have not seen a response as rapid as we might have to these higher prices. We will see it happen, however, and I anticipate the milk prices will certainly drop from their current numbers.

Q. For a period of time, many months?

A. Conceivably. I've pretty much given up trying to predict milk prices.

Q. Okay. Is there anything in the economic or production indicators that you observed, from which you would conclude, that in the foreseeable future there will be a price spike in Class III, or Class IV for that matter, similar to what we observed last spring?

A. No.

MR. VETNE: Okay. Thank you.

THE COURT: Mr. English?

REDIRECT EXAMINATION

BY MR. ENGLISH:

Q. I would let your document speak for itself. Did anybody in the industry, including the futures market, up to and including January 13th of this year predict the price spike that occurred in April and May of this year?

A. No.

Q. Okay. I thought not. Now, there's been some discussion by Mr. Vetne in using your document about the question of the timing of pricing. Would you agree with me that if all milk was pooled or all the same quality of milk was pooled over time, given the fact that the Class I differential remains the same, notwithstanding that lag in pricing, it will eventually average out?

A. Yes. Prices go up, prices go down, and the PPD corresponds in the same fashion. If prices increase rapidly, the PPD will become negative and become a very large positive at some later point in time when the Class III prices begin to fall.

Q. Sort of what happened between May and June of this year; correct?

A. Yes, yes.

Q. And, indeed, at that point we suddenly saw all the milk surge back into the pool; correct?

A. That's correct.

MR. ENGLISH: Thank you.

THE COURT: Mr. Beshore?

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Just a question or two. Dr. Jesse, hopefully this wasn't covered by one of the other questions here. As far as negative PPD's are concerned, you've discussed some of linkage, and you were asked about some of the dynamics of advanced pricing being a facilitator in that process. Isn't it correct, however, the PPD, being the arithmetic calculation that it is, we can have, and some of the statistics in the hearing will show that we would have negative PPD's, even without the advanced price inversions?

A. That's been demonstrated a number of times, and, in fact, we did not have price inversion, but still had a negative PPD because of Class IV usage, Class II coming on the market, that normally is not pooled, and other factors.

Q. All right, and the extreme volatility that we've seen in the last few years in Class III and Class IV prices, a major factor in that was the change in the support price tilt in 2001 by the USDA, would you agree?

A. I'm not sure I would, Mr. Beshore. That certainly influenced which of the classes was the mover, but I'm not sure it contributed to the volatility in milk prices that we've seen. I think the major factor has simply been that the support price is at such a level that it no longer is a principle influencer of the market price.

Q. Well, let me ask it this way. Did it not, the change in the support price tilt, the consequent reduction in the market value and the class value of Class IV nonfat solids has exacerbated the volatility in the spread between class -- or the difference in the spread between Class III and Class IV, nonfat solids, and, therefore, the PPD relationship with Federal Orders, has it not?

A. It has reduced the Class IV values, since Class IV skim follows the support price for nonfat dried milk almost in large step, but whether that's increased the spread, it hasn't decreased -- it has decreased the Class IV value. I'm not sure that it's increased the spread in general. I think the more important factor that increased the spread has been the strong cheese markets we've experienced over the last several months.

Q. Let's walk that through one more step. Were you here yesterday when I was exploring with Mr. Schaefer the relationship between Class IV and PPD -- Class IV utilization and PPD?

A. Yes.

Q. Okay, and if you remember, because butterfat for Class III and Class IV has the same value, the difference as far as PPD is concerned is the nonfat value in Class IV versus Class III?

A. Yes.

Q. Value of nonfat solids. Okay. Now, when the support price reduction reduced by, what, 20 cents a pound, the value of those nonfat solids and nonfat dried milk, is that about right?

A. The two tilts?

Q. Yeah, the two tilts.

A. Yes.

Q. Okay. When that was changed, and as you've testified, the market follows the support price for nonfat dry milk. When the value of those solids in Class IV usage, nonfat dry milk was reduced by 20 cents, the cheese price stayed about where it was, the increase -- the spread was increased, was it not?

A. Well, that's true. There's no question about that.

Q. And that's what contributes -- that adds to the possibilities of a negative PPD if you've got any Class IV in your market at all, would it not?

A. Yes, but at the same time -- well, yes, that's correct. Yeah.

Q. And in Order 30, as you've analyzed it thoroughly in your paper, when you've got distant milk, a large amount of which is Class IV being pooled on the market, you get those factors added together to affect the PPD in the Order?

A. Well, in general we would expect, and I'm sure that everybody who was involved in the 2000 Order Reforms expected, that Class IV would normally be below Class III, and that contributes negatively to the PPD. Negatively in the sense of lowering the PPD, so when that spread increased, obviously that did happen. What wasn't anticipated was the very high Class IV skim values that occurred in the early part of the Reform period.

MR. BESHORE: Thank you.

THE COURT: Questions? Anybody else, questions? Yes, sir. Mr. Lamers.

CROSS-EXAMINATION

BY MR. LAMERS:

Q. Good afternoon again, Ed.

A. Morning, Mr. Lamers.

Q. You state in one of your conclusions on page 16 of your paper that "A major objective of Federal Order is to assure orderly marketing. The unrestricted ability to pool and depool milk on a monthly basis causing wildly fluctuating PPD's does not fit any definition of orderly marketing. Handlers are not treated equally, the producers do not receive uniform prices." Now, this is part of your expert opinion and the facts as you see them?

A. Yes, it is.

MR. LAMERS: Thank you.

THE COURT: Questions anybody? Do I see anybody raising their hand? I'm not sure. Yes or no? All right. Fine. Thank you for much.

MR. ENGLISH: Thank you, Dr. Jesse.

THE COURT: And we already received Exhibit 27. All right. Let's stay off the record for a second.

(Discussion had off the record.)

THE COURT: Well, let's take a short five-minute recess.

(Recess taken from 2:46 to 2:56 p.m.)

THE COURT: Let's go on the record.

DENNIS TONAK,
after having been first duly sworn by
the Court says under oath as follows:
***

MR. BESHORE: Your Honor, before Mr. Tonak proceeds, I would like to ask that we have marked as the next exhibit a statement in support of Proposal 2 by Dennis Tonak.

THE COURT: We'll mark that as Exhibit 28.

(Whereupon, Exhibit No. 28 was
marked for identification.)

MR. BESHORE: It's a 26-page document, and as Exhibit 29 a two-page document, which has a chart on the first page and a table on the second page. A chart called mileage matrix on the first page.

THE COURT: I see it, and we'll make that 29.

(Whereupon, Exhibit No. 29 was
marked for identification.)

THE COURT: I think we've got pretty much everybody back together. Go ahead, Mr. Beshore.

DIRECT EXAMINATION

BY MR. BESHORE:

Q. Mr. Tonak, would you state your name and provide your business address, please.

A. May name is Dennis, D-e-n-n-i-s, Tonak, T-o-n-a-k. Business address is Mid-West Dairymen's Company, 4313 West State Street, Rockford, Illinois.

Q. Mr. Tonak's, what your educational background?

A. I've got a Bachelor of Science Degree in Dairy Science with a Business Minor.

Q. From what institution?

A. South Dakota State University.

Q. And when did you receive that degree?

A. 1973.

Q. Have you been employed in the dairy industry since that time?

A. Yes, I have.

Q. And could you tell us, you know, in what capacities and what roles you've had in your professional career.

A. I've been employed in a number of capacities by primarily National Farmers Organization, Southern Milk Sales for Mid-West Dairymen's Company, generally related to marketing and management, marketing of milk. Over the course of the years, I've worked with a number of Federal Orders throughout the eastern two-thirds of the United States and have lived in four or five different states, as I've moved in relationship to those capacities.

Q. Let's break that down a little bit. With NFO, what years were you employed, and in what capacities and what areas did you work?

A. I was employed initially with NFO from 1973 to 1987. I worked in Minnesota the Dakotas, later in Missouri, Iowa, Nebraska, Kansas, Illinois, some of the fringes of those areas. In 1987 until 1991 I was employed by Southern Milk Sales, ending as basically marketing and sales coordinator, working with pool reports going out of their office in San Antonio. I was responsible for coordinating the movement of milk across the south and southeast, Southern milk marketing.

Q. Okay. After those years with Southern Milk Sales, were you subsequently employed again with National Farmers Organization?

A. Yes, I was, and from '91 until '97 I worked either in the Ohio area and some of the surrounding states or in their national office as a national milk sales coordinator, and as such worked throughout the country.

Q. And what is your current employment?

A. Currently, I'm manager of Mid-West Dairymen's Company in Rockford and have been such since 1997.

Q. What are your -- Tell us about Mid-West Dairymen's Company and your responsibilities there.

A. Mid-West is a relatively small company. We have just a handful of employees, and as such I do a lot of the -- or all of the marketing work, along with management duties, communication roles with the producers, pool reports, and so on.

Q. Now, in your 30 years, 30-plus years, I guess, in the dairy industry, has that all been involved in marketing of milk?

A. Generally, yes.

Q. Okay. Under Federal -- involved with Federal Milk Market Orders in all of the areas of the country to which you referred?

A. Yes.

Q. Do you have any idea how many Federal

Milk Orders you've been involved with marketing under in those years, Dennis?
A. Twenty-five, thirty-five, somewhere in that general range.
Q. Pre-reform and post-reform?
A. Pre-reform and post-reform.
MR. BESHORE: Your Honor, I would offer Mr. Tonak as an expert witness in the area of milk marketing.
THE COURT: All right. There does not seem to be any objections, certainly he's so treated and so considered.
MR. BESHORE: Okay. Thank you.
BY MR. BESHORE:
Q. Okay. Mr. Tonak, have you prepared a statement as the chief spokesperson on behalf of the proponents of Proposal 2?
A. I have.
Q. Okay, and would you proceed with that statement at this time, please.
A. My name is Dennis Tonak. I'm the manager of Mid-West Dairymen's Company located at 4313 West State Street, Rockford, Illinois. Mid-West is a relatively small cooperative with 137 dairy farm members in southern Wisconsin and northern Illinois.

Mid-West is responsible for supplying the raw milk needs of an Order 30 distributing plant. Mid-West has a joint venture ownership interest in that plant. Mid-West also operates an Order 30 supply plant in Rockford. The majority of the Mid-West members' milk delivers to the fluid plant. Mid-West also sells milk to nonpool plants in the region.

This statement is on behalf of the proponents of Proposal 2. The original proponents are Cass-Clay Creamery, Inc., Dairy Farmers of America, Inc., Foremost Farms USA Cooperative, Land O'Lakes, Inc., Manitowoc Milk Producers Cooperative, Mid-West Dairymen's Company, Milwaukee Cooperative Milk Producers, Swiss Valley Farms Company, and Woodstock Progressive Milk Producers Association. Though Foremost Farms was an original proponent, this statement is not given on their behalf. Additionally, this statement is supported by and given on behalf of Plainview Milk Products Cooperative and Westby Cooperative Creamery. All are qualified cooperatives representing producers in the Federal Order 30 market.

"Introduction of issues." Federal Orders are economically proven marketing tools for dairy farmers. Without them, dairy farmers' livelihood would be much worse. The central issue of this hearing is to determine who may share in the market wide pool proceeds. Among the basic purposes of the Federal Order structure are to assure an adequate supply of milk for the fluid market, equitably share the pool proceeds in an economically justifiable manner, and promote orderly marketing.

Orderly marketing would encompass principles that attract milk to the highest value use when needed and clear the market when not needed. Market wide pooling allows qualified producers to share in the market returns on a fair and equitable basis and establish requirements that provide the necessary incentives to efficiently supply the market. Working in conjunction with classified pricing, these principles and requirements assure an adequate supply for the fluid market.

The supporters of Proposal 2 recognize the disorderly market conditions that now exist due in large part to what we see as loopholes in the Federal Order regulations. Milk can exit the pool at any time there are negative consequences to pooling and immediately return to the pool when it is extremely advantageous to do so. Milk that is so distant from the Order 30 Class I market that it virtually never ships to fluid use, after meeting the initial one-day touch-base requirement, shares in the fluid earnings in the pool in an opportunistic manner.

The agricultural press in the region has widely reported on the December 2003 milk pooled by state and county information released by the Market Administrator's Office. Jerome County, Idaho, had more milk pooled on Order 30 than any county in Minnesota or Wisconsin. While the milk pooled from the other counties in the top five was relatively stable, when compared to December 2002, the milk from Jerome County has doubled. It is found in Exhibit 5, Table 17 and 19. This leads producers to ask questions such as, "How can this be?" "How much money is this taking from me?" "Does any of this milk come to the Upper Midwest on a regular basis?"

Questions were also raised about the negative PPD's in April and May and the pooled milk volumes in February through June. Exhibit 5, Tables 3 and 9, shows that in February 2004 there was 1,944,216,880 pounds pooled with a PPD of 47 cents; in March 2004 there was 675,051,623 pounds pooled with a PPD of 21 cents; in April there was even less pooled, 608,028,839 pounds, with a PPD of a negative $4.11; in May 2004, 662,635,115 pounds pooled with a PPD of a negative $1.97; and in June 2004 the pool more than tripled with 2,113,701,569 pounds pooled and a PPD of 30 cents. The discussions when the negative PPD's hit producers' mailboxes were about milk jumping out of the pool and leaving others holding the bag, about equity and fairness, about a level playing field, and about government regulations that allow this to happen.

Producers who supply milk to meet the fluid needs of the marketplace have been penalized by the very regulations that they have supported in the past. Proposal 2 is a modest step in restoring a level of equity among those who supply the fluid market and those who function primarily as a reserve supply for the market's needs. It would also mandate that milk from far outside the marketing -- from the market area must be able to physically supply the Class I market on a continuing basis.

The adoption of Proposal 2 does not stop milk from Idaho or other distant locations from pooling on Order 30. It merely requires that this distant milk proves that it can and will supply the fluid market needs, not just for one day to touch base, but day after day, week after week.

Our Proposal does not stop depooling. It does, however, limit the ability of handlers to immediately repool and grab a share of the good times.

Proposal 2 consists of three interconnected and interwoven parts.

Limit the transportation credit, number 1; number 2, establish definitive performance requirements for distant milk; and three, limit repooling after depooling.

The adoption of only one part of the proposal will not achieve fairness and equity for those producers who regularly supply the market.

"Limit transportation credit." This may be the least controversial part of Proposal 2. The transportation credit helps offset the hauling cost on the Class I portion when the milk is transported from a supply plant to a distributing plant in Order 30. The transportation credit results in a decreased PPD since the transportation credit value is subtracted from the Producer Settlement Fund. Our proposal would limit the payment of the transportation credit to a maximum of 400 miles. It would not affect the calculation of the transportation credit in any other way.

Exhibit 7, Table S2, shows that in 2003, the maximum distance for milk that received the transportation credit to move was less than 400 miles.

Conversations with Market Administrator's staff indicated that the mileage in prior years was not significantly different. Exhibit 9, Table 1B shows mileages between supply plants in the larger milk producing counties within the marketing area and selected distributing plants. These are, AMPI - Jim Falls located in Chippewa County, Wisconsin, the seventh largest county in terms of milk pooled; Grassland in Clark County, Wisconsin, the third largest; Kraft-Beaver Dam, Wisconsin, is in the eighth largest county, Dodge; Melrose is in Stearns County, Minnesota, the largest county after Jerome County, Idaho; Mullins Cheese -- Mosinee, Wisconsin, is in Marathon County, the forth largest; Fond Du Lac is ranked fifth and the location of an NFO supply plant; Little Chute, Wisconsin, is in the tenth largest county. The greatest mileage shown is from Stearns County, Minnesota, Melrose Dairy Proteins, to the now closed Swiss Valley plant in Chicago at 502 miles and to Dean Foods, at Huntley, Illinois, at 477 miles. It is highly unlikely that it will be necessary to move milk from Stearns County, Minnesota, to northern Illinois on an ongoing basis to meet Class I needs. It is more likely that the Stearns County milk would move to the Minneapolis area, a distance of 93 miles from Melrose to Marigold Foods. Even if milk moved from the Stearns County area to northern Illinois distributing plants on a regular basis, it would not be appropriate for the Order transportation credit to cover the full mileage when closer alternatives are available.

Exhibit 29 is a modification of Exhibit 9, Table 1B, showing averages of the mileage from the various plants to a selected plant. This illustrates that milk is available from various heavy production areas with less than 400 miles of transportation.

Milk located in the marketing area and associated with the supply plants in those states that contain a portion of the marketing area is more than adequate to meet the fluid needs of the market. This is as easily seen by reviewing Exhibit 9, Table 3K, which shows that except during the times of massive depooling, the market's Class I utilization would have averaged less than 20 percent annually. With a 20 percent Class I utilization, there is no need to encourage the movement of supply plant milk when the distance between supply plant and distributing plant is greater than 400 miles.

In the 38 months from April 2001 through May 2004, 3,186,515 pounds of Idaho milk delivered to Order 30 distributing plants. Exhibit 9, Table 2. This milk would not receive a transportation credit, since it was not shipped from a supply plant. At least in 2003 it did not originate from a supply plant in Idaho, and we do not see anything to suggest that the balance of that milk was shipped from an Idaho supply plant.

I should add that the 3.2 million pounds of Idaho milk delivered to the Order 30 distributing plants, over 2.8 million pounds was delivered to the distributing plant in Rockford. Mid-West paid the going market price for this milk. Neither Mid-West, nor the receiving plant paid the transportation cost to move the milk from Idaho to Rockford. Additionally, it was very rare for a producer to ship more than the equivalent of one day's production to Rockford.

Since there's not been any milk that shipped over 400 miles from a supply plant to a distributing plant, our suggested change to the transportation credit would not impact any current pool participants.

A mileage limit on the transportation credit would prevent the draining of the Producer Settlement Fund dollars if new supply plants were located great distances from the distributing plants at some time in the future. This also would help assure that those producers located in and around the marketing area who traditionally supplied the market would receive the maximum returns for their efforts.

"Distant Milk and Market Performance." Jerome County, Idaho, had more milk pooled in Federal Order 30 in December 2003 than any other county. Since Jerome is between 1,200 and 1,600 miles from many of the Order 30 pool plants, this seen in Exhibit 9, Table 1A, the obvious question becomes, does the Jerome milk actually perform or does it just paper pool? And further, should that milk really share in the market wide pool? We must review what is meant by performance to answer these questions.

The decision from the 2001 Order 32, Central Order hearing directly addresses the performance question. We want to highlight a few selected paragraphs from that decision:

"The pooling standards of all milk marketing orders, including the Central Order, are intended to ensure that an adequate supply of milk is supplied to meet the Class I needs of the market and to provide the criteria for identifying those who are reasonably associated with the market as a condition for receiving the Order's blend price. The pooling standards of the Central Order are represented in the Pool Plant Producer, and the Producer Milk Provisions of the Order. Taken as a whole, these provisions are intended to ensure that an adequate supply of milk is supplied to meet the Class I needs of the market. In addition, it provides the criteria for identifying those whose milk is reasonably associated with the market by meeting the Class I needs and thereby sharing in the market wide distribution of proceeds arising primarily from Class I sales."

"Pooling standards are needed to identify the milk of those producers who are providing service in meeting the Class I needs of the market. If a pooling provision does not reasonably accomplish this end, the proceeds that accrue to the market wide pool from the fluid milk sales are not properly shared with the appropriate producers. The result is the unwarranted lowering of returns of those producers who actually incur the costs of servicing and supplying the fluid needs of the market."

"This decision finds that the milk of some producers is benefiting from the blend price of the Central Order while not demonstrating actual and consistent service in satisfying the Class I needs of the Central milk marketing area."

"The reform Final Decision, as it related to the Central marketing area, did not intend or envision that the pooling standards and pooling features adopted would result in the sharing of Class I revenues with those persons, or the milk of those persons, who had not be demonstrating a measure of service in providing the Class I needs of the Central marketing area."

"As previously indicated, pooling milk on the Central Order without demonstrating actual performance in servicing the Class I needs of the market area is neither appropriate nor intended."

The only logical way for distant milk to be part of the marketing area supply on an ongoing basis is for that distant milk to perform by delivery to meet the market's fluid needs. This would establish, without a doubt, that the distant milk is part of the market wide supply and is entitled to share -- to a share of the pool.

Johann Von Thunen, who is considered to be the father of modern location economics, advanced his theories in "The Isolated State." His theories have been refined and are applied today to such wide and diverse areas as rental values, land use and city planning, and agricultural pricing. His major hypothesis in its simplest form was to further the production area is from the consumption area, the lower the value of that production in direct relationship to transportation cost.

Additionally, products with high value and high transportation costs would be produced closest to the consumption areas. When the transportation cost became so great that the production value was substantially reduced, an alternative use with better returns would be found for the land, if such were available.

Von Thunen's theory is validated with the Idaho milk. The Idaho milk cannot economically move to serve the fluid needs of the Upper Midwest market when an alternative use, such as cheese, is available locally in Idaho. Exhibit 26.

The Federal Order Reform decision created a new Upper Midwest marketing area through the consolidation of the old Order 68 and old Order 30, with some modifications. The major criteria used as outlined in the decision were overlapping procurement and sales areas, the production of similar manufactured products, related geography, and natural boundaries. According to the Reform Decision, overlapping route disposition was generally the most important criteria for establishing the boundaries of marketing areas. The overlap of disposition would indicate competition for Class I milk sales.

Overlapping milk supplies were also used as criteria. Quoting from the decision, "The pooling of milk produced within the same procurement area under the same Order facilities the uniform pricing of producer milk." The Reform Decision also states that natural boundaries often inhibit the movement of milk. It is our view that these natural boundaries may also define changes in geography, topography, and land types. Such geographical changes may also be reflected in changes in dairy and other agricultural production characteristics.

Defining the marketing area so that there was as many common characteristics as possible is obviously important. From the Reform Decision:

"The pooling provisions for the consolidated orders provide a reasonable balance between encouraging handlers to supply milk for fluid use and ensuring orderly marketing by providing," and I want to emphasize the following, "a reasonable means for producers within a common marketing area to establish an association with the fluid market.

Obviously matching these goals to the very desperate marketing conditions found in various parts of the country requires customized provisions to meet the needs of each market. In the Upper Midwest market, a relatively small percentage of milk will be needed for fluid use. Accordingly, under the pooling standards for that Order, smaller amounts of milk will be required to be delivered to fluid milk plants and larger amounts of milk will be permitted to be sent to manufacturing plants."

There is a thorough discussion in the Reform Decision that marketing areas should encompass areas with similar characteristics, from geography, to competition for both producer milk and Class I sales, to the manufacture of similar products. The Decision goes on to discuss that the pooling and performance requirements should be specific to these common areas and provide for the sharing of the market wide pool with that milk, which is consistently available to serve the fluid needs of the market. Additionally, the milk within that common marketing -- that common market area should be allowed to serve the fluid needs as efficiently as possible.

To that end, plants, and more specifically, supply plants, within the marketing area can form units for the purpose of meeting the minimum pooling and performance requirements. This allows for all milk within or at the margins of the marketing area to be pooled if it has demonstrated, with a one-day touch-base shipment, that it is available to meet the fluid needs.

This approach to pooling and performance is reasonable, since any milk within the marketing area is relatively close to a fluid plant. Exhibit 5, Figure 1. Milk in the largest producing counties, with the exception of Jerome County, Idaho, is within a few hours of the major population centers. Exhibit 9, Table 1B. Within the context of the marketing area and the immediately surrounding procurement area, it is logical and makes economic sense for a portion of the producer milk to make deliveries to distributing plants and to allow the remaining milk to have the benefit of pooling. The alternative would require every producer to deliver some prescribed amount of his milk to fluid plants in order to fully participate in the market wide pool.

"Idaho Milk and Market Performance." Twelve percent of the milk pooled on the Upper Midwest Order in December 2003 originated in Idaho, and, as previously mentioned, more milk was pooled on the

Order from Jerome County, Idaho, than from any other county. This has made Idaho a flash point in the discussion of pooling and performance of distant milk. The milk in Idaho cannot reasonably serve the fluid needs of the Order 30 marketplace. The distances from Idaho to the Upper Midwest fluid plants are in the 1,100 to 1,600 mile range. The Class I returns do not justify the freight cost. Exhibit 26. The touch base delivery cost only realizes a positive return in most cases if there is ongoing pooling without further deliveries. Idaho is geographically isolated from the Order 30 marketing area. There is a mountain range and the Great Plains to cross when milk leaves Idaho for the Upper Midwest. We do not know of any overlapping fluid milk sales. There is no direct milk procurement overlap, though DFA, Manitowoc, and others have members in Idaho. Mid-West and others assist in the pooling of the Idaho milk, although Mid-West has no membership in Idaho.

During the time period of 2000 through 2002, the Upper Midwest market had a range in Class III utilization from 71.1 percent to 81.1 percent, and the Class IV utilization ranged from four tenths of a percent to 2.8 percent. The negative PPD and subsequent depooling in some months in 2003 and 2004 make comparisons more difficult, but in relatively normal months, the Class III utilization ranged from 68.5 percent to 77.9 percent, and the Class IV utilization ranged from 1.7 percent to 8.2 percent. This is found in Exhibit 9, Table 3K. It appears that the Class IV utilization increase had some relation with the Idaho pooling. The Upper Midwest market has high usage of milk in Class III products.

Milk pooled on Order 30 and diverted to nonpool plants in Idaho is 26.2 percent Class IV and 73.8 percent Class III, or a ratio of 1 pound of Class IV to 3 pounds of Class III. Exhibit 9, Table 4. The ratio for milk allocated to Class III and IV in the Order 30 pool ranges from 1 pound of Class IV to between 10 and 25 pounds in Class III, depending on the month. Based on these relationships, the milk in Idaho is not used in manufactured products in a similar ratio to the Upper Midwest milk. The Order Reform criteria for inclusion in the marketing area of the production of similar manufactured products are not met.

In December 2003, there were 33 producers from Jerome County, Idaho, with milk 102,087,118 pounds, pooled on Order 30. Exhibit 5, Table 19. This is an average production of 3,093,549 pounds per producer. Stearns County, Minnesota, had 768 producers with 88,817,055 pounds pooled, for an average production of 115,647 pounds per producer. In December, Idaho had a total of 263,365,666 pounds pooled from 182 producer, an average production of 1,447,064 pounds per producer. Minnesota had 548,429,503 pounds pooled from 4,569 producers, for an average of 120,032 pounds. The Idaho producers average over ten times larger than the Minnesota dairy farm.

We can find no evidence that there's a common marketing area encompassing the current Upper Midwest marketing area and the distant Idaho area. Due to the distances involved, the Idaho milk cannot function as a reliable reserve supply for the Upper Midwest market. In fact, it is our recent experience that often when the Idaho milk makes a touch-base delivery, local milk must be moved out of the fluid plant to make room. This results in the local milk balancing shipments from Idaho and not one -- and not what one would expect from a reserve supply. That is, the reserve supply, or in this case Idaho milk, balancing the local milk supply.

Order 30 requires that 10 percent of the pooled milk deliver to a pool distributing plant.

There are no pool plants in Idaho. In fact, only two-tenths of a percent of the Idaho milk has ever delivered to a pool plant, and of that less than one-third touched a fluid plant directly. The Idaho milk, plain and simple, is pooled based on the pool plant deliveries of milk that is either inside or close to the marketing area. Some would call this paper pooling. It may be more appropriate to call it fee for services.

Mid-West is familiar with the pooling of Idaho milk and has pooled some Idaho milk for approximately three years. In a typical arrangement, the milk in Idaho pays a fee for pooling. This fee may range from a certain portion of the pool draw to a percentage of the Class III, such as 1 or 2 percent, or it may be a set per hundredweight fee such as 10 or 15 cents. Pooling fees have become a significant revenue stream for some Order 30 handlers.

The Upper Midwest handler, then, includes that Idaho milk on the Report of Receipts and Utilization sent to the Market Administrator after the close of the month. The Upper Midwest handler's actual handling of the milk generally involves only making data entries on a piece of paper. Thus, the term paper pooling. Upper Midwest located milk is used to meet the 10 percent shipping requirement and the Idaho milk receives the benefit of the Upper Midwest PPD. This would generally be done by a transfer of money from the Upper Midwest handler to an Idaho plant or producer group with the Upper Midwest handler retaining the pooling fee.

The pooling fees are not shared uniformly across the market. They are not part of a market wide pool, but are retained by the individual handler. The affect of the Idaho pooling is shared uniformly across the market wide pool. The bottom line is that the pooling of Idaho milk decreases the PPD for all, but some receive a pooling fee that may more than offset the decrease. But the Idaho pooling very definitely has a cost to all market participants.

In Mid-West's case, and we expect with others, the benefit gained from pooling the Idaho milk is used in three interrelated ways, it helps offset the cost of supplying the fluid market, it helps make up the negative PPD's, and it helps the financial returns to our producer-members either directly on pay price or as a source of earnings. Mid-West does not particularly like the pooling of Idaho milk, but if we didn't do it, someone else would. We also see it as a method of business survival in a very competitive marketplace.

"PPD Impact." The Idaho milk has generally had a negative impact on the PPD. Exhibit 9, Table 5A. Initially, the impact of the Idaho pooling was a modest few pennies, but still a lot of money for Midwestern dairy farmers struggling with low prices. By mid-2003, the PPD impacts were becoming much larger. As an example, the Idaho milk is estimated to have reduced the PPD by 73 cents in September 2003. Not only was the volume pooled growing, thus increasing the pool dilution affect, but also there was an increasing spread between Class III and Class IV prices. Class IV milk jumped both in total pounds and in utilization percentage. Exhibit 5, Table 9 and Exhibit 9, Table 3K. While these pooling gains may have been a windfall for some of the large Idaho producers, it pulled money from the pockets of family farmers in the Midwest.

There are wide swings in the volumes of Idaho milk pooled that are directly related to price relationships and that have no bearing on market performance. In other words, if the return is positive, pool. If it is not, don't pool. There is no thought given to remaining in the pool, to maintaining pool integrity or association, but only to sharing the returns of the market wide pool if those returns are positive.

The termination of the Western Order will only magnify the pooling of distant milk, the Reform Decision stated, "Class I utilization rates are a function of how much milk is pooled on an Order with a given amount of Class I use. Differences in rates, to the extent they result in differences in blend prices paid to producers, provide an incentive for milk to move from markets with lower Class I utilization percentages to markets with higher Class I use."

Since the termination of the Western Order, there is no market wide Class I utilization available to milk in Idaho and Utah. This milk will be driven to find a new pooling home, and will only add to the PPD burdens in the Upper Midwest.

While the Reform Decision anticipated some changes in milk pooling, it did not, and in all likelihood could not, envision the magnitude of the changes. The Reform Decision anticipated that milk primarily at the borders of marketing areas would shift until equilibrium would be reached. This has not happened. Opportunistic pooling has dramatically affected the relationships that existed before Order

Reform. The industry continues to search for ways to assure that milk that pools and derives benefit from the market wide pool is actually entitled to those benefits. This hearing is part of that process and is in keeping with the principles outlined in the Reform Decision, and from the Reform Decision:

"Market wide sharing of the classified use value of milk among all producers in a market is one of the most important features of the Federal Milk Marketing Order. It ensures that all producers supply handlers in a marketing area receive the same uniform price for their milk, regardless of how their milk is used."

"A suggestion for open pooling, where milk can be pooled anywhere, has not been adopted, principally because open pooling provides no reasonable assurances that milk will be made available in satisfying the fluid needs of the market."

The lenient Order 30 pooling requirements have worked to the advantage of those who wish to share in the market wide pool, but who do not wish to bear the burden of continually serving the needs of the market.

"Distant Milk Solution." The proponents and supporters of Proposal 2 concluded that milk outside the marketing area and the adjoining defined area needed to perform, i.e. ship 10 percent to a fluid plant, in order to derive the benefits of the market wide pool. The supporters and proponents of proposal 1, AMPI, First District, Ellsworth, and Bongards' have come to the same exact conclusions. If 10 percent of the pooled Idaho milk were actually delivering to fluid plants in the Order, then it truly would be part of the market and would be entitled to a share of the pool. The question we wrestled with is how to best accomplish this objective. There may be a better alternative to Proposal 2, but we have not found it. Under Proposal 2, diversions to plants located outside the prescribed geographic area would not be allowed to pool. In order to gain pool status, our proposal requires a producer to continue to touch base only once, but all other deliveries must be to either an Order 30 pool plant or a plant located within the prescribed area.

We should note a change to our proposed language is necessary to avoid conflicting interpretations. The corrected language in Section 1030.7(c)(2), last sentence should read "Cooperative Associations may not use shipments pursuant to Section 1000.9(c) to qualify plants located outside the area described above."

The approach that Proposal 2 takes is mirrored on the Order 33 Decision. That Decision basically said that in area milk could not be used to qualify out of area milk. The out of area milk needs to perform on its own merit.

The predecessor orders to the current Order 30 have had a long tradition of differentiating between in area and out of area milk. Since 1976, Order 68 had a provision for reserve supply plants. Initially these plants had no regular shipping requirement except for the initial load of milk which established association with the market. There was, however, one major criteria these reserve supply plants had to meet, they had to be located in the marketing area. The same criteria applied for supply plant systems in old Order 30. A supply plant had to be located in the marketing area to be part of a supply plant system. Supply plants outside the marketing area were obligated to perform on their own behalf.

Further support for the approach that out of area milk should perform on its own is found in the requirements for the formation of pool plant systems in current Order 30. A supply plant must be located in the marketing area or be a grandfathered plant. Supply plants outside the marketing area, except for the grandfathered exception, cannot be part of a supply plant system. This method for supply plants to meet the Order's performance requirements was developed to allow milk to move to fluid use in the most economical fashion. By excluding plants from outside the marketing area, there was assurance that the included supply plants had ties to the market, even if an individual plant did not ship for fluid use. From the reform decision:

"The only requirement affecting an individual plant within the unit is that the plant must be physically located within the marketing area. This restriction is necessary to prevent distant plants from receiving the benefits from participating in the market wide pool without actually having an association with the market."

The Idaho issue was raised in the Order 30 hearing held in 2001. At that time there was very little Idaho milk pooled on Order 30. The focus of many of the hearing participants was the double dipping of the milk pooled from California.

One of the proposed distant pooling solutions at the 2001 hearing was based on performance by state units. The proposal would have required each state unit outside the marketing area to ship 10 percent of the pooled milk to a distributing plant. While this approach required the distant milk to perform, in the words of the decision, it established a different standard since.

"For example, of the milk received from Idaho, the DFA proposal would establish a standard for at least 10 percent of such milk to be shipped to a distributing plant in order for this milk to be producer milk pooled on the Order. However, the same would not be required, for example, that 10 percent of all Wisconsin milk be shipped to distributing plants regulated under the Order."

We view the plant-based approach in Proposal 2 appropriate, since supply plants or supply plant systems inside the Order area are treated no differently than supply plants located far from the Order's core. Both are responsible to ship 10 percent to distributing plants.

Additionally, there may have been difficulties in determining if a state unit met the shipping requirement at the time of pooling, though this would have been easily determined at audit. It is much easier to determine if an individual supply plant meets the minimum performance requirement at pool time.

Since the time of the 2001 hearing, the market situation has changed dramatically. The Western Order, which encompassed much of Idaho, has been terminated. The formation of the CMPC supply plant system has facilitated the availability of milk for fluid use, at least in the old Order 30 area. Class IV prices have swung from much higher than Class III to being significantly lower.

This changed relationship is primarily due to a change in the purchase price of nonfat dry milk power by the SCC under the milk support price program. This action was far outside the Federal Order realm, though it has a major affect on Federal Order class prices and pools.

The adoption of Proposal 2 will ensure that any milk, no matter how near or far from the marketing area, can and will serve the needs of the fluid market if it is going to enjoy the rewards of the market wide pool.

"Depooling and Repooling." The purpose of pooling is to share revenue. The generally accepted thinking is that through classified pricing, the Class I milk will generate added revenue for the pool. Exhibit 9, Table 11B shows this to be true. In each and every month since January 2000, the Class I milk added more revenue to the pool than the producers delivering to Class I received on component value, somatic cell adjustment, and PPD. During the same time period, the Class I value exceeded the Class III value in all but three months. Those were three of the seven months of negative PPD's occurring since July 2003, seen in Exhibit 9, Table 11A. It is fair to say that the Class I milk adds significant value to the pool.

This Class I revenue is shared with everyone who meets the current Order performance requirements. It does not make any difference if it is Class III milk in Minnesota or paper pooled Class IV milk in Idaho. There is a uniform return of the order value to all pooled milk, be it Class I, Class II, Class III, or Class IV, when adjusted for component levels and delivery location. Participation in the market wide pool equalizes value among all producers serving the different segments of the market. The Federal Order system, with the exception of the individual handler pools, has had market wide pooling and revenue sharing for many years.

Over the past twenty-plus years, the

individual handler pool structure in Federal Orders has been eliminated and replaced with market wide pooling. With an individual handler pool, the revenue from the classified prices is not shared with all market participants, but it is only shared with the milk that delivered to an individual plant. There could be wide variations in the minimum prices paid to neighboring producers shipping to different plants if those plants had different milk utilization and, therefore, different prices. This approach helped to assure adequate milk for the Class I needs since the Class I value was only shared with the milk that actually delivered for fluid use. It also could lead to disorderly market conditions as producers with milk delivery to lower valued uses tried to gain some of the Class I dollars.

One way to conceptualize an individual handler pool in today's markets would be to take a look at June 2004. There was a total of 2,113,701,569 pounds pooled. Of that 335,824,408 pounds were allocated to Class I, with 1,475,199,200 pounds allocated to Class III. The balance was in Class II and Class IV. The PPD at Chicago on the total pooled volume is 30 cents. Exhibit 5, Tables 3 and 9. The net Class I contribution to that 30 cent PPD was

$15,861,902. Exhibit 9, Table 1A. Under an individual handler pool the milk that delivered to Class III cheese plants would have a zero PPD, instead of 30 cents, while the milk delivering to Class I would have a $4.72 PPD, instead of 30 cents. I realize this is an oversimplification, but it does point out the value of a market wide pool to Class III milk.

Milk delivering to Class II, III, and IV plants can and will depool when there is no financial gain from pooling. In May 2004, the Class I milk, which always has to pool, received a negative $1.97 PPD at Chicago. At the same time, a cheese plant did not have to pool, and in effect, created an individual handler pool. The imputed PPD was zero. Exhibit 29. Incidentally, if the Class I milk could have created an individual handler pool in April, the PPD would have been a positive 68 cents.

In 2000 and 2001, there were many months that milk delivering to Class II and Class IV plants did not pool. The reasoning was the same, sharing in the market wide pool did not add value. This milk was quickly pooled, however, whenever there was a gain.

The ability to depool at will and then

quickly repool creates large differences in pricing at Federal Order values. This is especially noticeable when comparing the Class II price and the statistical uniform price in 2000, and the Class III price and the statistical uniform price since July 2003, the last twelve months. See Exhibit 5, Tables 3, 5, and 6.

These price differences create inequity among producers. We have already heard from producers who are impacted by the decisions to pool or not pool. The producer doesn't make these pooling decisions. Handlers make the decision when they fill out the Report of Receipts and Utilization. If milk is reported, it is pooled provided, of course, that it met the once-and-done touch base. If it isn't reported, it isn't pooled. This sounds a lot like paper pooling.

It also creates inequity among handlers. When there are negative PPD's, and the associated Class III depooling, it is very difficult for those supplying Class I in Order 30 to compete with cheese plants.

In April 2004, Mid-West made up the $4.11 negative PPD and paid a zero PPD. We did it with the pooling fees we received from pooling Idaho milk. Not everyone has that income stream. One cooperative that supplies fluid plants and Class II and Class III markets did not pay a negative PPD, but reduced component prices below Federal Order values. At the same time there were individual cheese plants that apparently depooled since they paid positive PPD's in the 40 to 60 cent range.

There is not any way to recover the negative PPD's from the Federal Order. A handler that must pool is always at a disadvantage when there's a negative PPD, and when there's a positive PPD, the handler who depooled during the negative PPD immediately returns to share in the pool.

There has been a recent effort to recover the negative PPD's through increased fluid market service charges. While admirable and welcomed by those who supply the fluid market, this effort is not sustainable over the long term. The increased price may have contributed to the larger than normal decline in fluid milk sales this summer. The fluid plants in Order 30 where the added price had been implemented have been placed at a competitive disadvantage with fluid plants in the Central and Mideast Orders and other areas where there has not been an increase.

The fluid plant cannot always recover

this increased cost from the marketplace. Many of the longer-term packaged milk supply arrangements with national and regional accounts have a price adjuster for changes in the Federal Order cost of the milk. There may not be any provision, however, for changes in over-order prices. The fluid plant ends up eating this increase, and the books show red ink.

Central Milk Producers Cooperative and Upper Midwest Milk Marketing Agency, CMPC and UMMA, respectively, are pricing agencies composed of some of the cooperatives who supply milk for Class I use in the Upper Midwest. CMPC and UMMA put an increased service charge, negative PPD surcharge, in place for those plants that obtained milk from CMPC and/or UMMA membership. Mid-West is not a member of CMPC or UMMA. Woodstock is not a member of CMPC or UMMA. There are fluid plant suppliers who are not members -- or there are other fluid plant suppliers who are not members. This adds to the difficulty of maintaining a negative PPD surcharge premium.

On April 16, 2004, I received a call from a cheese plant inquiring if Mid-West would need additional milk at the Muller-Pinehurst fluid plant the following week. We did. During the course of our discussion, I mentioned that the projections were for a fairly large negative PPD in April. They immediately concluded the phone call by telling me they would find somewhere else to sell the milk, that they had to cancel an offer made to deliver milk to another fluid plant, and they would just depool and not worry about the negative PPD. I am sure that this milk is part of the 1,475,000,000 pounds that returned to the pool in June.

If the current depooling/repooling scenario is allowed to continue, everyone will become like this cheese plant and make a decision to not serve the fluid market. Carried to the extreme, no one would serve the fluid market, except, perhaps, when there was a positive PPD. This would be disorderly marketing raised to a new level.

The Order 30 regulations determine which milk may share in the pool. The relatively loose pooling requirements contribute to the depooling/repooling problem. We are requesting a modest change to the regulations that would improve the equity among producers and among handlers.

"Depooling Solution." In the development of Proposal 2, the proponents reviewed the Order's pooling requirements. Among possible changes reviewed and discarded were changing the touch base to an every month requirement; eliminating split plants so that a plant was either a pool plan or nonpool plant at any given location; mandate a touch base prior to pooling after milk had been depooled; institute a Producer for Other Markets Provision; and develop a type of committed supply program. All of these would have meant some change, and in some cases great change, at great cost for Order 30 handlers. Generally, the touch-base-and-done, the ability to have split plants, and a 10 percent aggregate shipping requirement have worked well for producers and handlers in the marketing area. Our desire was to not change historical physical operations, if possible. Under Proposal 2 not a single hauler, plant, or producer in the marketing area has to make a change in how milk is picked up, delivered, or shipped.

Proposal 2 would limit how much milk a handler could add to the pool or repool each month. Milk pooled would be limited to 125 percent of the previous month's pooled volume with a few exceptions. It will not eliminate depooling. It does mean there are potential consequences to massive depooling. If you depool under the current regulations, there are no long-term consequences. In fact, there are virtually no negative impacts for those who depool.

If 100 percent of the eligible Class III milk had pooled in July of 2003 through May 2004, the estimated PPD would have averaged a negative 9.8 cents, while the actual PPD averaged a negative 77.3 cents. If only 50 percent of the eligible Class III milk had pooled, the average PPD would have been 28.9 cents for the eleven months. Exhibit 9, Table 5D. If there had not been any Idaho milk pooled, and 100 percent of the eligible Class III had pooled, the average PPD would have been 20 -- or pardon me, would have been 2.2 cents, and with 50 percent of the eligible Class III pooled, the PPD would average 8.55 cents. Exhibit 9, Table 5E.

Under Proposal 2, someone who wants to share in the market wide pool would need to continuously pool milk. If a very low level of milk was pooled in a current month, there would be less milk eligible to share in the pool in the future months. We believe this is in keeping with the basic philosophy of Federal Orders, those who participate share in the pool benefits.

Proposal 2 limits the pooling of milk in the current month to 125 percent of the handler's volume pooled in the previous month. The level of this limitation was chosen after receiving information similar to that found in Exhibit 9, Tables 9 and 10. The largest percentage change in Table 10 is 111 percent change from February to March. The 125 percent limitation in our proposal should accommodate this 111 percent increase and allows for additional added volume. As an additional safeguard, though, March has a 135 percent limit. We felt it was important to allow room for a handler to grow their business volume, but felt it unlikely that the business volume would grow by more than 20 percent in a given month. Allowances are also built in for the Market Administrator to waive the percentage limitation for new handlers or for an existing handler with a change situation, such as a merger, acquisition, or similarly a distributing plant that changes regulation.

Under our proposal, there is no limitation on pooling in August. In the Upper Midwest Order, August is often seen as the start of a new marketing year. The supply plant systems are formed to start operation in August, and there is an extra draw on fluid milk in late August to fill the school pipelines.

Restricting the pooling of milk based on prior performance is not new to Federal Orders.

The Northeast Order has had a Producer for Other Markets Provision for many years. Under this provision, milk of a producer cannot be immediately repooled if it has been depooled and is, in fact, excluded from the pool for an extended period of time. Proposal 2 would not impose such a burden on an individual producer, but limits pooling based on an aggregate total of the handler's previous month's pooled pounds.

Years ago, other Orders, primarily in the south and/or southeast either had a Producer for Other Markets Provision or a base plan. In these markets the intent of such provisions was to limit the sharing of the market wide pool during the spring months to those who pooled during the fall.

The pooling of distant milk has previously been discussed. We are concerned that if a safeguard for ongoing performance, the 125 percent limitation, is not in place, there would be individual months that distant milk would meet the 10 percent shipment requirement in an effort to gain access to the market wide pool. Exhibit 26, Table 4, discussed by Elvin Hollon, shows there are individual months when this would be advantageous. The competition for Access to the Class I market in a single month and the impact on the pool due to large volume swings would create instability. This instability could be prevented through our proposed limitation on repooling.

An additional benefit to our proposed limitation on pooling is that it would mitigate the need for an increase in the administrative assessment fee. The pool volumes would be more stable. It is our view that there would be more milk pooled and less need for a fee increase. At the very least, with stability and pool volumes, it would be easier for the Market Administrator to make staffing and other operational decisions.

"Conclusion." Milk from distant areas is being pooled on Order 30 in increasing volumes. This milk reduces the price paid to local producers who regularly supply the market. Due to distance and economic returns, the distant milk does not supply the market to any appreciable amount on a regular basis.

This distant milk was not envisioned as part of the Federal Order 30 market under Federal Order Reform. It has not been part of the market from a geographical and has not met the -- from a geographical basis and has not met the performance requirements of the market on its own. The fact that this milk shares in the market wide pool should be corrected.

Additionally, the records shows that there are local milk that shares in the market wide pool on an opportunistic basis. This milk detracts from the prices received by those who regularly and continually serve the needs of the Order 30 market, both when it pools and when it doesn't pool. Inequity among producers and handlers is apparent due to changes in pooling of this local milk. There also has been chaos in the marketplace. This milk should only share in the market wide pool if and when it demonstrates that it is regularly and continually part of the Order 30 market.

The Order 32 Decision says it very well. I just want to condense and paraphrase:

One, producers who consistently bear the cost of supplying the fluid market should share the pool; two, pooling standards are used to identify the producers who serve the Class I market; three, some producers benefit while not actually and consistently serving the market; four, pooling without performance is neither appropriate nor intended.

The solutions we propose are based on the rationale in prior Federal Order decisions and are sound and logical.

"Emergency request." The proponents and supporter of Proposal 2 submit that emergency marketing conditions exist that warrant the omission of a recommended decision. The volume of distant milk pooling on this market without providing any appreciable level of service to fluid plants has been growing. The termination of the Western Order will only facilitate further volume increases. Since our request for a hearing, there have been two large negative PPD's. The continuing volatility of market prices almost guarantees further negative PPD's and the associated depooling. These create disruptive and disorderly conditions and make it difficult to serve the fluid marketplace. Thank you.

THE COURT: You wish that statement to be received, I presume?

MR. BESHORE: I would like to move for both Exhibits 28 and 29, Your Honor.

THE COURT: They're both received. All right.

(Whereupon Exhibit Nos. 28 and 29 were offered and received into evidence.)

BY MR. BESHORE:

Q. Now, Mr. Tonak, just a few additional questions on -- for your direct testimony. Could you go to Exhibit 29, please.

A. Yes.

Q. Now, I'd like you to just describe and explain each of the -- there's two parts of Exhibit 29 that had been referenced in your testimony, and, perhaps, you could just elaborate on the actual exhibit, then.

A. Exhibit 29, the first page is a reproduction of Exhibit 9, Table 1B with some averages included, and these averages were determined by, as an example, taking AMPI - Jim Falls, Wisconsin, as a selected Upper Midwest Order plant on the upper level -- or upper part, and going down through the list of distributing plants; Dean Foods, Huntley, Foremost Farms, USA, Marigold Foods, Muller-Pinehurst, Swiss Valley Farms, Chicago, Illinois, and those various mileages, 396, 335, 110, 351, 419 and establishing a simple average. The same method was used going across the line. Let's take an example, Dean Foods, Huntley, 396, 245, 103, 477, 241, 118, 184, a simple average of 252 miles. Since these supply plants across the top of that page are located in large production areas for counties in the Upper Midwest Order, and the distributing plants along the side are located in or near the larger consumption areas, this gives an approximation of various locations that milk could be expected to be moved from supply area to consumption area on an average of some mileages that could be determined.

Q. Okay, and the second page of Exhibit 29?

A. The column labeled "Actual PPD" came out of the statistics presented in earlier exhibits. The column labeled "Imputed Class III PPD" is based on the fact that when Class III milk depools, it does not receive a positive PPD or a negative PPD, and as such, the imputed PPD is zero. It indicates on this table that for each month that milk depooled, the imputed PPD was zero. For each month it pooled, it received the Federal Order PPD as appropriate, the average of the actual PPD, and, again, this is a straight mathematical average, was a negative 68 cents, and the Class III would have received 15 and 3/4 cent positive for an 84 cent spread over the course of these months.

Q. So, in essence, you're comparing what the return would be to pool producers supplying at Class I plants, let's say, you're receiving the actual PPD, and producers who were opportunistically pooled or not pooled, depending on the class price relationships, and that's the other column?

A. That is correct.

Q. Now, if you turn to page -- the bottom of page 15, and the top of page 16 of your statement, Exhibit 28, you have proposed corrected language for the language of Proposal 2 as published in the hearing notice; is that correct?

A. That is correct.

Q. Now, is that addressing the question that was posed to Mr. Hollon earlier, if you remember, by Mr. Tosi, I think?

A. I believe that is correct. We are changing it from "qualified plants located outside of the marketing area" to "qualified plants located outside the area described above," which would be the States of North Dakota, South Dakota, Minnesota, Iowa, Illinois, Wisconsin, and the Upper Peninsula of Michigan.

Q. Okay. Now, if you turn to page 11 in Exhibit 28, you've cited there some volumes of milk pooled in December 2003 from Idaho, and the total volume, I gather, was 263 million-plus pounds during that month?

A. That is correct.

Q. Okay. Now, there's been a lot of

testimony, including your own, Mr. Tonak, in this hearing about fees for services and charges for pooling milk from Idaho, and I think you've testified that 10 to 15 cents per hundredweight is not a unheard of fee?

A. That's correct.

Q. If you just use 10 cents to be arithmetically easy, what's the potential revenue stream for handlers who have the ability to charge fees for pooling that milk, the first month?

A. In the month of December, it would have been over $263,000.

Q. And over a yearly period of time, that's -- what would that be?

A. Well, if you took $263,000 times 12, off the top I would say it's somewhere over $3 million.

Q. And that's available to -- under present regulation, that's available to some organizations and not to others, to some producers and not to others?

A. That would be correct.

MR. BESHORE: Okay. Your Honor, with one reservation, I have no other questions for Mr. Tonak. There's one very fine point of technical language in the proposal that we need to have some time to focus on, and I want to have the opportunity to do that when he's done, perhaps, but other than that, I have no other questions on direct.

THE COURT: I'd like just to take a 5-minute recess for everybody to rest just a little bit.

(Recess taken from 4:16 to 4:29 p.m.)

THE COURT: I think we're ready to beginning. Who has questions on cross-examination for the witness?

THE WITNESS: It doesn't look like there are any.

THE COURT: They're just going through their papers carefully. I think Mr. Vetne may have one question. Mr. Vetne?

CROSS-EXAMINATION

BY MR. VETNE:

Q. I'm going to wake up after your reading. John Vetne, for AMPI, etc. Let me enter an additional appearance, on behalf of Family Dairies for the limited purpose of the other part of Proposal No. 2. You and I were together here in Minneapolis as it was in 2001 in a similar hearing, do you recall that?

A. Yes, I do.

Q. And do you recall that in the course of that hearing you said that you didn't see any difference between including Idaho milk on handler reporting and northern Minnesota milk on handler reports, they are the same thing, they move the same way, do you recall that?

A. Yes, I recall making a comment similar to that. I'd say that, you know, you're entitled to at least one error.

Q. All right, and we've had previously in this Marketing Milk Associated Pre-Federal Order Reforms in New Mexico, milk coming from distant areas or pooled at distant locations is not new, it's not something that is exclusively the result of Federal Order Reform, is it?

A. That is correct.

Q. Well, let me give you the opportunity. The difference, if there is one, between your expression in 2001 that northern Minnesota or northern Wisconsin milk and Idaho milk is basically the same for pooling and performance purposes, and now if you had a change of view, I would give you a chance to express it, and tell us why.

A. I think the main change is a thorough review of the Federal Order reform decision and the criteria for the marketing areas, for sharing in the benefit of the market wide pool. When you look at the criteria established in that Decision, it says about a common marketing area, and northern Wisconsin or northern Minnesota may not necessarily deliver milk for fluid use to Rockford, Illinois, anymore than milk from Idaho may do it on an ongoing basis, but they are very tightly linked with the overall marketing area, because of the similarities in the production characteristic, the geographical location in close proximity to Minneapolis, as an example or, you know, the geography would be the main point. They have similar production characteristics and the fact that Idaho by any stretch of the imagination is not part of the common marketing area.

Q. There is now and there will continue to be, if your proposal is adopted, milk produced in Wisconsin and Minnesota and North Dakota and South Dakota that day after day, month after month goes into a manufacturing plant and is never shipped to a distributing plant; correct?

A. That is correct. It's still part of the common marketing area and close to that common marketing area.

Q. It's geographically part of it?

A. Yes, that's our position.

Q. This proposal is geographically based?

A. Partially, yes.

Q. Did you have a chance to look at Dr. Jesse's paper?

A. Not recently.

Q. You read it when it came out last, a couple of months ago?

A. Yes.

Q. Okay. Dr. Jesse didn't read his paper, and I'm grateful for that. He concludes, however, and I'll quote, "With advanced Class I pricing provisions coupled with liberal pooling standards, incentives to depool can be expected to be commonplace. Order changes need to address not only the incentive to depool, but also the Order-related conditions that underlie that incentive." Would it be correct to say that your proposal only attacks the incentive and not the Order-related conditions that create that incentive, or put another way, the symptom and not the cause?

A. That's definitely one interpretation. When Dr. Jesse says, and perhaps to use his words, the underlying causes, or however he words it, I don't believe he necessarily elicited the whole range of conditions in that concluding paragraph.

Q. No. He's got 15 pages preceding that, concluding the paragraph. Did you, either your company individually or your group collectively, entertain to make the Class I price more in sync with the Class III price as a solution?

A. In one of the meetings we had in December of 2003, we discussed a number of issues amongst a group of Federal Order 30 handlers, or I should actually say Federal Order 30 cooperatives, and the subject of Class I pricing, use of the CME as a driver for making changes in the entire Order structure, all of these things came up, but we were focussed on the hearing and Federal Order 30. We were not, and I was not, ready, nor willing to attempt to make changes on a national level, which we felt would be necessary to change the pricing provisions of the Order.

Q. Okay. Would it be correct to say that your request to -- strike that. Let me preface that. Depooling is a practice that occurs in almost every market, or did occur in almost every market last spring; correct?

A. In recent times I've pretty much only been associated with Order 30, so I really don't know.

I would assume there was some other markets where depooling took place.

Q. All right. You don't, in the course of your ordinary work, observe what's happening in other markets?

A. I observe it, but --

Q. You don't remember it?

A. I don't remember it.

Q. All right. Did you, in advancing, you as your organization individually or your group collectively, in advancing this proposal to address depooling only in Order 30 as opposed to other markets in which depooling also occurs, believe that USDA would not entertain a national hearing on this issue and generally have a disinclination to hear things on a national basis on any issue?

A. I personally, nor our group, never discussed anything as far as the inclinations of USDA on a national hearing.

Q. Okay, and you don't have a personal belief?

A. I don't have a personal belief on it.

Q. Okay. Do you -- Let me ask you this. Let's say Order 32 went first, all right, and there was a hearing just there to discourage repooling, would that concern you as far as the response of marketers on that depooled milk associated with Order 30?

A. I'm not sure how concerned I would be. It would probably be like a lot of things. If you have a hearing early on, let's use the 2001 hearing when only two months of Idaho information was available, you might have a conclusion that's different than you have when more information becomes available. My assumption would be that there's a possibility that more milk that is located in Minnesota and Wisconsin that occasionally delivers to the Order 32 areas, but predominately delivers to cheese plants and so on in Order 30, may end up pooling back on Order 30.

Q. And vice versa, if milk in Order 32 were the effective market and milk was being depooled, there'd be no restrictions on that milk being associated with Order 30?

A. I believe that would be correct.

Q. And Order 30 does intend to be the dumping ground for the milk that can't find a home anywhere else; correct?

A. In your words, not mine.

Q. Do you agree with my words?

A. I wouldn't characterize it in that fashion, but there's a lot of milk that ends up on Order 30 that sometimes pools elsewhere.

Q. It does tend to become the pooling home for milk that can't find a pooling home elsewhere?

A. That has happened.

Q. Which -- That is happening now with respect to the Idaho milk, I mean --

A. That's correct.

Q. -- that's part of the thing you're complaining about; correct?

A. That is correct.

Q. How much of the Idaho milk are you responsible for pooling?

A. It varies from month to month, depending on if Class III is pooling or if Class IV is pooling or if both classes are pooling.

Q. Is there a predominant use of the milk that you're pooling from Idaho?

A. The milk that we would pool is generally fairly well split, I would think, between Class III and Class IV.

Q. Is there an organization for which you're predominantly pooling?

A. We pool the milk of both proprietary

and cooperative plants, and in some cases the cooperative plants have other than cooperative members, and so by organization are you referring to cooperative affiliation or payroll affiliation? What do you mean by organization, I guess is my question.

Q. The handler or cooperative. Handler or cooperative.

A. Okay. Cooperatives would be Northwest Dairy Association and members of the Manitowoc Milk Producers Cooperative.

Q. You testified that pooling fees are not shared uniformly across the market. Is that not also the case for pooling fees that are paid within the Upper Midwest Marketing Area such as the 16 cents to CMPC?

A. I'm not sure how the CMPC pooling fees are gathered or paid on a definitive basis. We are a member of the CMPC system, and we have committed to ship over 10 percent of our producer milk to fluid use, and as a result, we don't pay any fee, and from time to time we may receive a check for a couple hundred dollars or so on that.

Q. Whatever those fees are, I mean, whatever is done with that 16 cents, for example, for the person who is paying to have his milk pooled, it's not shared with non-CMPC folks?

A. I don't believe it's shared outside of the CMPC pool system.

Q. So for that pooling fee money, it's like the Idaho money, it's not shared uniformly across the market?

A. To the extent that there's any money generated. I think one of the things we need to keep in mind about that CMPC pool system or supply plant system is that by design it encourages supply plants to ship milk to the fluid market on an ongoing basis, especially in the fall when milk is short, and thereby share in the market wide pool.

Q. You testified, I believe, that buyers of Class I milk made some payments to offset negative PPD's. Do you recall that? I was looking for it.

A. I'm trying to recall which -- I don't know if you're talking about making up the negative PPD that Mid-West did, is that what you're talking about?

Q. Looking at page 21, I found it here. The bottom of page 21, "CMPC and UMMA put the increased service charge in place, negative PPD surcharge." Could you explain a little bit more what that was, and how much it was?

A. In May 2004 the announced CMPC price increased dramatically. We buy a little bit of supplemental milk from some plants that have a membership, a cooperative membership associated with CMPC, so we saw a big price increase on some of that milk we purchased in May, and what we were told is that it was primarily to make up the negative PPD, and I believe it was $1.50.

Q. In May?

A. Yes.

Q. For April milk, or?

A. I don't think that was specified. It's just a big increase. That's why I don't think it's sustainable long-term, because there's too many questions about it, such as you have.

Q. So you don't know what month you were paying that $1.50 for?

A. No, we were paying it for milk delivered to us in May from CMPC members.

Q. And an explanation was that somebody had to make up that negative PPD?

A. Yes.

Q. Even though there would have been a negative PPD if all Class III milk had depooled? You bought the notion that a negative PPD represents a loss?

A. When you purchase milk from CMPC, they preannounce the price. When you order a load from a CMPC member, you pay that price. Like it or not, you pay that price. If there's -- whatever the reasons are. Whatever the philosophy of making up or not making up or buying into a notion, you buy a load from CMPC, you pay the CMPC price.

Q. And so this was simply a price that was announced?

A. Correct.

Q. In the beginning of the month or the middle of the month?

A. The CMPC price for May was announced late in April.

Q. And included that negative PPD surcharge?

A. That is correct. I should note that it's not noted as a negative PPD surcharge on the CMPC invoice, it's just folded into their overall pricing. What I was told is that there was $1.50 increase to make up negative PPD's.

Q. Whoever puts together that pricing quote might be hired as a consultant on writing producer checks. Let me ask you this. You got a call from a cheese plant in April, mid-April of 2004?

A. Yes.

Q. Offering to sell milk?

A. Yes.

Q. And the people that called you had no clue that a negative PPD was coming up?

A. Well, that was surprising to me also, because the price they quoted me was a very attractive price.

Q. Okay. When -- As part of your job, do you look at market indicators to predict or project PPD and classified prices?

A. Yes.

Q. You do. Did you, during March, predict what was going to happen in April?

A. I would think I probably did not. I am not a very accurate price projector.

Q. What do you look at to make those estimates?

A. Trends in the cash market.

Q. On the --

A. On the CME.

Q. -- CME?

A. Trends in the NASS prices for cheese, butter, nonfat dry milk, dry whey. Take into account a little bit of what are the milk production trends, then just plug your assumptions of where the prices will be into a spreadsheet using the formulas in the Federal Order and see what number is generated.

Q. Does the Mid-West contract to any other -- to an expert consultant for purposes of assisting the price projections?

A. No.

Q. Do you know that there are those available?

A. Mid-West ships approximately 90 percent of our producer member milk to fluid use, and so it's difficult for us to gain much price protection, if you will, in our view, through contracting.

Q. Okay. Does the fact that Mid-West ships 90 percent to fluid -- that delivers to a fluid plant; right?

A. That is correct.

Q. Regardless of how the plant uses it?

A. That is correct.

Q. Does the fact that you ship about 90 percent permit you to assist in the pooling of nine times that for somebody else?

A. Yes, as it would anybody else.

Q. And would it be correct to say that you do assist others, both within the Upper Midwest and outside, to take maximum advantage of your access to the fluid market?

A. Yes. I mean, I could give you two examples. June we pooled some milk from Grassland Dairy Products. We purchased milk for fluid use from Grassland as a supplemental supply. Our purchases in the month of June were down below our normal projections, and as a result, we ended up pooling some of their milk. In July, we received a call from Stockton Cheese wondering if we could assist them in pooling some milk, and we said, yeah, and we buy and sell milk to Stockton on an ongoing basis. We balance some of our weekend milk with Stockton, and so it's just part of being a good neighbor, if you will, in the area, trying to work with those that work with us.

Q. What is your prevailing charge to accommodating the pooling of milk of others?

A. The case of Stockton and Grassland there is no charge. We just did it because we are nice guys.

Q. After we get done, I'll tell you a story, but I'm not asking the last question. Thank you.

THE COURT: Mr. English?

CROSS-EXAMINATION

BY MR. ENGLISH:

Q. Mr. Tonak, Charles English for Dean Foods.

A. Hello.

Q. You were asked a number of questions by Mr. Vetne about what you did, you know, in advance of April, and could you in March know how much milk was going to be depooled on the Order for April?

A. No. I would add one other thing. Even if we knew how much, it would not have made a difference. We've got a long-term commitment to supply the fluid market. It's a commitment we value, and no matter what our price projections are, we're going to supply the fluid market.

Q. Could you know what the negative PPD was actually going to be announced by the Market Administrator in May for April back in March?

A. No. If we would have, we probably would have found a way out of your long-term commitment.

THE COURT: Nice guys that you are.

THE WITNESS: Nice guys that we are.

BY MR. ENGLISH:

Q. In fact, in addition to the paper and discussion with Dr. Jesse, isn't it true that negative PPD's happen because of other factors, other than advanced pricing?

A. Yes.

Q. And part of that is the spread between the Class III and the Class IV?

A. That is correct.

Q. And, in fact, that's been happening in this market?

A. That is correct.

Q. And, in fact, Dr. Jesse, when he addressed the issue of advanced pricing specifically in his paper said that you would have to also tie it strictly to Class III, which means you would have to get rid of the higher up pricing that USDA implements as part of Federal Order Reform of 2000; correct? That's what he says in his statement.

A. If that's what he says, that would be correct. I haven't read it recently.

Q. And if that's what he says, you're not only taking on a national issue for pricing, but you're taking on a national issue of the higher up; correct?

A. That is correct.

Q. These issues of advanced pricing seems

to ignore the fact that isn't advanced pricing also an incentive to repool, for instance, in June of 2004?
A. Yes. There's months that because of advanced pricing there's a large spread created between Class I and Class III and a large PPD.
Q. And, in fact, over time isn't it the case that with advance pricing, if all the milk were pooled, you would end up with that full value, that $1.80 from the Class I being spread over the pool?
A. That's correct.
Q. And, in fact, Class I processors or the milk that you distribute to Class I plants in honoring your long-term commitments must be pooled; correct?
A. Yes.
Q. And one of the small favors in return for having to be pooled for Class I is you get advanced pricing; correct?
A. That's what we are told, it is a favor for having to do that.
Q. When it actually turns out to be advanced, and it turns out it's not always advanced because of the negative PPD; correct?
A. That is correct.
Q. But that's the intent of the Order; correct?

A. That is right.
Q. In your statement on page 5 you said, "Additionally, it was very rare for a producer to ship more than the equivalent of one-day's production to Rockford." It's near the bottom of the page.
A. Yes.
Q. You were referring to Idaho milk in that case?
A. That is correct.
Q. So, for instance, if you had a requirement that there be a two-day shipment every month, that would be another way of dealing with distant milk; correct?
A. It would be a method of dealing with distant milk. I'm not sure that everyone in the Upper Midwest would like a two-day shipment requirement or touch base.
Q. But it would be one way of making sure that people are actually performing?
A. That is, yes.
Q. And there's been a lot of discussion in this hearing about performance; correct?
A. Yes.
Q. And, in fact, you actually perform?
A. Yes.

Q. On page 12 you state, "In fact, only .2 percent of the Idaho milk has ever delivered to a pool plant, and of that, less than one-third touched a fluid plant directly." Is that by way of saying that two-thirds of that .2 percent of Idaho milk was delivered to a pool supply plant rather than a pool distributing plant?

A. Yes.

Q. And then the pool supply plant would meet its 10 percent requirement with local milk; correct?

A. I'm not sure how the pool supply plant actually did meet its local requirement -- or its 10 percent requirement, but that's definitely one way to do it is with the local milk.

Q. And if Idaho milk did it in that circumstance, it was by coincidence that it went into the supply plant and it was pumped back out in a tanker that headed down to a pool distributing plant --

A. That is true.

Q. -- correct?

A. That is true.

Q. And on page 18, under depooling and repooling, you have the statement, "During the same time period the Class I value exceeded the Class III value in all but three months. Those were three of the seven months of negative PPD's occurring since July of 2003." Is that by way of saying that the other four months of negative PPD's occurring since July of 2003 were because of the Class III/Class IV price spread?

A. Yes, and the Class II, or possibly the Class II/Class III price spread.

Q. The bottom line, those four months didn't have to deal with advanced pricing for Class I?

A. There was a group of months that the Class I price was higher than the Class III price, and there was a negative PPD.

Q. So Class I was still contributing to the PPD in those cases?

A. Yes.

Q. You referenced on page 20, "One cooperative that supplies fluid plants and Class II and III markets did not pay the negative PPD, but reduced component prices below Federal Order Values" --

A. Excuse me. I may have made an incorrect response on your Class I and Class III.

Q. Okay. All right. Let's go back, then.

A. So if we could, I would like to go back on that, and this is referencing Exhibit 9, Table 11A and 11B. And under Table 11A, titled "Net Class I Contribution to the Producer Price Differential" there are three months, July and August of 2003 and April of 2004 that the net Class I contribution to the producer price differential was negative, which means the Class I contribution was under the Class III component values. Table 11B, which is the contribution -- or the "Net Class I Obligation to the Pool," or the difference between what the producers received as a PPD and what was paid into the pool by the Class I every month shows a positive contribution of the Class I compared to the PPD. When we go to PPD's being negative and if advanced pricing or whatever influences the negative PPD, out of the seven months of negative PPD, there are at least three months where the Class I price was higher than the Class III price.

Q. Okay.

A. And maybe that didn't clarify it, but technically it --

Q. But nonetheless, in the end there was never a month in which a Class I handler drew from the pool, was there?

A. That is correct.

Q. As a total. Class I, as a total --
A. On the Class I portion of the milk.
Q. Yeah, that's right. Going to your statement on page 20 that "One cooperative that supplies fluid plants and Class II and III markets did not pay a negative PPD, but reduced component prices below Federal Order values." Were there any consequences for that cooperative in the marketplace?
A. They lost some producers. At least that's what I've been told by them.
Q. Would you view losing producers under those circumstances as a disorderly marketing condition?
A. Yes. It's a little disorderly for them. When I lose a producer, it's greatly disorderly for me.
Q. And to the extent a Class I plant has any Class III usage, although I looked at the Order, and I'm not sure what that would be, because obviously for one of these months, Class III is above Class IV, so there's not shrinkage; right? To the extent a Class I plant would have Class III usage, it doesn't have the option of depooling that Class III milk; correct?
A. That is correct.

Q. So unlike its competitors with Class III, it's going to pay the full Order value into the pool on the Class III?

A. That is correct.

Q. You also referenced the entity, and Mr. Vetne discussed at least part of it with you more, but I think the more interesting part was not discussed, the entity that called you up regarding a sale in April and you told them about the negative PPD, and there's the reference that they had to cancel an offer made to deliver milk to another fluid plant.

A. Yes.

Q. Do you know who picked up that cancellation, or was it picked up?

A. I'm not sure I understand your question. Are you asking me who that offer was made to?

Q. No, I'm not, actually. What I'm asking is if the statement said they had to cancel an offer made to deliver milk to another fluid milk plant, do you know whether that offer to deliver milk to another fluid plant was actually cancelled, based upon your knowledge in the marketplace?

A. I believe it was.

Q. And then the next question is, if it

was cancelled, did the fluid milk plant simply not get the milk, or did they get it from someone else, like yourself?

A. That fluid milk plant didn't get the milk from us, but I believe they procured it from somebody else.

Q. And that someone else, in order to deliver that milk to the fluid plant, had to pool that milk and lose more on the PPD for that month as a result?

A. That would be correct.

Q. Now, last year July was a month with negative PPD's; correct?

A. Yes.

Q. And milk was depooled?

A. Yes.

Q. And yet your Proposal 2 would permit in a future month like that, which we know now has happened in July, for entities to depool milk in July and come on in August with no penalty whatsoever; correct?

A. Yes, that is correct.

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

THE COURT: Any other questions? Mr.

Vetne? I'm sorry, Ms. Deskins?

CROSS-EXAMINATION

BY MS. DESKINS:

Q. Mr. Tonak, I have a couple of questions for you. Okay, on page 23 of your testimony, you have "Milk pooled would be limited to 125 percent of the previous month's pooled volume with a few exceptions." I'm just trying to understand how Proposal 2 would work. Let's say I pool my milk continuously through February of 2004. If I don't pool it in March of 2004, and I want to pool it again in April, what percentage of my milk could I pool?

A. If you did not pool any milk in March of 2004, you would not be able to pool any milk in April 2004, except for the milk that you delivered directly to a pool distributing plant.

Q. Okay.

A. In other words, a bottling plant.

Q. Okay. So let's say I deliver continuously through February 2004, and I don't pool for March, April, May, and I want to pool in June, what do I do? I just can't pool it?

A. That is correct. You can't pool it unless, except that you can pool the milk that you delivered to a fluid distributing or a bottling plant.

Q. Is there any way for me to get back into the system so I can start pooling again once I depool?

A. Yes, and here again, one method is to deliver milk to the fluid plant and then work from there with the 125 percent. The other method is wait until August and return all the milk that you want to the pool.

Q. Okay, so if I, let's say I stop pooling in March, April, May, I really would have to wait until August and then I could get back into the system again?

A. That is correct.

MS. DESKINS: Okay. That's all the questions I have for you. Thank you.

THE COURT: Other questions? Yes, I thought you had a question.

MS. WARLICK: Yeah, I have a couple of questions.

THE COURT: Bring that microphone close to you.

CROSS-EXAMINATION

BY MS. WARLICK:

Q. Okay. Mr. Tonak, Carol Warlick with Dairy Programs. I have a question on small business.

Does your business qualify as a small business regarding fewer than 500 employees?

A. Yes. We have a lot less than 500 employees.

Q. Okay, and regarding the dairy farms that supply the milk, would they be less than $750,000 of gross revenue?

A. There are a few of our dairy farmer members that are approaching or may exceed the $750,000 gross revenue, but over 90 percent, in my estimation, would be under that limitation.

Q. Okay. On page 24 of your exhibit, you discuss in the first paragraph an additional safeguard where March has 135 percent limit, and then you say why it's important to allow room for a handler to grow their business volume, but why -- I don't understand why you picked March?

A. If you would, and it will take me a minute to find it, it's Exhibit --

Q. Oh, 24?

A. -- 9 --

Q. Oh, in the exhibits.

A. Table 9, is possibly the easiest way to see this, and if we look at March as an example of 2002, or March of 2003, and this is under the Upper

Midwest Order, but from February to March, March pooled milk was 113 percent above the February volume, and in 2003, the March pooled milk was 112 percent above the February volume. If we go to table 10, and the reason we looked at this in a couple of different ways, is because of the impacts of depooling and pooling/repooling, but Table 10 is the combined Minnesota and Wisconsin milk production, and that would include both depooled and pooled milk, and we can see that from February to March, there's 108.4 percent, 111 percent in 2001, 111, almost 112, in 2002, and so on. This is primarily a function of two things, February normally has 28 days, once in awhile 29 days, whereas March has --

Q. -- 31.

A. -- 31. I'm not an expert on the calendar, and so there's more days for more production. Additionally, there's generally a production increase on a daily basis from February to March or April, somewhere in the spring the production starts to increase as a normal function of the dairy production, and so when we looked at these numbers, normally there's somewhere around 100/105 percent or less than 100 percent, you add 20 percent to it, and that's 125 percent, and I'll tell you, the 20 percent addition was kind of a give-and-take discussion among the participants, but when we looked at March coming off of February, there was not that 20 percent allowance, and so it was increased to 135 percent to give that additional room for changes in a handler's operation.

Q. Okay. Thank you, and I just have two other clarifications. When in your Order language, Section 1030.13, producer milk, part (f)(2), when you talk about continuously pooled on any Federal Order, does this mean the same Federal Order, or can it be a combination of Orders, like two months for one Order and four months for another one?

A. It can be any combination of Orders, as long as the milk is continuously pooled, except for the loss of a Grade A status for a short period of time.

Q. And regarding this loss of Grade A status, if you lose the Grade A status, let's say for a week, and then -- in the middle of a month, and then you pool it again, would you be considered -- would it be considered continuously pooled --

A. Yes.

Q. -- for you to pool it again?

A. Yes.

MS. WARLICK: Okay. Those are all my questions. Thank you.

THE COURT: All right. Yes, Mr. Vetne?

RECROSS-EXAMINATION

BY MR. VETNE:

Q. Would you turn, please, to page -- can you turn, please, with me, to page 23 of your statement, and the second full paragraph, in the first sentence you observe that for the eleven months, if 100 percent of the milk had been pooled, the PPD would have been a minus 0.98 cents. The next sentence you say, if 50 percent of the milk had been -- the Class III milk had been pooled, the PPD would have been positive .289 cents. Now, does that seem intuitively that a positive PPD for half of the Class III milk is wrong? I did the arithmetic, and it comes up to minus 20.2 cents, and I don't want the Secretary here to make a decision based on a conclusion that 20 cents would have been positive in this scenario if you somehow pooled half the milk. It might have been better than pooling all of it.

A. You raise an interesting mathematical question.

Q. Well, do you want to just do the calculations, you know, later on?

A. And I have to try to --

THE COURT: You'll be back tomorrow morning, so if you want to do them overnight.

THE WITNESS: -- find where my spreadsheet came up with an error.

BY MR. VETNE:

Q. Yeah. I would suggest that you just check the arithmetic for the last three calculations in that paragraph. I did want to ask you about the part of the proposal that says, "Milk shipped to and physically received at a pooled contributing plant shall not be subject to the 125/135 limitation."

THE COURT: You lost the mic again.

MR. VETNE: Can you hear me now?

BY MR. VETNE:

Q. The part of the proposal that refers to -- that exempts milk received at pool distributing plants from the depool incentives. I'm not sure you talked about that, but I do want to ask about it, see if I understand it, first of all. If somebody depools a block of milk, his block of milk in one month, and in the following month there's an incentive to come on, if they could come to terms with your organization and trade milk delivered to your distributing plant and you deliver to their cheese plants, they can get it all repooled in the seconds month; right?

A. No. Under number 4 of our proposal, it says "A block of milk may be considered ineligible for pooling if the Market Administrator determines that handlers altered the reporting of such milk for the purpose of evading the provisions of this paragraph," and maybe the wording of that section 4 is not the best, but the intent is to give the Market Administrator the authority to look at a situation where there is a milk swap and determine that somebody's trying to evade the provisions of the act and declare some of the milk ineligible for pooling.

Q. Well, an organization, and this is for illustration purposes only, that makes a deal with your company to transport its milk to a distributing plant and receive transported milk from your company to their cheese plant, isn't simply altering the report, they're altering the way they're handling and delivering the milk, so section 4 really doesn't speak to that.

A. That's why I'm glad you raised it, because it doesn't really speak to it the way we intended it to do, and so the Secretary, provided they find for us, would have to alter that language to reflect our intent.

Q. I see. Well, in that case, why is Subsection (1) in there at all? What did you intend to capture if not to waive or exempt deliveries to pool distributing plants?

A. Just in the normal course of things, if a plant has a need to deliver some milk or if there was a marketplace need for some milk, and let's give an example, August you can pool milk to any extent you want, for whatever reason you decide not to pool, that leaves you in September not able to pool. September is a month that we normally need milk, added milk for the fluid market in relationship to the supply that is available, as is October and November.

Now, we were not going to penalize somebody that shipped a few loads of milk to the fluids market in those months when there was a need for it in the fluid market if they had not pooled the milk in the prior month. In other words, they could pool what they shipped to the fluid market.

Q. That would be part of the 125 or 135 percent?

A. Not if they had depooled entirely in the prior month. It would start to build them for the 125 percent if they shipped 100,000 to fluid market in September they could pool 125,000 in October and so on.

Q. So you envision the Market Administrator, then, applying a different standard for milk attempting to come onto the pool if it comes into a distributing plant, than if it comes into a supply plant or is diverted?

A. I would not say a different standard, necessarily. It's just easier for account -- to account for that milk on the pool reporting. I think none of us like to see milk that delivers to a distributing plant not eligible to be pooled.

Q. So in the first instance, at least, milk coming into a distributing plant, regardless of how much was depooled before, would be qualified and pooled?

A. Milk delivered to a distributing plant would be pooled.

Q. And if the Market Administrator, then, down the road, in the course of an audit comes to believe that, you know, maybe there was some undue swapping going on to avoid the 125/135 repool limitation, an audit adjustment would be made for that past period?

A. That would be correct.

Q. And it's not a determination he can

make when he receives a report; correct?

A. Well, it may depend on how obvious the swap is. If I swap milk with a cheese plant, and I'm pooling their milk, it might look a little odd if I ship all of my member producer milk to them and they ship all their producer milk to me, and that would be a fairly easy determination to make, I think, at pool time.

Q. Do you envision the Market Administrator creating some sort of procedure whereby he may make factual determinations and hear, perhaps, conflicting facts by folks who want to pool or don't want milk pooled?

A. He may decide to go in that direction. We discussed with the Market Administrator his ability in regards to some of these provisions. He thought, with some guidelines developed internally, they would be able to fairly and equitably enforce the provisions. Now, if there's some question about it, we can just take some of those parts out, as far as shipments to the distributing plant to regain access. It does not create us any particular heartburn within our group. We were just trying to accommodate those that depooled.

Q. With respect to a waiver for a chain

supply condition, again, it's a factual determination made by the Market Administrator; correct?

A. Yes.

Q. And you don't have any guidelines now, but you hope some will be developed post-hearing for applying that provision?

A. I think the Market Administrator has some guidelines now that apply to plant operations incase of a fire, natural disaster, work stoppage, strikes, these sort of things, and I would imagine that something fairly similar could be developed. The Market Administrator felt that they would be able to work within their normal course of action and have some guidelines to operate under that would be fair and equitable to all, and we weren't prepared to start debating section, line, and verse, if you will, of some guidelines to allow these couple of provisions to operate.

Q. Okay. Whatever those guidelines might end up to be, do you envision the Market Administrator making some kind of adjudication, like a judge, like an administrative law judge deciding what the facts are, and saying that these are the facts presented on this side or not? Do you envision any procedure whatsoever in which an effective handler may be able to present or contest evidence which may have resulted in an adverse decision?

A. I think the Market Administrator does that right now in other incidents, and I don't see why he would do things any differently under this provision.

Q. And what other circumstances does the Market Administrator do that you would like him to ambulate for this purpose?

A. Just as an example, making a determination if milk actually is eligible to be pooled. There's a situation involving Idaho milk where the paperwork that we, at Mid-West, initially saw, and the paperwork that the Market Administrator initially saw, indicated that the milk had delivered directly from farms in Idaho to pool plants in the Order 30 area. In subsequent audit of those records it was discovered that the paperwork may not have been entirely accurate, and upon further review, the Market Administrator and his staff made a decision to remove the associated milk from the pool and make a determination, obviously, that it was not eligible to be pooled, make corresponding audit adjustments, and it went back over a few months. I don't know if that gives you any indication, but it's the same basic premise. You review the information, you make a determination.

Q. So basically whatever procedure the Market Administrator now uses for audits of plants, auditors go out, they ask questions, they come back, and you get a letter?

A. It's no that simple in all cases. I mean, some of that, as in this case, there had to be a determination made, which set of documents was the correct set, which -- what actually did happen, what was the intent. I mean, it's relatively simple to depool a producer's milk, because it never touched base, it showed up in the pool. You discover on audit that it doesn't touch base. It's relatively simple. If a supply plant doesn't meet the 10 percent shipping requirement to depool the milk, some of these others call some judgment into place.

And I've had confidence over the years that generally the Market Administrator's staff throughout the country have made the right decision, and when they don't, you argue with them until you wear yourself out or wear them out.

Q. Do you, or does anybody from your coalition plan to present testimony responsive to Proposal 6, for a multiple day touch base and reduced aversions?

A. At this time, our group is concluding -- well, whenever I get done, will conclude their testimony.

Q. Okay. Have you ever experienced a producer being depooled involuntarily, that is by audit action of the Market Administrator of where the Market Administrator does not believe that what was received was a full day's production?

A. I can think of one producer, and, again, it's an Idaho producer, but he looked at it, he made a determination it wasn't a full day's production.

Q. Has your cooperative or anybody else you're pooling for?

A. That's the only case I can think of.

Q. Are you aware, that nevertheless that for a number of reasons the volume of milk produced by individual dairy farmers can vary greatly from -- within a month, from day-to-day?

A. Yes.

Q. So that if milk is received on a day that that producer has, maybe, more than usual cows out of production and is way below the average for the month, questions may arise on audit whether that producer has legitimately delivered the requisite number of days of production or the equivalent of two day's production on a monthly average basis?

A. Any time there's wide variations in milk production over the course of a month, questions can arise of what is one day's production, what is a representative two day's production?

Q. Would you practice caution if the touch-base requirement were increased, so as to receive, perhaps, a little bit more than necessary to make sure that milk isn't depooled as a result of something like that?

A. That's generally my recommendation to people is deliver a little bit more than the bear minimum, and it's relatively simple to sit down and look at the prior month's production and divide it out by the number of days in the month, and make the determination that's all we need to deliver. It does not create that big of a problem for most producers to deliver a little bit of additional.

MR. VETNE: Yeah. Okay. Thank you.

THE COURT: Any other questions? Yes, sir, Mr. Lamers. Come forward.

CROSS-EXAMINATION

BY MR. LAMERS:

Q. I'll try and be real quick here, Mr. Tonak.

A. Thank you.

Q. Obviously in your experience, you must have had a lot of experience in the procurement of producer milk?

A. That would be correct.

Q. Yes, and how much would it take for a producer to switch from one plant to another?

THE COURT: Under Order 30, are you talking about?

BY MR. LAMERS:

Q. Order 30, any Order, yeah.

A. Our experience is -- or my experience over the years is that the Order regulations have very little bearing on producers switching from one plant to another. Generally, it's been the requirements of the Health Department to make sure the proper paperwork and transfer, etc, is taken care of, and it's also been my experience that a lot of producers are cooperative members, and as such they have a marketing agreement with that cooperative that calls for them to perform to a certain period of time, and if they wish to terminate that marketing agreement, to do so with a certain notice and a legal manner, and this have been my experience, there's more of the criteria that determine how long it takes to switch a producer, and the time varies widely depending on the exact situation and location.

Q. And I expect that the reason they want to terminate and go to another plant is because they feel they have more dollars available in a competing plant?

A. That's a lot of times the case.

Q. Yeah, and so would that be 10 cent a hundred, 20 cents a hundredweight, or?

A. I've seen producers switch for a nickel, and I've seen producers that wouldn't switch for a dollar.

Q. Yes. Well, that's true. Some producers are very loyal, and they want, even if there is a difference in the price. Now, while all of this -- the work we've got going on here now in this hearing is all for the purpose of who are going to get the dollars out of the pool in excess of what the blend price is, is that not correct?

A. In my mind, it's who we're going to share those pool dollars with, is what's going on here. Now, that may be the same thing as what you said, I'm just not clear.

Q. Right, and Orders do not pay any pool moneys to any producers, they pay them directly to the handlers?

A. I believe that would be correct.

Q. Okay, so all righty. And then we also have the situation with price inversion, where the cheese market having a higher than the Class I price does not want to contribute to the pool, they do not want to share the dollars, so they depool their milk, am I reading that correct?

A. Yes.

Q. Okay, and then you say in your paper on Page 2, starting Page 2, "The discussions when the negative PPD's hit producers' mailboxes were about milk jumping out of the pool and leaving others holding the bag, about equity and fairness, and about a level playing field, and about government regulations that allow this to happen," that is what you have quoted in your statement?

A. Yes.

Q. And then back on page 1 you talk about "Federal Orders are economically proven marketing tools for dairy farmers. Without them, farmers' livelihood would be much worse." How could it get any worse?

A. I think that the simple explanation of that is to turn to table, and let me find it here, either Table 11A or 11B in Exhibit 9, and I'll just start reading some numbers here off of 11B. "Net Class I obligation to the pool, January, $6,959,174, February $8,141,849, and it goes on to November 2000, $14,435,772, December $12,983,895. I don't trust my math skills anymore, but I think there's somewhere around $75 million in that one year alone that the Class I price contributed to the pool. When you ask me how could it get worse, one answer may be, we do away with classified pricing, and we do away with Orders, and that $75 million, or whatever the correct total is, may simply disappear, and that would be worse.

Q. Well, except to the fact that if the price is lower to producers, then they will produce more milk, and then the price -- or they produce less milk, and the price comes up, supply and demand. The cheese market moves the price right back up, and higher now than it's been in a long time, actually. Supply and demand cheese price is what moves the market, does it not?

A. There's no doubt about it that supply and demand, milk production, dairy product consumption moves the market. My point is that the Class I price enhances, adds to whatever that income level is, and without Federal Orderers we lose that added income.

Q. Are you familiar with the fact that increased Class I price is forcing consumers who buy the milk to pay more money, and it's reduced consumption?

A. Yes, I am, and as with everything, there's -- you have to consider reasonableness, both on the high price and on the low end.

MR. LAMERS: That is correct. It all has to be considered. Thank you very much.

THE COURT: Mr. English?

RECROSS-EXAMINATION

BY MR. ENGLISH:

Q. Mr. Tonak, Charles English for Dean Foods. Going to some of the technical questions asked by Mr. Vetne about your proposal. First, with respect to the Provision 3, the Market Administrator may waive 125/135 percent limitation. The first category is a very specific item for a new handler in the Order; correct?

A. That is correct.

Q. And I take it you would be thinking the Market Administrator would be able to look at whether it's truly a new handler or an old handler who has just changed their name; correct?

A. I would think he could determine that.

Q. For the next one, item two, under (3), for an existing handler who significantly changed milk supply conditions due to unusual circumstances. I think you referenced, without the actual section, a provision that's already in the Order, and that is under (i), 30.7(i), which refers to unavoidable circumstances determined by the Market Administrator to be beyond the control of the handler operating the plant, such as a natural disaster, ice storm, wind storm, fluid, fire, breakdown of equipment, or work stoppage. Would you think that's the kind of language that you might be thinking about with respect to applying that term?

A. Those would be the type of things we're looking at, or I think we spell out some merger acquisition type terms in there also.

Q. Now, going to the comment that -- and ironically Mr. Vetne asked the question how do you get back on the pool yesterday of some witness, and one way is to make a shipment to a pool distributing plant, which is allegedly the most lucrative provision and the whole purpose of the Order; correct?

A. That is correct.

Q. So part of the purpose of having that No. 1 in there, is to encourage people to make shipments to the pool distributing plants when they need the milk?

A. That would be correct.

Q. And if you didn't have that provision in there, you'd have an ironic circumstance that a pool distributing plant would want milk, but if they took that milk in, it wouldn't be producer milk, it would be other source milk, and be allocated; correct?

A. That is correct.

Q. So you create a disincentive to ship the milk to the pool distributing plant where you want it?

A. That would be correct.

MR. ENGLISH: Thank you.

THE COURT: Any other questions? You're just going to be back tomorrow, so we're not going to say you're excused, sir, so we're going to now, I guess, adjourn until nine o'clock tomorrow. Anything else we can do this evening? You want to make it 8:30?

MR. ENGLISH: Yes.

THE COURT: Let's make it 8:30.

(Whereupon, the Federal Order 30 Hearing was adjourned at 5:48 p.m.)

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STATE OF MINNESOTA :
: CERTIFICATE
COUNTY OF HENNEPIN :

BE IT KNOWN, that I, Kelly E. Hanna, Court Reporter, took the foregoing Federal Order 30 Hearing;

That the witnesses, before testifying, were by the Court first duly sworn to testify the whole truth and nothing but the truth relative to said cause;

That the testimony of said witnesses were recorded in shorthand by me and were reduced to typewriting under my direction;

That the foregoing Federal Order 30 Hearing is a true record of the testimony given by said witnesses;

That I am not related to any of the parties hereto, nor an employee of them, nor interested in the outcome of the action;

That the cost of the original has been charged to the party who noticed the Federal Order 30 Hearing, and that all parties who ordered copies have been charged at the same rate for such copies;

WITNESS MY HAND AND SEAL this 31st day of August, 2004.

Kelly E. Hanna, Court Reporter,
Notary Public