USDA - FEDERAL MILK ORDER HEARING

Sheraton Hotel Station Square
300 West Station Square Drive
Grand Station Ballroom I
Pittsburgh, PA 15219

Thursday, December 14, 2006
8:45 a.m.

BEFORE: VICTOR W. PALMER
U.S. ADMINISTRATIVE LAW JUDGE

TRANSCRIPT OF PROCEEDINGS

VOLUME IV

Reported by:

Vivian D. Macurak
Court Reporter

APPEARANCES:

U.S. Department of Agriculture:	Office of the General Counsel by Garret B. Stevens, Deputy Assistant General Counsel, and William Richmond
U.S. Department of Agricultural Marketing Specialists:	Gino M. Tosi Jill Hoover
Dairymens Marketing Cooperative Association, Inc., Dairy Farmers of America, and Association of Dairy Cooperatives in the Northeast:	Marvin Beshore, Esq.
Select Milk Producers, Inc., Continental Dairy Products, Inc., and Dairy Producers New Mexico:	Yale Law Firm by Benjamin F. Yale, Esq., and Kristine H. Reed, Esq.
O-AT-KA Milk Products Corp.:	Upstate Niagara Cooperative, Inc. by Timothy R. Harner, General Counsel
National Milk Producers Federation:	Roger Cryan, Ph.D., and Kevin Brosch, Esq.
Agri-Mark Dairy Cooperative and Association of Dairy Cooperatives of the Northeast:	Robert D. Wellington
Lanco-Pennland Milk Producers:	Crossland & Speis, LLC by Edward C. Crossland Esq.
South Berlin Cooperative of New York:	Ken Dibbell

APPEARANCES (CONT.):

International Dairy Foods Association:	Covington & Burling, LLP by Steven J. Rosenbaum, Esq.
Alto Dairy Cooperative; Associated Milk Producers, Inc.; Bongards Cooperative Creamery; Burnett Dairy Cooperative; Ellsworth Dairy Cooperative; Family Dairies USA; First District Association; Manatowoc Milk Producers Association; Midwest Dairy Coalition; Mid-West Dairymens Cooperative; Milwaukee Cooperative Milk Producers; Prairie Farms Dairy, Inc.; Wisconsin Farm Bureau; Wisconsin Department of Agriculture, Trade & Consumer Protection:	John H. Vetne, Esq.
Dean Foods and New York Dairy Foods Association:	Brown, Raysman & Steiner by Charles English, Esq.

APPEARANCES (CONT'D.):

Citizens Against Government Waste:	John Frydenlund
HP Hood, LLC	Mike Suever
Smith Dairy Products Company	Ben Barner
New York State Dairy Foods and Queensboro Fram Products, Inc.:	Lewis Miller
Kraft Foods:	Michael McCully
Nestle USA and Dreyer's Grand Ice Cream Holdings, Inc.:	Patricia Stroup
Galloway Company:	Timothy Galloway
Dean Foods Company:	Evan Kinser

I N D E X

WITNESS: PATRICIA STROUP

WITNESS: TIMOTHY GALLOWAY

WITNESS: EVAN KINSER

WITNESS: MIKE SUEVER

WITNESS: BEN BARNER

E X H I B I T S:	MARKED	RECEIVED
EXHIBIT NO. 33	826	840
EXHIBIT NO. 34	870	893
EXHIBIT NO. 35	903	903
EXHIBIT NO. 36	910	935
EXHIBIT NO. 37	952	957
EXHIBIT NO. 38	961	1008
EXHIBIT NO. 39	961	1008
EXHIBIT NO. 40	961	1008
EXHIBIT NO. 41	1076	1085
EXHIBIT NO. 42	1086	1091

P R O C E E D I N G S

JUDGE PALMER: On the record, we are going to reconvene the hearing. First of all, I saw, there he is, I saw Mr. English. You wish to enter an appearance.

MR. ENGLISH: Thank you, Your Honor. Judge Palmer, at this time I would like to enter my appearance. I am Charles English with the law firm of Brown, Raysman & Steiner on behalf of Dean Foods and New York Dairy Foods Association. My address is 701 Eighth Street Northwest, Washington, DC, 20001. Other than the firm name everything is the same.

JUDGE PALMER: Mr. Vetne.

MR. VETNE: I told the reporter but I didn't do it orally, I want to amend the list of entities that I represent to include the Midwest Dairy Coalition.

JUDGE PALMER: Any other preliminary remarks? We asked about who might be testifying today, and there are a lot of different folks and I know they all have different time problems making plans and what have you.

I just received a card. I spoke to a gentleman, Mr. John Frydenlund, who is Citizens Against Government Waste and he wants to make a statement today. He did indicate as long as he got out by 2 he would be okay.

Where are we? How would we like to start? You have the next witness.

MR. ROSENBAUM: I think we have our order.

JUDGE PALMER: You have your order? Why don't we just start and see what happens.

MR. ROSENBAUM: Our next witness is Ms. Patty Stroup.

JUDGE PALMER: We are going to mark her statement as Exhibit 33.

(Hearing Exhibit No. 33 was marked for identification.)

PATRICIA STROUP

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Ms. Stroup, you prepared a statement that has been marked Exhibit 33; is that correct?

A. I have.

Q. Could you proceed to read that for the record.

A. My name is Patricia Stroup. I am the group manager for Nestle Business Services and today I am representing Nestle USA and Dreyer's Grand Ice Cream.

In my role with NBS I am responsible for milk and dairy ingredients procurement for Dreyer's and Nestle brands in the United States and Canada. This includes procurement relationships with individual dairy farms, cooperatives and proprietary handlers and manufacturers.

Prior to my position with Nestle, I

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held positions with Hilmar Cheese Company in Hilmar, California, Maryland and Virginia Milk Producers Cooperative in Reston, Virginia and Eastern Milk Producers/Milk Marketing, Inc. in Syracuse, New York and Strongsville, Ohio. I hold an M.B.A. from Purdue University and an undergraduate degree with a cognate in Dairy Science from Virginia Tech. I developed today's testimony in cooperation with Nestle and Dreyer's staff and present it today with authorization from Nestle beverage division and Dreyer's Grand Ice Cream executive staff.

Nestle in the United States includes Nestle USA, Nestle Nutrition, Nestle Purina PetCare Company, Nestle Waters North America, Dreyer's Grand Ice Cream, Inc. and Alcon Laboratories, Inc. and is part of Nestle S.A., the world's largest food company, in Vevey, Switzerland. Nestle USA's 15,500 employees operate 20 manufacturing facilities and five distribution centers focused on making branded food and beverages.

Dreyer's Grand Ice Cream Holdings, Inc. and its subsidiaries manufacture and

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distribute a full spectrum of ice cream products and frozen dessert products. The company's premium products are marketed under the Dreyer's brand name throughout the Western states and Texas and under the Edy brand name throughout the remainder of the United States.

Internationally the Dreyer's brand extends to select markets in the Far East and the Edy's brand extends to the Caribbean and South America. Dreyer's has 7,000 employees and operates six manufacturing facilities in Texas, Indiana, Maryland, Utah and California.

I testify today in opposition to the National Milk Producers Federation's proposal to sever the pricing relationship between Class I and II prices. Our opposition is based on two main factors.

First, increases in prices of Class I and II dairy products risk losing significant share of the consumer's stomach to nondairy products.

Secondly, from the milk procurement perspective, Nestle and Dreyer's are not experiencing milk shortages or increased

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premiums resulting from costs associated with "servicing" our Class I and II markets plants.

It is no secret that as milk production in the United States continues to climb the utilization of milk in Class I and II products has been declining and stagnant respectively. But what is more distressing is that the consumption of Class I milk in particular is not only declining in terms of percent utilization but also per capita and most alarming in terms of absolute pounds of usage. According to population numbers and fluid sales data from USDA Economic Research Service from 1990 to 2005, per capita consumption of whole, reduced, lowfat and nonfat milks declined in total by 21 percent.

More recently from 2000 to 2005 consumption of those products dropped by an average of 1.8 percent per year. In terms of absolute demand volume, "white" milk volume has decreased by 5.5 percent since 1990 and averaged over a 0.75 percent drop each year since 2000. This means that the industry cannot simply rely on increases in population

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to stabilize or grow Class I and II markets. It will need to rely on innovative product development, unique marketing and attractive price points.

It is shortsighted to look at milk as an isolated category. While NMPF's analysis looks strictly at the supply side and USDA's elasticities consider only the reactions to price of Class I milk as a whole, mainly "commodity" white milk, Class I milks truly include a wide array of beverages that reach beyond gallon jugs of milk.

Flavored milks have potential to lead growth in Class I sales. In the same periods I mentioned for white milk, from 1990 to 2005, per capita consumption of flavored milks increased by 55 percent while total volume increased 85.3 percent.

More recently, from 2000 to 2005 per capita consumption has been increasing even faster averaging over four percent improvement per year.

One would like to think that flavored milks have cannibalized the white milk

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loss so that users are staying within the milk category, but independent and proprietary attitude and usage research commissioned by Nestle and reported in 2006 indicates that consumer movement in and out of the flavored milk category does not generally come from white milk but rather from other beverages.

To be truly competitive as a company and as an industry we must look at milk's positioning against other beverages and not just other dairy products. We cannot increase prices on milk beverages without losing demand, not just from the category but from the use of dairy products in general.

Nestle Quick Ready to Drink beverages include single-serve, quart and half gallon offerings in such varieties as chocolate, banana, cookies and milk, strawberry and a host of other flavors. Nestle's recent attitude and usage study indicates that the main competition for Nesquik are not dairy-based beverages. The top competition for flavored milks are, in this order, soft drinks, bottled water and refrigerated pre-mixed orange

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juice. Only after those products did respondents list other milks. In fact, even non-beverages compete with flavored milks. Over half of the respondents indicate that they replace flavored milks with fruit or vegetable snacks, salty snacks, chocolate candy and snack bars.

One of the principles of price elasticity is that products with few substitutes generally have low price sensitivity. Unfortunately, we have found that flavored milks have many substitutes. Price becomes a major factor for consumers in deciding how to satisfy their snack cravings.

One of the critical results of our research indicated that price point affects elasticity of flavored milk more than price gap among flavored milk brands does. This means that consumers are using price as a determinant of whether to purchase a beverage in the category of flavored milks or another beverage more than they are using differences in price to choose among brands within the flavored milk category. In other words, the consumer

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question is chocolate milk or soda, not Nesquik or store brand milk.

Our elasticity studies using two years of scanner data ending in 2005 found that flavored milks exhibit above average price elasticities to price changes compared to other refrigerated items. Results indicate that single-serve flavored milk exhibits a negative 1.35 elasticity as 64-ounce flavored milk exhibits a negative 1.54 elasticity. Coupled with what we know about consumer food and beverage choices, we expect a majority of those lost sales will not go to other dairy products but to non-dairy beverages and foods.

At Nestle where our business is characterized by the phrase "Good Food. Good Life," and three-quarters of all research projects focus on health and wellness, we are particularly concerned about what an increase in milk price will do to the consumption of milk in the school market. This is a venue where we have exciting opportunities to encourage more milk consumption by children but also face daunting challenges from entrenched

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competitive beverages. Several studies have shown that children choose milk more often and consume more of what they do choose when they are offered new flavors and attractive packaging. The studies show consumption can be increased not only on the school meal line but also through dairy sales in a la carte and vending.

Flavored milk has been identified by a number of experts as a positive way to encourage more milk consumption. The Dietary Guidelines for Americans, 2005, cite flavored milk favorably as a product whose palatability is increased by modest amounts of added sugars, thereby encouraging people to consume the nine important nutrients found in milk.

But price is a factor in the school market. If students can buy a soda but milk in the adjacent vending machine costs more, the soda has a competitive advantage. If milk sellers hold vending prices down to ensure competitiveness, their vending operation is less likely to be financially attractive and milk vending machines will be placed in fewer

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schools.

Similar considerations apply to a la carte sales. This means that every increase in Class I prices poses risk to emerging sales opportunities like a la carte and vending in schools. Equally troublesome is the fact that, even if placed, less profitable items earn less attractive placement in schools and stores, again limiting consumption. Since these marketing opportunities not only can increase today's consumption but also build lifelong consumption habits, we should not lightly dismiss this risk.

While I have focused on price increase impacts on milk beverage demand, much the same can also be said of the effect of price increases in the ice cream category. Dreyer's Grand Ice Cream products include brands of frozen dessert products such as Grand, Slow Churned, Dibs, Haagen-Dazs, Nestle Drumstick, Nestle Crunch, Nestle Butterfinger, Nestle Toll House, Nestle Carnation, The Skinny Cow and others.

Dreyer's independently commissioned

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research on price and demand issues performed and reported in late fall 2005 indicates that increases in premium packaged ice cream prices of eight percent per 56-ounce package across the category result in up to a 9.8 percent decrease in sales volume. According to Dreyer's research, when consumers are not buying ice cream 75 percent of the time they are spending those potential dairy dollars on non-dairy dessert items like cookies and cake with the remaining 25 percent devoted to snack foods.

In summary, National Milk's assertion in its proposal that "processors of Class I and Class II products are able to pass on increased costs to the market" may be technically correct in that there is not a circularity issue with NASS survey pricing as there is with Class III and IV, but is entirely incorrect in its assumption that there is not an impact on usage and, therefore, cost, measured in cost per unit, cost in the net price impact to dairy farmers and cost in competitiveness of the industry on the store

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shelf.

Secondly, the petitioner asserts that premiums are increasing as a result of increased costs in servicing the Class I and II markets and that Class I and II milk supplies are at risk because of inadequate regulated pricing.

It has not been our experience at any of the Nestle divisions or are Dreyer's that Class I or II milk is in short supply. in fact, in preliminary work on our new Class I and II facility in Anderson, Indiana we have had discussions with five different milk suppliers interested in servicing that plant. Four of those contacts were unsolicited by us.

On the same note, at all of our Dreyer's plants milk and milk ingredients were all readily available this year and in net we are paying the same premiums for those products for 2007 that we did last year. We in fact had more proposals from suppliers for the Dreyer's business than we had the volume to accept.

The assertion that higher costs of servicing the Class I and II markets are being

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reflected in higher over-order premiums and/or lack of milk availability has not been our experience nationwide and illustrates to us that no emergency situation exists in that regard.

We urge USDA to consider carefully whether there is actual evidence that Class I and II supplies are at risk. The overriding function of federal milk marketing orders is to balance milk supplies by efficient allocation of supplies within the various utilization categories for milk and other dairy products. The hallmark of program administration should be efficient supply allocation, not aggregate price enhancement or depression.

For these reasons, because a price increase will result in decreased demand and because we are not experiencing milk shortages or increased premiums associated with servicing Class I and II milk, we oppose any increase in the Class I or II federal order pricing formulas.

Thank you for this opportunity to share Nestle's and Dreyer's position in this

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matter.

MR. ROSENBAUM: Your Honor, I will ask that Exhibit 33 be introduced into the record.

JUDGE PALMER: We will receive it.

(Exhibit No. 33 was received into evidence.)

BY MR. ROSENBAUM:

Q. Ms. Stroup, I have a couple of questions before we make you available for cross-examination. On page 4 of your statement in the second paragraph you talk about the elasticities with respect to your flavored milks; is that correct?

A. Yes.

Q. Just to clarify, to make clear for the record, when you describe these single-serve flavored milk as exhibiting a negative 1.35 elasticity am I correct that that means for every one percent increase in price you experience a 1.35 percent decline in sales?

A. Yes.

Q. Similarly for the 64-ounce flavored

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milk products, for every one percent increase in price you experience a negative 1.54 percent decline in sales; correct?

A. Correct.

Q. I take it the same concept is behind the decrease in sales volume that you discuss regarding ice cream on page 5?

A. Correct.

Q. Nestle being a worldwide operation has I assume ice cream facilities in other countries; correct?

A. We do.

Q. There has been some limited discussion of whether there are what are in this country known as Class IV products that can feasibly be substituted in ice cream for fresh cream.

Could you tell us please what your understanding is given your position in the company with respect to substitutability of Class IV products for fresh cream in ice cream.

A. The substitutability of alternate fats for cream in ice cream such as anhydrous fat or butter oil or even butter is common

P. Stroup - Cross by Mr. Beshore

practice in other countries. In Canada, for example, it has been done for over a decade and is regularly used instead of cream.

Q. It is technically feasible?

A. Definitely technically feasible.

Q. Do you believe that is a realistic choice in the United States as well?

A. Yes.

Q. Given your position and given Nestle's practice elsewhere, is this an issue you would take a hard look at if the Class II differential were to be increased in the manner proposed here?

A. It is.

MR. ROSENBAUM: She is available for cross-examination.

JUDGE PALMER: Are there questions for the witness? Yes, sir, Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good morning. Marvin Beshore, Association of Dairy Cooperatives in the

P. Stroup - Cross by Mr. Beshore

Northeast and Dairy Farmers of America. Good morning, Ms. Stroup.

A. Good morning.

Q. Your position with Nestle and Dreyer's is milk ingredients procurement I take it from your statement?

A. Correct.

Q. Are you involved in product development at all?

A. I am not.

Q. Can you tell us whether Nestle and Dreyer's presently have any pool plants in the federal order system?

A. Actually, we do. We pool some milk for chocolate production.

Q. Where is your pool plant?

A. I believe it is in the upper Midwest.

Q. Can you tell us the name of the plant or the location?

A. It would either be Burlington or Bloomington.

Q. Are you involved in the procurement of milk for that facility?

P. Stroup - Cross by Mr. Beshore

A. Yes.

Q. Where do you acquire milk from individual dairy farms?

A. In California.

Q. Anywhere in the federal order system?

A. No.

Q. Among Nestle's 20 manufacturing facilities and Dreyer's six manufacturing facilities one of those is a federal order pool plant?

A. I honestly don't know how many of our plants are pooled. I do happen to know that that one is. We could have others that I don't know about.

Q. So would I understand --

A. I don't do the paperwork on the pooling. I don't know which ones are.

Q. You are responsible for milk and dairy ingredients procurement, however?

A. Right.

Q. Wouldn't you be procuring for those facilities?

A. Right.

P. Stroup - Cross by Mr. Beshore

Q. Isn't it significant in procurement to know whether it is a pooled facility or not?

A. It is. I started in September, Marvin. I'm still getting up to speed on what is pooled and what is not.

Q. With respect to the studies that you have testified to, I gather you weren't involved in those things in any way?

A. No. Those were commissioned by large independent commercial research firms.

Q. How did you come to have any knowledge about those studies in order to testify about them today?

A. I met with our beverage and ice cream economists and discussed those studies with them and got the results from them.

Q. Do you have any of those studies with you to present for the record today?

A. I don't want to. That is proprietary information. I can't present that.

Q. You can present portions of those studies that you feel are favorable to your position in the hearing, but you are not going to present the study so that any other

P. Stroup - Cross by Mr. Beshore

participants including the Secretary can evaluate it; is that correct?

A. I cannot give you the proprietary information of our study.

Q. You provided some tidbits?

A. I have, but I can't give you the study. I have answered that.

Q. With respect to your comments on Class II, what do you understand the change in Class II pricing is going to be under the National Milk proposals?

A. Increase in fat, cost per pound.

Q. Is that your primary concern?

A. Yes.

Q. You procure in California; correct?

A. Yes.

Q. Did you hear Dr. Cryan's testimony about the cost of fat for Class II products under the regulated system in California?

A. No.

Q. Do you know what the cost for Class II fat is in California?

A. No. Ice cream is Class III in California.

P. Stroup - Cross by Mr. Beshore

Q. Class II or III. Let's just talk about --

A. I know the difference between Class III in California and Class II in the federal order is about 1.62 cents per pound average since 2000. This would about double that difference.

JUDGE PALMER: Did you mean per pound or per hundred?

THE WITNESS: Per pound.

Q. Could you go over that again please.

A. The difference between California Class III prices for fat and federal order --

Q. Prices for ice cream?

A. Class III would be ice cream in California and Class II in the federal order, is about 1.62 cents.

Q. Per pound?

A. Per pound.

Q. You are saying that the federal order fat is more expensive?

A. Correct.

Q. Are you aware of the spread between Class IV fat and Class III fat?

P. Stroup - Cross by Mr. Beshore

A. I don't have those numbers in front of me. I don't know off the top of my head what they would be.

Q. You don't know whether the relationship is greater or less than the federal system?

A. No.

Q. Do you have any information from the Dreyer's and Nestle consumer study on the consumer reaction to the reduction in the packaging of ice cream from half gallon to 56-ounce containers?

A. If we have any I don't know of it.

Q. You don't have any offer for that for the hearing?

A. I don't have any what?

Q. You don't have that information to offer for this hearing?

A. Of what consumers thought of reducing from half gallon to 56 ounces?

Q. Right.

A. I did not think that was relevant to this hearing. I don't have that information.

Q. What is Nestle's or Dreyer's, either

P. Stroup - Cross by Mr. Beshore

one, profit margin on the ice cream?
A. That would be proprietary information.
Q. Do you have the information?
A. No.
Q. What are their profit margins on any other Class II products?
A. I can't talk about any profit margins.
Q. Let's talk about the Class I products a little bit. Where are your Class I products? Do you make any in the federal order system?
A. We co-pack and license Class I products now. We are building a Class I plant in Anderson, Indiana that will be operational in 2008.
Q. Can you share with the record any information with respect to the growth pattern in those products over the past several years?
A. I don't have that information with me.
Q. Has it been growing?
A. Do we know what our -- yes, we know.

P. Stroup - Cross by Mr. Yale

I don't know what it is.

Q. Do you know whether it has been growing or not?

A. Flavored milks? Yes.

Q. Nestle flavored milks?

A. Yes.

Q. Do you know at what rate they have been growing?

A. No.

MR. BESHORE: That's all I have right now. Thank you.

JUDGE PALMER: Any more questions? Mr. Yale.

CROSS-EXAMINATION

BY MR. YALE:

Q. Good morning.

A. Good morning.

Q. Benjamin Yale on behalf of Select Milk Producers, Continental Dairy Products and Dairy Producers New Mexico.

I want to get to the most important question first. Did you bring any samples?

A. Sorry, no.

P. Stroup - Cross by Mr. Yale

Q. You were in the hearing yesterday; right?

A. Yes.

Q. You heard Mr. Tonak's testimony?

A. Yes.

Q. He had an exhibit that listed Grade B, the percentage of Grade B in the various states?

A. Yes.

Q. One of those states that had the largest amount of Grade B was California?

A. Yes.

Q. You have had experience working in the California system?

A. Yes.

Q. With who?

A. Almost ten years with Hilmar Cheese Company.

Q. In California what do they call Grade A milk? Do they use another term?

A. Market milk.

Q. This 33 million pounds that was suggested as being Grade B, what is that milk?

A. Manufacturing milk.

P. Stroup - Cross by Mr. Yale

Q. Is it of the same quality as the other? Why is there this amount of Grade B milk in California?

A. In California you must participate in the pool if you are Grade A even if you shift to a manufacturing plant, so even a producer, if a producer ships to a -- there is no depooling in California on a producer basis. The only way that a producer cannot participate in the pool is to forgo his Grade A status, so he would have to give up his grade A permit and become Grade B even if he completely qualifies to be Grade A, and many have done that in the past several years.

I don't know what the numbers are, but I am assuming you would see significant growth in Grade B production in California as producers, as the cheese price went up in California and Class 4b prices became a lot higher and it was not attractive for people who were shipping the cheese to pool their milk, they dropped their Grade A permit and became Grade B. It really doesn't have a lot to do in California with the quality of the milk or the

P. Stroup - Cross by Mr. Yale

facility.

Q. In your position with Hilmar were you involved in any efforts to procure milk for their new Texas plant?

A. I was.

Q. Are those all existing dairies or are there people building new dairies in that area? How would you describe the potential supply of milk in Texas?

A. The supply of milk in Texas is growing. If you look at the production, mass production numbers for Texas, it is one of the fastest growing states in the country as far as milk production.

Q. Are you aware of anybody making a grade B producer or were they all grade A producers?

A. I don't think Grade B would be an option. They were building from the ground up. That wasn't an option.

Q. There is some testimony that cheese milk, you can purchase Grade B milk and still produce cheese. I think you would agree with that in general; right?

P. Stroup - Cross by Mr. Tosi

A. You can do that. The problem would be if you are manufacturing Grade A whey you would not be able to purchase Grade B milk.

Q. Is the producing of Grade A whey a common practice?

A. It depends on who their customers are.

MR. YALE: I have no other questions.

JUDGE PALMER: Who else has questions? Yes, Mr. Tosi.

CROSS-EXAMINATION

BY MR. TOSI:

Q. Good morning. Thanks for coming to the hearing. I'm a big fan of your flavored milk drinks.

A. Good. You must be the reason we have growing consumption.

Q. Can you explain a little bit more about what you see as the severing of the pricing relationship between Class I and II and the manufacturing class.

A. As I understand it, the petition

P. Stroup - Cross by Mr. Tosi

would set a formula for Class I and II that now happens to mirror the III and IV formulas as far as yields go but at any point in the future would not. It really is not related to III and IV pricing at all as we look forward.

Q. If it turned out that it doesn't do that, would that change your opinion of whether it was severing the relationship or not?

A. If it doesn't do what?

Q. If it turns out that the new formula absent a 77-cent increase to the Class III or Class IV price formula yields no difference from what it is today and all we are doing is adding a 77-cent adjustment to it, can you explain where the severing takes place?

A. Even if you take 77 cents out and you are saying it is just going to be this set formula, the severing would be that it is no longer higher than Class III or Class IV. It is simply the higher of these commodity price formulas that are set separately. I would oppose the severing because as we move forward the relationship between III and IV and I and II would likely diverge. It won't stay

P. Stroup - Cross by Mr. Tosi

constant any more.

I have a problem with that because I think what would happen is we would end up back in here having hearings on the disorderly marketing because Class III is now under some new formula that might come along for III, is now attracting more milk, Class I can't compete or visa versa and the relationship between classes wouldn't be constant anymore.

Q. Could you explain when you are talking about consumption and what the effects are that happened on price increases -- you are talking about retail, aren't you?

A. Correct.

Q. Could you explain then what increases or decreases in consumption in your products have to do with any of the additional costs that dairy farmers incur in pricing the Class I and II market?

A. Can you restate the question please.

Q. Part of your reason for opposition is that you are explaining what the impact would be at retail on price changes.

A. Yes.

P. Stroup - Cross by Mr. Tosi

Q. I'm asking what does that have to do with the increases, excuse me, the higher costs that dairy farmers incur in supplying the Class I and II market?

A. I guess that I couldn't say that I know that dairy farmers have a higher cost in supplying the Class I and II market. I don't know that. My point in talking about demand is that if you have a decrease in demand it is not going to increase dairy farmer prices. The elasticities will show that increase in revenue or decrease in usage would offset, so I'm saying that the one product that you have in Class I that has the potential to increase dairy farmer revenue by bringing more pounds into Class I is put at risk if you are going to increase the price. From an elasticity standpoint the only time you ever want to increase the price is when your margin for that increased price is higher than what you are going to lose on your decreased quantities.

I think that that is reflected back into what would happen in Class I. We are chasing dollars on the one class that has had

P. Stroup - Cross by Mr. Tosi

consistently decreasing utilization, and not just decreasing utilization but decreasing pounds of pure total pounds of usage, so I'm not sure I see the logic in increasing the price so that we can further depress that demand.

Q. I'm a big fan of your products like I said. Your product where I shop usually sells for $1.79 an ounce.

A. 16-ounce single-serve?

Q. Yes. They are great too. They usually sell for about $1.79. I notice, because of my work I'm kind of aware where milk prices are, that I have seen where I could buy ten for $10 when milk prices were very, very high, and then when prices came down at the farm level the price of the product went back to $1.79.

Does that have anything to do with the additional costs that dairy farmers are incurring in supplying Nestle?

A. You are a little out of my league on the marketing side.

Q. That's all right. When you say that

P. Stroup - Cross by Mr. Tosi

you are not experiencing increased premiums resulting from costs associated, you are basing that on receipts of milk at how many plants of yours?

A. I'm basing that on our contracts for this past year.

Q. How many plants are we talking about?

A. Six ice cream plants. I don't know, and I apologize because I have just started. I'm not sure exactly how many plants we have that buy milk that are not ice cream. Several.

Q. Are any of your suppliers represented at this hearing today?

A. Yes.

Q. When they testify that they receive an over order premium, that seems to run counter to what your testimony is.

A. We do pay over order premiums. What I'm saying is that our over order premiums have not increased.

Q. For 2007?

A. Correct, so my impression is, and we are just doing these contracts and we just

P. Stroup - Cross by Mr. Tosi

finished up, of course now I'm inviting all my suppliers to come back to me with a higher premium request, but we haven't had requests for higher over order premiums.

Q. Premiums being paid, have they increased since 1998 through 2006?

A. I don't know that information.

Q. If you are paying a dollar premium per 100 whey, you regularly pay that and that's the real price that you are paying and the minimum regulatory price is asking to be increased by 77 cents, have we really changed reality here? I mean, you have the ability to do something different with your over order premium.

A. What we are asking to do is to put that into the regulated price which really won't be adjusted for specific local market conditions, where I can adjust for specific local market conditions and over order premiums. I would rather pay it as an over order premium so that I can tailor it to each plant's specific needs, and if I have higher quality or some kind of one plant versus

P. Stroup - Cross by Mr. Tosi

another plant I have the ability to negotiate that as an over order premium. I don't have the ability to do that if it is incorporated into the price.

Q. Are you of the opinion that all of our class prices have a relationship to each other that they are aligned if you will?

A. Now?

Q. Yes.

A. Yes.

Q. To the extent that they all contain a cost component in them all those cost factors should be considered simultaneously, and if you don't you risk distorting what the proper competitive relationships are for going to different uses?

A. As far as simultaneous consideration, I don't have an opinion on that. I haven't really considered that.

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

JUDGE PALMER: Yes, sir.

P. Stroup - Cross by Dr. Cryan

CROSS-EXAMINATION

BY DR. CRYAN:

Q. Good morning. My name is Roger Cryan. I'm with National Milk Producers Federation.

You have ice cream plants in California?

A. We do.

Q. Do you use butter, butter oil and anhydrous milk fat as a flavoring to make ice cream in any of those plants?

A. I don't think that I can talk about that. I think that is proprietary information. I can't talk about that.

Q. On page 4 in your statement you identified these two elasticities for single-serve flavored milk products and for 64-ounce flavored milk products. Are either of those for individual SC use?

A. No.

Q. Are they for Nestle products?

A. A study was done with Nestle and its competitive products in various areas across

P. Stroup - Cross by Mr. Vetne

the country, so it was done with more than just Nestle products.

Q. The elasticity is estimated for a larger category than just Nestle products?

A. Correct.

DR. CRYAN: That's all I have. Thank you.

JUDGE PALMER: Keeping in mind she has a plane to make, Mr. Vetne.

CROSS-EXAMINATION

BY MR. VETNE:

Q. John Vetne representing the Midwest Area Coalition and others.

The 1.26 cents difference in fat price between California and federal, which one is higher?

A. Federal.

Q. There is also a difference between California Class IVA and IVB prices and federal Class III and IV fat prices?

A. Yes.

Q. With respect to all of those class prices, II, III, IVA and IVB in California

P. Stroup - Cross by Mr. Vetne

versus II, III, and IV in the federal system there is also a difference in timing and synchronization, is there not?

A. Right. That is one thing that makes Mr. Beshore's question hard to answer. In California we forward price fat for Class III, so in other words the price of the butter price now will set the Class III fat price for February and March, so comparing the federal and the state price is difficult because we have a two-month timing in California on an advanced price.

Q. There are times, are there not, when it is economically advantageous for buyers and marketers of cream to ship cream from California to the Midwest, taking advantage of the out of sync prices and in reverse to similarly take advantage to get the best out of the cream and to get the price if you are a buyer?

A. There is a huge amount of arbitrage that goes on with cream over the California line, yes.

Q. With respect to your testimony that

P. Stroup - Cross by Mr. Vetne

all market milk, Grade A milk is pooled in California, that means if it is received by a California plant?

A. Yes.

Q. Market Grade A milk produced in California that is not pooled in California?

A. Right.

Q. There has been expressed concern in the federal system that if all Grade A milk is pooled there would be a problem supplying fluid milk plants. What mechanisms does California employ from where it is produced to where it is needed in Class I?

A. In California there are transportation allowances and credits that are supposed to move milk into milk deficit areas, say Los Angeles, there are not a lot of cows in Compton, so you can move milk into those areas necessary via transportation allowances and credits. There is also a comp provision in California. If there is an emergency shortage of Class I milk there is a comp provision.

Q. The transportation allowance and credits, in one case, I'm not sure which is

P. Stroup - Cross by Mr. Vetne

which, one applies to producers so that the producer gets more, and one applies to handlers so that the handlers' costs of moving milk from Location A to Location B is recovered or recovered in part.

A. Right. One is ranch to plant and one is plant to plant. In California that is a dairy farm.

Q. On page 3 of your statement you referred to a study reported in June 2006. Is this a proprietary report or is it something that is published that we can find?

A. No, this is a Nestle proprietary study, an attitude and usage study.

Q. Something reported in-house?

A. Correct.

Q. On then the last page of your statement, last paragraph, you cite two reasons for opposition, two general reasons. You are not experiencing milk shortages or increased premiums. If your premiums were increased but there was still plenty of milk available to you, would you have a different view on whether the proposal --

P. Stroup - Cross by Mr. Vetne

A. If there was a reason that that premium needed to be increased, as I said to Mr. Tosi I would rather pay for that in an over order premium where I could tailor it to my local market.

Q. Are you aware that if the regulated increases it would be a price that would be shared with producers who are not providing the service to your plants?

A. Yes.

Q. So that if there were for example a 50 percent market, if there were a one dollar increase in the costs of servicing your plant --

JUDGE PALMER: Now I think you are kind of testifying.

MR. VETNE: Let me ask the question.

JUDGE PALMER: I can hear the question. You are basically coming up with a scenario she hasn't testified about, so the cross-examination isn't really pertinent to what she said.

We have heard the theme that you are

making from other witnesses, and I don't know that we need to take her time to affirm your thoughts about what other people have thought about the industry, but she hasn't testified to that particular aspect.

MR. VETNE: My question deals with service recovery costs. Let me finish the question.

JUDGE PALMER: Go ahead.

BY MR. VETNE:

Q. If your supplier has one dollar increase in cost for supplying your plant and needs to collect one dollar more premium from you and 50 percent market is the Class I price or the regulated price increased by one dollar, your premium would have to go up two dollars for that supplier?

A. Right. That's what I mean by I would rather be able to tailor it to my local market to my specific suppliers who are supplying me with whatever parameters I require for that product.

MR. VETNE: Thank you.

JUDGE PALMER: I'm just trying

to move it along. Yes, Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Can you tell us what the cost of the dairy ingredient is in a pint of flavored milk, that Nestle flavored milk that Mr. Tosi referred to?

A. I have no idea. It is going to be different every month and I don't know what that is.

Q. On an average basis?

A. No.

Q. Any idea what percentage of that $1.79 the cost of milk is?

A. No idea.

Q. Can you tell us what Nestle's markup is from Nestle to the supermarket?

A. That would certainly be proprietary.

Q. Can you tell us how much the cost of that $1.79 pint of milk would change, the milk ingredient cost would change assuming it is a Class I product with a .77 cent proposed price increase?

A. No.

MR. BESHORE: Thank you.

JUDGE PALMER: Any other questions? You are excused. Thank you. We are going to recess for ten minutes.

(Recess taken.)

JUDGE PALMER: Call your next witness.

MR. ROSENBAUM: Timothy Galloway.

JUDGE PALMER: This statement will be Exhibit 34, Timothy Galloway, and we will so mark it.

(Hearing Exhibit No. 34 was marked for identification.)

TIMOTHY GALLOWAY

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Mr. Galloway, you have a prepared statement that has been marked as Exhibit 34; correct?

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A. I do.

Q. You can proceed to read that for us.

A. Thank you. Before I start I just want to thank my colleagues who allow me to testify so I can get home in time for my daughter's recital tonight.

My name is Timothy E. Galloway. I am CEO of Galloway Company located in Neenah, Wisconsin. Galloway Company is a third generation owned and managed family business. We manufacture concentrated fluid dairy ingredients used in further food and beverage processing. Specifically we make sweetened condensed milk, ice cream mixes and beverage bases that are all considered Class II products. Therefore, the majority my comments below will pertain specifically to Class II issues.

Galloway Company purchases raw milk year round from a number of cooperative and proprietary handlers in our area. Our finished products are sold nationwide. Galloway Company currently employees 70 people. Due to our number of employees and yearly dollar turnover

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we are considered a small business under the Act. We are audited by Federal Order 30.

Background: As noted above, Galloway Company products are all considered Class II. We have a choice of dairy ingredients to make our products. We can use Class II milk, use Class II milk and separate and condense it into useful components, use Class II components purchased from Federal Order sources or we can use components from nonregulated sources.

Similarly, our customers have a choice for their dairy needs, either buying our Class II dairy ingredients or buying Class IV or unregulated dairy components to make their products. When the cost of my Class II ingredients gets too far out of line from what can be purchased by Class IV or unregulated sources I and my customers may switch to cheaper sources, not due to issues of quality or service but due to the inequities in regulated prices. When my customers switch they often have to install specialized equipment to handle hydration, melting,

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blending, pasteurization, homogenization and the like. This equipment needs to be paid for, so once the decision has been made it is permanent. They don't switch back.

Let me illustrate. In 1995 the Agricultural Statistics Board of USDA reported that there was a total of 157,559,000 pounds of bulk sweetened condensed whole and skim milk produced in the United States. Ten years later in 2005 the same agency reported that there was 91,907,000 pounds of sweetened condensed whole and skim milk produced. In fact, almost 15 million pounds of sweetened was lost during 2004.

I have been selling sweetened condensed milk since 1980 and testified at hearings since 1990. I believe I know why this dramatic decline of more than 30 percent has taken place. It is because unwise classified pricing disparities between ingredients in Class II and ingredients in Class IV from unregulated areas grew to a point where major users decided to make a switch and never came back.

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I know a number of confectionary companies which formally used Class II sweetened condensed milk but now use milk powders and butter type products to make their confections. Of particular note, one customer made that switch in 2004, which was the largest component of the loss mentioned above. Not surprisingly, this switch has happened over a time span where the differential between milk for Class II and milk for alternative ingredients has grown from $0.30 cents over the BFP to the disastrous Class IIIa program to the current $0.70 cwt over Class IV skim.

Galloway Company is also a large producer of ice cream mixes. We are the manufacturing partner for Classic Mix Partners, LLC, which is a joint venture with Foremost Farms USA. I must state, my testimony today represents the view of Galloway Company and not necessarily those of Foremost Farms USA.

Ice cream can be made with fresh cream and condensed skim milk from Federal Order sources or it can be made with those ingredients from areas not regulated by the

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Federal Orders like California or it can be made from Class IV ingredients like nonfat dry milk or anhydrous or concentrated milk fat.

In May 2000 I testified at the hearing regarding proposed changes to the final rule that I knew ice cream mix competitors were using non-Class II fat sources during the extremely high and volatile butter prices in 1997 and 1998. I can now testify that this occurred again during the butter price run-up in 2001 and 2004 and 2005. It will continue to occur whenever Class II ingredients get further out of line with alternative ingredients.

Galloway Company also produces non-standard of identity beverage bases that contain some dairy components. Here too we have no problem using alternative ingredients that provide better value if Class II ingredients get out of line with historical differences.

Although I do not make other Class II products, I believe that the ability and desire to substitute Class IV or unregulated ingredients for high price Class II

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ingredients is the same for all other Class II products. What is baffling to me is that the proponents of this proposal claim that they want to raise the blend price for producer milk, yet this proposal would create a greater discrepancy between Class II and Class IV and unregulated ingredient prices.

As shown in the examples above, this will undoubtedly reduce blend dollars available from Class II as end users will substitute Class II fluid ingredients with Class IV and unregulated ingredients. Milk not used to make Class II products will have to fall into Class III and IV uses as the data indicates Class I continues to contract in volume. Additional production in Class III and IV will create additional surplus which will drive down prices, which leads to less blend money. In addition, less Class II demand will cause less competition for milk between handlers and therefore smaller farm premium dollars.

What is even more baffling is that this proposal admits that a National Milk Producers Federation supported the recent

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proposed changes in Class IV and III make rates. That proposal will depress farm income and raise Class III and IV processors' income.

This proposal will do the opposite. It will raise farm income and reduce Class I and II producer income. Could this result be due to National Milk Producers Federation members having more assets tied up in Class III and IV processing, thereby more to gain, and less assets in Class I and II, thereby less to lose? Apparently what is good for the goose is not good for the gander.

Comments related specifically to the NMPF Proposal:

Emergency consideration - having the perspective of testifying at many national hearings over the years, I would contend that the scope of the considerations involved in changing well established price relationships between milk classes, blend prices within and between Federal Orders and appropriate values for Class I and II make rates and differentials are too complex to be properly addressed in an emergency hearing.

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The proponents indicate that they have repeatedly tried to point out that the proposed changes in make rates for Class IV and III will affect Class I and II as if this was an unintended consequence. Far from an unintended consequence this is just what was expected when Class II was tied to Class IV under the current rule.

During the many years and hearings that established the current rule it was determined that there needed to be this direct tie between the classes. As noted above and further discussed below, the exact same factors that determine the make cost for Class IV products are the factors that determine the make cost of Class II products. As Class II manufacturers can alternate between Class IV components and Class II milk or components, there must be a direct tie between the price formulas to prevent disorderly marketing.

The proponents also argue that an emergency ruling is required as they perceive an inability to obtain milk for Class I and II needs and to prevent increased pooling. I can

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categorically state that Galloway Company has never shut down or turned down an order because we have not been able to obtain Class II ingredients.

In addition, recent changes to Federal Order 30 and similar changes to other orders were designed to severely cut back on pooling opportunities. In short, we see no reason for an emergency hearing.

Undue hardship to producers:

The proponents state that 52 percent of all milk pooled in Federal Orders in 2005 was Class I and II. Let's be clear. 39 percent was pooled in Class I and 13 percent was pooled in Class II. Therefore, any alleged hardship caused by retaining the current Class I and II formulas is primarily the burden of Class I.

If the proposals are adopted, there will be an undue hardship on Class II processors who elect to continue to use Class II ingredients but need to stay competitive with other processors who use alternative ingredients, and there will be an

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unintended further hardship to producers if the proposed changes are implemented as non-Class II substitution will cause as decrease in blend and premium income.

The adequacy of current Class I and II pricing vis a vis disorderly marketing:

As stated previously, Galloway Company does not have a problem obtaining Class II ingredients. The proponents don't even allege a problem with Class II. They only cite Class I over-order premiums, and frankly what is the problem with increased Class I premiums if the proponents are to be taken at their word about raising producer income? What are the proponents, who I suggest supply the vast majority of the milk used in Class I, doing with these over-order premiums if not passing them back to their producers thereby raising their income?

Finally, the Act is concerned about providing the safe and suitable supply of milk for the bottle. I don't believe the Act requires any mechanism to provide milk for ice cream, yogurt, cottage cheese, sweetened

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condensed milk and other Class II products.

If there is any disorderly marketing in Class II, I would suggest that it is the declining portion of Class II milk used to make Class II products because the make cost of $0.70 cwt is too high by the amount of hydrating the solids. It assumes the Class II processors would convert nonfat dry milk into plain or condensed skim before blending with other ingredients and processing. In fact, nonfat dry is often just added to the processing vessels and blended and heated with other ingredients so there is no separate hydration step.

New Class II Formulas - Skim:

The proponents allege that the current formulas artificially bind Class II to Class IV milk prices. There is nothing artificial about it. As stated previously, this was a conscious, deliberate and painstaking process leading up to the current rule that specifically ties Class II to Class IV. It is a clear recognition that prevents disorderly marketing by having an

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appropriate relationship between Class II and Class IV make rates for similar condensing processes.

The proponents propose a new calculation for the Class II skim milk. They claim that the change merely avoids the redundant application of the cost of drying condensed skim milk. It does that but so much more. The devil is always in the details.

The proposal postulates, "In its simplest form, the current Class II skim milk price is calculated as: (Nonfat dry milk price times 8.9) minus $1.2474 equals $0.70," yet the language of the order is, "The Class II skim milk price per hundredweight shall be the advances Class IV skim milk price computed in Paragraph (q)(2) of this section plus $0.70."

In other words, the current order is explicitly tying Class II skim price to the Class IV skim price, not just to nonfat dry milk as the proponents would have us believe. Any changes made to the calculation Class IV directly impacts Class II. We have just had one hearing on Class IV make rates and are

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about to have another about the entire Class IV calculation. Class II needs to reflect whatever changes are made to Class IV.

This proposal would create a point-in-time fixed differential between the cost of nonfat dry milk and Class II skim minus their interpretation of today's condensing and hydrating costs. It does not state as it should that the condensing cost is dynamic and has to be the same as that which is included in the Class II skim formula.

To make condensed skim, sweetened condensed skim milk or nonfat dry milk requires the same condensing process and the same costs. It would be arbitrary and capricious for the Order to allow a make rate for a process in one class that is a different make rate for the same process in another class. Otherwise, a processor in one class could enjoy a higher margin making solids in one class than making those solids in another class or processors of the same solid in another class purely through the operation of classified pricing. This is not the intent of the Act or the current rule.

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In addition, the condensing costs in the proposal are not documented but merely "industry estimates" and at the lowest end of their own reported range.

We have just concluded a full hearing with many documented studies on the cost of condensing in Class IV. Whatever numbers are part of the final rule in that hearing should be used in determining the Class II skim price as a function of the Class IV skim price.

In summary, any changes to the Class II make cost and/or differential should be based on documented cost of condensing and be the same as that which is used as the condensing cost in the Class IV as is the clear intent of the current rule. We should also wait until there is a final implemented Class IV make rate so that the condensing costs are the same.

Finally, we should make sure that it is clear Class II skim value is tied by reference to Class IV skim value so that when there is a future change in one class it will

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affect the other in a like manner. This is consistent with the intent of the current rule. New Class II formula - butterfat:

The proponents claim that butter is not a viable substitute for cream in most Class II products. That may be true when considering salted, colored, flavored butter in some very white, lightly flavored products. However, it is not true for a number of confections, ice creams, yogurts and beverages which can, and do, use other Class IV fat products like anhydrous milk fat, butter oil, buttermilk and concentrated milk fat. These products can and are being used to replace Class II ingredients in Class II products.

I earlier testified to the wide scale replacement of Class II sweetened condensed milk in the confectionary industry. The confections still need milk fat to make them taste and perform properly. If you read the ingredient declaration of the candy, it still claims some source of skim milk solids and milk fat, it just comes from a different class.

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I also testified that I know ice cream manufacturers are substituting anhydrous milk fat and concentrated milk fat in ice cream. Although Galloway Company uses fresh cream in our mixes, during the huge run-up in butter prices in 1998 we experimented with concentrated milk fat with acceptable results.

The proponents also make the statement that if butter minus a make allowance plus a Class II differential is not appropriate the differential for Class II fat should be the minimum Class I butter fat value. The only justification for this change is vague language about Class I and II supplies being complimentary and that much butter fat for Class II comes from Class I operations.

First, there is no definition or illustration provided for the word "complimentary". In fact, it could be well argued that many Class II products are much closer to Class IV than Class I in that they are produced close to the source of raw materials rather than consumer, have long shelf life and are shipped great distances for

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distribution.

For instance, I have testified that Galloway Company ships all three of its product lines throughout the country. In fact, we are the sole supplier of many of the products we sell because of their unique properties and there are many other instances of hard ice cream, yogurt and beverages that are only produced at one or at most several factories and yet supply the entire country.

There is no documentation to the claim of how much Class II butter fat comes from Class I sources. It is likely that much of the excess Class I fat ends up in internal Class II and IV operations of the processor. However, there are a number of Class II processors not part of Class I operations.

Galloway Company makes a number of high fat products and is fat deficit from our Class II milk. In my 26 years with the firm I do not recall us buying a single load of surplus cream from a bottling facility. Our additional fat comes from butter/powder facilities or skim based cheese processors. I

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am aware of a number of other Class II processors who do the same.

The proponents' arguments for the proposed changes for pricing Class II fat fall well short of the mark for accuracy, specificity and rationale to require any change in the Class II butterfat formula. The current rule clearly recognizes that milk fat in Class II must be tied to the same make allowances as Class IV plus a reasonable differential.

Constraint and incidentally related:

The proponents argue that the recent make allowance hearing was merely about establishing a wide enough margin to cover costs. That must be a very depressing thought for the hundreds of cooperatives and proprietary plants making products such as cheese and butter who thought they were in business to make a profit.

I contend the purpose to the make rate hearings was to have realistic make costs so these businesses can once again be profitable.

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It is true that Class I and II products are not constrained by higher product prices to set their minimum price, but it is absolutely wrong that Class II producers are able to pass on higher costs at will to the marketplace as implied by the proponents.

Instead our prices are constrained by the relationship between Class IV and Class II milk. I even have formula price customers which require us to demonstrate which ingredient selection is more cost advantageous and then make it that way. Class II products made from Class II ingredients are more than incidentally related to the Class IV make allowance. As is clearly and consistently stated in the current rule, Class II milk is constrained by substitution of less costly Class IV ingredients.

Costs of an adequate supply of raw Class II milk:

The proposal discusses the costs involved in supplying Class I and II milk as if these costs only apply to those classes. In most parts to the country the milk used for

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each class is interchangeable as the vast majority of all production is Grade A milk. Many Class II products do you not need to be Grade A. Apparently the proponents believe that producer cost increases for Grade A status should be borne entirely by Class I and II which, using the proponents' terms, is the real perversion.

The proponents are worried that not addressing these issues will result in not having a stable supply of milk and will result in more de-pooling.

These comments are made with no substantiation or support. I have testified that we have no problem securing Class II milk under the current rule and that the ability to de-pool in many orders has been seriously curtailed. I have testified that there is no requirement in the Act to provide milk for Class II. Therefore, there is no rationale for changing the Class II price formulas based on supply issues.

Class II formulas should include Class IV price formulas by reference:

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As clearly stated in the current rule and as testified to here today, the Class IV price formulas must be referenced in the Class II price formulas. The same value for condensing in Class IV must be used for Class II as there is direct substitution between ingredients between each class. To set a fixed point in time Class II differential without direct reference to the Class IV make allowance would destroy what is clearly the intent of the current rule to tie the price formulas. This is particularly pertinent as we approach the Class IV make rate balot and Class IV formula price hearing.

Conclusion:

The proponents' rationale for changes to Class II skim and butterfat pricing and the resulting proposed formulas are illusory, superficial, arbitrary, capricious or wrong. There is no mandate that there has to be a supply of milk for Class II products. There is no demonstration that there is a lack of Class II milk or ingredients for Class II processors, therefore no emergency. There is

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no substantiation of the amount of potential lost producer revenue in Class II from potential changes in Class IV make rates, a small amount at best given the low utilization in Class II.

There is no showing as to why the well considered rationale of the current rule to tie Class IV prices to Class II prices by reference should be invalidated. There is no demonstration that Class II ingredients do not have the same make class problems that affect Class IV ingredients. In short, we have nothing but naked claims and the assertion of producer hardship.

That concludes my statement. Thank you.

BY MR. ROSENBAUM:

Q. Thank you very much, Mr. Galloway. If I could just take you back to page 9 of your statement for a moment, the second sentence as set forth in your estimate reads, and I will quote, "It does not state, as it should, that the condensing cost is dynamic and has to be the same as that which is included in the

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Class IV skim formula."

Do you see that?

A. Yes.

Q. When you read that, you read that as "Class II skim formula", so I just want to confirm that the correct statement is as set forth in your written statement; correct?

A. That is absolutely correct. After a while the IVs and the IIs run together.

MR. ROSENBAUM: I ask that Exhibit 34 be entered into evidence.

JUDGE PALMER: It is received.

(Exhibit No. 34 was received into evidence.)

MR. ROSENBAUM: Mr. Galloway is now available for cross-examination.

JUDGE PALMER: Yes, Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Marvin Beshore. Just a couple questions. On page 2 you refer to statistics that you attribute to the Agricultural

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Statistic Board of the USDA. Can you tell us what publication series you got that data from?

A. No, and I did not bring that information, but it is information that I picked up off the USDA website. It is one of the many documents that is right on there. It might be the information on the Cornell website of USDA, but it is the published statistics whereby the government compiles the usage for products year over year and compares them.

Q. I don't remember seeing any of the publications from the USDA Agriculture Statistic Board for sweetened condensed production. I wanted to know if you can provide a little more specificity on where that came from.

A. I would be happy to send a copy to this group afterward because it is published. It is information you can download. Yearly the statistics are compiled. They come out in April. It is part of a big bound document and it is available off of the website. I will note that back in 1990 I think that sweetened condensed milk figure was closer to 200 million

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pounds.

JUDGE PALMER: Should we do this. Maybe Counsel in his brief will cite it and we will take official notice of it.

MR. BESHORE: Certainly.

Q. Obviously the Galloway Company has a good product as you are marketing it nationally from Wisconsin. Can you give us an idea just by state, I'm not looking for customer identity, where you deliver it at the greatest distance?

A. Sweetened condensed milk, our largest customer is in Georgia. I have a strong presence in Florida, Pennsylvania, Chicago, California and then large customers, several large customers in Wisconsin.

Q. You mentioned Georgia first. You deliver the product from your plant in Wisconsin to the facility in Georgia?

A. Yeah, and I pass a competitor along the way who is 800 miles closer.

Q. What form is the product in when it is transported from Neenah, Wisconsin down to Georgia?

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A. Bulk sweetened, tank truck.

Q. What is the ratio of solids to water?

A. Let me give it in general because someone could figure the proprietary nature, but in general sweetened condensed milk is anywhere from 28 total milk solids to 35 total milk solids. I do make one proprietary form and that is a sweetened condensed cream that is 43 percent total milk solids.

Q. If we use 30 as a percentage that is in there, 30 percent solids and the rest liquid?

A. Then there would be probably 40 percent sugar roughly, 40 or 45 percent sugar is the preservative.

Q. How far are you from Georgia?

A. 1,200 miles.

Q. What is the cost per pound of solids to transport sweetened condensed for that 1,200-mile distance?

A. I can tell you what the cost of transportation is and someone will have to do that math. I'm not going to do it up here. It

T. Galloway - Cross by Mr. Beshore

costs roughly $2,400 or $2,500 right now with fuel surcharges.

JUDGE PALMER: That is going in liquid form?

THE WITNESS: Yes.

JUDGE PALMER: You asked about the solids.

MR. BESHORE: We can do the math.

Q. Okay, $2,400 per tanker load to Georgia. Is that a 48,000-pound --

A. Yes.

Q. -- tanker? Okay. Why was 3A a disaster? I ask that because it had the effect of taking the price of cheese and the price of butter powder and segregating them rather than having them at one price.

A. The real problem there was that sweetened condensed milk unfortunately was still tied to the price of cheese and nonfat dry milk was in 3A and was at tremendously lower prices. That was during a time when cheese was hitting some maximum values historically, and my sweetened condensed milk

T. Galloway - Cross by Mr. Beshore

price, I would say this, that that is the period we lost the most volume in sweetened condensed milk because major confectioners said I'm done with this. This is silly for us to be tied with cheese. We don't make cheese. We making something that can be made with nonfat dry milk.

Q. It wasn't segregating cheese and nonfat dry milk, it was the change in the Class II relationship or the non-change of Class II during 3A?

A. It was keeping sweetened condensed milk tied to cheese rather than more appropriately to the alternative make ingredients.

Q. Got you. On page 9 the sentence Mr. Rosenbaum just asked you to correct, you talked about condensing costs being dynamic. Can you tell us what do you mean by dynamic? Isn't the cost of condensed --

A. I certainly don't mean dynamic the way the economists talk about it. Dynamic means that just as condensing costs have changed in the Class IV, the same evaporator,

T. Galloway - Cross by Mr. Beshore

in fact there are evaporators out there that are ahead of Dreyer's that also make sweetened condensed milk. When they get to a certain point they make a decision. Do they want to make nonfat dry or do they want to make sweetened condensed milk. The costs up to that pain are exactly the same price.

Q. That is the basic spread you are looking for between Class IV and Class II; correct?

A. Correct.

Q. Do you provide sweetened condensed for beverage uses?

A. We have one in trial right now, but, no, we have not put any sweetened condensed milk in beverages. Our beverage bases are a very unique proprietary base. They are acidified.

Q. One other question and I'm done. You state on page 11 in your testimony you don't recall ever buying a single load of surplus cream from a bottling facility. There is plenty of surplus cream from bottling facilities in Wisconsin. It is marketed all

T. Galloway - Cross by Mr. Beshore

the time without a doubt. Is that just your established relationships with cheese plants?

A. No, no. Because we generally buy our cream through brokers this is knowing where the truck that brings the cream in comes from. To get from my car to the offices I go right past where the unloading bays are and I see the receipts, I see the invoices. I know who we are buying it from.

I will tell you that Foremost Farms USA, who is our partner in Classic Mix Partners which the majority of our extra cream needs have come from, we never bought any cream from them and they are a bottling facility.

Q. You buy it through a broker and you get it from the best cost source available I take it?

A. The best cost and quality.

Q. For the most part that is from mozzarella cheese plants?

A. It can be mozzarella cheese plants. It can be from buttermilk plants, regulated, nonregulated. It comes from all over.

Q. You are not saying that there is not

a lot of surplus cream sold in the same marketplace that you are working in from bottling plants?

A. There are only three bottling plants in Wisconsin and I believe all of them have internal Class II utilization on their own. Therefore, they tend to suck up their own excess supply of cream.

MR. BESHORE: Okay, thank you.

JUDGE PALMER: Any more questions? Dr. Cryan.

CROSS-EXAMINATION

BY DR. CRYAN:

Q. Good morning, Mr. Galloway. I'm Roger Cryan with National Milk. You testified in 1998 when there was a high run on butter prices that you substituted some alternative butterfat products in place of your traditional source.

A. Actually, true, but we did not substitute. We experimented to make sure that if everything fell apart we would have a viable substitute and we confirmed that we did.

T. Galloway - Cross by Dr. Cryan

Q. If you made the substitute in that type of a situation, would that be likely to be an imported product?

A. Actually, this was product that we had put up -- for some of our cream needs we contract, and right about now in Wisconsin not a whole lot of cream is being consumed so sometimes we get low on fat and we have churned unconcentrated milk fat because being unflavored, unsalted, uncolored it is the greatest likelihood we can use that in our current products.

Q. In your statement you testified on page 12, "I even have formula price customers which require us to demonstrate which ingredient selection is more cost advantageous and then make it that way."

A. That is correct.

Q. Do any of those customers require you to demonstrate your butterfat ingredient selection in this example, this method?

A. Yes. We would have to declare a fat source because it makes a difference to their labeling.

J. Frydenlund - Direct

DR. CRYAN: Thank you.

JUDGE PALMER: Any other questions? You are excused, sir. We are going to take a short-five minute recess, then we are going to hear from Mr. Frydenlund.

(Recess taken.)

JOHN FRYDENLUND

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

JUDGE PALMER: We are going to start again. The witness is sworn. Let's try to take our place please.

Mr. Frydenlund, you have been sworn and you have a statement to give. I think you handed me a copy of it. We will mark it for identification as Exhibit 35, and I see you have all of your identification in your statement, so just start reading, sir. Proceed.

(Exhibit No. 35 was marked for identification and received into evidence.)

MR. FRYDENLUND: Thank you,

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Your Honor. My name is John Frydenlund. I'm the director of the Center for International Food and Agricultural Policy at Citizens Against Government Waste, CAGW. CAGW is a nonprofit, nonpartisan organization which grew out of President Reagan's Private Sector Survey on Cost Control, better known as the Grace Commission.

The organization's mission is to work for the elimination of waste, mismanagement and inefficiency in the federal government with the goal of creating a government that manages its programs with the same eye to innovation, productivity and economy that is dictated by the private sector.

On behalf of CAGW's more than 1.2 million members and supporters, I appreciate this opportunity to testify before this hearing to consider a proposal seeking to amend the Class I and Class II milk price formulas applicable to all federal milk marketing orders.

CAGW opposes this proposal, which, if adopted, would substantially increase

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pricing for Class I milk and Class II butterfat by 73 cents and 6 cents per hundredweight respectively. CAGW believes there is absolutely no legitimate justification for this action, which will raise costs to consumers, reduce fluid milk consumption, increase milk production and result in greater costs to taxpayers. This proposal will also worsen regional disparity in milk prices and frustrate market conditions.

USDA estimates that the proposal will result in increased retail milk prices amounting to 5.5 cents per gallon on average over the next nine years so the increased cost to consumers of fluid milk will be $292.6 million dollars annually, which is nothing more than a milk tax on consumers. Furthermore, since the higher price will encourage more milk production and less consumption of fluid milk, that means that government outlays will be higher.

Although the petition for this proposal talks about needing to make this change in order to ensure that there will be

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enough milk for Class I fluid use, the real impact will be to reduce demand for fluid milk by an average of 70 million pounds per year. This will result in increased government purchases averaging 12 million pounds per year, costing taxpayers at least $9.6 million annually.

The bottom line is that the markets are generating all the milk the U.S. public needs. However, this proposal will just cost the taxpayers more to encourage the dairy farmer to produce more milk which is not needed since it will cost consumers more and people will drink less milk, while at the same time making it more expensive to provide food and nutrition programs to those in need, another potential increased taxpayer cost, although what is more likely is that less of the needs of the poor will be met, particularly hurting disadvantaged families with young children.

The only thing that this proposal does accomplish is to once again demonstrate that federal dairy policy is woefully out of date. USDA's 2004 report to Congress,

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"Economic Effects of U.S. Dairy Policy and Alternative Approaches to Milk Pricing," pointed out that many of the individual programs that make up dairy policy were originally designed to deal with the industry's structure in the 1930s when most milk production, about 60 percent, was destined for fluid milk consumption, markets were predominantly local and many dairy enterprises were part of diversified farming operations. That report indicated that now "the largest share of milk is used for manufactured dairy products, especially cheese, rather than fluid milk, markets for manufactured products are national in scope and dairy farms are highly specialized, many of them large-scale industry-type farms."

The federal milk marketing orders are one of the most ludicrous components of federal dairy policy. In addition to establishing a formula for a minimum national price for milk, the marketing orders impose higher differential prices for fluid milk based upon how far from Eau Claire, Wisconsin it is

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produced. Supposedly, this is designed to encourage the movement of milk from so-called milk surplus areas into the so-called milk deficit areas.

The orders also establish different prices for milk based upon its end use. The federal milk marketing orders impose a $1.5 billion milk tax on consumers, with the greatest impact on low income families with young children.

In conclusion, this latest proposal is not only unnecessary and unwarranted but demonstrates that there is a clear need for massive reform for federal dairy policy. In today's increasingly complex and uncertain environment, a forward looking dairy policy would give producers greater access to risk management tools such as forward contracting, farmer savings accounts and/or revenue insurance to help manage the financial risks inherent in dairy farming.

If the federal government's goal is to help individuals build a viable dairy operation that could be passed down to future

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generations, it would be far more useful and progressive to provide producers the tools to self-manage risk rather than rely on wasteful and counterproductive government programs.

Thank you for the opportunity to present CAGW's position in opposition to the proposal to amend Class I and Class II milk price formulas.

JUDGE PALMER: Is there anything you wish to add to that or are you ready for questions?

THE WITNESS: I'm ready for questions.

JUDGE PALMER: Any questions at all? Apparently we are going to proceed with your statement and consider it.

THE WITNESS: Hopefully, you will consider it to be the gospel.

JUDGE PALMER: That may well be. Thank you very much.

THE WITNESS: Thank you.

JUDGE PALMER: All right, another witness. That will be Mr. McCully. I'm going to mark the next statement which I

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have just been handed as Exhibit 36.

(Exhibit No. 36 was marked for identification.)

MICHAEL MCCULLY

a witness herein, having been first duly sworn, was examined and testified as follows:

JUDGE PALMER: The witness has been sworn.

MR. ROSENBAUM: He has a statement which we ask be marked as --

JUDGE PALMER: 36.

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Mr. McCully, proceed to read your statement.

MR. MCCULLY: Good morning. My name is Mike McCully, Associate Director of Dairy Procurement at Kraft Foods, and I am testifying on their behalf. I have worked for Kraft over 10 years and currently have responsibility of US milk procurement, US and global dairy market analysis and price forecasting, and US dairy commodity risk

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management.

Kraft is a member of the National Cheese Institute, Milk Industry Foundation and the International Dairy Foods Association. My testimony is in opposition to National Milk Producers Federation's (NMPF) proposal to amend the Class I and Class II milk formulas, and also opposing the need for an emergency ruling.

Kraft is a major manufacturer and marketer of cottage cheese and sour cream with leading brand names of Breakstone's and Knudsen, along with other Class II products such as Polly-O Ricotta Cheese.

Kraft's production facilities are located in Walton, New York for cottage cheese and sour cream, Visalia, California for cottage cheese and sour cream, Campbell, New York for ricotta cheese, and Lehigh, PA for Tassimo coffee products. We also buy cottage cheese products made by CoolBrands at the former Kraft plant in North Lawrence, New York.

History has a way of repeating itself, and dairy policy is no exception. Take the case of Baldwin v. G.A.F. Seelig (294,

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U.S. 511, 523). It stated that milk prices needed to be artificially enhanced for the "maintenance of a regular and adequate supply of pure and wholesome milk; the supply being put in jeopardy when farmers are unable to earn a living income."

While this sounds like it was taken from today's headlines, it is in fact from 1935, and since the United States has not run out of milk since that time one can conclude similar comments currently, while retaining political and popular appeal, are not reflective of actual supply conditions.

More recently Dairy Farmers of America, formally Mid America Dairymen and others, proposed implementing a price floor of $13.50 cwt on Class I and II milk at an early 1998 hearing. While the approach was different from the current NMPF proposal, in effect it would have also decoupled Class I and II prices from Class III and IV prices.

USDA denied their proposal and the rest of 1998 saw record high milk and dairy commodity prices. If Kraft were acting in its

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own self-interest, we could actually support this proposal from NMPF. USDA's own analysis for this hearing has shown the increase in Class I and II prices would reduce Class I usage and force more milk into manufactured uses. As a result, following basic economic supply and demand logic, dairy commodity prices would decrease benefitting cheese companies like Kraft. However, Kraft opposes NMPF's proposal for the following reasons:

It would have a negative impact on Class II products.

It would result in benefits that are regionally disproportionate.

It is the wrong solution to a longer term problem.

Emergency marketing conditions do not exist.

Negative impact on Class II products:

NMPF's proposal would have a direct and negative impact to Kraft's Class II products, as well as to the entire Class II product category. Since Kraft's products sell

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for a premium in the marketplace we have limited ability to pass on higher costs.

However, private label products are more responsive to cost changes. We analyzed nearly seven years of data to determine the correlation between Class II milk prices and the retail prices for private label sour cream and cottage cheese. The correlations are positive and most apparent on a two-three month lag which is expected given how private label pricing works.

Proponents state the cost increases resulting from this proposal can simply be passed on through retail pricing of these products. However, there is no consideration given to the impact on consumer demand from those changes. Prior testimony on this subject as well as the economic literature has repeatedly documented the fact that consumer demand for manufactured dairy products is quite sensitive to changes in price.

Without getting into a lengthy discussion over what the correct price elasticity is, one thing is clear, passing

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increased costs on to consumers will negatively impact demand for those products and the dairy industry at large.

Kraft works every day to increase demand for dairy products. Unfortunately, the demand trends for most of the dairy products have been declining over the past 20 to 30 years. Per capita consumption of cottage cheese declined from the mid 1970s to the mid 1990s before stabilizing at current levels.

Kraft and other cottage cheese manufacturers have worked hard to stop this decline by introducing innovative new products such as Breakstone's and Knudsen Cottage Doubles and promoting the health benefits of the product. Per capita consumption of ricotta cheese increased steadily from the mid 1970s to about 2000 before falling slightly in the past five years.

It is important to note that this trend change was concurrent with the last increase in the Class II minimum price when the Class II differential was increased from 30 cents to 70 cents. If the goal for the

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industry is to increase consumer demand, increasing prices will not help to accomplish that goal. NMPF's proposal would create disparities between products made in the California and the Federal Orders.

Kraft has the ability to manufacture Breakstone's cottage cheese products in both New York and California. In July 2006 following the temporary closure of our Walton, New York plant due to flooding we shifted production of Breakstone's cottage cheese products to our plant in Visalia, California. Normally the Visalia plant produces Knudsen products for the West Coast, but it also has the ability to produce Breakstone's products that are sold in the Midwest and East. Currently, it does not make financial sense to make Breakstone's products in California. However, increasing the price spread between California and Federal Orders has the potential to create shifts in product production out of the Federal Orders and into California.

NMPF's proposal also would create disparities between dairy products and

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non-dairy products. As detailed earlier, if this proposal is implemented prices for Class II products will increase.

As an example, for a product like a dairy based dip, companies could consider reformulating the product to use more non-dairy products. Consumers would also potentially respond by shifting to non-dairy products such as vegetable based dips. Again, this does not help build demand for dairy products.

NMPF's proposal would create disparities between Class II milk and Class IV milk powders. While the current proposal to change the Class II skim price formula may appear to have an impact of less than a penny per hundredweight it is the future that is of greater concern. In the past, changes in the Class IV price formula (Class III prior to order reform) automatically changed the Class II price formula.

Under this proposal this link would be severed and the future changes in the Class IV price formula would automatically change the relationship between the Class II

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and Class IV skim prices.

The question of the appropriate price relationship among the different classes was addressed at the May 2000 Federal Order hearing. In the final decision from October 2001 USDA found that any reevaluation of the formulas used to price the components used in manufacturing products should be carried through to the class prices that are based on those component prices. The full summary provides additional context for the decision:

"Neither the price relationships established in the final decision between milk used in Class III or Class IV and milk used in Class I and Class II should be changed. To the extent that there may be differences in the Class III and Class IV prices between the current prices and those adopted in this decision as a result of adjustments to the component pricing formulas, those changes should be reflected in the Class I and Class II prices. Any reevaluation of the formulas used to price the components used in manufacturing

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products should be carried through to the class price that are based on those component prices. A change in the computation of the nonfat solids prices, for instance, is intended to better reflect the value of those solids in dry milk products. If the new nonfat solids price formula results in an increase in the Class IV price, the record provides no basis for changing the difference in the value of milk used in those solids between Class IV and Class II use. Similarly, the availability of milk for use in Class I is related to the higher of the alternative manufacturing values for that milk. The current relationships should be maintained." Federal Register, Volume 66, No. 207, Thursday, October 25, 2001.

To be consistent with USDA's decision from the May 2000 hearing, NMPF's proposal should be denied.

Finally, USDA's own analysis of the impact on the Class II market shows this is a lose-lose proposition for everyone involved. As published in the notice for this hearing, the model used to analyze the impacts of this

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proposal provided the following results:

Class II milk usage decreases by 20 million pounds.

Federal Order Class II receipts increase by $12 million, but it is not enough to offset decreases in cash receipts for other classes.

Total Federal Order class receipts fall by $8 million.

The all-milk price decreases by $0.01 cwt and average U.S. producer revenue decreases by $21 million.

To summarize, the cost to manufacturers and consumers increases, demand decreases and the price to farmers decreases. In short, this proposal seems to have the potential for significant negative impact without any benefit.

The benefits are regionally disproportionate:

Class I and Class II utilization varies widely by region. High Class I utilization markets include the Florida, Appalachian and Southeast orders. Low Class I

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utilization markets include the Upper Midwest, Pacific Northwest and Central orders.

The average for January through October 2006 is a 37 percent Class I utilization for all Federal Orders. For Class II utilization the Federal Order total is less than 13 percent in 2006.

Once again, the Upper Midwest has the lowest usage with 5.5 percent for the January through October 2006 period, while the Northeast has the highest utilization of nearly 20 percent.

Given the differences in utilization by order, it is clear NMPF's proposal would benefit producers in higher Class I and Class II utilization markets. Unfortunately, these same benefits do not accrue to producers in lower Class I and Class II utilization markets, specifically the Upper Midwest.

As a major buyer of cheese in Wisconsin, Minnesota, South Dakota and Iowa, we are very concerned over the long-term impacts to the dairy industry in the Upper Midwest from this proposal. USDA's own analysis has shown

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the negative impact on manufactured products and Class III and Class IV prices.

In areas with low Class I and Class II utilization this proposal would decrease the milk prices for farmers in those areas. At the same time, it would increase prices for producers in the higher price markets in the U.S. such as the Southeast, and do very little for, or harm, producers in the lower price markets such as the Upper Midwest.

In the Federal Register notice for this hearing, Volume 71, No. 225, USDA states, "The proposed increases to Class I and Class II movers have the same effect as increasing Class I and Class II differentials at all locations by the effective proposed changes."

I believe most of us remember the contentious and regionally divisive debate that took place in the late 1990s regarding Class I differentials. Unfortunately, NMPF's proposal has revised that debate.

The wrong solution to a longer term problem:

NMPF's proposal states current

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Class I and Class II prices are inadequate to ensure orderly marketing and notes the growing difficulty of supplying deficit markets.

We question whether this is a national issue or a local or regional issue. Since Kraft has not had any problem getting milk for our Class II plants in New York, Pennsylvania or California it appears that this is not a national problem.

If the problem is supplying deficit markets such as the Southeast, then specific policy, market and technological solutions should be pursued. For example, location differentials in specific Southeast markets could be adjusted or increased. Instead of a policy change, market driven over-order premiums could be increased to promote more local milk production.

Another example is concentrated milk could be shipped in from other areas where milk is more plentiful such as the Upper Midwest or New Mexico/West Texas. Oranges aren't grown in Wisconsin or New Mexico, but consumers seem to enjoy concentrated orange juice shipped in from

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Florida.

With today's technology concentrated milk could be utilized to fulfill the needs of those deficit markets, potentially at a lower cost for the entire system.

Looking at new technology, just recently researchers at Oregon State University developed a process to extend the shelf life of milk. Hydrostatic pressure processing produces a product with a 45-day shelf life when refrigerated and maintains the taste of fresh milk. These are just two examples of how technology has the ability to solve the problem of supplying milk to deficit areas.

The problem with milk supplies in the Southeast is not new. At the February 1998 BFP Price Floor hearing Dr. Bob Cropp from the University of Wisconsin concisely explained the milk supply situation in the Southeast:

"Increasing Class I and Class II prices will not solve the seasonal Class I deficit of locally produced Grade A milk supplies in the Southeastern markets. The Southeast will always have a seasonal deficit

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of Grade A milk for Class I needs because of climatic conditions. The hot and humid weather places a lot of stress on milk cows. As a result, during the summer and early fall months milk per cow declines and getting the cows bred back for more even yearly milk flow is not possible.

"With modern milk packaging, processing and transportation technologies high quality milk in both bulk and package form can move economically long distances. Recognition and use of these technologies would result in a more efficient and economical dairy industry and would better resolve the shortages of local Grade A milk supplies for Class I needs in the Southeast. Increasing Class I and Class II prices will not solve the problem.

"Further, if producers in the Southeast do respond to higher milk prices as expected, the Southeast would experience an increased problem of disposing of seasonal Grade A milk surplus that now occurs during some of the winter and spring months.

"For example, Florida during this

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time of the year has more Grade A milk than it can use for Class I and Class II uses and is sending loads of surplus Grade A milk as far north as Wisconsin to find a manufacturing home."

Nine years later it's still hot in the south in the summer, milk production continues to decline during this time and milk is still transported into the region from distance places.

Dr. Cropp noted several solutions to this problem and they remain valid today. Instead of implementing NMPF's proposal for a short term fix, the entire dairy industry would be better served by implementing a long-term solution to a long-term problem.

One of NMPF's reasons for proposing to increase Class I prices is the increased cost of maintaining Grade A status for dairy farms. First, a historical review of this subject reveals this proposal is unnecessary. The United States Public Health Service/Food and Drug Administration has been providing guidance on milk safety since 1924, with the

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first
Grade A Pasteurized Milk Ordinance published in 1965.

It was about this time when the dairy industry was undertaking a significant upgrade in sanitation and milk safety at every point of the supply chain. At that time period, a significant investment was required to upgrade a dairy farm's infrastructure to meet these standards, so Grade A milk commanded a premium in the marketplace. This premium was partially incorporated into the Class I differential and it provided a familiar incentive for farms to convert from Grade B to Grade A status.

By 1973 only about 15 percent of farms were considered Grade B and that number continued to decline over time to less than five percent by the late 1990s and has remained at two percent since 1999. Therefore, while a premium for Grade A milk was necessary 30-40 years ago it is not relevant today.

Many of you will remember the M-W price, which was the average price of

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Grade B milk in Minnesota and Wisconsin for manufacturing purposes. The basic formula price, BFP, replaced this series in May 1995 because the pricing of Grade B milk was no longer representative of the overall marketplace.

Today, Kraft does receive a small amount of Grade B milk at our Beaver Dam, Wisconsin facility. However, there is no difference in the price we pay for Grade B milk compared to Grade A milk and in fact is conmingled on the same truck. The Grade B milk issue is just one of many structural changes that have taken place in the dairy industry over the past several decades. Those macro structural trends will continue into the future regardless of micro changes to dairy policy and pricing.

From a supply standpoint, milk production is migrating to the most efficient lowest cost areas in the country. This phenomenon also occurs in the production of many products such as corn, soybeans, vegetables, televisions and computer chips.

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Another macro trend in dairy is the long-term decline in per capita milk consumption for the past 30 years and increasing milk prices will not reverse that trend.

Dairy farms contribute $0.15 cwt each month to the National Dairy Promotion and Research Board that gives most of the money to Dairy Management, Inc. to promote dairy products. NMPF's proposal to increase Class I prices is inconsistent with this effort. Aside from some high end luxury goods it is difficult to find an example of where increasing a product's price leads to increased demand for that product. For most food and beverage products higher prices lead to lower demand.

NMPF's proposal seems to also conflict with their own program, CWT, or Cooperatives Working Together. Each month the CWT program collects $0.10/cwt from participating farms and cooperatives. The money is then used to either retire herds or as an incentive to dairy manufacturers to export excess manufactured dairy products. In either

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case, the goal is to reduce the supply of milk available to the market.

If NMPF believes there is inadequate farm milk for the Class I and Class II markets in the U.S. today, the proposal seems to be inconsistent with the goal of the CWT program. It is noteworthy that there are regional safeguards in place for the herd retirements. According to the CWT website http://www.cwt.coop/cwt faq.html, limits are tightest in the East, South and Midwest and more lenient in the West and Southwest where production is expanding fastest.

With that mechanism, NMPF and the CWT program are attempting to align supply and demand on a regional, not national, basis. The export program attempts to deal with gluts of manufactured dairy products hanging over the U.S. market. Again, it is clear the deficit markets NMPF references are regional in scope, not national.

With increased focus on the global marketplace and the current Doha Round of WTO negotiations, U.S. dairy policy and pricing

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needs to become more market oriented. NMPF's proposal moves in the opposite direction and also raises a question with FMMO's and the classified pricing system in relation to the WTO.

A World Bank study in 2005 described the cross-subsidy that exists when consumers of premium or fluid dairy products subsidize the production of lower priced manufactured products. The study "suggested that this implicit consumption cross-subsidy could be construed as an export subsidy if the United States then exports the lower priced manufactured products." (Tom Cox and Yong Zhu, "Dairy: Assessing World Markets and Policy Reforms: Implications for Developing Countries" in Global Agricultural Trade and Developing Countries, Washington: World Bank, 2005."

Similarly, in a 2004 study on the WTO ruling of the United States "Step 2" cotton support program, Daniel Sumner from the University of California at Davis, and also the former assistant secretary for economics at

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USDA, drew a parallel to the current dairy programs of the United States.

"The price discrimination and pooling schemes under the milk marketing orders stimulate overall milk production and divert milk from beverage products that are generally not traded internationally to the production of cheese, milk powder, and butter, which are the main traded dairy products....the net result is a lower price of the tradable products and displacement of imports or stimulation of exports." Boxed in: Conflicts between U.S. Farm Policies and WTO Obligations, Cato Institute Trade Policy Analysis No. 32, December 5, 2005.

With the potential for increased scrutiny of U.S. dairy policy and pricing systems, NMPF's proposal to increase Class I and II prices would only exacerbate this problem.

Emergency Marketing Conditions Do Not Exist:

While NMPF has requested an expedited decision, the current supply and

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demand situation does not warrant it. It is clear that costs of production have increased, for example, the recent sharp increase in corn prices and the impact on feed costs. However, milk prices have remained higher than usually seen in expansionary phases of the milk cycle. Following two years where the all-milk price was the highest (2004) and the third highest (2005) in history, it follows economic theory to see lower than average prices as supply responds to the price signal to expand.

Indeed, milk production is up 2.8 percent versus last year (October year to date) and cow numbers in October actually increased after remaining flat for several months. Furthermore, NMPF even uses the surging milk supplies in 2006 as a reason they increased the monthly CWT investment from $0.05 to $0.10/cwt on July 1.

Additionally, a new dynamic has also helped increase dairy commodity and milk prices over the past two years, the world market. With record-high whey prices and the highest NFDM price in many years, these gains alone

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have added more than $1/cwt to the all-milk price relative to their longer-term averages.

Furthermore, current CME Class III milk futures prices for 2007 average nearly $14/cwt. Using a ten-year average difference between the Class III price and the all-milk price of $1.50, the futures outlook is for $15.50 milk for 2007, which would be the second highest milk price in history. An examination of the facts clearly shows emergency marketing conditions do not exist. Therefore, NMPF's request for an expedited or emergency decision should be denied.

Summary: Kraft Foods opposes NMPF's proposal to amend the Class I and Class II price formulas and sees no need for an emergency ruling. At a time when we should be considering simplification of U.S. dairy policy, NMPF's proposal adds unnecessary complexity to the system. It would have a negative impact on Class II products and result in regionally disproportionate benefits.

I appreciate the opportunity to present Kraft's viewpoint on this issue, and

M. McCully - Cross by Mr. Beshore

welcome questions regarding my testimony. Thank you.

MR. ROSENBAUM: Your Honor, at this point I would ask that Exhibit 36 be accepted into evidence.

JUDGE PALMER: It is received.

(Exhibit No. 36 was received into evidence.)

MR. ROSENBAUM: Mr. McCully is available for cross-examination.

JUDGE PALMER: Any questions? Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Marvin Beshore for the Association of Dairy Cooperatives in the Northeast and Dairy Farmers of America. Good morning.

A. Good morning.

Q. Do you recall testifying back in January at the make allowance hearing?

A. Yes.

Q. At that time you testified in part that because the make allowances were put in

M. McCully - Cross by Mr. Beshore

place in 2003 and there had been subsequent cost increases it has placed an undue financial strain on the manufacturing sector. Those are your words.

A. Uh-huh.

Q. We feel there is a need for an expedited decision on this hearing and request the Department issue and implement a final rule as soon as possible. Do you recall that?

A. Uh-huh.

Q. Is that a yes?

A. Yes.

Q. Let me see if I understand. Your cost increases to the processing sector between 2003 and January 2006 created an emergency requiring Kraft and others to call for expedited emergency consideration; correct?

A. Correct.

Q. To lower the milk price of the dairy farms; correct?

A. To adjust the make allowances to reflect more current costs.

Q. Which would reduce the price of milk to dairy farms; correct?

M. McCully - Cross by Mr. Beshore

A. If you just look at the calculation it would result in a lower Class III or Class IV price, yes.

Q. Is there any question about that? It reduces the price you would have to pay for milk for Class III and IV; correct?

A. If the question is does it impact the price that the farmers get, that relationship isn't as clear because actually the proponents of that were co-ops and if the co-ops were losing money in their operations, the net price to the farmer, I can't go all the way, if you are talking about Kraft's costs, our costs to pay for the milk, yes, it would be lower.

Q. There is no question Kraft is asking to pay less for milk and considered it an emergency; correct?

A. Correct.

Q. Now here we are today. Dairy farmers have not had any changes in federal milk order prices related to the cost of production and supplying Class I and II milk that are embedded in those prices, there hasn't

M. McCully - Cross by Mr. Beshore

been any change since the data from 1998; correct?

A. I'm not very familiar with how the Class I prices are calculated but --

Q. Since 1998 would you think dairy farmers have experienced the same increases in fuel costs that processors have for instance?

A. More than likely increased fuel costs, but those also were addressed by transportation credits and on our milk fuel surcharges.

Q. Transportation credits? What are you talking about?

A. I don't do transportation credits because we are not Class I milk, but to my understanding there are transportation credits and they have been addressed I believe in some orders here in the last several years, but specifically for our milk we get fuel surcharges, so increased fuel costs for support, we as the buyers of the milk are paying that through fuel surcharges.

Q. How about other increased input costs at the producer level? How are they

M. McCully - Cross by Mr. Beshore

reflected in your minimum regulated prices?

A. They are probably not reflected in, well, directly I'm not sure. In the minimum directly I'm not sure. Again, there is a history on all this. I would contend that how they are reflected is in the net price I pay which includes premiums, so I just refer to them as premiums would adjust given supply and demand conditions in areas that we are buying milk.

Q. Have your premiums increased as Dr. Cryan testified, the overall premiums increased?

A. Again, on average are you talking Federal Orders California, United States, Class II milk, Class III milk? I would say in general on average all the milk that we buy if I went back to the late 1990s or five or six years ago we have had very little if any changes in our overall premium structure. Maybe there has been a change during that time when we used to buy from farmers and we are now 100 percent cooperative supply, so there has been a little noise because of the change in

M. McCully - Cross by Mr. Beshore

that as well, but the overall level in the premiums across from California to New York areas really hasn't changed that much if we look at the total costs that we had when we were buying from producers versus what we are paying now to cooperatives.

Q. Let me see if I understand your testimony. You told me first I think that costs to farmers, farmers cost increases would be reflected in premiums?

A. There would be that as far as directly to be impacted on the premiums. I would contend that there is more of an impact if the costs truly go up what do you do? You adjust on your operation, you produce less, what have you that the overall market adjusts just like what happens in corn, in soybeans, in cattle, hogs and other ag commodities post cost production changes, you produce less, you produce more depending on how the costs change.

Q. So Kraft's position is that dairy farms should adjust to cost increases by changing their operations at the dairy farm, is that correct, that's Kraft's position that you

M. McCully - Cross by Mr. Beshore

just told me?

A. That's how it works in most ag commodities that I'm familiar with.

Q. But for Kraft buying milk you want your cost increase then reflected in lower regulated milk prices as you testified in January; correct?

A. The longstanding belief is we are for free markets and we would rather pay, have a minimum price that truly is a minimum price that the market clears and then there is a market-driven component over that, in this case it would be over-order premiums or premiums.

Q. Let's get back to premiums then. I think your testimony is and the record will reflect that cost increases of dairy farms since 1998 should be reflected in premiums that are charged to the marketplace; correct?

A. That is one way of doing it or they would actually respond to a high cost production, lower cost production by increasing or decreasing production, and I would look at milk production growth over the last several years or on average that we are still seeing

M. McCully - Cross by Mr. Beshore

gains like the number I quoted you was three percent increase in milk production this year, so it is not clear to me that if I went to Idaho I'm seeing seven, eight percent growth in milk production year over year through 2006 if there is a big issue with everybody losing money, which I think some people are trying to make the case, why would milk production jump up as much as it is. I think there are enough people around the country, and I go to New Mexico and see the expansion in that area, the expansion in California, the expansion in Idaho in addition to some other more traditional dairy areas, it is obvious that there is money being made in milking cows.

Q. Your thought is the dairy farmers who have testified in this hearing in their costs in production and the price they are getting now should basically go out of business and let it go to the guys in New Mexico and Idaho?

A. First of all, I wasn't hear on Tuesday. I only heard one yesterday and he didn't talk about cost production.

M. McCully - Cross by Mr. Beshore

Q. Assuming there has been testimony from dairy farmers that prices are below their cost of production, your message to them is close up shop and let the guys in New Mexico produce milk; correct?

A. That is correct. Again, that is what I pointed out in my testimony, is that this is a macro trend. No matter what we talk about here today or what kind of policy or emergency you try to put in, there are macro trends in the industry that if we were to have had this ten years ago or twenty years ago milk production was decreasing in the Southeast, it was decreasing in other areas and increasing in the West. These are longer term macro trends that are not going to be changed by things like we are talking about here today.

Q. Did you hear Mr. Crossland testify yesterday when you were here?

A. Where is he from?

Q. Lanco-Pennland.

A. Yes.

Q. He testified on behalf of 800 Amish and Mennonite dairy farmers.

M. McCully - Cross by Mr. Beshore

A. Yes.

Q. His testimony was that the requested price increases were not enough.

A. Yes.

Q. And the message for me to take to him would be that his producers should close up shop and let the guys in New Mexico and Idaho handle it?

A. It is a philosophical debate that we can get into. Again, I grew up as a corn and soybean farmer and we weren't having hearings to complain about corn prices in Nevada or Georgia. You just don't grow corn in those states or Maine. You raise a product where it is most efficient. We could be talking about cars or anything, just the most efficient, lowest cost place to operate and produce.

Q. And that's the proposition that you would submit to dairy farmers in Pennsylvania and New York?

A. Actually, in Pennsylvania and New York I don't think we can make a blanket statement on all those states. We have plants in New York and Pennsylvania. I have not had

M. McCully - Cross by Mr. Beshore

trouble getting milk. The premiums have not really changed substantially in the last number of years. I'm sure there are stories of people that have, whether it is a barber or a corn farmer, anything, I'm sure there are people that are having trouble making ends meet, but obviously there are other people expanding. Go into the north country in New York. There is expansion taking place.

Q. Of course the net is contraction in terms of farm numbers?

A. In farm numbers, yes, but not in overall production.

Q. You talked about corn and soybean prices. Are you familiar with those prices today and the futures market for the next year?

A. Not today. I know what level they are at. Soybean prices are a little higher than average, corn definitely higher because of the ethanol impact.

Q. You projected, you asked the Secretary to look at the futures market for milk over the next year; correct?

A. Correct.

M. McCully - Cross by Mr. Beshore

Q. Have you looked at, have you compared that price on a milk feed price ratio to the same indexes for corn and soybean prices?

A. Yes.

Q. Is it correct, Mr. McCully, that those prices show a very low milk feed price ratio over the next year?

A. The analysis I have done, it depends on how you define very low, I want to say very low being under 2.5, which is the traditional contraction, over 3.0 would be expansionary, under 2.5 would be contraction, if you define it that way, the numbers using milk futures and corn futures and soybean futures actually resulted when I did the analysis not too long ago, within the last three weeks or so, resulted in a milk feed ratio that was actually within that band, 2.75, somewhere in that neighborhood.

Q. That is your testimony, that that milk feed ratio is 2.75 on those futures?

A. When I did the analysis several weeks ago. I don't know how you define very

M. McCully - Cross by Mr. Beshore

low, but the numbers that I compared had an average 2.75, they were within the band of 2.5 to 3.0.

Q. 3.0 is the traditional break point one way or the other; correct?

A. There are different ways. I'm not sure how relevant that is anymore given the amount of substitution that can go into effect in different feed ratios, but the way it has been explained to me over time is that over 3.0 signals expansion, under 2.5 signals contraction and within the band is kind of neutral.

Q. Let me ask you about one other comment you made. You made the comment on page 3 since Kraft's products sell for a premium in the marketplace we have limited ability to pass on higher costs.

A. I thought I was going to hear a collective sigh when I said that but nobody felt sorry for us.

Q. My understanding of Econ 101 is when you have brand name value and you have price power that you can sell at a premium you have

M. McCully - Cross by Mr. Beshore

more ability to pass on higher costs than less ability to pass on higher costs. Isn't that the standard economic theory?

A. To a point. It gets to a point where you have really two different things. One is a price point that if -- I will just use an example -- if we have a product at $1.99 that is the key price point. If we would go up to $2.09 we lose consumers because of that, so by product, every product has a key price point that we need to be at. That is the first thing.

The other thing we manage is the price gap between our product and private label, our product and competitors, so if anything happens to make those come out of alignment, then we have an issue on the market side.

Q. You are at the top of your price point and at the maximum spread and any changes in the lower, in your competition below, you have to react to it?

A. Typically, yes, depending on the product. That is kind of a blanket statement.

M. McCully - Cross by Dr. Cryan

Q. You can always contract your premium though, couldn't you?

A. Correct, and we do. That is done as well.

MR. BESHORE: Thank you.

JUDGE PALMER: Questions? Dr. Cryan.

CROSS-EXAMINATION

BY DR. CRYAN:

Q. Good morning.

A. Good morning.

Q. Do you know what does it cost to ship a pound of cottage cheese from Visalia, California to Chicago, Illinois?

A. I don't, because typically the products made in Visalia, California are the Knudson products and that pretty much is West Coast distribution so it never gets into the Chicago marketplace. What is in the Chicago marketplace is Breakstone's product, which is produced on the East Coast, so I don't know the transportation costs of cottage cheese from California to Illinois because it doesn't

M. McCully - Cross by Dr. Cryan

happen.

Q. You said --

A. There was an emergency situation there. The Walton plant was actually closed for 13 days when it was flooding. It was made in Visalia and shipped back to processing distribution centers across the country, but I don't know what the cost of that was.

Q. Do you have any idea what it costs to ship a product like that per --

A. I don't on cottage cheese. I'm more familiar with on the cheese side of it.

Q. Do you support the Federal Order system generally?

A. Historically we have. When you look at different policy things going forward there are probably things that can be updated. I think that is consistent with our comments in the past. I talked about simplification, more market orientation. I think those, I would rather pursue those types of avenues than things like this that we are talking about here today.

DR. CRYAN: Thank you.

L. Miller - Direct

JUDGE PALMER: Any other questions? You may step down.

THE WITNESS: Thank you.

JUDGE PALMER: I see the next one is Evan Kinser. I suspect he will take some time.

MR. ENGLISH: Rather than breaking it up, could I change the order and present Mr. Lewis Miller? His is a two-and-a-half page statement.

JUDGE PALMER: Let's do that.

LEWIS MILLER

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. ENGLISH:

Q. Mr. Miller, can you state your name for the record please.

A. My name is Lewis Miller.

Q. You have a prepared statement?

A. I do, sir.

MR. ENGLISH: Can we have it marked, Your Honor?

L. Miller - Direct

JUDGE PALMER: Yes. We have marked it as Exhibit 37.

(Exhibit No. 37 was marked for identification.)

MR. ENGLISH: Mr. Miller will deliver his statement.

A. Good morning. My name is Lewis "Butch" Miller, and I am appearing today as the president of New York State Dairy Foods and as executive vice president of Queensboro Farm Products, Inc., a handler in Order 1 with a manufacturing plant in rural Canastota, New York and with a distribution business of Class I and II products in metropolitan New York City.

Our company will be 100 years old within the next two years and it is now run by the third generation of the Miller family. Queensboro is a proprietary handler presently purchasing in excess of 25 million pounds per month from independent dairy farmers.

For purposes of this testimony both Queensboro and New York State Dairy Foods have common interests and will be addressing the

L. Miller - Direct

prospective inequity in the Class II provisions of the USDA proposal.

Presently a relationship exists between the Class IV butterfat and skim prices and the Class II butterfat and skim prices. According to the present Federal Order System that relationship should price Class II milk at .70 per cwt. conversion cost above Class IV each month.

If my information is correct, these new proposals would increase the difference on butterfat alone from 0.7 cents per pound to 2.33 cents per pound. This would increase the cost of a tanker of 40 percent cream by approximately $328 per 50,000-pound load.

For both Queensboro and others in New York State Dairy Foods this is an untenable position. The Class II market is a national market and to have an additional surtax placed on our manufactured products is unfair.

Many of us are manufacturers of sour cream, cottage cheese, cream cheese, farmer's cheese, ice cream mix, heavy cream, et cetera. A selective cost increase on these products

L. Miller - Direct

would make our products uncompetitive in both regional and national markets. Manufacturers of these products in California and unregulated facilities would have a substantial advantage over us.

As significant Class II handlers in New York State, our members and ourselves would be faced with the prospect of higher cost butterfat products, reductions in the sales of Class II products as our customers substituted butter, butter oil and anhydrous milkfat for fresh Class II milkfat products. This would ultimately reduce our demand for Class II milk, reduce the market for our independent producers and drive the milk to a lower class utilization, hardly what NMPF intended with this proposal.

To take this scenario to its logical conclusion, it is important that the decision makers in USDA understand that our plants with fewer outlets for our Class II butterfat will receive and process less milk thus driving up our costs. The viability of manufacturing plants themselves are being questioned in this

L. Miller - Direct

era of greatly increasing costs of operation. Manufacturing plants in states would close, precious silo capacity would decrease and severely inhibit the already limited milk balancing capacities in the East. I'm sure USDA is familiar with the closing of 14 manufacturing operations in the East in the past few years. On top of this many jobs would be lost in New York's rural economy and many family multimillion-dollar investments in milk manufacturing facilities would be rendered worthless.

This proposal penalizes small business. To give the producers we are trying to protect fewer alternatives to market their milk is certainly not the desired result here.

At present there are proprietary handlers procuring independent producer milk supplies in New York State. These plants operate with sales of both Class I and Class II milk and balance their own supplies. These handlers absorb their own costs of this balancing and do not feel it is necessary to raise these class prices to accomplish this

L. Miller - Direct

balancing.

BY MR. ENGLISH:

Q. Does that conclude your statement, sir?

A. Yes.

Q. Just a couple questions. Is Queensboro a small business as defined under USDA rules regarding fewer than 500 employees in place?

A. Yes.

Q. You are speaking on behalf of an organization called New York State Dairy Foods, which has appeared at prior Federal Order proceedings; correct?

A. That is correct.

Q. Would you just briefly describe what New York State Dairy Foods is for the record since it is not yet in this record.

A. New York State Dairy Foods is a trade organization made up of 120 members in all facets of the dairy business doing business in the State of New York. They don't necessarily have to have headquarters in New York but they have to do business in New York.

L. Miller - Cross by Mr. Beshore

Q. In your statement on page 2 you referenced USDA being familiar with the closing of you said "14 manufacturing operations". The original statement said "14 milk manufacturing operations". The written statement was correct and you meant to say milk?

A. That's correct.

MR. ENGLISH: I have no further questions and this witness is available for cross-examination.

JUDGE PALMER: We will receive his statement as Exhibit 37.

(Exhibit No. 37 was received into evidence.)

JUDGE PALMER: Questions? Mr. Beshore.

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Marvin Beshore. Good morning, Mr. Miller. I gathered the biggest problem you have with the proposal is the Class II butterfat impact; is that correct?

A. Yes. We are talking about Class II

L. Miller - Cross by Mr. Beshore

only.

Q. When you refer to on the second page of your testimony that many jobs were lost in New York's rural economy and many family multimillion-dollar investments in milk manufacturing facilities would be rendered worthless, you are linking that to this proposal?

A. Yes.

Q. Can you enumerate the many? You have a Class II facility. I assume you are including your facility in that group?

A. Yes, and there are others.

Q. How many is many?

A. Probably three or four.

Q. Class II facilities in New York that you believe, you are testifying perform that --

A. Manufacturing facilities.

Q. -- that you are testifying this proposal would render worthless; is that your testimony?

A. That is the testimony.

Q. Because you would have to pay a cent and a half more per pound of butterfat if that

L. Miller - Cross by Mr. Beshore

was adopted, Class II butterfat?

A. If the butterfat moved from .077 cents per pound to 2.3 cents per pound as this proposal dictates.

Q. 23 million pounds of milk per month, that is your average butterfat test?

A. I don't know that figure offhand.

Q. Do you know how much .077 cents per pound would be, assuming it is all Class II, in your butterfat pounds at your plant?

A. Well, we know in relationship to what a tanker of cream would cost, and we understand that in a competitive market where we are selling against California to begin with to lose margin would just make us further uncompetitive and perhaps force us to discontinue some of the lines which could impact the viability of the plant.

Q. Are you buying cream or selling cream from the Class II plant?

A. Primarily selling.

Q. As a seller this would render the value of your cream, it would increase the value of your cream as a seller; correct?

L. Miller - Cross by Mr. Beshore

A. It would decrease our margin on cream the way I understand so we would take a loss of $328 more than we are taking now.

Q. If you are selling the cream and the prices increased so the minimum regulated value is higher, it would then increase the value of your cream for sale, would it not?

A. And our cost.

Q. And your cost?

A. The net result would be loss of $328 per load.

Q. You are selling your cream at a profit presently?

A. We are selling our cream at what the marketplace demands and if this proposal is adopted we would be selling it for $328 a tank less.

Q. How many times do you sell per month from Queensboro?

A. Around ten.

MR. BESHORE: Thank you.

JUDGE PALMER: Any other questions? There don't appear to be any. I think we are going to break for lunch at this

E. Kinser - Direct

point. Thank you, sir, for your testimony.

(At this juncture, a luncheon recess was taken.)

(Exhibit Nos. 38, 39 and 40 were marked for identification.)

JUDGE PALMER: Let's go on the record. We have Mr. Kinser's statement, which we marked as Exhibit 38. There are two pages of charts. Chart 1 is Exhibit 39 and Chart 2 is Exhibit 40. Let me go over that one more time. The statement has been marked as Exhibit 38, Chart 1 is Exhibit 39 and Chart 2 is Exhibit 40. Very well, sir.

EVAN KINSER

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

JUDGE PALMER: Mr. Kinser has been sworn. Proceed, Mr. English.

BY MR. ENGLISH:

Q. Mr. Kinser, you have a prepared a statement marked as Exhibit 38.

A. Yes.

E. Kinser - Direct

Q. Either during your testimony and probably afterward during further examination by me we will discuss Exhibits 39 and 40 that you have prepared.

A. Yes.

Q. Please proceed with your prepared statement, sir.

A. My name is Evan Kinser, and I am employed by Dean Foods Company as director of dairy policy and commodities. Dean Foods owns and operates Class I and Class II plants located in and/or regulated in some form by all of the ten Federal Orders impacted by this hearing.

I'm appearing today to oppose all proposals being considered at this hearing and to oppose the issuance of an emergency decision. Dean Foods is a member of International Dairy Foods Association and supports its forthcoming testimony.

Undocumented claims made by NMPF in request for hearing:

I would like to begin my testimony by referring to Exhibit 5, testimony for

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National Milk Producers Federation, NMPF. This testimony articulates two points justifying the need for the emergency action. Page 4 contains the second numbered point which is titled "The Inadequacy of Current Class I and Class II Pricing Contributes to Disorderly Marketing in Federal Order Markets."

This broad statement by National Milk is a serious concern for the Department in upholding the Act, particularly if the claim made would be true. The good news for the Department is that it is not true when one considers the support that NMPF provided and the error is documented by the Secretary's recent decisions.

Proposed rule published on February 22, 2006 :

The first evidence cited by NMPF to support this case is a claim about growing difficulty to supply the markets. Interestingly enough, in a hearing held in December 2004 evidence was presented to the Secretary for the purpose of establishing a transportation credit in the Central Order to

E. Kinser - Direct

help supply milk to the Class I market in that order. The Secretary concluded the following, and I will quote the Secretary in the decision:

"The record does not support concluding that handlers serving major urban areas such as Denver, Oklahoma City or Tulsa experienced difficulty in attracting milk supplies. This supports concluding that the issues raised by the proponents are at best localized in nature rather than marketwide.

"In addition, the record reveals in the testimony of the AMP et al., witness that some transportation and assembly costs incurred by handlers for milk delivered to distributing plants are recovered by the marketplace...record evidence supplied by a Class I handler located in St. Louis indicates that the firm is able to continue receiving, bottling and selling milk in the St. Louis area. This evidence suggests that milk movements to handlers in the St. Louis area are occurring and meet the order's Class I needs. This evidence provides a basis to conclude that the order provisions attract sufficient milk

E. Kinser - Direct

for fluid use. In this regard the need for additional government intervention beyond what the order currently provides in meeting the market's fluid demands is not warranted.

"At best, record evidence demonstrates that if there are difficulties in procuring milk for Class I use, they are isolated to a fraction of the marketing area." It is from the Central Pooling Proposed Rule 9031, Federal Register, Volume 71, No. 35, published February 22, 2006.

It is difficult for me to understand how in a matter of two years an adequate milk supply has eroded to inadequate and disorderly. It is possible that NMPF found a few select areas, none of which they or their supporters testified to, like St. Louis, Missouri and tried to extrapolate that local market condition into the broadest of circumstances to encompass every county covered by a Federal Order. The Secretary should not be misled by any localized problem, and should remain consistent in evaluating the entire market, in this case entire system, before concluding a

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problem exists, particularly a problem requiring emergency action.

I would also note that in the decision referenced the Secretary recognizing that the handlers are able to recover handling and supply costs from the marketplace.

Economic analysis performed by USDA for this hearing:

Before leaving this claim of inadequate milk supply over concern that someone can find an argument that things have so quickly eroded in two years I would like to point out to the Secretary his own analysis for this hearing. I am referring to Exhibit 1, the hearing notice, specifically Table 1 found on the third and fourth page titled Table I, "Model Results for National Milk Producers Federation Proposed Class I and Class II Changes."

My focus is on the line titled "Government Removals of nonfat dry milk or NFDM. This line represents the millions of pounds of nonfat dry milk purchased by the government under the Milk Price Support Program

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in the years 2007 through 2015. Specifically it details the baseline, the effect of implementation of the proposed Class I price change, the effect of the implementation of the proposed Class II price change and the effect of the implementation of the proposed Class I and Class II price changes. I find it interesting that in the baseline -- that is no action to be taken by the Secretary -- that there would be sales of NFDM to the government. Yet, to listen to National Milk, it would seem we are in dire straights of not having milk in the United States.

A more detailed review of the Secretary's own analysis reveals that there is so much milk that NFDM is going to be purchased by the each year.

These proposals would, if adopted by the Secretary, have two negative effects for US taxpayers. First, they would see more of their tax dollars being spent to purchase powder unless of course the Secretary would only adopt the change in Class II price. Second, taxpayers would get to pay more for the

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Class I and Class II dairy products they consume.

This is no deal. Consumers in the United States are far from facing the risk of having no milk to drink. If it is National Milk's position that the market is failing to move this milk to Class I, that would require another different action. More discussion on this topic later.

The Secretary has already taken action:

NMPF's other points allegedly supporting emergency action are in the third and fourth paragraphs of this section. Here the argument is made about rising Class I over order premiums in surplus markets and a great increase in depooling in recent years. These are correct observations.

What is not noted in the testimony is the connection of these two issues and the fact that the higher regulated Class I prices once pooled will not solve the problem. It was noted by the Secretary in his Decision on Chicago Regional Order Proposed Rule published

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in the Federal Register on October 15, 1987 that Class I competes with manufacturing milk for a milk supply. In evaluation of the record the Secretary offered the following conclusion:

"The very nature of the market tends not to encourage the movement of milk to distributing plants for Class I uses because manufacturing plants are located throughout the marketing area and provide strong competition for producer milk supplies. The result is that distributing plants have difficulty attracting adequate milk supplies at prices that allow them to be competitive with handlers under other nearby orders."

That is taken from the 52 Federal Register 38235 and 38240, published October 15, 1987.

If Class I milk is at a regulatory disadvantage, i.e. depooling of Class III milk, handlers would need to pay something more beyond the pool price to attract a milk supply. More on this later.

To this point the Secretary has recently recognized the disorderly marketing

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conditions caused by depooling and promulgated new pooling standards. These changes went into effect at the beginning of this month.

This same decision and implementation by the Secretary applies later in the statement when NMPF concluded that today's proposals are needed to decrease the risk of depooling. In a national hearing regarding all orders, not just the orders where depooling has been an issue, the Secretary should not consider marketing conditions that have already been addressed in other proceedings and not been given enough time to be tested before using such conditions as rationales for emergency action or support of an otherwise unjustified price change.

Incorrect conclusion drawn by NMPF:

NMPF appears to believe that increases in Class I and Class II milk prices will flow directly to the producers providing that milk. This is a seriously flawed argument. In the discussion of the new Class I and Class II formulas NMPF offers its reasoning behind the Class I and Class II differentials.

E. Kinser - Direct

To quote from the bottom of page 8 of Exhibit 5, Class I and II "differentials are designed to compensate not processors, but rather the suppliers of Class I and Class II raw milk."

NMPF's assumption that Class I and Class II price increases will flow directly back to the raw milk suppliers is something Dean Foods has addressed multiple times. With marketwide pooling the increases are diluted and will not reach the producers actually providing the service.

Because of marketwide pooling, the price paid by higher value production such as Class I and Class II does not flow to the plant suppliers. Instead, it flows into the pool where it is blended with all other class values to create a uniform price. The result is that producers and cooperative associations are made indifferent, with the exception of the location differential, between supplying any plant.

Thus, a higher Class I price doesn't mean something only to the supplier incurring supply costs, it also means something to all

E. Kinser - Direct

producers pooled on the order. So if the Class I price increase is going to be sufficient to make the suppliers whole, marketwide pooling will allow a non-supplier to reap significant benefit with little or no incurred costs -- while we oppose the current proposals -- a solution for another day would be to ensure that a significant portion of any Class I differential revenue flow to the producers supplying Class I market. Regional inequities:

A major flaw in this proposal is that it does not have the same impact on all producers. When any class price is increased because of marketwide pooling the dairy producer's benefit is limited to the percent of that class in the market's pool.

For example, suppose there were two Federal Orders. The first was 75 percent Class I milk while the second was 30 percent Class I. Now let's imagine the NMPF's proposal is adopted and increases the Class I price by .77 a hundredweight. Dairy farmers pooled on the first order would experience a 57.75 cents per hundredweight increase, a result of

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75 percent times .77. Now moving to the second order, dairy farmers pooled on this order would experience a 23.1 cents per hundredweight increase, a result of 30 percent times 77 cents. This is a simplistic representation of the way this proposed change would play out across the ten orders.

In summary, dairy farmers in high Class I utilization markets will get closer to penny for penny increase in their milk check while dairy producers in lower utilization markets will experience much less of a gain before recognizing any marketplace dynamics.

This action will create an opportunity for more pool riding. As this disorderly condition develops we will all meet again for another round of Federal Order hearings to discuss the pool provisions.

Potential to repeat history:

I don't want to bore the Secretary, the Department staff or the attendees of this hearing, yet I'm concerned if we don't learn from history we will be doomed to repeat it. I will attempt to cover a lot of ground in quick

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order by referring the Department to its own website which contains all the Federal Order hearings since reform. I provide the URL.

I would like to review the rounds of hearings held since 2001 dealing with pool provisions.

Upper Midwest, pooling provisions, start date was June 26, 2001.

Mideast, October 23, 2001.

Central started on November 14, 2001.

The Northeast started on September 10, 2001.

Upper Midwest, again pooling provisions starting August 16, 2004.

Central, December 6, 2004.

Mideast starting March 7, 2005.

As the Orders took effect from Federal Order Reform, handlers began to play by the new rules and the results were different than what was expected. Now years later the Secretary has changed the rules in hopes of restoring orderly market conditions. I would add to this list the nearly completed hearing

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for transportation credits in the Southeast and Appalachian orders. In the decision the Secretary concluded disorderly marketing conditions were present and addressed them as it related to pooling through use of milk receiving transportation credits.

Adopting the proposals being considered today will not lessen disorderly marketing conditions. Instead, it will create new opportunities for pooling games and provide economic incentives for pool diversions.

These games will create disorderly marketing conditions which have been addressed twice in three different orders in less than seven years, the most recent of which was less than two years ago. There is no reason to believe the circumstances that created those opportunities have changed so significantly in less than two years to indicate they won't occur again.

Incorrect assumption made by NMPF:

In reference to lowering the Class I and Class II price along with the changes to the make allowance for Class III and Class IV,

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page 21 of NMPF's testimony states the following:

"By contrast, the processes of Class I and Class II products are able to pass on increased costs in the market."

NMPF implies that Class I and Class II processors operate in a very simplistic cost plus setting. They offer no regard for competitive or demand factors that are part of the consumer marketplace.

I would agree to the point that there are no product price formulas for Class I and Cross II products. However, to extend that statement to mean that price increases are easily provided to consumers with no implications is simply not the case.

Consumers respond to price. When we experience a price increase and go to the market in an attempt to pass it along it is not without an effect to sales.

Further, we continue to see new product developments that are formulated in more and more creative ways. Some contain dairy products and some do not, all competing

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against our products. Increasing Class I and Class II raw milk prices will continue to encourage beverage formulators and consumers to look for something other than milk. While Dean Foods does own silk and supports consumption of soymilk, we are at heart a dairy company and don't want to see price changes accelerate the loss of per capita consumption of fluid dairy products.

All Class I and Class II processors operate in a competitive and dynamic environment. One such dynamic is the existence of unregulated Class II processors. With this proposed change to the order system that dynamic could get worse. If these proposals are adopted a possible occurrence would be increased depooling or more stand alone Class II plants being unregulated. In spite of the fact that the Secretary has taken action to limit the likelihood of depooling, this proposal will only strengthen the chances that a plant will simply choose to remain outside the pool. If such happens, as Dean Foods testified to in all the depooling hearings, it

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will weaken the effectiveness of the order, the very opposite of NMPF's proposed solution. I maintain my stance that NMPF has failed to identify a nationwide problem.

As to California, on page 18 of Exhibit 5, NMPF's testimony, it is reported that the price spread between the California equivalent of Federal Order Class II and Class IV is 3.7 to 3.9 cents. NMPF then claims that this means that raising Class II prices would not cause processors to entertain the use of Class IV products as a substitute for Class II cream.

I don't contest the description of the price spread in California, but disagree as to the conclusion that can be drawn. The California pricing system works differently than the Federal Order system in that their Class II equivalent, Class II and Class III, is advanced price with only changes six times a year as opposed to the Federal Order lag pricing and monthly changes. The result of this nuance is that over time a reported spread does exist; however, it is unknown what the spread will turn out to be until it is passed.

I refer you to Chart 1, which we have now labeled as Exhibit 39. In looking at Exhibit 39 it is plain to see that the implied constant advantage suggested by NMPF is not there. In fact, sometimes the California equivalent to the Federal Order Class II price is higher than the California equivalent to the Class IV price and sometimes it is lower. The advantage and disadvantage can be quite large.

Thus, if a manufacturer is going to change alternative ingredients for a price advantage it is going to need to be ready to make that change back and forth continually. This is a serious challenge, to continually alternate ingredients to maintain a consistent product.

Thus, it seems quite reasonable to me that we don't have a substantial substitution of butter, butter oil or anhydrous milk fat for cream in California. This unpredictably would not exist in the Federal Order where the prices announced would be tied to the same butter market thereby providing

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manufacturers of a known and constant margin to make a one-time permanent change to alternative ingredients.

NMPF has offered the wrong solution:

Late in the NMPF testimony three points are offered on how its proposals allegedly better meet the objectives of the Act. The second such point focuses on the cost of suppliers for Class I and Class II milk.

This fails meeting the objective of the Act on two fronts. First, the Act is not concerned about an adequate supply of Class II milk. Secondly, the cost borne by suppliers of Class I milk, again the only milk supply of concern of the Act, are not evenly shared by all producers, so to increase the price allows unaffected producers to benefit without incurring the costs.

Both concerns are made quite clear in the Secretary's decision relating to the 1987 change to establish transportation credits in the Chicago Regional Order. A brief excerpt of that decision follows:

"Through the operation of marketwide

pooling, that portion of the costs covered by the location adjustment is shared by all producers.

"However, as noted earlier in this decision, the location adjustment provisions no longer adequately reflect current hauling costs. Thus, handlers who pay for transporting for milk between plants incur a greater cost as recognized by the order. Those handlers who incur such additional hauling costs have higher costs than other handlers who do not receive milk from other plants.

"Moreover, the other additional hauling costs, which are not reflected in the order's blend prices, are not shared by all the producers who enjoy the blend prices that result from marketwide pooling. However, as indicated earlier, full recognition of hauling costs in the location adjustment provisions is not a practicable means of dealing with this problem.

"The transportation credits provided herein will promote orderly marketing through

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provisions that are fully consistent with the intent and the purposes of the Act. The operation of the credits will improve equity among competing fluid milk handlers by reimbursing a portion of the additional costs incurred when such handlers must reach out to other plants to obtain milk for Class I uses.

"On the other hand, the cost of such reimbursements will be spread out among all the marketings producers. Thus, all producers who share in the benefits of the high returns of the fluid market through marketwide pooling will share also the costs of servicing the fluid milk sector of the market on a more equitable basis."

This is from 52 Federal Register 38235, 38242, published October 15, 1987.

In this same decision the Secretary also considered three ways to direct the market problems: Increasing the Class I price, changing the location differential and implementing transportation credits. It was the Secretary's determination then and we believe should be the Secretary's determination

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now that the appropriate solution was neither an increase in the Class I price nor changing the location differential.

Producer pay prices:

It is interesting to me that some cooperatives are here supporting NMPF's position and agreeing that there are increased costs associated with supplying Class I and Class II and that those prices should be increased for such costs to be captured. Testimony for DFA indicated that it has different charges though, as I interpreted it, either the agency pricing contractual arrangements and/or negotiated adjustment for changes in hauling that capture some cost changes. In direct testimony it was stated that such increases have not been sufficient to cover cost increases.

I find this an interesting contrast to direct testimony in the Southeast and Appalachian transportation credit hearing. At that hearing DFA testified that in general it was paying over blend in that market as supported by the following quote:

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"In those areas for the period January through June of 2005, our prices at that comparison would have been ranging from $.25 below the blend price to $.30 above the blend price with the majority being at about $.20 above the blend price." This is by Mr. Hollon Hearing Transcript FMMO 5 and 7 hearing, January 12, 2006, page 264.

It seems inconsistent to me that DFA is unable to cover costs with price increases and yet in another hearing to be paying prices in excess of federal minimum price. Regardless of the weight the Secretary gave this evidence to support DFA et al's petition, the Secretary did side with them for increasing the transportation rate and the maximum assessment.

Knowing the Secretary took action to address transportation costs in two orders and listening to the testimony of this hearing, it would appear there is a degree of double dipping occurring. The claim was made in the southern orders that transportation costs had increased and compensation was needed. Now we are hearing increases in the same

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transportation costs in another request for an increase. Just prior to the just referenced hearing the Secretary rejected proposals to promulgate new rules for transportation credits in both the Central and Mideast order.

It seems hard to reconcile different actions taken by the Secretary in orders to address transportation costs with this hearing's alleged nationwide problem requiring national action related to transportation cost changes. I think the proponents went looking for evidence of things that provided a response to dairy farmers' struggles without working for a win-win solution to improve dairy farm prices while improving market performance.

Effectiveness of over order premiums:

There has been a lot of discussion thus far about over order premiums. It has been stated and/or implied that the cooperatives are unable to pass along costs. I would like to illustrate how in two particular pricing agencies, which were referenced in NMPF's testimony to support the need for action, the cooperatives have

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significantly responded to market changes.

On page 12 of NMPF's testimony there is a discussion of the changes in Class I prices in Chicago, Milwaukee and Minneapolis. These prices are established by two agencies. Central Milk Producers Cooperative, CMPC, sets the raw milk prices for sales into Chicago and Milwaukee while Upper Midwest Marketing Agency, UMMA, sets the price for raw milk for sales into Minneapolis.

Chart 2, which has been marked as Exhibit 40, is a graph of both the CMPC and the UMMA target Class I over order premiums for January 2003 to current. Notice the very significant shift in those premiums in May 2004 which on the surface would look quite peculiar. However, understanding the competitiveness of this milk supply area and the marketing conditions at the time it makes sense.

In April of 2004 the Producer Price Differential, the PPD, for Federal Order 30 was announced at minus $4.11 in Cook County, Illinois. This meant that all the milk that had been pooled was going to have a Federal

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Order minimum price at $4.11 under the Class III price while the competitors whom had opted to depool were likely paying near Class III prices to dairy farmers. CMPC and UMMA members recognized they had a significant problem. They had to pay more for their milk than they had received or else they would not retain their milk supplies. The following month they increased the premium to recoup their competitive losses. In December of the same year and February of the next negative PPD's occur. This resulted in an increase in the premiums for the months of February and March 2005.

The point of this illustration is to show how effective Cooperative Over Order Agencies are at recognizing and responding to market conditions that are necessary to remain competitive. To be clear, the Secretary has evaluated the market conditions and determined that depooling is in fact disorderly marketing and offered a rule change to deal with this problem.

NMPF is actually asking for a policy shift

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disguised as a price increase:

Dean Foods is extremely concerned about the Department recognizing the significant policy shift that is being supported by the proponents in the name of simplification. Said in a very straightforward way, the proponents want to disconnect the Class I and Class II prices from the remaining class prices.

While Dean Foods does not agree with National Milk's comments about the lack of substitution on Class II butterfat and skim, for argument's sake I will stick with the example on Class II skim. If NMPF's proposal is adopted and the manufacturing costs change such that a change is needed to the make allowance, it is highly likely that a situation could develop whereby the Class IV price would be decreased with no impact to Class II prices thus providing dairy processors incentives to utilize NFDM in the place of Class II skim. While that would happen in the future, it is the proposal today that would cause that result. Disorderly marketing conditions could

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only be remedied by a hearing to lower the Class II skim costs.

It seems problematic to me for the Secretary to change policy where it is highly likely that another hearing will be required to address disorderly marketing when keeping the current policy would prevent such unnecessary work and effort on both the part to the industry and the Department.

Another solution:

Dean Foods is disappointed that the Secretary opted to take such quick action on this request by National Milk without considering any alternatives. We appreciate the past practice of the Secretary to request alternative proposals prior to notice of a hearing.

Though unable to attend in person Dean Foods was encouraged and is supportive of the workshop discussion on proposals. However, the handling of this proceeding sends a conflicted signal to the industry. While we continue to have contact from different potential suppliers wishing to supply our

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plants, there are regulatory options that we feel could improve the pooling conditions.

We would suggest the Department consider doing away with or reducing the impact of marketwide pooling. If the Secretary does not want to go that direction, maybe a more specific action would be the tightening of pooling provisions so less milk is associated with/riding on the Order. We appreciate the actions that the Secretary has taken to improve these provisions but would suggest there is room for more good to be achieved.

Double payment - don't get penny/penny reduction:

To the degree that the Secretary would take a different view from past action and determine that the costs incurred in serving the market should be addressed through higher Class I and Class II prices, this action does not help us address the problem purported to exist with increasing costs for balancing as reported by National Milk.

For example, we have numerous independent producers from whom Dean Foods

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purchases milk. In these instances Dean Foods is responsible for milk balancing costs. To the degree these costs have changed the burden has not been borne by the dairy farmers. Dean Foods has paid them. Increasing our Class I price does nothing to address our balancing costs. Purchasing a balanced milk supply at Class I price for a fully regulated plan is difficult.

It is our belief the Secretary should reject this proposal since it will not treat all handlers equally. We will experience no change in our balancing costs. Thus, we will pay twice for the same service, one in the form of higher regulated costs which is supposed to help offset balancing costs, and the other costs will be our realized balancing costs.

It is troubling for us to be here in opposition to higher prices for dairy farmers. We do not oppose higher prices to dairy farmers, yet we feel that the Class I price is sufficient such that dairy farmers could receive more money if the pooling was

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structured in such a way that it provided payments to those who serve the Class I market and a limited reserve supply.

Instead, it appears to be NMPF's position that the reserve supply needs to be larger and larger against a flat demand. This proposal to increase the overall price will just make the scramble to be part of the reserve supply in the South more competitive and cause more dilution, pool riding, disorderly marketing and likely result in very little if any of these higher Class I and Class II dollars sent back to the Southern United States dairy producers' pockets that supply our plants.

We are appreciative of the Secretary's decision to take action to reverse the trend in the Southeast and Appalachian order in his decision from the Transportation Credit hearing and Dean would gladly support actions to increase dairy producer prices when it means positive changes in market structure, something this proposal does not do.

Summary opposition:

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Dean Foods believes that National Milk's analysis of the national marketing landscape and resulting conclusions are in error. We would recommend that the Secretary reject all proposals. The market problems reported to exist don't and action taken by the Secretary is sure to create, as demonstrated by history, conditions that will be disorderly and lead to more hearings. The significant policy shift proposed should not be taken lightly, and in absence of solid evidence of market disruption the Secretary should not use emergency procedures.

Dean Foods believes the Secretary has clearly established evaluation criteria for examining the proper relationship between Class I prices and manufacturing prices. Furthermore, we believe that Class I processors and consumers will be adversely impacted by National Milk's proposal to increase Class I and Class II differential is adopted.

Dean Foods believes that if National Milk's Class I and Class II differential increase proposal would be adopted that there

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will be far reaching unintended consequences likely creating more disorderly marketing. In full knowledge of this, Dean Foods urges the Secretary to reject National Milk's proposal and continue with the longstanding existing policy.

BY MR. ENGLISH:

Q. Does that conclude your prepared statement, Mr. Kinser?

A. Yes.

Q. A couple of times you deviated from a prepared statement intentionally. Let me just go over a couple of times I believe you intentionally deviated from the statement. One time was on page 9 with respect to a statement changing six times a year, the bottom of the page; correct? You made an intentional change?

A. As it relates to California, that is correct.

Q. You inserted the year 2006?

A. I inserted the word price, six price changes.

Q. That time you deviated from the statement, that was intentional; correct?

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A. That is correct.

Q. On page 12 in reference to the hearing transcript where Mr. Hallon testified you inserted the year 2006 between January 12 and page 264; is that correct?

A. That was an intentional correction, yes.

Q. That was page 12. The bottom of page 15 you inserted the word "regulated" between the words fully and plant. That was an intentional change; correct?

A. Correct.

Q. Any other time that you deviated would it be fair to say that it was an unintentional deviation whether you created it at the time or not?

A. Yes.

Q. The written statement, Exhibit 38, with those modest corrections, that is the intended testimony?

A. That is correct.

Q. Let's turn now for a couple moments to Chart 1, Exhibit 39, and Chart 2, Exhibit 40. You didn't read for obvious

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reasons the URL site, but Exhibit 39 -- first, did you prepare this document?

A. I did.

Q. What was the source of your information?

A. The source was from the California Department of Agriculture website on prices. They have a spreadsheet where they have extended price history for every component of every class that they establish a price on.

Q. For a particular month, say January 1997, it looks to be month where the positive difference between the Southern California Class II butterfat price less the California Class IVA butterfat price is a positive almost .90; is that correct?

A. Yes.

Q. Can you explain what this chart shows when those numbers are positive and when they are negative.

A. The chart reflects the difference between the Class II butterfat value versus the Class IV butterfat values, so the instances that you referenced in January 1997 reflected

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that the Class II butterfat price was approaching .90 per pound of butterfat over the January Class IVA butterfat price.

Q. Sometime around January 1999, it could have been December 1998, we see a negative price conversion; correct?

A. Yes.

Q. That is somewhere in the .92 cent range?

A. I would agree with that.

Q. What does that mean for that particular month?

A. At that point in time it would indicate that the Class IVA butterfat price was over the Class II butterfat price, the exact inverse of the example we just talked through.

Q. Why does that happen in California?

A. It happens because in California they established a Class II price six times a year and it is established in advance using two months prior data.

For example, when the December Class II butterfat price in California is established it reflects the butter market

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conditions of October and November and then would be in effect for December and January.

Q. Recognizing that formulas are different and differentials are different, does that chart, Exhibit 39, represent what would also exist in Federal Orders?

A. No. In the Federal Order because the price series is the same under the current regulation and actually in this instance under National Milk's proposal so that the line would be flat and it would be unchanging at any point in time.

Q. When you say the price series is the same, is that a way of saying that the butterfat price for Federal Order Class II and the butterfat price for Federal Order Class IV are announced using the same formula and at the same time?

A. Connected to my prior statement it is not the same formula in the current versus what National Milk has proposed, but what it is the same on is the mass price.

For example, if the NASS price comes up with $1.20, that $1.20 gets used until the

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federal Class II price as well as the federal Class IV price under both the current and that which is proposed in today's hearing.

Q. As an economist, as someone working for Dean Foods, given the difference between California's Class II butterfat pricing and Federal Order what do you conclude relative to National Milk's conclusion?

A. That in California if you were going to substitute you would have to continually choose to substitute and not substitute to be price competitive versus in the Federal Order if the proposal before us today would be accepted by the Secretary inflation would be constant and one would not have to guess whether or not to continually use the substitute.

Q. Advising the Secretary what do you conclude about National Milk's conclusion about extending the California rule or what hasn't happened in California to the Federal Order?

A. Extending their example is an error and does not recognize the volatility that exists in California that would not be a factor

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for consideration in the federal system.

Q. Were you here for the testimony of Tim Galloway earlier?

A. Yes.

Q. Would the fact that some of the testimony he gave about permanent loss of Class II based upon permanent differences be consistent with that position?

A. Absolutely.

Q. Let's go to Exhibit 40 for a moment, Chart 2. I know you described it in your testimony, but just did you prepare Exhibit 40?

A. I did.

Q. What is the source of the information in Exhibit 40?

A. CMPC and UMMA pricing.

Q. I have only been here today, but I know you have been here throughout the hearing and I have heard from others. Do you recall a number of questions of witnesses concerning the increased cost to dairy farmers for Class I and Class II?

A. Yes.

Q. Why is the National Milk proposal

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the wrong solution for any such increased cost?

A. The National Milk proposal has two shortcomings in my opinion, the first of which is the pooling and that the cost would be diluted such as I testified in my statement, that if a price change occurred that the direct dollars would not flow back to the suppliers of Class I and Class II milk and would get diluted in the pool and their effect would be the same as the effect of dairy farmers who are providing no service or minimal service.

Q. But you have endorsed in the past as recently as this year payments to dairy farmers in Federal Orders increased costs to Class I processes, correct, in the Southeast?

A. In the Southeast we supported the market administrator's ability to increase the maximum assessment which was a direct increase to Class I processors.

Q. You said that there were two limitations of the National Milk proposal addressing this problem of higher Class I and II costs. What is the second limitation?

A. The second has been referenced

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occcasionally in testimony as the decoupling or the disconnection between the Class I and Class II prices from the establishment of the Class III and Class IV prices.

Q. Discuss the decoupling as you view it.

A. As I see it, if you look at the Class I price as the mover plus the differential, so we will pick on Boston, and Boston having a three and a quarter price, if over time when Class III is the mover if you take the Boston price and subtract out the announced Class III price from that, I would expect that difference in price to be $3.25.

If the National Milk proposal is adopted and you would do that going forward, take the actual Class I price at Boston when the cheese market is moving it and subtract out the Class III price, you will no longer expect it to be three and a quarter or if we adopt National Milk and add the .77 and take it up to 4.02, you would no longer expect it to continually be $4.02 over a period of time. Every change implemented by the ? Hearing whether that be a yield change or a make allowance change would cause that number to vary such that it could even become unpredictable if in fact the Secretary would decide to adopt an indexing make allowance where over whatever period the index would affect the make allowance which would affect the Class III price that would not immediately flow on to the Class II price and the number would vary according to however the index would affect the Class III price.

Q. Indeed, if in the future for some alternative or whatever energy costs were to change and if the make allowances actually went down and UFC held a hearing and went down, you could actually have a circumstance where the differential is lower than 3.5 even though that is what is established in the order; correct?

A. It is possible, yes.

Q. That is what you mean by decoupling?

A. Yes.

Q. Is that also what you mean by abandonment of the longstanding policy in the last statement of your testimony?

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A. That is correct. Step back and you look at when we had, it is going to be a big step back in history, when you look at when we the MMW price series, that established a continuous relationship between Class I price and the manufacturing price.

As we move to today we no longer have the competitive price series in place of it, we have a product price formula, and so to disconnect the Class I price or decouple that Class I price from the manufacturing price established today in their price formulas as opposed to competitive price you are in fact deviating from a longstanding history the Secretary has followed.

Q. Let me go to a couple other subjects before I turn you over for cross-examination. Is there milk not regulated by the federal government the price of which will be impacted out there in the United States if this Federal Order change is made?

A. Yes.

Q. Are there state orders that rely in part or total on federal pricing as a mechanism

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for establishing their prices?

A. My understanding is that there are. Examples of that would be like Maine, Virginia, Southern Nevada.

Q. What about Central Pennsylvania?

A. Central Pennsylvania.

Q. Based upon your understanding of the model the USDA has done for a response, do you understand any of that milk has been included intheir model?

A. My understanding is extremely unclear as to whether or not they have factored in the supply response that would occur as this links to other states that are not federally regulated.

Q. What about California?

A. In California while not formulaically linked by regulation they are by statute required to evaluate surrounding market conditions, and when you look at surrounding market conditions in those Federal Orders it would not be unreasonable to assume an interest in raising Class I prices in California should this be adopted by the Secretary for Federal

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Orders.

Q. We have discussed or you discussed in your testimony perhaps other solutions such as transportation credits that have been adopted or could be adopted.

Turning for a moment to some of the price announcement mechanisms, are there some problems as you understand it with the way data is either collected or announced that might also have an impact on producer prices, for instance as to nonfat dry milk?

A. There is a significant problem. Actually, it is something that is kind of a soap box issue for me. Lately the market price as experienced by Dean Foods and others as best as we can tell for nonfat dry milk has significantly increased, but yet the NASS is a long ways below that to the point of the spread has been I would say 30, and one could even make an argument that the spread could be closer to $1 although that wouldn't be the marketwide and that is per pound of nonfat dry milk.

Q. If some of that were picked up what

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would that have done to producer prices during the last part of this year?

A. By just rough calculation applying existing formulas to a ten cent increase to nonfat dry milk would increase the Class IV and Class II prices, and based on the 2005 national allocation of that, that would increase dairy farm revenue to the tune of about $1.5 million a month. If you increase the Class I price that ten cents turns out to be almost $3 million a month, so the combined effect would be about $4.5 million of increased monthly income for a dime increase in nonfat dry milk.

Q. You think you have seen at least $0.30 at some point this year?

A. Yes.

Q. This is the kind of issue you would like the Secretary to address rather than this proceeding under emergency basis?

A. Yes, because that is capturing what is going on in the marketplace and getting it to dairy farmers rather than trying to restructure the regulation.

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Admittedly, from the Dean Foods perspective the fact that it is working the way it is now is great because our Class II costs for skim have been lower, but in reality we would much rather have the market mechanism work, and if that is the value that the skim powder is worth then go through the dairy farmer rather than spending time and effort to be at hearings to talk about restructuring the rules to try and get more dollars in the pockets of dairy farmers.

MR. ENGLISH: Your Honor, I am finished with my direct examination. I move for the admission of Exhibit Nos. 38, 39 and 40.

JUDGE PALMER: They are received.

(Exhibit Nos. 38, 39 and 40 were received into evidence.)

JUDGE PALMER: Questions for the witness? Mr. Beshore.

E. Kinser - Cross by Mr. Beshore

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Just to pick up that last point, has Dean made any proposals to change the price discovery mechanism for Class IV?

A. It is our understanding that while unable to attend that there was discussion about that at the workshop and that there is at least some proposal already on the table.

Q. Would you support using spot market for powder as the Class IV price?

A. Depending on how one defined spot market it is possible.

Q. The prices that you are talking about that are $0.30 NASS to $1 over NASS, those are essentially current spot market prices for nonfat dry milk, correct, current transaction prices?

A. They are, which reminds me that the other flaws, even if we didn't change away from NASS those numbers are probably not even being captured in NASS because they are transactions between resellers and so they don't qualify to

E. Kinser - Cross by Mr. Beshore

even be in the price series.

Q. Your suggestion then for a win-win situation which you want according to your testimony, your suggestion then for getting that revenue out to dairy farmers is to, what, change the way you capture powder prices in NASS or in Class IV so that it is higher?

A. Change it so that it captures what is really going on in the marketplace so it is representative of the value of the commodity.

Q. Dean Foods will be supporting that at the upcoming Class III and Class IV hearings; is that correct?

A. So long as the mechanism used appears to be a fair mechanism, so for example if tomorrow some new price series would be suddenly available in the marketplace that has never been seen before and it is proposed that we use that new untested unknown, I can't assure you that we are going to jump on board for that.

Q. Are you going to help find that price series that can be put in place in the formula so that that money can be passed on to

E. Kinser - Cross by Mr. Beshore

dairy farmers?

A. We would be open to being involved in discussions about a price series that could be considered, yes.

Q. Are you going to help find one? There is not one now. Are you going to help find one so that we can have this win-win situation?

A. Sure, yes.

Q. It is very unfortunate that Mr. Hollon had to leave the hearing and isn't able to be here because you have charged him with testifying "inconsistently". I want to explore that a little bit. That is page 12 of your testimony. He is not able to respond in this hearing to this. I just want to perhaps ask a few questions on his behalf as best as we might.

You talked about, you quote Mr. Hollon's testimony at the Order 5 and 7 hearing in January 2006; correct?

A. Yes.

Q. I take it your point there is that since he said DFA was paying over blend at

E. Kinser - Cross by Mr. Beshore

least in some cases that it was covering its costs?

A. Yes.

Q. You find that to be inconsistent with his testimony in this hearing that it could not recover all its costs with premiums; correct?

A. I assumed in his testimony that he was representing a national situation and it would seem inconsistent with testimony about a region of the country.

Q. Why would you assume that because a cooperative can in some cases pay over the minimum blend price that they were recovering their costs?

A. The only draw out of the pool I would assume in this area, all of that milk would be pooled milk would be the minimum Federal Order price.

Q. Doesn't every supplier of milk have to procure milk at a competitive cost at the farm? Isn't that just a truism?

A. Yes.

Q. Do you remember what the Dean

E. Kinser - Cross by Mr. Beshore

independent producers testified was the price they were being paid in the Southeast for milk at the January hearing?

A. I remember that there was a very small number of individual producers that testified, and it is my understanding from Mr. Hollon's testimony that he was covering and stating in a very broad sense within these numbers, not the entirety of their prices.

Q. My questions was do you remember what the Dean independent producers testified they were being paid for milk in the Southeast?

A. As far as an exact number?

Q. How close can you get? What is your recollection?

A. I know that they provided numbers.

Q. How about at least a dollar? The producer that was shipping was within 50 miles of Nashville shipping to Nashville and to another Dean plant. Do you recall that testimony?

A. Yes.

Q. It was at least a dollar over; correct?

E. Kinser - Cross by Mr. Beshore

A. That could be. I would again say that you are comparing an individual, you are comparing one against a sample and within the sample there could be something beyond the range that Mr. Hollon testified to.

Q. Let's assume that Dean wouldn't be paying any more than the competitive going rate or what it needed to get milk supplies to certain producers, would it?

A. Unlikely.

Q. So let's assume that's the competitive going rate and DFA as a competitive supplier in that area with the costs it has, because, by the way, when it delivers milk to Dean it is DFA.

A. That is correct.

Q. If that premium is such that it can only return to its dairy farms in the same area a range of 30 over to 2500 at the blend, on what basis do you say they are covering all their costs?

A. You are still paying in excess of the minimum price. To the degree that they are losing money to be competitive makes no logical

E. Kinser - Cross by Mr. Beshore

sense to me.

Q. The gross premium that they are getting from Dean and other handlers, the gross price they are getting including the over order premium allows them to pay their truckers, their other costs and return price to their dairy farmers at substantially under market now. Is that a situation where the supplier, it may be covering its cost to third-parties but its cost to dairy farmers is not a competitive payment; correct?

JUDGE PALMER: Can I ask you one question on your question? When you say under market, to whom, to the dairy farmers?

MR. BESHORE: To the dairy farmers.

JUDGE PALMER: They are getting less?

MR. BESHORE: Yes.

JUDGE PALMER: I just wanted to qualify what was meant by that. Can you answer his question?

A. I wasn't clear even before you interrupted exactly what the question was.

E. Kinser - Cross by Mr. Beshore

JUDGE PALMER: He is talking about paying dairy farmers less than what independent dairy farmers are getting when they received a price from you.

BY MR. BESHORE:

Q. Let me rephrase. Assume that DFA like Dean would have to pay a dollar to its farmers to get their milk like the Dean farmer and then with the premium it had collected from Dean and the other handlers it had a 75-cent per hundredweight loss on the transaction, the difference between a dollar and 25 cents. Would it be covering its costs?

A. I'm sorry to ask you, could you please restate that again. I know it is the third time. I'm sorry.

Q. I'm probably not being clear about it. Let's assume that one of the suppliers, the cooperative supplier, let's assume one of his costs is paying his dairy farmer a competitive price and then he has the cost to pay truckers and field men and all the other costs of supplying the market. Let's assume DFA pays it dairy farmer a competitive cost of

E. Kinser - Cross by Mr. Beshore

a dollar a hundredweight that the other farmers are getting. It gets the gross premium from it customers. When it takes that gross premium dollar, pays its farmers a competitive cost, now it is 75 cents short of handling its other costs of supplies. Is it covering its cost out of that premium?

A. No.

Q. Let's talk about California a little. On Exhibit 39 did you calculate the average difference between Class II butterfat price and Class IVA butterfat price over the eleven-year period?

A. I did.

Q. What was it?

A. I'm sorry, I can't recall the exact number, but I would represent to you that it was reasonably close to Dr. Cryan's testimony. It was in that range.

Q. 3.7 to 3.9 cents or so?

A. I don't know that I want to get that technical, but I would say it was something close to three cents.

Q. If that were a steady number is that

E. Kinser - Cross by Mr. Beshore

enough to cause substitution of ingredients?

A. I don't know that I know enough about what it takes to make that substitution. I know that we have experience with using substitution and at least the anecdotal information that I got would suggest that, yes, that would be sufficient.

Q. Are you doing it in California?

A. I cannot confirm that either way.

Q. You are not sure?

A. That's correct.

Q. Do you know if other Class II processors in California are doing it?

A. No, I don't have any knowledge of any other operations in California to know whether they are or aren't.

Q. If you were looking at that as a prudent cost, ingredient cost buyer, you saw a spread like that over time, 3 plus cents let's say over time, and that was enough to make it worthwhile, you would probably invest that, wouldn't you?

A. It is more complicated than that. I'm not a formulator, but in some of my roles

E. Kinser - Cross by Mr. Beshore

in procurement and some of the things we have gone through this year formulation changes make operations folks very anxious.

We have a product that we put in front of consumers day after day that we want to have the same experience today as tomorrow as next week as they had last year, so the idea of stating that you can just on a moment's notice flip a switch and put something else in and get the exact same product out is a stretch as I understand it.

Q. I wasn't suggesting a month to month switching. I'm just saying if there is a predictable spread that is enough to change over time you might do it?

A. If it is a predictable spread that is always there, then, yes.

Q. Or that if it averages three cents over eleven years and the formula is the same it is probably going to be in that area over time; right?

A. That assumes that your competition makes that exact same decision, so it is difficult to take a short run view and make a

E. Kinser - Cross by Mr. Beshore

long-term investment in a competitive environment i.e. the competitors did not make the switch, so when you are significantly price advantaged to be under water is a hard pill to swallow in our operation.

Q. I'm not sure what a competitor's formulation has to do with your product formulation.

A. I have to be as competitive, if I'm going to make a long-term switch that over the long term will return me something but in the short run I'm losing money, I have a problem.

Q. Can you tell us how the California Class I price is calculated?

A. The Class I price in California is a function of the higher of two formulas that take into account cheese, butter and nonfat dry milk.

Q. Neither of those formulas are the Class III or Class IV price; correct?

A. That is true.

Q. In the lingo of this hearing it is a decoupled Class I pricing?

A. That is correct. Can I further say

E. Kinser - Cross by Mr. Beshore

in California the pooling that they talk about doing is significantly different than the pooling of the Federal Order, so the fact that that spread moves around doesn't cause milk to move from one pool to another versus in the Federal Order that price spread would cause milk to move from order to order.

Q. You are saying California is one order marketwide state pool?

A. In a sense, yes.

Q. I want to go back to the Southeast. The transportation credits that you supported, which we appreciate, in the Southeast that were adopted there are seasonal, are they not, for six months of the year?

A. That is correct.

Q. Whatever additional transportation costs there might be in the Class I system anywhere else, six-month credits only address six months of the year?

A. That's correct, and just to kind of connect that to our earlier questioning the six months that did not apply is the six-month time period that Mr. Hollon was testifying to.

E. Kinser - Cross by Mr. Beshore

Q. The six-month time period were not transportation credits?

A. That is correct.

Q. The six months, how are you linking those two?

A. My concern is the record could be confused in thinking that the reason Mr. Hollon was stating the prices he did was that they had help coming from the pool, when in fact the time period he was referencing was a time period when the transportation credit fund was not providing those supplements as you correctly stated.

Q. It wasn't providing any supplements before and not now, January through June.

A. That's correct. The supplemental period has not changed as a result of that hearing.

Q. At the bottom of page 12 you talk about a win-win solution. Other than the nonfat dry milk price discovery change that you have explored would I be correct to understand that what you see as a win-win solution for producers and handlers are tightening up

E. Kinser - Cross by Mr. Beshore

pooling provisions, possibly individual handling pools, that sort of thing?

A. Yes.

Q. On page 15 you talk at the bottom about double payment. It references balancing costs. You talk about Dean Foods or other handlers I assume procuring milk from independent producers. Isn't it true that in many cases including cases in the Southeast and elsewhere, proprietary handlers and independent producers, they don't rely on those independent producers for their entire milk supply, that is a common procurement situation, is it not?

A. I would agree that it does exist.

Q. In those cases certainly almost without exception the handler relies on the cooperative to take up the balancing differences in volume demand throughout the --

A. At a price that is provided, yes.

MR. BESHORE: That's all the questions that I have at the moment. Thanks.

JUDGE PALMER: Any questions? Mr. Vetne.

E. Kinser - Cross by Mr. Vetne

CROSS-EXAMINATION

BY MR. VETNE:

Q. Mr. Kinser, I am John Vetne representing the Midwest Area Coalition and others. Mr. Kinser, you discussed a little bit about the California butterfat differentials Class II in relation to Class IVA in California.

A. Yes.

Q. Is Class III in California a different formula or is that the same butterfat?

A. There is a differential in California between Class II and Class III that is fixed. I can't tell you the number, but it is effectively the same within a slight adjustment between the two.

Q. The same formula but there is a difference so that fat going into ice cream has a differential lower price or a higher price?

A. I should be able to recall that. It is in the spreadsheet. The formulas would bear out what the difference is, but I can't tell you which one is higher.

E. Kinser - Cross by Mr. Vetne

Q. Were you present in the room during the testimony witness for Nestle?

A. Yes.

Q. Do you recall some discussions with her about the opportunity for arbitrage when butterfat prices under California regulations are different than Federal Order butterfat prices?

A. Yes.

Q. Has Dean Foods taken advantage of the economic opportunities in moving fat to and from California or to and out of Federal Orders?

A. Yes.

Q. For price comparison purposes when milk or cream moves out of California, moves into a non-California plant, first of all, does it get incorporated into the California pool somehow, some utilization?

A. It would be utilization of the plant that received the milk.

Q. Is it not the case that the plant receiving the milk to the extent it has utilization available can designate that

E. Kinser - Cross by Mr. Vetne

utilization as it desires and that is what flows back to California?

A. That is my understanding of how it is handled.

Q. You indicated that a problem in the Federal Order system that does not exist in California is one that results from having different pools?

A. I'm sorry, can you restate.

Q. You indicated in response to a question from Mr. Beshore distinguishing California from the Federal Order system that in California there is one pool so you don't have this pool of milk shifting between pools and in the Federal Order there are multiple pools to milk et cetera to and from. Did I paraphrase your testimony?

A. That sounds to be a fair paraphrase.

Q. In California there are two pricing orders but one pooling order?

A. Yes.

Q. There is an order that established handlers' prices for Southern California and a separate order, regulatory set of rules that

E. Kinser - Cross by Mr. Vetne

establishes handler price for Northern California?

A. That is correct.

Q. Within each of those orders there are adjustments in Class I prices based on delivery location?

A. By adjustments to price at delivery locations do you mean such in a way that in the Federal Order we have a $2 zone and another zone and in California would have the same?

Q. In California there are different Class I prices at different places in the California markets such that Los Angeles or Southern California has the highest Class I price?

A. I would say that the two marketing areas established their own Class I prices and that they are not the same.

Q. They are not the same and it is lower up north than it is in the south?

A. Yes, it is lower in the north than the south.

Q. Northern California is the surplus supply area somewhat akin to the Upper Midwest

E. Kinser - Cross by Mr. Vetne

in relation to marketing to the south?

A. That is a fair characterization.

Q. Within the pooling order there is also an independent provision for adjusting producer prices based on location; correct?

A. On the same level between north and south?

Q. Yes.

A. I believe that to be correct.

Q. You mentioned a series of state regulated markets which adopt or capture federal Class I pricing level and incorporate that in some way into the state regulation. You did not mention Montana. Is it not true that Montana does the same thing?

A. I have not seen the code and in discussions I have had with Montana I can't state to you that I know that to be true.

Q. You are not aware that the Administrative Rules of Montana, ARM on the website defines Class I price as federal mover plus X?

A. I don't know that.

Q. With respect to California, your

E. Kinser - Cross by Mr. Vetne

testimony in response to Mr. English was California is required to look at marketing conditions in nearby markets and compare that to California when esbatlishing prices.

A. The code -- and actually I know this because last week the workshop was occurring in Washington and I was actually in California testifying on a proposed Class I change -- and the code that is quoted uses reasonable relationships.

Q. Actually, I have a copy of the decision. There was a Class I hearing on approximately May 6, 2005 on a proposal to reduce Class I prices.

A. There was a hearings held May 5 and May 10, 2005 in which there was a decision provided by the Department.

Q. The Department posts its proposals and its workshop materials and a decision of a panel which is like a staff report and then an independently reviewed decision by the Secretary of agriculture?

A. That is true.

Q. All of those are posted?

E. Kinser - Cross by Mr. Vetne

A. Yes.

Q. The statute to which you refer if I can refresh your memory is Food and Agriculture Code of California Section 62062.1 which requires Class I prices paid to producers to be in reasonable relationship with Class I prices paid to producers in contiguous states, and if they are not in such a reasonable relationship the Secretary shall immediately hold a hearing to consider adjustments to Class I prices.

A. That is the portion that is continually quoted.

Q. It is reasonable to assume and it has been in past practice that if USDA increases Class I prices in federal markets contiguous to California that the California Secretary of Agriculture must consider adjusting California Class I prices and in that process establish reasonable relationships called for by statute.

A. It might even be more than reasonable. The whole premises of the hearing that just occurred had to do with the fact that California's formulas more correctly stated is

E. Kinser - Cross by Mr. Vetne

not linked between Class I and Class III and so they, California Class I and California Class IVB or IVA are not linked, so they don't recognize the influence of whey prices in their Class I price while the Federal Order Class III price does, and that influence of whey on the Federal Order Class I prices has significantly increased them in not being captured in California, so the producers in California were asking that the Secretary recognize that price spread and adjust to California Class I price.

Q. You also indicated your understanding, or perhaps it was lack of understanding, you indicated a belief about whether milk is not regulated under the Federal Order system, that is state regulated milk in Virginia, PA, New York, Maine, Montana, Nevada or totally unregulated milk in Idaho and state regulated milk in California, that milk was included in the model by USDA whether any Class I price was attributed to that milk.

Was that a concern of yours or was that an understanding of yours?

A. It is a concern of mine.

E. Kinser - Cross by Mr. Vetne

Q. We don't know, you have examined the model documentation or the analysis and been able to conclude whether that volume of milk would contribute to an increase and whether any supply response from such an increase was included in the model?

A. From my limited review of the documentation I could not tell that that supply response was factored in.

Q. California produces, what, about 20, 25 percent of milk in the country?

A. Or maybe something slightly higher than that.

Q. In any event, the viable milk produced in nonfederal markets is about a third or more?

A. That seems to be a fair representation.

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

JUDGE PALMER: Any other questions? Dr. Cryan.

E. Kinser - Cross by Dr. Cryan

CROSS-EXAMINATION

BY DR. CRYAN:

Q. I will try to be quick. You talked about, you quoted Mr. Hollon in his testimony about the January through June. You arrived at the conclusion that the co-op is recovering costs if they can pay the blend prices.

Aside from the differences that Mr. Beshore expressed about that conclusion, is it also fair to say that, and that may be if you are just looking at January through June, the fact that blend prices over six months of the year doesn't necessarily mean they are paying blend costs for the whole year; is that right?

A. That is a fair assessment.

Q. You talked about the volatility between California Class II and Class III butterfat prices and California Class IV butterfat prices and you showed it in this chart. Mr. Beshore asked you if you take advantage of some sort of arbitrage that the witness Nestle talked about in terms of taking

E. Kinser - Cross by Dr. Cryan

advantage of the differences between butterfat prices in California and the Federal Order system and you said you did at least on occasion; is that right?

A. I stated that the statement was correct, yes.

Q. Is that arbitrage based on a difference in the formulas between California and the rest of the country or is it based on a difference in the timing and essentially the fact that the Class II and Class III butterfat prices in California are out of sync with the butterfat prices in the Federal Order system?

A. Can you restate that question? I'm not sure --

Q. The arbitrage from month to month between butterfat supplies, between cream supplies in California and in federal milk marketing areas is based on price differences; is that right? I mean that is what arbitrage is?

A. Yes.

Q. The movement of cream one way or other, are those primarily based on the

E. Kinser - Cross by Dr. Cryan

underlying differences in the long-term formula or are they based on timing differences because of the two-month advance pricing of the butterfat in California Class II and Class III?

JUDGE PALMER: I'm going to give you this assistance. If you don't absolutely know, you don't have to say. You are taking a while pondering this and I'm not sure that answer is popping into your mind.

A. I guess I am unclear because in my mind the formula is all connected. I'm not sure if you are trying to disconnect something.

Q. Does cream move in both directions depending on the price relationship from month to month?

A. The cream moves in both directions, yes.

Q. Depending on the price at a given time?

A. Yes.

Q. Depending on the relative regulated prices or at least the market prices to the extent that the market prices reflect the regulated prices?

E. Kinser - Cross by Dr. Cryan

A. I would say that cream moves in the direction that is beneficial to the arbitrage, so for example when there is a price advantage in California for buying cream not regulated from the California pricing system that cream would flow in that direction, and from a federal standpoint there is an advantage of procuring cream tied to California butterfat prices if they would move from California out.

Q. Thank you. That's a good answer. You show a lot of volatility from month to month but you did agree if I understand correctly that in the long run the difference between IVA and IVB butterfat pricing and the Class II and III butterfat pricing in the California system does have a difference that reflects that difference in the formula of three cents plus something, something around three plus cents?

A. When you stretch it out over an extended period of time it does reflect the formulaic difference that turned out to be very similar to your testimony.

Q. And the California handlers know

that?

A. I would suspect the California handlers are aware of the pricing system in California.

Q. If the three plus cents is enough to cause substitution of cream of Class II and Class III cream with butter, butter oil and anhydrous milk fat based on a fixed difference does it make economic sense for them not to make the same decision on the long run gap being the same?

MR. ENGLISH: I think that was asked and answered by Mr. Beshore. The witness answered that question already.

MR. CRYAN: That's fine. I heard something like that and I wasn't sure what the answer was.

JUDGE PALMER: Thank you, sir. Mr. Tosi.

EXAMINATION

BY MR. TOSI:

Q. To the extent that other witnesses have been critical or looked to speak to the

E. Kinser - Cross by Mr. Tosi

shortcomings of the preliminary economic analysis of what the Department thought would be the outcome based on how the Department understood National Milk's proposal, are you pretty much in agreement with them with respect to their criticisms and with respect to the shortcomings of the analysis?

A. Can you be a little more specific on what exact shortcomings you are thinking others were testifying to?

Q. To the shortcomings that have been testified to at this proceeding.

A. Let me maybe try to answer. I will try to be detailed in my answer. Based on some of the discussions both with Mr. English and Mr. Vetne I do have concerns about whether the Secretary's evaluation if the model took into account I will call it the ripple effect, that a change in the Federal Order system absolutely applies to federally regulated milk but there are other pricing systems, state orders, we have talked about a few of those including California that either have what I call a direct link or is a pretty tightly dotted line

E. Kinser - Cross by Mr. Tosi

connection that will provide whatever Federal Order change occurs a price signal to non-federally regulated milk that I would assume a supply response from, and I don't know if the model included that.

Additionally, while I don't have any exact numbers to testify to, from my experience in other studies that I have seen, some which would fit into the range testified to by Dr. Gould, I am concerned about the elasticity numbers that are in there and I do fear that the number used in the Secretary's model is too low, that the response would be more, there would be a larger negative response than has been molded.

Q. To the extent that you point out on page 3 of your testimony it would sort of suggest that perhaps when it came to the point that is in agreement with your position that the study was really good because it would show these numbers?

A. I guess the point that I just talked about, the elasticity and the surround supply response, if the model is sound on all other

E. Kinser - Cross by Mr. Tosi

fronts and those two things, if my fear is correct about the shortcomings in the model, then that is just going to accelerate my point because if their supply response is not being recognized that means we are going to have even more supply, and if the elasticity creates such that there is a larger negative response or decreased consumption and there will be less milk used in Class I and more milk used in Class III and IV then the government's purchase of nonfat dry milk would be accelerated, so to the degree I have concerns about the model it just accelerates the testimony in my written statement on page 3.

Q. To the extent that the same model was used to provide an economic analysis of what the Department thought the impact would be on make allowance changes, if it turns out to be the same model, did that in any way challenge the legitimacy of the cost information that suggested manufacturers experience higher costs than what our make allowance is reasonably providing for?

A. Maybe I missed something, but I

E. Kinser - Cross by Mr. Tosi

didn't understand the Secretary used the model to make the determination of what changes should have occurred for make allowances or maybe I misunderstood your question.

Q. I'm wondering what the connection is here between an analysis that tries to predict what we think outcome is going to be by making certain changes to federal regulations and in this case or in the case of the make allowance hearing the legitimacy of the costs evidence that was presented in that proceeding?

A. What I understood of that proceeding is that the Secretary did a preliminary analysis much the same that was done for this that would show the effect on milk prices should certain assumptions be made, and at the same time the Secretary was entertaining testimony in a public record for deciding whether or not the assumption is what the decision should be, and so to kind of tie that out after the decision was made the Secretary then ran the same analysis, only that time instead of using assumptions based upon a request or based on something else, that

E. Kinser - Cross by Mr. Tosi

actually the Secretary calculated it based on the tentative rule that was being issued.

Q. To the extent that your testimony here on page 3 again suggests that the Secretary already has the answer here that the government is going to end up purchasing more nonfat dry milk powder over the period of 2007 through 2014, to the extent that the Federal Order rules are adopted that would increase MILC payments by $25 million, is that something that is related to cost information?

A. As the Secretary has done the analysis for this study, there were assumptions made to establish a baseline and then from that baseline holding all other things constant the Secretary analyzed the effect of making a change to Class I, the effect of making a change to Class II and the effect of combined changes, so to the degree that another policy change would occur, to your point the extension or change of MILC, the Secretary would need to do one of two things and maybe both, first to analyze against the baseline the implication of that change to MILC and then possibly

E. Kinser - Cross by Mr. Tosi

reestablish the baseline with that new assumption of the MILC and run the implication of say the proposed Class I price change, the proposed Class II price change and the implications of both.

I would be concerned to the same degree that Mr. Beshore was when examining Dr. Gould about the lumping of multiple effects in at once. It is difficult to make policy analysis as it is when you are just changing one increment. It gets extremely complicated when you have multiple moving parts, and to that extent I guess I appreciate the Secretary recognizes that there are at least two issues at the hearing, the Class I price and the Class II price and they are not knitted together, and in the analysis that the Secretary did he did establish a Class I analysis and a Class II analysis and then both of them were connected back together, but if you were going to throw some sort of shift on the MILC I think that is a completely separate analysis and may call for replicating everything that exists.

E. Kinser - Cross by Mr. Tosi

Q. Let me throw a hypothetical at you. We have some adopted rules that we increase MILC payments by $25 million, but the government would reduce its purchases to the tune of about $7 million of nonfat dry milk powder for example. Is that a good trade?

A. I don't have the numbers in front of me. Let's just suppose what you just stated to me was a dollar for dollar tradeoff for the government, so if you will the balance in the checking account for the United States government would not be any different.

Q. I'm sorry, maybe I didn't say it clear. May I try again?

A. Sure.

Q. On the one hand the government is going to pay out $25 million more by making this change, but at the same time it is going to pay $7 million less on something else.

Is that a good trade?

A. So the net effect is an increase in government spending if I'm doing the math right of $18 million?

Q. Yes.

E. Kinser - Cross by Mr. Tosi

A. It would depend on exactly who you look at if that is a good spend because you could, it is not necessarily an equal tradeoff for every dairy farmer and it may not be equitable for every dairy farmer, so to be a good economist I would say it depends.

Q. Does any of that have anything to do with any cost information about whether or not dairy farmers' costs have increased since 1998 in defining a Class I market, the additional costs that they incur?

A. I would say as it relates to MILC and the milk support price program those are far reaching public policy decisions that weigh out public good versus public expense and leave it at that.

Q. Do you make a distinction between transportation credits in the Upper Midwest, that they are primarily plant to plant transportation credits, one plant supplying another rather than direct from farm to plant? Do you make a distinction there?

A. That is true. As I understand it, it has been a while since I have worked with

E. Kinser - Cross by Mr. Tosi

it, but to qualify for a transportation credit in Order 30 for plant to plant movement of milk, but also in that same order is credits for the plants that put the milk together, but to contrast that against the Southeast situation there is not a credit and the transportation credit is for defined milk that can be moved from a farm.

Q. With respect to your opinion about or that National Milk's proposal delink Class III and Class IV price formulas from Secretary Class I and Class II prices, if the Secretary should determine that the additional cost to producers incurred should be reflected in the level to the differential, would that change your opinion about the consequences of adopting National Milk's proposals in the context of their new advanced Class III and Class IV formulas before the adjustment, before the 77-cent adjustment?

A. Let me try and say it this way and see if I'm answering your question. If National Milk had just taken existing formulas we are using today and went through the algebra

E. Kinser - Cross by Mr. Tosi

of moving them around such as they have and then presented that as a proposal for the Department to consider, I would still be sitting before you today stressing concern that that is a significant shift in policy from the practice of the Secretary.

Q. What policy is that, sir?

A. That is the policy connecting the Class I price to the manufacturing price.

Q. What you are saying then is we leave the Class III and Class IV formulas alone, make no changes there, okay, but now we are going to change the level of the Class I differential somewhat. Are you saying then that any change to the Class I differential represents a shift in the longstanding policy of the Secretary or the Federal Order program?

A. No. Let me try it this way. If instead of doing what National Milk has done and they were looking for the 77 cents they had asked for every differential that is listed in I think it is 1,050 whatever differentials are listed, they had taken those numbers and added 77 cents to them and laid them before us and

E. Kinser - Cross by Mr. Tosi

that is what I was testifying to. I would not be testifying that there was a policy change. I would still disagree that there was a need for a price increase, but I would purely be talking about not having a need for a price increase, I would not be talking about that we first don't need a price increase but second we definitely do not need a change in policy by the Secretary.

Q. I appreciate that. What is your understanding of what the purpose of the Class I differential is?

A. My understanding of the purpose of the Class I differential is it is a piece of meeting the objective of the Act to ensure that there is an adequate supply of wholesome packaged or fluid milk.

Q. With that what do you understand the pooling standards, what are they intended to do?

A. The pooling standards have to do -- the Secretary talked about this. I'm not sure I quoted it, but the Secretary talks extensively about it in that 1987 decision that

E. Kinser - Cross by Mr. Tosi

I referenced.

Pooling standards have to do with what milk should be eligible to receive the uniform blend price, and so that Class I differential creates an incentive for there to be milk in the marketplace.

Pooling establishes who should really receive that incentive, so what milk is needed, so that's why in the South the pooling, the price is extremely high but the pooling provisions are very tight because you want the milk available there to be in the Class I and Class II supply to make sure that there is fluid milk available to consumers because the local milk supply is less relative or in contrast to say the Upper Midwest where there is ample milk around relative to the population and so the pooling provisions are much more lax.

Q. Would you agree that the pooling standards also set a criteria that if met qualifies other milk to be pooled to the extent that it meets a certain minimum volume that is delivered to distributing plants?

E. Kinser - Cross by Mr. Tosi

A. I would agree that if milk meets the performance standard of the Order that it then qualifies to receive the blend price of the Order.

Q. To the extent that you participated in some of these past pooling hearings, to the best of your recollection were any performance standards here changed to help provide a more reasonable assurance that Dean Foods for example had more of an assurance that it would be supplied with milk for fluid use?

A. On page 7 I listed a total of seven hearings and their start dates, so working from the bottom of that list back as I recall the Mideast on March 7 did in fact in the decisions published thus far include a change in the percent of milk that could be diverted which in fact was a tightening of that order. I think the same also applied to the Central which was held on December 6.

The Upper Midwest on August 16, I do not belive that to be the case though what happened at that hearing was it defined the location of nonpool plants to which milk could

E. Kinser - Cross by Mr. Tosi

be diverted so it changed some of the geographical relationships and at the same time it set a cap on the miles that could be eligible for transportation credit which has an effect of again tightening the milk that could be in effect.

I don't have very much knowledge of what happened prior to that in the Northeast, Central Mideast or Midwest, but it is my belief in general those hearings all resulted in the Secretary tightening in some way, shape or form provisions of what milk could qualify to participate in the blend price.

Q. Was one of its key considerations that pooling provision provide a reasonable assurance that distributing plants like yours would receive an adequate supply of milk?

A. That was true of all the decisions that I just referenced in detail in the Mideast, Central and Upper Midwest, that milk that left the pool could not jump back on until the Secretary talked to a cap of how much could be increased and it should have the effect of lessening pooling which ensures that the milk

E. Kinser - Cross by Mr. Tosi

stays as part of the supply and available to serve district companies.

Q. To the extent that the pooling standards have provisions that provide a reasonable assurance that they are getting an adequate supply of milk, the balance of saying how much milk can be pooled on an order, who makes that decision?

A. Some of it is within the determination of the Secretary as what is needed for a necessary reserve in establishing the balance of the pooling provisions, but when it comes to the actual milk that participates in a month's calculation and a month's draw, the uniform price, it has to do with the handlers of the neighborhood that qualifies and what they choose to write on their pool reports.

Q. Would you agree that it would be possible in the Upper Midwest to say tighten the pooling provisions such that truly only those that supply almost every drop of milk is going to Class I use to reflect that quantity?

I'm not done yet. Also, let's say

E. Kinser - Cross by Mr. Tosi

it would have a performance standard of say 60 percent; okay? To the extent that out of all the milk that is in that area maybe only ten percent is actually needed for Class I use but only ten percent of the producers are actually day in and day out incurring the cost of actually supplying that market, don't you think that it is up to those producers who are supplying that market to determine who else can participate in sharing their money?

A. You give a very interesting example in that the ultimate decider of sharing the money is the producers themselves in that they vote for the order and so the order you were picking on would have the majority of the milk in a nonsupply situation that use their typical benefitters of the order with minimum performance it is going to be hard for them to vote against their self-interest to make a change that would help the orderly marketing of milk.

Q. But in another order where they choose to, where the producers who are day in and day out regularly providing Class I market

E. Kinser - Cross by Mr. Tosi

choose to be less generous if you will on how far out a reserve supply that they would need in all those producers, that would be okay? That is okay?

A. It gets easier for producers to support things where they are the beneficiary of that, so when you flip from say Upper Midwest to the extreme Southeast you have a larger percent of the producers who are, let's say that they are a part of that expense and so, yes, they would want it tighter so that they weren't sharing the benefits with people that weren't bearing their same percentage cost.

Q. So once pooling standards provide a reasonable assurance that Class I milk is available it is really an issue among market producers to decide who is in the pool and who is not, who they are selling to, sit down at the table at the end of every month and share in the pool?

A. In the broadest sense, yes.

Q. Your recommendations are to do something with the pooling standards that would

E. Kinser - Cross by Mr. Tosi

be in the arena of providing you a higher assurance of an adequate supply of Class I milk or are you talking about how far our producers should share Class I revenues?

A. I would be inclined to say that the two points, adequate supply and how far out, are connected points.

Q. Well, sure they are, of course, but to the extent that the first is satisfied, meaning you are satisfied as a handler that needs the milk, after that, how far out? Who should be deciding that?

Your proposal sort of suggests that we could do something there, but it is unclear to me are you talking about do you want higher performance standards if you will? Do you want more of an assurance that the order is going to bring Class I milk first or are you wanting the Secretary to do something? That is how producers decide amongst themselves how they want to share this money.

A. It is our bottom line most that we would like the dollars that we pay to go to those producers which supply us milk, and

E. Kinser - Cross by Mr. Tosi

marketwide pooling disrupts that signal and the dollars we spend get spread across a lot of different voices that supply that is not putting milk into our plant.

Q. Are you advocating individual handler pooling?

A. We would be supportive of that, yes.

Q. Have you ever submitted a proposal asking for that?

A. It is my understanding that we have in fact submitted a proposal for that.

Q. Since Federal Order reform?

A. Since Federal Order reform, yes.

Q. When you were talking about Mr. Hollon's statement that is reflected on page 12 of your testimony, to the extent that that testimony was testimony in providing evidence for establishing a new intramarket transportation credit, do you draw a distinction there in the conclusions that you are drawing from this testimony because you seem to link it to the intramarket, bringing supplemental milk in when the market needs supplemental milk to satisfy Class I demands?

E. Kinser - Cross by Mr. Tosi

A. The sole purpose of quoting Mr. Hollon was to introduce to the record that it appears as though there was definitely revenue beyond the Federal Order that is able to make it to dairy farms and while nothing to that effect at least that I have heard has been presented at this hearing Mr. Hollon did in fact go on the stand at a recent hearing to provide evidence to the record, and to me it seemed that it was still reasonably timely to be included in this record as evidence of my point.

Q. One of the other concerns that I take away, do you draw a distinction between equitable and equal?

A. Yes.

Q. Could you tell me what that is please.

A. I kind of hate to plagiarize, but I would agree at least as I interpret it with Mr. Tonak's testimony that the proposal before us would equally increase the Class I price but that it will not be equitably shared with producers.

E. Kinser - Cross by Mr. Tosi

Maybe to translate that a little more to again a principle you and I were just talking about of Dean Foods, and that is that we will experience an equal increase across all areas, but unfortunately producers that serve our plants will not all receive equal payments and even equal compensation for their service to us. The costs of serving our plant is not equitably shared across all dairy farmers.

Q. Okay, so then you would be of the position that, to refer back to Mr. Tonak's testimony, a producer in the Upper Midwest who meets the most minimum of performance standards in the pooling standards performance standards and actual Federal Orders should share equally with producers say in the Southeast or Florida where all of their production is geared towards providing a service to the Class I market and all the additional costs that are included in that, you would consider that equitable? I understand that it is not equal, but I'm trying to understand what your sense of equitable here means.

A. Maybe I'm really not sure I

E. Kinser - Cross by Mr. Tosi

understand. Let me try answering it this way. If in fact there is a need to increase the Class I and Class II price because of costs incurred, again hypothetically, I'm not saying I support that proposal, then if that's where the need is then it seems to me equal and equitable that that should go back to the dairy farmers that supply that milk as opposed to going into the pool and being shared among all dairy farmers that are able to associate or "qualify" for the pool.

Q. Why is that your concern what producers do or decide amongst themselves how they want to share revenue when it comes to Class I sales?

A. Because when we have milk that connects to a market that is not supplying the market it lowers the blend price for the whole market and that deviates again from our core principle that we would like the money that we pay for our milk to go to the dairy farmers that are supplying our milk, and the more milk that gets associated with not supplying Class I markets they are just lowering the payment to

E. Kinser - Cross by Mr. Tosi

the dairy farms that are supplying the market.

Q. I understand that. Then let's go back again to all of these rounds of pooling hearings that you cited. To the extent that some of these order areas that you have identified are the result of a consolidation of a large number of orders into one single large one and each of those orders had its own performance standards and pooling standards, and in order to meet a congressional mandate when we have a certain number of orders, what pooling standards do you decide on? How do you decide to pick those things?

JUDGE PALMER: I didn't quite hear the question.

Q. How do you decide to pick what your pooling standards should be?

A. I think at the end of the day the pooling standards get what is the necessary reserve supply and so --

JUDGE PALMER: Let me interrupt for a second. I hate to interrupt particularly when someone from the government who is going to be involved in preparing the

E. Kinser - Cross by Mr. Tosi

decision is asking a question because whatever he needs he needs, but you don't have a proposal for any particular pooling standards before us today, do you?

THE WITNESS: As I understand, the proposals before us today we don't have.

JUDGE PALMER: So you don't have any proposal on that, but you are talking about at some time in the future you would like to see some pooling standards come into being but you haven't prepared your thoughts as to what they should be?

THE WITNESS: That's correct. We are here to express concern about not having an opportunity to offer alternative proposals.

JUDGE PALMER: All right, so you don't have an alternative proposal, you would have liked to have, but since you don't you have put together the kind of pooling standards that you think would be the most appropriate for various markets; is that right?

THE WITNESS: That's true.

JUDGE PALMER: I think we are going into an area that is not going to be

E. Kinser - Cross by Mr. Carmen

helpful to you since it is not before us really.

MR. TOSI: Are you making that decision for the Department?

JUDGE PALMER: That's what it appears to me. Are you still going to ask him questions about that? He doesn't have a proposal here, and at such time that he might have one he probably wants to rethink the thing. Later on if he did have a proposal you really couldn't use what he said here today anyway. It would be a different hearing with a different set of records.

MR. TOSI: I have my reasons, Your Honor, but I will stop. That is all I have.

JUDGE PALMER: Any other questions for this witness?

CROSS-EXAMINATION

BY MR. CARMEN:

Q. Clifford Carmen on behalf of the Department of Agriculture. To expand some more on the econometric model the Department is

E. Kinser - Cross by Mr. Carmen

using and on whether or not it represents the Federal Order as well as other areas of United States, the equations represented in the documentation for the milk out equation and the yield per cow equation use an all milk price.

The all milk price is your understanding as reported by NASS? It is not a Federal Order price, it includes Federal Orders but it is reported by NASS that there is an all milk price for Grade B as well as fluid grade milk?

A. Is the question do I understand the NASS all milk price to reflect --

Q. All prices received by dairy farmers are delivered to plants?

A. Yes.

Q. So we have a supply side of the model that relates to the all milk price including Federal Orders as well as other parts of the United States that are not included in Federal Orders?

A. I don't recall that I looked at that detail, but if the supply side is such that it stated that the supply equation of the model

E. Kinser - Cross by Mr. Carmen

would link to the U.S. all milk price, then I would agree that changes across the country would capture the supply. I guess the concern I have is we have taken care of the supply but we figured the all milk price, did it in fact recognize those other states.

Q. The milk supply is represented in Table 2 of the documentation as contained on the USDA website. If we go to Table 12 of the documentation, the model estimates an all milk price based on the Federal Order prices as well as a proxy to represent the revenues received by processors and then transferred back to dairy farmers for other parts of the country i.e., that proxy is calculated by the Federal Order price compared to the all milk price so that in a sense the all milk price is a function of Federal Order prices plus other revenues out there.

MR. ENGLISH: Is there a question there?

JUDGE PALMER: He made a statement. Do you understand what he said and do you agree with him? If you don't know, say

E. Kinser - Cross by Mr. Carmen

you don't know.

THE WITNESS: I understand what he told me. I don't know if that is what is printed or not.

JUDGE PALMER: You don't know what?

THE WITNESS: I don't know if that is what was printed.

JUDGE PALMER: You wouldn't disagree with him or agree with him because you don't have the table in front of you?

THE WITNESS: Yes.

JUDGE PALMER: Any other questions? Apparently not. Thank you very much, sir.

MR. STEVENS: Your Honor, I think I have to do this. I want to take exception to your ruling that Mr. Tosi can't pursue his questions. Let me make my point. The point is that a lot of these questions you have to build a foundation. You have to ask a few preliminary questions. I know it is long and I know we all want to get out of here, but the point is there are very important points that need to be made and I think Mr. Tosi should be able to ask the questions. I put it to the group.

I want to make my point, which is that marketing specialists are here to make a full record. They are here to inquire of the witnesses and to make a record. If Your Honor wants to limit that questioning by these people I object because their role here is to get evidence to put it on the record and have it there for the Secretary's evaluation, important points that need to be made. I'm not putting it to a vote, but that's what this hearing is about.

JUDGE PALMER: I agree with you. I thought I had detected a disconnect between what the witness was saying here and what Mr. Tosi was trying to get and so I was trying to point that out. If Mr. Tosi wants to ask more questions we are going to let him.

We are going to take a break for five minutes and then we will come back and Mr. Tosi can examine the witness.

(Recess taken.)

E. Kinser - Cross by Mr. Tosi

BY MR. TOSI:

Q. What cost information presented by National Milk for increasing the Class I pricing do you take issue with?

A. I believe the record will bear out that there is conflicting evidence between National Milk's testimony and other testimony as it relates to the cost of maintaining the Grade A standard; also, the idea that the Class II butterfat price can be increased so significantly without implication in a product that has a lot of substitutability. I don't have numbers to present to either support or deny National Milk's proposals to changing costs of balancing, but to refer again to my testimony it is not going to be equal or equitable for handlers again contrasting proprietary handlers of independent supply versus proprietary handlers that are cooperatively supplied.

I really can't recall the rest of the points. That is as far as I'm thinking through what they were saying and what our position is.

MR. TOSI: Nothing more. Thank you.

JUDGE PALMER: Any other questions? We have already had a break. Do we have another witness?

MR. ROSENBAUM: We do.

JUDGE PALMER: Is he here?

MR. ROSENBAUM: Yes. I think Mr. Vetne wants to say something.

MR. VETNE: Your Honor, I have to leave tonight. There are a couple of things and this is a good time to do it if I might. Earlier in the hearing we had some observations about Howard McDowell's absence. At that time there was not yet apparent any need to question about what is in there. Now there is.

There are three things in particular. First of all, for myself and I believe for my clients we don't have any great criticism of the model. In fact, Dr. Gould testified that the model appeared to be reasonable and it does what econometric models do although they have some variability, but there are some things about the model that we don't know, but more importantly there are some things about the consumer or user of the model that we don't know. The model is one that is developed by the chief economist of the USDA. The users of the model, in this case dairy programs, we don't know what was input into the model, so there are three questions, and maybe somebody else has some other questions, but there are three questions for which I would like an answer and it would be satisfactory to me to have the response posted on the Internet fairly soon so we can incorporate it into the briefings.

Number one is whether employment of the model, the price increases for Class I and Class II were limited to the production in Federal Orders or whether they were also input into other markets which either adopt or respond to Federal Orders.

As far as I know that includes virtually all the milk except possibly for, well, Utah, Idaho, which is unregulated, but they maybe do so competitively, but California responds and all of the others that were mentioned actually incorporate the figures.

If that price increase wasn't attributed to a third of the Class I milk in the country there would be a different result, a supply response would be different and the Class III and Class IV prices would be lower. The model would work the same way but with numbers that more accurately reflect the response including the regulatory response of other agencies. That is number one.

Number two, Dr. Gould backed into some inference that he thought was fairly reasonable about what the supply elasticity used in the model was. It wasn't something that was transparent or taken on its face. The supply elasticity of cow numbers was, but not for milk per cow, and maybe he was right and maybe wasn't exactly right but if we could simply have a representation of what the total supply elasticity is or the combination cow number and yield elasticities are so we could work with those, that would be very helpful.

Under number three there was nothing there by which to make conclusions within confidence intervals and Dr. Gould testified that was pretty important. These estimates are not a pinpoint. What they usually give you is here is what we expect the future to look like within a 95 percent confidence or 90 percent confidence or 80 percent confidence. We don't have that information.

Those are the three things that are very important to my clients and I think important for this record to have in order to be able to make an intelligent brief on the probable outcomes of the proposal and the implications of those outcomes to federal dairy policy.

The difference in this hearing compared to the make allowance hearing and use of the model is that for that hearing we had a witness to talk about the model and the analysis and in this hearing the witness didn't come. We learned a lot about the model and its applications at the last hearing. A few additional questions occurred now and the answer to those three questions may help others have different questions.

To that extent those three answers would be fine for me, but maybe USDA could post after we go home from this hearing within five days we will be receiving questions for either the people who created the model or the person who used the model and consider whether to give answers and then post those answers at some point before the briefing is due. That is my request in lieu of adjourning and reopening the hearing for that limited purpose I think it is more efficient.

JUDGE PALMER: I have heard your request and they have heard your request.

MR. STEVENS: Let me say for the record, Your Honor, we have talked about this and we are willing to take that request back to the Department and review the request and if answers are forthcoming they will be put on the website and we will try to do that as expeditiously as we can. That's what I can offer.

JUDGE PALMER: I guess that's where we will leave it. Thank you, sir.

MR. VETNE: I have a couple of

official notices from various government sources. From NASS, the national Agricultural Statistical Service, these are all website-available documents on the NASS website, a monthly document called Milk Production, releases for February, at least the ones released in February for 1998 through 2003; a document called Milk Production Disposition and Income, which is an annual summary published usually in April, sometimes in May of each year for the prior year and shows among other things total production as well as the percent of production represented by Grade B farms or nongrade A farms, and for that annual publication I would like these, these are all on the website, the April or May release for 1979, 1989 and 1999 through 2006.

There is a related publication called Milk Disposition and Income Final Estimates, which is released annually during or about May which makes adjustments and corrections for prior publications, and I would like those publications released during 1998 through 2006.

There is also a new publication, fairly new, starting in February 2004 called Licensed Dairy Herds and that has since been published in 2005 and 2006. That is a separate publication which contains information which used to be contained as a special edition to the February Milk Release, so those three years for that publication, Licensed Dairy Herds, for the NASS data.

For that subagency, for AMS Federal Milk Order Market Statistics comes out annually for 1998 through 2006. As it is currently developed the information is put on the Web as it accrues for the year and then becomes annual. Dairy Market Statistics also comes from dairy programs AMS which is a compilation of information reported weekly in dairy market and weekly dairy market publications, annual dairy market statistics again for 1998 through 2006 as released.

On the dairy programs website there also is a documentation published, not predictably, not at any particular interval, but occasionally there are two of three of them in 1998 showing producer milk pooled by state and county. Those publications for periods from 1998 forward, and again all of these of course relate to the period from the recommended decision for Federal Order reform to the current time.

Then California Department of Food and Agriculture Statistical Data. It is all published on the CDFA website. California Dairy Statistics is an annual publication and then California Dairy Information Bulletin is published monthly.

Then under the California Dairy website hearings, hearing matrix, there is a notice of hearing and a decision for May 6, 2005. The recommendation of the hearing panel and the decision of the Secretary in that case explains the California system and the statutory requirements applicable to the California system and again the notice of hearing to extend the decision before briefing for the December 5, 2006 hearing, to which I think Kinser referred, and finally a publication previously referenced I think by

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Mr. Gallagher which was a report by the office of the Secretary submitted to the United States Congress and required by Congress and released in July 2004 called Economic Effects on U.S. Dairy Policy. That concludes my list of requests.

JUDGE PALMER: Any objections? Official notice will be taken.

MR. ROSENBAUM: We call Mr. Mike Suever.

(Exhibit No. 41 was marked for identification.)

MICHAEL SUEVER

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Mr. Suever, you have an exhibit we have marked as Exhibit 41. Can you please read that.

A. My name is Mike Suever. I am a senior vice president for HP Hood LLC and am responsible for milk procurement, research and

M. Suever - Direct

development and engineering.

Our company has substantial capital invested in facilities that process and package milk into Class I and Class II products. We operate 14 Class I and Class II plants in Federal Order One and six plants in the Upper Midwest. As such, we are keenly interested in the outcome of this proceeding.

I have testified at many federal and state regulatory hearings over the last 25 years in the business. I must say that I was surprised when the USDA announced that it was willing to consider changes of this magnitude on an emergency basis and affording a very short time for the industry to prepare. I am generally an advocate of a rapid process, but the substance of this proceeding requires more time for preparation.

Class I milk is the principle focus of the Federal Order system, yet potentially massive changes are being considered on less than three months' notice. This includes not only a change in the relationship of Classes I and II from III and IV, thereby reversing

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decades of practices, as well as extremely large increases in the Class I and Class II prices.

HP Hood LLC is opposed to Proposals 1 through 5 as published and recommends that the Department deny the requested changes. One of the overriding arguments used by the proponents for requesting this hearing at this time is the impending impact to producers' income as a result of the recommended changes to the Class III and Class IV make allowance.

The proponents suggest that the circular nature of the current Class III price formulas make it difficult to seek recuperation in those markets. Rather than deal with the problem of circular pricing head-on the proponents have sought out the Class I and Class II markets for relief. The proponents claim that there is a growing difficulty to supply local and regional markets in the Southeast and Northeast.

I am not intimately familiar on a day-to-day basis with the Southeastern market

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but I would like to comment on the milk supply market in the Northeast. As noted, HP Hood is a very prominent player in that market. We are not experiencing any difficulty in attracting milk to our Class I and Class II plants in the Northeast. In fact, just the opposite is true. Some of the largest co-ops in the Northeast have requested an even larger share of our business in the last 60 days. It has been a number of years since the local market administrator felt it necessary to request a call hearing within the Northeast. The fact that such calls once occurred but do not now is an indication of the adequacy of the supply.

If I am not mistaken, the Northeast has the largest concentration of Class II production in the Federal Order system and yet an adequate supply of milk exists in the market. Furthermore, at the very time that the co-ops are indicating that milk is supposedly unavailable for the Class I and Class II markets they are collecting $0.10/cwt for their members so that dairy herds can be terminated.

I don't see how you can purposely

M. Suever - Direct

try to reduce the supply and then claim that the supposed inadequacy of the supply requires government intervention.

The next area of focus by the proponents is the rising cost of transportation to all markets. As they note, "transportation costs affect all markets" yet they seek compensation from only the Class I and Class II markets. They note processors achieve savings through the operation of larger plants but claim that the higher hauling rates and longer hauls that allow these plant savings are imposed upon producers and their cooperatives.

Larger plants are not exclusive to facilities that only make Class I and Class II products. In fact, some of the largest dairy plants built in recent times have been Class III plants, which in many cases are at least partly owned by cooperatives. There is no basis to try to shift these transportation costs to Class I and Class II markets.

The Federal Order has dealt with transportation costs to serve markets in other ways. For the proponents to ignore the myriad

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of details involved with transportation and simply state that one change to the price mover is the way to deal with things or will take care of things is preposterous. The producers have often looked to USDA for a quick fix. Let's not make that same mistake again for expediency.

The proponents also focus on the existence of voluntarily negotiated and increasing Class I premiums as the purported rationale for proposed changes to the mover. The following table depicts the average Class I premium charged by CMPC members in the Federal Order 30 Eastern/Chicago market followed by the premiums charged in Federal Order 68 Upper Midwest.

Unfortunately, the data that was provided to me by the CMPC did not include a full year for 1995, but I have noted that the data and average here only is indicative of the time period from August to December.

As you can see from the data, over time the premiums move up and down. The premiums for the two areas do not follow in

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lock step with each other. In fact, the latest data which includes 2006 shows that premiums have been moving lower from a high in 2004.

I do not believe for one moment that these premiums are an indication of the inadequacy of the current minimum Class I prices to draw milk to the pool to meet Class I needs. The fluctuation of Class I premiums has been influenced by any number of things within the market or adjacent markets. Some of these factors include the amount of Class I access that various co-ops have at any given time and the influx of very large farms just to the east of the region. Even infighting amongst co-ops has had a significant impact.

The assertion that changes in the Class I premiums should be used to make an adjustment to the mover is baseless. I have asked our co-op suppliers what will happen to our voluntary premium if a portion of the current premium becomes institutionalized in the Class I price. They have made it clear that they cannot reduce our premium. They claim that their producers have come to expect

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the current level of premiums in their monthly check.

Another major problem with the proposal is its impact in the Upper Midwest where HP Hood also has significant operations. Based on my calculations, producers that supply our milk plants in the Upper Midwest will actually end up with less money at the end of the month if this proposal is approved. When I ran a set of numbers using the proposal in conjunction with the expected MILC payments, the producers that supply our Upper Midwest plants would experience a lower total price for their milk.

We are now dealing with Class II. The proponents note that the spread between Class II butterfat is 3.7 cents to 3.93 cents higher than the butterfat formula for California Class IVA while their proposal would establish a spread of only 2.7 cents above the Class IV butterfat formula in the Federal Order areas. They then go on to assert that substantial substitution of butter, butter oil or anhydrous milkfat for cream has not occurred

M. Suever - Direct

in California.

I did not hear any of the proponents define the term substantial in this context. I fail to understand how the market dynamics of California which is a year-round exporter of butterfat in many forms can be compared to the Northeastern market that imports butterfat at least nine months of the year.

The proponents also fail to note that substitution of nonmilk fat sources can and do occur already. A perfect example is a product called Cream Cheez made with some vegetable oil. This product does not meet the standard of identity for cream cheese but is gaining an ever growing share of the food service historic cream cheese market.

In summary, the cooperatives are looking for a quick fix to compensate the producers for any impact due to a change in the Class III and IV make allowances, but their solution has little to do with this alleged problem and would carry significant negative consequences. Their proposal ignores the real problem of a circular manufacturing price

M. Suever - Cross by Mr. Beshore

formula and location adjustments that should be revisited. We should not change the movers just to avoid the real issues concerning milk price calculations.

Thank you for allowing me to testify today.

MR. ROSENBAUM: I will move Exhibit 41 into evidence.

JUDGE PALMER: Yes, we will receive it. Any questions?

(Exhibit No. 41 was received into evidence.)

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good afternoon, Mike.
A. Good afternoon, sir.
Q. When you calculated the impact in the Upper Midwest if I understand your testimony correctly that was based on using the MILC payments as presently in law?
A. Yes.
Q. Of course you know that that expires very shortly, correct, that legislation?

M. Suever - Cross by Mr. Beshore

A. My assumption was that it would continue as it currently exists.

Q. You stay the Northeastern market imports butterfat nine months of the year. Can you tell us anymore about that?

A. Based on my experience in that market for the last 15 years we are a net importer of milkfat into the Northeast market at least nine months of the year. It varies, sometimes a little bit more, sometimes a little bit less, but on average my experience in the Northeast for the last 15 years that has been my experience.

MR. BESHORE: Thank you.

JUDGE PALMER: Any questions? Thank you, sir.

MR. ROSENBAUM: Should we call another witness? We call Mr. Barner.

(Exhibit No. 42 was marked for identification.)

B. Barner - Direct

BEN BARNER

a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Mr. Barner, you have a prepared statement. If you could read it for us please.

A. Smith Dairy is a privately owned independent dairy with two production plants. One is in Richmond, Indiana and the other is in Orrville, Ohio. Both of these plants are in the Federal Order 33 Mideast market.

The Ohio plant packages fluid milk and manufactures ice cream, cottage cheese and other cultured products. It is about 50 miles south of Cleveland. We employ about 300 associates in Ohio. Our primary customers are retail food stores, food service accounts and warehouses, schools and other manufacturers which need dairy products as ingredients. We ship products mostly throughout the State of Ohio.

Our Indiana plant packages both HTST

B. Barner - Direct

and UHT fluid products. About 100 associates work here. Its customer base includes large retail grocery chains, food service warehouses and manufacturers needing dairy ingredients. Products are primarily shipped throughout Kentucky, Indiana and Ohio. An exception to that is the UHT products. They are shipped to a much wider area.

Our combined monthly milk value is about 30 million pounds. Both plants have an independent non-co-op milk supply produced by approximately 250 farms located mostly within 50 miles of each facility. This is supplemented by milk provided by the Dairy Farmers of America.

I am Ben Barner, Smith Dairy's field service representative for the Ohio plant. I am responsible for working directly with the producers shipping milk to our plant. I monitor the procedures utilized to ensure that a quality and safe supply of milk is shipped to our plant. I sign up new producers when we need more milk. I have been working in this position for seven years.

B. Barner - Direct

As a dairy company receiving milk from independent non-co-op member dairy farmers, Smith Dairy is in an important position from which to comment on the procurement of Class I milk. My remarks focus on two issues related to the proposals under consideration in this hearing.

First, contrary to any implications of the proponents that a greater Class I differential is necessary to attract for Class I use, Smith Dairy is not experiencing a current problem in attracting enough milk for Class I use for our plants. In fact, we maintain a list of approximately 12 dairy farms waiting to become regular shippers to Smith Dairy should a current supply farm decide to ship milk elsewhere.

Second, because we receive milk from independent dairy producers we perform and cover our own costs of balancing. Several methods are utilized to balance our supply and demand. They include: When feasible, we ship milk between our two plants to balance the supply and needs of each.

B. Barner - Direct

We have an arrangement with a cheese plant whereby we ship them up to a maximum number of loads per week to dispose of any surplus we have. If we need extra they will sell us a few loads.

If we have more surplus or needs than the two options above can satisfy, the Dairy Farmers of America will supply extra or take some of our surplus.

Another option we have used to dispose of a surplus is working with several other cheese manufacturers. At the right price they usually will buy milk from us.

For each of these there are costs and premiums that we pay. When we need to buy milk we already pay on top of the Class I minimum and the over order premium an additional premium to get the milk we need.

Conversely, when we have too much milk we often receive less than class value, sometimes significantly less, for the bulk milk we sell. Both the higher price we pay when milk is scarce and the lower price we pay when milk is plentiful are among the balancing costs we bear in doing business in the dairy industry.

It would be unfair to ask us to pay a higher Class I price to pay someone else for balancing when we in fact are performing and paying for that ourselves.

MR. ROSENBAUM: I would ask that Exhibit 42 be entered into evidence.

JUDGE PALMER: Very well. It is received.

(Exhibit No. 42 was received into evidence.)

MR. ROSENBAUM: The witness is available for cross-examination.

JUDGE PALMER: Are there any questions?

CROSS-EXAMINATION

BY MR. BESHORE:

Q. Marvin Beshore. Mr. Barner, I represent the Association of Dairy Cooperatives in the Northeast and Dairy Farmers of America. I know you have been here throughout the whole hearing. Do I understand your supply

B. Barner - Cross by Mr. Beshore

arrangement correctly that basically when you need another extra load of milk you acquire it in terms of your relationship with the DFA?

A. That's correct.

Q. And when you have for one reason or another perhaps some flush milk from your own producers that you don't need and your other customers don't want it, the DFA takes it?

A. Yes.

Q. The balance --

A. They said they would. I am not so sure that we have worked with them before. We work with the cheese plant. They may have. I'm not aware of it.

Q. You don't handle that particular part of the company's business?

A. No, I don't.

Q. You work with producers on a day-to-day basis?

A. Yes.

Q. Certain producers have testified from time to time at prior hearings and if I recall their testimony correctly they regularly receive premiums in excess of a dollar?

B. Barner - Cross by Mr. Vetne

A. Some of them can make more than a dollar, that's correct.

Q. You heard some reports recently that you have taken on a couple producers in recent months; is that true?

A. Yes.

Q. In some cases they have been assured premiums in the area of $1.50?

A. That's correct, they could. Our better bigger firearms can do that, yes.

Q. If you were offering minimum Federal Order price do you think you would have supply in your plant?

A. Probably not. I would say not.

MR. BESHORE: Thanks.

JUDGE PALMER: Mr. Vetne.

CROSS-EXAMINATION

BY MR. VETNE:

Q. John Vetne, Mr. Barner. The word "associates" here, is that synonymous with total employees?

A. Yes, that's at the Ohio plant.

Q. At those two locations?

B. Barner - Cross by Mr. Vetne

A. Yes.

Q. Between the two locations you have a total of 400 approximate employees?

A. Approximate, yes.

Q. All of your other locations and all the business endeavors submitted have less than 500 employees?

A. Yes.

Q. That's one thing. The other question is are you familiar with any of the other plants in the Mideast region that predominantly receive milk from independent producers?

A. In our area?

Q. Yes.

A. I'm familiar with some, yes.

Q. Are those plants much like yours in that they also have their own balancing costs?

A. Right.

Q. In that respect they are different from some of the large, huge corporate plants that get all their milk from co-ops and pay co-ops for those balancing costs?

A. Yes.

B. Barner - Cross by Dr. Cryan

Q. As a small business in fact this proposal would be different upon you than on your competitors?

A. Yes.

JUDGE PALMER: Dr. Cryan.

DR. CRYAN: I have one question.

CROSS-EXAMINATION

BY DR. CRYAN:

Q. The cheese plant that helps you balance your supply, is that a pool plant? Can you name the plant?

A. Middlefield Cheese.

DR. CRYAN: Thank you.

A. They are not the only one but they are one of them. That is the one that we use 99 percent of the time.

CROSS-EXAMINATION

BY MR. YALE:

Q. Ben Yale for Select and others. Mr. Beshore asked you a question about if you didn't have an over order premium would you be

B. Barner - Cross by Mr. Yale

able to attract that milk.

A. Yes.

Q. If a substantial portion of your dollars or more than you are paying in premiums becomes part of the minimum price, would you have to pay even more for your milk to continue to have a dollar, a dollar and a half spread over the minimum price?

A. If I understand your question I would say yes.

Q. You would add the extra 75 cents or whatever this would be plus that to attract the milk?

A. I would say yes.

Q. The over order premium is attracting the milk to your plant; is that what you are saying?

A. Yeah. I'm not sure I understand the question.

Q. You will still have the need for an over order premium to attract milk to your plant?

A. Yes.

JUDGE PALMER: Any other

questions? Thank you very much, sir. We will close down the hearing for tonight. We are going off the record.

(Whereupon, the above-entitled matter was concluded at 4:45 p.m. this date.)

C E R T I F I C A T E

I hereby certify that the proceedings and evidence are contained fully and accurately in the stenographic notes taken by me on the hearing of the within cause and that this is a correct transcript of the same.

S/Vivian D. Macurak

Vivian D. Macurak