EXHIBIT EIGHTY-EIGHT

**In re: Milk in the Northeast, Appalachian, Florida, Southeast, Upper Midwest, Central, Mideast, Pacific Northwest, Southwest and Arizona Marketing Areas**
**Docket Nos: AO-14-A78 et al.; DA-09-02; AMS-DA-09-0007**

**Exhibit __**

# STATEMENT OF SALLY KEEFE

## I. Introduction

My name is Sally Keefe. I am a Vice President at Aurora Organic Dairy. I have been with the company since it began in 2003. My responsibilities include dealing with regulatory issues affecting the company. I have a bachelor's degree in Economics from Middlebury College and an M.B.A. from the University of Colorado. Prior to working at Aurora, I was responsible for milk procurement at another organic dairy. I am familiar with the FMMOs and their impact on the organic milk market.

Aurora Organic Dairy is a leading supplier of private-label and store-brand organic milk and butter to U.S. retailers. Our mission is making high-quality organic milk and butter more affordable and available for mainstream Americans.

We have 345 employees. We milk about 12,000 cows every day at our five farms in Colorado and Texas. Aurora is organized as a corporation in which a number of employees have an equity stake. Aurora Organic Dairy is a producer-handler. All of the milk that we process in our plant in Platteville, Colorado is produced on our farms.

Our goal when we started was to develop the market for private label organic milk. We had identified this market segment as being underserved. To do this, we needed both reliable organic milk supply and processing. Most organic milk was and still is processed under co-packing arrangements. This creates a situation where organic competes for line time, attention, etc. with everything else that the co-packer is making. So we decided to build a dedicated processing plant for our own milk. In 2004 we opened our state-of-the-art processing plant. Our total investment in the plant is over $35 million.

## II. The Burdens Of Balancing

One critical responsibility a producer-handler necessarily undertakes is balancing its own milk supply. Balancing is a burden the producer-handler takes on in exchange for the benefits of operating independently. We balance our milk by (1) careful management of our finished goods inventory; (2) production of powder and butter at co-packers; (3) bulk sales; and (4) farm production. We use our finished goods inventory to even out the peaks and valleys of our orders relative to our farm production. Powder and butter are medium and long-term balancers as their shelf lives are substantially longer than that of fluid milk. Sales of bulk milk outside of our business are made as either organic or conventional, but there is no way to anticipate whether there will be an organic outlet for any extra production we might have at any given point in time. To balance ourselves over the long term we very carefully manage our production at the farms.

Milk balancing is what we have to do when the supply and demand for our milk do not line up. Suggesting that we are somehow incapable of balancing our own supply because of our status as a producer-handler is nonsensical. It is always the case that our customers have alternative suppliers, as well as product options and a variety of size formats. Such choices include beverages other than fluid milk; for example, fortified juice and soy drinks.

If anything, the fact that we can only look to ourselves for the milk we need to fill our orders puts increased balancing pressure on us. Because Aurora is not a qualified pool producer, it does <u>not</u> share in the pool value. So if we overproduce and need to sell our milk into the conventional market to a cheesemaker, for example, we only obtain the Class III price for that milk, not the blend. Although the blend price would not offset the significantly higher cost of production of organic milk, it is still additional compensation to which we do not have access.

## III. <u>The Cost Of Milk</u>

We do not produce anything other than certified organic milk. As a result, our cost of production is considerably higher relative to conventional producers. Because only milk that has been produced and certified in accordance with the requirements of the Organic Foods Production Act and the National Organic Program regulations is entitled to be called organic and labeled with the USDA Organic seal, our milk is simply not interchangeable with conventional milk. We cannot purchase conventional milk from pool producers and sell it as organic. We can only use certified organic milk.

The proponents of Proposals 1, 2 and 26 have suggested that a producer-handler acquires milk at the blend. This is simply not true. A producer-handler acquires milk at the cost of production on the farm. The cost of production for organic milk always exceeds FMMO class and uniform prices. Our cost of production is about $30 per hundredweight. This is at the farm gate and includes the capital and operating expenses of the farms, <u>e.g.</u>, feed, cattle, labor, debt service. This figure, however, does not include transportation from our farms to our processing plant, nor does it include any capital or operating costs associated with our processing plant. Nor would it include any distribution costs.

We are not similarly situated to others in the organic marketplace because we have invested in both organic dairy farming and processing and bear the full risk and responsibility of both. Dairy farming is a biological process and inherently uncertain. It is risky for a number of reasons, including (among other things) the uncertainty of calving schedules, the threat of disease, ever-changing commodity costs and the impacts of weather. Likewise, processing has its attendant risks, among which include equipment and packaging failures and variability of customer orders, not to mention the large investment required up front to build the plant in the first place. A producer-handler incurs all of this risk and must also develop and sustain markets for its products.

## IV. How We Compete

I am aware that NMPF and IDFA assert that producer-handlers win business from the regulated pool on the basis of a theoretical price advantage. This, however, is not true. As someone who has been on sales calls, I am here to tell you that in the absence of service and quality, price is irrelevant. Moreover, producer-handlers do not actually have a price advantage.

Retailers select private label suppliers who have the ability to provide the needed product and volume, prioritize the customer's business to meet all expectations and challenges and deliver reliable fulfillment of product orders. Customers want private label suppliers who show rigorous quality assurance capabilities, are in control of their supply chain and can implement corrective action effectively and quickly.

The benefits of being vertically integrated include providing traceability and complete control of our organic milk. The fact that we process all of our organic milk ourselves is very important to our customers, because as a result, our customers know the source of all of the milk and also know that it was processed in a plant that is dedicated to organic. A lot of processing plants do both organic and conventional milk – for example, on alternate shifts – and it gives our customers a great deal of comfort knowing that their milk could not possibly have been commingled with conventional milk.

The importance of good service and quality in a competitive environment can be illustrated by several examples.

- One regional customer launched its organic milk brand with another vendor who could not fulfill its orders completely. The customer pulled the products because of high out-of-stock conditions risked potential damage to its store brand image with consumers. Over a year later, we were hired to relaunch the products and the business succeeds today.
- A national account customer hired us for a secondary supply role after being initially supplied by a national brand vendor. Our service levels continuously exceeded those of the national brand. This, in turn, made it clear to the customer that the branded supplier simply did not value the SK customer's private label business the way we did. We were awarded additional roles with the customer, even at higher prices than the other vendor, until all the business was awarded to us.

- One customer launched its private label organic milk with another vendor and discontinued the products after suffering spoilage problems. After being reassured by our product quality and reliability, the customer relaunched the products and has been successful.

Based on our experience, we have not observed that producer-handlers have any price advantage resulting in a competitive advantage in the marketplace. We have lost customers to other organic milk suppliers who were able to provide what the customer perceived to be a better value. These suppliers are not producer-handlers. In addition, it is also worth noting that most of our customers carry other organic milk in addition to that which we supply. This means that our customers give shelf space to the products of other organic suppliers, and it is therefore absolutely the case that many of our customers also buy from our competitors even while buying milk from us.

V. The Impact Of Proposals 1, 2 and 26

The effects on Aurora if Proposals 1, 2 or 26 are adopted by USDA would be dramatic and potentially devastating. It is overly simplistic to conclude that because Aurora Organic Dairy is a producer-handler that we have a price advantage, much less a price advantage that would create any disruption in the market. Unlike organic producers who do not process their own milk, we have invested millions of dollars in a dedicated processing plant. And unlike handlers who do not produce organic milk, we have invested millions of dollars into our farming operations. We have also incurred the attendant risk of balancing ourselves, which as previously indicated is no small risk given that we have to find our own markets and outlets for extra supply.



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With respect to the pool itself, is there a stable and certain supply of organic milk for us to call upon? No. Is there a balancer willing to dry and sell organic powder in our milk shed? No. For us in the organic market, the pool does not facilitate the balancing function due to the fragmented and dispersed nature of the organic milk supply and plants. If the proposal to eliminate producer-handlers is adopted, Aurora would have to restructure and essentially completely revise our business model.

VI. Conclusion

We support the existing regulatory provisions and we do not want to see any changes. In our view, it is not possible to determine the presence or absence of orderly marketing conditions without considering the actual prices being paid to producers and the actual costs incurred by handlers for the milk they buy. Based on the actual prices and costs in our market, we do not observe any unfair competition or the creation of any disruption in the market as a result of producer-handlers.

In light of this, we believe the status quo is the best available course. If Proposal 23 or Proposal 25 were adopted, Aurora could continue to operate as a vertically-integrated business, although some modifications might be necessary. AIDA has proposed an own-farm milk exemption, which we understand to mean that anything purchased from outside our own farm operations would be valued at the Class I price to the pool.

Aurora also supports individual handler pools. As other organic producers have testified at these proceedings, organic producers and processors obtain very limited benefits from pooling. This is also true of other differentiated milk markets, such as



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grass fed and kosher. Individual handler pools would result in differentiated producers and processors being on equal footing with respect to the pools.

Aurora believes that any national policy that is adopted should preserve options, not foreclose them. Some of the proposals frankly punish vertical integration in any form other than a cooperative. This is quintessentially anticompetitive and bad for consumers, because it freezes the U.S. marketplace, it picks one business model as the winner, it stifles entrepreneurial enterprise, and it eliminates independent vertically-integrated operations that meet changing consumer demand.

Thank you for the opportunity to testify today. I am prepared to answer questions regarding my statement.