CERTIFIED TRANSCRIPT

NATIONAL FEDERAL MILK MARKETING ORDER

PRICING FORMULA HEARING

DOCKET NO.: 23-J-0067; AMS-DA-23-0031

Before the Honorable Jill Clifton, Judge

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Carmel, Indiana

January 29, 2024

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Reported by:

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(Please note: Appearances for all parties are subject to change daily, and may not be reported or listed on subsequent days' transcripts.)

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IN CHRONOLOGICAL ORDER:

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MONDAY, JANUARY 29, 2024 -- MORNING SESSION

THE COURT: All right. We're back on record. It is 2024, January 29. It's a Monday. It's approximately 8:01 a.m. Eastern, and this is Day 48 of this milk hearing.

I know we have a number of preliminary matters. I think I'd like to get into the testimony before we go into most of those.

What preliminary matters should we address before resuming testimony?

MS. TAYLOR: Good morning, Your Honor. I know I have a list of witnesses that need to finish up the week, and I was just wondering if parties might put that on the record so we all have the same list. I don't know if my list is correct. So we know what to expect.

MS. VULIN: Good morning. Ashley Vulin with the Milk Innovation Group.

We'll be starting with Dr. Stephenson addressing the questions that arose at the end of the prior testimony on Proposal 20. And then we will also have Ms. Sally Keefe in opposition to Proposal 21. I expect she will be last or near last at the end of the hearing once we conclude the remainder of Proposal 20 witnesses.

THE COURT: Now, Ms. Vulin, come back to the mic for just a minute.

Did you notice how enormously sensitive it is to whether you are two inches from it?

MS. VULIN: I did, Your Honor. So I will be

better --

THE COURT: We have a little bit of a different system than we did last time, so we'll all have to be a little more mindful.

MS. VULIN: Thank you for the reminder.

MS. HANCOCK: Good morning. Nicole Hancock, National Milk.

We'll have Jeff Sims in opposition to Proposal 20, and Carl Rasch in opposition to Proposal 21. Mr. Sims will go following Dr. Stephenson, and Mr. Rasch will plan on today or tomorrow.

MR. ROSENBAUM: Steve Rosenbaum for the International Dairy Foods Association.

We have three witnesses. We have Mr. Mike Giles, who we anticipate will testify today on Proposal 19. We have Steve Galbraith, who will testify on Proposals 19 and 21, potentially today. And we have Kyle Powell who will testify on Proposal 21 tomorrow.

MR. MILTNER: Thank you, Your Honor. I'm Ryan Miltner representing Select Milk Producers.

We will not have a witness this week. We indicated that to counsel last week, but we wanted to put that on record. We were discussing having a producer who was going to be here today, but he will not be testifying.

THE COURT: And I notice Carl Rasch's name is spelled C-A-R-L, R-A-S-C-H.

I'm not sure Steve, that I know Steve Galbraith's spelling.

MR. ROSENBAUM: That's G-A-L-B-R-A-I-T-H.

THE COURT: That's what I wrote down. Amazing. Okay. Great.

Is there anything else preliminary to the witness testimony?

All right. I'd ask the witness again to state and spell his name for the record.

THE WITNESS: My name is Mark W. Stephenson. That's M-A-R-K, S-T-E-P-H-E-N-S-O-N.

THE COURT: Dr. Stephenson, you remain sworn.

MARK STEPHENSON,

Having been previously sworn, was examined and testified as follows:

THE COURT: And we have some exhibits to mark, do we not?

MS. VULIN: Yes, Your Honor. The first is MIG-Exhibit 16C, as in cat, and we'd ask that that be marked as Exhibit 490, please.

THE COURT: 490 yes.

(Thereafter, Exhibit Number 490, was marked for identification.)

MS. VULIN: The second is MIG Exhibit-16D, as in dog. We ask that be marked as Exhibit 491.

THE COURT: Now, does it have about 59 pages?

MS. VULIN: It does, Your Honor. It's an Excel spreadsheet submitted to USDA in Excel format, but we have printed it here.

THE COURT: Very good. And that is going to be

491? Yes.

(Thereafter, Exhibit Number 491 was marked for identification.)

MS. VULIN: Correct, Your Honor.

Next is Exhibit 16E, and that will be Exhibit 492.

THE COURT: Yes.

(Thereafter, Exhibit Number 492 was marked for identification.)

MS. VULIN: And finally, Exhibit -- MIG Exhibit 16F, and that will be 493.

(Thereafter, Exhibit Number 493 was marked for identification.)

THE COURT: I'm caught up. Thank you.

You may proceed.

MS. VULIN: Thank you, Your Honor.

DIRECT EXAMINATION

BY MS. VULIN:

Q. Good morning, Dr. Stephenson.

A. Good morning.

Q. Thank you for joining us again.

A. Good to be here.

Q. So you had previously submitted some data to USDA reflecting shadow prices for Class I and Class III, correct?

A. Correct.

Q. And I understand that in response to some questions --

THE COURT: Let's make sure our mics are good.

THE WITNESS: Are they on? Yes.
THE COURT: It's on, but your voice is softer than Ms. Vulin's. I would like them to match. So either, Ms. Vulin, you could step back a bit, or, Dr. Stephenson --
THE WITNESS: I'll try to make sure I'm tight.
THE COURT: All right. Thank you.
BY MS. VULIN:
Q. And I understand that in response to some questions you went back and looked at that data again, correct?
A. I did. Yes.
Q. And so you have some documents here to correct and supplement that prior data; is that right?
A. I do. And also to explain just a little bit about the derivation of those data.
Q. Okay. Thank you.
So just to identify the documents that we have marked, first we have Exhibit 490, and that's your written explanation of an additional testimony, correct?
A. Correct.
Q. Exhibit 491 is the corrected dataset?
A. Correct.
Q. Exhibit 492 is the corrected map?
A. Correct.
Q. And Exhibit 493 is a box-and-whisker chart that reflects the corrected data?
A. That's correct.

Q. Great. So we'll just start at the beginning.

Were you able to identify the issues with the data?

A. Yes, I was. And I would thank Ms. Taylor for her probative questions, and the AMS staff for having spotted that.

The -- when we run models, we're typically looking at asking ourselves what would happen if we had a change in something. We would then typically go through our baseline calculations, which are our best representation of the way the dairy world actually looked and worked at a particular point in time, as in March, or September, or May, or whatever the month may have been, in this case, year 2016, and that becomes our baseline. And then when we run scenarios, we will do something like impose a new plant in a new location, and then ask ourselves, "What difference does that make?" And that's a comparison to the baseline.

Apparently I had chosen one of the scenarios that we had run as the data form and not the baseline data.

Q. And so you went back and pulled that original baseline data, correct?

A. I pulled the original baseline data right from the model dump that we get, the large amount of data that comes out of there, and then did the calculations again to do all of the county-level distributions.

Q. And Exhibit 491, which is also MIG Exhibit-16D, reflects that corrected baseline data, correct?

A. That's correct. And in this case, it was asked last time why we had additional precision on the data table, because the data that had been presented earlier for National Milk's model runs by Dr. Nicholson were rounded to the nearest dime, and so I rounded these to the nearest dime.

Q. And did you confer with Dr. Nicholson at all in your -- the research to identify the baseline data?

A. I did. We did go through this. I also had some questions about the model coding and the way that we were calculating the dual values in there.

Q. And so are you and Dr. Nicholson confident now you have the original baseline data?

A. Yes.

Q. Great.

And so with the corrected data, you said you re-ran your calculation of the difference between the Class I shadow price and the Class III shadow price, correct?

A. That's correct.

Q. So if we could pull up the PowerPoint, please.

Now, this first slide is from MIG Exhibit-16B.

That was the data that contained the error, correct?

A. That's correct.

Q. And this is from Exhibit 451, I will note for the record, at page 10. So this is the prior map.

Now, if you could go to the next map, please.

A. There. Sorry.
Q. No problem.
So this is the corrected difference map found in MIG Exhibit-16E?
A. This is the corrected map. And I would just stress that the colors may look somewhat more intense on here. That was just my choice of color selection. And apparently I didn't precisely match what the previous map was, but the connotation is the same.
Q. You say "the connotation is the same."
What -- what similarity or consistency is there between what you had previously presented and this corrected map?
A. Well, the similarity is that the red areas are showing places where the marginal value, the shadow price, if you will, of Class III is greater than the shadow price of Class I. The green areas are where Class I shadow prices are greater than Class III. And those gray areas are zones where they're approximately equal.
Q. And the conclusions that you previously presented based on the difference data that you calculated, did those still stand with the corrected data?
A. Yes. They, in most cases, are within, you know, a few cents of one another any place you are looking at. So the differences, if they were close to $3, were close to $3. If they were $1, they were close to $1. So they were not much different.
Q. And your prior conclusion or the takeaway from

your data regarding the impact of manufacturing and Class I and the supply of milk, do those conclusions still hold with the corrected data?

A. They do.

Q. And if I compare these maps, the area where I really identify any difference seems to be kind of Nevada and a little bit in California; is that right?

A. Yes. The previous map, and I can perhaps pull that up again over here, you will notice in this area that the California/Nevada maps almost stand out on a state line basis as being particularly green in -- in an area bordered by red-colored counties.

Over here in the new data, it's not as much. It's more green in the populous areas of California and a little bit in Nevada. But it looks a bit smoother and not just bordered by states.

Now, when I go back and was trying to ask myself, what could possibly have been different between these runs?

In the 2016 model iterations, it was the first time that we were trying to impose plant-level constraints of volume of processing. Now, clearly we don't have information on all plants in the country, but we do have a good idea about the volume going through a lot of the plants in the country. And my belief is it wasn't documented or noted on that particular one, but it was when we had plants that were probably excessively constrained in California and Nevada. Doing that would

have meant their shadow price values would have risen for the fluid plants in that area.

Q. Thank you.

And I know we can parse out the county level data. But do you have any -- is your takeaway intended to be a localized county-level analysis, or is it more an industry or nationwide conclusion that you are presenting?

A. Well, I think the story line that I would like to try to leave and have people aware of is that our industry has changed quite a lot over the decades, and it's now come to the point where the manufacturing portion of the industry is highly competitive, and in particular, in some regions of the country, and I don't think really can be ignored in a lot of the regulation that we do. We -- we have to recognize that those plants are very competitive and they are creating the products that consumers in this country want. So it does make it difficult for some of the plants, like fluid plants in those regions, I think to compete with pooled values of -- of the Class I differential.

Q. And you were also asked about whether or not there would be a shadow price of zero in any county.

Can you just briefly explain to us how this zero shadow price works within the USDSS?

A. Yes. There -- there will always be a zero shadow price value.

Now, I should make sure that I clarify this by letting you understand that when we are doing the model at

this point in time, we don't have milk price values, we have component values. But we get back to milk price values by creating a standardized milk value from the component. So that's 3.5 pounds of butterfat and 3.1 pounds of protein, 5.9 pounds of other solids. That gives us a hundredweight equivalent of shadow price value at locations.

When we have those values, there will always be a zero value somewhere. And recognize that we have shadow prices at all areas with constraints. So for example, farm milk production, as given, is constrained. There's no more milk at a point than -- than we say there is, and there will be a shadow price value for those products. There are shadow price values at plants, and we can look at just Class I or just Class III or all plants where you have shadow price values for demand for dairy products. And those kind of fall on the spectrum.

Fluid milk plants, if they are at exactly the same location as the adequate or surplus raw milk supply, may have a zero-point value. But if the plant is not exactly at the milk supply, if milk has to travel some distance to get there, then the fluid plants will have a very low shadow price near that area, but it's not going to be quite zero.

So in this particular case, the low point was actually at Boise, Idaho, and the value was $0.13 per hundredweight at that plant. So close to zero, but not zero. The actual zero value is going to occur at a raw

milk supply.

Q. At a point within the county?

A. Maybe.

Q. Potentially?

A. Maybe not within the county, but nearby, yes.

Q. And there's also rounding of the data, correct?

A. Yes. And when we're rounding, there are two effects of rounding. One of them is this kriging methodology that we use. That $0.13 takes place at a point in Boise County, and we have to calculate the average values for Boise County. And that's influenced by the other fluid milk plants that would be somewhere nearby, and so the average of Boise County can come up. If it comes up above $0.15, for example, by that average, then the rounding to $0.10 increments is going to give you a $0.20 value, which is what it has in this particular case.

Q. And are you confident that the data that you are presenting here, the corrected data, is accurate?

A. To the best of our capabilities, it's accurate. And I mean, I obviously am not going to do this quickly to get back here. I wanted to make sure that the data are accurate.

Q. And if you were to run this same comparison with 2021 data, knowing what you know about the industry, do you expect it to be qualitatively similar or substantially different?

A. I think it would be qualitatively very similar.

We have now got at least the example of two model runs with 2016 data: The first one, the one that was a scenario that we had run, and then this baseline data. And I think that you can see that there are differences, but qualitatively, the story line is the same.

Q. And I understand that you wanted to provide USDA with another visualization of this data, correct?

A. I did. I thought it would be helpful.

Q. So if we could go to the next slide, please. And this is MIG Exhibit-16F, which has been marked as Exhibit 493.

So this is our friend, a box-and-whisker chart, correct?

A. It is. And I would not have probably chosen to toss that up here except that I understood that Ms. Keefe has already explained what the box-and-whisker plots are to the group.

Q. Thank you.

So can you walk us through what this box-and-whisker chart shows us about the Class I shadow price in comparison to the Class III shadow price.

A. Sure. I have two box-and-whisker plots for each of the 11 Federal Orders, and one of them is showing the Class I shadow prices, and the other one is showing the Class III shadow prices.

I think the box-and-whiskers are nice because they give you not only an idea about the range in values that you can see in any given area, but also the distribution.

You know, in other words, are the data relatively tight around the observation or do they have long tails?

So just as an example, in this Appalachian value, the long and tall box-and-whiskers plot are the Class I values. So there is a distribution of values that goes from, oh, roughly a value of 3 to a value of maybe $5.80, something like that.

Q. And what does that tell us about the value of Class I milk in that order?

A. Well, it tells you that there are some plants obviously in different locations, and some of them have easier access to milk supplies and ability to process in that region. Those would be the lower shadow price value plants. And those plants that are more constrained or having a more difficult time getting milk to the plants are going to be up here at the upper end of that range.

Q. Thank you.

And then next to it, what is the plot with the two yellow carats I'm told they are called?

A. Yes. These smaller box-and-whiskers plots represent the Class III distribution of observations in the Appalachian order. So you can see that those are much tighter, much closer together.

The reason that the distribution is not as large is because these are plants that can take those same components that are available in milk and condense them into a much more nutrient-dense package that can be shipped longer distances, if needed, so we don't see as

big a distribution for Class III. That doesn't mean that they aren't different. Even within the Appalachian order they are different, but as you move over to Arizona, Las Vegas order, you can see that they have diminished there, California and so forth. So they do differ. Scale can be quite different, though, for these plants. It is much tighter than it is for the fluid plants.

Q. And if I'm comparing, because they are next to each other, the Appalachian order where there's overlap in the box-and-whisker plants between the Class I and III shadow prices, whereas when I move to the Arizona order, the Class III shadow prices are far above what the distribution is for the Class I prices, what does that tell us about milk supply and demand in those two areas?

A. Well, for plants that are represented in the upper half or maybe two-thirds of the Appalachian order where their shadow price is well above, you know, all of the Class III plants, these would be counties that would be shown in green on the map. And these are plants that would have the ability to attract the milk that's necessary because of the value of the product. This is where cost of balancing probably becomes more important than acquisition of the milk. Plants that are down here in this area would --

Q. When you say "this area," you mean the bottom quarter of the Appalachian order distribution?

A. That's correct. Thank you. The bottom quarter of that distribution in Appalachia is below all of the

Class III plants. So there are a handful of plants in Appalachia that would have difficulty procuring milk in their plant away from a cheese operation.

When you take a look at the order that's next to there, Arizona, Las Vegas, the manufacturing plants, Class III plants, are all well above the fluid plants, which just tells me that the value of milk going into manufacturing is much higher than it is into the fluid plants there. Fluid plants would have a difficult time without a substantial premium, in my estimation, to get milk into the plant.

Q. And that's because the system is saying that it's the manufacturing use of that milk that's going to be the highest and best use?

A. Yeah, this is the -- the economic realities that the plants face. There is a market for the product coming out of those -- sorry -- a market for the value of the products coming out of those manufacturing plants that will pay them for that milk in such a way that the fluid plants would have a difficult time matching.

Q. And does all of this data reflect maybe a shift in the role of manufacturing or the role of manufactured dairy products in the dairy industry compared to what it may have been in the 1930s or even in the 1990s?

A. I think so. When -- in the earlier part of the orders we may have had 60 or 70% Class I utilization in the order. That additional milk that was there and pooled had access to pool dollars that would have been adequate

to pull milk into those fluid plants. But that's not necessarily the case any longer, at least in some of the regions, that the pool value gets really fairly diminished across a large volume of milk.

Q. Thank you.

Anything else on this data that you would like USDA to takeaway?

A. No, I don't think so.

Q. And then lastly, just a small item, you were also previously asked about providing Make Allowance data that summarized the low cost, high cost, and average for plants.

Do you recall that?

A. I do.

Q. And you identified that you had already provided that data found in IDFA Exhibit 1, which is Hearing Exhibit 178, starting at page 12, correct?

A. That's correct. There are four tables there for each of the four products that do have the breakouts by low cost and high cost plants, as well as the average. So my verbal testimony at the time had a table that looked at a comparison over years, but it was looking at the average of all the plants and not the high and lows.

MS. VULIN: If I could have just one moment, Your Honor.

THE COURT: Yes. Let's go off record. You can move around a bit. Don't go away from your chair. We go off record at 8:30.

(An off-the-record discussion took place.)

THE COURT: We're back on record at 8:33.

Ms. Vulin.

MS. VULIN: Thank you, Your Honor. Nothing further.

Thank you, Dr. Stephenson, for returning.

And the witness is available for cross-examination.

CROSS-EXAMINATION

BY MS. HANCOCK:

Q. Good morning. Nicole Hancock, National Milk.

I just have a couple of questions. Maybe I should have asked them before to better understand this, but since you are back and I have a fresher mind today, I can try and figure it out again.

If -- if I'm just looking at Exhibit 492, which is the map, if I maybe oversimplify it, is it fair to say that where we see the green areas or the lighter colored areas that get into kind of a gray area or white shade, that's an area where we want to pull Class I milk into those areas?

A. Well, we need Class I milk in all areas. But if you take a look at the very green areas, those are areas where Class I milk is needed in the fluid plants, but they can, with the value of the end product, very well compete, I think, with cheese plants in that region.

Their costs here -- relatively high shadow price values in a state like Florida have more to do with

balancing costs than they do with procurement cost.

Q. Okay. So it means that if it's in the green areas, there's more -- Class I is in a greater competitive position against competing Class III manufacturing plants?

A. That -- that's correct.

Q. So do you have to -- you have a greater amount of balancing cost in those areas?

A. The balancing cost would be the -- I mean, this is indicating in many of these areas that we have deficit milk production. And in the deficit regions of -- you know, let's just use Florida as an example. Milk supplies may have to come from some distance during some parts of the year, and may be pushed away in other parts of the year. That becomes the large cost for Class I in those regions more than is the case in the heavily-surplus areas.

Q. And this was based on a model run that was done in the spring of 2016?

A. Yes. This is the flush season values that are shown in this map.

Q. And did you ever run it again in comparison with, say, October?

A. Well, we always run a flush season and short season run. I didn't bring that or provide that here. The colors would have looked somewhat different. I believe that in the National Milk testimony by Dr. Nicholson, that you had some idea about the differences between the flush season and short season

values for the 2021 data.

Q. Okay. So you didn't map that to see how it changes?

A. I didn't map that here, no.

Q. Okay. Did you just map it -- did you map it at all to know what the differences were?

A. Well, I have in the past, but I didn't look for that -- and I have never mapped them this way. This difference between the Class I and III is something that was new to this particular testimony.

Q. And so you said that there would be a greater amount of balancing that would be required in the areas that are lighter or more green?

A. My intuition, professional, from having done this for a long period of time is that we would have seen this green area creep a little bit further up toward the Upper Midwest than it shows on this particular map during the flush season.

Q. Maybe you did answer that, I'm not sure, but I thought when you were talking about the -- in Exhibit 493, the box-and-whiskers plotting chart, I thought that you described the Appalachian region as that -- that overlap between Class III and Class I there as having additional balancing costs than in the red areas?

A. Yeah. The additional balancing costs are going to be more in the green regions. The red areas are probably showing you where fluid plants would have more procurement issues than they would balancing issues.

Q. Okay. Then you would have, in those areas, more need to incentivize movement on an on-demand basis?

A. Yes.

Q. Okay. Two of which are the elements that go into the Class I differentials, balancing and incentivizing movement of milk?

A. That's -- that's the narrative that we have been working under.

Q. Okay. And so this doesn't do anything to suggest that those balancing costs and incentive costs are no longer needed, you are just saying it's needed differently in different areas?

A. Yes.

Q. Okay. And --

A. I think that balancing costs are real. Don't -- don't let that be a takeaway message.

Q. And incentive to move milk costs are also real?

A. Certainly.

Q. And you specifically focus the comparison of these shadow prices between Class I and Class III with the model, so you don't -- you just treat all manufacturing as modeled under Class III; is that right?

A. No. I -- we could have looked at this with Class IV included. We could have looked at this with Class II included. I didn't choose to do that. Class III is a very large volume product and important product in the country, and so I just looked at Class III as an example.

Q. Do you know how your model results would have differed if you would have averaged Class III and Class IV?

A. The Class IV shadow price values, if you think about the box-and-whiskers plots, how the Class III box-and-whiskers are relatively condensed, Class IV would look like that, and they would be at a lower overall average value than Class III is. And I haven't looked at Class II, but I would suspect that they would be intermediary between Class III and I.

Q. And I think we have established this previously, but this is a novel approach that -- for which the model's never been used previously; is that right?

A. Well, the data are always there, but we haven't chosen to look at them. I mean, typically speaking, the requests have always been to look at either the primals, the flows of, you know, milk and product through the industry, or the dual values for Class I, or in some cases, we're looking at the dual values for raw milk at the farm level. So, for example, a question may be coming to us, how would this impact farmers in the area if we had any plant or something like that.

Q. You are not aware of anytime that the USDA has ever used the model results for -- in the same way that you have proffered them in your testimony, are you?

A. I'm not aware that they have used them in any way other than the Class I shadow price values.

Q. Are you aware of -- of the model ever being used

in this way to support a peer-reviewed article or study?

A. In this way?

Q. Yeah.

A. No, this was the first time that this was done.

Q. Okay. And so -- and because the industry hasn't used it and because it's never been published and peer reviewed, we have never had an opportunity to really test this methodology against real life, have we?

A. No. I offered this as an observation that I think ought to ask additional questions of the way that we're regulating. I'm not suggesting that this is the answer to the way we should be regulating. I'm suggesting that this should raise questions about what we're currently doing, because I think it makes what we're currently doing difficult.

Q. Okay. So fair enough.

It -- it's a way to raise some questions and look at it through a new lens; is that fair?

A. I think so.

Q. Doesn't answer the question of what should be done, though; is that right?

A. No, it doesn't answer the question of what should be done.

MS. HANCOCK: That's all I have. Thanks so much for your time.

THE COURT: It's 8:43. Let's go off record just a moment.

(An off-the-record discussion took place.)

THE COURT: We're back on record at 8:43.

Who will next cross-examine Dr. Stephenson?

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good morning, Dr. Stephenson.

A. Good morning.

Q. Ryan Miltner. I represent Select Milk Producers.

I wanted to ask a few questions about the box-and-whisker chart. I think some of this was discussed the last time we had a chart like this during the hearing. I want to make sure that my understanding of what this represents is the same as what I previously understood it to be.

So if I look at the Appalachian order, for instance -- and really this, I think, would apply to all the boxes -- but the upper and lower bounds of the whiskers represent the entire range of data for that particular order; is that correct?

A. For that particular order and that particular class of plant.

Q. Okay. Now, in between the two whiskers within the box is a line in the middle.

That represents the median of the dataset?

A. The median, yes.

Q. Okay. And the upper and lower bounds of the box itself are the bounds of the second and the third quartiles of the data within that set, correct?

A. That's correct.

Q. What about the shaded area in the box around the median, what does that represent?

A. It's a shaded area around the median. And it's around the median, I think, in all of these particular cases, although the California one looks like maybe it's close. But that shaded area represents a 95% confidence interval that the true meaning of the data would lie within that range.

Q. Now, if I'm looking at California for Class I, the Northeast for Class I, and the Upper Midwest for Class III, there's a circle outside of the whiskers. I guess I also see some in the Mideast and Northeast.

Those are outlying data points for those particular datasets; is that correct?

A. Those are statistically flagged outliers, that's correct. They would just say that, statistically speaking, they lay outside the distribution of the rest of the observations.

Q. And then to the extent for any box-and-whisker, the median is not in the middle of the box, or the whiskers are of different lengths, that suggests that the distribution of the data within that set is not normal, right?

A. It can be suggestive of that, yes. I mean, so, for example, if you had a -- well, look at the Southwest as an example of this. You can see that the lower whisker is quite a bit longer than the upper whisker. This suggests that the distribution is skewed toward the upper

end.

Q. Okay. Would you agree that one of the underlying assumptions for having Federal Order regulation in pooling, particularly, is that absent pooling, producers would engage in ruinous competition to supply Class I plants?

A. It's my understanding that as a student of dairy history that we have had classified pricing and pooling. The pooling portion of it is to have equitable distribution of classified pricing to producers. It's not equal distribution, as we have zones within the orders, but it is a more equitable distribution.

Q. As I think about your testimony and I look at the graphical evidence you have presented, it suggests to me that maybe you are implying that that underlying assumption may no longer be true?

A. We have had quite a bit of milk depooling from orders, and I don't mean just in extraordinary circumstances, I mean, as in choosing not to pool on a regular basis. And I think that, you know, that's symptomatic of the fact that we have got more milk trying to pool or to -- acted on orders than we have seen historically from the way that orders were first constructed and built.

I do understand what you are talking about in terms of the competitive nature, but if the value of the pool is smaller than it would have otherwise been, I think we would find that many farms would choose not -- or many

suppliers of milk would choose not to pool their milk because it wouldn't be of enough value to them for the location of the milk or the headache of having to deal with paperwork or supplying the pools.

Q. If I remember correctly, the last time we were here with you on the stand, you were asked if there is still a role for price regulation, and specifically, classified pricing and pooling. My recollection is that you said that there is.

Do you agree with my recollection?

A. Yeah. My recollection of the question was whether I agreed there was still a role for Federal Orders. I'm not sure it was as specific as that.

But, yes, I do think that there's still a role for it. In my testimony that was offered, I suggested a possibility where part of the value of what had been pooled across the wide order could be targeted toward the procurement of milk, and the rest of the value be pooled, you know, across the order. Which in some orders would not be very much value, I understand that.

But, again, I'm going back even a step further than that to recognize what Federal Order's mission was, why they were created in the first place, and what we were trying to do with that, and that is to service, you know, the Federal Milk Marketing -- or excuse me -- to service the fluid markets and to assure an adequate supply of milk.

Q. Do you have an opinion as to whether Federal

Orders would be more effective if the geography of the orders were more focused on those individual Class I markets that you referenced?

A. Can you rephrase that question or --

Q. Yeah. Would we -- would Federal Orders be more effective in achieving their mission if we had more smaller orders that focused or organized around Class I geographic markets?

A. Historically, the boundary of Federal Orders described an area where Class I handlers competed for the sale of their product, and they're competing across wide areas now. I don't know if that's still an adequate description of what Federal Order boundaries should be, but I think that's becoming very difficult to achieve.

MR. MILTNER: That was my last question. Thank you very much.

THE COURT: Are there other cross-examination questions for Dr. Stephenson before I call on the Agricultural Marketing Service for questions?

I see no one. I invite the Agricultural Marketing Service questions.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good morning.

A. Good morning, Ms. Taylor.

Q. Thank you for returning this week.

A. You're welcome.

Q. I wanted to start, I -- I had to race out and pull

out -- I wanted to pull out your exhibits from the last week, so I might have missed part of your explanation on kind of what you found to be -- what's different than the old versus the new generally.

And I think what I caught was, in the run you put in two weeks ago, you weren't comparing it against the baseline, it was against a different run. And you went back, and this exhibit you are putting in this time around is something against what the baseline numbers were; is that correct?

A. Yes. These represent the baseline numbers. The previous testimony happened to be a scenario that we ran. So in other words, we were looking at a change from baseline, something that didn't exist --

Q. Got you.

A. -- but, you know, something that we were trying to impose to answer a question.

Q. Okay. And then you mentioned that you thought one of the reasons that kind of California and Nevada stood out before was that the plants were -- the fluid plants in those regions were constrained in the model?

A. Yeah. We do attempt to constrain all of the plants within a boundary of what we think they process.

Now, I -- I don't have complete knowledge of this, but we do have contacts with industry sources. We do try to collect information that gives us an idea about plants, and we don't constrain that to specifically the number that we have. Rather, we look at a plus and minus 10%

from what we think. So there is a range that plants can process in.

Q. Okay. And so in those two states before, it was pushing up against the constraint is what you said?

A. I think that that was the case. Now, I can't tell you specifically, because when I went back to look at the model run that I had reported on last time, there were not notes as to what that scenario actually was. But in that 2016 data, it was the first time that we had tried to utilize our plant capacity information. So there was quite a lot of work that was done to collect information about plant processing volume and that type of thing.

Q. So in this run, did you lift the constraints or you just maybe made your range plus or minus a different percentage? You mentioned before it was plus or minus 10.

A. If we had questions about it, then we would have gone back and solicited additional information from other people, if we could, to try to find what, you know, volumes those plants may have been. So you can see that if there's a real need for fluid milk in an area like Nevada or California, and if plant capacity is not adequate to supply that volume of fluid milk, then you can have those shadow prices increase rather substantially. It would be asking for more opportunity to process there.

Q. And that's when we would see more green?

A. Yes. Those shadow prices, the Class I values would have been higher.

Q. Okay.

A. I should perhaps at least comment, too, that we have the volume estimates on quite a large number of the plants in this country, and the total volume accounted for by those plants -- they tend to be the larger operations as well -- is close to 90% of the volume of total milk produced in the country. So the additional 10% of volume is dispersed over quite a lot of smaller plants. Those plants are available for operation. They are just not constrained because we don't know what they process.

Q. Okay. Okay. So I just want to make sure we're all clear. So this is -- you didn't rerun anything. You had your baseline numbers, and that's what we have in these exhibits?

A. Can -- can you say that again, please?

Q. Sure. This is -- the baseline -- you didn't -- the baseline numbers didn't change between this set and the other set of numbers. It's just that this is actually reporting now baseline numbers, and before it was reporting out a change for the baseline?

A. Either the change from the baseline or runs that we were making trying to get to the baseline. So our idea of the baseline is the best that we can do to represent the dairy industry as it existed at that point in time. And I don't recall if that set that I had used before was as we were trying to get to the baseline numbers or if it was a scenario from the baseline numbers, but it was a model run that was not what we considered to be the baseline of 2016.

Q. Okay.

A. I might just also mention, though, that even though there are differences between the data presented before and this, I think that qualitatively, the results are quite robust. I mean, they look fairly similar. I mean, the story that I was trying to show, demonstrate, you know, is the story that is in both of these maps, I think, even though the low point wasn't in Idaho.

Q. I do appreciate you going back to look at this, though. I know it takes quite an effort, and so I do want to thank you for doing that and coming back here.

A. You're very welcome.

Q. I did have one question on the Make Allowance questions.

So I think if I caught correctly, you mentioned you had put highs and lows, and I think it was Exhibit IDFA-1.

A. Yes, there are -- Hearing Exhibit 178?

Q. Yeah. Yes.

And I was -- I went back and looked at the online copy. And so you -- you did have highs and lows in there for your 2023 survey. I think what we were looking for were highs and lows of the non-transformed numbers in the 2021 survey.

A. Oh, okay.

Q. Yeah.

THE COURT: When would you like to come back?

MS. TAYLOR: Well, if we're done, maybe he can --

I won't speak for him. But we'll be here today and tomorrow.

THE WITNESS: I won't. I didn't bring those values, and apparently I didn't understand what you were requesting.

BY MS. TAYLOR:

Q. Okay.

A. I -- I can pull those together if you really want them, but I'm not sure how to submit them to you.

Q. Yeah. I don't think we'll be able to submit them after we close the hearing, unfortunately, so -- okay. That would be --

THE COURT: Ms. Vulin?

MS. VULIN: Could I propose that either Mr. Brown or Ms. Keefe could submit them tomorrow? Or at least let's look into that. We'll see.

MS. TAYLOR: I would be great with that, but I don't know if from my attorney's perspective he would be good with that, so how about we circle back on that. One?

MS. VULIN: That's fair.

THE COURT: Would you articulate again what you need?

MS. TAYLOR: Yes.

BY MS. TAYLOR:

Q. What we're looking for, we're just trying to get a full comprehensive set of data over whatever years we can get, and then we can make comparisons to kind of look at changes.

So in IDFA-1, you put in 2021 study numbers based on your non-transformation allocation of unallocated costs, and you put those in as averages in the text of your document. What we're looking for is the high and low breakouts of that non-transformed numbers for the 2021 survey.

A. I'd have to look here, but I'm pretty sure that these are the non-transformed numbers in 178. What -- what is not non-transformed are the earlier years.

Q. Right. That's what I'm looking for. You put 2023 in, and you used the -- I'll call it the old allocation method.

A. Yes.

Q. And that's what 2023 numbers are. And I'm just looking for the 2021 numbers, high and low, based on the old allocation method.

A. I'd have to look to see if I had that.

Q. Okay.

A. I may have to actually rerun all of that. I did rerun those for my testimony where that table shows the total average, but I don't recall if I broke that out by the high and low plants.

Q. Okay. I think we can talk and see what we may be able to do tomorrow.

MS. VULIN: I may have spoken out of turn. I'm not sure if Ms. Keefe or Mr. Brown worked on any of that data. I had misunderstood that. I can see the issue now.

MS. TAYLOR: Yeah.

THE COURT: Where there's a will, there's a way.

MS. TAYLOR: One could hope.

THE COURT: So we'll see.

MS. TAYLOR: I think that's it from AMS. Thank you again.

MS. VULIN: Your Honor, just a short redirect.

REDIRECT EXAMINATION

BY MS. VULIN:

Q. You have used the terminology procurement costs, balancing costs, and incentive.

And is procurement costs and incentive costs, are those the same thing conceptually?

A. I'm meaning that to be that way, that's correct.

Q. And Ms. Hancock had asked you about the need for balancing costs and incentive costs in some areas of the country but not in others, correct? Identical needs.

A. Yes. The needs are different in different parts of the country. But, yes.

Q. Uh-huh.

And so in looking at this map, if -- if we set balancing and incentive values in red areas based on what those values would be in the dark green areas, what does that do to the system? What kind of impact would that have?

A. Well, access to milk and balancing function is much easier -- or excuse me -- access to the balancing function is much easier in the red areas simply because you have got capacity in manufacturing plants to handle a

little extra milk, if it may be surplus in fluid plants, or to give up a relatively small amount of the total proportion for fluid needs. So balancing costs tend to be much smaller in those regions.

Procurement, on the other hand, can be quite a bit different, as you will see in some of the orders where enticing that milk away from the cheese plant that has sales for their final product is difficult and costly to do.

Q. And so there's really no way to set a national balancing and procurement cost that would apply uniformly in all of these areas and still be accurate; is that fair?

A. I think it's really difficult to do. And if we look at the records where we see $0.30 for one of the values and $0.40 for another, or something like that, that suggests awfully round values, which, to me, you know, suggests that we didn't really actually know what those were at the time either, that it seemed like a good number to throw out there.

Q. And then, lastly, you were asked about the newness of the methodology used to calculate these differences.

So developing the Class I shadow price has been done before to set Federal Order policy, correct?

A. That's correct. I mean, all of these shadow price values have been done before. So developing those values is not new at all, it's just visualizing and using them in this way is -- is new.

Q. And when you say "this way," running the

difference between the Class I shadow price and the Class III shadow price, correct?

A. Correct.

Q. And that's just simple subtraction math?

A. Sure.

MS. VULIN: Nothing further, Your Honor.

MS. TAYLOR: This is Erin Taylor from AMS. I still have one more question, actually.

MS. VULIN: Yes.

RECROSS-EXAMINATION

BY MS. TAYLOR:

Q. You talk about why there's a near zero point for the Class I shadow price.

Is there -- should there be or why isn't there a near zero Class I dollar value for the Class III shadow price?

A. Why is there not?

Q. Yeah.

A. You can think about those shadow prices in the model solution as being on a complete spectrum from zero to the highest value shadow price that we have, which is, I'm guessing without looking on here, but probably for consumer demand for fluid milk in Key West, okay? So those shadow prices for all products in all constraints, in all regions of the country, are going to be on that spectrum somewhere.

And your question was why don't we see a zero price?

Q. A near zero price in the Class III shadow price?

A. The near zero price on Class III is because those products are needed and are generally being shipped or having to be shipped some distance to consumers from the plant locations, so they are incurring transportation costs to get from surplus regions to places where they are needed.

Q. Okay. Thank you.

MS. VULIN: Thank you, Your Honor. We would move to admit Exhibits 490, 491, 492, and 493.

THE COURT: Is there any objection to the admission into evidence of MIG Exhibit 16D, which is Exhibit 491?

There is none. Exhibit 491 is admitted into evidence.

(Thereafter, Exhibit Number 491 was received into evidence.)

THE COURT: Is there any ob- -- well, I started with 491. Sorry, I'm out of order.

But is there any objection to admission into evidence of MIG Exhibit 16C, like cat, which is Exhibit 490?

There is none. Exhibit 490 is admitted into evidence.

(Thereafter, Exhibit Number 490 was received into evidence.)

THE COURT: Is there any objection to the admission into evidence of MIG Exhibit 16E, also

Exhibit 492?

There is none. Exhibit 492 is admitted into evidence.

(Thereafter, Exhibit Number 492 was received into evidence.)

THE COURT: Is there any objection of the admission into evidence of Exhibit MIG-16F, which is Exhibit 493?

There is none. Exhibit 493 is admitted into evidence.

(Thereafter, Exhibit Number 493 was received into evidence.)

MS. VULIN: Thank you, Your Honor.

THE COURT: Thank you so much, Dr. Stephenson. I appreciate your working with Ms. Vulin to determine whether the issue that the Agricultural Marketing Service would like a little more information on could in some way be provided.

THE WITNESS: Thank you.

THE COURT: Thank you. And you truly are a gentleman and a scholar. Thank you for coming back.

Let's take a ten-minute break. Please be back and ready to go at 9:22.

(Whereupon, a break was taken.)

THE COURT: Let's go back on record.

We're back on record at 9:26.

We have a new person in the witness chair.

Would you please state and spell your name for us.

THE WITNESS: Jeffrey Sims, J-E-F-F-R-E-Y, S-I-M-S.

THE COURT: You remain sworn.

JEFFREY SIMS,

Having been previously sworn, was examined and testified as follows:

THE COURT: Ms. Hancock, if you'd identify yourself and then walk me through these exhibits.

MS. HANCOCK: Nicole Hancock, National Milk.

And, Your Honor, I believe we're on Exhibit 494.

THE COURT: Correct.

MS. HANCOCK: So we have Exhibit NMPF-112, which is Mr. Sims' written opposition statement. We'll mark that as Exhibit 494.

THE COURT: Yes.

(Thereafter, Exhibit Number 494, was marked for identification.)

MS. HANCOCK: And then we have NMPF-112A through D, like David, and we'll mark those in order.

So National Milk-112A will be Exhibit 495.

THE COURT: Yes.

(Thereafter, Exhibit Number 495 was marked for identification.)

MS. HANCOCK: National Milk-112B, as in boy, will be 496.

THE COURT: Yes.

(Thereafter, Exhibit Number 496 was marked for identification.)

MS. HANCOCK: National Milk-112C, as in Charlie, will be 497.

THE COURT: Yes.

(Thereafter, Exhibit Number 497 was marked for identification.)

MS. HANCOCK: And last, National Milk Exhibit-112D, as in David, will be 498.

THE COURT: Yes.

(Thereafter, Exhibit Number 498 was marked for identification.)

MS. HANCOCK: Delta for the pilots in the room. Did we get the --

THE WITNESS: Yes.

MS. HANCOCK: We're good to go.

THE WITNESS: If we can turn on the display.

MS. HANCOCK: Okay. Your Honor, is it okay to proceed?

THE COURT: It is. So we're looking at what's been marked as Exhibit 495.

DIRECT EXAMINATION

BY MS. HANCOCK:

Q. Good morning, Mr. Sims, and welcome back to the stand. Let's just identify the documents that we have here first.

They won't all show on the screen right now, but we'll start with Exhibit 494, that's your written testimony that you are going to provide in just a moment; is that right?

A. Yes.

Q. Exhibit 495, which is 112A that's showing on the screen, can you tell us what this exhibit is?

A. Yes. This calculates two or three things simultaneously by Federal Milk Marketing Order by month for calendar years 2021 and 2022. It simply takes -- and these data are from the MA websites or the price announcements or other data that's been presented at this hearing in terms of the Class I producer milk pounds and the producer milk pounds in each pool, the 11 pools, for -- again, for the years 2021 and 2022. It calculates the cost, the reduction in pool revenue by month, and then summarized annually for each of the 11 orders, the reduction in pool revenue from reducing across the board Class I differentials by $1.60 per hundredweight. And it simply takes those dollars and divides them by the producer milk pounds in the month, which would create, then, a change per hundredweight in the PPD, in the component pricing orders, or the uniform price in the four skim fat orders.

I then just put in the announced PPD at the base zone for each order in the next to last column, and then simply took the change in the PPD compared to the PPD as announced.

And then the last column would be a revised PPD based on reducing the pool revenues by $1.60 per hundredweight.

I will note that Ms. Keefe's testimony earlier had

some data in there on 2022, and my data in terms of the change in the order blend price or PPD or uniform price, whichever way you want to look at, and hers are within -- I rounded mine out to three decimals, she rounded out to two, and within that rounding they are identical.

So the process that she used to compute the change in the weighted price or the blend prices for 2022 and mine match, again, within the, you know, rounding out to one-tenth of a cent. So the process is something that matches exactly what Ms. Keefe did earlier.

Q. And if we turn to page 13 of Exhibit 495, you have a summary page there?

A. I do.

Q. And do you want to explain that page?

A. Yes. This simply takes the individual results per order and adds them up together to get, for the two years number, the weighted average change across all orders in terms of the change in blend prices for each of the two years. Also sums the change in pool revenues for each of the two years. Notably, for 2021, about 674 thous- -- excuse me -- $674 million in pool revenue reduced as a result of Proposal Number 20, and just under $656 million for the year 2022.

And then over to the side we simply take a quick look at how the Proposal Number 20 would impact the occurrence of negative PPDs and how it would increase the incidence of negative PPDs, current, or as was announced by each Federal Order, the PPD. And then the impact of

Proposal 20 on the occurrence or the number of times you would -- we would see negative PPDs in the Federal Orders.

Q. Okay. And then Exhibit 496, can you tell us what that exhibit is?

A. Yes. This exhibit takes the -- I guess you could say the -- as -- as today, for 2021 and 2022, the top half of each page -- and the pages are procedurally identical, 2021 being the first page, 2022 being the second page. It simply takes the base zone uniform price or statistical uniform price for the component pricing orders, subtracts the location adjustment to -- from what I would call representative reserve supply areas for the Southeast. These reserve supply areas Deaf Smith County, Texas; Hereford, the city; Manitowoc, Wisconsin, in Order 30; Rensselaer, Indiana, in Order 33; St. Johns, Michigan, in Order 33, also; and Lancaster, Pennsylvania, for Order 1.

It simply calculates the blend price gradient, if you will, between these reserve supply areas and the order blend price of -- that was announced in Orders 5, 6, and 7. And, again, these transactions represent what I would call kind of typical reserve supply sources for each of the three orders in the Southeast, largely the Southwest, and the Upper Midwest, and the Middle Midwest for Order 7, Michigan for Order 6, and the Order 1 area generally for Order 5.

It simply calculates the blend price gain from buying milk in a reserve supply area and the blend price gain when you sell it in Orders 5, 6, and 7. If you

reduce the $1.60 out of the Order 5, 6, and 7 pools, because Orders 5, 6, and 7 have the highest Class I utilization of all the orders in the country, that $1.60 impacts those orders most negatively. In other words, the blend price goes down in Orders 5, 6, and 7, more than it goes down anywhere else if you take a flat $1.60 off of every pool. Now, every blend price and every pool goes down, but Orders 5, 6, and 7 goes down more than typical because of their very high Class I utilization.

And so then I used -- basically take the same blend price changes that I computed in Exhibit 111 -- National Milk 112A, and applied them to these five typical milk movement scenarios on an annual basis, and it -- maybe I can -- maybe I can get that one up while we're -- let's see. We need B, don't we? There we go.

So as we can see, the blend price, because, again, every order, the blend price goes down as a result of Proposal Number 20, the announced Federal Order blend price or uniform price or statistical uniform price, they all fall. But they fall most and biggest, a biggest fall, the biggest decrease, in Orders 5, 6, and 7.

So when you compare the blend price incentive to move milk, bulk milk, farm milk, from these reserve supply areas to the Southeast, Proposal 20 actually harms or reduces the incentive to move supplemental milk from these reserve supply areas to the Southeast more than any other place, to the tune of, depending on the place, depending on the origin point of the supplemental milk, the

destination point, and the year, anywhere from 50-some-odd cents per hundredweight decline in the incentive to move milk to more than $1 per hundredweight to -- that would reduce the incentive.

So basically Order 1 -- excuse me -- Proposal 20 damages the ability or the -- what I would call the blend price gradient between reserve supply areas and the Southeast pretty substantially. And I think it bears a bit of a reminder that packaged milk tends to move on Class I prices; bulk milk moves on blend prices.

So this is the calculation that, for example, I, in my position, would go through to determine where to get supplemental milk, or what supplemental milk should cost, et cetera, for these areas, particularly for Lone Star Order 7, this is exactly the kind of comparison I do when I start thinking we might need supplemental milk or what is milk worth. This is the kind of calculations I do. And it -- and this Proposal Number 20 would severely damage the Southeast's ability to attract supplemental supplies in these reserve areas.

Q. Thank you.

And let's move to Exhibit 497.

Can you explain for us what is represented in Exhibit 497.

A. Yes. And I'm going to go -- I have been accused of going fast, but I'll try to go slow.

The question has arisen in this hearing about the impact of Class I differentials on Class I demand. And if

we -- if you think intuitively, you would think that if you raise Class I differentials, that raises -- it should raise retail prices, and consumers, if there is a response or a relationship between what consumers do and how much milk they buy, they are responding to retail prices.

So we investigated the question of, is there a cause and effect relationship between Class I differentials and retail prices? Because that's what -- again, that's what consumers respond to.

For the year, for the ten months ending October 2023, when we initially did this, I don't think the last two months have been announced yet, we used the 30-city AMS Dairy Program Retail Price Survey as our data source. So these are USDA announced retail prices from their monthly survey, 30 cities across the U.S.

This first page here is a standard graph of the relationship for each of those 30 cities of the retail price, the ten-month retail price, again, ending October 2023, as an -- you know, provided in that USDA data, compared to the Class I differential at that city, the current Class I differential.

Perhaps the easiest one to look at is the one to the very, very far right. You will see a dot there, oh, a little bit closer to $4 than it is $4.50 on the retail price per gallon, and hovers greatly above $6. Most of us who mess around with Class I differentials and prices know that that's Miami. Miami is the current only place that I think that has milk plants and has people and has a

Class I differential of $6. So far out to the right, that one is Miami, in the intersection of the retail price, ten-month average retail price, and the Class I differential.

If we look at the one at the top, the very -- the kind of the second line, the -- or excuse me -- the second column, the $2 per hundredweight differential group, the number there is a number just above $6 per gallon. That is Kansas City.

So we plotted in a scatter graph the relationship as the retail price was reported by USDA against the Class I differential at that city. For -- again, for Kansas City, $2; Miami, $6, et cetera. And then just did a quick statistical test, an ordinary least squares regression, to get the trend line, the best fitting regression line.

And out of that you can then ask, what is the R-square which represents a statistical measure of how much of the difference in all these data points is represented by that best-fitting regression line?

Q. How well they correlate?

A. How well they correlate.

Q. Okay.

A. In this case, in an R-square, it's been a long time since I did them, but I do remember that zero means, in essence, completely random, absolutely no relationship whatsoever. A factor of one means absolute relationship. That the -- that the dependent variable moves in lockstep

with the independent variable.

In this case, when we were -- and intuitively, again, you would think that Class I differentials would have a direct impact on the retail price in an area. The higher the differential, you would think you would, you know, intuitively believe that that should result in the highest retail price.

That is absolutely not the way the world is. The R-square here is .0032, meaning more than 95.5% of the impact on retail prices is from factors other than the Class I differential. It is almost as close to random as you can get. There is virtually no cause and effect relationship between the Class I differential and the price per gallon for retail milk sold in a particular area. They are completely disassociated actions or activities.

Q. And so I hate to say the word again because I feel like there will be a collective eye roll, but we have heard a lot of debate at this hearing about price elasticities and whether the retail price of milk causes any kind of effect on consumer behavior. And I want to be clear on what we're talking about in this Exhibit 497.

You are not talking about price elasticities here, are you?

A. We are not. We're simply saying that if you make the intuitive conclusion that higher Class I differentials will raise retail prices or, conversely, lower Class I differentials will necessarily reduce the likelihood or

create a likely reduction in retail prices, that cause and effect relationship simply does not exist.

Q. And because if you increase Class I differentials, there's a lot of intervening events that can happen to either absorb or reduce costs along the way before it gets to a retail outlet; is that fair?

A. All we're saying with this data and what the data says is that the relationship between the Class I differential and a retail price has virtually nothing to do with the Class I differential. It's gillions of other things, retail pricing behavior, any number of things that can drive that, but what is not driving it is the Class I differential.

Q. Okay. Let's turn to page 2.

A. Yes.

Again, intuitively you would think that, again, retail prices and Class I differentials should be at least indicative of each other, right? So we prepared a couple of maps here, one of which will not be any surprise to anybody in the room. We'll start with the map on the right, which simply just for the 30 cities announced in that USDA AMS retail price service, the 30 series -- the Class I differential at those 30 cities compared to the median Class I differential for those 30 cities.

In this case, the median Class I differential is $2.45. That's not too far off what we normally think of as the average Class I differential across the country completely, but for this subset of cities, the median

Class I differential is $2.45 per hundredweight. And they range from, of course, well less than that to up to $6 in Miami.

The gradations in this map simply show the relationship of the city Class I differential to the median. The most red state, now, no political commentary, is Florida. It has the highest Class I differential compared to the median. And when you get to the Upper Midwest and parts of California or the cities in California that are surveyed, you have the largest difference less than the median Class I differential.

So this map looks exactly like you would expect. The highest Class I differentials compared to the median in the Southwest and up the Eastern Seaboard, the lowest in the Upper Midwest and on the West Coast.

The map on the left-hand side makes the same comparison, but with retail prices. And you don't see what you would expect there. If you -- if prices -- retail prices followed Class I differentials in relative consistency.

There is a good bit of difference. The places where the retail prices are higher, substantially higher than the -- than the Class I differential, or higher than the mean -- excuse me. Strike that.

The places where they are higher than the median, you know, deep red, largely across some of the central states and Pennsylvania. Higher than the median in California and the Upper Midwest. Tend to be lower than

the median in the South, Georgia and Florida, and the Southwest.

So this shows that the -- again, the lack of connection between retail prices and -- and the Class I differentials, or chose, at least on this one, the picture of where the retail prices deviate from -- from the median.

We also asked the question, well, yeah, the -- the implication of the statistics is that there's no relation, but could this be a regional thing? Could there be some sort of regional implication that says, "Okay, here's why it doesn't look why there's no relationship," and that's some sort of regional pricing behavior on retail prices. So I'm going to go, again, through this one fairly slowly.

And I struggled with the right nomenclature, but, again, if you -- if you think intuitively or you consider intuitively the Class I differential and the retail price, normally we would think they ought to move together or be consistent. But there's just as many places where they are completely inconsistent.

A blue state in this case means that -- one of two things: Either the median differential is higher than the -- or the actual retail price is higher than the median and the Class I differential is higher than the median, or conversely, the retail price is lower than the median and the Class I differential is lower than the median. In other words, they kind of move like you would expect. Right?

But then all the red states show a place where they move entirely differently, or the relationship is exactly opposite. You have a high Class I differential but a relatively low retail price, or vice versa, a low Class I differential but a relatively high retail price.

There's obviously no geographic relationship in terms of this disconnect. And in fact, if you look to the three states that -- in kind of the Northeast, the Ohio and the Northeast, Pennsylvania -- Ohio, Pennsylvania, and New York, each of those states has two cities in the USDA retail price surface -- or survey. In each of those states, the two cities themselves aren't even consistent in terms of how they relate to their retail price versus the median.

So this is not a regional question. It's not there's a regional impact, or it's -- this is just simply their -- these data show that if you are looking for a cause or effect relationship between Class I differentials and retail prices, it simply doesn't exist.

Q. Okay. And then briefly Exhibit 498, tell us what that exhibit is.

A. Yes. The type is kind of small, we tried to get as many as we could on a page, but -- there's been some discussion, implication at this hearing that the Proposal 19 Class I differentials are somehow skewed such that they tend to create a competitive advantage for cooperative-owned Class I plants, that the implication is that we went -- in developing Proposal 19 we somehow

inherently or systematically or systemically inserted a bias to competitive advantage for cooperative plants.

So this is a plant list that I think came off of, I believe the footnote says Exhibits 299 and 301. 289, I believe -- 289 distributing plants and supply plants. And the Class I working group went in and simply, to the best of our knowledge and belief, marked whether those plants are owned by a cooperative or whether they are owned by a proprietary company, including in what we have included in proprietary companies vertically-integrated grocery store chains.

Q. And what's the executive summary or the takeaway from Exhibit 498?

A. If we can get to the bottom.

We made calculations, and that the -- across -- compared to the current differentials -- there's a small table at the bottom that simply summarizes the -- the -- the statistics.

Cooperative-owned plants, the current differential is approximately $2.55, simple average across those co-op-owned plants. The order -- excuse me -- the Proposal 19 proposed differential across that universe of plants is $4 and roughly $0.02, a difference of $1.46, $1.47, the delta per hundredweight.

The proprietary plants, again, including the vertically-integrated grocery stores, the current average differential is 4 -- roughly $4.03 a hundredweight. The proposal -- excuse me -- the Proposal Number 19 is $4.03,

compared to a current differential average across those of $2.58 per hundredweight, a difference of $1.44 roughly per hundredweight.

This shows that across the country compared to the current Class I differentials -- which seem to be important to a number of the witnesses in terms of maintaining price alignment, the current price alignment seemed to be an important consideration for them. Compared to the current differentials, the cooperative-owned plants, their increase is ever so slightly more than the proprietary plants, but I would say that these represent virtually identical numbers.

But if there is any difference or any notable difference, it's that the co-op plants tend to go up more than the proprietary plants, again, including the vertically-integrated grocery store chains.

Q. Okay. Let's turn to your opposition testimony to Proposal Number 20 in Exhibit 494. You have approximately 32 minutes left.

A. Oh, am I limited? I didn't think I was.

Q. Well --

MS. TAYLOR: All witnesses get an hour.

MS. HANCOCK: I thought it was direct testimony.

MS. TAYLOR: Is this not direct testimony?

MS. HANCOCK: It's rebuttal testimony to 20.

(Discussion held, not reported.)

MS. HANCOCK: Okay. Well, I saw the clock running, so I think we're going to be close.

THE WITNESS: Okay.

BY MS. HANCOCK:

Q. Exhibit 494, if you could provide that testimony.

A. Yes. And I -- my name is Jeffrey Sims, as we said earlier. I work for Lone Star Milk Producers, and I'm a member of the National Milk Producers Class I working group.

We present this testimony on behalf of National Milk in opposition to Proposal Number 20. Proposal Number 20, if adopted, would result in calamitous, disorderly marketing conditions in the U.S.

I'll do my best to stay under my 30 minutes.

We enumerate a number of challenges and concerns regarding Proposal Number 20. Number one, as we indicated in that -- one of the previous exhibits, there's an enormous amount of Class I revenue which leaves the Federal Order pools, which would result on -- from order -- excuse me -- Proposal Number 20, somewhere in the $650 million to $670 million range per year.

Importantly, there is no guarantee, no guarantee, that any of the $660 million would materialize in the form of over-FMMO prices. A substantial portion of the country would have a zero Class I differential per hundredweight under Proposal Number 20. That would significantly increase the incidences of Class I price inversions, and would also significantly increase the incidences of negative PPDs.

Negative PPDs are a major concern for dairy

farmers, and they -- provisions which would tend to increase the incidences of and magnitude of negative PPDs are not embraced, and will not be embraced in the dairy farming community.

I think I'll pause here and go off script, since we're not going to follow the script. Mr. Schuelke last week, two weeks ago, made a very interesting observation about -- from Crystal Creamery, Mr. Schuelke -- about negative PPDs. He said, "Negative PPDs tell dairy farmers to deliver to Class III, not to Class I." I think that's a very interesting observation.

Number three, Proposal Number 20 would reduce or even eliminate the regulated price economic incentives to supply Class I plants, and this would occur across the country, not just in predominantly Class I markets.

Proposal Number 20 ignores or assumes away -- this is a substantial cost of balancing Class I plants -- and ignores or assumes away 25 years of increases in milk hauling costs.

Proposal Number 20 ignores the difference between the on-farm milk production costs of Grade A milk versus Grade B.

Effective -- Proposal Number -- or item number six, Proposal Number 20 would effectively return much of the country to individual handler pools which can cause market disorder rather than the market-wide pools which have been determined by the Secretary to enhance orderly marketing.

Proposal Number 20 would create conflicts with other Federal Milk Marketing Order provisions.

Proposal Number 20 makes no improvement in the Class I price surface to encourage milk to move from reserve supply areas to areas of milk need and, in fact, would disincentivize the delivery of milk from reserve supply areas to milk deficit areas.

Number nine, Proposal Number 20 improperly concludes, as we have just described in our -- one of the previous exhibits, the Class I will -- demand will be reduced or eliminated -- excuse me -- if you reduce or eliminate Class I differentials.

Proposal Number 20 relies on substantial immediate and permanent increases in over-order prices to transmit the dairy product values through raw milk. If -- if the -- if such increases in over-order prices were to occur, which is a highly speculative occurrence we believe, there is no guarantee that such increases would be immediate and permanent, and certainly no assurance that the over-FMMO prices would sufficient -- would rise sufficiently to offset the $660 million in pool revenues.

These problems build on each other and multiply each other --

THE COURT: Do you want to just re-read just after "offset"?

THE WITNESS: Oh. Over-FMMO prices, there's no assurance that over-FMMO prices would rise sufficiently to offset the $660 million lost in FMMO pool revenues.

THE COURT: Thank you.

THE WITNESS: These problems build on each other and exacerbate each other.

Number one, Proposal Number 20 reduces pool revenues in all Federal Milk Marketing Orders. As we mentioned, computed in that previous exhibit, that number is rounded $650 million to $670 million.

Proposal Number 20 increases the incidences of Class I price inversions and increases the incidences of magnitude of negative PPDs. It's pretty straightforward. We reduce $1.60 off of every order Class I differential, that then lowers the blend, that lowers the -- reduces the Class I price, it increases the incidences of Class I price diversions, and increases the occurrence of negative PPDs.

This is particularly problematic with Class II, with -- if the mover goes back to the higher-of, every time the mover is set on Class IV, you can have a -- in those areas where there's a zero Class I differential, you will have a Class I to Class II price inversion.

Proposal Number 20 reduces or eliminates the incentive to supply for Class I one. I'll try to summarize here. The way to get Class I milk delivered to Class I is to make Class I price the highest price class. Okay?

In much of the country, under Proposal Number 20, there would be no notable difference between the manufacturing class prices, Class III and IV particularly,

and the Class I price. You -- in essence, we may still have classes of use, but in a place where there is a zero Class I differential, you do not have classified pricing because all the class prices are going to be pretty much the same. So you -- when you take that money away, the Class I price looks exactly like, or very nearly like, the manufacturing class prices.

Why would anybody -- why would a dairy farmer choose to serve Class I plants when the revenue at that Class I plant that flows into the pool is virtually identical to the revenue that flows in from Class III and Class IV? We have a real problem there if we need a place that has a zero or very nearly zero Class I differential.

If the -- if the Class I and Class III/IV prices are equal or virtually equal, there is absolutely no economic incentive within the orders to supply milk to Class I. And the fact that we -- you know, so the orders would not reflect the cost of balancing, the order prices would not reflect the cost of acquiring milk for Class I, there is no practical reason why a dairy farmer would elect to take on the cost of balancing a Class I plant when there is no more money in the pool which comes from Class I than comes from Class III or Class IV.

Class I differentials need to have a slope which encourages milk to move from reserve supply areas to deficit regions, particularly. Dr. Stephenson, I believe, admitted that in one of his pieces of testimony.

Order -- Proposal Number 20 does not address the

need to increase the price gradient to track supplies from reserve supply areas to deficit areas.

Proposal Number 20 dismisses the undeniable and harmful effects of 25 years of escalating hauling costs as inconsequential. As we demonstrated in the exhibit, Proposal Number 20 actually reduces the incentive, the blend price incentive, to move milk from reserve supply areas to deficit areas in absolute conflict with the aims and purposes of the orders and as directed in the market -- in the Agricultural Marketing Agreement Act.

Proposal Number 20 would negate the impact of pooling provisions or milk delivery performance standards.

THE COURT: I'm going to interrupt you just a moment, Mr. Sims. You are at the bottom of page 6.

THE WITNESS: I am at the -- about two-thirds of way down page 6. I -- again, I'm bouncing as quickly as possible.

Proposal Number 20 would negate the impact of pooling provisions or milk delivery performance standards. There's been some talk at this hearing that if we want to get milk to move to Class I, then, hey, just tighten pooling provisions, and then milk will move to Class I. Well, that's not true. The math doesn't prove that.

If the Class I price in those areas where the differentials are zero or very nearly zero, if the Class I price is virtually unrecognizable compared to the manufacturing class prices, it doesn't matter what the Class I utilization in the pool is.

Mathematically, we can explain that. If you have a pool that's 90% Class I, and the Class I price and the Class III price, in this case, are the manufacturing prices are $17, the Class I price and the manufacturing class prices are identical or virtually identical. If you are 90% Class I times $17, plus 10% in the manufacturing class times $17 per hundredweight, you are going to get a $17 blend. If all the class prices are the same, you don't have any impact from higher Class I differentials. If it were 10% Class I and 90% Class I, you get the same answer.

If the Class I price is not higher than the manufacturing prices, you can boot all the milk out of the pool, the manufacturing milk you want to boot out, and it doesn't impact the blend. That doesn't -- those incentives to supply Class I become -- or that use of pooling provisions reduces the incentive or the effectiveness of pool previsions.

Proposal Number 20, again -- now I'm at the bottom of page 7. Proposal Number 20 does not recognize a substantial cost of balancing Class I markets and does not recognize more than 25 years of increased hauling costs.

The discussion at this hearing has indicated that balancing costs of Class I plants, while they exist, may not be as important as they used to be. That is not true. There is substantial daily, weekly, monthly, and annual variation in the receiving at Class I plants. It's expensive to balance Class I plants purely because of

their variation day to day, week to week, et cetera. That milk has to go somewhere, whether it's sitting in reserve or for Class I.

We have provided clear and convincing evidence at this hearing on the increases in milk hauling costs and how those increases in milk delivery costs are today, not tomorrow, threatening a continuous supply of milk to Class I.

Proposal Number 20 dismisses away those increases in hauling costs and how it has impacted the ability and desirability of delivering milk to Class I plants.

Milk has regional value. Proposal Number 20 does nothing to improve or recognize the hauling costs and its impact on the relative value of milk as it moves across the country.

I would note that, again, something we have said before, Make Allowances are a reflection of product use utility, the conversion of raw milk and the conversion, the cost to change the form and product utility of those -- of class -- of fluid milk to hard products. Class I differentials are time and place utility. It costs money to move milk from where it is to where it needs to be and when dairy farmers need to be compensated for that conversion in time and place utility.

Proposal Number 20 -- again, now top of page 9. Proposal Number 20 does not recognize the substantial cost of producing Grade A milk versus Grade B. We won't go too very deep into this one. We have had this debate. Other

than to point out an odd piece of information.

One of -- there was a proposal submitted by the proponents of Proposal 20 to institute in the orders a delivery credit, which would have come out of the pool, by the way, $0.55 per hundredweight. So the proponents of 20 -- of Proposal 20 are, in fact, recognizing that there are costs associated with balancing and supplying milk to Class I, and they pegged that at $0.55 in that unregula- -- unnoticed proposal.

But they are also saying that the Grade A/Grade B piece of the current minimum differential is zero, or should be zero. The cost of delivering -- or the incentive to pool milk out of manufacturing or incentivize deliveries to Class I is or should be zero. And the third element, the balancing cost -- or the Grade A/Grade B is $0.40 or that should be zero.

If you admit that there is a balancing cost of $0.55 or a need to attract milk to Class I plants and that cost is $0.55, then one of the other elements must be -- or the other two elements must be a negative 55. In this case, they say there's plenty of milk in the country, no need to incent milk to move to Class I, so if you do the math, the simple algebra, they are saying that actually Grade A milk is cheaper to produce by $0.55 per hundredweight than Grade B. We go through that math in the testimony, generally on page 10.

Moving to page 11. Proposal Number 20 would create conflicts with other provisions in the Federal

Orders. There are a number of items that are classified based on the lowest price class when they occur. Things like shrinkage, overage, milk inventory, other uses. This would be a real problem if the Class I price and the manufacturing places are the same. It -- well, the -- there would be a real conflict there. When you have Class I price inversions, Class I becomes the lowest price class, so you would start some of the allocations -- or classify some of these products at Class I in one order and perhaps another class in another neighboring order where there is a positive differential.

Also, there is any number of orders -- or the sections of -- in 44, section 44 of the orders, that start with the allocation of Class IV and other source milk, step-wise moving way up, and that would not work well if Class I is the lowest price class. It would be, in fact, disorderly.

Proposal Number 20 would effectively return much of the country to individual handler pools.

And I think I just want to read this section rather than hit the high points.

THE COURT: And you are at the top of page 12?

THE WITNESS: Yes, ma'am. Top of page 12.

Several of the witnesses supporting Proposal Number 20 did not even try to cloak their disdain for the Federal Milk Marketing Order program and market-wide pooling, instead, in effect, espousing the self-serving but disorderly return to individual handler pools.

An important element, if the Secretary to adopt Proposal 20, would be a reversal of the Secretary's rejection long ago of individual handler pools as an orderly method of handler and producer milk pricing. The reliance on over-FMMO prices to encourage milk to be delivered to Class I plants will actually defeat multiple purposes of FMMOs: First, uniform classified pricing; and second, the objective of the orders to eliminate ruinous competition for milk sales.

Over-FMMO prices, except in some rare cases, are not pooled, that is, the billing supplier of the milk generally keeps the over-order premium for themselves. Also, in many regions, over-order prices are class specific, a fact basically acknowledged by the proponents of Proposal Number 20 when they encouraged the Secretary to allow them to set their own Class I price.

Having Class I differentials at or near $0 per hundredweight that are supposed to be replaced with over-order prices means any additional milk price value associated with the delivery of milk for Class I would be handler specific, a circumstance which would have the same result as creating individual handler pools.

The Secretary's rejection of individual handler pools as tools to encourage orderly marketing is reasoned and proper. When dairy farmers are paid for the milk based on the Class I utilization of the specific plant to which they deliver rather than at the market-wide Class I utilization, dairy farmers will seek to deliver to plants

with the highest Class I utilization because those plants will likely return the most money per hundredweight for the milk.

This is exactly the marketing scheme envisioned by the proposals of Proposal Number 20 when they say virtually in unison and with a coordinated voice that the Secretary should let them direct their individual plant Class I values to the farmers delivering milk to their plants.

The natural consequence of an individual handler pool marketing structure is that dairy farmers will begin fighting for the ability to supply the higher-paying Class I plants. The only bargaining chip the farmers have is price, and when the basic additional value of Class I milk is not regulated, they will begin bidding down the over-FMMO premiums, a milk marketing eventuality described by Dr. Stephenson in page 3 of his Exhibit MIG-16.

This pernicious competition and the disorderly markets that follow it is exactly what FMMO pooling is designed to eliminate. The logical progression of price deregulation to declining dairy farmer income and declining of milk costs to processing plants is doubtless not lost on the proponents of these thinly disguised individual handler pools, in fact, they are counting on it.

At the bottom of page 12. Proposal Number 20 improperly concludes that Class I demand will increase when reduced, while eliminating Class I differentials.

We have described the data we analyzed regarding the relationship of Class I differentials and retail prices and that there is no such relationship.

I will point out an interesting piece of information. This is taken from a Hordes Dairyman article just earlier this month. They took a look -- it looks like exactly the same data as in the USDA AMS monthly retail price survey, and they found that in 2023, the average retail price for national Class I milk was $4.34 per gallon, which was $0.08 per gallon higher than the average in 2022.

Hit the high points of the numbers. For 2022, the average Class I mover in the United States was $23.66, with a -- so that would be approximately -- with an approximate national average Class I differential, the annual national average Class I price in 2022 was $26.26 per hundredweight. We use the same method, you get an average Class I price in 2023 of $21.80, a decline of 20.5% in the Federal Order average national Class I price than 2023 versus 2022.

To be clear, the retail fluid milk prices rose 1.9% from 2022 to 2023, in a year when the national average Class I price fell 20.5%. We're supposed to believe, based on the Proposal Number 20 pricing, that reduced Class I prices will spur fluid milk product demand because retail prices will invariably follow Federal Order prices, and that is not borne out by the evidence.

By the way, Dr. Balagtas basically uses the same

data in his Exhibit Number 436, the PowerPoint at page 17, where he shows that the retail price in 2023 was higher than the retail price in 2022 by $0.08 per gallon.

THE COURT: And now you are on page 14.

THE WITNESS: Middle of page 14. Eight minutes.

Proposal Number 20 places the ultimate incentive of supplying Class I markets on over-FMMO prices. The reliance on premiums would require the Secretary to abrogate his responsibility under the AMAA. We have -- previous testimony has documented the challenge in securing over-order prices and the challenge in retaining them. Southeast is a perfect example of premiums are at substantially less than they were few years ago.

Over-order prices are hard to get. The record of this hearing is replete with the history of over-order pricing and its limitations and its impertinence -- or excuse me -- its impermanence. The Secretary should pay particular note that the parties that benefit the most from over-FMMO prices and benefit when they increase, that is dairy farmers, are also warning of over-order prices limitations, and they simply can't be relied -- or that they simply can't be relied on over any appreciable said length of time.

On the other hand, the supporters of lowering regulated milk prices and then theoretically substituting market-set prices for those regulated prices are those parties who benefit from the reduction in regulated prices and benefit again when Federal Milk Marketing Order

over-order prices crumble, which they most certainly will do eventually.

I'll jump now down to the middle of page 15, implications for Proposal Number 20.

Proposal Number 20 fails to represent several basic facts associated with milk marketing and the need to address these facts and regulated pricing.

There's a difference in the cost of producing Grade A and B milk.

There remains a need to incentivize delivery of milk to Class I used in preference to other classes by establishing a Class I price superior to the manufacturing class prices.

Balancing Class I prices -- plants is expensive. We need to continue to incentivize the milk movement from reserve supply areas to milk deficit regions.

Milk is bulky and expensive to transport, and the cost of moving milk and supplying Class I plants have seen significant increases in costs over the last 25 years.

Milk is a perishable product and there continues to exist an imbalance of market power of processors over dairy farmers.

Proposal Number 20 assumes away or ignores these important factors. The problems with Proposal 20 are multiple and multiplicative in their failures. The predictable result of these market failures would be undeniably lead to producers questioning the need for Federal Milk Orders.

Let me back up and preface that.

If the class prices are all virtually equal, the Class I price is virtually equal to the manufacturing class prices, you may have classified pricing -- you may have classification, excuse me, but you don't have classified pricing. If the prices are all the same, you don't have classified pricing. If you don't have classified pricing, you don't need a market-wide pool. If you don't need a market-wide pool, you don't need a Federal Milk Marketing Order. That logical progression is inherent in everything in this Proposal 20. The move toward deregulation, the partial -- the initial request to partially regulate will lead undoubtedly to the destruction of a Federal Milk Marketing Order program.

Summary. And now I'm on page 17. Federal Milk Marketing Orders cannot meet the mission of the Agricultural Marketing Agreement Act without Class I differentials. The AMAA requires incentives for milk to be delivered to Class I plants. With no Class I differentials, the USDA is dependent on unregulated over-order premiums to create the economic incentive to meet its mission under the AMAA. So a Federal Milk Order with no economic incentives to move milk to Class I violates the Act and, therefore, should be considered illegal.

USDA must uphold the law, and thus, by regulation, it cannot have a situation with a Federal Milk Marketing Order and no Class I differentials.

Whenever industry discusses with USDA potential amendments to the orders, invariably a USDA staff member will remind us that we must look at the enabling legislation for FMMOs, the Agricultural Marketing Agreement Act. They are right in these reminders. We must follow the law.

So let's remind ourselves of what the Act says and how Proposal Number 20 fails to follow the law, or at least suborns the Secretary to fail to follow the law.

The plain language of the Act says, "he" -- meaning the Secretary -- "shall fix such prices as he finds reflects such factors, insure a sufficient quantity of pure and wholesome milk, and be in the public interest." The factors to be considered include "the available supplies of feeds, and other economic conditions which affect market supply and demand for milk."

Let's repeat: "Fix" -- "shall fix such prices." "Fix."

The AMAA does not direct the Secretary of agriculture to rely on the bargaining power of dairy farmer producers to set sufficient milk prices. The AMAA does not direct the Secretary to rely on the benevolence of the buyers of milk to set sufficient milk prices. The AMAA does not direct the Secretary to rely on the invisible hand of supply and demand to set sufficient milk prices. And the AMAA does not direct the Secretary to rely on divine providence or sheer dumb luck to set sufficient milk prices.

It's the Secretary's job and duty to fix those prices that ensure a sufficient quantity of milk, nobody else. No other force, it's on the Secretary.

The plain and straightforward reason the AMAA wisely and appropriately places this job square in the Secretary's hands is that these other options or alternative methods always fail. Always. We can rely on the Secretary and the power bestowed by the AMAA to fix the milk prices to bring forth a sufficient quantity of milk. The dairy industry and the consuming public can't depending on -- depend on anything else to get the job done, it's just that simple.

Proposal Number 20 asks the Secretary to ignore the Secretary's responsibility to "fix" prices. The Secretary must follow the law and the USDA must deny Proposal Number 20 in its entirety.

This concludes our prepared testimony. Thank you.

THE COURT: How many seconds does he have left?

MS. HANCOCK: I don't think we're really operating under that, are we?

THE WITNESS: Apparently we are.

MS. HANCOCK: I mean, they -- they put on, like, 14 witnesses in opposition to our Proposal 19. I mean, we're putting on one witness, and I thought only the direct testimony was limited by an hour.

MR. HILL: Each witness.

MS. HANCOCK: Only for the direct testimony, not for rebuttal testimony. We haven't done it for any of the

other rebuttal witnesses.

MS. VULIN: If I may, Ms. Keefe was limited to one hour for her Proposal 19 opposition.

MS. HANCOCK: You had, like, 14 witnesses opposing Proposal 19.

MS. VULIN: Each of whom was limited to one hour.

MS. HANCOCK: Never did they run the clock.

THE COURT: You may continue your direct examination.

MS. HANCOCK: Thank you, Your Honor.

BY MS. HANCOCK:

Q. Mr. Sims, are you aware of Walmart opening a plant?

A. Yes.

Q. A new plant?

A. Yes.

Q. And where is it located?

A. I understand that one is planned for construction.

Q. And where is it located?

A. South Georgia.

Q. What is the effect of Walmart opening a Class I fluid milk plant in Georgia?

A. What would be the effect?

Q. Yeah.

A. In what vein?

Q. Well, what do you think it will do, for example, to over-order premiums in that area?

A. It will make them a bigger challenge. The -- the

plant that was opened in Northern Indiana suppressed over-order prices in that world almost immediately when that plant opened, substantially. And those lessened over-order premiums impacted a big swath of the country. Marketing agency in common -- marketing agencies in common pay attention to the over-order prices existing in neighboring agencies, and so when one agency has a failure in its over-order price, it can impact others.

I have no reason to believe that that would not be a similar result as a result of the South Georgia new plant. I suspect it will put substantial pressure on over-order prices across the Southeast.

Q. Meaning that over -- it puts pressure on those prices in a way that makes over-order premiums go down in that region?

A. That's what I mean by pressure, yes.

Q. We have heard also repeatedly the MIG witnesses have testified that they want to eliminate the price differentials and for producers to just trust that they will put that into the over-order premium pool.

Even if we assume that their intentions are as genuine and authentic as what they have testified to, I'm wondering if you can talk about what your experiences are in that continuing long-term.

A. Over-order prices, in my career -- and it's a fairly long one -- I have seen the gamut in over-order prices. I have seen them pretty high, more than $3, approaching $4, and I have seen them at zero. And no

matter how high they are or how -- they always come down. If they get high, they come down. And the more you rely on over-order prices, and the more you rely on over-order prices to be high, the more likelihood they are to crumble. And they all crumble eventually. It's -- it just kind of happens. And, in fact, the higher you make them, the more incentive there is for them to be caused to crumble.

So we -- my -- my experience is that over-order prices are -- you almost have to consider them here today, gone tomorrow. They do not generally last a long time, they go through cycles. And those cycles are difficult. The cycles, they -- let me say this, the peak periods of over-order prices when they kind of get up to a fairly high level last considerably longer than those periods of time when they are suppressed and near zero. The valleys are substantially longer in duration than the peaks. And over-order prices simply cannot be counted on to exist long-term.

Q. And do you -- in your experience, do you believe that producers have sufficient bargaining power in order to command the prices that they need to cover the elements that we have been talking about that are currently factored into Class I differentials?

A. All I can say in response to that question is that it's the -- it's a very unusual circumstance for over-order prices to cover all the costs of balancing plants. They generally are insufficient in their -- in

how much we are able to charge for -- for those services.

Q. And have you heard from plants how they use the Federal Order announced minimum price in order to pass that price along to their customers?

A. Yes, that's a common theme. We hear plants, particularly traditional plants that have retail customers, say that their -- the formulas that are used -- that are used to set the wholesale price, the price that the plant gets from the -- from the wholesaler, the retailer, are driven purely by month-to-month changes in the Federal Order prices. I think it's been described something like a tolling circumstance, where there's a fixed per gallon, per half gallon margin that in essence is -- creates the transfer price, which is over and above the regulated Class I price.

A very common statement when we talked with our customers about changes in pricing is that if it is on the Federal Order price announcement, we can pass it on; if it's in the form of a premium, not so much. In fact, it's very difficult for them to pass -- if not impossible -- to pass on to their wholesale and retail customers. If it's on the Federal Order price announcement, they can pass it on to their packaged milk customers. If it's in a premium, much, much, much more difficult for them to pass it on.

Q. And we're going to hear from Mr. Giles later on today or possibly tomorrow, and he's a customer of yours; is that right?

A. He's a customer of Lone Star Milk Producers, yes. We supply them raw milk.

Q. And we have heard other MIG witnesses who have talked about that with their cooperatives that they pay balancing costs within some of the costs that are enumerated in the -- by the co-ops.

Have you heard that testimony as well?

A. Yes.

Q. And they say that they are double paying for that when they have to pay Class I differentials, and they also pay balancing costs to the cooperatives. And in anticipation of one of your Lone Star's customers coming up to testify later and talk about the over-order premiums that he pays to Lone Star, I'm wondering if you can talk about whether you believe there is a double-dipping that occurs.

A. I'm just -- I'm -- I will not reveal the nature of our relationship between Lone Star and Plains, but I can say this generally -- how's that -- that between what the order may -- the Federal Order price may reflect in terms of the value or cost of balancing, plus what generally can be captured in an over-order premium, very, very rarely the sum of those covers the real cost of balancing.

Q. Okay. So if it very rarely, if ever, covers the real cost of balancing when you take the current Class I differentials and your over-order premiums, is it fair to say that you are not getting double paid for any of those balancing costs?

A. We're generally getting paid between the sum of the two less than the real cost.

Q. And just to put a fine point on all of this. Is it -- in your experience, have the costs of moving fluid milk to the handlers gone up, at least in proportion to the 109% increase in inflation that has occurred over the last 20 years?

A. The cost of moving milk or the cost of balancing or all of the above?

Q. The totality of all three of those.

A. Yes. Certainly, dairy farmers and the cost to move milk, balance milk, get milk supplies to where it's needed, are not immune from the general cost increases in the economy. Our costs have gone up, and they go up every year. And they were insufficient when -- you know, years ago; they are insufficient today.

Q. Okay. Thank you so much for your time today.

MS. HANCOCK: Your Honor, Mr. Sims is available for cross-examination.

THE COURT: Thank you. We'll need a break before we start that. Let's take 15 minutes. And please come back ready to go at -- let's come back at 1:53 -- excuse me -- 10:53.

(Whereupon, a break was taken.)

THE COURT: Let's go back on record.

We're back on record at 10:53.

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CROSS-EXAMINATION

BY MR. ROSENBAUM:

Q. Good morning. Steve Rosenbaum on behalf of the International Dairy Foods Association.

Good morning, Mr. Sims.

A. Good morning.

Q. I understand your testimony to be both rebuttal in support of Proposal 19, as well as opposition to Proposal 20; is that fair?

A. There is some support for 19, and then -- but primarily opposition to Proposal Number 20.

Q. I'm going to focus on the rebuttal with respect to Proposal 19 aspect of things.

A. Not rebuttal, support for 19.

Q. Well, however you want -- okay. Lawyers might call it your testimony in this context to be rebuttal, but that's technical and not really important.

So what I want to focus on is Hearing Exhibit 497 --

A. Yes.

Q. -- which is the chart that's called "Class I differential and U.S. average retail packaged fluid milk price correlation."

And just to orient ourselves, Proposal 19 would increase Class I differentials, correct?

A. Yes.

Q. And Proposal 20 would decrease them, correct?

A. Yes.

Q. Okay. And so is it fair to say this chart is, in that sense, relevant to both proposals?
A. Yes.
Q. So and -- and from a Proposal 19 perspective, is it fair to say that you're relying upon Hearing Exhibit 497 to suggest that there may not be much of a relationship between an increase in Class I differentials and the retail price of milk?
A. This exhibit, I think, provides substantial evidence that there is no cause and effect relationship between Class I differentials and how high they are or how low they are and the resultant retail price in a particular city.
Q. And, in fact, you -- you compute an R-squared, which is a statistical way of measuring the relationship between two things; is -- is that fair?
A. Yes.
Q. And you compute an R-squared of 0.0032, correct?
A. Yes.
Q. Which is a low R-squared, correct?
A. Meaning that the relationship between the dependent and independent variables is almost random. It -- this trend line or the dispersion of the independent -- or the dependent variable here has virtually no relationship whatsoever with the dependent variable, which is, of course, the retail price.
Q. Okay. So what puzzles me, Mr. Sims, is the fact that National Milk put on an expert witness, Dr. Henry

Kaiser, on this very issue, and he reached conclusions that are the exact opposite of what you submitted here; isn't that fair?

A. I don't recall Dr. Kaiser's -- I was not present for Dr. Kaiser's testimony. All I can say is this data showed that they are not, there's no relationship between Federal Order Class I differentials and retail prices. If he was discussing demand, that's a different story.

Q. And -- and we're going to hone in right on that. And let me give you a copy of his written testimony, which was National Milk Producer Federation Exhibit 48, marked as Hearing Exhibit 115.

So if those people who have copies of Hearing Exhibit 115 would pull it out, that would be -- if they could read along to the major parts of it that I'm going to focus on.

So you understand that Dr. -- maybe you don't understand.

Are you aware that Dr. Kaiser did two things? First of all, he calculated how much of an increase in the Class I differential would be reflected in retail prices, and then calculated how much such an increase in retail prices would reduce demand.

Are you aware that that's what he did?

A. I -- again, I said I was not present for Dr. Kaiser's testimony, and I don't -- I have not studied his testimony.

Q. Well, if you could turn with me to page 3 of his

written testimony, which is Hearing Exhibit 115. There's a paragraph that begins with the words, "How would increasing."

Do you see that?

A. I do.

Q. And I'll just read the key sentences.

"How would increasing the Class I price differential impact retail fluid milk demand? NMPF's proposal recommends a nationwide increase of the Class I price differential by an average of $1.49 per hundredweight. At current Class I prices, this is an 8.6% increase. To translate the Class I price increase to the retail level, we need an estimate of the price transmission from the farm price to the retail price. Based on monthly Class I and retail price data from 2013 through May 2023, I estimate that a 1% change in the Class I price would cause a 0.55% change in the same direction in the retail CPI for all milk products." He says, "Calculations from this are available from the author."

Do you see that?

A. I do.

Q. Do you interpret this language to mean that he had concluded that if Class I differentials go up by 1%, retail prices would go up by 0.55%?

A. That appears to be the implication. But what I obviously do not know is whether he's comparing differentials or the Class I price. You get a

substantially different answer when you make that comparison.

Q. Well, he's -- I mean, it's pretty plain that he's saying that if the Class I differentials go up by $1.49, then you would see a corresponding -- well, strike that.

He is discussing what impact a 1% change in the Class I price would have, correct?

A. He makes that statement, yes.

Q. Okay. And you are proposing to increase the Class I differentials, meaning increasing the Class I price, right?

A. All things being equal, yes.

Q. Okay. So let's look at page 9, the last page of his exhibit, where he provides the econometric output for farm to retail price transmission.

Do you see that?

A. Page 9.

Q. It is the last page.

A. Yes, I see a table there.

Q. Okay. And you understand that in this context, the farm price, that's the price that farmers are getting for their milk, correct?

A. Well, if you could point out where that is on the table.

Q. Well, okay. Let's just -- if you look at the -- if you weren't here, you didn't hear him testify.

Do you see the "sum of lags" at the bottom of that chart?

A. Yes.
Q. And do you see that the -- he has four lags, and then the sum of them are 0.54929.
Do you see that?
A. I do.
Q. And do you see -- do you -- do you understand -- do you see that that is, in fact, the same number that he uses to -- as the impact on retail prices from the 1% increase in Class I prices?
A. Well, sir, I am not capable of answering whether that fifty- -- that .54929 is the 55% that he cites in that paragraph you quoted in page 3, but I will agree that those numbers are quite similar. I can't say that that is the number or how it came about, but they are --
Q. Okay.
A. -- principally the same number.
Q. Have you had an opportunity to review his oral testimony in this hearing on August 31, 2023?
A. I have not.
Q. And if I -- let me just read to you lines 10 through 16 of his testimony: "And so I basically looked at this, and the bottom part of that graph is four months of lag, and so the sum of the lags where it says .54929, that basically means that over a four-month period a 1% increase in the Class I price would result in a little over a half a percent increase in the retail price, that's the price transmission."
So with that explanation, do you agree that's what

this chart is showing?

A. I don't know how to interpret that.

Q. Okay. Well -- okay. Let's -- let's -- I mean, do you have some difficulty with the language I just read to you as to what it means?

THE COURT: Ms. Hancock?

MS. HANCOCK: Your Honor, I would object. This witness has already said he doesn't -- he didn't hear the testimony and he can't speak to this, and at this point he's just badgering the witness about if he has some difficulty in understanding.

I mean, if there's something that this witness has for direct knowledge, I think it's fair game. But just reading another statement into the record and trying to get him to adopt it or disagree with it I don't think is appropriate.

THE COURT: I sustain your objection, Ms. Hancock.

But, Mr. Rosenbaum, you are making the point beautifully.

MR. ROSENBAUM: All right.

BY MR. ROSENBAUM:

Q. Well, let me call your attention to one other number in this chart, which is the R-squared.

Do you see an R-squared of 0.746673?

A. Yes.

Q. And that is, like, 20 times higher than the R-squared you calculated, correct?

A. It's almost infinitely higher.

Q. And just let me -- and by the way, these are -- these -- this is a question -- this question was by Mr. Miltner that -- that resulted in these answers.

"Question --"

THE COURT: Mr. Rosenbaum?

MR. ROSENBAUM: I'm just -- I'm just going to ask whether --

THE COURT: I want to you move on.

MR. ROSENBAUM: All right. That's all I have, Your Honor.

THE COURT: And as I say, you made your point.

All right. Who next has cross-examination for Mr. Sims?

And let us return these record copies of the Exhibit 115 before we forget to do so.

CROSS-EXAMINATION

BY MS. VULIN:

Q. Good afternoon, Mr. Sims -- or morning, I guess, wherever you would put 11:00 a.m.

A. I would call it morning.

THE COURT: Ms. Vulin, identify yourself for the record, please.

MS. VULIN: Ashley Vulin with the Milk Innovation Group.

BY MS. VULIN:

Q. So, Mr. Sims, I want to start kind of bigger picture about the purpose of FMMOs.

FMMOs are not a price guarantee, correct?

A. They guarantee that at whatever price the commodity prices generate and that the uniform prices generate, that regulated plants must pay that value to their suppliers of producer milk.

Q. Thank you. That was an inartfully-worded question, so your clarification is fair.

They are not a guarantee of prices that will cover all costs, correct?

A. The prices that the Agricultural Marketing Agreement Act instructs the Secretary is to fix such prices as will create a sufficient quantity of pure and wholesome milk, including certain economic factors and prices of feed. Long-term, the Act directs the Secretary to set prices -- fix prices is the word it uses -- which a sufficient quantity of milk will be produced.

There is no month-to-month, day-to-day guarantee of a particular price. No dairy farmer is guaranteed a profit. No dairy farmer is guaranteed a market. But over the long-term, the Secretary is responsible for determining and setting prices which will make sure that this country has enough milk.

Q. And so just to make sure I'm tracking your point to summarize that, it's your interpretation of the Act that the Secretary is obligated to set long-term prices to ensure that over time, dairy farmers costs are covered by the minimum FMMO price?

A. I didn't say -- you said dairy farmer costs are covered. There is 20-some-odd thousand dairy farmers in

this country, all of whom who have a different cost structure. So any one of them cannot be guaranteed that the Federal Order prices will generate revenues which cover their costs.

Q. And I'm not trying to misstate your testimony, I just want to make sure I'm tracking it.

So then if -- if the Secretary is not setting long-term prices to cover all dairy farmers' costs, then what is the benchmark for how much cost should be covered in your interpretation of the Act?

A. The sufficient -- the prices are set such that it would generate a sufficient supply.

Q. So prices should be set not to ensure that costs are covered, but to ensure that enough costs are covered that there is a steady stream of milk for fluid use; is that fair?

A. That's reasonably fair, yes.

Q. Okay. So then if you could go, please, to page 12 of your testimony. I'm on the last paragraph.

And just to summarize your point before this paragraph, you're arguing that a reduction of the Class I differentials to zero essentially creates an individual handler pool structure; is that right?

A. I'm saying that if you reduce, sufficiently, reduce seriously, the regulated Class I price with the intent or the promise by buyers that they will replace those revenues with over-order prices, those over-order prices and the farmer-to-plant relationship becomes, in

essence, an individual handler pool.

Q. And do you believe Proposal 20 does such a thing?

A. I do.

Q. Okay. So this --

A. I will say this, excuse me. It does it if there are any over-order prices. Those become a -- an individual handler pool. But as we have said, there certainly is no guarantee. In fact, it brings into great question whether there would be sufficient over-order prices.

Q. And so under Proposal 20, if those over-order prices are going to the -- to the suppliers for those handlers, it's your conclusion that -- and this is a quote, starting that paragraph, that last paragraph: "The natural consequence of an individual handler pool marketing structure is that dairy farmers will begin fighting for the ability to supply the higher paying Class I plants."

Is that right?

A. Yes.

Q. And another way to say this would be that the natural consequence of Proposal 20 is that dairy farmers will begin fighting for the ability to supply higher Class I plants?

A. If those Class I plants are paying a premium.

Q. Thank you.

A. Not a given.

Q. Appreciate the clarification.

So then if you could go to page 7, please. I'm in the middle of the page here, the paragraph that starts "in areas where."

A. Yes.

Q. And so after first reading page 12 and thinking, okay, a problem of Proposal 20 is that all of the suppliers will want to serve the Class I processors if they are paying an over-order premium. Then I read here, "In areas where the Class I prices and the manufacturing class prices become virtually equal at a location, the decision on whether to serve Class I will be largely one of logistical costs uninfluenced by the milk price. The foreseeable result is that some Class I plants may not get served."

Did I read that correctly?

A. You did.

Q. And so as I read this, you are arguing in the first instance that Proposal 20 will cause disruption because everyone will want to serve Class I, but then in the same breath, cause disruption because no one will want to serve Class I?

A. No one will want to serve Class I if there are no premiums. Everybody will want to serve Class I if there are premiums or if they are substantial. The quote you just read, basically, is the natural evolution of pricing in an unregulated market, it will fall. The over-order premiums will fall, and -- and then, thus, there is no incentive to supply Class I.

Q. So without Federal Order -- well, strike that.

We have over-order premiums today, correct?

A. Yes. In some places, yes.

Q. And so somehow Class I processors have figured out how to ensure their plants are served using over-order premiums in the current structure, correct?

A. Yes. But we have to remember that they are operating in a structure where those over-order premiums are a substantially small portion of the total value of the milk. The Federal Milk Orders provide the regulated value or the substantial portion of the regulated value, and the over-order premiums are a small piece over and above that. We're trying -- the Proposal 20 changes that substantially, puts the emphasis on the premium and takes away the influence of the orders.

Q. And is it your conclusion that Class I processors will be -- somehow be inept at using over-order premiums to attract milk if we don't have a base Class I price of $1.60?

A. I would never call a Class I processor inept. But I can say that what influences Class I differentials are -- excuse me -- what influences over-order prices are a myriad of things not necessarily associated with any particular plant. The degradation of premiums 100, 200, 300 miles away can domino into an area. And at the end of the day, Class I processors are seriously -- and mostly as we have heard in testimony -- concerned about the price that their neighboring competitor plant is paying. So

when premiums start to degrade, erode, that's going to naturally erode them everywhere.

Q. And if a Class I processor is not able to attract sufficient milk, do you have any reason to believe that they would be unable to offer over-order premiums to do so?

A. They certainly can offer it. The question is their permanence.

Q. The question for the supplier is their permanence you mean?

A. The question for the buyer is they may very well be willing in the very short-term to -- to increase -- pay a premium to get milk, but the question is how long will they pay them and how high will they be, and will they -- being combined with the much less valuable blend from the orders, will that be enough to attract a supply long-term.

Q. And, again, going back to your point of the problem with over-order premiums serving that role.

Why are Class I plants unable to manage that type of typical supply chain using over-order premiums without the $1.60 Class I differential?

A. I'm sorry, I don't think I understood your question.

Q. So your argument is that without the $1.60 in the Class I differential, more of the payment has to come in the form of an over-order premium, correct?

A. To attract the supply, yes.

Q. And that because it's in the over-order premium,

and it's not necessarily permanent, that will result in suppliers being less willing to serve that Class I plant?

A. Yes.

Q. So why can't we, then, rely upon Class I processors and suppliers to negotiate like they do every day, some kind of mutually-agreeable outcome of an over-order premium that works for everyone?

A. The basic problem with those over-order premiums are that they are not uniform, or don't have to be, or typically may not be. They are -- they will be -- since an over-order premium is based on an individual plant, and often the Class I utilization at that plant, that may be striated by class, you will create a competition. And it's disorderly pernicious competition to serve those Class I plants when an outsized portion of the value of the milk is subject to individual relationship between a plant and a supplier. Those are -- those will, in essence, be an individual handler pool, and those -- and those circumstances force prices down.

Q. Despite the fact that we still use over-order premiums today?

A. But they are a very small portion of the total value of milk, that's the difference.

Q. What portion?

A. Depends on the area.

Q. Have you done any study or analysis to give us numbers to support that contention?

A. I could -- I could offer anecdotal evidence. The,

you know, premiums are, say, $1 or so, maybe $1.15 depending on the price of fuel in the Southeast. They are a little bit less than that in the Mideast. They may be a little -- they may not be existent at all, or certainly not coordinated, in the Northeast. They are -- but they are all similar, but represented fairly small.

The portion of the value is inversely related to the Federal Order price. So $1 premium in the Southeast, percentage-wise, is a smaller representation of the total value of milk than $1 in the Mideast where the blend price is lower.

Q. And given that the issue here is service of Class I plants, wouldn't you agree that USDA should give fairly high credence to testimony from Class I processors that they are confident they will be able to obtain sufficient milk supplies without the base $1.60 in the Class I differential?

A. That testimony was delivered. The history of over-order prices across the last 40 years suggests that that -- although intentions may be high, that other factors will force them down when one of their competitors -- when -- I as a processor, I might say, I'm willing to pay an over-order price, but as long as the plant down the road pays one, too, and the plant down the other way pays one, too. And everybody -- and without a Federal Order, there is no guarantee that those numbers are equal. So they will, by natural competition, fall to the least common denominator.

So you may have high intentions of paying an over-order premium, but you won't pay one if you think the plant up the road is getting a better deal.

Q. Isn't that natural economic market competition?

A. It's disorderly markets, because then you have fights for Class I, and you have -- and you have degradations in prices, you have high variation in prices, you do not have uniform prices to producers, and you do not have uniform prices to plants. It is disorderly. It may be natural, but everything we have learned about milk over the last 80-some-odd years is that milk does, in fact, function in a purely competitive market. That's why we have price regulation, to prevent those disorderly marketing conditions.

Q. Are there any market circumstances, in your opinion, that would warrant a decrease in the Class I differential price?

A. All the cost factors say the differentials need to increase. The sheer fact that we are here to discuss both the cost of transforming milk into manufactured products leads us to the natural inquiry about the cost of moving milk. I -- I -- based on the 25 years of increase in cost of moving milk, I can't envision any circumstance that would suggest differentials in the main should decrease.

Q. You can't imagine a circumstance that would support decreasing the Class I differentials?

A. I can't -- I can understand that there could be. I just don't see them today.

Q. What could they be? What would be a circumstance that would support reducing Class I differentials?

A. A serious -- serious oversupply of milk, perhaps.

Q. And a serious oversupply of milk, given natural supply and demand forces, would support a reduction in the Class I price?

A. Not necessarily. It might, if you could -- you could retain the same Class I price, and when the blend prices go down, that sends the signal to the producers, so you don't have to lower the Class I price to send that signal. Those signals actually will be transmitted through the blend.

Q. Assuming sufficient Class I utilization.

A. If the manufacturing class prices decline, the blend prices decline given the equal before and after Class I differential. That's where the price signals come.

Q. But my question was about Class I, right? So if there's a surplus of milk on the marketplace, even in that circumstance, you wouldn't believe that Class I should be able to pay less for their milk?

A. Say that again, please.

Q. So my question was, is there -- is there a situation in which you would ever agree that market circumstances would support a decrease in the Class I differential?

A. Yes.

Q. And you had said a surplus of milk.

A. Maybe I'll amend my statement. Maybe not a surplus. If the price of diesel fuel drops back to $0.75 a gallon, and the cost of a truck drops back to $25,000, and the cost of labor to drive that truck drops back to the minimum wage, maybe we can get milk moved for substantially less than we get it moved now. But the costs of moving milk today justify an increase.

Q. So you strike your prior answer; you don't agree that a surplus of milk on the marketplace would warrant a decrease in the Class I differential?

A. I'm saying it wouldn't necessarily warrant it, no.

Q. Sorry, say again?

A. Would not necessarily. Directly, that particular circumstance is not an automatic trigger, or should not be considered an automatic trigger, that Class I differentials are somehow improperly aligned. We have to also consider intra- -- you know, within market and -- intra-market price alignment.

Q. And you agree with me that the Class I marketplace is in decline both by volume and per capita, correct?

A. Certainly per capita.

Q. By overall volume you disagree?

A. The trend has been that Class I -- Class I producer milk has declined in the orders, yes.

Q. Do you believe that USDA should consider that when setting Class I differentials?

A. The Agricultural Marketing Agreement Act instructs the Secretary to make sure there's a sufficient supply of

milk for fluid use. That's the -- to the Secretary and standard the Secretary should follow.

Q. And so to the extent there's less fluid use, there's less need to attract milk to it, correct?

A. Not necessarily. We have a very different world today. I think Dr. Stephenson made some comment about the predominance of manufacturing and its importance. It's harder to shake milk out of manufacturing today. It may -- the milk may actually be converted into a Class III or Class IV product, but that doesn't mean that that milk is available for Class I use.

Today, milk plants are built to serve a demand customer. You don't build a plant purely for balancing anymore, it's too expensive. So all these plants have customers that they are serving that are demand customers, they want to run to serve their demand. So there is not this large pool of reserve supply. Those -- the Class III and IV demand, those plants are going to want to run, it's harder to shake milk out of them for Class I. Just because there's milk going to Class III and IV doesn't mean it's available for Class I.

Q. For the milk to be available to Class I, a Class I processor would have to attract that milk, correct?

A. You don't take milk to a plant just to take it, they have a need for it. The same as Class I is as Class III and IV.

Q. And would you agree with me the most direct way to attract milk to a plant is through an over-order premium?

A. I think over-order premiums have their limits. They have -- I don't think, I know that over-order premiums have their limits. They are a nice tool to partially compensate the organizations that serve Class I plants, but they should not be. They should not be the predominant tool to attract milk to a Class I plant.

Q. And have you calculated the portion of the price between the over-order premium under Proposal 20 and what makes up the bulk of the Class I price, namely the base Class I skim price? Have you run that comparison?

A. I'm sorry, I -- you are going to have to simplify that question.

Q. There was -- your statement that you just made, you have no numbers to support that for us today, correct?

A. I'm -- please repeat the question. You asked me about numbers, and I need you to repeat the question.

Q. You said -- and I'm summarizing your testimony, so let me know if I get it accurately. You had testified that if the over-order premium plays too large or plays the substantial role of moving milk, that that is going to not serve to sufficiently attract milk?

A. I'm saying that over-order prices are not sure. They are temporary at any one point in time. They can disappear overnight for things that have absolutely nothing to do with the cost of supplying a particular place or a particular plant. And if they are, if they -- I can tell you the percentage of the value of milk for when a premium is at zero, it's 0% of the value of milk.

Q. There's nothing to stop Class I processors and suppliers for agreeing to any unlimited number of years, for a set price for over-order premium, is there?

A. They -- the contracts might read that way, but at the end of the day, the important part to any one particular plant is how they fare against their competitor. So if they can't have assurance, like a Federal Milk Order provides of uniform and competitive pricing with their neighbor plant, that will, in itself, degrade premiums over time.

Q. And proprietary Class I processors compete with cooperative-owned Class I plants, correct?

A. Yes.

Q. But cooperative Class I plants can reblend; isn't that right?

A. They can reblend when it comes to payment to the producers, but they are obligated -- a cooperative-owned plant is obligated to the Federal Order pool at the class prices, just like a proprietary plant. There is absolutely no difference.

Q. So I want to break out a little bit your testimony between the base Class I skim price and the county-level differentials. Right? Because those are two separate aspects of the Class I differential, correct?

A. Yes.

Q. We have the base Class I skim price $1.60, and then there's the differentials that go on top of that that are county-level specific, right?

A. Yes. It also applies to butterfat.

Q. And let's start with the base Class I skim, the Grade A piece. You testified that if there is no financial incentive to produce Grade A milk, reversion to Grade B could be a viable option at the farm level.

And my -- my question is, are you aware of any farm that is really intending to become a Grade B farm if the outcome of this hearing is to reduce the $1.60 by $0.40?

A. If the outcome is to reduce the base minimum differential by $0.40? I have no idea if there are anyone who has -- any dairy farmer, any individual dairy farmer who is contemplating that, but certainly within the realm of possibility.

Q. It's physically possible, but is it likely in your professional opinion?

A. Likely? If you -- if you make the value of Class I milk equal to the value of manufacturing milk, dairy farmers will respond economically. They will either stop supplying Class I, or if there's money to be saved by reverting to Grade B, they will do it. They will respond.

Q. So that kind of addresses the entire $1.60, and I really want to keep us focused on the $0.40 for Grade A, because that's the specific limits of my question.

So you agree that the Grade A factor, right, is about what USDA determined was necessary to ensure a sufficient supply of Grade A milk for fluid use, correct?

A. Yes.

Q. And that was $0.40.
A. That -- that number has been quoted, yes.
Q. Do you have any reason to believe it is a different amount than $0.40?
A. No. My reading of the final rule in 1999 suggests that -- that the portion of the $1.60 minimum differential associated with Grade A to Grade B is $0.40 per hundredweight.
Q. And Grade A standard, that's essentially a food safety standard, correct?
A. The Grade A standard, yes.
Q. And so my question is, if the Class I differential, $0.40, dedicated to that Grade A maintenance, if that is cut out and the $1.60 is reduced to $1.20, is it your testimony that it is likely that enough farms would convert from Grade A to Grade B that we would not have enough Grade A milk to serve Class I processors?
A. I would agree it's unlikely. But I think it is important that the prices still reflect that there is a possibility of the reversion from Grade A to Grade B, and it could be that -- it could be a problem that is localized. There may be an area where that becomes a real potential. May not be a broad potential, but it certainly could be a potential in some number of places, which threatens the supply of Class I.
Q. Then I would like to move to the balancing factor then that accounts for $0.60 of the $1.60.

A. Yes.
Q. And you testified a bit about the costs of balancing, I believe, are on page 8 of your testimony.
A. Yes.
Q. So my first question is, have you done any calculations, any survey, any studies, to determine what the average cost of balancing is to suppliers today?
A. No.
Q. So you are not sure if it's significantly less than $0.60?
A. I can say from my experience that it is not less -- significantly less than $0.60.
Q. Is the cost of balancing uniform between every single supplier?
A. No.
Q. Would you agree with me that processors can bear certain balancing costs?
A. Yes.
Q. And would you agree with me that processors and suppliers, given the unique contributions each would make to balancing in their individual relationship, can negotiate how to approach that balancing cost?
A. They can negotiate, yes.
Q. So then I would like to move back briefly to the incentive piece. We have spoken a little bit about that already.
But you have a number of places in your testimony where you criticize situations where the Class I price and

the manufacturing price would be equal?

A. Yes.

Q. And those would be places where the current Class I differential is $1.60, correct?

A. I would -- I would also include places where the current differential is, you know, within a few dimes of $1.60. You can -- you basically get to the same place as -- at the places where the differential is $1.60 per hundredweight, $1.70 per hundredweight, $1.80 per hundredweight. The Class I price would look remarkably like the manufacturing prices -- the manufacturing class prices.

Q. And I believe it's on page 5, I'm looking at the top of your testimony there. You say that "given that Proposal 20 would lead to a significant portion of the country experiencing scenarios in which the monthly Class I price aligns closely or even equals at least one of the manufacturing class prices, why would producers show any interest at all in meeting Class I demand?"

Do you see that?

A. I do.

Q. Is it your testimony that a significant portion of the country has Class I differentials at or near $1.60?

A. I would say the portion of the country that has $1.60, $1.70, $1.80 is very significant.

Q. And that testimony would not apply equally to areas of the country with higher Class I differentials based on their county-level differential, correct?

A. There would be a different result of that, but we -- when -- then we still have to circle back to the question of the impact on blend prices and the blend price relationship, and the blend price surface, which encourages bulk milk to move to supply, particularly deficit areas.

Q. And if the Class I price is roughly equal to the manufacturing class price, Class I processors can still use over-order premiums if they need to attract milk, correct?

A. They can. The obvious question is, will they? And history shows they will not, that the over-order premiums will come under pressure at some point, and the prices generated between the Federal Order price and the over-order price will be insufficient to encourage the milk to supply Class I.

Q. And can you tell me an example of a situation where Class I has not been able to ensure it was sufficiently served using over-order premiums?

A. Say that -- ask that again, please.

Q. Have you heard any testimony at this hearing from a Class I processor that they were unable to attract sufficient supplies of milk using over-order premiums?

A. No.

But we also need to remember that we're operating under a Federal Milk Marketing Order, and the class and the over-order prices are a small portion of the total value of milk. To say that I have never had a problem

getting a supply to my plant, those people all are regulated by Federal Milk Orders. The Federal Milk Orders are doing their job in making the supply of milk to them attractive.

Q. They also could be too high, correct, if every processor has testified that they have a sufficient supply of fluid milk?

A. No. That I -- I don't think that those two are -- would -- those two statements are logically -- could --

Q. Would you agree with me that a supplier can always decline to sell their milk to a Class I processor if the price is not sufficient in their estimation?

A. Always? I would not agree with that, always.

Q. Are -- are you aware of any situation where a supplier is legally compelled to sell their milk to a Class I processor?

A. They may have a contract which requires it, yes.

Q. And they voluntarily entered into that contract, correct?

A. Yes.

Q. Just one moment so I can spin through my notes to see if I covered everything.

You have a few statements in your testimony that the purpose of Proposal 20 is to eliminate Federal Milk Marketing Orders; is that fair?

A. That is -- it is a logical conclusion from Proposal 20 that that would be a logical result of the proposal.

Q. But Class I processors can't eliminate any Federal Order, correct?

A. If -- they can propose provisions which would make Federal Orders so irrelevant that the industry would walk away from them. I -- I see this as a very straightforward logical progression. If you have Class I prices that are equal to the manufacturing prices over a significant portion -- and I repeat, it's a significant portion of the country where the Class I price and the manufacturing class prices are virtually equal. You may have classified products, but you don't have classified pricing. If you don't have classified pricing, you don't need a market-wide pool. If you don't need a market-wide pool, you don't need a Federal Milk Order. It seems to me those two logical steps are very, very impossible to ignore.

Q. So it's your testimony, based on your experience, that producers, that farmers will find no value in FMMOs outside of the Class I contribution of $1.60 to the pool?

A. There are other values to Federal Orders. But if you reduce the Class I price enough in those areas where there -- where those prices are identical or nearly identical to class -- to the manufacturing prices, there -- the other values will tell them, we are telling you that you need to go seek these values outside the pool, and they will -- and the logical conclusion will be, why have a Federal Order?

Q. And I believe a number of MIG witnesses testified to the benefits of Federal Orders beyond just pricing.

Do you recall that?

A. I recall them saying they like the information that orders provide. I don't recall any of them saying that they -- they appreciate the pricing under -- provisions under Federal Orders.

Q. But it's your testimony that you believe farmers will only care about the pricing provisions for those counties with a zero-level Class I differential because -- of course, right, we have many other counties that will still have positive Class I differentials if Proposal 20 is adopted, correct?

A. The obvious concern is if a significant portion of the country decides that they don't need Federal Milk Marketing Orders, that the disorderly marketing conditions that might exist in those areas can bleed over into the next order, and the next order, and the next order.

Q. And you believe Class I processors and Class I suppliers will be incapable of solving those issues the way they do today, using the Federal Milk Marketing Orders system with the combination of over-order premiums?

A. We are not -- you are not -- you are comparing apples and washing machines. Today we have a Federal Order price which establishes the vast majority of the value. You are imposing the change where the Federal Order price becomes, if not insignificant, nearly insignificant, and the major portion of the value is entrusted to over-order prices. You cannot say that that's the same environment as we have today.

MS. VULIN: Nothing further.

Thank you, Your Honor.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Ryan Miltner representing Select Milk Producers.

It is still morning?

Good morning, Mr. Sims.

A. Good morning to you.

Q. On Exhibit 497, it's NMPF-112C --

A. Yes.

Q. -- this one, on the third page you have a note.

A. Yes.

Q. Can you explain what you mean by that note?

A. Yes. Yes. I may have had to truncate my description earlier.

Each of those three states, and I think there are two other states actually, two cities in those states have -- are a part of the 30-city retail price survey. In Ohio, I think it's Columbus and Cleveland. I can look it up. I guess it's not material.

But this picture shows that one of the -- in each of these three states, one of those cities has a retail-to-differential relationship which I would call intuitive, that the -- you know, the differential is lower than the -- the median, and the retail price is lower than the median. But the other city in that state has a counterintuitive, or inconsistent, price relationship from what you would expect regarding the relationship of

differential to retail. So even within a state you don't have -- you don't have consistency about the relationship between a retail price and the differential. In those three states, they are -- even in a state, you have inconsistencies.

Q. If we could go back to USDA's data, we'd find, whatever it is, that New York might be -- Buffalo and New York City --

A. I think it's New York City and Syracuse, if my memory serves.

Q. Okay. Pennsylvania might be Philadelphia and Pittsburgh --

A. I believe that one is correct.

Q. Even if there are two cities in those states, and they are not consistent?

A. Yes.

Q. I now want to ask a couple of questions about Exhibit 498, which is your list of plants and their ownership.

A. Yes.

Q. To be clear, the column labeled "Proposed Differential" --

A. Yes.

Q. -- those differentials are those that are from Proposal 19 as offered by National Milk Producers?

A. Yes.

Q. Did you do this analysis using the results of the economic model without further adjustment?

A. No. This -- this comparison simply compares the change -- delta, some people have been using that term -- between the Proposal 19 proposed differential in each of these plant locations and the current.

When looking at it, we -- we thought about the testimony from a number of the Class I handlers whose -- who said over and over that their concern in terms of pricing, or a major concern, was there was the consistency in -- in the relationship in pricing. And so we -- our question was, compared to the current differential, which is a given, we compared the proposal.

Q. And for -- again, so my understanding is clear, when you are looking at this comparison between the average differential of pool distributing plants that are owned by cooperatives and that are proprietary, this is the national average across the entire -- for the 289 plants that you have identified on this list?

A. Actually, the number of distributing plants in the list is 219. So this averages across the 219 pool distributing plants, yes.

Q. Then that leads into my next question, which is you have some plants on here that are identified as supply plants.

Is it correct those plants were not included when you calculated the summary data at the bottom of the exhibit?

A. That is correct. The summary data pertains solely to the pool, the pool distributing plants, however that's

defined in each order.

Q. But you did not look at and so we don't know what the relationship between cooperative plants and proprietary plants would be if you had just looked at the results of the spatial model?

A. That is not included on this.

Q. Okay. I don't want to repeat questions, but these are somewhat similar to some you have already been asked. So I apologize, but I want to understand your opinion about why something might not happen.

And I'm looking at the bottom of page 4 of your testimony, Exhibit 494. And you are stating that if there was a zero zone, there would be no incentive to supply milk to a Class I plant, correct?

A. I probably would say that there is no regulated price incentive to supply Class I.

Q. In that hypothetical scenario where there's a zero county or a zero zone, it seems that both the manufacturing plant and the Class I plant are simply going to have to bid against one another to get milk to move to their plant, correct?

A. Theoretically.

Q. Your conclusion seems to be that that -- that there is no incentive for the producer. And I just want to make sure that we understand your experience and -- and opinion as to why that won't occur. Why would there be a market failure there where the plants bidding for milk won't get the milk to move to the plant?

A. My concern, given my very long observation of this industry, is that the -- that the -- number one, that the market power in the negotiation process is tilted toward the buyer. We have a very perishable product that we are marketing, and if you don't get it to a plant in a hurry, it becomes an unmarketable product. So the buyer knows that.

The other concern is that factors having absolutely nothing to do with the local supply and demand for milk can influence over-order prices.

And I want to clarify something I may have said earlier. In the natural historical cycle of over-order prices, the peaks last considerably less than the valleys. If I said it backwards earlier, I want to make sure that that's understood.

High over-order prices don't last very long, they never have. Low over-order prices drag on. And that is -- those are the concerns that we don't have a -- you know, all these questions of negotiation presume that the buyer and seller are in the same position, that, you know, I have an alternate place I can take my milk every day instantly.

That's not necessarily true, and you must -- it's a perishable product, and it has to be gotten rid of or disposed of to a place that can make it into a product less perishable very quickly. That creates an uneven competitive circumstance.

MR. MILTNER: I think all my other questions were

already asked, so I won't try to ask them again. Thank you very much.

THE COURT: Ms. Vulin.

CROSS-EXAMINATION

BY MS. VULIN:

Q. Mr. Miltner's questions prompted a couple additional ones from me.

So you said that suppliers have a perishable product, and because of that, are at a disadvantage vis-à-vis their buyers?

A. Generally, yes. Not generally, it's true, that you -- that the perishability of their product makes marketing decisions need to be instantaneous.

Q. And isn't the inverse also true, that if you are a Class I processor, your need for supplies to make your product is a need for a product that you need to be delivered daily?

A. Generally, Class I processors can wait longer than the dairy farmers can.

Q. A Class I processor --

A. Can -- can -- can suspend their purchases for a longer time than a dairy farmer can hold their milk off the market.

Q. A dairy processor cannot stockpile three months' worth of raw milk to use as needed, correct?

A. They cannot.

Q. They also have to have a steady stream of milk coming at a rate that allows them to process it as

required by the PMO and other food safety regulation, correct?

A. They would desire a steady supply.

Q. They would need one in order to operate their business, correct?

A. You can't make packaged fluid milk without raw milk, yes.

Q. So this issue of perishability cuts both ways. It creates a product that needs to be sold quickly, but also a supplier that needs frequent -- excuse me -- a buyer that needs frequent supplies of this perishable product?

A. Again, that knife does cut both ways, but it isn't as sharp on both sides. The dairy farmer is in the disadvantageous position.

Q. And that disadvantageous position, when you are talking about the spot market, right? Where you need to unload a load of milk day the next day very quickly is very different than a long-term negotiated contract for milk supply, correct?

A. The spot market and long-term negotiated contracts are not the same.

Q. And Mr. Miltner had asked you about this issue of manufacturing and Class I prices being equal, resulting in those respective processors just merely competing for milk on the marketplace, correct?

A. That was -- I think -- I believe that was the nature of his question, yes.

Q. And were you here during Crystal Creamery's

testimony where Mr. Schuelke testified about the challenges that FMMOs can pose for getting Class I milk supplies when competing with manufacturers under the current system?

A. I -- I was here. I don't recall that testimony specifically. But, yes.

Q. So to the extent the current system was disadvantageous for Class I processors in competing for fluid milk, something that brought them back to baseline with manufacturers could be an improvement over the current system?

A. I don't think so.

MS. VULIN: Nothing further. Thank you.

THE COURT: Are there any other cross-examination questions before I turn to the Agricultural Marketing Service for their questions?

I see none. I invite the Agricultural Marketing Service.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good morning.

A. Good morning.

Q. I only have a few questions. Let's see.

If we can turn to Exhibit 497.

A. Yes.

Q. I just want to make sure we know where the data is coming from. I know you have the link down there, but is this -- in one instance you said it was January to

October 2023 data, and then in another instance I -- what I thought I heard it was October 2023 data.

A. It is January 2023 through October 2023.

Q. So you averaged all those numbers?

A. Yes.

Q. Okay. And on that retail price series, there's quite a number of different data points in there, so I wanted to know which one you looked at.

Was it conventional? Whole milk?

A. The conventional whole milk.

Q. And then on Exhibit 495, and I want to make sure we're just straight on this, for Orders 5, 6, and 7 that don't have PPDs, it is -- these are changes from -- in the last three columns that would be the uniform price?

A. Hold on. I'm having a hard time finding that. 495. Found it. I'm sorry.

Q. Yep. I might have said columns -- I mean rows, but I meant columns.

So the last three columns for information for Federal Orders 5, 6, and 7, those are changes -- example in the third column from the end, changes in the uniform price, not changes in the PPD?

A. Yes. And for consistency, I put in a proxy announced PPD which was simply the difference between the uniform price, the -- you know, the 3.5% skim and butterfat equivalent uniform price under Orders 5, 6, and 7, and 131, and the Class III price at 3.5. So it's that -- that -- those changes are -- the changes in the --

oh, it does say PPD, doesn't it? That shouldn't. It is uniform in that -- one, two, three, four, five -- should be uniform price in that fifth column.

Q. Where it says "MIG Proposal 20 PPD change," it's a uniform price?

A. Yes. For Orders 5, 6, 7, and 131, that is uniform price, not PPD.

Q. And then in the last column as well?

A. Yes. Well, again, I -- for consistency's sake, to calculate how often there would be a negative PPD, I converted, in Orders 5, 6, and 7, and 131 using a proxy PPD. And so the uniform price change, in essence, you could maybe make the case of as the same thing as the blend price going down, or the blend price change, so that moves over and is compared in the final column, revised PPD, or revised proxy, if you will.

Q. Okay. So you said in some questions bulk milk moves on blend prices?

A. Generally, yes.

Q. And so if I take your statement big picture, what you are saying, in your opinion, is a reduction in the Class I differentials filters through to a reduction in the blend price.

A. Yes.

Q. And that results in your opinion of milk less willing to serve the Class I market?

A. My -- the Exhibit 496 -- well, National Milk-112B shows that the -- because of the high -- higher than

average Class I utilization percentages in Orders 5, 6, and 7, when you take $1.60 away from that Class I price in those orders, the blend price reduction will be greater -- the reduction will be greater -- if that's not an oxymoron -- the reduction in blend price will be greater in those orders than the reserve supply orders that surround Orders 5, 6, and 7.

So when you -- if you lower the blend price $0.40 in Order 33, and you lower it $1 in Order 7, the incentive to move milk from Order 33 to Order 7 declines by $0.60 per hundredweight. They are all going down. All the blends, all the uniform prices go down as a result of Proposal Number 20. But they go down more in Orders 5, 6, and 7 than anywhere else, so that changes the blend price gradient, which is what bulk milk moves on.

Q. So in particular, in your opinion, those orders would have trouble getting the supplemental supplies that they need?

A. The problem getting supplemental supplies to those orders will get worse. It's already a problem, but they will get worse.

Q. And you had some discussion back and forth on individual handler pools. And from what I hear from your opinion is that more of the actual Class I price should be reflected in the Federal Order prices and less left up to over-order premium negotiation?

A. I believe that the -- that if we're going to adjust the values in Federal Orders to reflect the value

of Class I, that adjustment should be made in the Federal Order prices and not left to increases in over-order premiums which haven't materialized. And it's certainly true on the converse, we certainly should not reduce the Class I revenues in the pools and put more reliance on over-order prices.

Q. Is your concern mitigated at all given that Class I processing in the U.S. does have a significant -- and I don't define significant -- but portion of it owned by cooperatives?

A. No. They are treated in the -- under the order identical to a proprietary that's -- I don't see any -- any structural difference.

Maybe I misunderstood your question.

Q. Well, you were concerned about revenue sharing, and that if there's an individual handler pool, you know, what I heard was, they don't have to share all that revenue with all the market participants who are pooled?

A. Yes.

Q. Would that be accurate?

A. It's unlikely that the over-order revenue will be shared broadly across a pool.

Q. And I'm just -- was kind of piggybacking on that to say, is that concern mitigated at all because of cooperatives that own a significant portion of Class I processing?

A. I don't think so. I think the value of the uniform pricing to producers is of such substantial value

that we should avoid the implications that come with individual handler pools.

Q. Okay. And just to continue -- and that implication to you is non-uniform prices to producers; is that correct?

A. There's multiple implications, but simply the question of market-wide pooling versus individual handler pools, one of the implications is non-uniform producer pricing, and the ruinous competition which would come for the desire to supply those high Class I plants in an individual handler pool environment.

MS. TAYLOR: That's it from AMS. Thank you.

THE COURT: Shall we break for lunch before redirect?

I'm getting a yes. All right. Please come back at 1:05. We go off record at 12:05.

(Whereupon, the luncheon recess was taken.)

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MONDAY, JANUARY 29, 2024 - - AFTERNOON SESSION

THE COURT: Let's go back on record.

We're back on record at 1:07.

You may proceed, thank you.

MS. HANCOCK: Nicole Hancock for National Milk.

Your Honor, we have no further questions. We would just move for the admission of Exhibits 494 through 498.

THE COURT: Is there any objection to the admission into evidence of Exhibit NMPF-112, marked Exhibit 494?

There is none. Exhibit 494 is admitted into evidence.

(Thereafter, Exhibit Number 494 was received into evidence.)

THE COURT: Is there any objection to the admission into evidence of Exhibit NMPF-112A, also marked Exhibit 495?

There is none. Exhibit 495 is admitted into evidence.

(Thereafter, Exhibit Number 495 was received into evidence.)

THE COURT: Is there any objection to the admission into evidence of Exhibit NMPF-112B, like boy, also marked Exhibit 496?

There is none. Exhibit 496 is admitted into evident.

(Thereafter, Exhibit Number 496 was received

into evidence.)

THE COURT: Is there any objection of the admission into evidence of Exhibit NMPF-112C, like cat, also marked Exhibit 497?

There is none. Exhibit 497 is admitted into evidence.

(Thereafter, Exhibit Number 497 was received into evidence.)

THE COURT: Is there any objection to the admission into evidence of Exhibit 112D, like David, also marked 498?

There is none. Exhibit 498 is admitted into evidence.

(Thereafter, Exhibit Number 498 was received into evidence.)

MS. HANCOCK: That's all we have for this witness, Your Honor.

THE COURT: All right. Thank you.

Did anyone else have any questions for Mr. Sims before I invite him to step down?

No one.

Mr. Sims, thank you so much.

THE WITNESS: Thank you.

THE COURT: Let's go off record while we switch out the laptop. Who will be the next witness, though?

MS. HANCOCK: Your Honor, we'll have Carl Rasch as our next witness for National Milk.

THE COURT: Thank you.

Mr. Rasch, while we're on break, you may make yourself comfortable in the witness chair.

Let's go off record at 1:10.

(An off-the-record discussion took place.)

THE COURT: We're back on record at 1:11.

I have in front of me an exhibit, but before we turn our attention to that, I'm going to ask the gentleman in the witness chair to state and spell his name.

THE WITNESS: All right. My name is Carl Rasch. First name C-A-R-L; last name, R-A-S-C-H.

THE COURT: Good.

And have you previously testified in this proceeding?

THE WITNESS: No, I have not.

THE COURT: I'd like to swear you in.

CARL RASCH,

Being first duly sworn, was examined and testified as follows:

THE COURT: Thank you.

And, Ms. Hancock, I'm looking at Exhibit NMPF-113. I believe that will be marked 499.

(Thereafter, Exhibit Number 499 was marked for identification.)

MS. HANCOCK: I wish we had one more exhibit so that we could have the 500 mark.

THE COURT: Would you like me to tear off the last page?

MS. HANCOCK: I think the honor will go to someone

else.

DIRECT EXAMINATION

BY MS. HANCOCK:

Q. Good afternoon, Mr. Rasch. Thank you for being here.

And I will note that you spent a considerable amount of time at this hearing because you were slotted to previously testify, but in our effort to expedite some of the proceeding and witnesses, and when we trimmed some witnesses, you were one of the witnesses that graciously gave us back your time. So thank you for being here then, and thank you for returning again for this topic as well.

You have prepared Exhibit NMPF-113, which is now marked as Exhibit 499, in support of your rebuttal to Proposal Number 21; is that right?

A. That's correct.

Q. Would you provide us with that testimony, please.

A. Okay. So the testimony that I'm going to present today is a little background about myself.

As I indicated, my name is Carl Rasch, and I am engaged as a consultant for the Michigan Milk Producers Association. And prior to working as a consultant, I was employed by them for 40 years as their director of bulk milk marketing.

And my business address is 41310 Bridge, B-R-I-D-G-E, Street, Novi, N-O-V-I, Michigan, 48375.

So my name is Carl Rasch. I'm here today to present testimony in opposition to Proposal 21 on behalf

of the National Milk Producers Federation, hereby referred to as NMPF, with the support of the Michigan Milk Producers Association, hereby referred to as MMPA.

MMPA is a member of NMPF. I am a private consultant engaged by MMPA to represent their interests at this proceeding. I was also designated to be MMPA's representative on the National -- on the NMPF task force, which developed the recommendations for Federal Order modernization. Those recommendations were ultimately approved by the NMPF Board of Directors and were included in the notice of hearing issued by the USDA.

From 1977 to 2017 I was the director of bulk milk marketing for MMPA. In that capacity, I was responsible for negotiating and executing third-party raw milk sales agreements. Additionally, I was responsible for producer payrolls, Federal Order reporting and pooling, and representing MMPA at various public hearings.

The NMPF Federal Order task force reviewed many of the current Federal Order regulations during the process of identifying critical issues to be addressed in this modernization process. One of the issues considered by a working group of the task force was the appropriate level of the Class II differential. While there was acknowledgement that the differential could be changed, there was no consensus as to how much of a change should be proposed.

Therefore, NMPF decided it would not submit a proposal to change the current Class II differential of

$0.70 per hundredweight, which is -- and I'm going to strike the word "applicable" and replace it with "uniform," so it should read -- which is uniform in all Federal Milk Marketing Orders. It may be appropriate to consider changing the Class II differential at a separate Federal Order hearing.

THE COURT: Let me interrupt you there, and we'll make this change on the record copy. So on page 1 of Exhibit 499, the next to the last full paragraph, you're changing the word "applicable" to the word "uniform." It's done. Thank you.

THE WITNESS: Okay. So in regards to the issue of substitution incentive. There were numerous -- numerous concerns were expressed in arriving at this decision by the task force work group. And I might add that many of those same concerns have been expressed by various other witnesses at this proceeding, witnesses for both the Milk Innovation Group and the International Dairy Foods Association.

Chief among our concerns was the possible creation of an incentive to substitute Class IV powder for fresh milk ingredients, which currently are classified as Class II. This would reduce pool revenues which determine the prices received by dairy farmers. Encouraging substitution of lower cost ingredients for higher value fresh milk ingredients is counterproductive to the basic purpose of the Federal Order program.

NMPF is concerned that the Class II differential

proposed by the American Farm Bureau Federation, hereby referred to as AFBF, would create an incentive to substitute milk powder for fresh milk. AFBF's method to determine the proposed differential of $1.56 per hundredweight is too simplistic. Because milk powder is relatively nonperishable, it can be purchased today at an attractive price, stored under proper conditions, and utilized within 12 months, when it -- when it -- when it -- it should say "when it is more financially advantageous." In other words, the original cost of the ingredient may be less than the current cost of that same ingredient. Setting the Class II differential too high may incentivize the practice of substituting cheaper powdered milk for fresh milk.

The cost of transportation of ingredients is another concern not addressed by the AFBF proposal. Milk powder is a concentrated form of milk solids, far more so than raw milk or concentrated skim milk. The buyer of milk solids is typically located some distance from the source of the product, and transportation costs are incurred in delivering the product to its destination. Because milk powder has nearly all the cow water removed, it is much cheaper per pound of milk solids to transport than fresh milk ingredients.

AFBF's rationale for establishing new and higher differential value does not account for this added cost for fresh milk ingredients. This difference in transportation costs also contributes to the incentive to

substitute milk powder for fresh milk ingredients.

Disorderly marketing. Federal Order regulations do not require the pooling revenue generated by Class II usage unless the handler is a fully-regulated distributing plant. Consequently, if a class price misalignment exists, there is the -- an opportunity to depool significant volumes of Class II milk. In fact, the current differential of $0.70 per hundredweight has consistently provided an incentive to depool Class II milk. Because I am most familiar with marketing activities within the Mideast Milk Marketing Order, I will use statistics for that market for illustration purposes.

Beginning in December of 2021, there have been incentives to not pool Class II milk on the FMMO number 33 every month. Due to the strength the non-fat milk powder and butter prices relative to cheese and whey prices, there has been a significant price spread between Class IV and Class III prices for the last 23 months.

So the 23-month period I'm talking about here is December of 2021 through October of 2023. That was the most recent information available at the time I prepared this statement.

THE COURT: That would be October or November?

THE WITNESS: October of 2023.

THE COURT: Okay.

THE WITNESS: After adding the $0.70 per hundredweight differential to the Class IV advanced price factor, Class II price -- Class II skim prices averaged

$14.32 per hundredweight versus $10.92 per hundredweight Class III average for calendar year 2022. The Class II skim value exceeded the Class III skim by $3.40 per hundredweight. Additionally, the Class II butterfat value exceeded the Class III butterfat price by .007 cents per pound. The average PPD for --

THE COURT: Let me stop you there just so we make sure the record's right.

So you have got the dollar sign, and then a decimal point, and then 007.

THE WITNESS: Cents.

THE COURT: Yes.

THE WITNESS: Per pound.

THE COURT: All right. Thank you.

THE WITNESS: The average PPD for Federal Order Number 33 during 2022 was $1.50 per hundredweight. The Class II price exceeded the sum of the Class III price plus the PPD every month, which would have resulted in a payment obligation to the producer settlement fund if the Class II milk were to be pooled.

The same milk price misalignment continues to exist in 2023. Through the month of October, the average Class II price was $10.15 per hundredweight, and the Class III price was $7.17 per hundredweight, which is a difference of $2.98 per hundredweight. The average PPD through October was $1.58 per hundredweight. Class II milk pooled on Federal Order 33 also would have had a payment obligation to the producer settlement fund for

every month of 2023. Consequently, there's been a huge decline in the volume of Class II milk participating in the Federal Order Number 33 pool beginning in December of 2021.

And so I went to the statistical page for Federal Order 33 and was able to determine the volume of milk participating in the pool in each of the calendar years 2020 through October of 2023, and that's what I have listed here as the sum of the total Class II utilization pooled in Federal Order 33.

For the year 2020, the total Class II pounds were 4,065,109,000 pounds.

In 2021, the Class II pool pounds were 3,857,237,000 pounds.

THE COURT: Would you read that number again, please.

THE WITNESS: 3,857,237,000 pounds.

By 2022, that number had declined to 1,517,464,000 pounds.

And through the month of October, the cumulative volume of Class II pooled sales in 2023 was 1,200,786,000 pounds.

And if I look at the price relationship in volumes for November and December of 2023, the same depooling situation existed. Not only does this create inequity for dairy farmers due to non-uniform prices paid in a common market, it also results in unequal procurement costs for suppliers. An entity that supplies milk to a fully

regulated plant for Class II usage has paid the market's uniform price, while another entity that supplies milk to an unregulated plant for Class II usage is typically paid the prevailing Class II price.

As demonstrated earlier in my testimony, the difference between the Class II price and the market uniform price has been huge during 2022 and 2023. For twenty- -- for the year 2022, the difference on average was $1.91 per hundredweight, and so far in the year 2023, the difference on average has been $1.40 per hundredweight.

Many pool distributing plants generate excess cream which is not utilized in the production of packaged Class I products. Traditionally, this excess cream has been utilized to produce butterfat intensified products such as half and half, whipping cream, sour cream, cottage cheese, and ice cream mixes. All these products are categorized as Class II, and any distributing plant that is fully regulated has this Class II utilization included in the calculation of the plant's total classified value and its obligation to the producer settlement pool.

However, if the same byproducts were to be produced at a partially-regulated or completely unregulated plant, those plants would have no obligation to the pool if they chose not to -- to not pool the milk. This creates a huge cost disadvantage for a pool distributing plant. As an operator of a pool distributing plant at Canton, Ohio, this price disparity causes MMPA

great concern. If the Class II differential was to be increased to $1.56 per hundredweight as proposed by AFBF, we envision almost all Class II production being shifted to non-pool facilities and the elimination of a valuable source of revenue from the Federal Order Number 33 pool.

So in conclusion, NMPF opposes the adoption of Proposal 21 for all the reasons presented in my testimony. Also, NMPF believes that AFBF's proposal to increase the Class II differential is a subject better addressed at a future Federal Order hearing.

NMPF has offered five proposals which are intended to modernize Federal Order regulations. All of these will affect the calculation of class prices. Not knowing what the outcome of this public hearing might be, it is impossible to evaluate the consequences of any change to the Class II differential at this time. Additionally, there are issues separate from the correct value for the differential that need to be considered that are not addressed in Proposal 21. Therefore, USDA should reject Proposal 21 and maintain the Class II differential at $0.70 per hundredweight.

Respectfully submitted by Carl Rasch on behalf of NMPF.

MS. HANCOCK: Thank you, Mr. Rasch.

Your Honor, we would make him available for cross-examination.

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CROSS-EXAMINATION

BY MR. MILTNER:

Q. Ryan Miltner representing Select Milk Producers.

Mr. Rasch, do you have an opinion as to what the Class II differential, the proper differential should be?

A. Well, as I indicated, it's tough to evaluate what it should be not knowing, you know, how the formulas are going to work in the future. I guess all I would say at this point, increase -- proposing an increase of $0.70 to $1.56 at minimum, you know, if -- if, you know, the $1.56 calculation is based on the current Make Allowance for powder, and everyone has proposed that the Make Allowance be increased, so given the proposal as presented by American Farm Bureau, there's a potential for it to be even more.

Historically, Class II differentials have been pretty modest. I can remember the day when it was Class III plus $0.10, and then we increased it from Class III plus $0.30, and then with Federal Order Reform, the basis for determining Class II was changed to Class IV plus $0.70. And there was previous testimony earlier in the proceeding indicating that, you know, substitution of powder for fresh milk did occur with the increase to $0.70.

So as we indicated, you know, this was the consensus of the members of National Milk that were represented on the task force, and we did not have an opinion as to what the correct differential was. We

indicated it should stay at $0.70 until more information is available to make that determination.

Q. Based on the state of the regulations and price formulas that we have today is $0.70 appropriate?

A. There is some substitution. I'm aware of a fairly significant manufacturer of private label ice cream in Michigan that uses powder exclusively in their operations, so we really don't -- there's -- there's two concerns. We don't want to be eliminating -- as you can see in my numbers for Federal Order 33, you know, the volume of milk pooled has decreased dramatically, and it's not because some of it might have been done due to substitution, but the majority that was due to price misalignments.

So, you know, one concern is substitution. But probably the more overriding thing is what is it going to do to exacerbate the concern that everybody has with depooling.

Q. In the fourth paragraph of your testimony you -- you stated that, "While there was acknowledgement that the differential could be changed, there was no consensus as to how much of a change should be proposed."

When I heard you say that, I took away the idea that at least some members of the National Milk task force felt there should be an adjustment to the Class II differential.

Am I correct in that assumption?

A. Correct. Some were of the opinion that it could be increased; some thought it should be decreased.

Q. So I guess that makes sense then that National Milk wouldn't -- wouldn't include that in their package if you couldn't get consensus?

A. That's true. Because we had -- on all of the proposals we submitted, there was consensus of opinion.

Q. But then I also read your statement, I heard you present your statement, and it seems to suggest that because National Milk hasn't come to a consensus, USDA shouldn't consider making any adjustments at all.

Is that what you are suggesting?

A. I think our bigger -- the takeaway the Department should get from this proceeding is we're trying to make a decision as to what the appropriate level of the differential is operating with -- with sort of in a vacuum.

We don't know how the formulas are going to work, so how can you determine what you should do for the differential?

And -- and at this point, other than American Farm Bureau Federation suggesting that it be $1.56, I have not heard anybody else suggest what the appropriate level should be, so I don't know how they would make a decision.

MR. MILTNER: Thanks. That's all I have.

THE COURT: Would anyone else like to cross-examine Mr. Rasch?

I see no one. I invite the Agricultural Marketing Service to ask questions they have;

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CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good afternoon.

A. Good afternoon.

Q. Thanks for coming to testify. We just needed to make sure you were here --

A. Waited a long time.

Q. Excuse me. Just a couple of questions.

Mr. Miltner asked you what you thought the Class II differential should be set at -- or should be.

I want to ask you a slightly different question, as what do you think it should represent?

A. Obviously, you know, representing producers, we would like to keep as much of the Class II value in the pay price for the producers. It should be a neutral decision, you know. It may be more appropriate for a processor to use powder, but cost should not be the driving factor. If -- you know, if they use powder, now we're substituting Class II value for the producer for Class IV. And Class II is -- is tied directly to the Class IV price, so you are always going to lose pool value if there's substitution of fresh milk with powdered milk, simply to -- simply for economic reasons.

Q. So then you talked a bit about the shift that you noted in Class II pooled volumes -- it's very echoey.

THE COURT: We have quite a bit of echo on the AMS mic.

MS. TAYLOR: Sorry.

BY MS. TAYLOR:

Q. You list -- there's Class II volumes on page 3 in Federal Order 33, so you talk about you think that shift was due to price alignment. And so tying back to what you just said, as your goal is to -- from the producer's perspective, is to keep as much of that -- that revenue in the pool, is that any price misalignment that would cause, that Class II milk to be depooled is what you are trying to avoid. Or not used, I guess, is the right word.

A. The depooling is -- is entirely a result of the misalignment in pricing.

Q. At standalone plants?

A. At a standalone plant, yes. And -- and even at a partially-regulated plant as well. They have -- they are required to pool their Class I volume, but they can choose to depool anything that's not Class I.

Q. At the end in your conclusion when you talk about basically if there's -- does need to be a change in the Class II differential, it should be at a future hearing because there are issues separate from the correct value for the differential that need to be considered.

I was wondering if you could expand on what those issues are you see.

A. Performance standards, you know, in order to be eligible to participate in the pool. If you depool milk, there are consequences, there's restrictions as to how much milk you can pool in the subsequent month after your depooling action. So performance standards, pooling

restrictions, you know, they vary. What do we have, 12 Federal Orders now, or 11?

Q. 11.

A. 11. All 11 have different standards based on their own market conditions, you know. I indicated, you know, that in the past the differential has been pretty modest, if we were to go to something in the range of $1.50 to $2. Should the differential be uniform across all orders or should it be variable like the Class I differential? So those are just a few things. And they just haven't -- you know, I don't know that they have been taken into consideration when Proposal 21 was prepared and presented.

MS. TAYLOR: Thank you very much. That's it from AMS.

MS. HANCOCK: Thank you, Mr. Rasch. Appreciate your time.

Your Honor, we would move for admission of Exhibit 499.

THE COURT: Is there any objection to the admission into evidence of Exhibit NMPF-213, also Exhibit 499?

MR. HILL: There's no objection, Your Honor, but I do want to make a correction that Mr. Rasch made on page 2, since he brought it up, which was in line 5 he added the word "is" between "it" and "more." "It is more financially advantageous."

And since I'm in here, let's go to page 3 as well.

Very minor change. It is next to the 2020 line, that 4.065, obviously, that's supposed to be a comma. I wanted to mention that.

THE COURT: Very good. Let's make those changes on the exhibit copy. The -- I mean, the original exhibit.

So the top of page 2, five lines down, we're adding the word "is," I-S, just after the word "it." That's done.

And then on page 3, with regard to the four different numbers, the top number needs a comma after "4," it's 4 billion, comma.

That's done. You are very quick.

MS. HANCOCK: Thank you, Mr. Rasch.

MR. HILL: No objection.

THE COURT: All right. So as corrected, we're ready now to admit Exhibit 499. Exhibit 499 is admitted into evidence.

(Thereafter, Exhibit Number 499 was received into evidence.)

THE COURT: All right. Good. You're free to go. Thank you, Mr. Rasch. How many days were you here?

THE WITNESS: What's that?

THE COURT: How many days were you here in attendance?

THE WITNESS: A dozen.

THE COURT: A dozen?

THE WITNESS: I'm fairly close. I have been able to drive in and drive away.

THE COURT: Excellent. Well, we appreciate you filling in today. Thank you.

MS. HANCOCK: Your Honor, we note Mr. Rasch, I believe, is the final National Milk witness.

MR. ROSENBAUM: Steve Rosenbaum for the International Dairy Foods Association.

Our next witness is Mr. Mike Giles, G-I-L-E-S, and I'm distributing copies of his presentation.

THE COURT: Let's go off record while those are distributed.

We're off record at 1:45.

(An off-the-record discussion took place.)

THE COURT: Let's go back on record.

We're back on record at 1:52.

Mr. Rosenbaum, why don't you start by introducing yourself, and then I'll have the witness identify himself, and then we will number the exhibit.

MR. ROSENBAUM: Steve Rosenbaum, International Dairy Foods Association.

THE COURT: All right. And I'd like the gentleman in the witness chair to state and spell his name.

THE WITNESS: I'm Mike Giles, M-I-K-E, G-I-L-E-S.

THE COURT: Have you previously testified in this proceeding?

THE WITNESS: No, Your Honor.

THE COURT: All right. I'd like to swear you in.

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MIKE GILES,

Being first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Good afternoon, Mr. Giles. You have on your computer a PowerPoint presentation. We have distributed hard copies of that presentation which are marked as IDFA-Exhibit 67, and I would ask that be marked with the next Hearing Exhibit number, which I believe is 500.

THE COURT: Correct.

(Thereafter, Exhibit Number 500 was marked for identification.)

THE COURT: A milestone.

MR. ROSENBAUM: We arranged the order so you would be the one.

THE WITNESS: I guess I should say thank you at this point.

MR. ROSENBAUM: I had to fight for that.

BY MR. ROSENBAUM:

Q. Before we start your presentation, tell us what your current position is.

A. I am president and general manager of Plains Dairy in Amarillo, Texas.

Q. We'll talk about Plains in a little bit in a minute.

Is this -- how long have you held that position?

A. I have been there five years this January.

Q. And do you have experience in the dairy industry that goes back earlier than that?

A. I do. Previously I worked for a short term at H-E-B, another captive dairy. And then before that I was vice president of manufacturing for Brookshire's Grocery Company for a long time.

Q. And did they have dairy facilities of their own?

A. Yes. We had a dairy, ice cream plant; a water, tea, bottling operation; a sweet goods bakery; and an ice plant.

Q. All right.

THE COURT: Would you spell the name of that establishment for me.

THE WITNESS: B-R-O-O-K-S-H-I-R-E-S. The headquarters and plant was located in Tyler, Texas. It's now a Hiland plant.

BY MR. ROSENBAUM:

Q. All right. Appreciate you providing that background to us.

I think if we could go ahead and pull up the PowerPoint presentation at this point, and go to page 3, and tell us about Plains.

A. Okay. Plains has been in Amarillo since 1934. Its present location --

THE COURT: Let me interrupt just a minute. So my -- my Exhibit 500 starts with a number 2.

MR. ROSENBAUM: It was printed off with two pages per page, Your Honor. If you look back on page 1, you

will see there's a 1 and a 2 both.

THE COURT: Exactly.

MR. ROSENBAUM: So that's -- that's the cause of that confusion.

THE COURT: Thank you so much. So I have pages 1 and 2, and then I have3 and 4 on the next page.

MR. ROSENBAUM: Exactly, Your Honor.

THE COURT: Now I understand. I'm sorry to have interrupted.

You may proceed.

THE WITNESS: No problem, Your Honor.

So we are a fluid milk plant. We run the typical fluid, creams, milk, chocolate milk, buttermilk -- we do have cultured there, buttermilk, eggnog, half and half, and heavy cream. Also run a lot of non-dairy as well.

Our parent company is Affiliated Foods of Amarillo, and they are the largest of the nine remaining independent grocery wholesalers in the United States. They are about a $1.7 billion distribution company. They are a co-op. And about 88% of our milk ships through a warehouse channel. Affiliated Foods acquired the dairy in 1996, and the members of the co-op are independent grocery store owners, mainly in small towns or rural settings.

Q. If we could go to the next page to see a map.

A. So we -- we -- the parent company distributes groceries in a total of nine states, and all the way up from Amarillo in the middle of the Panhandle there of Texas. All the way up to Torringon, Wyoming, you see one

little red dot up there in the corner of Wyoming. All the way down to Zapata, Texas, which is actually further to Zapata than it is to Torrington, Wyoming. And all the way to Dallas -- Arizona on the border, a little bit into Arkansas, all the way up to South Dakota.

Q. And when you say that 88% of your milk is shipped through a warehouse channel, I take it that means the milk goes to a warehouse owned by Affiliated Foods?

A. Affiliated Foods, yes.

Q. And then distributed?

A. Yeah. We send truckloads of milk to the warehouse, and then they distribute it through their channels.

Q. Okay. If we could go to the next slide, slide 5.

A. So we are, again, owned by Affiliated. We're an independent dairy. We buy our milk from the Lone Star co-op for at least the last 15, 20 years. We pay an over-order premium to the co-op. We receive seven days a week and have the opportunity to earn receiving credits.

Our milk supply is all Texas milk and comes within 30 minutes to an hour of the plant. All single-load producers. We have a small DSD operation that operates throughout the Panhandle, approximately about a hundred miles around the plant and into the Lubbock market.

Q. And so these would be shipments that you yourself are making as opposed to going through the warehouse?

A. Right. Right. And we have a few other customers as well.

Q. All right.

A. So we believe that Plains has a unique position in the industry that, from my perspective, the hearing may not have heard from yet.

We're -- because we're owned by a grocery distributor that sells groceries to its members, and those are mainly small town grocery stores, sometimes these stores are the only store in the town where they are located. And our -- Affiliated Foods, our parent, also owns other manufacturing, a water bottling facility, which I run as well, a meat plant, a bread bakery, and all those kind of go together to make the model or the mousetrap for the distributor.

Q. What's your position on Proposal 19?

A. We do not support it, Mr. Rosenbaum.

Q. And if we go to the next page, tell us why.

A. Okay. We have several reasons. We feel like Proposal 19 is inconsistent with the USDSS study and the remarkable growth in milk supply in the Texas Panhandle in the last 20 years, being very close to the milk supply or the majority of it coming to us less than a hundred miles.

Q. I take it that tends to reduce the transportation cost?

A. I would think so. So in the 2021 University of Wisconsin modeling study, our differential came in at 2.20 a hundredweight and -- for the May study, and 2.30 for the October '21 study. Our current differential --

THE COURT: Let me stop you, Mr. Giles. I want to

make sure that this is captured in the transcript as dollars and cents. So would you read that bullet point again and make it clear what you have written.

THE WITNESS: For the 2021 University of Wisconsin modeling study, our differential came in at $2.20 a hundredweight for the May '21 study, and $2.30 a hundredweight for the October 2021 study.

Our current differential is $2.40 a hundredweight.

And the Proposal 19, National Milk's proposal is -- has our differential at $3 a hundredweight.

BY MR. ROSENBAUM:

Q. And just to pause there. The University of Wisconsin model, based upon what you just told us, actually recommends a decrease in your current Class I differential, correct?

A. That is correct.

Q. And does that reflect a tremendous growth in milk production up in the Texas Panhandle?

A. That is correct. There's tremendous growth, both on the producer side and the manufacturing side.

Q. Okay. Continue on, please.

A. So between the two, the May '21 model study of estimate of $2.20 a hundredweight and the National Milk's proposal, it's about $0.80 a hundredweight difference. That's about $0.07 a gallon to a fluid milk operator. And $0.07 does matter if you are doing a bid to a warehouse, entity, or a large company. We are -- we are very condensed, and increasing the differential could further

affect our volume and the business and the competitiveness of our members' stores as well.

Q. Okay. And -- and so basically, the USDSS model would give you a raw milk cost $0.07 less than what is being proposed in Proposal 19; is that correct?

A. Well, hang on a second. Could you repeat the question?

Q. Yes. The fundamental issue is that the University of Wisconsin model, if followed, would result in a Class I differential for your company, $0.08 less than Proposal 19 --

A. Eight --

(Continuous crosstalk. Court Reporter clarification.)

BY MR. ROSENBAUM:

Q. Let me start it again just --

A. Okay.

Q. -- so she can get my question down and then your answer.

The University of Wisconsin model provides a Class I differential to your plant in Amarillo at a cost $0.07 a gallon less than Proposal 19?

A. That's correct.

Q. If we go on to page 9, I think you got a chart that shows all of this.

A. Right. Here's just a chart shown in green, our current differential; in yellow, the first is the May 21st [sic] study at 2.20; then the 2.30 for the

October study, and then the National Milk proposal of $3.

Q. All right. Please continue.

A. So it's my opinion that when -- it seems, to a Class I producer, sometimes when the changes to the FMMO are needed by -- by the farmers, by the producers, the first thought is to raise the price of Class I milk. And Class I milk is declining per capita for many, many years, to the point that fluid milk utilization, I think when the market order first started in the '30s, it was over 85% utilization of the total milk supply, and right now it's down to about 17 or 18%, which is approximately equal to the U.S. dairy exports.

We know that cheese is driving the bus in dairy utilization, and Plains Dairy is opposed to the concept of raising Class I as the first best answer.

We believe the industry needs a financially-sound solution that is best for the long-term sustainability of all parts of the industry. And, again, we're not against reform, we're just against maybe not data-driven reform.

I talked about milk consumption declining. And the latest data shows milk volume down around 1.9% nationally. Just attended the Milk -- MilkPEP there, before the dairy forum, and that was the information presented. I think it was two or three months old.

Mass merchandisers like Walmart Supercenters, Costco, Sam's, are up 1%, while drug stores, C stores, and traditional grocery are all down.

Our membership, that is the membership that is

part of the Affiliated co-op, is almost totally made up of traditional grocery. And traditional grocery that's not urban but mainly rural, with some C stores, mostly, again, in that small town setting.

These stores, traditional stores, according to MilkPEP, are down 4 to 5%, with C stores down over 10%. So -- and the thought there is that consumers are starting to run out of money and switching to more valued formats and driving further from home to access them.

Dr. Capps' study at Texas A&M University testified in December on his most recent elasticity study, he found that the milk price elasticity is more elastic than earlier studies, with every 1% increase in price resulting in a more than 1% decrease in sales volume. This is a dramatic change from pre-COVID.

And for an example sake here, I used $0.20 per gallon wholesale cost, the increase to these stores could raise retail as much as $0.35 in our stores.

Q. And does that reflect the fact that the stores are taking a markup over and above the wholesale price?

A. Yeah. In a perfect world, they do that. And a traditional grocery markup is around 35%.

In other formats, it is not. You know, the Walmart model, it is a pretty well known common fact that their markup is less, about 22 to 24%. Sam's, Costco markups are 19%. But if one of our grocery retailers, our members have a store and there's a -- say it's in a town where there's a Walmart, and the Walmart has a lower

price, they are going to match that price and not be able to go up and just take a loss.

MR. ROSENBAUM: That completes Mr. Giles' testimony. He is available for cross-examination.

THE COURT: Who will begin cross-examination?

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good afternoon, Mr. Giles.

A. Good afternoon.

Q. I'm Ryan Miltner, and I represent Select Milk Producers.

Earlier in the hearing we had some testimony from folks on the cost to move raw milk in a tanker from farm to plant.

And I wondered in your experience, do you happen to have a rule of thumb for what it costs to move packaged milk from your plant to the warehouse or from warehouse to store?

A. All that is -- that's totally dependent probably on the, you know, current diesel and -- price and that sort of thing. I think somebody testified earlier that if the cost of a semi and tractor-trailer rig was less, and diesel was down, and, you know, it would be inexpensive, but it's not.

Pre-COVID, the cost of a tractor-trailer rig was a lot less than it is currently, almost double what it was before COVID.

Q. I guess -- I think when they were -- when people

were testifying about raw milk, it was more just the incremental cost of actually moving it, not so much taking into account the equipment. I thought it was about $1 per hundredweight per hundred miles.

Now, if I just took that and I backed it into a gallon, it would be about $0.085, I think, if my math is right, to move a gallon of milk a hundred miles.

And I don't -- I was just curious if that -- if there was any type of equivalent like that, or if that's something you guys just don't track the same way that farmers do?

A. Well, you know, talking to co-op representatives in the past, I have heard that the cost that they are getting for the transportation of milk, say, from the Panhandle to Dallas is not what -- you know, what they are able to charge or get for that. So other than that, you know, locally, a hundred miles would be $1 hundredweight, that wouldn't be a lot more than $2.40 I guess, right?

Q. Sure. The distance from Amarillo to some of the more distant stores within your cooperative, what -- some of the cities you mentioned, but looks like, when I was looking at the map, maybe Torrington, Wyoming, to the north; Bentonville, Arkansas, to the east; Laredo to the south; and Safford, Arizona, to the west, they are all in that 500- to 600-mile distance.

A. I think -- I think right now a good rule of thumb is about $3 a running mile for grocery delivery, not bulk. I don't know what bulk is, but that's what I have heard

from our transportation department. I'm no expert on that.

Q. Okay. How many gallons of milk would be in a truck?

A. It depends on the store. They are going to order -- they may get two or three shipments a week with their groceries. So they are getting all the groceries for that store, along in that truck with the milk, and the milk may only be a pallet scattered through the load, or it may be half a truckload. It just depends on the store and their order.

Q. And from your testimony and the questions with Mr. Rosenbaum, I understand that you do all your processing there at the plant in Amarillo, and then -- and then you ship to one or more than one warehouse for distribution?

A. Just one. It's about five miles across town.

Q. Okay.

A. And the grocery company has to add on additional transportation costs to get it to the store.

Q. Thank you.

On slide 8 of your presentation, you stated that Proposal 19 is inconsistent with the USDSS study.

And I'd like to ask, other than the specific differentials applicable to your county, what you found inconsistent between Proposal 19 and the study, if anything?

A. Well, from our perspective, and being right there

at the milk supply, and our differential going up $0.60 a hundredweight instead of going down $0.20 like the May '21 study, University of Wisconsin, to me that's inconsistent.

Q. So are you -- you believe the output from the study itself is correct and should be considered as well?

A. I think it's some of the better data that we have.

Q. Thanks.

MR. MILTNER: I don't have any further questions.

THE WITNESS: Thank you.

THE COURT: Is there other cross-examination before I invite the Agricultural Marketing Service questions?

I see no one. I invite the Agricultural Marketing Service to ask questions.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. Good afternoon.

A. Good afternoon.

Q. Thank you so much for coming to testify today.

A. My pleasure.

Q. I'm glad you feel that way still.

I wondered if you could just explain a little bit the co-op grocery model for the record, since we talked a lot about the co-op side and the dairy farmer side, but could you just kind of explain just a little bit how that works.

A. Well, so the -- the co-op is basically a grocery distributor made up of independent grocery store owners.

And our board is grocery store owners as well. We do have a couple of larger members, but the bulk of our membership is -- one, two, five, six, seven -- eight store type owners, a lot of ones and twos. And they may have a store 30 miles outside of Salina, Kansas, in a little town with 1500 people, that may have to drive 35 miles to go to a bigger city to access, say, like a, you know, Walmart or another chain store grocery store to get their groceries. So they operate in and they perform a great service for these independent members.

By having a dairy be vertically integrated with some manufacturing, having a dairy, having a meat plant that makes -- takes boxed beef and puts it into retail cuts, because butchers are very hard to find in small towns, usually they will go to a larger town if there's a butcher available and make more money, so that's a service they offer.

A bread plant, it's all part of their, you know, what I call a mousetrap for their model. And it attracts, you know, those grocery store owners rather than a competitive independent wholesaler like AWG or somebody like that.

To give you an example of how serious our board is about it, during COVID, you know, people went -- went and -- everything got shut down, people went to the grocery store and bought everything, and you couldn't get toilet paper, and paper towels, and bottled water. We have store brands in our company -- and we control

about -- we were buying about a hundred loads of bottled water at the time a week, truckloads. 65 of those were in private label.

Well, our supplier, Niagara, the manufacturer, couldn't keep up because the demand went up probably to a hundred loads. But it went up everywhere, all our customers went up. So it was kind of a force majeure situation, and we only got like eight loads of water a week when we needed a hundred. And some of our competitors, maybe in a big box store, got pretty much what they needed.

And our board got upset about that, so they built a water plant. And, you know, we were able to do that because it was the beginning of COVID, and the supply chain was still pretty much intact at the very beginning. We were -- jumped on it the next month and started. 14 months later, we had first saleable product in our water plant because of that. Some of these little towns had water where they wouldn't have had water when they had to drive a long way. So, you know, that's part of the value of our co-op membership.

The other thing is, our profits go back to the members at the end of the year. You know, we hold money out for cash flow and capital expenditures, but then profits go back to the members in the form of a rebate, so it kind of helps keep their costs down.

Q. Okay. Thank you so much for that.

A. Uh-huh.

Q. And then did I hear you correctly, maybe this is just from the dairy side, so you have one -- you -- Plains Dairy manufactures the milk and then ships it to a warehouse, and then that's where the distribution happens?

A. That's correct.

Q. And is that in regards only to the dairy or that is for all the different meat packing?

A. So picture a big grocery warehouse. That's what Affiliated is like. And we ship our product five miles across town to them, and then they distribute our milk with all the groceries as the stores order them.

Q. Got you.

And you mentioned that you buy your milk from a dairy former cooperative?

A. Correct.

Q. And that's the -- they are your sole supplier?

A. They are.

Q. So we have had other testimony at the hearing on kind of how those relationships are, how those negotiations go when it comes to over-order premiums, et cetera.

So I was wondering if you could add a little information to the record that you are comfortable with adding kind of in how that works.

A. Well, when we first started out, we had a relationship with Lone Star. I think they were in an agency. I'm not sure they are anymore. They are?

We get a competitive price, even though, you know,

whether they are or they are not. But we have a contract, you know, so it kind of outlines our relationship. They have been good vendors to us.

Q. And when it comes to fulfilling the supply that you need, do they provide balancing services to you, or are you pretty steady seven days a week?

A. No. No. We don't bottle on the weekends. So, you know, we'll -- we'll receive seven days a week, but we don't bottle every day. So, yes, they provide balancing services for us.

Q. Okay. And then your over-order premiums, there's discussion about, on one side those can be negotiated; from the other side says those are really difficult to get anywhere and they could be short lived.

Can you talk a little bit about if you pay over-order premiums, how often they might be negotiated and maybe what you think --

A. There's not much negotiation on our side, I don't think. So, you know, they are what they are. And I have seen them -- as Mr. Sims said, I have seen them in my 35, 40 years of dairying zero, and I have seen them over $3. So -- but you usually just get a notice of what they are going to be from my side.

Q. Okay. I want to turn to slide 8, and the bottom bullet there you are talking about the increase in differentials could affect -- further affect your volume and business and the competitiveness of our member stores.

I wanted to see if you could expand on that,

particularly when you mention that a lot of your members might be a single -- you know, might be the only grocery store in town.

A. Right. If that's the case, they -- if we go up, and there's no competition there, they are probably going to go up. But, you know, there's a point there where if they can drive 30 miles and save $1 a gallon, they might decide to do that, right?

The other side of it is if there isn't competing store in a little town like that, and the competitor has, say, milk at $2.99, then they are going to match the $2.99 no matter what their cost is, just to, you know, be competitive.

Q. Uh-huh.

A. And it affects their profit.

Q. And you mentioned consumers might drive a longer distance.

Is that what you mean on your last slide when you talk about switching to value formats? Could you expand on what that means.

A. Yeah. Value format, like a mass merchandiser. You know, you go to a Costco or Sam's, it's -- their prices are going to be a little less expensive than if you are in small-town America from an independent.

Q. Okay. And slide 10 at the bottom you say you "believe the industry needs a financially-sound solution that's best for the long-term sustainability for all parts of the industry."

What, in your mind, would be a sound solution or what factors would go into that?

A. I don't know. And I don't envy y'all's position either, listening to months of testimony and probably going to have to relive it for the next few months to come up with your proposals to submit.

We don't really get to be -- have a vote as a processor, so I wish you luck with that, you know.

I just think it -- I am not against reform. I just need -- I think it needs to be data driven, and the data says our particular plant should go down in differential, not up.

Q. Okay. And then my last question at the back, on slide 11, you give an example, a $0.20 per gallon wholesale increase to the stores could raise retail as much as $0.35 per gallon.

I'm just trying to understand the math, how you got to $0.35, and I don't need an equation but generally.

A. Well, if a retailer pays $3 for a gallon of milk at wholesale, he's not going to sell it for $3 if he doesn't have to, unless he has a competitor across the street that's selling it for $3. He's going to sell it for $4.50 because that's -- that's his markup. That $1.50, you think, well, that's a 50% markup, right? $3, $1.50.

That's not how they figure it. They figure $1.50 divided by $4.50, that's a 34% markup. And traditional grocery stores are about a 35% markup, where, you know,

your value super center type is more along the 20% level, like a Sam's or Costco.

Q. So if what I am -- I don't need to follow the math, but I think -- I just want to make sure I understand your general point, is that if the differentials go up, some retailers will use that price increase, and also in addition to whatever it is at the wholesale level, add an additional markup to the consumer?

A. They will raise the price, and they will try to get their traditional markup on top of it, if they can. But it all depends on their -- you know, their format, what type of store it is. And competition. A lot of times they won't be able to get that because of competition.

Q. Does that happen in the reverse, when prices go down?

A. I think you will find in retailers world, that prices -- prices go up very fast. And they come down pretty slow, but they will come down, but usually it's competition that drives it.

Q. Uh-huh.

MS. TAYLOR: I think that's it from AMS. Thank you so much.

THE WITNESS: Thank you.

THE COURT: Mr. Rosenbaum.

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REDIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Just a follow-up on the questions about over-order premiums.

I mean, do you -- how do you find out literally what your over-order premium is going to be?

THE COURT: I think that was heard, but it was pretty faint.

(Court Reporter clarification.)

BY MR. ROSENBAUM:

Q. You answered a couple of questions about over-order premiums.

How do you find out what the amount of your over-order premium is going to be?

A. Well, first off, Mr. Rosenbaum, they don't change very often. And when they do, I usually get a phone call if it's been a long time and they are going to change a lot, followed by a notice in the -- in an e-mail.

Q. Okay. And that's when it comes from the cooperative; is that correct?

A. That's correct.

Q. Okay. Is there any real negotiation that's going on?

A. No, sir.

MR. ROSENBAUM: That's all I have.

Your Honor, I would move Hearing Exhibit 500 into evidence.

THE COURT: Is there any objection to the

admission into evidence of IDFA Exhibit 67, also marked Exhibit 500?

There is none. Exhibit 500 is admitted into evidence.

(Thereafter, Exhibit Number 500 was received into evidence.)

THE COURT: Mr. Giles, is there anything further you would like to add before you step down?

THE WITNESS: No, Your Honor.

THE COURT: Thank you so much for being here.

I would like to take a break, but let me find out who will be the next witness before we take the break.

MR. ROSENBAUM: Steve Rosenbaum.

Your Honor, Steve Galbraith will be the next witness.

THE COURT: Very good.

MR. ROSENBAUM: And I'll just mention, he has two separate statements, and I will distribute them during the break.

THE COURT: Very good.

Let's take 15 minutes. It's now 2:30. Please be back and ready to go at 2:45.

(Whereupon, a break was taken.)

THE COURT: Let's go back on record.

We're back on record at 2:45.

I have a new witness in the witness chair.

Would you please state and spell your name.

THE WITNESS: Steve, S-T-E-V-E, Galbraith,

G-A-L-B-R-A-I-T-H.

THE COURT: Have you previously testified in this proceeding?

THE WITNESS: Yes, Your Honor, I have, on August 30th of last year.

THE COURT: Oh, my. You remain sworn. Well, I'm glad you get to see both climates.

THE WITNESS: I have seen both experiences.

STEVE GALBRAITH,

Having been previously sworn, was examined and testified as follows:

THE COURT: Mr. Rosenbaum, I have two documents.

MR. ROSENBAUM: Yes, Your Honor. We have two testimonies, written testimonies, by this witness. The first one is labeled IDFA-Exhibit 65, which we would ask be marked as Hearing Exhibit 501.

THE COURT: Yes.

(Thereafter, Exhibit Number 501 was marked for identification.)

MR. ROSENBAUM: And the other is marked as IDFA-Exhibit 66, which we would ask be marked as Hearing Exhibit 502.

THE COURT: Yes.

(Thereafter, Exhibit Number 502 was marked for identification.)

DIRECT EXAMINATION

BY MR. ROSENBAUM:

Q. Mr. Galbraith, your written testimony starts with

some introductory background, most of which -- I guess all of which probably we covered back in August. But since it's been a few months, let me just start by asking you a few questions.

Remind us the name of the company for which you work and what your position is.

A. I'm employed at Saputo Dairy USA, in Dallas, Texas, where I am --

(Court Reporter clarification.)

THE WITNESS: I'm employed by Saputo Dairy USA, in Dallas, Texas, where I am vice president of procurement and commodity risk management.

BY MR. ROSENBAUM:

Q. All right. And remind us how many plants Saputo has and basically what you make.

A. So we have 29 plants across the United States. We manufacture some Class I, Class II, Class III dairy products across multiple plants.

Q. All right. And Hearing Exhibit 501 addresses Proposal 19, correct?

A. Correct.

Q. So if you could go to the first page, and to the second heading, opposition of Proposal 19, and go ahead -- and read your testimony for us.

A. Okay. First I would like to comment on Proposal 19, the potential impact of increasing Class I differentials in a category that's seen annual average decline of 2%, or over 20% cumulatively, since 2010.

In a previous testimony by Mike Brown, it was noted that the current supply of milk greatly exceeds by any measure the amount necessary to satisfy fluid needs. There is no justification to increase Class I differentials and stimulating a larger milk supply given the presence of an already far more than adequate milk supply. I would agree with that proposal as well.

In the choosing to raise prices for any product category that is experiencing steadily declining volume has not proven to be a recipe for growth due to some of the potential following outcomes.

Mandating higher Class I differentials would reduce the price difference between Class I milk and plant-based beverages. This narrow price difference may incent some consumers to try and ultimately switch to plant-based beverages, resulting in further Class I volume decline. Although the volume does remain wide today, that potential outcome certainly exists.

Continued lower milk volume will drive a change in the fluid distribution model from primarily direct store delivery to the delivery through distribution centers. Delivery through distribution centers with longer supply chains will require ESL, or extended shelf life, milk processing, which comes at a higher cost. The move to more ESL processing will result in less HTST processing.

And over the past decade, some of the HTST manufacturing plants who shuttered their doors had cultured production -- cottage cheese and sour cream as an

example -- associated with them, and they were forced to consolidate that cultured production into centralized facilities further away from customers. These categories remain popular, and if more HTST plants close, any associated cultured production capacity will need to be replaced. As that transition is likely to continue, additional costs to consumers will be required.

The loss of Class I consumption reduces milk demand overall. If farmers continue to increase production, that excess milk may ultimately find its way into Class III and Class IV product. Continued supply due to the declining Class I demand will depress prices of Class III and Class IV categories, and reducing the value of Class III and Class IV is not in the best interest of producers or processors.

To summarize what I am saying, we have added cost to Class I category over the past several decades with consolidation and increased miles on our product. Adding additional cost will not continue to grow the category. I spent the last 40 years working to build brands and create consumer value. I have never seen structural increases in costs and/or prices be a path to achieving either objective.

That's a general overview of, you know, kind of where we're coming from. There are, however, some specific issues that will impact Saputo specifically.

We do operate some Class I manufacturing plants across the U.S. We do have a kind of gappy area in the

Rocky Mountains and in the Pacific Northwest. At times, we struggle to get milk to certain Saputo facilities that are not located in traditional milk sheds. The marketplace has a mechanism that helps us get milk to where we need it, when we need it, by paying larger over-order premiums.

The over-order premium is not promulgated nor implemented through regulatory means. Higher proposed regulatory costs, such as higher Class I differentials, will not change the relationship between the hard-to-get milk locations and the milk-surplus areas. It has a potential to increase inefficiencies between those locations and make processing milk in those hard-to-get locations even more expensive.

So, specifically, when you do the math, Proposal 19 pushes the Class I differential in Saputo's Federal Marketing Order Number 7 facility up from the current $2.70 per hundredweight to $4.60 per hundredweight, an increase of $1.90 per hundredweight.

Saputo's Class I differentials in Federal Milk Marketing Order 51 would move up from $1.70 per hundredweight to $2.50 per hundredweight, an increase in $0.80 per hundredweight.

Saputo manufactures Class I value-added ESL milk and distributes across several states. Proposal 19 puts the facilities in Federal Order 7 at a greater cost disadvantage compared to the West.

The same logic applies to facilities in Federal

Order 1 and Federal Order 30 when you compare those to the other Federal Milk Marketing Orders. And I -- there's a chart attached with proposed differential changes.

The free market and the use of over-order premiums will help bring milk production closer to the demand. Proposal 19 has a potential to move production to alternative locations or, worse yet, drive the cost high enough to reduce overall demand.

Creating value in the minds of the consumers is the most effective way to increase revenue in the dairy industry --

(Court Reporter clarification.)

THE WITNESS: Creating value in the minds of consumers is the most effective way to increase revenue in the dairy industry. A great example of this is a cream market and the continued increase in cream multiples over the past several years. Not only have butter prices maintained a historic high price, but cream multiples have also continued to increase over the years as manufacturers strive to secure supply to make product for a growing dairy category.

Due to this increased consumer demand, co-op agencies can increase cream multiples in the marketplace. The same story needs to be repeated in the minds of the consumer relative to skim solids in the various formats in which they can be delivered to the consumer. Increased regulation and regulation mandating higher prices will not resurrect the category that has been declining for over

50 years. The best solution is to build value in the mind of the American and global consumer.

BY MR. ROSENBAUM:

Q. Thank you very much, Mr. Galbraith.

Let's move, then, to your other testimony, which has been marked as IDFA Exhibit 66 and Hearing Exhibit 502, which addresses Proposal 21.

And if you could start in the middle of the first page after the heading, "Position - Proposal 21."

A. I testify today in opposition of Proposal 21 that seeks to increase the Class II differential from $0.70 hundredweight to $1.56 over the Class IV price.

Saputo manufactures products in several different states that utilize Class II milk, both skim solids and butterfat components, and opposes Proposal 21 for the following reasons.

When I testified on August 30th in opposition to of Proposals 1 and 2, I presented data demonstrating the Saputo plants in Federal Milk Marketing Orders 6 and 7 were not receiving milk to contain skim solids below the 9% level.

Q. I think you put in a "not." Can you re-read that part?

A. That contains -- oh, were receiving milk that contains skim solids below -- oh, you are right. Sorry.

Q. Why don't you read the whole sentence over again.

A. All right. When I testified on August 30th in opposition to Proposals 1 and 2, I presented data

demonstrating Saputo plants in Federal Orders 6 and 7 were receiving milk that contained skim solids below the 9% level. Raising the calculation of costs above 9%, as proposed in 1 and 2, would only cause Saputo to pay for solids not being received today.

Increasing the premium from $0.70 to $1.56 is simply asking to pay higher levels for solids that are not being received today, placing manufacturing facilities in Federal Orders 6 and 7 at a further competitive differential -- further competitive disadvantage.

The differential increase of $0.86 is intended to increase revenue to dairy producers, but will likely not have the intended effect. Class II skim solids demand is likely to decrease, as alternative milk solids have greater substitution values.

The last reason -- or the fourth reason would be cream multiples will increase, further increase in cost to consumers.

So I'll stop there for a second.

For the table below in the testimony, so -- is the following values of skim solids based on published price of various indexes over the past five years. I just pulled these different data points. They are not landed delivered costs to our plants, but they are data points, and they are intended to show the deltas between the different classes.

So the Western non-states -- non-fat dry milk, the Western states non-fat dry milk powder has averaged just a

little bit over $1.25 and a half over the last five years, Class II skim solids have averaged $1.1495, just under $1.15, and the proposal for Class II skim solids would move that up to $1.2445, just under $1.24 and a half.

Q. And those are all in per pound numbers, correct?

A. Those are all per pound solids basis, that is correct, skim solids, because we buy in solids and obviously we formulate in solids.

Based on the last five years' market values spread, the following conclusions can be derived.

Substitution of non-fat dry milk values for Class II skim solids in raw milk does not seem to make economic sense given that non-fat dry milk carries a premium.

When you add premiums for condensing skim, the Class II condensed skim gets closer to non-fat values; however, the rehydration time and expense has prevented substitution to date for financial reasons.

Consequently, if there is any substitution going on today, or has gone on in the recent past, it is not due to market values.

Should the American Farm Bureau proposal to increase the Class II skim solids by over $0.095 a pound, it is possible we could see substitution of non-fat dry milk in a formula replacing Class II skim solids in certain months.

This is likely to be done at various levels in the supply chain from the condensing skim manufacturing

process to the milk plant itself where the finished product is made.

The net result would be the same amount of milk solids used. However, there would be limited or no additional revenue anywhere in the supply chain for producers when this substitution occurs.

Q. Would those solids now be priced at Class IV rather than Class II?

A. It would be priced at Class IV if you were buying powder, correct.

Q. Please continue.

A. When making ice cream mix, processors can create ice cream mix formulas that incorporate milk solids other than Class II solids.

These substitutions include whey, sweet whey. That substitution for skim solids is a one-for-one. Sweet whey substitution for the past five years would have benefitted an average of just over $0.69 a pound. Sweet whey substitution under Proposal 21 would benefit nearly $0.79 per pound, so an additional dime advantage.

Buttermilk. The substitution for skim solids includes removing some of the butterfat as well as skim solids. The table below shows the substitution or cost benefits, so that's cost increase, over the past five years, when compared to actual market and -- and a market where Proposal 21 is enacted.

There are a couple of takeaways from this data. Buttermilk substitution would have been beneficial two of

the last five years under the current market dynamics. Buttermilk substitution under Proposal 21 would have been beneficial four of the last five years.

The larger these substitution savings opportunities become, the more likely owners of the formulas, customers, will look closer to opportunities and ultimately make the switch. The net result of implementing Proposal 21 would likely result in a decrease in Class II skim solids in current formulas.

Then I talked about Class III skim solids and why I refer to Class III skim solids in the table below. Because there are companies similar to Saputo that do acquire non-fat dry milk for a variety of reasons. Some of those may be intentional. They market play -- take advantage of a market price or some distressed inventory.

Some of those reasons maybe unintentional when milk must be diverted to a balancing plant for numerous reasons.

When a -- when you assess the disposition of that non-fat dry milk, there's really two options, outright sale into the marketplace or substitution of powder into Class III or Class II products.

The option is often done when the non-fat dry milk inventory is valued at less than Class III or Class II solids.

So we look at our inventory that we have for powdered milk, we'll say, what is the value of that inventory and does that inventory value work into Class II

or Class III formula. And the best option always is going to be to replace the highest priced skim solids that you have in your network, and that is more likely to be Class II if the differential is increased.

Q. So we're not going to have you read the chart that follows into the record, but as an example, you show here that under the actual market there were a couple of years where net per pound buttermilk was at a price advantage --

A. Right.

Q. -- over Class II.

That would turn into having an advantage four out of five years if Proposal 21 had been in place; is that correct?

A. That is correct.

Q. And what, just as a businessperson, if you see that substituting buttermilk will make you money four years out of five, what does that give you an impetus to do?

A. Yeah. So what it does is we look at the markets every week. We'll get -- look at the ingredients every week, and we try to do a least cost formulation. And what this tells us is that four out of five years, had Proposal 21 been enacted, we would have been substituting buttermilk in our formulas for ice cream mix versus the current where we really only had financial advantage to substitute two out of the five years.

So it just provides some of those -- some of that we pass on to our customers; some of it, you know, we

keep. A lot of it we do pass on to our customers.

Q. Please continue.

A. Another impact of increasing Class II differentials would be the impact of cream prices. Cream premiums will increase by an average of half a multiple point based on Class II solids increase. In a tanker load of cream, there's probably 2,550 pounds of skim solids. Cream sellers will realize the increased value of skim solids by increasing the multiple charge for the fat. By increasing the cost $0.09 per pound, that would increase multiple by .0045, or a half a point, when butter is valued at $2.50.

I can go through the math if you want to, but it gets boring. So increasing butterfat pricing in an already high value market may not always prompt additional usage and could have a negative impact on consumption.

And the last point really has to do with the calculation itself and when the math is applied to the current increase in Class II versus Class IV solids.

Butterfat in the current increases .007 per pound. The skim solids increase $0.0778 per pound, by a factor of 11. Because the skim milk goes up $0.70 a hundredweight, there's only nine pounds of solids in that skim, you put all $0.70 on that nine pounds, but the fat only goes up seven-tenths of a cent per pound.

So if you increase to $1.56, you are still going to have that same 11 factor increase in Class II skim solids versus the butterfat. To me, that just -- why

would you want to increase the skim solids disproportionately to the fat level? Particularly given the fact that the marketplace does not value the skim solids at the same level they do the fat. It just seems illogical to me. And, you know, given the struggles that we've seen with demand in the marketplace, it seems like a weird calculation. But I'm kind of a numbers guy.

Q. Thank you very much.

MR. ROSENBAUM: Your Honor, the witness is available for cross-examination.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. Good afternoon, Mr. Galbraith.

A. Good afternoon.

Q. My name is Ryan Miltner. I represent Select Milk.

I'm the guy that wants to understand your cream multiple math.

A. Okay. So if there's 2550 pounds of skim solids in a tanker load of cream, a 48,000-pound tanker load of cream, 2550 pounds of skim solids, they go up by a value of $0.095 per pound, because you went from $0.70 to $1.56. There's 20,360 pounds of butterfat in a tanker load of cream, and we buy thousands of them every month, so we kind of have our average that we use, 20,360 pounds of butterfat in a tanker load of cream. Do the simple math, and then that's how much per pound of fat. And then you got to pick a butter price. And you use 2.50 on average, probably a decent number -- was a decent number for this

year, probably be decent number for next year. That's how you get there.

Q. When you refer to a cream multiple, what are you referring to?

A. When you buy cream, the value of the cream is based on the butter price times a multiple. So most cream is traded on the previous week's average spot butter price times a multiple, and that multiple varies for a variety of reasons. So that's the multiple.

Q. But the multiple itself is just set by the market, is it not?

A. The multiple is set by the market, yes. But it's also set as a baseline cost. So there's two things involved there: There's the cost and then there's a market.

Q. So what is your baseline cost?

A. The baseline cost would be Class II butterfat plus the skim solids. That's the cost that the processor paid for the milk.

Q. So when you are saying your cream multiple is going to increase, you are not discussing whether the multiple for any given month is 1.25 or 1.20 or 1.40, because that is still market driven, correct?

A. That is market driven.

Q. Okay. So the change -- I'm having trouble linking up a change to the Class II differential resulting in a change in a market-driven --

A. Okay.

Q. -- multiplier.

A. So when you buy cream on an annual contract, that becomes a negotiation of market value that starts as a baseline of cost. That baseline cost automatically moves higher by a half a point. That becomes a built-in foundation of where the starting point is. So it -- as another example would be, if the Class II butterfat formula was not 1.211, but 1.10, that would change the baseline cost structure of the contracts going forward because your base started, not at 1.211, but at 1.10. It's the same concept.

Q. But in that case where you are talking about butter yield, you are changing the price of Grade AA butter, which I understand is the multiplier times the multiple?

A. I'm not changing the butter price, I'm changing the multiple. 1.211 is the yield factor --

Q. Correct.

A. -- in the Class II formula. So I use -- just use that as an example. If that formula changed, that would -- that would change the base price as well.

Q. I misspoke. You are not changing the Grade AA butter price, you are changing the price of butterfat?

A. Yes.

Q. Okay. But by changing the price of butterfat, again, when you are negotiating to buy cream, you are still going to go to your seller or buyer, depending on which side of the transaction you are on, look at the

available cream in the market and the available churning capacity, and a thousand other factors, and say, our multiplier is 1.24 for the term of this contract, hypothetically, correct?

A. And one of those thousands of other factors you refer to is a cost of the skim solids. So what we see, if -- if milk -- if non-fat dry milk is $2 versus $1, that's one of the factors used in calculating a tank load of cream.

Q. So is it correct for me then to say, when you say the cream multiple will increase, what's really happening is that the change in the price formula is the equivalent of changing the multiple; the market will still set a multiple based on an entire litany of factors?

A. That's correct, it will. The market will settle on that, but that will be a factor.

Q. Okay. I realized I brought up just one of your two statements. I need to grab the other one to see if I have any other questions. Give me just a moment.

A. Sure. Okay.

Q. This ties back to the cream multiples a little bit. This is Exhibit 501, which was your first statement.

A. Okay.

Q. And it's the end of page 2, continuing to page 3. And you write, "Due to this increased consumer demand, co-op agencies can increase cream multiples in the market place."

Can you give me a little context around what you

mean there.

A. So we purchase cream from agencies. I don't think I need to name them, but we do purchase cream from agencies, which is more than one co-op. And because demand is high, they are able -- and because they control a large amount of the cream, they are able to elevate prices.

Q. So it's really just a statement about market power in that context for cream sales?

A. Yes.

Q. Okay. Saputo itself, the parent company, is a Canadian entity, correct?

A. Yes.

Q. Now, fluid milk consumption in Canada has not fallen to the extent it has in the U.S.

Would you agree with that?

A. I haven't seen the data, but I'll take your word for it.

Q. I was wondering if within Saputo, if they have had any observations about why -- why fluid milk sales have not declined in Canada as much as --

A. I have not been privy to these conversations, so I wouldn't be able to comment.

Q. Now, if a gallon of milk -- or four liters of milk is selling for $7, that might suggest that fluid milk declines in the U.S. aren't entirely tied to price.

Would you agree with that?

A. I think there's a lot of factors involved in the

decline of Class I milk, a lot.

MR. MILTNER: I don't think I have anything else. I appreciate you answering my questions.

THE WITNESS: Thank you.

CROSS-EXAMINATION

BY MS. HANCOCK:

Q. Good afternoon. I'm Nicole Hancock with National Milk.

I'm on Exhibit 501 on page 2 of your testimony.

A. Okay.

Q. On the halfway point on the page you have three bullet points there. I'm just below the third one. You have a new paragraph there that says, "The free market and the use of over-order premiums will help bring milk production closer to the demand."

Do you see that?

A. Yes.

Q. I'm wondering if you could explain that to me.

A. So we process milk in Federal Orders 6 and 7, not the most dynamic milk shed in the world, as you know. There's not a lot of cows in that part of the country. And in order for us to get milk, we have to pay a higher over-order premium in there, and that market dynamic in itself works.

So the point is, why would we need to structurally increase it more when that dynamic works?

Q. So when you say that that market dynamic works, you mean from the handler's perspective?

A. Yes, from our perspective.

MS. HANCOCK: That's all I have. Thank you so much.

THE COURT: Is there other cross-examination before I call on the Agricultural Marketing Service for questions?

There is none. I invite the Agricultural Marketing Service questions.

CROSS-EXAMINATION

BY MR. WILSON:

Q. Todd Wilson, AMS.

Good afternoon, Mr. Galbraith.

A. Good afternoon.

Q. I'm going to start on Exhibit 502, sorry, and on page 3, I want to kind of go through this chart that you have and just make sure that we understand clearly what some of the annotations are.

The first column -- well, the second column, first column of data, has a Class III skim solids.

A. Yes.

Q. Can you tell me how that was -- how are you calculating that?

A. Class III skim milk divided it by nine.

Q. The announced Class III Federal Order skim price --

A. Divided by nine.

Q. -- divided by nine? Perfect.

Same with Class II, it's not the announced

Class II non-fat solids price?

A. You say -- yeah, it was the announced, not the advanced. Class II is -- the skim is advanced.

Q. Correct.

A. Should say announced.

Q. Okay. Then we move across to about the middle of the chart, "SS pounds," what does that --

A. Skim solids.

Q. Skim solids.

"BMS," next column over? Butter --

A. Wait. I'm looking for the next column.

Buttermilk.

Q. Then the next column over is "SS pounds," and you have there 1, the number 1 in that column.

What is that in reference to? Is that a price? I mean a -- or 1 pound or --

A. Where are you at?

Q. So the first -- the top chart, do you see where it says "Actual Market" as a header? It's on page 3.

A. Okay. Got it. Okay. Buttermilk.

Q. Yes.

A. Skim solids pounds, so that's the substitution.

Q. Just the 1 is --

A. So you would take out -- you would put in 1 pound of skim solids, 1.0256 pounds of buttermilk solids, and take out .0256 pounds of butterfat. That's the substitution. Sorry I was looking at the wrong sheet.

Q. That's okay.

A. So when you -- you -- when you -- because buttermilk is about 2.5% butterfat, you have to take that -- you would take out some butterfat when you put in buttermilk, but you've got to replace the skim solids one for one. So you put in 1 pound of skim solids, 1.0256 butterfat, and then you just take out .0256 pounds of -- you take out .0256 pounds of butterfat, so 1.0256 pounds of buttermilk solids --

(Court Reporter clarification.)

MS. TAYLOR: Just say the numbers.

THE WITNESS: You start with your formula, and you take out 1 pound --

BY MR. WILSON:

Q. I'm going to interrupt you.

You start with what?

A. An ice cream mix formula.

Q. A formula?

A. Formula of ice cream mix.

Q. Not a price on this chart?

You are not taking 1 out of something on this -- in another part of the piece of the data?

A. I am taking out 1 pound of skim solids at Class II price.

Q. The .9157?

A. Yep.

Q. Okay.

A. I'm taking buttermilk solids. I'm adding 1.0256 pounds of buttermilk.

Q. It is the replacement?
A. As a replacement.
Q. Got you.
A. But because I put 2.56 more pounds of buttermilk than I took out skim solids, I have to take out butterfat. And that --
Q. That equates out to the next column?
A. Yes.
Q. Net per pound buttermilk --
A. Yeah. It was an $0.08 premium in 2019 on average. It saved you $0.03 a pound in 2020. It cost you $0.05 in 2021. It cost you $0.14 a pound in 2022. And in '23, you saved $0.12 under the current price -- the current formula.
Q. I think we're understanding it now.
A. Okay. Sorry.
MR. WILSON: Thank you.
THE WITNESS: I'm a math guy.

CROSS-EXAMINATION

BY MS. TAYLOR:
Q. Okay. I'm going to turn to Exhibit 501.
A. Okay.
Q. Hopefully I'm not going to be too repetitive of questions I may have asked you back in August, but to be honest, I've forgotten what I asked you back then, so that's why I have a transcript to read later.
So Saputo has ESL products.
Do you do any HTST?

A. No.
Q. And on your ESL products, do you -- do you do any risk management with those?
A. Yes.
Q. Can you elaborate a little bit on that if you are willing?
A. We have customers that request fixed price. Most of those customers are menu board customers. So for obvious reasons, you know, they have -- they would like to have a fixed price, because they don't like to change their menus that often. And so we provide them that ability to do that.
So, yes, we do on Class II.
THE COURT: Say that again? So, "yes, we"?
THE WITNESS: We -- we have customers that request fixed pricing for periods of anywhere from three to nine to 12 months out for butterfat and skim solids. And they do that for obvious reasons.
BY MS. TAYLOR:
Q. So that's what you provide your customer.
Do you then go out to the market to hedge that risk?
A. Yes.
Q. Okay. For the same three to six months out each time period?
A. Yes.
Q. And then on your ESL products, what's the shelf life on average of those products, do you know?

A. 90 days.

Q. Thank you.

On the -- towards the bottom of page 1 you have a bullet in there talking about how continued lower milk volume -- and I think what you are talking about is Class I sales, Class I utilization -- will drive a change in the fluid milk distribution model from primarily DSD through -- to delivery through distribution centers, and those distribution centers will require a longer supply chains and require ESL, extended shelf life, products.

A. Uh-huh.

Q. And then ultimately resulting in less HTST processor, if I move through the logic of your statement.

I guess I was wondering, first, if you could talk a little bit on what you think the incentives are for a Class I processor to move from HTST to ESL production, like what drives you to make that decision?

A. It's distribution of the product. So today, a HTST processor has direct store delivery. Does not take extra time to go through a distribution network. And the -- in the old days, that's almost -- exclusively it was all direct store delivery.

As you go through distribution systems, and you consolidate that with other shipments, because you don't have enough volume in milk to justify taking directly to the store and having somebody take it in there, the volume is not there, you run that through your distribution system.

When you run that through your distribution system, that takes time. And so if you don't have the date code on there, where the consumer sees it on the shelf and it is -- it is not about to expire, you need to extend that shelf life. So -- so we see that in foodservice, and it only makes logical sense that it would go to retail as you get less and less direct store delivery.

Q. And is it that distribution system also that allows shipments to move longer distances than -- not really -- it takes longer to go through the chain from point A to whatever the ultimate destination was, but does it allow for longer distances to be travelled generally to service other markets?

A. Yes. It does that as well.

Q. Okay. And are those decisions made at all in regards to -- in the Class I processor side, the cost of the raw milk supplied?

A. No, not necessarily. Not -- that really hasn't had the impact.

Q. Okay.

A. It's not been a discussion point.

Q. And so when I read this statement --

A. Let me rephrase that. One of the key drivers to making the decision whether you need that extended shelf life is scrap. How much product are you day coding out? If you are one or two or three or five, whatever the percentage is, the higher the value of that product, the

lower percentage tolerance you have to scrap it out.

Q. When you say "scrap," just so the record's clear, it expires and you can't sell it.

A. Expires. Codes out, yes.

Q. Yeah.

A. And you can't sell it anymore.

Q. Uh-huh.

A. The value of that -- the higher the value, the less tolerance you have for -- for coded out product. That's why we see a lot of high value heavy cream products with more and more ESL because of that. Indirectly it has an impact, the cost has an impact, the -- you know, but obviously fluid milk doesn't have the same cost as a heavy whipping cream on a per unit basis.

Q. Uh-huh. Okay.

And so when I read your statement about how eventually we could result in more ESL processing, do you think that's a good or a bad thing?

A. I think it's a more expensive thing, and that was the point. And, you know, do we really want to add additional costs? Whether it's good or bad, it's more expensive, and any time you add expense to any category, it's never good.

Q. Okay. So I'm just trying to tease out kind of the Federal Order part role in all of that, right? Because you talk about --

A. So the Federal Order part becomes just another incremental cost. That's all. It's simply, we're going

to take this -- we're going to move Federal Order 7 up, whatever I said it was in here, up $1, whatever, a hundredweight. It's another incremental cost, that's all. That's where the Federal Order becomes -- adding structural costs that are not market driven just adds further cost to a category.

Q. And in a declining category as you say?

A. In a declining category.

Q. Okay. I do want to talk a second about the example you put in the middle of page 2 about your plant in Order 7, under Proposal 19 would see an increase of $1.90 in your plant, and in the California order, under the proposed differentials, would see an increase of $0.80.

A. Yes.

Q. And you say that puts your Order 7 facility at a greater cost disadvantage compared to the West Coast?

A. That's correct. So I preface that statement with we operate in multiple locations. We process lactose-free milk for a lot of customers. ESL travels a long distance. We do it in certain regions of the country.

If you've got one in -- one in Kentucky and one in California, and you are servicing the intermountain West, where do you ship that from?

Q. Uh-huh.

A. So you look at it and say, okay, what's my landed cost delivered to the customer in Denver, Colorado? Let's pick that as a point. What goes into that? A lot of

things go into that. Cost of milk goes into that, number one. Number two would be processing. Number three would be transportation.

And given the fact that West Coast transportation for reefer units coming out of California going back east, particularly into the high plains and the high meat regions, is cheaper than bringing finished product from Kentucky out West, you know, you start to put Kentucky at a disadvantage to California.

Q. In your experience, those two plants compete for the same sales?

A. They will ultimately. We look at the supply chain for the lowest landed cost. We look -- we get the same sale. The question becomes is, what -- what plant gives you the lowest landing cost.

Q. Sure.

A. And milk is a factor of that, probably the largest piece of that.

Q. And you can say that now. Right? I mean, with the -- based on the differentials, one is going to give you an advantage over the other? One place will have the advantage over the other place?

A. Well, of the total cost of goods, milk would be largest percentage of the cost of goods.

Q. Uh-huh.

A. Then there's other factors involved that I talked about.

Q. Okay. On that chart on page 2 where you list the

different plants, Saputo plants, could you mind just reading what states they are in, if it is not -- are obvious; some are not.

A. Okay. So Gustine is in California; Wilmington's in Connecticut; Plant City is in Florida; Murray is in Kentucky; White Bear Lake's in Minnesota; Friendship and Delhi are both in New York; Sulphur Springs is in Texas.

Q. Thank you.

MS. TAYLOR: I think that's it from AMS. Thank you very much for your time.

MR. ROSENBAUM: Steve Rosenbaum, International Dairy Foods Association.

I would simply ask that Hearing Exhibits 501 and 502 be entered into evidence.

THE COURT: Is there any objection to the admission into evidence of IDFA-Exhibit 65, also marked as Exhibit 501?

There are none. Exhibit 501 is admitted into evidence.

(Thereafter, Exhibit Number 501 was received into evidence.)

THE COURT: Is there any objection to the admission into evidence of IDFA-Exhibit 66, also marked Exhibit 502?

There are none. Exhibit 502 is admitted into evidence.

(Thereafter, Exhibit Number 502 was received into evidence.)

MR. ROSENBAUM: Thank you, Your Honor.

THE COURT: Thank you, Mr. Rosenbaum.

Is there anything else that you would like to add, Mr. Galbraith?

THE WITNESS: No, it's been a good experience. I really enjoyed talking to people.

THE COURT: Well, we're glad to have a math guy.

THE WITNESS: I usually bring my calculator with me, but I didn't bring it today, I'm sorry.

THE COURT: Most of our witnesses have stated, "I don't do math on the witness stand. I don't add, I don't subtract."

THE WITNESS: We do it every day.

THE COURT: Well, we're glad you came.

THE WITNESS: Thank you.

THE COURT: Thank you. You may step down.

So what would be the best witness to call next? Would it be Ms. Keefe or is there --

MS. TAYLOR: Your Honor, if we could have maybe a five-minute break so we can all confer. I think there's one witness who will not be here until tomorrow, and I'm not sure if the other two have their statements printed yet. So maybe a five-, ten-minute break and we can get a plan.

THE COURT: Let's do ten. Please be back -- and it's now about 3:36. Please be back and ready to go at 3:46.

(Whereupon, a break was taken.)

THE COURT: Let's go back on record.

We're back on record at 3:47.

MS. VULIN: Good afternoon, Your Honor. Ashley Vulin with the Milk Innovation Group. We call Sally Keefe to the stand.

THE COURT: Ms. Keefe, would you state and spell your name, please.

THE WITNESS: My name is Sally Keefe, S-A-L-L-Y, K-E-E-F-E.

MS. VULIN: And I'm sorry, Your Honor --

THE COURT: No, I -- I was going to say, I know you have testified before. You may proceed with the exhibit.

MS. VULIN: Thank you. I almost said she is still sworn, but you've got us all very well conditioned on that front.

THE COURT: You do remain sworn, as you know.

SALLY KEEFE,

Having been previously sworn, was examined and testified as follows:

MS. VULIN: So, Ms. Keefe, you have in front of you MIG-Exhibit 67, correct?

THE WITNESS: Yes, I do.

MS. VULIN: Your Honor, I ask that that be marked as Exhibit 503.

THE COURT: Yes.

(Thereafter, Exhibit Number 503 was marked for identification.)

DIRECT EXAMINATION

BY MS. VULIN:

Q. And, Ms. Keefe, this is your testimony in opposition to Proposal 21, correct?

A. Yes, that's correct.

Q. And then there were a couple outstanding questions that had arisen in the hearing that you also wanted to address on advanced pricing and organic pricing, correct?

A. Yes, that's correct.

Q. And before we get started, I know there's one correction we have to make.

If you could please turn to page 5, footnote 1. The third line down identifies Mr. Galbraith's testimony as Exhibit 501.

But in fact, that should be 502, correct?

A. Yes. That's right. We just heard that.

Q. Our guess there was wrong.

MS. VULIN: So, Your Honor, we would ask that the record copy be marked such.

THE COURT: It has been done.

BY MS. VULIN:

Q. Ms. Keefe, I know given the timing we don't have a fancy PowerPoint. We'll ask that you please read your testimony into the record. And if you want to skip your background, you are welcome to do so given the amount of times you have testified.

A. Thank you. I'll get started on page 2, just before section 2.

I'm an expert consultant for MIG in support of its proposals at this hearing. I am testifying in opposition to AFBF's Proposal 21 here today.

MIG's position is that USDA should not adopt Proposal 21 as it is not an equitable nor justifiable approach to determining the Class II differential. Class II utilization is important to fluid processors, namely because Class I products will inherently have excess cream that must either be sold, typically to a Class II or Class IV manufacturer, or made use of.

Class I processors use the excess cream that fluid milk generates in a variety of ways. It's common for a fluid plant to bottle both Class I fluid milks and Class II fluid creams, as well as other beverages that are also part of Class II. Additionally, many fluid plants have Class II lines for production of cottage cheese, sour cream, yogurt, ice cream mix, et cetera. Conversely, it is also relatively common today for Class II plants not to bottle fluid milk, i.e., standalone Class II manufacturers are more prevalent than they were historically.

Class II includes milk used for a diverse array of dairy products. As detailed at 7 CFR 1000.40(b), Class II includes skim milk and butterfat used for: Fluid cream products such as half and half and whipping cream; soft, semi-solid, and frozen products such as cottage cheese, ice cream, sour cream, and yogurt, including beverage forms of these; products used for infant feeding or dietary use including meal replacements; and products for

commercial food processing, such as large format fluid milk and sweetened condensed milk.

Importantly, 7 CFR 1000.40(b)(2)(ix) states that Class II includes skim milk and butterfat used for "(a)ny product not otherwise specified in this section." Thus, Class II milk includes any use which is not explicitly I, III, or IV.

This link between Class I and Class II is largely out of a fluid processor's control because of the relatively low butterfat utilization of Class I fluid milk as determined by consumer preferences for skim, 1% low fat, 2% reduced fat, and whole milk. As shown in Table 1 below, Class I is the only class with butterfat percentages consistently and significantly below that of FMMO milk in total, i.e., producer milk.

Table 1 contains the butterfat percentage of FMMO milk by class for 2013 to 2022. It's found on page 4 of my written statement. I'm not going to read the table into the record.

These facts all make clear that any Class II specific proposal will significantly impact fluid processors if adopted. If adopted, American Farm Bureau Federation's Proposal 21 would create winners and losers: In short, Class I would again be the loser. Under Proposal 21, standalone Class II processors would be able to depool when economically rational, while Class I processors with Class II manufacturing would always be subject to pooling. While the pool plant provisions vary

modestly across the orders, generally distributing plants with 25% or more Class I utilization of milk receipts and at least 25% of Class I sales within the applicable marketing area are fully regulated pool plants.

Fully regulated distributing plants are mandatory FMMO participants. As such, pooling includes all milk used by the distributing plant, even the non-Class I utilization. In contrast, participation for a standalone Class II plant is voluntary. Like other non-fluid participants, they pool when it is economically rational to do so.

The unfairness here is that a fluid plant making Class II products that meets the typical 25% threshold would be subject to pooling at all times for all of its milk. Adoption of Proposal 21 would not change the mandatory participation of fully regulated distributing plants and the voluntary participation of others, including standalone Class II operations.

This disparity would leave competitors inequitably and unfairly positioned in the marketplace. Standalone Class II processors would have an economic advantage over Class I processors making Class II products. FMMOs cannot and should not regulate identical products differently.

Certainly, this disparity already exists today, and it is worthwhile to consider long-term the place of the Class II differential with FMMO pricing. But without doubt there's no reason to impact the Class II differential given the unfair impact doing so would have

on fluid processors.

Proposal 21 is going to make it more difficult for distributing plants with Class II products to continue to compete in the marketplace against standalone Class II operations and all because of an unequally applied regulatory burden. USDA must reject Proposal 21.

Not only would AFBF's proposed increase in the Class II differential unfairly impact Class I, but the increase would also create disorderly marketing within the marketplace as a whole. AFBF seeks to increase the Class II differential from $0.70 per c-weight to $1.56 per c-weight, more than doubling the Class II differential. This large increase would encourage substitution of Class IV ingredients for Class II milk in Class II products with particular ingredient formulations and standards of identity. It would also change the pool/depool decision for Class II.

Even AFBF recognizes that adoption of Proposal 21 "could increase the likelihood of depooling Class II milk when the Class II price is above the uniform price." However, they claim that since "much Class II use is at distributing plants, Class II milk is less subject to depooling based on price relationships than other classes."

This statement proves the point above that distributing plants are captive to the FMMO system for all utilization, Class II included. However, monthly FMMO Class II milk volumes show that AFBF's claim is wrong and

that Class II milk is indeed routinely depooled. As illustrated by Chart 1 below, conservatively, Class II milk was depooled in 22 to 28% of the months during the 60-month period January 2018 to December 2022, so 13 to 16 of the 60 months.

Q. So I want to talk a little bit about Chart 1.

Can you tell us the billions of pounds represented by the Y axis, what is that reflecting.

A. Yes. So the Y axis here is Class -- is FMMO Class II milk volume. So this is the -- across all 11 of the FMMO s, all of the Class II milk.

Q. And this is all of the pooled Class II milk, correct?

A. Yes. Because this is FMMO milk, this is not all milk that would have been used to make Class II products. This is only the FMMO volume.

And so to -- I shaded the area down between 0.9 billion pounds and 1.2 billion pounds to indicate months where there were significantly lower volumes of Class II milk within the FMMO system, and that is one of the ways that you can see depooling happening in the data.

Q. And so if we look at 2022, that was a year where there was significant depooling of Class II milk?

A. Yes. As was testified by a previous witness, he walked through an example for Order 33 in 2022 and explained sort of the price dynamics behind that. This is looking at the volume nationally in 2022 and what you see on Class II volume within the orders, all of them, during

that same time period.

Q. And it appears there's not clear consistency of kind of seasonality, where milk is routinely pooled in the spring or not in the fall vice versa, it kind of moves sporadically?

A. Yeah. So because Class II is such a diverse class, there's a lot of different products in there. There are a number of different seasonal trends that impact the volume of milk that you are going to see here, so things like when ice cream mix is being made before ice cream season starts, and then when -- you know, when some of the products within Class II are very sensitive to seasonal promotions like a whipping cream at the holidays, things like that, so -- and not everything is perfectly countercyclical leading to like very stable Class II. Like, there's a lot happening here because Class II, when you think about it, is a lot of very different products.

Q. And just to be clear, this chart reflects depooling -- actual depooling under the actual current prices, correct?

A. Yes.

Q. Thank you.

A. And it's not a projection forward. It's just indicating, like if you look at the volumes, you can see that there was substantially less milk pooled in those months.

Q. Thank you. Please continue.

A. Yep.

Depooling decisions are made based on the particular circumstances of the handler and the FMMO they are regulated by. Depooling is determined not only by price, but also FMMO utilization and its corresponding effect on the uniform price as well as pool quality qualification requirements, et cetera.

Monthly average FMMO milk volumes by class and order are shown in Table 2 below. Class utilization and total pool volume vary across the 11 FMMOs. On the average, Class II utilization ranges from 5 to 24%. Like pool volume and utilization, pooling rules and qualification requirements, also vary across the orders.

If Proposal 21 were adopted, for those handlers able to do so, depooling of Class II milk would most likely decrease. As --

THE COURT: Would you read that again?

THE WITNESS: If Proposal 21 were adopted, for those handlers able to do so, depooling of Class II milk would most likely increase. As noted by AFBF increasing the Class II differential to $1.56 per c-weight would increase the months when the Class II price would be expected to exceed the uniform price for many orders.

BY MS. VULIN:

Q. So then just to transition slightly. I know there were some prior questions about advanced pricing prior to order reform, and that you have a little bit of history there to share with us.

A. Indeed.

So two weeks ago there were some questions and discussion regarding both advanced pricing and organic pricing that I wanted to just offer a few quick remarks on.

Today, both Class I skim milk and butterfat prices are advanced, meaning the price for each month is announced before the start of that month. Each month the Class I prices are announced on or before the 23rd day of the prior month and are computed using the most current two weeks of commodity survey price data available. This has not always been the case. In 1972, the FMMOs were amended to establish advanced pricing of the skim milk portion of Class I.

The decision stated: "The rapidly changing structure of the milk distribution industry throughout the United States makes it desirable that handlers be notified at reasonable period in advance of changes in the price they must pay for Class I milk."

While some advocated for also advancing the Class I butterfat differential, that change was not made then.

Specifically, the decision noted: "The Class I butterfat differential changes infrequently. This is because the Chicago butter price quotations, which are strongly influenced by the prices paid for butter by the Government under the price support program, do not vary significantly from month to month. Consequently, there is no compelling need to advance the Class I butterfat

differential announcement in connection with the adoption of Advanced Class I pricing."

At the time of order reform, the butterfat differential for the preceding month was still announced on or before the 5th day of the current month. As testified to by other witnesses, this lack of advanced pricing for the butterfat differential was burdensome for the industry. To address that issue, during Federal Order Reform, USDA aligned the timing for Class I butterfat and skim prices.

With respect to Class I, the order reform final decision stated: "Announcement of Class I butterfat and skim prices in advance eliminates current problems caused by calculating the butterfat differential after the month for which it is effective. Handlers will have true advance Class I pricing."

Witnesses, including me, have noted throughout this proceeding that advanced pricing remains important for Class I handlers today. Advanced pricing underpins the standard terms of trade for the traditional HTST segment of Class I fluid milk.

And now on to organic milk pricing.

USDA raised some questions regarding the methodology for organic prices. Given my long history in that marketplace, I wanted to provide some background and context for how pricing works for organic milk.

Fundamentally organic milk prices are not pegged to conventional milk prices because the two markets are

distinct. It would be akin to agreeing to tie the conventional milk price to the price of pork. There may be similar inputs, like labor, energy, fuel, et cetera, but at heart, they are just two different market places.

The organic and conventional dairy markets are distinct due to organic milk's unique production requirements. After emerging in the 1980s, the organic market expanded rapidly following the passage of the Organic Foods Production Act in 1990 and the issuance of the final rule establishing the USDA National Organic Program in 2000. From the beginning, organic dairy farmers have sought stable prices to: One, cover the high cost of organic milk production; two, provide funds to maintain and grow their operations; and three, better facilitate business planning. While the FMMOs predate organic's emergence, organic farm milk prices are unrelated to unconventional FMMO prices.

The organic milk prices not simply structured as a premium over conventional because the cost of production for organic dairy farmers is determined by the inputs and practices required of certified organic dairy farmers, namely, organic feed and the cost of replacing organic animals.

Dr. Juan Velez's testimony described the organic producer cost of production in detail, including feed, labor, operations and replacement. Organic production costs are not only higher than conventional, but they also do not necessarily track with it.

I also have an example to share of a failed attempt to tie the organic milk price to the FMMO minimum price. In the mid to late 1990s there was an organic milk supply in the Northeast primarily located in New York that was priced using the New York-New Jersey Order 2 uniform -- also known as the blend -- price plus an organic premium. This organic milk was affiliated with Elmhurst's Worcester Creamery and was the primary supply for their Juniper Valley brand.

In 1998, Horizon Organic Dairy acquired Juniper Valley from Elmhurst. At that time, I was responsible for milk procurement, fluid co-packing, and balancing for Horizon.

This price structure with an organic premium over conventional was not aligned with either the organic handlers' or organic producers' needs. For organic producers, the FMMO conventional blend plus organic premium pricing was too volatile. Worse, while not perfectly countercyclical, too often the structure provided low organic milk prices when organic feed costs were high.

Ultimately, Elmhurst found itself unable to attract the organic milk supply necessary to meet Juniper Valley's needs using the conventional plus organic premium structure. Organic Valley/CROPP Cooperative, The Organic Cow of Vermont, and Horizon offered stable fixed prices for organic milk and were out-competing Elmhurst's program in the countryside. Fundamentally, the problem was that

Elmhurst's organic milk pricing structure was reflecting the conventional market and not responding to the organic market.

And so in conclusion, Proposal 21 must be rejected as it would promote, rather than relieve, disorderly marketing. It would create perverse incentive to substitute dried dairy ingredients for farm milk in Class II manufacturing and increase Class II differential disadvantages processors that make Class II products in pool distributing plants.

Dairy has seen remarkable innovation with Class II products as testified to by MIG member Tim Doelman. The regulatory structure should support, not hinder, this innovation, particularly for the struggling Class I sector. Encouraging growth and diversity in offerings will benefit the industry as a whole, and rejecting Proposal 21 is consistent with the type of regulatory approach USDA should take to further support the dairy industry.

Q. Thank you, Ms. Keefe.

Anything else you would like to add to your testimony?

A. I'm good. I'm happy to answer questions.

MS. VULIN: Ms. Keefe is available for cross-examination. Thank you, Your Honor.

THE COURT: Who will begin?

Mr. Miltner, you always have excellent questions. Please come forward.

CROSS-EXAMINATION

BY MR. MILTNER:

Q. I'm Ryan Miltner, I represent Select Milk Producers.

And this is going to -- this is not going to be important, and then people are going to say, "We extended this thing ten minutes for nothing."

Ms. Keefe, I had a question for you about your comparison in the organic market and the conventional milk market, and you testified that they are distinct markets. But then you likened it to tying conventional milk to the price of pork.

And you have been recognized as an expert in this hearing, correct?

A. Yes.

Q. Yes. I mean, when you -- when you -- a consumer of organic milk, if it's not available on the shelf, what do they purchase?

A. It varies. Today I would say that many of them will purchase a plant-based beverage. They -- most often people switch in to organic milk from conventional milk. But they don't necessarily go back to conventional when organic is not available.

Q. But many do, correct?

A. I'm sure some do. Like, my area of expertise with respect to organic and what I have -- what I have been testifying about at the hearing is not on the -- is not on the consumer behavior of anyone.

Q. But if I'm going to go buy organic milk, and I'm not going to use it to drink, I'm going to use it to make pudding, and it's not available.

I could buy conventional milk and end up with a very similar, if not almost identical, output of the evidence, could I not?

A. You could buy conventional milk and make pudding and -- with a conventional ingredient instead of the organic.

Q. Now, if I need to go buy a pork tenderloin and they are out, I can't -- I can't grill milk?

A. Sadly, no.

Q. Organic or otherwise, correct?

A. I would agree.

Q. Okay. So, I mean, while there may be differences in the markets for those, they are in -- at least up to the point of consumer preference, perfect substitutes for each other?

A. They are not perfect substitutes for each other because you can't -- for me, a perfect substitute would be that you can go in either direction.

And so with respect to the processing of organic milk, they are most assuredly not perfect substitutes. You cannot substitute conventional milk for organic and label it as organic.

Q. But for purposes of consumer use, aren't they perfect substitutes?

A. For consumers, like, the way that they use them,

they would -- you could substitute. Consumer preferences, that's a different situation.

Q. Okay.

MR. MILTNER: That's the ten minutes I wanted to waste. Thank you.

THE COURT: Is there other cross-examination before I turn to the Agricultural Marketing Service questions?

There is none. I invite the Agricultural Marketing Service to question Ms. Keefe.

MS. TAYLOR: Thank you, Your Honor.

CROSS-EXAMINATION

BY MS. TAYLOR:

Q. And thank you for preparing your statement quickly so we could get it on today.

A. No problem. Happy to help.

Q. I just want to turn to page 7. There's the chart Table 2.

First I want to note -- and I know this was done quickly, so I just want to note what's probably a typo so we can get it correct on the record.

In the Roman numeral row, I believe the third one should be "III" and not "II." So it would go "I," then "II," then "III," then "IV."

A. Yes, I completely agree.

Q. Okay.

MS. TAYLOR: If we could have that changed on the record copy.

THE COURT: It is already done.

MS. TAYLOR: Thank you.

BY MS. TAYLOR:

Q. And then just my own question on this chart because I just wanted to make sure that I'm walking away with the point you are trying to make with this when I read your narrative, is that you're highlighting the different uses by class, and as you work through your narrative, the Class II differential, if it was increased, that would cause a lot of that Class II milk to not be pooled.

And that's what this column 2 -- excuse me -- Class II, both in billions of pounds and percentages, is trying to show, the amount of milk on each of these orders that could be not pooled?

A. It's the amount of milk that could be not pooled. Now, some of it will, frankly, be forced to be pooled because some of it is going to be inside of Class I distributing plants. But the point I was trying to make is that you would start seeing more orders looking like, you know, the Upper Midwest, which is relatively low, versus the Northeast, which is the high one.

Q. Okay. Thank you.

MS. TAYLOR: That was it from AMS. Thank you.

THE WITNESS: You're welcome.

THE COURT: Ms. Keefe -- oh, Ms. Vulin will be there in just a minute.

MS. VULIN: Thank you, Your Honor.

REDIRECT EXAMINATION

BY MS. VULIN:

Q. So Mr. Miltner's questions on substituting organic milk for conventional.

The statement you made about the problems with pegging the organic price to conventional are about the inputs for producing organic milk, correct?

A. Yes.

Q. And so you can never substitute conventional feed for organic feed, can you?

A. No, you cannot.

Q. And you can never substitute a conventional cow for an organic cow, correct?

A. You cannot.

Q. And so your statement about tying those prices is not about what a consumer could do with those products, it's about what are the farmers' options in substituting inputs or comparing inputs for producing that organic milk, correct?

A. Yes. It's from the perspective of dairy producers and dairy processors, not organic dairy consumers.

Q. Thank you.

MS. VULIN: With that, I move to admit Exhibit 503.

THE COURT: Is there any objection to the admission into evidence of MIG Exhibit 67, also marked Exhibit 503?

There is none. Exhibit 503 is admitted into

evidence.

(Thereafter, Exhibit Number 503 was received into evidence.)

MS. VULIN: Thank you, Your Honor.

THE COURT: Thank you, Ms. Keefe, for providing this excellent information.

THE WITNESS: You're welcome.

THE COURT: All right. Is it true that there are no other witnesses available to testify today? It appears to be true.

We did have some preliminary matters that I put off that we could have started with today, but I'm glad we started with the testimony instead.

How would the Agricultural Marketing Service like to use some more of today's time?

MS. TAYLOR: I think it might be helpful, we could probably go off record and come back on when we have made a decision, but go off record and kind of discuss possible briefing schedules, et cetera, and what the regulations provide for, so everyone can think about that this evening before we put it on the record tomorrow.

THE COURT: Great. Let's do that.

Does anybody want a break before we do this off record or are you good to go?

Everybody's good to go. All right. Let's go off record then at 4:22, and we will go back on before we finish today.

(An off-the-record discussion took place.)

THE COURT: Let's go back on record.

All right. We're back on record. It's 4:48.

While off record we were discussing parts of the federal regulations. I started with Title 7 of the Code of Federal Regulations Section 900.10, certification of the transcript. And we have also dwelt on 7 CFR Section 900.27, deadline for filing post hearing briefs and corrections to transcript.

I did indicate while we were off the record that I will not shorten the 30 days that people have to file with the hearing clerk by 4:30 p.m. Eastern on the deadline their proposed transcript corrections.

And when does the 30 days begin? Well, it will begin when the transcript has been posted on the AMS website in its entirety. So AMS will use its website to notify people that the 30 days has begun to run and when it ends what the deadline is.

And then with regard to the briefs, what we have asked all of you here to do is talk about whether you will be happy with just a brief submitted by the 60-day deadline. The 60-day deadline will begin when this hearing has ended, which may be as early as tomorrow.

So those 60 days, if you want to have them all for your initial brief, then there will just be one brief. If you'd prefer to have an opportunity to file responses to other people's briefs, then you will need to come to some consensus as to what you might like to do about that. If you can't agree, then each of you should speak, and I'll

choose something. But puts extra pressure on you if you have to go early with your initial brief, but if it gives you an opportunity to respond to other people's briefs. It may be worth it to you, I don't know.

And then we talked about the lists -- I'll call them the official notice lists that you all have been compiling, and we talked about how it would be wonderful if you would bring that in writing tomorrow so that it can be dealt with as an exhibit and accepted or not, and no one would have to read into the record the contents of that document.

What else would anybody like to make a record of our informal discussion?

MR. MUNCH: Just one quick comment for tomorrow. We at the last minute are adding something for tomorrow morning from Farm Bureau. We just had some policy reaffirmed next week, and we want to write a letter that will be submitted. But we will need about -- I will need about ten minutes at 8 a.m. when FedEx opens to print it out. So if we can wait until -- for me to go up until then, I would really appreciate that. Thank you all.

THE COURT: Tell me your name again.

MR. MUNCH: Danny Munch. I'm an economist with the American Farm Bureau Federation.

THE COURT: Good. Thank you.

Mr. Rosenbaum.

MR. ROSENBAUM: I'm now perhaps becoming repetitive, but since we're now on the record, I just did

want to refer once again to the language in 900.27, that what's due in 60 days is the parties to file, obviously, but that we can file proposed findings and conclusions and written arguments or briefs, all of that's included.

THE COURT: Yes. And most valuable are, in my opinion, are the proposed findings and conclusions.

All right. Would anyone like to do anything else before we call it a day? No one?

We go off record at 4:53. Thank you. See you tomorrow morning at 8:00.

(Whereupon, the proceedings concluded.)

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STATE OF CALIFORNIA)
) ss
COUNTY OF FRESNO)

I, MYRA A. PISH, Certified Shorthand Reporter, do hereby certify that the foregoing pages comprise a full, true and correct transcript of my shorthand notes, and a full, true and correct statement of the proceedings held at the time and place heretofore stated.

DATED: February 19, 2024

FRESNO, CALIFORNIA

MYRA A. PISH, RPR CSR
Certificate No. 11613